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The Nicaraguan Canal Agreement

A Study of a Contemporary Investment Agreement and the Historical Patterns that Helped Shape It

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Summary

In December 2014, Nicaragua officially launched one of the world's largest engineering projects in history, as construction began on a 278 km transoceanic canal with an estimated cost of US$50 billion. To implement and finance the project, Nicaragua has made an agreement with the foreign investor HKND that has received widespread attention and critique. The purpose of this thesis is to examine this agreement and explain its content through an historical examination of the development of international rules on the protection of foreign property.

The first part of the thesis examines the most important provisions of the Nicaraguan canal agreement with respect to the rights and obligations of each party, focusing on the provisions of the agreement that affect the regulatory and legislative capacity of the state of Nicaragua. It draws the conclusion that the agreement is heavily tilted in favor of the foreign investor. The agreement grants generous rights to HKND, enables the corporation to steer Nicaraguan legislation and protects it against any costs that might result from Nicaraguan legislation and regulation.

Drawing on theories that form part of Third World Approaches to International Law (TWAIL), the second part of the thesis seeks to explain the imbalances in the agreement based on a historical examination of the development of international rules on the protection of foreign property. By identifying characteristic features of the legal protection of foreign investments throughout history, the thesis finds that this development has been characterized by fundamental conflicts of interests between capital-exporting states and capital-importing states. These conflicts have resulted in international legal rules and principles that generally protect the interests of foreign investors against the interests of host states.

The conclusion is drawn that historical legal developments have contributed to the inequities identified in the Nicaraguan canal agreement by exacerbating already existing inequities on a legal level. The thesis finds that the tensions and controversies that surround the agreement are fundamentally not new. Rather, the agreement's content and existence manifest the fundamental conflicts of interest that have dominated international investment law from its emergence to the present.

Sammanfattning

I december 2014 påbörjade Nicaragua konstruktionen av en 278 km lång kanal genom landet. Projektet beräknas kosta 50 miljarder dollar och för dess genomförande och finansiering har Nicaragua ingått ett avtal med den utländska investeraren HKND, ett avtal som har fått stor uppmärksamhet och som också har mötts av mycket kritik. Syftet med denna uppsats är att granska avtalet och förklara dess innehåll med hjälp av en genomgång och analys av investeringsrättens historiska utveckling.

I uppsatsens första del analyseras de mest centrala delarna av det nicaraguanska kanalavtalet med avseende på de rättigheter och skyldigheter som åligger var och en av parterna. Denna analys har framförallt koncentrerats till de delar av avtalet som påverkar Nicaraguas exekutiva och legislativa befogenheter. Det konstateras att avtalet är tydligt balanserat till förmån för den utländska investeraren. Avtalet ger HKND vidsträckta ekonomiska rättigheter, tillåter investeraren att styra Nicaraguansk lagstiftning och skyddar den samtidigt från alla eventuella kostnader som kan uppstå till följd av genomförandet av nya lagar och regler i Nicaragua.

Med utgångspunkt i teoribildningen *Third World Approaches to International Law* (TWAIL), söker uppsatsens andra del förklara ojämlikheterna i avtalet utifrån en analys av den historiska utvecklingen av den internationella investeringsrätten. Genom att identifiera karaktäristiska drag i hur rätten använts för att skydda utländska investeringar, konstatera att denna historiska utveckling har präglats av fundamentala intressemotsättningar och konflikter mellan kapital-exporterande och kapital-importerande stater. Dessa konflikter har resulterat i att internationella regler och principer huvudsakligen skyddar utländska investerares intressen gentemot kapital-importerande stater.

Slutsatsen dras att denna rättsliga utveckling har bidragit till de ojämlikheterna i det nicaraguanska kanalavtalet genom att förstärka redan existerande ojämlikheter på en rättslig nivå. Dessutom konstateras att den kritik och debatt som omger avtalet inte är unik. Tvärtom så tydliggör avtalet de fundamentala intressemotsättningarna som har präglat den internationella investeringsrätten genom historien.

Preface

With the submission of this graduate thesis, I will be finishing up four and a half years in law school. I would like to take the opportunity to thank a few people in particular.

Thank you:

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Lastly, I want to thank my supervisor Markus Gunneflo for his supervising of this thesis and his valuable advice.

Malmö, 3 January 2016

Rasmus Kjulin

"The past isn't dead and buried. In fact, it isn't even past."

– William Faulkner

Abbreviations

BIT	Bilateral Investment Treaty
ERM	Environmental Resource Management
FDI	Foreign Direct Investments
FSLN	Sandinista National Liberation Front
HKND	Hong Kong Nicaragua Canal Development Investment Company
IACHR	Inter-American Commission on Human Rights
ICSID	International Centre for Settlement of Investment Disputes
MCA	Master Concession and Implementation Agreement in respect of the Nicaragua Canal and Development Project
NIEO	New International Economic Order
PSNR	Permanent Sovereignty over Natural Resources
TWAIL	Third World Approaches to International Law

1 Introduction

1.1 The Nicaraguan Canal Project

Building a transoceanic canal through Nicaragua has long been a dream of the nation, but despite numerous attempts it has never been accomplished. However, under current president Daniel Ortega, it appears as if the canal might actually become reality. Since 2012, plans have been progressing for a transoceanic canal that has been billed as the largest engineering endeavor in history.[1] The waterway, which will compete with the Panama Canal for traffic between the Pacific and Atlantic oceans, is projected to stretch 278 km at an estimated cost of US$50 billion and stand completed in 2020 (for a map of the proposed route, see Supplement A).[2]

President Ortega has presented the canal as Nicaragua's fastest way to rapid economic development, a compelling argument for the second poorest nation in Latin America. In return for the concession to the foreign corporation Hong Kong Nicaragua Canal Development Investment Company (HKND), Nicaragua hopes for billions of dollars in investment, tens of thousands of jobs and, eventually, a stable source of national income.[3] Yet, the project is controversial for many reasons. Critics question the need for a second Central American canal, the social and environmental effects of the project as well as the foreign investor's experience with large infrastructure projects.[4]

As the project progresses in its initial phase, protests have grown in strength. Opponents claim that the canal concession law and the subsequent agreement with HKND violate constitutional guarantees to private property, natural resources, and indigenous lands.[5] Much of the critique is directed at provisions in the concession agreement that require Nicaragua to enact constitutional reform to fulfill the agreement, as well as investment protection clauses that appear to heavily circumscribe the regulatory and legislative capacity of the Nicaraguan government.[6] This has led many to question why Nicaragua would enter such an agreement in the first place.

HKND's investment in the Nicaraguan canal project is part of a larger trend of increasing flows of foreign direct investments (FDI). Such investments are characterized by a lasting interest and control by a company in an enterprise resident in an economy other than that of the foreign direct investor, and a significant degree of influence on behalf of the investor on the management of that enterprise. The United Nations Conference on Trade and Development (UNCTAD)

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[1] Serrano, 2015 [electronic source].
[2] McDonald, 2014 [electronic source].
[3] Watts, 2015 [electronic source].
[4] Laursen, 2014 [electronic source].
[5] Rogers, 2013 [electronic source].
[6] Sweet, 2015 [electronic source].

projects that the total global inflow of FDI will grow by 11 per cent to US$1.4 trillion in 2015 and that it will grow even further in the following years.[7] A majority of FDI:s are made in developing countries and investments abroad by multi-national enterprises now account for a third of those investments.[8] Meanwhile, the debate over the value of FDI:s is polarized. Proponents of FDI note that it benefits both home states (the state from which the investment originate) and host states (destination of the investment). Opponents of FDI note that the main benefactors often are multi-national corporations that are able to wield great power over smaller and weaker economies, and the developed states with which they are identified.[9]

The agreement between HKND and Nicaragua is a concession agreement, a type of investment contract in which a government grants a project sponsor the right to develop, own, construct and operate a project under certain terms and conditions.[10] The degree of use of concessions has varied over history. From the mid-1800s to the 1930s they were particularly common in both colonial and non-colonial settings, but subsequently became less popular.[11] Another spike in the granting of concessions occurred in the 1990s, as Latin American countries in particular granted concessions for the development and operation of different infrastructure projects. Generally, modern-day concessions fall in the category of infrastructure contracts, just as the Nicaraguan canal agreement.[12]

While the global value of foreign direct investment grows, the number of international investment disputes has increased dramatically.[13] Critique has been levied at the international investment law regime generally, and investment contracts specifically[14], for being tilted in the investors' favor.[15] In light of this development, the Nicaraguan canal agreement serves as an illustrative example of some of the implications of the current investment law regime, for a particular investment agreement in a particular host state. Indeed, for an undertaking of such magnitude as the Nicaraguan canal project, the details of the canal agreement could have consequences that would overshadow almost any other investment agreement.

This thesis examines the Nicaraguan canal agreement and seeks to explain its content and existence: what prompted the agreement, what are the agreements most important provisions and how do they affect the legislative and regulatory ability of the Nicaraguan state? And how does the conflict-torn history of international investment law explain the existence and content of the investment agreement?

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[7] UNCTAD, 2015, pp. ix-3.
[8] Ibid., pp. 5-10.
[9] Trakman & Ranieri, 2013, p. 5.
[10] Hoffman, 2008, p. 145.
[11] Veeser, 2013, pp. 1136-1138.
[12] Sirtaine, 2005, p. 4.
[13] UNCTAD, 2015, p. 124.
[14] Sheppard & Crocket, 2011, pp. 333-334.
[15] Bishop, 2005, p. 10.

1.2 Purpose

This thesis examines the canal concession agreement between the state of Nicaragua and the Hong Kong Nicaragua Canal Development Investment Company (HKND), with respect to the rights and obligations of each party. A particular focus of this examination is the provisions of the agreement that affect the regulatory and legislative capacity of the state of Nicaragua.

Following the study of the canal concession agreement and its implications, the thesis seeks to explain the agreement between Nicaragua and HKND through an historical analysis. It examines the origins of international investment law and its historical development, concentrating on important developments with respect to concession agreements, by identifying characteristic features of the legal protection of foreign investments throughout history. This approach is based on the underlying theoretical assumption that a presentation that merely examines the current investment law regime and its more recent history, would fail to provide a deeper understanding of the Nicaraguan canal concession agreement and the current legal regime of which it forms apart.

1.3 Research Questions

With the above-described purpose and the delimitations (1.7) in mind, the research questions of the thesis are phrased as follows:

- What are the essential rights and obligations of the two parties under the canal agreement between HKND and Nicaragua and how do they affect the legislative and regulatory power of the state of Nicaragua?

- How can the essential rights and obligations of the two parties under the agreement and their effects on the legislative and regulatory ability of the Nicaraguan state, be explained by the historical development of rules on foreign investment protection in international law?

1.4 Theory

The theoretical basis of this thesis is connected to a historical focus on how historical power-struggles have shaped the content of international investment law and concession agreements. The thesis draws on theories that form part of Third World Approaches to International Law (TWAIL). It is a scholarship that grew out of discussions among scholars interested in post-colonialism, critical race theory and law and development studies at Harvard Law School in the mid 1990. Since its establishment, academic work related to TWAIL has expanded into a heterogeneous and polycentric field of study.[16] Broadly, the scholarship focuses on how issues of material distribution and imbalances of power affect the way in

[16] Gathii, 2011, pp. 26-34.

which international legal concepts, norms and doctrines are produced and understood.[17] It seeks to understand, deconstruct, and unpack the uses of international law as a medium for the creation and perpetuation of a hierarchy of international norms and institutions that subordinate non-Europeans to Europeans.[18] Moreover, it challenges what is viewed as a tendency of 'mainstream scholars' of international law to treat the colonial era as a thing of the past, overcome by the process of decolonization. Instead, it connects issues of political economy, the uses of violence and the exploitation of natural resources and cultural practices of differentiation to the development of international law.[19]

The theories of two TWAIL scholars in particular, Anthony Anghie and Kate Miles, have provided the theoretical frame for this thesis. Anthony Anghie[20], author of *Imperialism, Sovereignty and the Making of International Law (2005)***,** examines the relationship between imperialism and international law and conceptualizes the doctrines, principles and institutions of international law as products of the interaction between the colonizer and the colonized. Anghie approaches international law as the legal resolution to problems arising within the colonial context and argues that traditional principles of international law take on a different form when applied to the non-European world.[21] Kate Miles[22], author of *The Origins of International Investment Law: Empire, Environment and the Safeguarding of Capital (2013),* draws on Anghie's scholarship but focuses on the particulars of international investment law. In her work, Miles examine historical conflicts over the content of international investment law with a focus on the power relations involved in its emergence.[23] This approach is based on theories of Lauren Benton[24], whose theory connects the creation of international rules and institutions to social, political and economic patterns. Benton identifies how contests over cultural difference in the law are intertwined with disputes focusing on the control of property and its legal definition, asserting that international law emerged together with the spread of capitalism through "repetitive assertions of power and responses to power".[25] Based on Benton's theory, Miles view the development of international investment law regime as the result of a "dual process of assertion and creation"[26], focusing on conflicts between capital-exporting and capital-importing states and their role in shaping international investment law.[27] Adopting Miles approach, this thesis analyzes the repetitive and combative mode of interaction that has shaped concession agreements and the international investment law regime.[28]

[17] Eslava & Pahuja, 2011, pp. 104-105.
[18] Mutua, 2000, p. 31.
[19] Eslava & Pahuja, 2011, p. 105.
[20] Professor at the College Of Law at University of Utah.
[21] Anghie, 2005, pp. 6-11.
[22] Fellow and College lecturer in Law at Gonville and Caius College at Cambridge.
[23] Miles, 2013, p. 7.
[24] Professor of History at New York University.
[25] Benton, 2002, pp. 10-11.
[26] Miles, 2013, p. 7.
[27] Ibid., p. 7.
[28] Miles, 2013, pp. 386-387.

1.5 Methodology

The thesis consists of two main parts. The first part investigates the Nicaraguan canal concession agreement and seeks to explain its most important provisions in a clear manner. The second part seeks to explain the findings in part one based on an analysis of the historical development of international investment law and the use of concession agreements, relying on the theory described above. These different approaches have required two different methodologies, which are described below.

