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# Is Arbitration a Threat or a Boon to the Legitimacy of International Investment Law?

Charles N. Brower\* and Stephan W. Schill\*\*

## I. THE “LEGITIMACY CRISIS” IN INTERNATIONAL INVESTMENT LAW

International courts and tribunals are, in contrast to their domestic counterparts, in the unique situation of having to defend themselves on a regular basis against attacks on their legitimacy as mechanisms for resolving disputes about the scope and the limits of state sovereignty. By “legitimacy” we mean acceptance of “a rule or rule-making institution which itself exerts a pull toward compliance on those addressed normatively because those addressed believe that the rule or institution has come into being and operates in accordance with generally accepted principles of right process.”<sup>1</sup> Such legitimacy concerns affect not only dispute-settlement institutions as a whole, but also inform the self-understanding and the work of those who decide disputes on the international level—in other words, international judges and arbitrators. This holds true for any of the many international dispute-settlement bodies that have come into existence over the past two decades or so.<sup>2</sup> It holds particularly true in what

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<sup>1</sup> For this definition of legitimacy, see Thomas M. Franck, *The Power of Legitimacy among Nations* 24 (Oxford 1990).

<sup>2</sup> On the proliferation of international dispute-settlement bodies and their impact on the international legal system, see generally Lucy Reed, *Great Expectations: Where Does the Proliferation of International Dispute Resolution Tribunals Leave International Law?*, 96 Am Socy Intl L Proc 219 (2002);

appears to be the fastest growing area of international law at this time: international investment law. Without a *compte rendu* of their function and impact on society, those deciding investment disputes not only will have difficulty responding to legitimacy-related criticisms—they also will have trouble understanding their own position and the responsibility it entails.

Defenses of the legitimacy of international investment law and investment dispute resolution have not, however, kept pace with the enormous development of this field of international law and the accompanying critical attention it has received. Indeed, investment treaties have proliferated to an unprecedented degree, having surged from less than 400 in 1989 to well over 2,500 bilateral, regional, and sectoral treaties today.<sup>3</sup> Equally, the volume of investor-state arbitrations under these treaties has risen just within the last decade to well over two hundred, with new arbitrations being initiated on an almost daily basis.<sup>4</sup> This rise of international investment law and its dispute-settlement mechanisms does not, however, take place in a void. It is a consequence of equally unprecedented increases in transborder investment flows, a necessary concomitant of the increasing globalization that has taken place since the end of the Cold War.<sup>5</sup> It is this change in the world's social and economic environment that has created the need for legal institutions that

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Shane Spelliscy, Note, *The Proliferation of International Tribunals: A Chink in the Armor*, 40 Colum J Transnatl L 143 (2001); Roger P. Alford, *The Proliferation of International Courts and Tribunals: International Adjudication in Ascendance*, 94 Am Socy Intl L Proc 160 (2000); Jonathan I. Charney, *The Impact on the International Legal System of the Growth of International Courts and Tribunals*, 31 NYU J Intl L & Pol 697 (1999); Benedict Kingsbury, *Is the Proliferation of International Courts and Tribunals a Systemic Problem?*, 31 NYU J Intl L & Pol 679 (1999); Cesare P.R. Romano, *The Proliferation of International Judicial Bodies: The Piece of the Puzzle*, 31 NYU J Intl L & Pol 709 (1999); Laurence R. Helfer and Anne-Marie Slaughter, *Toward a Theory of Effective Supranational Adjudication*, 107 Yale L J 273 (1997). For the remaining contributions to a symposium held at New York University School of Law in October 1998 on the proliferation of international courts and tribunals, see also 31 NYU J Intl L & Pol 679–933 (1999).

<sup>3</sup> On the statistical increase of investment treaties, see UN Conference on Trade and Development, *Bilateral Investment Treaties in the Mid-1990s* 9 (UN 1998). See also UN Conference on Trade and Development, *Recent Developments in International Investment Agreements (2006–June 2007)* 2 (2007), available online at <[http://www.unctad.org/en/docs/webiteia20076\\_en.pdf](http://www.unctad.org/en/docs/webiteia20076_en.pdf)> (visited Dec 5, 2008) (recording an aggregate of 2,573 bilateral investment treaties at the end of 2006).

<sup>4</sup> UN Conference on Trade and Development, *Latest Developments in Investor-State Dispute Settlement*, 1–2 (2008), available online at <[http://www.unctad.org/en/docs/iteia20083\\_en.pdf](http://www.unctad.org/en/docs/iteia20083_en.pdf)> (visited Dec 5, 2008) (recording an aggregate of 290 investment based disputes).

<sup>5</sup> On the development of foreign investment flows, see UN Conference on Trade and Development, *World Investment Report 2007: Transnational Corporations, Extractive Industries and Development* 3–30 (2007), available online at <[http://www.unctad.org/en/docs/wir2007\\_en.pdf](http://www.unctad.org/en/docs/wir2007_en.pdf)> (visited Dec 5, 2008) (highlighting increasing corporate profits worldwide and increased investment in developing countries, particularly those countries rich in natural resources).

structure and stabilize foreign investment activities and help to regulate conflicts that unavoidably arise out of increases in investment cooperation.

Equally unavoidably, the rise of investment treaties and investment-treaty arbitration has attracted critical attention from the users of the dispute-settlement mechanism (that is, investors and host states) as well as various interest groups that claim to represent “civil society” and the “public interest.” Although these critical voices vary in the specific points they raise and in the tone in which they raise them, they have contributed to a considerable amount of literature intimating that investment law may be in a veritable “legitimacy crisis.”<sup>6</sup> On the one hand, this crisis is caused by the vagueness and indeterminacy of the standard investor rights, leading to problematic predictability in the application of investment treaties.<sup>7</sup> On the other hand, it originates from procedural aspects of investment treaty arbitration, specifically problems relating to the overlap between different arbitral institutions and control mechanisms<sup>8</sup> and the resulting inconsistencies in the decisions of different arbitral tribunals.<sup>9</sup>

While some of these problems, in particular unpredictability and incoherence in investor-state dispute settlement, are considerable and in need of serious attention, arguably a solution will come with the passage of time. Increasing dispute-settlement procedures and doctrinal efforts promise to prove that concepts relating to investors’ rights, such as fair and equitable treatment and indirect expropriation, are not as vague and indeterminate as some argue. They increasingly will provide yardsticks for the judicial settlement of disputes that have proven to be workable not only in several international fora—such as the Iran–US Claims Tribunal<sup>10</sup> or the various claims commissions established at the

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<sup>6</sup> See M. Sornarajah, *A Coming Crisis: Expansionary Trends in Investment Treaty Arbitration*, in Karl P. Sauvant, ed., *Appeals Mechanism in International Investment Disputes* 39–45 (Oxford 2008); Ari Afilalo, *Meaning, Ambiguity and Legitimacy: Judicial (Re-)construction of NAFTA Chapter 11*, 25 *Nw J Intl L & Bus* 279, 282 (2005); Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law through Inconsistent Decisions*, 73 *Fordham L Rev* 1521, 1523 (2005); Ari Afilalo, *Towards a Common Law of International Investment: How NAFTA Chapter 11 Panels Should Solve Their Legitimacy Crisis*, 17 *Georgetown Intl Envir L Rev* 51 (2004); Charles H. Brower II, *Structure, Legitimacy, and NAFTA’s Investment Chapter*, 36 *Vand J Transnatl L* 37 (2003); Charles N. Brower, Charles H. Brower II, and Jeremy K. Sharpe, *The Coming Crisis in the Global Adjudication System*, 19 *Arb Intl* 415 (2003); Charles N. Brower, *A Crisis of Legitimacy*, *Natl L J* B9 (Oct 7, 2002).

<sup>7</sup> See Brower II, 36 *Vand J Transnatl L* at 52 (cited in note 6).

<sup>8</sup> Brower, Brower II, and Sharpe, 19 *Arb Intl* at 419 (cited in note 6).

<sup>9</sup> Franck, 73 *Fordham L Rev* at 1545–47 (cited in note 6) (explaining the different scenarios under which inconsistencies most commonly occur).

<sup>10</sup> On the concept of indirect expropriation as applied by the Tribunal, see Charles N. Brower and Jason D. Brueschke, *The Iran–United States Claims Tribunal* 394–410 (Kluwer 1998); George H.

beginning of the twentieth century to solve investment-related disputes<sup>11</sup>—but also in domestic courts that entertain disputes concerning the relationship between property protection and competing private and public interests.<sup>12</sup> Thus, the passage of time—bringing with it a continuous stream of investment jurisprudence, a refinement of state practice and treaty making, and growing doctrinal analysis—may help create a better understanding of the content and scope of the central principles of investment protection and result in the creation of a *jurisprudence constante*.

There is, however, another arguably more serious critique that questions the legitimacy of international investment law and arbitration beyond the problems of predictability and consistency. It comes in two forms: first, a hegemonic critique of international investment law that originates from a Marxist analysis of international law and views international investment law as an attempt by developed countries to impose their power on weaker, developing countries;<sup>13</sup> and second, a more nuanced critique of the perceived unevenness created by a regime that protects property, investment, and foreign investors without sufficient regard to other non-investment-related interests of host states.<sup>14</sup> Both strands consistently turn, however, around a common core: the criticism that investment treaties unilaterally favor the interests of investors over the host state's competing interests, thus establishing an asymmetric legal regime that is detrimental to state sovereignty. In other words, the criticism asserts that

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Aldrich, *The Jurisprudence of the Iran–United States Claims Tribunal* 174–88 (Oxford 1996) (outlining the doctrines that justify the Tribunal's takings rulings).

