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Economics and the rule of law: balancing investor's rights and national sovereignty.

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Introduction

I am grateful for the invitation of the New Zealand Bar Association to participate in this conference. It is always a pleasure to return to enjoy the beauty of the South Island and the extraordinary warmth of the people of New Zealand, and the very special collegiality of the legal community here.

I would wish to associate myself with the remarks of Justice Beazley this morning. This has been an excellent conference, with papers of the highest standard which have made important contributions to the Rule of Law debate in many areas. It is a privilege to have been asked to participate.

The description of this session — international investment treaties: balancing national sovereignty and investor protection — presupposes a premise that is open to debate. Is there a necessary opposition between legal standards for the protection of foreign capital and the enjoyment of sovereignty by nation states?

That is a large question, which it is not possible to resolve fully in the time available. I will, however, suggest the outline of an answer later. Before doing so, I have two principal tasks: to introduce the history and rationale of investment treaties; and to summarise some of the main areas of controversy in relation to the structure of international investment law, and in particular investor–state arbitration. I am therefore speaking about "the system", an understanding of which is crucial to assess competing claims made about developments or controversies in particular

cases, and the prospect of there being a fundamental trade-off between national and investor interests.

History and rationale

Investment law is a subject of public international law, concerned with the treatment of foreign investors by their host states. It is trite orthodoxy that the subjects of public international law are sovereign states, not individuals. Although that orthodoxy is somewhat strained in the modern era, as a matter of history it is States that were the key actors in the development of international investment law. And it is probably still the case that although the beneficiaries, and now the direct enforcers, of the applicable standards are private individuals and entities, the legal relationships remain between states.

The most concrete origins of investment law were in treaties. Some of these were very early indeed: the most favoured nation clause, a hallmark of many modern investment treaties, has been traced to treaties from the thirteenth and fifteenth century.[1] It was not until the nineteenth century, however, that a modest degree of consistency emerged, in a series of agreements known as friendship, commerce and navigation treaties (FCNs). These were primarily targeted at facilitating international trade, but some contained provisions protecting foreign property.[2]

In addition to the early treaties, rules developed in customary international law regarding the treatment of "alien" investors. Assuming that such rules exist (and that is an open question), unlike treaties they are of universal application. But to form part of customary international law and thereby offer a basis for regulation of international investment they would have to be shown to be the subject of a virtually uniform consensus among the community of states. That is a very

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1 See Tawil "Most Favoured Nation Clauses and Jurisdictional Clauses in Investment Treaty Arbitration" in Biner and others (eds) *International Investment Law for the 21st Century: Essays in Honour of Christoph Schreuer* (Oxford, 2009) at 10.

2 Dugan and others *Investor-State Arbitration* (Oxford, 2008) at 37.

significant limitation. It means that customary international law is both modest and, importantly from an economic and rule of law perspective, uncertain.

By the middle of the 20th century, this old legal order was evidently inadequate. Capital was flowing, or trying to flow, globally rather than locally or regionally. In 1959 the first modern bilateral investment treaty — a treaty between two states dealing exclusively with investments in one by nationals of the other — was concluded, between Germany and Pakistan.[3] It was followed by approximately 2900 more, to date.[4] Investment provisions are also contained as discrete parts of free trade and subject-specific treaties, both bilateral and multilateral. Prominent examples of the multilateral variety are the North American Free Trade Agreement,[5] the Energy Charter Treaty,[6] and the yet-to-be-concluded Trans Pacific Partnership.

The substantive parts of all these agreements populate what was previously something of an international legal wilderness, with what are now a well-known and reasonably consistent menu of protections. In very brief outline, the substantive part of a typical BIT or investment chapter will contain the following provisions: [SLIDE]

- First, a guarantee that foreign investors and investments will be treated equally with nationals of the host state;
- Secondly and cumulatively on national treatment, a guarantee that investors and investments will be treated no less favourably than the standard accorded to investors from states "most favoured" by the host states other investment agreements;
- Thirdly, a guarantee that investors will be treated fairly and equitably;
- Fourthly, the provision by the host state of "full protection and security", most obviously by the provision of an adequate level of internal order and policing;

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3 Treaty for the Promotion and Protection of Investments 1963 UNTS 24 (signed 25 November 1959, entered into force 28 April 1962).

4 UNCTAD *World Investment Report 2014* at 114.

5 (1993) 32 ILM 289 and 605 (signed 17 December 1992, entered into force 1 January 1994).

6 2080 UNTS 100 (signed 17 December 1994, entered into force 16 April 1998).

- Fifthly, an "umbrella" provision that guarantees performance by the host state, as a treaty obligation, of contractual obligations with investors;
- Sixthly, a guarantee of adequate compensation for expropriated property; and
- Seventhly, provisions that ensure the ability to realise investments.