1.5.1 The Agreement

In the first part of the thesis, I describe the canal concession agreement and the two Nicaraguan laws preceding it based on the following method. First, I have established the relationship between the three different legal acts: law 800, law 840 and the concession agreement, by examining the provisions that concern their legal standing, nationally and internally. Second, I have relied on a contractual legal analysis to determine the content of the Nicaraguan canal concession agreement itself. In essence, I have examined the agreement's provisions to assess their legal effect and their relationship to other provisions of the agreement, in order to achieve a holistic view of its content.

As the concession agreements provides the contractual framework for a gigantic infrastructure project and an investment estimated to US$50 billion, the structure and terminology of the agreement is inevitably complex. Describing the content of such an agreement in a legible manner while staying true to the legal formulations has admittedly been a challenge. To the best of my ability, I have sought to properly balance these considerations in the presentation of the agreement.

The first part of the thesis only briefly touches upon the concession agreement's standing in international investment law. As the historical analysis of this thesis will show, this question has been subject to intense legal and political dispute.[29] For the purpose of the first part of this thesis, it suffices to conclude that the canal agreement is *lex specialis* with respect to the canal project. To the extent the agreement is connected to or makes references to principles of international investment law, such aspects are included in the presentation. The historical disputes and their relevance for the Nicaraguan concession agreement will be elaborated on in the second part of the thesis.

1.5.2 The Historical Development of International Investment Law

The second part of the thesis examines the origins of international investment law and its historical development, with particular attention paid to the role and debate over concession agreements. This examination is conducted to highlight the nature and underlying dynamics of the Nicaraguan canal concession agreement. In writing

[29] Dickstein, 1988, p. 54.

the second part of the thesis, I have turned to a method based on theories that form part of TWAIL scholarship.

It should be pointed out that the field of international investment law is methodologically challenging. A rule of international law must derive from one of the recognized sources, namely (1) treaties and conventions, (2) international custom, (3) general principles of law and (4) the 'subsidiary sources' of judicial decisions and legal teachings. In practice, the two most important sources international law are treaties and international custom.[30] However, despite many attempts at codification, there is not yet a single comprehensive treaty on the law of foreign investment that constitutes the core body of international investment law. Most of modern international investment law is instead based on investment agreements and customary international law, which has grown out of jurisprudence of international courts and tribunals, state practice and a number of "soft law" instruments adopted with the help of the United Nations (UN).[31]

Methodologically, I apply Kate Miles theory of the creation of international law to explore and explain the development of international investment law. To reiterate, this theory views international law as having emerged through a process of "repetitive assertions of power and responses to power".[32] Accordingly, I identify significant patterns of conflict over the content of international investment law, to trace how different states have asserted and enforced their view as representing international law and thereby shaped the content of the law.[33] It is a method that is well suited for the study of international investment law, which throughout history has been mostly based on customary international law and has been characterized by recurring conflicts between states.[34] In its nature, the content of customary law must be deduced from states' actions and pronouncements. Rules of customary international law result from the combination of two elements: an established, widespread and consistent practice on the part of states and *opinio juris*, the notion that state practice to be relevant must be accompanied by a conviction of adhering to an existing rule of law.[35]

As mentioned in the previous section, it is not clear that a concession agreement between a foreign investor and a state should fall within the sphere of international law. In fact, under traditional interpretations of international law only states are recognized as subjects.[36] However, concession agreements have undisputedly formed an important part of the conflicts and assertions that characterizes the history of international investment law.[37] Indeed, the dispute over concession agreements' legal standing is in itself illustrative of the historical dynamics of international investment law. Moreover, some of the provisions of the Nicaraguan canal agreement connect it to rules or principles belonging to the larger international investment law regime. Therefore, an historical analysis of the historic

[30] Thirlway, 2014, pp. 91-93.
[31] Subedi, 2014, pp. 727-728.
[32] Benton, 2002, p. 11 & Miles, 2013, p. 7.
[33] Miles, 2013, p. 7.
[34] Subedi, 2014, pp. 727-728.
[35] Thirlway, 2014, pp. 102-103.
[36] Anghie, 2005, p. 224.
[37] Lipson, 1985, pp. 4ff.

development of international investment law and the use of concession agreements is not only justified but also highly relevant to explain the Nicaraguan canal agreement. By analyzing the very origins of international investment law and the use of concession agreements, rather than taking the starting point in the mid 1900s, the thesis is able to accentuate the repetitive dynamics of conflict throughout the development of international investment law. In so doing, it is able to provide a deeper understanding for the Nicaraguan canal agreement and locate its dynamic as part of this ongoing mode of interaction.

1.6 Terminology

With respect to the area of foreign investment, a few terms are important to understand and bear in mind. In a specific foreign investment relationship, a state that is the destination of a foreign investment is called the *host state*, whereas the state from which the investor originate is called the *home state*. For the purpose of this thesis these descriptions refer to flows of direct investments, not portfolio investments. Generally, states both export and import capital but can be labeled either *capital-exporting* or *capital-importing*, depending on the net balance of their capital flows.[38]

Traditionally, multi-national corporations have identified with developed states and their interests have dominated FDI.[39] For much of history, it is therefore accurate to describe capital-exporting states as generally being developed countries, and capital-importing states as generally being developing countries.[40] Consequently, these expressions are sometimes used interchangeably in the historical examination of this thesis, which helps provide a more stringent presentation. However, it is acknowledged that this terminology sometimes might lead to an oversimplification of complex events. In addition, it should be pointed out that the FDI landscape has been shifting in recent years, as some developing state's outward flow of FDI has increased.[41] This trend does not negate the terminology of the historical examination of this chapter, yet is significant for the broader context of foreign investment. For example, China is projected to become a net exporter of capital in 2015.[42]

The thesis makes use of expressions such as *developing states* and *developed states,* as well as the expression *Third World* countries to some extent. It is acknowledged that there are unsatisfactory aspects to these expressions. Admittedly, they might insufficiently describe the complexities involved and might be seen as a continuation of a colonial framing of states as civilized or uncivilized.[43] However, as some sort of categorization of states is necessary the thesis does make use of

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[38] Trakman & Ranieri, 2013, pp. 2-5.
[39] Ibid., 2013, p. 4.
[40] UNCTAD, 2015, iii (the report defines developed states as the members of the OECD plus the new European Union countries which are not OECD members. In general, developing states are all economies not placed in that group).
[41] Ibid., p. 10.
[42] China Daily USA, 2015 [electronic source].
[43] Anghie, 2005, p. 3.

these terms. Moreover, they appear to be used within much of international legal discourse.

1.7 Delimitations

Following the purpose of this thesis, certain delimitations have been made in its examination of the Nicaraguan canal agreement as well as with respect to its historical analysis. In its examination of the canal concession agreement, the thesis focus on the core rights and obligations of the agreement afforded to the parties, with a particular focus on the provisions that affect the regulatory and legislative ability of the Nicaraguan state. Accordingly, while the agreement has been examined in its entirety, parts of the agreement that does not fall within the scope of this thesis have not been included in the presentation.

The analysis of the historical development of international investment law seeks to identify broader patterns of interactions between capital-exporting and capital-importing states. Inevitably, for such an historical analysis to be presented in a clear manner, not every specific event of importance to the development of international investment law is accounted for. In addition, it must be underscored that the thesis' account of this legal development is not aimed at determining the specific content of international customary law on the protection of foreign property at given points in time. Considering the conflictual history of this area of international law, such determinations would after all be very difficult to successfully accomplish. Moreover, the historical analysis' particular focus on the use of concessions has resulted in that other areas of relevance to the development of international investment law and the current legal regime are covered in less detail. For example, the thesis does only briefly cover the topic of bilateral investment treaties (BITs). Even though they have become paramount to the larger international investment law regime of today, they are arguably of lesser importance to the Nicaraguan canal agreement. To the extent the BIT regime is relevant to the canal agreement, such aspects will be included in chapter 4.

1.8 Previous Research

A considerable body of scholarship has critically examined the history of international law and the relationship between imperialism and international law, not least under the TWAIL scholarship as described previously (1.4). Such an approach is adopted by Anthony Anghie in *Imperialism, Sovereignty and the Making of International Law (2005)* and Charles Lipson in *Standing Guard: Protecting Foreign Capital in the Nineteenth and Twentieth Centuries (1985)*, among others. Yet very little of this scholarship has examined the particulars of the history of international investment law. The most extensive account of this historical development is provided by Kate Miles in her book *The Origins of International Investment Law: Empire, Environment and the Safeguarding of Capital* (2013). The scope of this thesis and the work of Kate Miles do overlap and, consequently, Miles' work has provided an important framework for the historical

analysis of this thesis. However, as far as the author is aware, no such historical analysis has been provided with a consistent and particular focus on the use of concession agreements. Moreover, no other such historical analysis based on TWAIL scholarship has been carried out with respect to the Nicaraguan canal agreement. To that end, the thesis may provide a substantial contribution.

1.9 Material

The first part of the thesis is based on both primary and secondary sources. The concession agreement between Nicaragua and HKND is executed in both an English and a Spanish version that have equal validity and effect.[44] However, the agreement is also enmeshed with Nicaraguan legislation, especially with two laws, law 800 and law 840, that are both written in Spanish. For as comprehensive an understanding of these laws as possible, I have relied on a written translation of law 800 provided by Rolando Ernesto Tellez, an English professor at the Universidad Nacional Autonoma de Nicaragua and a translation of law 840 by fellow Spanish-speaking student Josef Hellman.

For an account of the debate and critique surrounding the project I have relied on international news sources such as the New Yorker, the Guardian, the Economist and the Wall Street Journal. Sources with more detailed knowledge of Nicaragua or specific thematic areas, such as the English-language news publication the Nicaragua Dispatch and the national resources news site Circle of Blue, have also been of use. Moreover, I have examined descriptions and press releases on HKND's website regularly to gain further insight into the project and to sufficiently take account of the investor perspective.

The historical examination of this thesis primarily relies on literature that form part of TWAIL scholarship, which have been discussed previously in this chapter (p. 8). However, it is also based on literature outside of this scholarship, including works of writers such as Rudolf Dolzer, Christoph Schreuer, Surya P. Subedi and Ian Brownlie. In addition, it should be noted that, despite the amount of controversy over BITs and their effects on regulatory autonomy, there has been very little attention paid to the sort of stabilization clauses found in the Nicaraguan canal agreement.[45] Therefore, the options in terms of material for this part of the thesis have been limited. Arguably, the most important source for the use and impact of stabilization clauses has been the 2009 study on stabilization clauses and human rights overseen by the United Nations (UN) and the International Financial Corporation (IFC) of the World Bank.[46]

1.10 Structure

This thesis is structured as follows: the first chapter (chapter 1) has provided an introduction to the purpose and scope of the thesis and presented its theoretical

[44] MCA, p. 5196.
[45] Howse, 2011, p. 3.
[46] Shemberg & Aizawa, 2009.

basis. The second chapter of this thesis (chapter 2) provides a historical background to the canal agreement in Nicaragua and describes the debate surrounding the project. Thereafter follows a presentation of the content of the Nicaraguan canal concession agreement and the rights and protections it affords the investor vis-à-vis the Nicaraguan state (chapter 3). In particular, this examination focuses on the provisions of the agreement that limit the regulatory and legislative abilities of the Nicaraguan state. The following chapter (chapter 4) analyzes the development of international investment law and the use of concessions agreements historically, connecting this development to the content of the Nicaraguan canal agreement. Finally, the conclusions of the historical analysis are used to achieve a more thorough analysis of the content of the Nicaraguan canal concession agreement in the thesis' last chapter (chapter 5).

2 Background to the Nicaraguan Canal Project

This chapter presents the background to the Nicaraguan canal project. First, it gives a brief account of previous attempts at building a transoceanic Nicaraguan canal and a presentation of the context in which the current agreement was made. Thereafter, it summarizes the critique and debate that has surrounded the agreement, both within Nicaragua and internationally.

2.1 Dreams of a Nicaraguan Canal

Dreams of a Nicaraguan transoceanic canal are centuries old and have been held by foreigners and Nicaraguans alike. International businessmen, engineers and explorers have considered a canal an option to facilitate maritime world trade and, similarly, Nicaraguan leaders have investigated possibilities of a canal to boost the nation's economy. In the early 1800s, the Federal Republic of Central America, of which Nicaragua was then a part, reached out to the US Congress for support in building a canal, but the Americans eventually rejected the plans. Investigations were made anew during the Californian Gold Rush in the mid 19th century, as the American banker Ozro Childs laid out plans for a canal, yet construction never began. Shortly after Child's plan, the American business magnate Cornelius Vanderbilt sought to build according to a similar plan, but the project fell through shortly after its initiation as a civil war broke out.[47] Additional attempts were made in the early 1900s, as the U.S. gained rights to build a Nicaraguan Canal. However, the United States instead decided to take control of an attempt at construction of a transoceanic canal in Panama – the Panama Canal. Attempts at the construction of a transoceanic Nicaraguan canal have also been made fairly recently. Under former president Enrique Bolaños (2002-2007), a proposed canal project worth US$25 billion was suggested. However the project received plenty of critique and insufficient foreign aid and was ultimately not ratified by the national assembly. [48]

Nicaragua remains the second poorest country in the Western Hemisphere after Haiti. During the past century, the country has suffered from a 43-year dictatorship, civil war and natural disasters. According to the latest World Bank statistics, 42,5 % of the Nicaraguan population live in poverty.[49] Even though Nicaragua's economy grew by more than 4 % in 2014, income distribution is uneven and the average Nicaraguan earns less than US$2,000 per year.[50] Over the years, Nicaraguan opinion has been divided over whether a transoceanic canal is a disastrous ambition or a grand design from which the country will reap huge reward. Proponents claim that the canal project is the fastest way to pull Nicaragua out of poverty, raise employment rates and attract investments. Opponents question the economic rationale behind such a project, and fear that a canal will have

[47] Arizona State University, 2015 [electronic source].
[48] Runde, 2015 [electronic source].
[49] The World Bank Group, 2015 [electronic source].
[50] Central Intelligence Agency, 2015 [electronic source].

disastrous environmental and social effects.[51] Nevertheless, 71 percent of Nicaraguans living far from the canal route support it, according to the latest poll conducted in December 2014. Yet support dropped to 42 percent among those living along the canal's path.[52]

The current attempt at a transoceanic Nicaraguan canal appears to have both the political and financial backing necessary to make it through to completion. President Daniel Ortega, the elected president of Nicaragua, has made the canal a centerpiece of his legacy.[53] Formerly a leader of the Sandinista National Liberation Front (FSLN) that fought against the ruling Somoza family, he has been a key player in the Nicaraguan political landscape since at least the 1970s. Ortega previously served as president of Nicaragua between 1984 and 1990 and was reelected 2007 thanks to strong support among Nicaragua's poor.[54] During the last election, Ortega's party FSLN won 62 seats in the Nicaraguan National Assembly, obtaining a majority that enables it to undertake constitutional reforms singlehandedly.[55]

Nicaragua has granted the canal concession to Hong Kong Nicaragua Development Group (HKND), a private infrastructure development firm based in Hong Kong led by Chinese businessman Wang Jing. According to the company website, HKND has ”extensive experience in construction management and infrastructure development”[56], yet analysts point to HKND's lack of experience from major infrastructure projects.[57] Moreover, little is known of exactly how HKND will raise the estimated US$50 billion required for the project. Wang, who rapidly rose to wealth in the Chinese telecom industry during the 21st century, has yet to reveal any of co-investors in the project and China has denied involvement in the project.[58] Such uncertainties, together with social, environmental and legal concerns have resulted in widespread attention for the project.