- 11 See A.H. Feller, *The Mexican Claims Commissions: 1923–1934: A Study in the Law and Procedure of International Tribunals* (Macmillan 1935) (describing Mexico's history with transnational claims commissions and its efforts to resolve conflicts between these commissions).
- 12 See Richard A. Epstein, *Takings: Private Property and the Power of Eminent Domain* 96–97 (Harvard 1985) (explaining how common law rules can evolve and allow for government intervention without drastic undermining of property interests).
- 13 See, for example, B.S. Chimni, *International Institutions Today: An Imperial Global State in the Making*, 15 Eur J Intl L 1, 7 (2004) (arguing that the subjection of national law to international standards is an attempt to remove local barriers to capital accumulation); B.S. Chimni, *Marxism and International Law*, Econ & Pol Wkly 337 (Feb 6, 1999).
- 14 See, for example, Olivia Chung, Note, *The Lopsided International Investment Law Regime and Its Effect on the Future of Investor-State Arbitration*, 47 Va J Intl L 953, 956–57 (2007) (arguing that existing bilateral investment treaties strongly favor investors and that these inequalities will eventually lead to greater difficulties in enforcement of such treaties); Gus Van Harten, *Investment Treaty Arbitration and Public Law* (Oxford 2007); Vicki L. Been and Joel C. Beauvais, *The Global Fifth Amendment? NAFTA's Investment Protections and the Misguided Quest for an International "Regulatory Takings" Doctrine*, 78 NYU L Rev 30, 35–37 (2003) (criticizing international tribunals for adopting US regulatory takings standards too aggressively given the legal climate of the rest of the world, taking that precedent even further than it has been applied within US courts). See also Naveen Gurudev, *An Evaluation of Current Legitimacy-Based Objections to NAFTA's Chapter 11 Investment Dispute Resolution Process*, 6 San Diego Intl L J 399, 402 (2005).

investment treaties and investment-treaty arbitration institutionalize a pro-investor bias that casts the legitimacy of the entire system of international investment law and arbitration into doubt.

These critics make three arguments about the supposedly asymmetric nature of the substance and procedures of investment treaties and investment-treaty arbitration. First, they claim that, as regards substantive obligations, investment treaties do not match investors' rights with investors' obligations and therefore pose a threat to the authority of the state in advancing public interests that compete with the protection of property and investment. Second, critics argue that investment treaties exacerbate this pro-investor bias procedurally by providing investors with a right to initiate investment-treaty arbitration, but denying such a right to the host state. Finally, critics question the legitimacy of the dispute-settlement mechanism provided for under investment treaties, taking issue with the ad hoc appointment of arbitrators for specific disputes by the disputing parties, in contrast to other international dispute-resolution mechanisms that feature more permanent adjudicators appointed through more neutral processes.

These perceived shortcomings have led to calls for replacement or radical redesign of investor-state dispute-settlement mechanisms. Suggested alternatives range from a return to state-to-state arbitration to the less-radical call for the establishment of a permanent international investment court with tenured judges. The necessity of such changes is said to gain urgency from the fact that recently certain states have withdrawn from bilateral investment treaties,<sup>15</sup> have either denounced or announced their intention to denounce the Convention on the Settlement of Investment Disputes between States and Nationals of Other States ("ICSID Convention"),<sup>16</sup> or have re-crafted the substance of their investment-treaty practice in a way that reflects concerns about the growth and the jurisprudential trends of the system of investment arbitration.<sup>17</sup> Notably,

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<sup>15</sup> On April 30, 2008, Venezuela communicated to the Netherlands its intention to terminate the Dutch-Venezuelan Bilateral Investment Treaty as of November 1, 2008. Luke Eric Peterson, ed, *Investment Arbitration Reporter* 2 (May 16, 2008), available online at <<http://www.iareporter.com/Archive/IAR-05-16-08.pdf>> (visited Dec 5, 2008) (reporting that Venezuela had chosen to end the treaty citing reasons of "national policy").

<sup>16</sup> As of November 3, 2007, Bolivia has withdrawn from the Convention on the Settlement of Investment Disputes between States and Nationals of Other States ("ICSID Convention"). See *Bolivia Denounces ICSID Convention*, 46 ILM 973 (2007). Rhetoric about withdrawal from the ICSID Convention has also been heard in respect to Nicaragua, Venezuela, and Cuba. See Marco E. Schnabl and Julie Bédard, *The Wrong Kind of Interesting*, Nat'l L.J. § 1 (July 30, 2007).

<sup>17</sup> See Gilbert Gagné and Jean-Frédéric Morin, *The Evolving American Policy on Investment Protection: Evidence from Recent FTAs and the 2004 Model BIT*, 9 J. Intl Econ L. 357, 363 (2006); Stephen Schwebel, *The United States 2004 Model Bilateral Investment Treaty: An Exercise in the Regressive*

such developments are present in capital-importing as well as capital-exporting countries that themselves have been defending against investment arbitrations.<sup>18</sup>

Until now, this critical literature on investment treaties and investment-treaty arbitration has not been matched by an equally forceful defense of the system that explains its advantages over proposed alternatives and justifies the institutional and structural choices that states made when setting up the current system. To begin to fill this void, this Article responds to these criticisms and attempts to put forward a critique of the critique of international investment law. We argue that investment treaties and investment-treaty arbitration do not unilaterally favor investors' interests over competing public policy choices and do not institutionalize a pro-investor bias. To the contrary, investment law is much more nuanced and balanced, both with regard to its substance and its procedural implementation. Much more than buttressing singular capital interests, investment treaties and arbitration aim at anchoring good governance standards that lock states into a policymaking framework that is open towards the functioning of markets in a global economic system, without losing sight of the state's legitimate regulatory interests.

For this purpose, the present Article addresses three distinct issues that are central to the critique of investment treaties and arbitration. First, it discusses the virtues of granting investors an independent right to initiate dispute settlement directly against the host state instead of forcing them to rely either on dispute resolution in domestic courts or on interstate dispute resolution. Second, this Article shows how investment-treaty arbitration takes into account private and public interests in deciding whether state conduct has violated the rights granted to investors under investment treaties. It thus argues that concepts related to investors' rights, such as fair and equitable treatment or the concept of indirect expropriation, do not establish rights that unilaterally favor investors over states. Third, this Article addresses the relatively recent critique of whether arbitration, as compared to a permanent court with tenured judges, vitiates the legitimacy of international investment law. It explains the institutional choice in favor of arbitration, analyzes the independence and impartiality of arbitrators and shows which control mechanisms preclude the arbitral mechanism from becoming a source of pro-investor bias. Finally, the Article concludes by pointing to strategies by which the present system of investment-treaty arbitration can, and increasingly does, accommodate the legitimate concerns of nonparties to the

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*Development of International Law*, 3 *Transnatl Disp Mgmt* 1, 3-7 (Apr 2006); Mark Kantor, *The New Draft Model U.S. BIT: Noteworthy Developments*, 21 *J Intl Arb* 383, 385 (2004).

<sup>18</sup> See generally Guillermo Aguilar Alvarez and William W. Park, *The New Face of Investment Arbitration: NAFTA Chapter 11*, 28 *Yale J Intl L* 365 (2003) (discussing the phenomenon of developed countries as respondents in investment treaty arbitration).

proceedings. Such strategies, it is argued, do not require a radical redesign of the entire system, but can be integrated into the existing system of international investment law and arbitration. In sum, this Article argues that investment treaties and investor-state arbitration constitute a legitimate vehicle for structuring and stabilizing foreign investment activities.

## II. THE VIRTUES OF INVESTOR-STATE DISPUTE RESOLUTION

The right of a foreign investor to initiate arbitration against the host state is one of the primary targets of criticism of investment treaties. This right is one of the most striking differences that modern investment treaties offer to alien investors as compared to customary international law, and has been designated rightly as a “change in paradigm in international investment law.”<sup>19</sup> Indeed, without the investor having the option of recourse to arbitration, investment treaties would be mere political declarations (albeit with some implications on the diplomatic level) instead of a set of rules enforceable against states. The importance of this right in fulfilling the object and purpose of investment treaties to protect and promote foreign investment becomes most apparent in considering the function that independent dispute-settlement mechanisms perform in stabilizing and enabling economic exchange in the investment context.

Dispute settlement has a central function in stabilizing the expectations of foreign investors and enables them to counter opportunistic behavior by the host state, such as unreasonable interferences with the investor’s economic rights or even expropriations without compensation. Recourse to a dispute-settlement and enforcement mechanism empowers the investor to effectively hold states liable for breaches of their promises in investment treaties to not expropriate foreign investors without compensation, to treat them fairly and equitably, to provide full protection and security, and so on. Conversely, from the host state’s perspective, the investor’s right to initiate arbitration enables the host state to make credible the commitments it made under its investment treaties.<sup>20</sup> This, in turn, reduces the political risk of foreign investment, lowers the risk premium connected to it, and therefore makes investment projects more cost-efficient. This increased efficiency benefits not only investors, but also the host state, as the products and services that a foreign investor offers become cheaper.

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<sup>19</sup> See generally Christoph Schreuer, *Paradigmenwechsel im Internationalen Investitionsrecht*, in Waldemar Hummer, ed., *Paradigmenwechsel im Völkerrecht zur Jahrtausendwende* 237 (Manz 2002).

<sup>20</sup> See Alan Schwartz and Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 *Yale L J* 541, 556–62 (2003).