Those substantive protections, some of which will be looked at more closely in Chief Justice Menon's talk, are one side only of "the system". The other is procedural. Here too the great innovation came in the mid-20th Century, in the form of the ICSID Convention.[7] Up until then, what standards of treatment there were in international law were often of cold comfort to investors: individuals, as opposed to states, had no standing. The procedural mechanism for enforcing international obligations for the benefit of individuals was diplomatic protection, or the espousal of nationals' claims by their home state in the international arena. It was an inherently political exercise, and varied hugely in both method and success. Substantive uncertainty was therefore compounded by procedural uncertainty.

In article 25(1) of the ICSID Convention, by contrast, the state parties agree that with written consent on both sides, nationals of one state may sue another state directly in relation to investment disputes. Other provisions in the Convention contain a stand-alone set of procedural rules for the conduct of arbitrations, and the enforcement of awards.

Importantly, the ICSID Convention does not itself constitute state consent in relation to any given dispute; it merely provides the arbitral procedure once state consent is given, along with corresponding consent on the part of an investor (which is usually proffered simultaneously with bringing a claim). There are a number of potential sources of state consent. Most usually, a BIT or other treaty will contain an arbitration clause, in which the state parties make a "standing" offer to arbitrate

[7] Convention on the Settlement of Investment Disputes between States and Nationals of Other States 575 UNTS 159 (adopted 18 March 1965, entered into force 14 October 1966).

future disputes with nationals of the counterparty state (which offer is accepted by the investor's notice of arbitration) and the state thereby consents and submits to that arbitration. That effectively contractual analysis of the method of operation of the arbitration clause in a BIT can be found, by way of example, in the English Court of Appeal's decision in the *Occidental v Ecuador* case[8]. More unusually, contracts governing the investments themselves may contain arbitration agreements. More unusually still, there could be direct submission of an existing dispute on an ad hoc basis, after it has developed.

Similarly, the ICSID convention is silent on the substantive law applicable to a dispute: article 42 provides that "such rules of law as may be agreed by the parties" apply, or failing agreement, "the law of the Contracting State party to the dispute … and such rules of international law as may be applicable". Enter again the BITs and other treaty obligations that have so spectacularly proliferated in recent decades, and the growing body of cases that have been decided under them. The nature and effect of that case law is a subject of study in its own right; suffice to observe here that it undoubtedly affects both the outcome of future cases, and the conduct of states and investors.

To complete the picture, while ICSID was the catalyst for the growth of investor–state arbitration, it does not have a monopoly. Many treaties provide for alternative modes of arbitration. The most common are arbitration under the rules of the United Nations Commission on International Trade Law, or those of the International Chamber of Commerce. These are familiar from the international commercial arena. Different procedural rules apply, and enforcement is under the New York Convention[9] rather than the ICSID Convention, but the basic concept is the same: an investor claims directly against a state for breach of international law rules contained in an applicable treaty with the claim determined by binding arbitration.

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8 [2006] Q.B. 432

9 Convention on the Recognition and Enforcement of Foreign Arbitral Awards 330 UNTS 3 (signed 10 June 1958, entered into force on 7 June 1959).

Structural criticisms

The view that the development of international investment law, including investor–state arbitration is generally a "good thing" is one to which I would subscribe. It has been and continues to be an integral part of the economic history of capital flows as critical part of globalisation. But that is not a universal view, and indeed the value and legitimacy of "the system" has become a fraught subject.

Fraughtness has come and gone with time. The period from 1958 to the mid-2000s can be characterised as the "rise" of modern investment law and arbitration: the number of investment treaties went from nil to thousands; a relatively high degree of consistency was reached in the core substantive standards contained in those treaties; and awareness developed of the unique ability of arbitration to produce final and binding determinations of disputes. Undoubtedly that increased awareness was a consequence both of the exponential growth in global movements of capital and the heightened alertness on the part of investors to the existence of enforceable rights. Indeed the existence of BITs developed as a relevant factor in the investment decision making process — undoubtedly influencing investors in circumstances where in many sectors states were competitive in chasing capital, for example in the energy sector. An international energy company considering buying power stations in different former Soviet Union countries would consider carefully as part of its decision making process what BIT protections would be available to it. All other things being equal, the combination of an express guarantee of compensation for expropriation (for example) and an effective adjudication and enforcement mechanism in the form of ICSID arbitration, would render a given destination for capital clearly more attractive than its neighbour.