2.2 Criticism and Concerns About the Project

The Nicaraguan canal project has received ample attention and critique. It has been particularly criticized for being rushed through without proper consultation or transparency. Critics point to the fact that the Nicaraguan parliament only had two days to debate the canal concession proposal, despite that it is by far the biggest project in the country's history.[59] Broadly, three lines of criticism can be discerned: critique aimed at the constitutionality of the agreement, critique concerning the project's environmental effects and critique levied at the economic rationale behind the project.

[51] Hanson, 2015 [electronic source].
[52] Erlich, 2015 [electronic source].
[53] Runde, 2015 [electronic source].
[54] Editors of Encyclopaedia Britannica, 2015 [electronic source].
[55] European Union Election Observation Mission, 2011, pp. 35-36.
[56] HKND (1), 2015 [electronic source].
[57] McDonald, 2014 [electronic source].
[58] Runde, 2015 [electronic source].
[59] Watts, 2015 [electronic source].

2.2.1 Constitutional Aspects

Law 840, which approved Nicaragua's concession agreement with HKND, was met by a flurry of constitutional challenges filed by the opposition, civil society and indigenous groups. The challenges alleged violations of constitutional guarantees to natural resources, private property and indigenous lands.[60] However, the Nicaraguan Supreme court dismissed all suits against the canal concession law in late 2013.[61] According to Supreme Court President Alba Luz Ramos, "Law 840 is not unconstitutional. It remains exactly as it was approved in the National Assembly."[62] Nevertheless, claims against the agreement of constitutional violations remain. Opponents say they fear the concession agreement will leave Nicaragua's national sovereignty "in pieces"[63] and many Nicaraguans worry over the effects of the investor's right to expropriate land, believing it will lead to unfair land confiscations and evictions.[64] Property owners in the proposed canal zone also complained last year that they were intimidated, sometimes with violence, by surveyors accompanied by army and police.[65]

Because of the size of the project, HKND's concession may have enormous social impact. According to some estimates, as many as 30,000 Nicaraguan property owners might be affected by expropriation carried out in the name of the project.[66] Moreover, in a constitutional complaint to the Inter-American Commission on Human Rights (IACHR) canal opponents warned that roughly 120,000 people would be directly uprooted by the canal project.[67] The concession affects areas and populations of the Nicaraguan Atlantic coast region that enjoy specific constitutional protection. The region is home to many distinct ethno-racial groups, including the indigenous Miskito, Mayangna and Rama groups as well as two groups of African descent: the Creole and Garifuna.[68]A number of these groups, together with territorial government authorities in the Atlantic autonomous region, filed one of the first suits to the Supreme Court, arguing that the concession law violated provisions of both Nicaragua's Constitution and the coast's Autonomy Statute.[69] Under the constitution, the peoples of the Atlantic coast area have the right to preserve and develop their distinct cultures, languages and religions; to have ownership of their communal lands; to use and benefit from the region's natural resources and to enjoy regional autonomy. These constitutional rights are the result of a long-lasting struggle. Since their incorporation into Nicaragua in 1894, the groups of the Atlantic coast fought for the self-government rights they were promised until they were given such rights under the new Nicaraguan Constitution, ratified in 1986 by the Sandinista government.[70] The Inter-American

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[60] Serrano, 2015 [electronic source].
[61] Sweet, 2015 [electronic source].
[62] López Baltodano, 2014 [electronic source].
[63] Rogers, 2013 [electronic source].
[64] Watts, 2015 [electronic source].
[65] Freedom House, 2015 [electronic source].
[66] Anderson Lee, 2015 [electronic source].
[67] Serrano, 2015 [electronic source].
[68] Hooker, 2009, pp. 2-3.
[69] Hegg Ortega, 2013 [electronic source].
[70] Hooker, 2009, p. 3.

Commission on Human Rights (IACHR) called the implementation of the canal project, without consultation of indigenous groups ”troubling”.[71]

2.2.2 Environmental Impact

The potential environmental impact of the canal project and its effects on wildlife and ecosystems has also led to much criticism. Scientists are particularly alarmed over the project's effects on Lake Cocibolca, the largest freshwater lake in Central America on which more than 200,000 Nicaraguans rely for their drinking water. To allow the passage of the massive container ships, too large to fit through the Panama Canal, nearly the entire path through the lake would have to be dredged to remove 1,2 billion tons of sediment, which inevitably would effect water quality and aquatic life.[72]

To meet such concerns, HKND has commissioned the firm Environmental Resources Management (ERM) to perform an Environmental Impact Study (ESI) of the canal project. Yet environmental experts and scientists have heavily criticized the assessments made by ERM. An independent panel of scientist and experts in Florida, who were allowed to review drafts of the study in March 2015, described the study as rife with scientific flaws. Moreover, it deemed the period allowed for the assessment by HKND, 1,5 years, insufficient considering the magnitude of the project.[73] The panel concluded that the studies by ERM used insufficient data with regards to water quality, geology, erosion and biodiversity. One of the main concerns of the panel was how the removal of 1,2 billion tons of sediment from Lake Cocibolca might threaten water quality and aquatic life. The analysis of ERM on this point was labeled “incomplete and implausible”.[74] Further, the panel said the study provided limited data on how the physical barrier created by the canal would inhibit animal movement and gene flow, possibly resulting in inbreeding and decreased biodiversity affecting threatened or endangered species. Overall, the panel argued, much more extensive sampling was needed over several seasons to provide a sufficient assessment of the environmental impact of the canal.[75]

In response to the panel's review statement, ERM generally agreed with the weaknesses in the work that the panel illustrated, but said that some analysis had been reworked. The company admitted that the time frame for the assessment was short and recommended itself that several additional studies be completed to confirm key assumptions “before a final decision is made by the government of Nicaragua”.[76] It also partly agreed with the panel regarding the need for a more robust evaluation of the project, and said “further consideration of alternatives is warranted in several areas.”[77]

[71] Inter-American Commission on Human Rights, 2014 [electronic source].
[72] Serrano, 2015 [electronic source].
[73] Nicaragua Canal Environmental Impact Assessment Review Panel, 2015, p. 1.
[74] Ibid., p. 3.
[75] Ibid., p. 9.
[76] Environmental Resource Management (1), 2015, p. 2.
[77] Environmental Resource Management (1), 2015, p. 2.

On may 31st, ERM completed its report to HKND which handed it over to the Nicaraguan government.[78] In its report, ERM concluded that there was "an unacceptably high level of uncertainty associated with some key impact conclusions"[79] and called for further studies of the project's potential effects. Among other things, the study questioned whether Lake Cocibolca could survive the dredging of its bottom. While the study argued that the canal project holds the potential for improving conditions in Nicaragua, it also acknowledged that it carries with it many risks and underscored the importance of good project governance.[80] At first, it appeared the ERM study had prompted the Nicaraguan government to postpone the start of construction until late 2016.[81] However, on November 5th the Nicaraguan government issued the "environmental permit" for the project and HKND was confident it could proceed "with full speed".[82]

2.2.3 Economic Feasibility

Another stream of criticism concerns the project's underlying economic rationale. HKND and the Nicaraguan government argue that the project will profit from growing maritime trade and an increased use of gigantic container ships that are too big for the Panama Canal.[83] The Nicaraguan canal would allow the passage of ships capable of carrying 25,000 containers and weighing up to 400,000 tons[84], whereas the Panama Canal after its current expansion will only be able to accommodate 12,000-container ships. The Nicaraguan government and HKND are betting that growth in maritime trade and ship sizes will help the canal become a successful enterprise.[85] Governmental predictions estimate the project will double Nicaraguan GDP by 2020, raise incomes and create roughly 250,000 jobs once completed.[86] In response to critics of the project, the president of the Canal Authority said the economic benefits of investment and jobs would easily outweigh the costs.[87] However, no independent economic feasibility study has yet been conducted to support these claims.[88]

Many economists have raised concerns regarding the economic case for the canal and question whether Nicaragua will actually benefit from the project.[89] The estimated cost of the project, already reevaluated from US$40 billion to US$50 billion, is still viewed by some as overly optimistic.[90] Moreover, critics point to key questions that dispute the competitiveness and success of the Nicaraguan canal, such as slower trade growth during recent years and possible rival trade routes that

[78] HKND (2), 2015 [electronic source].
[79] Environmental Resource Management (2), 2015, pp. 75-76.
[80] Ibid., p. 21, 78.
[81] Kraul, 2015 [electronic source].
[82] HKND (3), 2015, [electronic source].
[83] HKND (4), 2015 [electronic source].
[84] HKND (5), 2015 [electronic source].
[85] Butch, 2015 [electronic source].
[86] Watts, 2015 [electronic source].
[87] The Economist, 2013 [electronic source].
[88] Journal of Commerce, 2015 [electronic source].
[89] Lee, 2014 [electronic source].
[90] Anastasia O'Grady, 2015 [electronic source].

may open up through the Arctic because of global warming.[91] Others claim that demand for the kind of large vessels HKND and Nicaragua hope for is unlikely to materialize any time soon.[92]

Moreover, many point to the relatively small amounts of direct revenue that would transfer to the Nicaraguan government, other than the US$10 million HKND has agreed to pay during the first ten years of canal operation and the subsequent rise in government shares in the company.[93] There is also concern regarding the financing of the project. Many doubt that HKND will be able to raise the billions of dollars necessary to complete the canal, and precisely where financing will come from remains unknown.[94] HKND has declined to name any investor backing the project with reference to international practice, and many speculate that the Chinese government is secretly supporting the project.[95] In an interview, the president of the canal Authority hinted that he hoped for official Chinese backing and investment[96], yet so far China has not confirmed any affiliation with the project.[97]

2.3 Summary

To conclude, the Nicaraguan canal project may result in long-term economic benefits for the nation and its people. Yet the project is surrounded by many uncertainties and has received plenty of critique. It may have significant social impact, causing the displacement of up to 120,000 Nicaraguans and affecting constitutional rights of several indigenous groups. In addition, it may result in disastrous effect on the Nicaraguan environment, among other things threatening the water quality of Lake Cocibolca on which more than 200 000 Nicaraguans rely for their drinking water. These issues and concerns should serve as a constant background as the thesis moves on to examine the legal preparations for the canal project and the content of the Nicaraguan canal agreement.

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[91] Smith, 2014 [electronic source].
[92] Anastasia O'Grady, 2015 [electronic source].
[93] The Economist, 2013 [electronic source].
[94] Smith, 2014 [electronic source].
[95] Kondalamahanty, 2015 [electronic source].
[96] The Economist, 2013 [electronic source].
[97] Runde, 2015 [electronic source].

3 The Nicaraguan Canal Agreement

The main part of this chapter examines the content of the Master Concession and Implementation Agreement in respect of the Nicaragua Canal and Development Project (hereafter the 'agreement' or the 'MCA'). It is officially an agreement between four actors: the government of Nicaragua, the Nicaragua Canal and Development Project Commission (the 'Commission'), the Nicaraguan interoceanic Grand Canal Authority (the 'Authority'), HKND and the investor Empresa Desarroladora de Grandes Infraestructuras (EDGI).[98] As EDGI is controlled by HKND, it is effectively an agreement between Nicaragua and HKND.[99] Before the examination of the canal agreement, the thesis briefly presents the two Nicaraguan laws, law 800 and law 840, that paved way for the agreement.

3.1 Law 800

Enacted by the Nicaraguan National Assembly in July 2012, law 800 formally allowed for the construction of the Nicaraguan interoceanic canal. Its main purpose was to provide a legal framework for further regulations of the canal project.[100] Among other things, the law established the Nicaraguan Canal Authority to supervise the project, addressed the ownership of the canal project and sought to regulate land rights and environmental protection.[101] Law 800 is subordinated law 840 and the MCA, and several of its provisions were subsequently modified by those acts.[102] Nevertheless, it gives insight into the first legal steps made to facilitate the investment agreement.