Certainly, the credibility of the host state's commitments does not solely rely on the availability of dispute-settlement mechanisms. Reputation, community pressure, the moral obligation to keep promises, or the host state's self-interest may also contribute to the host state's adherence to its investment treaties.<sup>21</sup> Reproachable conduct against one investor might negatively impact the trust that other investors have in the political stability of the host state and thus cause them to refrain from investing there. Equally, political pressure exercised by other states might further incentivize host states to comply with promises they have made vis-à-vis foreign investors.<sup>22</sup> Yet in the investment context, such mechanisms only work imperfectly as demonstrated by numerous examples of large-scale expropriations without adequate compensation, for instance in Cuba, Iran, and Zimbabwe.<sup>23</sup> This is because in a typical situation the host state can potentially benefit by unilaterally resiling from its obligation once the investor has completed his initial investment.<sup>24</sup> In this situation, the host state has an incentive to change the investment terms unilaterally, impose additional obligations on the investor, or even expropriate an investor without sufficient compensation. The investor, in turn, cannot easily reemploy his investment elsewhere without significant losses in the form of sunk costs. Thus, often the only possibility for the host state to make credible commitments and immunize investor-state cooperation against subsequent opportunistic behavior is through the establishment of independent third-party dispute-settlement mechanisms such as courts or arbitration.<sup>25</sup> Such post hoc control and governance mechanisms ensure that the bargain initially struck will be upheld and thus empower the parties to engage in cost-efficient private ordering and to make credible commitments. Dispute settlement is thus necessary to compensate for the structural inequalities between foreign investors and host states.

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<sup>21</sup> See generally Andrew T. Guzman, *How International Law Works: A Rational Choice Theory* 71–117 (Oxford 2008) (detailing how reputation functions as a mechanism to induce states' compliance with their obligations under international law).

<sup>22</sup> See Anne van Aaken, *Perils of Success? The Case of International Investment Protection*, 9 Eur Bus Org L Rev 1, 14 (2008).

<sup>23</sup> For a general discussion of large-scale expropriations, see Eric N. Baklanoff, *Expropriation of U.S. Investments in Cuba, Mexico, and Chile* (Praeger 1975).

<sup>24</sup> The underlying change in the incentive structure after one party has started performing or placed an asset under the control of the other party is also described as a hold-up problem. See Oliver E. Williamson, *The Economic Institutions of Capitalism: Firms, Markets, and Relational Contracting* 52–56 (Collier 1985). See also Andrew T. Guzman, *Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 Va J Intl L 639, 658–66 (1998). For a game-theoretic reconstruction, see Robert Cooter and Thomas Ulen, *Law and Economics* 184–85 (Pearson 5th ed 2008).

<sup>25</sup> See Zachary Elkins, Andrew T. Guzman, and Beth A. Simmons, *Competing For Capital: The Diffusion of Bilateral Investment Treaties, 1960–2000*, 60 Intl Org 811, 823–24 (2006).

However, neither the courts of the host state nor the courts of any third state are well-positioned to enforce the state's promises vis-à-vis foreign investors, including those in investment treaties. The problem with most state courts is that they are not—or at least they are not perceived to be—sufficiently neutral in resolving disputes between foreign investors and host states. In many developing and transitioning countries, independent courts that decide cases in accordance with pre-established rules of law in a timely fashion are missing altogether. Corruption in the judiciary is a sad but daily business in the courts of many countries.<sup>26</sup> Additionally, lengthy and inefficient court proceedings dragging on over years, if not decades, remain too commonplace.<sup>27</sup> Under such circumstances, it is difficult to argue convincingly that dispute resolution in many host states' courts constitutes a way for investors to make a recalcitrant host state comply with its investment-treaty commitments.<sup>28</sup>

Similarly, the courts of third states are not better placed to offer effective dispute settlement between investors and host states. The judiciary outside the host state is often equally reluctant to subject sovereign nations to full-fledged judicial scrutiny and control. Various legal obstacles—including state immunity and doctrines of judicial restraint such as the act-of-state doctrine—constitute significant limits to the subjection of host states to third-country jurisdiction.<sup>29</sup> Courts outside the host state are, therefore, equally incapable of providing

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<sup>26</sup> On corruption in the judiciary, see generally Maria Dakolias and Kimberley L. Thachuk, *Attacking Corruption in the Judiciary: A Critical Process in Judicial Reform*, 18 Wis Intl L J 353 (2000); Eduardo Buscaglia and Maria Dakolias, *An Analysis of the Causes of Corruption in the Judiciary*, 30 L & Poly Intl Bus 95 (1999).

<sup>27</sup> See, for example, European Commission for the Efficiency of Justice, *Length of Court Proceedings in the Member States of the Council of Europe Based on the Case-Law of the of the European Court of Human Rights* 27-42, 45, CEPEJ-TF-DEL (2006) 3 (report by Françoise Calvez), available online at <<http://siteresources.worldbank.org/INTLAWJUSTINST/Resources/CEPEJCourtDelay.pdf>> (visited Dec 5, 2008) (reporting that the European Court of Human Rights found reasonable time violations in 41 cases between 1987 and 2004, and describing some of the reasons for these time delays).

<sup>28</sup> Exceptions to these observations exist, especially in countries with well-developed judicial systems that provide for effective and independent protection against government conduct. This may also account for the non-inclusion of an investor-state dispute-settlement mechanism in the recent Australia-US Free Trade Agreement. See William S. Dodge, *Investor-State Dispute Settlement between Developed Countries: Reflections on the Australia-United States Free Trade Agreement*, 39 Vand J Transnatl L 1, 2-4 (2006).

<sup>29</sup> M. Sornarajah, *The Pursuit of Nationalized Property* 253-301 (Martinus Nijhoff 1986). Specifically on the situation in the United States, see Ronald Mok, Comment, *Expropriation Claims in United States Courts: The Act of State Doctrine, the Sovereign Immunity Doctrine, and the Foreign Sovereign Immunities Act. A Roadmap for the Expropriated Victim*, 8 Pace Intl L Rev 199 (1996). See also *Banco Nacional de Cuba v Sabbatino*, 376 US 398, 421 (1964) (on the act-of-state doctrine); *Baker v Carr*, 369 US 186, 208-13 (1962) (on the political question doctrine). Comparable doctrines also exist in other domestic legal systems.

effective enforcement mechanisms that could back up the credibility of promises a host state makes vis-à-vis foreign investors.

The investor's options for the enforcement of host-state promises are not any better under the framework established by customary international law. Here, investors are denied standing to initiate proceedings in international courts and tribunals. Instead, only the home state of an investor is able to espouse its claim and exercise diplomatic protection.<sup>30</sup> Significant drawbacks, however, vitiate the effectiveness of diplomatic protection in making host states comply with promises given to foreign investors. First, the investor has no right vis-à-vis its government to a grant of diplomatic protection, and the latter no duty to accord it. Instead, states remain free to decline diplomatic protection.<sup>31</sup> Second, the home state exercises exclusive control over the rights of its nationals on the international level and hence is entitled to settle, waive, or modify them by agreement with the host state.<sup>32</sup> In practice, this has led to the settlement of international claims concerning the violation of the rights of foreigners by lump-sum agreements.<sup>33</sup> Third, under customary international law the entitlement to receive compensation for the violation of international law protecting foreign nationals is vested not in the alien but in his or her home state. Compensation

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<sup>30</sup> See, for example, *The Mavrommatis Palestine Concessions (Greece v Britain)*, 1924 PCIJ (ser B) no 3 at 12 (Aug 30, 1924) (“By taking up the case of one of its subjects and by resorting to diplomatic action or international judicial proceedings on his behalf, a State is in reality asserting its own rights—its right to ensure, in the person of its subjects, respect for the rules of international law.”). On diplomatic protection, see generally Chittharanjan F. Amerasinghe, *Diplomatic Protection* (Oxford 2008).

<sup>31</sup> See, for example, *Barcelona Traction, Light and Power Company, Ltd (Belgium v Spain)*, 1970 ICJ 3, 44 (Feb 5, 1970), stating:

The State must be viewed as the sole judge to decide whether its protection will be granted, to what extent it is granted, and when it will cease. It retains in this respect a discretionary power the exercise of which may be determined by considerations of a political or other nature, unrelated to the particular case.

Similarly, most domestic legal systems do not oblige the state to pursue claims of its nationals by means of diplomatic protection. See generally Annemarieke Vermeer-Künzli, *Restricting Discretion: Judicial Review of Diplomatic Protection*, 75 *Nordic J Intl L* 279 (2006) (discussing national jurisprudence and developments on the international level and observing an emerging development towards a state's obligation to exercise diplomatic protection in case of serious violations of human rights law).

<sup>32</sup> Edwin M. Borchard, *The Diplomatic Protection of Citizens Abroad* 366–75 (Banks 1915). But see Juliane Hagelberg, *Die völkerrechtliche Verfügungsbefugnis des Staates über Rechtsansprüche von Privatpersonen* 49–52 (Nomos 2006) (arguing, however, that human-rights law restricts the home state's disposition over claims of its nationals, see *id.* at 147–48).

<sup>33</sup> Richard B. Lillich and Burns H. Weston, *International Claims: Their Settlement by Lump-Sum Agreements* (Virginia 1975) (listing verbatim the text of 126 lump-sum agreements for settling outstanding international claims without international adjudication and analyzing their central features); Burns H. Weston, David J. Bederman, and Richard B. Lillich, *International Claims: Their Settlement by Lump-Sum Agreements, 1975–1995* (Transnatl 1999).

received therefore need not be paid to the investor by the home state espousing the claim.<sup>34</sup> Finally, diplomatic protection and interstate dispute settlement are subject to the requirement that local remedies first be exhausted.<sup>35</sup> While this affords the host state an opportunity to redress a violation of a foreign investor's rights, it also hardly affords efficient dispute settlement between investors and host states if the host state's courts are not impartial and independent enough in addressing that state's opportunistic behavior. The foregoing factors thus illustrate the insufficiency of diplomatic protection as a procedural means for efficiently enforcing host-state promises vis-à-vis foreign investors and for enabling host states to make fully credible commitments.