Then came what can be described as the "backlash". Indeed, there has even been published a substantial book of essays titled *The Backlash against Investment Arbitration*.[10] The roots of the backlash can be traced to a series of actions taken by post-colonial states from the 1970s onwards, most evocatively captured in the

[10] Waibel and others (eds) *The Backlash against Investment Arbitration: Perceptions and Reality* (Kluwer, 2010).

declaration by resolution of the United Nations General Assembly of a "New International Economic Order" founded on the supremacy of national interests.[11] The rise and rise of treaty-based investment law and investor–state arbitration, however, proved to be an energising force for the critics. A series of structural criticisms has become almost a refrain, and the illegitimacy of "the system", sometimes in extreme terms, has become orthodoxy in certain parts of academic and social discourse. The discourse has in some cases also translated into concrete action on the part of particular countries. More on that later.

Finally, against the backlash there has I think been an "anti-backlash", with some powerful responses being served at the critics,[12] and some sophisticated scholarship being produced on the effect of the proliferation of BITs and international arbitral awards on the shape and content of public international law.[13] There are still criticisms, but they are less alarmist and more nuanced. Proposals for reform are incremental rather than radical, and focused on outcomes rather than ideology.[14]

The backlash still being live, however, let me offer an overview of the main heads of criticism, and some of the responses on the part of the anti-backlashers.

First, at the substantive level, the privileges given to foreign investors are said to be too much, either absolutely by comparison to a host state unfettered by legal constraints, or relatively by comparison to the obligations owed by host states to their own nationals. The answer to this is in the process of being given by evolution in the detail of treaty obligations, in particular in more recent BITs and investment chapters. For example, the United States' preferred fair and equitable treatment

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11 Charter of Economic Rights and Duties of States (GA Res 3281, 12 December 1974).

12 Notably, Judge Stephen M. Schwebel "In Defence of Bilateral Investment Treaties" (keynote address to ICCA, 6 April 2014).

13 See eg Kaufmann-Kohler "Arbitral Precedent: Dream, Necessity or Excuse?" (2007) 23 Arbitration International 357; Kingsbury and Schill "Investor-State Arbitration as Governance: Fair and Equitable Treatment, Proportionality, and the Emerging Global Administrative Law" in van den Berg (ed) *50 Years of the New York convention* (ICCA, 2009).

14 See eg UNCTAD IIA Issues Note No. 2 "Reform of Investor-State Dispute Settlement: in Search of a Roadmap" (2013).

provision expressly ties the treaty standard to customary international law.[15] That may be a backwards step from the point of view of certainty,[16] but it represents a swing towards latitude being given to host states. International investment law does not purport to be a system of normative absolutes.

Secondly, in terms of procedure, an alleged lack of transparency and public participation in investor–state arbitration are particular flashpoints. It is illegitimate, it is said, that decisions with the potential to impact significantly on matters of public interest are made in secret and without "stakeholder" participation. In terms of transparency, again incremental evolution is responding constructively to the criticism. In 2006 the ICSID arbitration rules were amended to allow third-party attendance at hearings, albeit subject to party veto.[17] Going further is the trend trend toward express transparency provisions in recent BITs (with the 2012 US Model BIT again being an example),[18] and the very new UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration, which came into force on 1 April this year and apply to UNCITRAL arbitration pursuant to treaties concluded after that date.

Turning to public participation, the 2006 ICSID rules[19] and the UNCITRAL transparency rules[20] also permit submissions of amicus briefs, as do certain specific treaty regimes.[21] And third parties have availed themselves of the opportunity, with recent analysis identifying a growing trend of participation.[22] Here, however, I think part of the answer to the critics is not simply that their arguments are inaccurate, but

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15 See article 5(1) and (2) of the 2012 Model BIT.

16 See Schwebel "The United States 2004 Model Bilateral Investment Treaty: An Exercise in the Regressive Development of International Law" in Aksen and others (eds) *Global Reflections on International Law, Commerce and Dispute Resolution* (ICC, 2005).

17 Rule 32(2).

18 See article 29.

19 Rule 37(2).

20 Article 4.

21 See eg, under NAFTA, "Statement of the Free Trade Commission on Non-disputing Party Participation" (7 October 2003)

22 See Bastin "Amici Curiae in Investor–State Arbitration — Eight Recent Trends" (2014) 30 Arbitration International 125; Christina Knahr "The new rules on participation of non-disputing parties in ICSID arbitration: Blessing or curse?" in Brown and Miles (eds) *Evolution in Investment Treaty Law and Arbitration* (Cambridge, 2011).

substantively misconceived. Arbitration is an adjudicatory process, and even where the public interest is involved, a wider role for civil society beyond limited participation by way of amicus briefs may be impossible to reconcile with the need to do justice between the parties. Is not the public interest sufficiently accounted for by the state as a litigant?