In law 800, the Nicaraguan Canal Authority (the 'Authority') was tasked with representing the Nicaraguan government in matters concerning the canal project, supervising every phase of the preparatory studies, as well as the construction and operation of the canal.[103] The Authority was also given the task of raising investment for the project by creating and promoting the Nicaragua Canal Company, intended to result in mixed public-private ownership of the canal project in which Nicaragua would own 51 % of the shares.[104]

For the purpose of expropriation, law 800 declared all real estate or land rights in areas required for the operation of the canal to be in the public interest.[105] In addressing the potential social impact of the project, the law established a duty for the Authority to inform affected populations if expropriations affected their territories.[106] In addressing the environmental impact of the project, it established a

[98] MCA, p. 5185 (page numbers as found in official Nicaraguan publication of agreement).
[99] Ibid., p. 5186.
[100] Law 800, article 1.
[101] Ibid., articles 15-16, 20-36.
[102] Ibid., articles 23-24.
[103] Ibid., article 6.
[104] Ibid., article 15.
[105] Ibid., article 31.
[106] Ibid., articles 33-34.

duty for the Authority to ensure its environmental sustainability.[107] This duty included ensuring an environmental impact study, planning for a sustainable use of water resources, contributing to conservation and restoration of ecosystems as well as adapting the project to risks posed by climate change.[108]

3.2 Law 840

Law 840, frequently referred to as the canal concession law, was enacted in June 2013. Passed through a contentious party line vote in the Nicaraguan parliament after only two days of debate, it gave the approval for the government to sign the agreement with HKND and also afforded the agreement special status under Nicaraguan law.[109] Preparations for an agreement with HKND had been made well before: in the fall of 2012 Nicaragua had signed both a memorandum of understanding and a deed of cooperation with the corporation.[110]

Law 840 created a new entity, the Nicaragua Canal and Development Project Commission, and transferred all obligations of the Authority over to the Commission.[111] More importantly, the law made significant changes to the previous framework created by law 800. It changed the structure of ownership for the canal project, reducing the number of shares owned by the government of Nicaragua from 51 % to 1 %.[112] Significantly, it appears to have given the MCA the status of law by incorporating all provisions of the agreement into law 840. Any other law that impedes or contradict the obligations or rights afforded under the MCA, were deemed inapplicable to the canal project.[113] For further facilitation of the canal agreement, the law modified and removed any other legislation that explicitly or implicitly contradicted its wording or the wording of the MCA.[114] It specifically removed certain provisions of law 800 concerning the rate of public ownership in the canal project and Authority's abilities. It also removed regulations concerning public property and public interest, instead referring to the content of the MCA.[115]

In sum, law 840 and the MCA are given a very special status under Nicaraguan law. They are also afforded strong protection from the legislature itself. According to article 23, a majority of 60 % of the votes is required in the Nicaraguan assembly to amend, change or remove the law.[116] The variation between law 800 and law 840 documents how Nicaragua changed its ownership ambitions in the canal project significantly, from 51 % to 1 %. As presented, law 840 and the MCA are interconnected and several provisions of law 840 also overlap with the MCA. For the sake of clarity and the thesis' particular focus on the concession agreement, those provisions are presented as part of the MCA.

[107] Law 840, articles 20-21.
[108] Ibid., articles 9, 21-27.
[109] Watts, 2015 [electronic source].
[110] HKND (6), 2015 [electronic source].
[111] Law 840, articles 4, 7.
[112] Ibid., article 10.
[113] Ibid., article 17.
[114] Ibid., article 24.
[115] Ibid., article 24.
[116] Ibid., article 23.

3.3 The Master Concession and Implementation Agreement

3.3.1 Investor Rights and Ownership of the Project

To this date, the Master Concession and Implementation Agreement is the most detailed regulation of the canal project that is publically available. It creates a framework for the project and divides it into several sub projects, including the construction of the canal, an airport, roads, two ports and the establishment of a free trade zone.[117] The agreement grants HKND the exclusive right and authority to develop and operate the canal project and its sub projects, to use and receive any and all benefits arising from the projects, as well as to collect tolls and any other charges from any person utilizing any portion of the canal or the other sub projects under an extensive period of time. The concession period stretches 50 years from the first date of commercial canal operation, but the investor may extend the concession by another 50 years.[118] During the concession period, HKND and its affiliates are not subject to any taxation by the Nicaragua state. The government has agreed to ensure that all project affiliates and investors shall be exempted from any requirements to pay taxes or other duties.[119]

HKND and its investors will own 99 % by the beginning of the concession period and the remaining 1 % will be owned by the Nicaraguan state. Beginning after 10 years of commercial operation, ownership will be transferred to the Nicaraguan state by 10 % per decade. During the first then years of operation, HKND will pay the Nicaraguan government US$10 million, minus potential deductions for current debt it deems it is owed. [120] This initial monetary compensation and the transfer of shares in HKND to the Nicaraguan state serves as the "full and final compensation" for the granting of the concession.[121]

3.3.1.1 The Right to Expropriate

The agreement gives HKND wide-ranging rights to expropriate land at its own discretion, with the assistance of the Nicaraguan state. Under the agreement, the Commission must ensure the investor legal title of ownership to all land that may be "reasonably necessary or desirable"[122] to develop and operate any part of the project, free and clear of any legal claims to such land such as hypothecation, mortgage or other restrictions. Such a title of ownership includes the exclusive rights of the investor to possess, occupy, use or perform any activities upon such property.[123] Further, the Nicaraguan state must ensure that all such property remain in peaceful possession and enjoyment of the investor during the entire concession period. In the event of any obstruction by persons claiming right, title or interest in

[117] MCA p. 5192.
[118] Ibid., p. 5198.
[119] Ibid., p. 5204.
[120] Ibid., pp. 5189, 5192-5193, 5199.
[121] Ibid., p. 5199.
[122] Ibid., p. 5201.
[123] Ibid., p. 5201.

sub project assets or sites, the government shall defend the investor and take all steps necessary to provide the investor with unencumbered use of project land and infrastructure, and keep the investor indemnified against all losses that the investor may suffer from the action.[124]

In the event of expropriation, the investor is required to pay compensation to the owners of the property, yet this obligation is not followed by any specification of how such compensation will be calculated.[125] The MCA does however contain a definition of an "Expropriation Value", defined as the lesser of the taxed value of such property and the price at which such property would transfer in "an arms' length sale between unaffiliated parties in an open market at the date of this Agreement"[126]. The exact implications of this for each individual expropriation remain unclear.

Other than the aforementioned obligation to compensate private property owners for their land in the event of expropriation, the investor has little duties towards affected parts of the Nicaraguan population. According to the MCA, the government shall ensure that the investor face no other liability of compensation in the event of expropriation. Specifically, the agreement establishes a governmental responsibility to ensure that the investor has no obligation to any person in connection with the relocation and resettlement of any people or communities currently situated in areas to be utilized by or in connection to any of the sub projects.[127]

To conclude, the rights afforded HKND and its investors under the agreement are generous. In return for its investment, HKND will own the exclusive rights to develop and operate the canal project and receive all benefits thereof. It will be able to expropriate Nicaraguan land at its own discretion along the canal route and in connection to any of the other sub projects. Additionally, the investors are completely exempted from any taxes during a potential 100-year concession period and the government has committed to protect and indemnify the investor vis-à-vis any claims that may arise during the project. In return, Nicaragua receives little direct revenue and will only gradually, beginning after 10 years of operation, increase its ownership in HKND. The state will slowly reap more of the benefits of the project as their shares in HKND increase. However, it will take 60 to 70 years before Nicaragua becomes a majority shareholder in the company.[128]

It must be noted that the basic structure of the Nicaraguan canal agreement is to some extent characteristic for concession agreements between host states and foreign investors, especially in developing countries. Modern concession agreements often follow a similar structure to that of the Nicaraguan canal agreement, in which a private entity develops, constructs and operates the project and eventually transfer the project to the government. As part of such agreements, foreign investors usually require certain assurances from the government, including

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[124] MCA, p. 5202.
[125] Ibid., p. 5202.
[126] Ibid.,, p. 5189.
[127] Ibid., p. 5201.
[128] Ibid., p. 5192.

an exclusive right to undertake and exploit the project, assistance in the acquisition of land rights and the enjoyment of tax benefits.[129] Thus, the Nicaraguan agreement is connected to the broader use of concession agreements in developing countries, which in turn increases the importance of its examination.

Undeniably, investors are granted certain rights in return for their commitment to invest. Yet the rights granted under the Nicaraguan agreement are of a remarkable magnitude and put the foreign investors in a highly privileged position, both with respect to the Nicaraguan state and the rights of Nicaraguans at large. How come a sovereign nation would grant such rights to a foreign private entity that affect large swaths of its own territory? The imbalance in rights between the investor and Nicaragua cannot be explained simply as a result of commitment of capital and the bargaining between two actors. Rather, there appears to be an imbalance in these provisions of the agreement that has historical and legal overtones. This hypothesis is furthered strengthened by the fact that agreements of similar structure are common in developing countries. Moreover, the content of the agreement hints at the fundamental conflict of interests between the foreign investor and the host state. Its imbalance will only become more prominent as I move on to examine the provisions affecting the legislative and regulatory power of the state of Nicaragua.

3.3.2 Demands on Legislative and Regulatory Action

Several provisions of the agreement affect the legislative and regulatory ability of the Nicaraguan state, making demands on national legislative and regulatory action for its facilitation. The Nicaraguan government undertakes to use its best endeavours to ensure that each law and amendments to existing laws, that is necessary or desirable, shall be passed, enacted, published and gain the full force of a statute. This legislative process is to be carried out on an “expedited basis” and includes a governmental obligation to propose laws to the National Assembly of Nicaragua. It also includes the implementation of any other rules or regulations necessary to facilitate the agreement. After the enactment or implementation of such laws and regulations, the government shall ensure that the statutes are maintained, enforced and abided by each government entity.[130]

The demands on national legislative action also include changes to the Nicaraguan Constitution, in order to make valid and binding certain provisions of the agreement. The provisions in question regulate the right of the investor to determine any tolls, tariffs, fees or other charges to be paid by persons utilizing any portion of the sub project assets, as well as the delivery and execution of a Sovereign Immunity Waiver from the Central Bank of Nicaragua with respect to the agreement.[131] In the agreement, the parties declared the intention to present an amendment to the National Assembly of Nicaragua in order to ensure that those actions are considered in accordance with Nicaraguan law. This amendment was to be presented to the National Assembly of Nicaragua and passed “as soon as

[129] Hoffman, 2008, pp. 145-149.
[130] MCA, p. 5202.
[131] Ibid., p. 5203 - Generally, such waivers aim to secure the successful enforcement against the central bank as the monetary authority, in the event of an arbitral award.

practicable" [132]. Despite significant protests by canal opponents and political opposition, the National Assembly passed the required amendment in February 2014.[133]

3.3.3 Legislative and Regulatory Protection of the Investor

Another core element of the agreement affecting the legislative and regulatory ability of the Nicaraguan state are the limitations set by the concepts of "Change in Law" and "Political Force Majeure Event", which if triggered result in a number of obligations for the Nicaraguan government. The concept of "Change in Law" is constituted of a number of actions. First, a repeal, in whole or in part, or a modification of or an amendment to any law, affecting any part of the project or an investor, as well as the enforceability of any part of the agreement, constitute a "Change in Law". Second, any enactment, adoption or making of new law or requirement for any form of consent affecting, directly or indirectly, the project or its sponsors or the enforceability of any part of the agreement constitute a "Change in Law". Moreover, cancellations, non-renewals of, or an "adverse change" in the qualifications, conditions or restrictions applicable to any project consent or the issuance, renewal or modification thereof constitute a "Change in Law". Any imposition of a new requirement for a sub project or the sponsor to obtain permission, as well as a change in the manner in which any relevant law or requirement is applied or enforced or interpreted by a government entity also falls under the definition.[134]

The concept of "Political Force Majeure Event" establishes additional limitations to Nicaragua's regulatory and legislative power. It includes some more typical cases of political force majeure, such as acts of war, invasions, armed conflicts and acts of terrorism within the country.[135] Other examples of such cases involve violent demonstrations, public disorder and civil commotion or sabotage. However, many other events related to the actions of the Nicaraguan state are considered to be "Political Force Majeure Events". Examples of such events include any action or inaction of the government that prohibit, delay or otherwise restrict any investor or project affiliate.[136] Moreover, if any sub project sponsor does not obtain a governmental consent necessary to develop and operate the sub project in a manner determined at the investor's discretion that constitutes a "Political Force Majeure Event". Further, the issuance or making of any law, order, ban or declaration by any government entity, including national courts, in respect of archaeological or paleontological items or remains discovered on any project site constitute a "Political Force Majeure Event". So do any regulations that directly affect the revenue of the project in any way, as well as any condition or qualification to any

[132] MCA, p. 5203.
[133] Freedom House, 2015 [electronic source].
[134] MCA, p. 5187.
[135] See for example: Hoffman, 2008, p. 149.
[136] MCA, p. 5187.

part of the project consent which has the effect of restricting, impeding, delaying or reducing the transfer of any amounts yielded by such sub project.[137]

To understand the effects of the occurrence of a “Change in Law” or a “Political Force Majeure Events”, one must turn to two other legal concepts of the MCA, “Destabilising Event” and Destabilising Event Situation”. Any event considered a “Political Force Majeure Event” or a “Change in Law”, as well any other change to sub project consents by the Nicaraguan government, is considered a “Destabilising Event”. In turn, a “Destabilising Event” may, both indirectly and directly, give rise to a “Destabilising Event Situation”, the occurrence of which establishes a number of obligations for the Nicaraguan government and releases the affected investor from certain obligations.[138]

The term “Destabilising Event Situation” is very broad in scope. Such a Situation arises if the Nicaraguan state, in violation any of the limitations of its legislative or regulatory power set up in the agreement, act in a way that result in any sort of failure or delay on behalf of the investor to comply with its obligations under the agreement. Such a Situation also arises in the event of any changes to rights, benefits and obligations of any of the sub project parties. Moreover, if Nicaragua’s actions result in any costs to or loss in revenue of any sub project party, that too constitutes a “Destabilising Event Situation”.[139]

If a “Destabilising Event Situation” occurs, the Nicaraguan government has a number of obligations towards the investor and its affiliates. First, it is to indemnify and keep indemnified the affected investor and its affiliates and hold them harmless from the “Destabilising Event Situation” and its effects. Second, it must pay compensation equal to all losses directly or indirectly incurred, suffered or paid by the affected investor and its affiliates. Thirdly, the government shall take all other actions necessary to put the affected investor or affiliate in the same position in which it would have been in had such “Destabilising Event” not occurred.[140]

In addition, the occurrence of a “Political Force Majeure Event” alone results in additional obligations for the Nicaraguan government. Its occurrence excuses the investor from any performance and it shall not be considered in default of any obligation under the agreement to the extent that lack of performance is due to the event. Any time limits or deadlines for the performances by the affected investor or its affiliates shall be extended by a period equal to the period of the Political Force Majeure. Also, any fixed costs during the time a sub project is unable to be developed or operated properly due to a Political Force Majeure Event are to be covered by the Nicaraguan Government.[141]

To summarize, the described provisions have significant effects on Nicaragua’s regulatory and legislative ability. They enable the investors to steer Nicaraguan

[137] MCA, p. 5208.
[138] Ibid,, pp. 5188, 5207.
[139] Ibid., p. 5207.
[140] Ibid., p. 5207.
[141] Ibid., p. 5209.

legislative and regulatory action through the agreement, to the extent that it has prompted an amendment to the country's constitution. Moreover, the provisions of "Change in Law" and "Political Force Majeure Event" ensure a blanket protection of the investor towards any action from the Nicaraguan state. To be clear, these provisions do not explicitly exempt the project and the investor from any new regulations, yet any Nicaraguan legislation or regulatory action that in any way affect the investor results in an obligation on behalf of the state to compensate the investors for all losses that directly or indirectly result from such regulations. Notably, this investment protection does not make exemptions for any regulation or legislation enacted in the public interest, be it for social or environmental reasons, despite the magnitude of the project and the risks associated with it. Furthermore, Nicaragua has to bear the fixed costs of the affected investor during any resulting delay to the project.