Likewise, contractual arrangements, which some suggest as an alternative to investment-treaty arbitration,<sup>36</sup> are inefficient and, above all, available only to investors with sufficient negotiating power. Certainly, large-scale investment contracts have always contained contractual arbitration clauses and have included choice-of-law clauses, stabilization clauses that insulate an investor-state contract from future changes of the law governing a contract,<sup>37</sup> or internationalization clauses that subject a contract to international law as the governing law.<sup>38</sup> By means of such contractual arrangements, investors and host states are thus able to deal with some of the limitations of dispute settlement under customary international law. Arbitration clauses remove the settlement of disputes from the realm of domestic adjudication and alleviate connected deficiencies; choice-of-law clauses, stabilization clauses, and internationalization clauses, in turn, protect investor-state contracts against unilateral changes in the governing law by the host state that might affect the contractual equilibrium.

By contrast, small- or medium-scale investors, who make up a large part of the claimants in contemporary investment-treaty arbitration, are in a more difficult position to negotiate for such protections. They may not have the

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<sup>34</sup> See Borchard, *Diplomatic Protection of Citizens Abroad* at 356–59, 383–88 (cited in note 32); Hagelberg, *Die völkerrechtliche Verfügungsbefugnis* at 51 (cited in note 32). The home state, in turn, is under no obligation to pass the compensation on to the investor who suffered the damage.

<sup>35</sup> Chittharanjan F. Amerasinghe, *Local Remedies in International Law* 200–03 (Cambridge 2d ed 2004); A.A. Cancado Trindade, *The Application of the Rule of Exhaustion of Local Remedies in International Law* 57–58 (Cambridge 1983) (explaining the rationale behind the rule of exhaustion, but arguing that the purpose of the rule is still to give redress and that exceptions should exist where no adequate redress is available locally).

<sup>36</sup> Jason Webb Yackee, *Do We Really Need BITs? Toward a Return to Contract in International Investment Law*, 3 *Asian J WTO & Intl Health L* 121, 128–36 (2008).

<sup>37</sup> See generally Hanno Merkt, *Investitionsschutz durch Stabilisierungsklauseln* (1990). See also F.V. Garcia-Amador, *State Responsibility in Case of "Stabilization" Clauses*, 2 *J Transnatl L & Poly* 23, 23–24 (1993).

<sup>38</sup> See Soranarajah, *Pursuit of Nationalized Property* at 279–82 (1986) (cited in note 29); Prosper Weil, *Problèmes relatifs aux contrats passés entre un Etat et un particulier*, 128 *Recueil des Cours* 95 (1969-III).

necessary market strength and bargaining power to negotiate comparable protection mechanisms and thus are placed at a structural disadvantage compared to larger investors. Consequently, such investors are more likely to refrain from making foreign investments at all because the risk associated with the lack of enforceable commitments on behalf of the host state is too high.

Moreover, contractual solutions are unavailable to those investors who do not enter into contractual agreements with the host state when engaging in foreign investment projects, but instead make their investments based on the country's general foreign-investment legislation. Such investors, who are not in privity with the state or any of its agencies, are therefore excluded from bargaining for contractual arrangements with protections and arbitration-initiation rights comparable to those offered by investment treaties. In the end, such contractual provisions, if not made subject to mandatory arbitration of disputes, may be just as unavailing as any other promise that is not kept.

Certainly, the reverse situation of foreign investors behaving opportunistically and attempting to renege on their original promises also exists. However, the host state as a sovereign actor is typically able to react to such conduct by unilaterally imposing sanctions on the investor and enforcing them against the assets of the investment project.<sup>39</sup> Consequently, the host state does not depend on a dispute-settlement and compliance mechanism to make the investor comply with its promises. Hence, the criticism that investment treaties afford unilateral benefits to investors presents a very limited and in fact contorted picture of investor-state relations.<sup>40</sup> It disregards the fact that the host state already possesses a power that the foreign investor lacks. In this perspective, a direct right of action for foreign investors is but a modest limitation on the host state's sovereignty and is essential to creating a basis for effective and efficient foreign-investment activities. The fact that investor-state arbitration makes host states comply with their substantive obligations should thus not be considered as a mark against the legitimacy of international investment law. Much to the contrary, it would be illegitimate to enter into treaty

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<sup>39</sup> Exceptionally, there are situations where this mechanism does not work effectively, such as when an investor does not have any or sufficient assets within the host state's jurisdiction. But this is not the usual situation in which foreign investors find themselves.

<sup>40</sup> Furthermore, it may be noted that the procedural rules for investor-state arbitration, in particular the ICSID Convention, do not exclude the possibility that host states may bring claims against misbehaving investors. See, for example, ICSID Convention, Regulations and Rules, art 36, available online at <[http://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/CRR\\_English-final.pdf](http://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/CRR_English-final.pdf)> (visited Dec 5, 2008). In addition, respondent states may bring counterclaims against foreign investors in investment arbitrations. Hege Elisabeth Veenstra-Kjos, *Counter-Claims by Host States in Investment Dispute Arbitration 'without Privity'*, in Philippe Kahn and Thomas W. Wälde, eds, *Les Aspects Nouveaux du Droit des Investissements Internationaux/New Aspects of International Investment Law* ch 13 (Martinus Nijhoff 2006).

obligations and then deplore that sanctions in case of a breach can actually be enforced.

### III. INVESTMENT PROTECTION AND REGULATORY POWERS

The second major attack against the legitimacy of international investment treaties is the often-heard reproach that investment treaties protect the investor against every kind of risk, including business risks, or at the least require the host state to compensate the investor for every regulatory change the host state would like to introduce in order to further some legitimate public policy. This reproach is, however, equally unpersuasive. First, investment treaties do not protect investors against business risks or their own bad business judgment,<sup>41</sup> but only against the political risks inherent in investing in a foreign country.<sup>42</sup> Consequently, an investor has no claims against the host state for unfavorable business conditions or a deterioration of the general business environment. Instead, liability under investment treaties requires that the host state interfere with the investor's investment. For instance, the existence of an economic crisis as such will not entail any liability for the host state.<sup>43</sup> Liability may attach, however, if the host state, in reaction to this crisis, takes measures that directly and adversely interfere with the investor's rights.<sup>44</sup> Claims that investment

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<sup>41</sup> See, for example, *Marvin Feldman v The United Mexican States*, ICSID Case No. ARB(AF)/99/1, Award of (Dec 16, 2002) ¶¶ 112–14, available online at <[http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC587\\_En&caseId=C175](http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC587_En&caseId=C175)> (visited Dec 5, 2008); *Emilio Agustín Maffezini v Spain*, ICSID Case No. ARB/97/7, Award of (Nov 13, 2000) ¶ 64, available online at <[http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC566\\_En&caseId=C163](http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC566_En&caseId=C163)> (visited Dec 5, 2008); *Robert Azinian, Kenneth Davitian, & Ellen Baca v The United Mexican States*, ICSID Case No ARB(AF)/97/2, Award of (Nov 1, 1999) ¶ 83, available online at <[http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC544\\_En&caseId=C156](http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC544_En&caseId=C156)> (visited Dec 5, 2008).

<sup>42</sup> On the notion of political risk, see Noah D. Rubins and Stephan Kinsella, *International Investment, Political Risk and Dispute Resolution* 1–25 (Oceana 2005).

<sup>43</sup> See, for example, *Sea-Land Service, Inc v Iran*, Award No 135-33-1 (1984), reprinted in Vol 6 Iran–US CI Trib Rep 149, 164–65.

<sup>44</sup> See, for example, *Sempra Energy International v Argentine Republic*, ICSID Case No ARB/02/16, Award of (Sept 29, 2007) ¶¶ 325–91, available online at <[http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC694\\_En&caseId=C8](http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC694_En&caseId=C8)> (visited Dec 5, 2008); *Enron Corp and Ponderosa Assets v Argentine Republic*, ICSID Case No ARB/01/3, Award of (May 22, 2007) ¶¶ 143–44; *LG&E Energy Corp, LG&E Capital Corp, LG&E International Inc v Argentine Republic*, ICSID Case No ARB/02/1, Decision on Liability of (Oct 3, 2006) ¶ 205, available online at <[http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC786\\_En&caseId=C208](http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC786_En&caseId=C208)> (visited Dec 5, 2008); *CMS Gas Transmission Co v Argentine Republic*, ICSID Case No ARB/01/8, Award of (May 12, 2005) ¶ 317, available online at <<http://icsid.worldbank.org/ICSID/>

treaties secure foreign investors against business risks and make host states pay for their realization are thus simply not accurate.

Similarly distorted is the complaint that investment treaties can lead to a regulatory chill since they require host states to compensate foreign investors for any adverse change in the host state's regulatory framework. Quite to the contrary, while investment treaties establish rights only for foreign investors, they do not abolish the host state's regulatory powers. Instead, as arbitral jurisprudence illustrates, neither the standard of fair and equitable treatment nor the concept of indirect expropriation establishes absolute rights for foreign investors. Rather, they require that the host state, in taking measures that affect foreign investors, give due consideration to the importance of the protection of foreign investments by balancing the rights of foreign investors with conflicting private and public interests.

Even though balancing or proportionality tests are not yet strongly conceptualized, several investment-treaty arbitrations have already applied them.<sup>45</sup> Thus, arbitral tribunals have recognized that despite the lack of express textual support in most investment treaties, states continue to dispose of their core regulatory powers and are not required to compensate foreign investors for the effects of bona fide, general regulations that further a legitimate purpose in a nondiscriminatory and proportionate way. Under the concept of indirect expropriation, for example,<sup>46</sup> it is firmly recognized that "regulations" do not give rise to a right to compensation, even if they restrict the use a foreign investor can make of its investment. In this context, the vast majority of arbitral

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FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC504\_En&caseId=C4>  
(visited Dec 5, 2008).