Thirdly, the critics accuse arbitral tribunals of being cut from a particular cloth, and one that is distinctly ill-disposed to states. Coupled with the lack of an appeal mechanism, this criticism often collapses into undifferentiated accusations that the system as a whole is biased. In my view this branch of criticism is the least sophisticated. Appointment rules invariably provide for an equal role for the states in constituting tribunals, and I am confident that anyone who has served on a tribunal will confirm that state appointed arbitrators discharge fully and appropriately their role of ensuring that their appointers' arguments receive fulsome consideration in deliberations. Simplistic assertions of the bias on the part of the system as a whole are not borne out by a rudimentary consideration of the number of awards given in favour of states as a portion of the whole.[23] Considerable research has been done of those awards that are in the public domain (and that is a large number) suggesting that in fact States succeed in having claims dismissed in most cases – about ⅓ are dismissed on jurisdictional grounds, about ⅓ are dismissed on the merits, and investor claimants succeed in about ⅓. That does not suggest any systemic bias.

Sovereignty exercised to encourage future investment

At the beginning of this paper, I posed the question, is there a necessary opposition between legal standards for the protection of foreign capital and the enjoyment of sovereignty by nation states?

I have briefly examined international investment law as a mechanism for achieving the former aim. I think the answer to the question, however, lies in its second element, and a closer look at state sovereignty. It has long been recognised in

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[23] Set out in Schwebel, supra.

public international law that it is quite in order for a state, by way of agreeing a treaty, to fetter for the future its exclusive jurisdiction over its territory. As the Permanent Court of International Justice stated in its judgment in 1923 in *The SS Wimbledon*:

> *The Court declines to see in the conclusion of any Treaty by which a State undertakes to perform or refrain from performing a particular act an abandonment of its sovereignty. No doubt any convention creating an obligation of this kind places a restriction on the exercise of the sovereign rights of the State, in the sense that it requires them to be exercised in a certain way. But the right of entering into international engagements is an attribute of State sovereignty."*[24]

As has been noted by Judge Stephen Schwebel, a former President of the International Court of Justice, that is a powerful counter-argument to the suggestion that investor–state arbitration unduly constrains the "policy spaces" of states.[25]

Crucially, sitting behind the treaty-making power are domestic constitutional arrangements. These differ as between states, with greater or lesser degrees of democratic oversight, but they provide an underlying legitimacy to exercises of sovereignty that constrain future action. And that legitimacy is not a formulaic one: in recent years Australia's democratic processes have led to an executive moratorium on arbitration clauses in BITs,[26] subsequently abandoned, followed by a legislative proposal to ban all forms of investor–state dispute settlement.[27] Interestingly just about a week ago, the Senate Standing Committee on Foreign Affairs, Defence and Trade recommended that that Bill **not** be passed.[28]

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24 After *SS* "*Wimbledon*", *United Kingdom v Germany (SS Wimbledon)* (1923) PCIJ A01.

25 Schwebel, supra.

26 "Trading Our Way to More Jobs and Prosperity" (Trade Policy Statement, 12 April 2011).

27 Trade and Foreign Investment (Protecting the Public Interest) Bill 2014.

28 http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Foreign_Affairs_Defence_and_Trade/Trade_and_Foreign_Investment_Protecting_the_Public_Interest_Bill_2014/Report

India and Indonesia are currently reviewing their policies on investment dispute resolution,[29] and a number of South American states have taken the ultimate step and denounced the ICSID Convention.

These events are useful reminders that as with other decisions by states to limit their future actions — a good counter-example is the International Covenant on Economic, Social and Cultural Rights[30] together with its Optional Protocol — the decision to engage in the international investment law system is a political one. Although it is also a decision with important and sometimes coercive legal consequences, many more states have chosen to opt in than not.

And to be clear, we are not talking about historical decisions by states to opt in, taken long ago when the need of capital importing states was great, and which decisions are now regretted. Nor are we talking about investment treaties concluded only North-South, capital exporter to capital importer. Of the 3000 investment treaties concluded between 180 countries, some 600 are South/South bilateral investment treaties, concluded with the assistance and advice of the Asian-African Legal Consultative Organization.

There may indeed be an important debate to have about the content of the protections in treaties, and whether some of the typical provisions need refinement. But the decision of States to enter into the existing treaties should be seen as an **exercise** of state sovereignty, rather than in derogation of it.

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[29] See Luke Nottage "The 'Anti-ISDS Bill' before the Australian Senate" (Kluwer Arbitration Blog, 27 August 2014).

[30] 993 UNTS 3 (signed 16 December 1966, entered into force 3 January 1976).