The provisions that limit the Nicaraguan legislative and regulatory ability in the agreement are a form of so-called "stabilization clauses".[142] **S**pecifically, they are a form of hybrid stabilization clauses that require Nicaragua both to restore the original economic equilibrium of the contract if it is impacted by a change in law, and to compensate the investor for any losses suffered as a result of any new legislation or regulation. Such clauses have been widely used in various forms in investor-state contracts and regularly so in the infrastructure and transportation sector. The clauses take different forms but are often wide in scope, apply throughout the life of the investment and serve to protect foreign investments.[143] Notably, this kind of stabilization clauses appear to be much more common in developing countries and often include protection of the investor from any legislation regardless of purpose.[144] Thus, these provisions of the agreement are again connected to the broader use of investment agreements in developing countries.

The similarities of these provisions of Nicaraguan canal agreement to other agreements in developing states, further motivates a study of their origins. The comprehensive protection of the investors and their rights under the agreement may seriously impair the Nicaragua's ability to regulate and legislate. How come a sovereign state enters into an agreement of this nature, granting generous rights and allowing foreign investors to steer legislation while shielding their activity on Nicaraguan territory from any effects of Nicaraguan legislative and regulatory action? Again, this imbalance between investor and state in the agreement cannot simply be explained as a result of a bargaining between two actors, but appears to have historical and legal overtones. Lastly, to fully account for the standing of these provisions, I present the terms of amendment and termination as well as the provisions on governing law and dispute resolution in the agreement.

[142] Hoffman, 2008, pp. 151.
[143] Miles, 2013, pp. 205-206.
[144] Shemberg & Aizawa, 2009, pp. 38-39.

3.3.4 Amendment and Termination

The Nicaraguan government has undertaken not to challenge the validity or enforceability of any provision of the agreement. Likewise, any effort to amend the agreement requires the consent of each party to the concession agreement. However, the ability to terminate the concession or any of its sub projects varies between the parties.[145] For example, if the investor determines that a sub project for any reason is not viable or that it should not be developed or operated, it has a right to terminate the concession for that sub project.[146] If the financing of a sub project does not meet the financing requirements of the project within 72 months of the date of the agreement, or the project is not successfully completed within 10 years of its financing, both parties have the right to terminate the concession in that part.[147] Moreover, there is a right to terminate in the event of default with respect to a sub project for both parties. This right also exists in the event of different cases of prolonged force majeure. In the event of a natural force majeure, which continues for a continuous period of 12 months or an aggregate of 360 days or more within 24 months, both parties have the right to terminate the agreement regarding the affected sub projects. In the event of a prolonged political force majeure, which for a continuous period of sixty days or more or an aggregate of 90 days within a period of 120 days, the investor has the right to terminate the concession with respect to the relevant sub project.[148]

3.3.5 Governing Law and Dispute Resolution

The agreement and any dispute arising out of it are governed and determined in accordance with the laws of Nicaragua and "such rules of international law as may be applicable".[149] However, this should be viewed in light of the blanket economic protection of the investor against any legislative or regulatory action of the Nicaraguan state. Furthermore, disputes arising out of or in connection with the agreement shall be submitted exclusively to international arbitration. Nicaragua has waived any right of sovereign immunity "to the fullest possible extent",[150] which enables the investor to bring a cause of action against the government without the government's consent.[151] The party that initiates the arbitration may turn to either the International Centre for Settlement of Investment Disputes (ICSID) or the International Court of Arbitration of the International Chamber of Commerce (ICC) to settle the dispute.[152] Thus, the agreement is enforceable under international arbitration.

[145] MCA, pp. 5215, 5219.
[146] Ibid., p. 5209.
[147] Ibid., pp. 5193, 5210.
[148] Ibid., pp. 5209-5210.
[149] Ibid., p. 5217.
[150] Ibid., p. 5219.
[151] Hoffman, 2008, p. 158.
[152] MCA, pp. 5217.

3.4 Summary

To conclude, the above-described clauses buttress the imbalances previously found in the agreement and further strengthen the protection of the agreement already afforded under national law**.** Nicaragua has unequivocally bound itself to the agreement and cannot alter it without consent of the investors. Meanwhile, the investors have greater possibilities to terminate the agreement and the interpretation of the agreement and any disputes arising out of it will be settled through international arbitration. Judging by these provisions it appears as if Nicaragua has entered what can almost be described as a treaty with another sovereign, in which Nicaragua's possibility to exercise any powers in the interests of its people result in numerous obligations towards HKND. This structure appears enigmatic; after all it is an agreement between a private investor and the state, concerning a matter of the state's territory. Yet it adds to the fundamental imbalance of the agreement and calls for a further investigation into the nature of the agreement beyond the present.

While the Nicaraguan canal project might be unique in scope, investment agreements of similar structure and with similar level of foreign investment protection are common, particularly in the developing world. It is a structure that has taken the following expressions in the Nicaraguan canal agreement. The investor has been granted the exclusive right to develop and operate the project, will pay no taxes or fees and is granted the ability to expropriate land at its own discretion. Moreover, it is also able to make demands on Nicaraguan legislative action and has already been able to prompt an amendment to the country's constitution. Meanwhile, the investor is shielded from the effects of any legislative or regulatory action on behalf of Nicaragua that would affect any of its rights under the agreement. In addition, Nicaragua can do nothing to alter the agreement without the consent of the investor and all potential disputes arising out of the agreement are subject exclusively to international arbitration. This structure should be viewed in light of the great risks inherent to the project and the potentially disastrous social and environmental effects it may have for Nicaragua and part of its population.

How come an agreement of this nature regulates what is arguably Nicaragua's most important project in history? And how come foreign private investors are able to achieve contracts with similar rights and investment protection in developing countries? Undeniably, any investment agreement is to some extent the result of the bargaining between different parties. Yet the inequities found in the Nicaraguan canal agreement are so fundamental that they cannot simply be viewed solely as a product of this bargaining. Moreover, the agreement's explicit connection to international legal rules and the similarities in practice in other developing countries imply a connection to the broader context of international rules on foreign investment protection. This further strengthens the thesis' hypothesis that historical legal factors are at play and have helped shape the basis of this agreement. For a complete explanation of the agreement's content and structure, it must therefore be placed in the context of the historical development of the international law on foreign investment protection – international investment law – and the fundamental conflicts that have shaped it.

The history of international investment law and its connection to the present is disputed. Many legal scholars argue that past controversies over the meaning of international investment law have little relevance today.[153] Historic controversies between capital-importing and capital-exporting states have been overcome today, it is said, by more than 3000 investment agreements. This argument presents international investment law's past as irrelevant and separates it from the political conflicts and controversies that created it. In contrast, I argue that the principles of international investment law were formed through the protection of foreign investments and emerged from claims made in a context of exploitation and political contest between capital-exporting and capital-importing states.[154] As the following chapter will show, concession agreements served as an important instrument throughout this process[155] and their legal nature has been formed to serve similar interests.[156]

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[153] Dolzer & Schreuer, 2008, p. 16.
[154] Miles, 2013, pp. 2-8.
[155] Veeser, 2013, p. 1142.
[156] Anghie, 2005, pp. 227-232.

4 The Historical Development of International Investment Law

To explain the phenomenon of the Nicaraguan agreement and its effects on the legislative and regulatory ability of the Nicaraguan state, this chapter examines the historical development of the rules on foreign investment protection based on the theories of Kate Miles. First, it describes the origins of international investment law and the use of concession agreements in the 19th century (4.1). Thereafter, the chapter examines the broader conflicts over the content of international investment law between capital-exporting and capital-importing states in the 19th and 20th century (4.2 & 4.3). In connection to this examination follows a presentation of the debate over the internationalization of concessions and its effect for the content of such agreements (4.4). Finally, the chapter describes the emergence of the BIT regime and the increasing use of stabilization clauses in investment agreements, connecting these trends to the fundamental conflicts that have shaped the international rules on foreign investment protection and the Nicaraguan canal agreement (4.5).

4.1 The Origins of International Investment Law and the Use of Concessions

Modern international investment law and the rules on the protection of foreign investment originate from reciprocal agreements between European states that were made during the 17th and 18th century. These states, which possessed fairly equal bargaining power, sought to secure mutual minimum standards of treatment for actors engaged in investment activity within their territories.[157] Many agreements were made in the form of friendship, commerce and navigation treaties, which have often been described as the first generation of bilateral investment treaties.[158] Such treaties addressed a wide range of subjects related to nationals of the state parties and focused on protecting individuals and their property: guaranteeing freedom of movement, ensuring rights to trade and enabling foreigners to use local courts to enforce their claims. Together, these agreements created a network of reciprocal trade protection measures and formed a framework for international protection of foreign capital in Europe.[159]

At the time of the European commercial and legal expansion in the early 19th century, European rules protecting foreign individuals and their property were not the only system governing such interactions. Regulations of trade and other forms of international interaction existed in other continents as well, as groups of nations and peoples had developed international legal regimes to govern their interactions. The significance of this for the development of international law is that European

[157] Lipson, 1985, pp. 8-12.
[158] Subedi, 2012, p. 233.
[159] Lipson, 1985, pp. 8-9.

nations were not creating legal regimes on a blank canvas. Rather, processes of political and jurisdictional contest took place and different legal systems vied for supremacy as European nations expanded their global influence.[160] These processes, and the imposition of European foreign investment protection rules, coincided with the increasing migration of capital and the emergence of the global economy. Beginning in 1820, the colonial era also became an era of international investment. According to legal scholar Kenneth Vandevelde, this transformation was triggered by at least three major events. The first was the end of the Napoleonic Wars in 1815, which was followed by almost a century of relative peace in Europe. A second trigger was the industrial revolution, which generated an enormous demand for imported raw materials and resulted in reduced transportation costs. A third triggering event was the emergence of liberal economic theory, which emphasized the promotion of exports and promoted free international trade to create national wealth.[161]

As European capital-exporting states sought to establish international rules to protect their investments outside of the continent, the reciprocal character of their international investment rules changed fundamentally. Out of self-interest, European states had practiced self-restraint regarding foreign investors among themselves. Any arbitrary seizures of property or use of coercion would inevitably disrupt a state's own commercial relations. However, outside of their own continent European nations enjoyed few reciprocal relationships with developing nations and both could and had to exert considerably more force to ensure the protection of their nationals and their investments in these countries. As a result, foreign investment protection law moved from a base in reciprocity to one of imposition.[162] Subsequently, treaties of friendship, commerce and navigation with non-European states often became a first step in establishing a more intrusive European presence in these nations. The treaties were interpreted increasingly in European favor as the military and political power of European states grew, limiting the host state sovereignty to further trade and investment rights for European entities. This process became closely linked to colonialism, military interventions and a coercive protection of commercial interests.[163] That natural resources of host states and colonized nations were commodities for the use of Western interests was a view inherent to this process.[164]

The process of commercial and political expansionism was both facilitated by international investment law and helped shape its content. Capital-exporting states directed the evolution of international investment law through the use of force and the assertion of foreign investment protection as existing international law. Inevitably, European states shared a common understanding of the international legal principles governing foreign investments that reflected their interests and accentuated the obligations of nations to facilitate trade and investment. Repeated assertions of those obligations, as well as the legitimacy of actions taken to enforce them, contributed to solidifying these views as rules of international law. Thus,

[160] Miles, 2013, pp. 22-23.
[161] Vandevelde, 2010, pp. 20-21.
[162] Anghie, 2005, p. 85-86.
[163] Lipson, 1985, pp. 8-13.
[164] Miles, 2013, p. 46.

international investment law both served as an important tool and evolved throughout the process of the Western expansion.[165]

The acquiring of concession agreements was an important part in the effort to establish European notions of property rights as international law.[166] Concessions were used to supply elements that capital-exporting states deemed to be lacking in host countries, effectively inserting a European legal order to protect home states' investors.[167] Generally, such concessions concerned public utilities, such as the construction and operation of railways, canals or the exploration and exploitation of mineral or timber resources.[168] The rights granted were often wide-ranging and gave broadly defined jurisdiction to private investors for long periods of time. Concessions frequently gave special privileges to the concessionaire as well, in the form of tax exemptions, limited or full monopoly or guaranteed rates of return on capital. As legal historian Cyrus R. Veeser explains: "although some legal historians deny that privileges were intrinsic to concessions, in practice they usually were, in colonies as well as in sovereign states".[169]

During the second half of the 19th century, European states increased diplomatic pressure to secure concessions, often as part of wider aims to expand political and commercial influence. For example, Britain applied an interventionist policy to every concession that was deemed to be politically important. If it were viewed to be in Britain's political interest to obtain a particular concession, the government would pressure the host state, through the use of force if necessary.[170] States and private investors collaborated to obtain such concessions. Investors such as the English East India Company were granted great powers by their home states to enter agreements and gain wide-ranging rights within host territories, which helped establish a network of European political and commercial influence.[171] The transfer of economic and jurisdictional control that often followed from such concessions contributed to the process of spreading European based notions of property rights.[172]

Once obtained, concessions were protected by military force of the home state and any coercive actions of the investor's home state was legitimized with reference to international rules on investment protection. The invocation of international property rights by concessionaires and their reiteration by the home state were assertions of the principles of the content of the law, but also served in the creation of its principles. Inevitably, such assertions reflected their capital-exporting interests and focused on the protection of their nationals' investments and property.[173] The enforcement and protection of concessions and other foreign investments were closely connected to the establishment of an alignment between state and investor interests under international law and the assertions of an

[165] Miles, 2013, pp. 22-23.
[166] Ibid., pp. 22-26.
[167] Veeser, 2013, p. 1143.
[168] Schrijver, 1997, pp. 174-175.
[169] Veeser, 2013, p. 1142.
[170] Miles, 2013, p. 30.
[171] Schrijver, 1997, pp. 174-175.
[172] Miles, 2013, p. 31.
[173] Ibid., pp. 28ff.

international minimum standard for the protection of foreign investments.[174] These efforts were met with resistance from capital-importing states who disputed the legal privileges of foreign investors.[175] The unfolding conflict between capital-exporting and capital-importing states in the 19th century and onwards encapsulates the fundamental tensions and conflict of interests concerning the treatment of foreign investments that have characterized international investment law ever since.