<sup>45</sup> See Benedict Kingsbury and Stephan Schill, *Investor-State Arbitration, Fair and Equitable Treatment, Proportionality, and the Emerging Administrative Law of Global Governance*, presented at the International Congress of Commercial Arbitration (June 9, 2008) (forthcoming 2009).

<sup>46</sup> On the concept of indirect expropriation, see Rosalyn Higgins, *The Taking of Property by the State: Recent Developments in International Law*, 176 *Recueil des Cours* 259, 322-47 (1982). For further discussions of indirect expropriation, see generally Andrew Newcombe, *The Boundaries of Regulatory Expropriation*, 20 *ICSID Rev Foreign Inv L J* 1 (2005); L. Yves Fortier and Stephen L. Drymer, *Indirect Expropriation in the Law of International Investment: I Know It When I See It, or Caveat Investor*, 19 *ICSID Rev Foreign Inv L J* 293 (2004); Jan Paulsson and Zachary Douglas, *Indirect Expropriation in Investment Treaty Arbitrations*, in Norbert Horn and Stefan Kröll, eds, *Arbitrating Foreign Investment Disputes* 145 (Kluwer 2004); Catherine Yannaca-Small, "Indirect Expropriation" and the "Right to Regulate" in *International Investment Law*, OECD Working Paper on International Investment No 2004/4 (Sept 2004), available online at <<http://www.oecd.org/dataoecd/22/54/33776546.pdf>> (visited Dec 5, 2008); Thomas W. Waelde and Abba Kolo, *Environmental Regulation, Investment Protection and 'Regulatory Taking' in International Law*, 50 *Int'l & Comp L Q* 811 (2001); Rudolf Dolzer, *Indirect Expropriation of Alien Property*, 1 *ICSID Rev Foreign Inv L J* 41 (1986); Burns H. Weston, 'Constructive Takings' under International Law: A Modest Foray into the Problem of 'Creeping Expropriation', 16 *Va J Int'l L* 103 (1975); George C. Christie, *What Constitutes a Taking of Property under International Law?*, 38 *Brit YB Int'l L* 307 (1962).

tribunals adopt the so-called “police power” doctrine in deciding whether a general measure entitles an investor to compensation.

Thus, the Tribunal in *Tecnicas Medioambientales Tecmed SA v Mexico* held that “[t]he principle that the State’s exercise of its sovereign powers within the framework of its police power may cause economic damage to those subject to its powers as administrator without entitling them to any compensation whatsoever is undisputable.”<sup>47</sup> Similarly, the Tribunal in *Methanex Corp v United States* stressed that

as a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, inter alios, a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation.<sup>48</sup>

In principle, therefore, the mere interference with a property interest is not necessarily sufficient for a finding of expropriation. Especially general regulations will only constitute expropriations to the extent they impose a disproportionate burden. Conversely, host states will not have to compensate for proportionate general regulation.

The concept of proportionality was further elaborated upon by the Tribunal in *Tecmed v Mexico*. The Tribunal stressed that it had to

consider, in order to determine if [the interferences] are to be characterized as expropriatory, whether such actions or measures are proportional to the public

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<sup>47</sup> *Tecnicas Medioambientales Tecmed SA v The United Mexican States*, ICSID Case No ARB(AF)/00/2, Award of (May 29, 2003) ¶ 119, available online at <[http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC602\\_En&caselId=C186](http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC602_En&caselId=C186)> (visited Dec 5, 2008). See also the jurisprudence of the Iran–United States Claims Tribunal, which emphasizes the “principle of international law that a State is not liable for economic injury which is a consequence of bona fide ‘regulation’ within the accepted police powers of states.” *Sedco, Inc v Iran*, Award No ITL 55-129-3, reprinted in Vol 9 Iran–US Cl Trib Rprt 248, 275 (1985); *Sea-Land*, 6 Iran-US Cl Trib Rep at 165; *Emanuel Too v Greater Modesto Insurance Association and United States*, Award No 460-880-2, reprinted in Vol 23 Iran–US Cl Trib Rep 378, 387 (1989), stating:

[A] State is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation or any other action that is commonly accepted as within the police power of States, provided it is not discriminatory and is not designed to cause the alien to abandon the property to the State or to sell it at a distress price.

<sup>48</sup> *Methanex Corporation v United States of America*, NAFTA, Award of (Aug 3, 2005) part IV, ch D, ¶ 7, available online at <<http://www.state.gov/documents/organization/51052.pdf>> (visited Dec 5, 2008). See also *Saluka Investments BV v The Czech Republic*, Permanent Court of Arbitration, Award of (Mar 17, 2006) ¶¶ 254–62, available online at <<http://www.pca-cpa.org/upload/files/SAL-CZ%20Partial%20Award%20170306.pdf>> (visited Dec 5, 2008); *International Thunderbird Gaming Corp v The United Mexican States*, NAFTA, Award of (Jan 26, 2006) ¶ 127, available online at <[http://www.iisd.org/pdf/2006/itn\\_award.pdf](http://www.iisd.org/pdf/2006/itn_award.pdf)> (visited Dec 5, 2008); *LG&E*, ICSID Case No ARB/02/1 at ¶¶ 194–97; *Marvin Feldman*, ICSID Case No ARB(AF)/99/1 at ¶¶ 103–06.



interest presumably protected thereby and to the protection legally granted to investments, taking into account that the significance of such impact has a key role upon deciding the proportionality.<sup>49</sup>

Proportionality reasoning therefore helps to achieve a balance between the affected property right and the public interest that is to be protected. In deciding whether such a balance existed in the case at hand, the Tribunal in *Tecmed* looked at the legitimate expectations of the investor, the importance of the regulatory interest pursued by the host state, and the weight and the effect of the restriction. In addition, a general measure, in order to be proportionate, must not specifically target or unequally affect one investor compared to other investors and thereby violate equal protection. As a consequence, general regulations can give rise to a right to compensation if they restrict property disproportionately or lead to a “special burden” on some investors.<sup>50</sup>

With respect to the intensity of the impact of the measure on the property, tribunals rather unanimously require the passing of a high threshold. A diminution in the value of foreign-owned property alone is not sufficient. Thus, the Tribunal in *LG&E Energy Corp, LG&E Capital Corp, LG&E International Inc v Argentina* reiterated that an indirect expropriation does not occur “where the investment continues to operate, even if profits are diminished. The impact must be substantial in order that compensation may be claimed for the expropriation.”<sup>51</sup> It is necessary to show that the business activity was affected in such a way that any business activity has “disappeared; [in other words,] the economic value of the use, enjoyment[,] or disposition of the assets or rights affected . . . [has] been neutralized or destroyed.”<sup>52</sup>

By contrast, *Metalclad Corp v Mexico*, which often is cited for exemplifying a much more rigid application of the concept of indirect expropriation, is not really apposite. While it has been interpreted as a particularly clear example of the exorbitant scope of the protection of property under investment treaties, endorsing what has been described as the “sole-effects” doctrine<sup>53</sup> that

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<sup>49</sup> *Tecmed*, ICSID Case No ARB(AF)/00/2 at ¶ 122. For a closer look at the proportionality test used in *Tecmed*, see Stephan Schill, *Revisiting a Landmark: Indirect Expropriation and Fair and Equitable Treatment in the ICSID Case Tecmed*, 3 *Transnatl Disp Mgmt* 1, 8–13 (Nov 2006).

<sup>50</sup> This idea is conveyed in an important strain of takings jurisprudence in Germany that relies on whether property owners suffered a “special sacrifice” (“*Sonderopfer*”) to the benefit of the general public. See Waelde and Kolo, 50 *Intl & Comp L Q* at 845–46 (cited in note 46).

<sup>51</sup> *LG&E*, ICSID Case No ARB/02/1 at ¶ 191.

<sup>52</sup> *Tecmed*, ICSID Case No ARB(AF)/00/2 at ¶ 116.

<sup>53</sup> Rudolf Dolzer and Felix Bloch, *Indirect Expropriation: Conceptual Realignment?*, 5 *Intl L Forum du Droit Intl* 155, 158–163 (2003); Rudolf Dolzer, *Indirect Expropriation: New Developments?*, 11 *NYU Envir L J* 64, 79–90 (2002).

disregards the purpose a certain measure pursues,<sup>54</sup> this case did not, in fact, involve a regulatory taking at all. Rather, *Metalclad* concerned the frustration of an assurance that the central Mexican government had given to the investor in question that all permits to operate the envisioned waste landfill had been granted and that construction could start.

In sum, the concept of indirect expropriation therefore leaves broad leeway for host states to regulate foreign investment, provided that such regulation serves a legitimate government purpose, is nondiscriminatory, and strikes a reasonable or proportional balance between the protection of the investor's investment and any competing public interest.

The same holds true with regard to the concept of fair and equitable treatment. Although this standard seems particularly vague and is used broadly by tribunals as a yardstick for the host state's judicial, administrative, and legislative actions, its application is not as unpredictable and capricious as some critics argue.<sup>55</sup> In particular, it does not entitle arbitral tribunals to second-guess government decision making or elevate the arbitrators' personal understandings of what is fair and equitable to a benchmark for government decision making.<sup>56</sup> Instead, fair and equitable treatment can be understood as government according to the rule of law that establishes basic substantive and procedural rights concerning the stability and predictability of the legal framework; consistency of the host state's decision making; the protection of investor confidence or "legitimate expectations"; procedural due process and the prohibition of denial-of-justice; protection against discrimination and arbitrariness; and the requirement of transparency.<sup>57</sup>

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<sup>54</sup> *Metalclad Corporation v The Mexican United States*, ICSID Case No ARB(AF)/97/1, Award of (Aug 30, 2000) ¶ 103.

<sup>55</sup> On fair and equitable treatment, see generally Stephan W. Schill, *Fair and Equitable Treatment under Investment Treaties as an Embodiment of the Rule of Law*, IILJ Working Paper 2006/6, available online at <<http://www.iilj.org/publications/documents/2006-6-GAL-Schill-web.pdf>> (visited Dec 5, 2008); Barnali Choudhury, *Evolution or Devolution?: Defining Fair and Equitable Treatment in International Investment Law*, 6 J World Inv & Trade 297 (2005); Christoph Schreuer, *Fair and Equitable Treatment in Arbitral Practice*, 6 J World Inv & Trade 357 (2005); Catharine Yannaca-Small, *Fair and Equitable Treatment Standard in International Investment Law*, OECD Working Paper on International Investment, No 2004/3, available online at <<http://www.oecd.org/dataoecd/22/53/33776498.pdf>> (visited Dec 5, 2008); Rudolf Dolzer, *Fair and Equitable Treatment: A Key Standard in Investment Treaties*, 39 Int'l Law 87 (2005).

<sup>56</sup> See, for example, *Pope & Talbot, Inc v Canada*, NAFTA, Award of (Apr 10, 2001) ¶ 155, available online at <[http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/Award\\_Merits-e.pdf](http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/Award_Merits-e.pdf)> (visited Dec 5, 2008); *SD Myers, Inc v Canada*, NAFTA, Award of (Nov 13, 2000) ¶¶ 261, 263, available online at <[http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/myersvcnadapartialaward\\_final\\_13-11-00.pdf](http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/myersvcnadapartialaward_final_13-11-00.pdf)> (visited Dec 5, 2008).

<sup>57</sup> Schill, *Fair and Equitable Treatment* at 11–23 (cited in note 55).

However, like the concept of indirect expropriation, the standard of fair and equitable treatment does not immunize investors from regulatory changes unless host states have promised specifically to refrain from such changes. Fair and equitable treatment does not require absolute stability, in the sense that the parameters under which an investment operates could never be changed without compensating the foreign investor. Instead, the standard of fair and equitable treatment simply requires the state to give due consideration to the position of investors and to the importance of the continuation of a specific regulatory framework. Thus, the Tribunal in *Saluka Investments BV v Czech Republic* stated that a determination under the fair-and-equitable-treatment standard requires “a weighing of the Claimant’s legitimate and reasonable expectations on the one hand and the Respondent’s legitimate regulatory interests on the other.”<sup>58</sup>

The Tribunal did not deem the protection of the investor’s expectations as absolute, but allowed the state to restrict them proportionately. Thus, the Tribunal held that the host state had the power to “implemen[t] its policies bona fide by conduct that is, as far as it affects the investors’ investment, reasonably justifiable by public policies and that such conduct does not manifestly violate the requirements of consistency, transparency, even-handedness and non-discrimination.”<sup>59</sup> That the fair-and-equitable-treatment standard does not suppress the host state’s power to legislate in the public interest was also stressed by the Tribunal in *Parkerings-Compagniet v Lithuania*, which stated:

It is each State’s undeniable right and privilege to exercise its sovereign legislative power. A State has the right to enact, modify or cancel a law at its own discretion. Save for the existence of an agreement, in the form of a *stabilisation* clause or otherwise, there is nothing objectionable about the amendment brought to the regulatory framework existing at the time an investor made its investment. As a matter of fact, any businessman or investor knows that laws will evolve over time. What is prohibited however is for a State to act unfairly, unreasonably or inequitably in the exercise of its legislative power.<sup>60</sup>

The approach of both awards is therefore similar to the proportionality test that various tribunals have applied in the context of applying the concept of indirect expropriation and that aims at balancing property interests and competing public policy concerns.

The substantive rights granted in investment treaties therefore leave ample room for host states to implement the policy goals they consider desirable,

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<sup>58</sup> *Saluka*, Award of (Mar 17, 2006) at ¶ 306.

<sup>59</sup> *Id* at ¶ 307 (emphasis omitted).

<sup>60</sup> *Parkerings-Compagniet AS v Republic of Lithuania*, ICSID Case No ARB/05/8, Award of (Sept 11, 2007) ¶ 332, available online at <[http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC682\\_En&caseId=C252](http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC682_En&caseId=C252)> (visited Dec 5, 2008).

including protection of the environment, human rights, labor standards, etc. Investment treaties require, however, that the protection of investors be duly taken into account. Equally, these treaties prevent governments from sacrificing foreign investors for the public good by protecting them against expropriations without compensation and measures that exceed what is reasonably acceptable in a market economy. Although one can object to any such restrictions on governments and disagree with the basic choice that investment treaties make in favor of the protection of property and investment, one should not suggest that investment treaties unilaterally favor investment protection over every competing private and public interest. In particular, they do not go beyond the guarantees of property that we know from various constitutional and international law frameworks, and have not prevented governments from implementing their noneconomic policy choices.

#### IV. IMPARTIALITY AND INDEPENDENCE OF ARBITRATION

The final reproach advanced against the legitimacy of international investment law concerns the selection of those who decide investment-treaty disputes, in particular disputes that involve politically sensitive issues, such as the scope of emergency powers or conflicts between business interests, on the one hand, and human rights or the protection of the environment on the other. Critics argue that arbitration, as compared to dispute resolution in courts, is unsuitable for such public law disputes because arbitrators are privately contracted by the parties to specific disputes and do not hold, like tenured judges, a public office.<sup>61</sup> For this reason, arbitration is said to institutionalize a pro-investor bias because arbitrators are influenced by their self-interest in being reappointed in future cases. This critique, however, disregards that arbitrators are impartial and independent dispute resolvers who interpret and apply the governing law and are subject to a number of mechanisms that can prevent private interests from taking precedence over public interests.

First, it is already questionable whether, as critics argue, arbitrators really lack a public office. Certainly, arbitrators are usually party appointed.<sup>62</sup> The appointment procedure, however, is contained in the rules of the respective arbitration institutions that are referenced in an investment treaty. That is, the basis of jurisdiction of tribunals in investment-treaty cases is not the type of

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<sup>61</sup> Van Harten, *Investment Treaty Arbitration* at 152–53 (cited in note 14); Been and Beauvais, 78 NYU L. Rev. at 45–46 (cited in note 14); Marc R. Poirier, *The NAFTA Chapter 11 Expropriation Debate through the Eyes of a Property Theorist*, 33 *Envir. L.* 851, 914–27 (2003).

<sup>62</sup> See, for example, ICSID Convention, Regulations and Rules, art. 37, available online at <[http://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/CRR\\_English-final.pdf](http://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/CRR_English-final.pdf)> (visited Dec 5, 2008).

party consent we find in commercial arbitration cases, where two parties agree on arbitration as a dispute-settlement mode. Appointment can be governed by the ICSID Convention, the UN Commission on International Trade Law Arbitration Rules, the Rules of Arbitration of the International Chamber of Commerce, the Arbitration Rules of the Arbitration Institute of the Stockholm Chamber of Commerce, etc. The consent to arbitration by host states, in turn, is contained in a treaty and not in a conventional instrument. It is treaty-mandated arbitration without privity,<sup>63</sup> comparable much more to a form of international administrative review than to purely commercial arbitration, in which the parties have full sovereignty over the proceeding.<sup>64</sup> Furthermore, the consent to arbitration in investment treaties is itself a sovereign act of the state.<sup>65</sup> Consequently, the basis of the arbitrators' authority in investment-treaty cases is founded in a public office which is conferred upon them based on international treaties. This counters the argument that public disputes under investment treaties are subjected to privatized dispute settlement.

The second argument—the lack of permanent appointments—is the more serious criticism of investment-treaty arbitration. Arbitrators, the argument goes, earn their living by the fees they earn from appointments. Consequently, since they have an interest in being reappointed in future cases, they may be inclined to cater to the interests of those who will appoint them in the future.<sup>66</sup> Arbitrators thus are viewed as having a financial stake in the outcome of the proceedings and therefore as not fully impartial and independent. Tenured judges, by contrast, earn their living independently of the number of cases they hear and of the results they reach. Only tenured appointments are thus viewed as meeting the standards of impartiality and independence that are appropriate for

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<sup>63</sup> See generally Andrea K. Bjorklund, *Contract without Privity: Sovereign Offer and Investor Acceptance*, 2 Chi J Int'l L 183 (2001) (pointing out that consent to arbitration under investment treaties constitutes a standing offer to initiate arbitration which can be accepted by covered investors by initiating arbitration); Bernardo Cremades, *Arbitration in Investment Treaties: Public Offer of Arbitration in Investment-Protection Treaties*, in Robert Briner, ed., *Law of International Business and Dispute Settlement in the 21st Century* 149 (Heymanns 2001) (describing the host state's consent to arbitration under an investment treaty as a public offer directed to investors covered under the treaty); Jan Paulsson, *Arbitration without Privity*, 10 ICSID Rev Foreign Inv L J 232 (1995).

<sup>64</sup> See Van Harten, *Investment Treaty Arbitration* at 58–68 (cited in note 14); Thomas W. Wälde, *The Specific Nature of Investment Arbitration*, in Kahn and Wälde, eds., *Les Aspects Nouveaux du Droit* at 43, 112 (cited in note 40); Gus Van Harten and Martin Loughlin, *Investment Treaty Arbitration as a Species of Global Administrative Law*, 17 Eur J Int'l L 121, 145–50 (2006).

<sup>65</sup> Van Harten himself considers the host state's consent to constitute a sovereign act. See Gus Van Harten, *The Public-Private Distinction in the International Arbitration of Individual Claims against the State*, 56 Intl & Comp L Q 371, 378–80 (2007).

<sup>66</sup> Van Harten, *Investment Treaty Arbitration* at 180–84 (cited in note 14).

the kind of public-law disputes in investment-treaty arbitrations.<sup>67</sup> Tenure of judges is viewed as the only institutional mechanism that can ensure the decision maker's impartiality and independence.