For the purpose of explaining the Nicaraguan canal agreement, it important to conclude that the foundation of the modern principles of foreign investment law can be traced to this era of European expansionism in the 19th century. International rules on the protection of foreign investment and the acquiring of concessions facilitated this expansion and were shaped in the process. Inevitably, these rules aimed to protect home states' investments abroad and did not place emphasis on the interests of capital-importing states or consider the complexities of the environment in which they were made. Already, this examination illustrates the fundamental conflict of interest between capital-exporting states and host states. By tracing this pattern and the development of international investment law further, the connection between these historical origins and the Nicaraguan canal agreement become clearer.

4.2 Diplomatic Protection, the International Minimum Standard and the Calvo Doctrine

During the second half of the 19th century, international legal rules on the protection of foreign investment developed within a branch of international law known as the diplomatic protection of aliens. The doctrine was based on the premise that any injury incurred by a foreigner in another was an injury incurred by his or her state. Accordingly, it permitted states to take action on their national's behalf, either diplomatically or through the use of force.[176] The doctrine of diplomatic protection established an international minimum standard for the treatment of aliens, described by its proponents as a "moral standard for civilized states".[177] The standard set up a number of preconditions for the expropriation of foreign property: it had to be carried out for a public purpose, it could not be arbitrary or discriminatory and prompt, adequate and effective compensation had to be paid. Notably, the standard's scope did not include consideration of social or economic needs of the host state, the capacity of a state to pay the compensation amount, or previous investor conduct.[178] In favor of such a standard, capital-exporting states of Europe and North America argued that equal protection under national law at times would result in insufficient protection of foreign investors. Therefore, it was argued, the international minimum standard rather than national

[174] Miles, 2013, pp. 42-49.
[175] Lipson, 1985, p. 18.
[176] Bishop, 2005, p. 4.
[177] Brownlie, 2008, p. 525.
[178] Miles, 2013, pp. 48f.

law should apply to investors and their investments if national law was considered under-developed or failed to meet standards of justice and equity.[179]

During the 19th century, claims under international diplomatic protection in the aftermath of expropriations were common, particularly in Latin America.[180] Expropriations by home states were rarely large-scale, yet minor skirmishes and incidents of seizures of property were common and included property of concessionaires.[181] Starting in the 1870s, countless concessions had been granted and this trend would continue several decades into the 1900s.[182] Leaders of many developing states had granted concessions voluntarily despite frequent public opposition, often presenting concessions as essential mechanisms for modernizing the economy. However, many concessions that were ostensibly aimed at economic development were often close to fraudulent and sparked controversies due to their exploitive nature. Even though many developing states, particularly Latin American ones, had welcomed investments and used concessions to reassure foreign investors, they resisted their local influence and protection by foreign powers.[183] In particular, the assertion of an international minimum standard to govern foreign investments was met with persistent resistance by many Latin American states.

For many host states, the frequent invocations of diplomatic protection together with treaties and concessions became a source of grievance that inspired efforts to change the norms regulating international investment. Seeking to shield their regulatory power and jurisdiction and alter the nature of foreign investment protection, they argued that investment regulation and expropriation of foreign property were matters of domestic jurisdiction. They further asserted that the doctrine of state sovereignty precluded interference by other governments in disputes over the treatment of foreigners and their property rights. Carlos Calvo, a prominent Argentine lawyer, was the first to systemize the elements of this claim at a legal level in 1868. This doctrine came to be known as the Calvo Doctrine, but is also referred to as the standard of national treatment.[184] The doctrine stipulated equality before the law between nationals and foreigners and that aliens who established themselves in a country had the same rights to protection as nationals of that country, but could not lay claims on a more extended protection.[185] In short, as long as a state did not discriminate against foreign investors it was not violating any rules of customary international law.[186]

Many developing countries put considerable emphasis in their foreign policy on principles of national sovereignty, territorial integrity and non-interventionism.[187] Newly independent Latin American countries adopted this position and frequently required the insertion of a so-called “Calvo Clause” into investment contracts concluded with foreigners, under which the investor committed to refrain from

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[179] Subedi, 2014, pp. 729-730.
[180] Ibid., p. 729.
[181] Miles, 2013, p. 52.
[182] Veeser, 2013, p. 1138.
[183] Ibid., p. 1139-1141 & Lipson, 1985, p. 18.
[184] Schrijver, 1997, pp. 176-178.
[185] Subedi, 2014, p. 730.
[186] Brownlie, 2008, p. 524.
[187] Schrijver, 1997, p. 176f.

seeking diplomatic protection in a dispute with the host state and instead turn to local remedies.[188] However, countries like Britain and the United States declared that the Calvo Clause did not in any way affect their rights and duties under international law, but could only be a factor in determining whether or not a state would intervene on behalf of their national. Such statements coupled with military action by capital-exporting states enforced their view of international law and were simultaneously also part of the creation of international legal rules protecting foreign investors.[189]

Because of the military and economic strength of capital-exporting states, they were able to enforce their perspective as law and frame foreign investment protection as part of state responsibility, focusing on the protection of the investor and connecting the interest of state and investor through the doctrine of diplomatic protection.[190] Generally, capital-exporting states adopted practices on intervention under diplomatic protection that suited their political and commercial interests. If deemed necessary, states were willing to use considerable force to enforce their view of international law and protect their foreign investments.[191] For example, in the 1850s the United States sent a fully armed naval fleet to Paraguay in response to an alleged expropriation of property belonging to an American company, pressuring Paraguay into agreeing to submit the claim to a tribunal for settlement.[192] In the early 20th century, Britain and Germany bombarded the Venezuelan capital Caracas to ensure compensation for nationals whose property had been destroyed during the civil war and forced Venezuela, which insisted on the exclusive jurisdiction of its local courts, to consent to international arbitration.[193] Such violent instances illustrate the highly polarized positions of capital-exporting and capital-importing states over the rules of foreign investment protection. Ultimately, the efforts on behalf of host states to influence international law were unsuccessful and the Calvo doctrine was not accepted as a rule of international law.[194] Instead, the minimum standard was used to alter the presumption that an alien who was conducting business abroad had submitted himself to the local jurisdiction and law of that country.[195] This presumption enabled capital-exporting states to exert control over the investment protection process in foreign nations.[196]

To conclude, international investment law evolved in the 19th century as a mechanism that sought to protect the interests of foreign investors and their home states. The process involved repetitive assertions by capital-exporting states of their viewpoint as representing international law, often imposed through the use of force or other coercive measures. The conflict that emerged during the 19th century illustrates the highly polarized positions of capital-importing and capital-exporting states and the fundamental conflict of interests over the treatment of foreign

[188] Schrijver, 1997, p. 178.
[189] Miles, 2013, pp. 51-52.
[190] Ibid., p. 49.
[191] Schrijver, 1997, p. 175.
[192] Mora & Cooney, 2007, pp. 19-21.
[193] Waibel, 2011, pp. 30-31.
[194] Miles, 2013, pp. 51ff.
[195] Brownlie, 2008, pp. 524-525.
[196] Miles, 2013, p. 49.

investment. Foreign investment and concessions were not undesired by developing states, yet their legal status and protection undeniably proved to be great sources of conflict. Already in the 19th century, the granting of concession agreements was a double-edged sword for developing states, as power asymmetries enabled foreign investors to gain very favorable concessions and enjoy protection by their host states. Provisions that might appear self-evident in the Nicaraguan agreement, such as the international dispute resolution and the limitations on the state's legislative and regulatory power, are issues that were subject to intense and violent conflicts between capital-exporting and capital-importing states already in the 19th century. Throughout the 20th century, similar asymmetries of power would continue to shape international rules on foreign investment protection to reflect the interests of capital-exporting states through a process of assertion and creation. In the following presentation, a particular emphasis is placed on the developments of the second half of the 20th century.

4.3 20th Century: Recurring Patterns of Conflict

During the first half of the 20th century, further important conflicts over the content of international rules on the protection of foreign property occurred as challenges were made by host states to alter the principles of foreign investment protection. One of the most significant challenges occurred as part of widespread land reforms after World War I in states such as Mexico, the Soviet Union and several Eastern European states, which led to extensive uncompensated confiscations of land. These states challenged investor protection rules and the content of the international minimum standard by asserting a right to seize property for social purposes, "nationalization", arguing that it differed from previous forms of expropriation and exempted a government for any obligation to pay compensation. Inevitably, such reforms posed a major threat to foreign investments. Nationalizations were met by intense opposition from investors and their home states, who reiterated their assertion of a right to compensation under international law. This opposition also served to further entrench capital-exporting states' views as international law.[197]

One dispute in particular between Mexico and the United States over land rights and oil operations would give rise to a principle of long-lasting importance for international law, the so-called 'Hull Formula'. Following the Mexican nationalizations, the US Secretary of State, Cordell Hull, asserted the American position that "adequate, effective and prompt payment" for seizure of foreign-owned property was required under international law and rejected the validity of any exemption for social need.[198] In his communiqué to Mexico, Hull underscored that the real issue was not whether Mexico should pursue social and economic policies designed to improve the standard of living of its people, but whether in doing so the property of American nationals could be taken without prompt payment of just compensation under international law. This statement captured the viewpoint of capital-exporting states generally. Moreover, this understanding of international law was supported in writings of legal experts, decisions from arbitral

[197] Miles, 2013, p. 75.
[198] Ibid., p. 76.

tribunals and entities such as the International Law Association. The reactions of capital-exporting states to such nationalizations and its support among legal experts during this time, was used to assert the validity of the Hull formula demanding compensation according to international law in the event of expropriation. Attempts by host states to shape the content of international investment law were rejected and also triggered a response that enabled a reassertion of the content of international investment law.[199] This pattern of host states challenges to the rules of international investment law and hostile responses from capital-exporting states would occur with renewed strength during the decolonization process after World War II.

4.3.1 The New International Economic Order

In the years after World War II, calls for a new international economic order (NIEO) surfaced as part of a campaign directed at systemic impacts of colonialism and wider issues of economic injustice. Newly independent states sought to change old doctrines to which they were ostensibly bound, but had played no role in formulating under colonial rule. As part of this movement, developing states, which regarded customary international law as biased against their interests came together with the post colonies and used the law-making mechanism of the United Nations.[200] Relying particularly on the Calvo Doctrine, they attempted to create new doctrines of international investment law and reorient the international rules of foreign investment protection. [201] One of the most important examples of the campaign for a NIEO was the effort to grant new states permanent sovereignty over natural resources (PSNR). A key strategy of this movement was the attempt to allow states to revisit concessions granted by colonial authorities, based on the understanding that national law governed these concessions and that the contracts had ceased at the extinction of the colonial territory.[202]

The PSNR effort became an important instrument by which new states sought to regain control over their own natural resources and use them to promote their own welfare.[203] In 1962, the General Assembly passed Resolution 1803 on the principle of permanent sovereignty over national resources[204], which contained repeated references to the sovereignty of the state and the fundamental importance of sovereign control over natural resources in the promotion of economic development.[205] Developing states later came together to reinforce their approach in stronger terms through the adoption of the 1974 Charter of Economic Rights and Duties of States (CERDS)[206], stating that compensation would be determined under national laws and disputes over compensation be settled by national courts. The adoption of the charter was preceded by polarized debates between developed and

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[199] Miles, 2013, p. 76.
[200] Anghie, 2005, pp. 198ff.
[201] Miles, 2013, p. 94.
[202] Anghie, 2005, p. 211.
[203] Ibid., pp. 198, 211.
[204] Declaration on Permanent Sovereignty over Natural Resources, GA Res 1803 (XVII), 17 GAOR, Supp. 17, UN Doc. A/5217m 15 (1962).
[205] Anghie, 2005, pp. 211-216.
[206] Charter of Economic Rights and Duties of States, GA Res 3281 (XXIX), UN Doc A/RES/3281 (XXIX) (1974).

developing nations in the UN, but the sheer number of developing states in the General Assembly enabled the adoption without any amendment.[207]

In sum, both the 1962 and the 1974 resolutions served to back attempts at strengthening developing states' regulatory capabilities and emphasizing investor responsibilities.[208] The movement for a new international economic order and the recurrent attempts by developing states to change international law once again put foreign investments at risk. Many of the natural resources in the post colonies and developing states had been subject to foreign-owned concessions to investors from the developed world, often at extraordinarily favorable terms and more often than not occurring as a result of direct coercion.[209] Unsurprisingly, many capital-exporting states vigorously objected to the propositions made by the newly independent and developing states. They rejected the rule-creating potential of the NIEO instruments on the grounds that they had not been supported by developed states, and accordingly did not represent any unanimity amongst states or provide evidence of any rule of international customary law.[210] Instead, they argued that well-established rules of international law required postcolonial states to honour the concessions and fulfill the contract terms of concessions that had been agreed during colonial rule. Moreover, they objected to the proposition that domestic law would govern the concessions, arguing instead that they were governed by an international law of contracts and that the disputes should be settled by international arbitration. The position of capital-exporting states found support in numerous of arbitral awards that helped "internationalize" concession agreements, a development which is of fundamental importance to the understanding of the Nicaraguan canal agreement. Again, recurring conflicts over the protection of foreign investment would lead to reassertions of the existing content of international investment law but also to the development of new principles for the protection of foreign investment.[211]

4.4 The internationalization of Concessions

The legal standing of concessions and their connection to international law caused a particular rift between the positions of developing and developed states. Developing nations contended that disputes over such agreements fell within their national jurisdiction and that international law did not apply, as concessions were contracts between a state and a private party. Instead, they argued, national law governed concessions and therefore the cancelation or modification of such concessions was a prerogative implicit in the notion of retaining permanent sovereignty. In response, developed nations, whose corporations were most often the concessionaries, insisted that sovereign states had to abide by their undertakings and recognize international law as governing concessions. Further, they argued that any upcoming disputes arising out of concessions should be determined by international arbitration, and that host states either had to perform their obligations

[207] Miles, 2013, p. 99 (Vote 120-6 – with 10 abstentions).
[208] UNCTAD, 2015, pp. 122-123.
[209] Anghie, 2005, p. 211.
[210] Schrijver, 1997, pp. 97-101.
[211] Miles, 2013, pp. 80-81.

or pay monetary compensation equal to the full prospective value of the contracts.[212] The intensity of the debate over the legal nature of concession agreements was indicative of the importance of its outcome. In an ordinary agreement between a state and a private entity, the state would maintain certain powers with respect to the agreement that it would be able to exercise in the interest of its people. However, if concession agreements with foreign investors were seen as similar to international treaties, states' abilities to change the terms of the agreement would consequently be very restricted.[213]

From the 1950s and onwards, a series of arbitral awards would adopt the reasoning of capital-exporting states and help to internationalize concession agreements.[214] The principles advanced by these awards had been thitherto unknown in international law.[215] It had previously been uncontested that in usual circumstances, the laws of the host state would govern the agreements as they were made between the host state and a private entity and not between two sovereign states.[216] As late as in the 1952 case between the United Kingdom and Iran, the International Court of Justice (ICJ), declared that an agreement between a state and a corporation could not be elevated to the international level.[217] However, several arbitral awards departed from this established principle by holding that host state law was inadequate to address the complexities of modern commercial contracts.[218] Concession agreements were framed as unique agreements, so-called economic development agreements, and a new system of law that had international character but which was not public international law, were said to govern them. This new law of contracts emerged in these arbitral decisions and the law of home states that represented the 'modern law of nature' in effect selectively replaced the law of host states.[219]

Arbitral decisions and scholarly writings of the time in their support influenced the nature of arbitral clauses in concession agreements. Whereas earlier such clauses rarely had made specific reference to international law as governing the agreements, concession agreements in the following decades often made reference to dispute resolution through arbitration that would apply "general principles of law".[220] This enabled the further internationalization of concession agreements. As the legal scholar Anthony Anghie writes, it was "a category which by now enabled the effortless transposition of Western concepts of law that provided for the comprehensive protection of property".[221] This movement was accompanied by a parallel development in the institutional architecture governing foreign investments. In 1965, efforts backed by capital-exporting states and headed by the World Bank, led to the Convention on the Settlement of Investment Disputes between States and

[212] Dickstein, 1988, p. 55.
[213] Anghie, 2005, p. 233-234.
[214] Miles, 2013, p. 80.
[215] Sornarajah, 1994, p. 21.
[216] Anghie, 2005, p. 227.
[217] Anglo-Iranian Oil Co. Case, 1952, p. 93.
[218] See e.g.: Abu Dhabi Award, 1951 & Ruler of Qatar Award, 1953.
[219] Anghie, 2005, pp. 227-229.
[220] Ibid., p. 230.
[221] Anghie, 2005, p. 230.

nationals of Other States (ICSID convention).[222] ICSID was created to administer international investment arbitrations, the first institution specifically given this task, and was presented as a "depoliticization" of investment disputes.[223]Nevertheless, this development supported the positions of capital-exporting states and helped frame their position as legal rather than political.[224]

In 1977, the *Texaco* decision further internationalized concession agreements by elaborating on the principles established by previous arbitral awards. The case concerned a concession contract granted to the Texaco Corporation by Libya and was delivered when the NIEO movement was at its peak. The decision would become a keystone in the construction of the modern international law on foreign investment.[225] In the decision, the arbitrator concluded that a reference to 'international arbitration' implied both that the dispute had to be resolved through international arbitration and that the law applied was the new international law of contracts. Moreover, the mere fact that the contract was an "economic development agreement" elevated it to the level of international law, even if explicit reference was made to national law as the governing law. The arbitrator held that concessions between foreign corporations and developing states were designed specifically to prevent states from exercising their usual sovereign powers. In particular, the investor had to be protected against the risks of the law of the host country being modified and against government measures that would terminate the contract.[226]

The characterization of concession agreements as similar to "quasi treaties" by capital-exporting states and legal scholars further advanced the argument that concession agreements had been internationalized. Concessions were argued to exist between two international entities, the developing state and the corporation, which were seen as having a quasi-sovereign status that enabled it to take action against the state on an international plane. The significance of this argument was that it considerably limited states' abilities to change the terms of concession agreements, as the ability of a state to unilaterally amend the obligations in a treaty was limited by the principle of *pacta sunt servanda* in international law. Thus, the characterization of concessions as quasi-treaties had the effect of restricting the regulatory ability of developing states.[227]

To conclude, the NIEO movement and its period of confrontation led to insecurity about the customary international rules governing foreign investment[228], yet ultimately failed in its attempt to reorient international investment law.[229] Yet again, capital-exporting states' responses led to reassertions of the existing content of international investment law but also to the development of new principles on the protection of foreign investment. Legal doctrine and the arbitral awards reinforced the assertions made by capital-exporting states that served to limit host states' power to unilaterally amend their obligations under agreements with foreign

[222] Bishop, 2005, p. 8.
[223] Dolzer & Schreuer, 2008, p. 20.
[224] Miles, 2013, pp. 86-87.
[225] Cantegreil, 2011, p. 442.
[226] Texaco Award, 1975, pp. 454-456.
[227] Anghie, 2005, pp. 231-233.
[228] Dolzer & Schreuer, 2008, p. 15.
[229] Anghie, 2005, p. 235.

investors.[230] As concessions between states and governments were made into internationalized contracts, host states could not rely on any residual power to amend the terms of the contract, whatever the demands of public welfare. As a consequence, developing states were deprived of a hugely important source of bargaining power, their sovereignty. This inevitably shifted the relative strength of the two parties in a significant manner and had implications for the content of investment agreements. The application of contract principles in situations where developing states were deprived of their sovereignty as a source of bargaining power considerably shifted the relative strengths between them and foreign investors.[231]

The internationalization of concessions added a new legal layer to such agreements. Previously in history, concession agreements had served to insert legal concepts for the protection of foreign property in many developing nations, yet the enforcement of these rules had been dependent on the actions of investors' home states. Now, enforcement was made possible through the legal sphere. The connection of agreements between host state and foreign investors to international law and international arbitration sought to remove the agreements from the national sphere and the power of host states. This development was no coincidence, but rather a continuum of the fundamental conflicts over the protection of foreign property and the creation of principles in international investment law centered on the protection of foreign investors.

The internationalization of concessions also shifted the relative bargaining powers between host states and investors. A legal climate balanced in the favor of the investor evolved that exacerbated the already relatively weak bargaining position of developing states. This continuous process paved the way for the inequities found in the Nicaraguan canal agreement. It enabled a focus on investor rights and not responsibilities to the detriment of host state interests, and the view of host states' regulation as political risk that had to be mitigated could find clearer expression. Examining this legal development, it appears logical that the environmental and social effects of the foreign investment are not given due consideration under the Nicaraguan canal agreement. Consistently, rules on foreign investment had been focused on the protection of such investments. Competing interests of host states were treated as risks to such investments and could be regulated that way in the evolving legal climate.

If concession agreements had remained purely under the sphere of national law, the Nicaraguan canal agreement would most likely have looked very different. Instead, the treatment of concession agreements and their connection to international investment law would to continue to evolve. For the challenges by capital-importing states during the 1970s resulted in additional responses from capital-exporting states. This led to a further judicialization of the protection of foreign investment. The increasing use of economic stabilization clauses and the spread of bilateral investment treaties (BITs) provide the final pieces to this chapter's explanation to the content of the Nicaraguan canal agreement.

[230] Dickstein, 1988, p. 71.
[231] Anghie, 2005, p. 234.

4.5 Into the 21st Century: Responses Through Regime Creation and Stabilization Clauses

4.5.1 Responses Through Regime Creation

Following World War II, several attempts at creating a multi-lateral framework for international investment protection had been made by capital-exporting states and investor organizations. However, largely due to the resistance of capital-importing states to the proposed level of investment protection, no binding agreement was reached.[232] Instead, many capital-exporting states shifted focus and started to engage in one-on-one negotiations with developing states to conclude bilateral investment treaties (BITs).[233] The first BIT was concluded already in 1959, yet between 1959 and 1989 only 386 such agreements were concluded despite increased efforts.[234] However, a remarkable surge in the number of BITs concluded occurred in the beginning of the 1990s and continued up until 2008. In terms of content, the agreements generally resembled previous draft conventions for multi-lateral treaties and focused on protecting investors of developed countries investing in developing countries.[235] In parallel, ICSID had become the main forum for the settlement of international investment disputes and was increasingly interwoven into the framework of international investment agreements.[236] Through international arbitration, investor protection standards in BITs developed. The interpretation of foreign investment protection standards in international tribunals, notably the standard of fair and equitable treatment, the focus on legitimate expectations of the investor and requirements to maintain a stable legal framework, have expanded the investor protection under such treaties.[237]

Some scholars argue the vast expansion of BITs and the references to international arbitration prove that previous conflicts over the content of international investment law have been overcome.[238] Rather, it appears as if a number of factors coincided to cause developing nations to enter into BITs and effectively assume obligations to which they had previously vigorously objected. First, the 1980s saw a strong political movement towards economic liberalization. Institutions such as IMF and the World Bank continued efforts towards opening markets in developing countries to trade and investment, promoting a set of economic policy prescriptions known as the "Washington Consensus".[239] Second, the fall of the Soviet Union in 1991 caused a significant geopolitical shift and left further room for policies aimed at economic liberalization. In addition, China had adopted its "Open Door" policy with the explicit aim of attracting foreign investments.[240] These trends coincided with declining credit and foreign aid flows to developing states, which contributed

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[232] Miles, 2013, p. 85.
[233] Newcombe and Paradell, 2009, pp. 41-42.
[234] UNCTAD, 1998, p. 207.
[235] UNCTAD, 2015, pp. 122-124.
[236] Dolzer & Schreuer, 2008, p. 20.
[237] Miles, 2013, p. 89.
[238] Dolzer & Schreuer, 2008, pp. 15-16.
[239] Pahuja, 2011, p. 13.
[240] UNCTAD, 2015, p. 123.

to increasing levels of debt in developing states. In this environment, developing states were left with few options to raise capital and as a result the competition for foreign investment increased.[241] Participation in BITs became seen as a "must" to attract foreign investment, despite the fact that evidence on the impact of such treaties on FDI flows is ambiguous.[242] Even though collectively developing states might have been better served by rejecting high protection of foreign investments, individual conclusions of BITs resulted in pressure on other developing states to agree to similarly high levels of investor protection.[243]

In recent years the number of BITs concluded has slowed down, yet the number has still been increasing. As of today, 2929 active BITs form part of the international investment agreement network, and have arguably become the model agreement to regulate foreign investments.[244] Meanwhile, investor protection standards of BITs have been interpreted expansively in international tribunals. Paradoxically, it appears as if individual conclusions of BITs have resulted in a framework for the protection of foreign investment that capital-exporting states have been seeking and that capital-importing states have been resisting throughout history.[245] However, this should not been interpreted as a global consensus over the content of international investment law and the rules on international investment protection. In fact, BITs have received increasing criticism during recent years for being heavily tilted in investors' favor.[246] The number of tribunal cases has increased significantly during recent years to 608 known cases in 2014, and discontent has been growing among states with the existing international investment agreement regime and its impact on regulatory powers to pursue policies in the public interest. As a result, several countries have sought to revise their model agreements renegotiating their existing BITs. A smaller group of countries have announced their suspension of future investment agreement negotiations, while some have started to terminate their existing international investment agreements.[247]

The impact of the large number of BITs on the evolution of customary international law on the protection of foreign investment remain unclear and this linkage between treaty law and customary law has been subject to much academic debate.[248] Yet growing criticism from developing states of the level of investment protection under the BIT regime illustrate that the fundamental tensions between capital-importing states and capital-exporting states remain in international investment law. The parallel evolution in the use of stabilization clauses in investment agreements related to those of the Nicaraguan canal agreement has followed similar patterns.

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[241] Miles, 2013, pp. 89-91.
[242] UNCTAD, 2015, pp. 123-126.
[243] Miles, 2013, p. 90.
[244] UNCTAD, 2015, pp. 106, 124.
[245] Salacuse, 2015, p. 104ff.
[246] Bishop, 2005, p. 10.
[247] UNCTAD, 2015, p. 124.
[248] Dolzer & Schreuer, 2008, pp. 16-17.

4.5.2 Stabilization Clauses and the Nicaraguan Canal Agreement

Beginning in the 1970s, stabilization clauses[249] became an increasingly important feature of long-term investment agreements. They served as an additional response to the challenges by capital-importing states during the NIEO movement directed at wider issues of economic injustice. Under traditional stabilization clauses, it was taken that states consented to suspend their usual public legislative and regulatory powers with respect to the contract once they had entered into it. That no unilateral amendment of the agreement could take place once the agreement was signed served to further ensure that host states would abstain from cancelling or modify agreements with foreign investors.[250] The binding effect of such clauses under international law was supported by the argument that a state could exercise sovereignty by binding itself to a particular arrangement. However, this position radically differed from similar agreements standing in capital-exporting states, where government contracts were susceptible to unilateral amendment.[251]

Doctrinal opinion remained sharply divided over the issue of the international legal effect and validity of stabilization clauses. One school of thought expressed the view that such clauses rendered the principle of *pacta sunt servanda* applicable to the investment agreements. Thus, any breach of contract by a host state was considered an unlawful act under international law. A second school of thought maintained that permanent sovereignty over national resources constituted *jus cogens*, which a state cannot waive, and thereby questioned the validity of stabilization clauses. Following this argument, sovereignty would thus constitute a lawful ground for termination of agreements without compensation.[252] In addition, opponents of stabilization clauses argued that while the principle of *pacta sunt servanda* might apply to private contracts, it had no application to state contracts that traditionally are regarded as defeasible in the public interest.[253] This debate illustrates the continuous conflict over the rules on foreign investment.