The difficulty with this critique, however, is that it takes a myopic view of how impartiality and independence can be secured. It disregards the fact that investment-treaty arbitration is imbued with several formal and informal mechanisms that ensure the impartiality and independence of arbitrators. First, arbitrators are under a duty to disclose relevant information that might cast doubt on their ability to render an impartial and independent decision. Thus, they must disclose existing and past relations with any of the parties, such as earlier engagements as counsel or the existence of specific financial stakes in the outcome of an arbitration proceeding (for example, ownership in an arbitrating corporation). Such disclosure requirements filter out the most obvious stakes an arbitrator can have in the outcome of an investment-treaty case and putatively make him unable to decide such cases in an impartial and independent manner. Furthermore, arbitrators are subject to challenges that either party can bring against them. This allows an independent and disinterested third party—either a domestic court, the appointing authority, or the arbitral institution itself—to consider whether there are indicators that cast the arbitrators' impartiality and independence into doubt.

Furthermore, there are significant informal control mechanisms that so far have been overlooked in the current debate about the suitability of arbitration. Certainly the parties, both investors and states, have an interest in appointing arbitrators that they hope will support their respective positions. Significant investors would be ill-advised, for example, to appoint as arbitrator a person who is known to be critical of large businesses. Equally, a state would not appoint somebody who has a minimalist view of the objectives of state activity and is critical of any state intervention with private affairs and the market.

Notwithstanding these basic and obvious dynamics, it is important to stress that arbitrator appointments in investment-treaty cases do not hinge primarily on the arbitrator's position on the substantive issues in dispute in a specific case. What is primarily important is the arbitrator's reputation for impartial and independent judgment. After all, arbitrators in investment-treaty cases are not advocates for the party that appointed them, and both parties and arbitrators understand that. Instead, investment-treaty arbitration does not differ substantially from dispute settlement by domestic courts with regard to the decision making process itself. Arbitrators engage, like judges, in the finding of the relevant facts and apply the governing law to those facts. Most importantly,

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<sup>67</sup> Gus Van Harten, *A Case for an International Investment Court*, SIEL Inaugural Conference Working Paper, available online at <<http://ssrn.com/abstract=1153724>> (visited Dec 5, 2008).

arbitrators in investment-treaty disputes are required to reach their decisions based on their impartial and independent judgments. For this reason, investment-treaty arbitration has little in common with private-law arbitration where the parties have full sovereignty in determining not only which law arbitrators have to apply, but also whether they should render an impartial and independent decision at all. Instead, investment-treaty arbitration in its decision making process is an adjudicatory process based on independent fact-finding and legal analysis according to rules of law by neutral, independent, and impartial decision makers.<sup>68</sup> One can therefore very well conclude that international arbitration, including investment-treaty arbitration, is in fact not classic arbitration where the parties have full liberty to set the standards for the decision-making process and can control the way the dispute is resolved.<sup>69</sup>

Appointments therefore are essentially merit-based. The crucial factor for appointment is not the possible or real bias of an arbitrator in favor of a party's position. It is rather his or her reputation for impartial and independent judgment that earns appointments. Reputation is difficult to build up and is easily destroyed; these characteristics thus work against any incentive to taint one's decision making in favor of either party in order to secure future appointments. A reputation for independence and impartiality, in other words, is too fragile to risk by biased decisionmaking and therefore works as a control mechanism that ensures the arbitrators' independence and impartiality.

Another important informal control mechanism is public scrutiny. Unlike commercial arbitration awards, most investment-treaty awards are made available to the public almost instantaneously via online resources.<sup>70</sup> Consequently, arbitrators and their decisionmaking are subject to scrutiny by both the professional community of arbitrators and academics as well as the general public. Today, investment-treaty awards are discussed and scrutinized in law review articles, internet blogs, and online discussion fora.<sup>71</sup> Arbitrators

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<sup>68</sup> See Susan D. Franck, *International Arbitrators: Civil Servants? Sub Rosa Advocates? Men of Affairs?: The Role of International Arbitrators*, 12 ILSA J Int'l & Comp L 499, 503–04 (2006).

<sup>69</sup> See generally Jan Paulsson, *International Arbitration Is Not Arbitration*, EC Brierley Memorial Lecture (May 28, 2008), available online at <[http://www.arbitration-icca.org/media/0/12224354891890/international\\_arbitration\\_is\\_not\\_arbitration.pdf](http://www.arbitration-icca.org/media/0/12224354891890/international_arbitration_is_not_arbitration.pdf)> (visited Dec 5, 2008).

<sup>70</sup> The most common online resources in this area are the ICSID home page, available online at <<http://icsid.worldbank.org>> (visited Dec 5, 2008); the Investment Treaty Arbitration home page, available online at <<http://ita.law.uvic.ca>> (visited Dec 5, 2008); the Transnational Dispute Management home page, available online at <<http://www.transnational-dispute-management.com>> (visited Dec 5, 2008); the NAFTA Claims home page, available online at <<http://www.naftaclaims.com>> (visited Dec 5, 2008); and Oxford UP's Investment Claims home page, available online at <<http://www.investmentclaims.com>> (visited Dec 5, 2008).

<sup>71</sup> OGE MID (oil, gas, energy, mining, infrastructure, and investment disputes) is the most prominent example. On the changes the internet brings to the way academic discussion is

therefore are constantly in the spotlight of those communities that have an impact on their reappointment. This public observation exercises additional pressure on arbitrators to render impartial and well-reasoned awards that live up to the expectations of the parties and the general public. Arbitrators who do not live up to such standards will be seen by the relevant community to have fallen short in that regard, with consequent effects on their careers. Future appointments as tribunal chairperson, president, or presiding arbitrator almost certainly will be curtailed, if they do not disappear completely. If an arbitrator becomes branded as distinctly “pro-state” or “pro-investor,” party appointments will be channeled accordingly. In the latter case that individual’s reputation for such apparent bias will undercut his or her influence within tribunals, which over time inevitably will decrease that individual’s market appeal. No discerning party or counsel will want to appoint as arbitrator someone unlikely to enjoy sincere respect for intellectual integrity within a tribunal. Thus reputational damage, made quicker and easier by public scrutiny, is arguably an effective mechanism ensuring the impartiality and independence of arbitrators and their objectivity in applying international law.

The historical record further supports the legitimacy of arbitration as a dispute-settlement mechanism for investment-treaty disputes. Far from being perceived as casting the legitimacy of dispute resolution into doubt, arbitration has served as an accepted system of dispute resolution in public international law and has been tested and accepted by states over centuries.<sup>72</sup> Thus, modern interstate arbitration grew into a sophisticated system much before private-law arbitration did. Starting with the Jay Treaty of 1794 between the UK and the US, public international law arbitration has flourished and grown into and beyond the twentieth century. Thus, the establishment of an international institution—the Permanent Court of Arbitration, which could administer arbitrations between states—was considered one of the great successes of the Hague Peace Conferences of 1899 and 1907.<sup>73</sup> Interstate arbitration was also the precursor of the international courts that later came into existence, in particular the Permanent Court of International Justice that took up its work in 1922 and the

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structured in international law and investment arbitration, see generally José E. Alvarez, *The Democratization of the Invisible College*, available online at <<http://www.asil.org/ilpost/president/pres071108.html>> (visited Dec 5, 2008).

<sup>72</sup> See generally John Graham Merrills, *International Dispute Settlement* (Cambridge 4th ed 2005); John Graham Merrills, *The Contribution of the Permanent Court of Arbitration to International Law and to the Settlement of Disputes by Peaceful Means*, in Phyllis Hamilton, ed, *The Permanent Court of Arbitration: International Arbitration and Dispute Resolution: Summaries of Awards, Settlement Agreements and Reports 3* (Kluwer centenary ed 1999). See also Lori F. Damrosch et al, *International Law: Cases and Materials* 836–38 (West 4th ed 2001).

<sup>73</sup> See Shabtai Rosenne, ed, *The Hague Peace Conferences of 1899 and 1907 and International Arbitration: Reports and Documents* 83–88 (TMC 2001).



International Court of Justice (“ICJ”) that followed in 1946. The strong support of states to resolve disputes through arbitration thus underscores the fact that states considered arbitration as one option for dispute resolution, and surely one that was no less proper or legitimate than settling disputes in a permanent court.

In addition, the legitimacy of investment-dispute arbitration rests, to a large extent, on the fact that the parties to the proceedings can participate in the appointment of the arbitrators. This ensures that the decision-making process is not perceived as something wholly extraneous to the parties, but instead as a legitimate mode of resolving disputes. Participation in the appointment of those who decide disputes is particularly important when states are involved in international dispute settlement. Thus, even when submitting a dispute to the ICJ, states that do not have one of their nationals as a titular judge of the court are entitled to appoint a judge ad hoc in order to be represented among the decision makers.<sup>74</sup>

Furthermore, the possibility of appointing decision makers in investment-treaty arbitrations by no means favors the interests of investors over the interests of states. Instead, it ensures that states have, by means of appointing an arbitrator, a certain degree of control over the future direction of investment arbitration. They can thereby react to jurisprudential developments of which they disapprove by appointing individuals who support a line of thinking and reasoning that is aligned with the understanding states have of the way investment treaties should be applied and interpreted. The possibility of influencing the appointment of arbitrators on an ad hoc basis is all the more important for states as it is one of the few ways in which they can influence the direction of investment jurisprudence after an investment treaty has been signed.

Certainly, all contracting parties can get together and formally change an investment treaty or agree by other binding means on the interpretation to be given to certain investor rights.<sup>75</sup> Similarly, the contracting parties can establish treaty organs, like NAFTA’s Free Trade Commission, that are empowered to issue such interpretations and thereby steer investment tribunals into directions

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<sup>74</sup> Statute of the International Court of Justice (June 26, 1945), art 31, 33 UN Treaty Ser 99.