The exact legal significance and effect of traditional stabilization clauses has never been fully clarified, which is illustrated by the divergence in jurisprudence.[254] Based on the principle of *pacta sunt servanda*, some arbitral awards found that such clauses prohibited otherwise lawful nationalizations. Notably, this view formed part of the internationalization of concessions and was for example advocated for by the arbitral tribunal in the *Texaco* decision.[255] However, other arbitral awards discarded this line of reasoning. In *Aminoil v Kuwait*, the tribunal concluded that a typical stabilization clause should not be presumed to imply that a state lost the right to expropriate a contract valid for 60 years. Yet the binding effect of stabilization

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[249] Broadly, the term “stabilization clause” refers to contractual clauses in contracts between investors and host states that address the issue of changes in law in the host state during the life of a project (see Shemberg & Aizawa, 2009, p. vii).
[250] Dickstein, 1988, p. 74.
[251] Anghie, 2005, pp. 234-235.
[252] Wälde, & Ndi, 1996, pp. 242-245.
[253] Sornarajah, 2004, p. 422f.
[254] Dolzer & Schreuer, 2008, p. 75.
[255] Texaco Award, 1975.

clauses was upheld. The tribunal found that the value in such a provision was that it reinforced the necessity for full compensation in the event of any expropriation from the host state.[256] This view was supported by later cases brought to international arbitration.[257]

The lack of homogenous jurisprudence and the uncertainty associated with the legal effects of traditional stabilization clauses in event of their breach, contributed to their decreasing use in practice together with additional factors.[258] Many foreign investors began to acknowledge that stabilization clauses which completely froze the legal order of the host state for purposes of the contract, did not necessarily safeguard their interests. Particularly in situations where host states adopted legislation that would otherwise benefit the investor, such stabilization clauses instead protected the interests of the host state.[259] Moreover, beginning in the 1990s the enactment of new environmental regulations became seen as a growing political and financial risk to foreign investors. In 1996, the legal scholars Wälde & Ndi wrote: "Perhaps most relevant at the moment is the imposition of new environmental obligations by subsequent regulation or by an administrative/judicial ruling reinterpreting existing law on which the investment decision may to some extent have been based".[260] These factors all contributed to the increasing use of economic stabilization clauses similar to those of the Nicaraguan agreement, which focused on the indemnification of investors in the event of legislative action.

The use of economic stabilization clauses has become increasingly popular in the 21st century. Their supporters praise them as a compromise between state's exercise of legislative and regulatory power and the viability of contractual relationships. They also point out that such clauses do not necessarily exclude the possibility of new regulations that change the law applicable to the contract, but simply intends to remedy the negative impact of such regulations and are used to avoid uncertainty regarding the consequences of a breach of a stabilization clause. Nevertheless, some supporters of such clauses also acknowledge that the presence of stabilization clauses may have a deterrent effect on the state exercising its legislative power.[261]

The flexibility of economic stabilization clauses is used to explain their increasing popularity among developing countries. A United Nation's report on stabilization clauses and human rights (Shemberg and Aizawa report) observed that host states in the developing world use such clauses as a way to assure investors of a favorable investment climate. The use of these stabilization clauses has been described as part of the current "favorable investment climate".[262] However, the use of economic stabilization clauses has received ample critique from human rights advocates. They argue that the requirement of a host state to compensate the investor for compliance with new regulations is wrong in principle, as it denies the state its proper role as legislator with powers different and greater than corporations.

[256] Aminoil Award, 1982, pp. 4-5.
[257] See e.g. Amoco Award, 1987.
[258] Dolzer & Schreuer, 2008, p. 75.
[259] Faruque, 2006, p. 322.
[260] Wälde & Ndi, 1996, p. 230.
[261] Faruque, 2006, pp. 329-334.
[262] Shemberg & Aizawa, 2009, p. 5.

Further, they point to the chilling or hindering effect of stabilization clauses on the application of social and environmental standards. Furthermore, they claim that such effects are particularly grave in developing countries where rapid legislative development and implementation is needed.[263] Similar concerns have been echoed by the Office of the High Commissioner for Human Rights, who have pointed to the risk of investment liberalization in favor of investors' rights to the detriment of rights and interests of other actors.[264]

Such concerns have found empirical support. In 2009, the Shemberg and Aizawa report found that stabilization clauses in developing countries were likely to limit the application of new social and environmental laws to the investment. These clauses stood in stark contrast to the use of stabilization clauses in developed countries, where new laws of general application were instead usually at the risk of the investor. In fact, investors in developed countries were usually only shielded from new laws if those were clearly discriminatory. The report's general proposition for the reasons of this disparity was that the practice of more extensive stabilization clauses in developing countries correlated with perceptions of investment risk. However, according to the report this did not sufficiently explain to the disparity in practice between developed and developing host states.[265]

The precise impact of economic stabilization clauses remains unclear. As of a few years ago, there were no reported cases where such clauses had been enforced in private or international arbitration. Yet, as the Shemberg and Aizawa report concluded: "…it should be assumed that investors include such clauses in investment contracts with the expectation that they may rely on them when faced with adverse changes in the law, and they expect them to be enforced".[266] Accordingly, the report concluded that stabilization in modern contracts that did not allow exemptions might negatively impact the host state's ability to implement new social and environmental regulation.[267]

4.6 Summary

The increasing use of economic stabilization clauses, the spread of BITs and the growing role of international arbitration bring the historical legal development into the present. As the effect of traditional stabilization clauses have become less certain, increasing emphasis have been put on the indemnification of foreign investors in the event of host state regulation. In a similar way, the spread of BITs have served to fill the gap after failed attempts at multi-lateral frameworks for the protection of foreign investment. As presented, these agreements have often resulted in a level of investment protection that many host states have resisted throughout history. It is in this legal environment that the Nicaraguan canal agreement has been made.

[263] Shemberg & Aizawa, 2009, p. 11.
[264] UN High Commissioner for Human Rights, 2003.
[265] Shemberg & Aizawa, 2009, pp. 33-39.
[266] Ibid., pp. 35-36.
[267] Ibid., p. 35-37.

The spread of BITs and the use of economic stabilization clauses can be seen as a continuum of previous efforts to secure the protection of foreign investments. While the character of these efforts has changed over time, the focus on protecting the interests of capital-exporting states has remained the same. In light of this development of international investment law, the critique of economic stabilization clauses and the BIT regime for their potentially chilling effect on the regulatory powers of host states come as no surprise.

The fact that economic stabilization clauses are predominantly used in developing countries highlights how international investment law aggravates existing asymmetries of power. To an extent, economic stabilization clauses can be viewed as legal tools to insure the foreign investor against economic risks. However, the same clauses often appear to reduce the bargaining power of host states. Particularly for smaller developing states, which are already in a relatively weak bargaining position vis-à-vis foreign corporations, this legal practice appear to provide fertile ground for agreements that are incredibly generous to the investor. It is no surprise that agreements of similar character are hard to find in developed countries.

5 Conclusion

Approaching international law as having emerged through a process of repetitive assertions of power and responses to power, this thesis has highlighted a recurring pattern of conflict that has shaped the current investment law regime. This methodological approach has been informed by a considerable body of legal scholarship, which has critically examined the history of international law and its connection to socio-political imbalances of power.

In answer to the thesis' first research question, it is concluded that the Nicaraguan canal agreement is heavily tilted in favor of the foreign investor and might have significant effects on Nicaragua's legislative and regulatory power. In answer to the second research question, which seeks to explain the findings in part one, it is concluded that historical legal developments have contributed to the imbalanced nature of the agreement. As the historical analysis shows, the tensions and controversies surrounding the Nicaraguan canal agreement are fundamentally not new. Rather, the agreement's content and existence manifest the conflicts of interests that have dominated the development of international investment law since its emergence in the 19th century. The outcome of these contests has found expression in the law and in agreements, mostly legitimizing the position of capital-exporting states.

From the very beginning, international investment law evolved as rules on the protection of foreign investment, to facilitate the European commercial and political expansion. Concession agreements specifically were used as legal tools to insert European standards of property protection into host states' legal environments. During these processes, little to no emphasis was placed on the interests of host states.

Since the 19th century, host states have challenged the rules made by capital-exporting states and investors. Disputes were not necessarily about the desirability of foreign investment. In fact, many 19th century leaders of developing states viewed concessions as essential mechanisms for boosting the economy. Yet they persistently resisted the legal protection of these concessions and their enforcement by capital-exporting states. As many challenges resulted in violent disputes that often related to the expropriation of foreign investments, arguments were advanced in the shape of the international minimum standard and the Calvo doctrine, which encapsulated the fundamental and persistent disagreements between the parties.

The Nicaragua canal concession shows both similarities and differences to the 19th century use of concessions by developing countries. By promoting the canal concession as a way to lift Nicaragua out of poverty and modernize the economy, president Daniel Ortega has used arguments similar to those put forward by his historic predecessors. However, while host states in the 19th century vigorously objected to the levels of investment protection enforced by home states, the Nicaraguan government has not objected to any of the legal implications of the concession. Instead, the canal agreement appears to have removed these historical

conflicts. Nevertheless, the intense criticism surrounding the Nicaraguan canal project show how fundamental conflicts of interests remain.

Intermediate processes in the 20th and 21st century can explain the apparent paradox between the content of the agreement and the conflicting Nicaraguan interests at stake. For much of the 20th century, challenges by host states to the protection of foreign investments resulted in additional expropriations and fierce debate over the rules governing foreign investments. Certainly, home states' interests in preventing arbitrary expropriations of foreign property were to some extent legitimate**.** However, the historical examination show how responses by capital-exporting states not only reinforced current legal principles, but also further tilted them in favor of the investor. The establishment of the Hull formula during the first half of the 20th century serves to illustrate this point. In response to widespread land reforms, capital-exporting states not only reasserted the content of international investment law for the protection of foreign property, but also explicitly discarded any other needs of host states as irrelevant to international law. Subsequent developments would further reduce the powers of developing states.

During the second half of the 20th century, the specific legal standing of investment agreements came at the center of these conflicts. Through the internationalization of investment contracts, tribunals changed legal doctrine and supported capital-exporting states' attempts to lift investment agreements out of national legal orders of host states. The portrayal of host states' law as inadequate to address the complexities of modern commercial contracts were particularly directed at protecting foreign corporations in developing states. Moreover, the establishment of ICSID[268] served to institutionalize and depoliticize the issue of enforcement of foreign property protection. This development weakened the bargaining positions of new and developing states, the very states that needed the flexibility necessary to achieve development.

As the historical chapter of this thesis has shown, substantial challenges by host states under the NIEO movement in the 1970s and 1980s led to uncertainty about the theory of internationalization of contracts. Yet additional responses from capital-exporting states in the shape of BITs, references to international arbitration and the increasing use of economic stabilization clauses served to further protect foreign investments. The significant shift in international investment law that followed was facilitated by an era of increased economic liberalization that coincided with a number of other factors. Increasingly, foreign investments were secured protection under treaties and investment agreements, a protection further expanded by international arbitration. These developments resulted in the legal climate in which the Nicaraguan canal agreement was negotiated.

The increasing use of economic stabilization clauses has been hailed as a successful compromise between host states and foreign investors. Undeniably, host states stand to gain from reassurances to foreign investors and have used concession agreements historically for the same reasons. However, the insertion of economic stabilization clauses is but a tiny step towards acknowledging the interests of host

[268] International Centre for Settlement of Investment Disputes

states, after countless steps in favor of foreign investors. The connection between investment agreements and international legal rules and arbitration was never self-evident. Neither was the notion that host states' exercise of action in the public interest is conditioned upon the complete satisfaction of foreign investors. Arguably, economic stabilization clauses only represent a slight turn towards the consideration of host states' interests.

The Nicaraguan canal agreement demonstrates the effect of this legal development for a specific investment agreement in a small developing country. It amplifies existing asymmetries of power between Nicaragua and HKND, undermining the state's already relatively weak bargaining position both in the making of the agreement and during the life of the project. The legal development thereby helps explain the scope of investor rights under the concession agreement: the blanket tax exemptions, the slow transfer of ownership to the Nicaraguan state and the investor's exclusive rights under an extensive concession period.

By examining the canal agreement and the intensive debate that surround it, this thesis illustrates some of the practical implications of this legal development for stakeholders other than the foreign investor. The potential effects of the Nicaraguan canal project are enormous. Up to 120,000 Nicaraguans may be uprooted as a direct effect of the project and about 30,000 people may have their property expropriated. Indigenous groups' right to their communal land, which are protected under the constitution after a century-long political struggle, are disregarded by the agreement. Furthermore, the environmental effects could be catastrophic. The dredging of Lake Cocibolca, on which more than 200,000 people rely for their drinking water, has alarmed environmental scientists. The project's impact on wildlife and ecosystems is similarly a subject of great concern to the scientific community.

The environmental and social impact of the Nicaraguan canal project illustrates a fundamental conflict of interest for the state itself. The magnitude of the project might require substantial regulation by the Nicaraguan state to protect its interests. Even so, HKND is protected against any of the economic effects of such regulatory action. Accordingly, it appears as if Nicaragua will have to bear any costs that result from such legislation during the life of the project. Not only could this result in significant costs for an already poor nation, but it might also impact Nicaragua's ability to implement new social and environmental regulations in the first place. Clearly, there is an underlying tension between the two ideas that Nicaragua should honour its contractual commitment to HKND and that it ultimately should act in the public interest. Because of the current legal climate and the connection of concession agreements to the sphere of international law, this tension has currently resulted in an overwhelming focus on Nicaragua's contractual commitment. Although the agreement operates in a social and environmental context, it does not appear to engage with issues of environmental sustainability or social considerations of Nicaragua. Had concession agreements remained in the sphere of national law, the Nicaraguan canal agreement would most likely have looked very different.

It is easy to discard historic conflicts as a thing of the past and separate them from legal doctrines in the present. The spread of BITs and similar investment agreements could be taken at face value as a proof of international consensus over the rules of international investment protection. Yet, recent criticism of the BIT regime and terminations of investment agreements hint at the fundamental conflicts inherent to this legal regime. Such indications underscore that historical conflicts cannot simply be regarded as long since overcome. These conflicts have provided the foundation for the legal environment in which the Nicaraguan canal agreement was made and will continue to shape the rules governing foreign investments.

Thus, simply explaining the content of the Nicaraguan canal agreement as a result of the bargaining between two parties would be a fundamental mistake. This is not to say that Nicaragua has been forced to enter into the agreement under the current circumstances. Yet, as this thesis has shown, these circumstances have been shaped by a historical development. Perhaps, the construction of a transoceanic canal through Nicaragua will finally lift the country out of poverty. Yet, for many decades to come, Nicaragua risks being caught between its commitments to HKND and its undertakings to its citizens. Only time will tell what effects this will have for Nicaragua and its people.

Supplement A

Proposed route for the Nicaragua Canal

Image source: http://geographical.co.uk/places/wetlands/item/526-nicaragua-canal-construction-begins, last visited 2016-01-06

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