<sup>75</sup> See, for example, *National Grid v Argentina*, UNCITRAL, Decision on Jurisdiction of (June 20, 2006) ¶ 85, observing that

after the decision on jurisdiction in *Siemens*, the Argentine Republic and Panama exchanged diplomatic notes with an “interpretative declaration” of the MFN clause in their 1996 investment treaty to the effect that, the MFN clause does not extend to dispute resolution clauses, and that this has always been their intention.

Such understandings on the interpretation of investment treaties between the contracting states are binding as subsequent understandings under Article 31(3)(a) and (b) of the Vienna Convention on the Law of Treaties. See, for example, *Methanex*, NAFTA at part IV, ch C, ¶¶ 20–22.

that are in tune with the states parties' intentions.<sup>76</sup> Yet such changes require the consent of all contracting parties, which is often quite difficult to achieve because, once an investment treaty is in force, the parties may have different incentives and interests compared with the situation that existed when they entered into the treaty.

Influencing investment jurisprudence by means of the appointment process might, by contrast, be easier to achieve. Thus, a permanent court with tenured judges that are not removable might result in the creation of an institution that potentially restricts state sovereignty more significantly than arbitrators allegedly do today. The establishment of a permanent court that is even less deferential to state sovereignty than contemporary arbitration, therefore, may make the system of investor-state dispute settlement even less acceptable to states and thus less legitimate.<sup>77</sup> In any case, the capacity of states to appoint arbitrators in investment-treaty arbitration counters any potential pro-investor bias that the investor-appointed arbitrator might evince. In the end, the resolution of the dispute thus will be grounded in accepted modes of applying and interpreting international law and in the application of this law to the facts as submitted by the parties. It is no more and no less biased than the settlement of investment disputes in an international court.

## V. CONCLUSION

Overall, states seem to accept that international investment treaties and investment-treaty arbitration are legitimate, even if they occasionally disagree with some of the decisions arbitral tribunals reach on some of the finer points of international investment law. They sometimes react negatively to such decisions and adapt their future investment-treaty practices by introducing language that restates the content of standard investors' rights. As an example, the US 2004 Model Bilateral Investment Treaty contains, in reaction to certain decisions of arbitral tribunals, language that concretizes fair and equitable treatment or the concept of indirect expropriation.<sup>78</sup> Such reactions by states should, however, not be read as casting doubt on the legitimacy of the entire system of investment-treaty protection and arbitration. They are rather part of a dynamic

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<sup>76</sup> See Gary H. Sampliner, *Arbitration of Expropriation Cases Under US Investment Treaties: A Threat to Democracy or the Dog that Didn't Bark?*, 18 ICSID Rev Foreign Inv L J 1, 30–32, 43 (2003); Patrick G. Foy, *Effectiveness of NAFTA's Chapter Eleven Investor-State Arbitration Procedures*, 18 ICSID Rev Foreign Inv L J 44, 99–103, 108 (2003) (both arguing that such mechanisms are effective).

<sup>77</sup> Compare Eric Posner and John Yoo, *Judicial Independence in International Tribunals*, 93 Cal L Rev 1 (2005), with Laurence R. Helfer and Anne-Marie Slaughter, *Why States Create International Tribunals: A Response to Professors Posner and Yoo*, 93 Cal L Rev 899 (2005).

<sup>78</sup> See Gagné and Morin, 9 J Intl Econ L at 357 (2006) (cited in note 17); Kantor, 21 J Intl Arb at 383 (2004) (cited in note 17). See generally Schwebel, 3 Transnatl Disp Mgmt 1 (cited in n 17).

that we can equally witness in the domestic realm in the interaction between the judiciary and the legislature. There, just as in investment-treaty arbitration, the legislature may “correct” developments in the jurisprudence that it did not foresee or with which it does not agree.

The more drastic reactions of states, such as terminating investment treaties or withdrawing from the ICSID Convention, by contrast, are a phenomenon that seems to be limited to a minority of states and can often be explained more by the countries’ internal political situation rather than a more widespread view of a lack of legitimacy of international investment law and arbitration. Above all, the situation today differs considerably from the times of the New International Economic Order in the 1970s when developing countries and the socialist bloc attempted, through UN General Assembly resolutions, to do away with the protection of alien property under international law and attacked the very basic consensus on the desirability of the protection of property by international law and the submission of states to international dispute settlement.<sup>79</sup> Today, by contrast, most states do not espouse such extreme views.<sup>80</sup> Consequently, there is no reason to view the isolated opposition of some states to international investment law as an indicator of a more universal discontent or a firm basis upon which to question the legitimacy of this field of international law.

What should, after all, not be forgotten in this debate is that both capital-importing and capital-exporting countries derive benefits from increased flows of foreign investment. Apart from the transfer of technology connected to foreign investment, the creation of employment, additional tax revenue, etc., investment treaties create a legal infrastructure for the functioning of a global market economy by protecting property rights, offering contract protection, establishing nondiscrimination as a prerequisite for competition through national and most-favored-nation treatment, and making effective dispute-settlement mechanisms.<sup>81</sup> Perfect market conditions presupposed, this leads to the efficient allocation of capital, economic growth, and development, and benefits both

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<sup>79</sup> See Rudolf Dolzer, *Eigentum, Enteignung und Entschädigung im geltenden Völkerrecht* 24 (Springer 1985). More generally on the politics and economics connected with the New International Economic Order, see Jeffery A. Hart, *The New International Economic Order* (St. Martin’s 1983); Jagdish N. Bhagwati, *The New International Economic Order* (MIT 1978).

<sup>80</sup> See Thomas W. Wälde, *A Requiem for the “New International Economic Order”: The Rise and Fall of Paradigms in International Economic Law and a Post-Mortem with Timeless Significance*, in Gerhard Hafner and Gerhard Loibl, eds, *Liber Amicorum: Professor Ignaz Seidl-Hohenveldern in Honour of His 80th Birthday* 771 (Kluwer 1998).

<sup>81</sup> Stephan Schill, *Tearing Down the Great Wall: The New Generation Investment Treaties of the People’s Republic of China*, 15 *Cardozo J Intl & Comp L* 73, 116–18 (2007).

capital-exporting and capital-importing countries through an increase in overall well-being.<sup>82</sup>

Certainly, investment-treaty disputes today touch on intricate questions that can go to the heart of a state's public policymaking. Investment treaties can affect the way host states govern, legislate, and adjudicate and can have a profound impact on local populations. Disputes about the supply of public-utility providers, for example, or disputes arising out of measures for the protection of the environment, directly affect the host state's society. As a consequence, those affected by the outcome of such disputes have an interest in being informed about or even in participating in investment-treaty arbitrations. This legitimate concern can and should, however, be accommodated in the current system of international investment protection. Steps towards an accommodation of such interests consist, for example, in the increased transparency of investment-arbitration proceedings and investment-treaty awards and the participation of third parties as *amici curiae*.<sup>83</sup> Such concerns, however, do not require a fundamental redesign of the entire system of international investment protection.

While aspects of the system should be critically observed and evaluated, the system design as such faces fewer fundamental concerns than critical voices purport. Instead, critics should look to the outcomes of arbitration proceedings in order to evaluate the legitimacy of international investment protection and the capacity of arbitrators to live up to the standards of independence, impartiality, and judicial judgment. Arbitrators not only achieve efficient and effective dispute settlement but they also, through their independent and impartial application of the governing law, foster the international rule of law and an investment-friendly environment. It is also true that investment jurisprudence leaves states the necessary leeway to implement their policy choices and to legislate in a self-

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<sup>82</sup> On the connection between institutions and growth, see generally Daron Acemoglu, Simon Johnson, and James Robinson, *Institutions as the Fundamental Cause of Long-Run Growth*, in Philippe Aghion and Steven N. Durlauf, eds, *Handbook of Economic Growth* 385 (Elsevier 2005), pre-publishing working paper available online at <<http://www.nber.org/papers/w10481>> (visited Dec 5, 2008); Dani Rodrik, Arvind Subramanian, and Francesco Trebbi, *Institutions Rule: The Primacy of Institutions over Geography and Integration in Economic Development*, 9 *J Econ Growth* 131 (2004).

<sup>83</sup> On issues of transparency in investment treaty arbitration see generally Christina Knahr and August Reinisch, *Transparency versus Confidentiality in International Investment Arbitration—The Biwater Gauff Compromise*, 6 *L & Practice Intl Courts & Tribs* 97 (2007); Jack J. Coe, *Transparency in the Resolution of Investor-State Disputes—A Story of Adoption, Adaptation, and Evolving Expectations*, 54 *Kan L Rev* 1339 (2006). See also Carl-Sebastian Zoellner, *Third-Party Participation (NGOs and Private Persons) and Transparency in ICSID Proceedings*, in Rainer Hofmann and Christian J. Tams, eds, *The International Convention for the Settlement of Investment Disputes (ICSID)—Taking Stock After 40 Years* 179, 180, 192 (Nomos 2007) (cautioning that investor-state arbitration, having origins in private commercial arbitration, is highly confidential, and suggesting ways to build in greater transparency to the procedures).

determined and sovereign manner. If one prefers, by contrast, a world in which property interests must yield to any other public interest, where the state's contractual promises have no real value in the face of changed political preferences and where good governance standards cannot be enforced, one can do away with international investment treaties and investment-treaty arbitration. This, however, would hardly lead to more legitimacy in international investment relations, but rather to a chill in the global economy that is not in the interest of host states or their populations. In general, investment treaties and investor-state arbitration therefore constitute a legitimate mechanism for structuring and stabilizing international investment relations without institutionalizing a pro-investor bias or disregarding the host state's legitimate power to regulate in the public interest.