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Investment Treaty Arbitration and Public Law

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Investment Treaty Arbitration and Public Law

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General Editor's Preface

Some of the most important substantive developments in international law are taking place in the arbitral tribunals that are adjudicating upon claims arising from bilateral investment treaties. Questions such as the limits of the right of a state to regulate its economy, the balancing of private rights against public interests, and the adequacy of governmental proceedings to meet the emerging requirement of 'transparency' in international law are being raised in, and settled by, these tribunals. Indeed, this is perhaps the most active and rapidly developing of all areas of international law at this moment. The paradox is that these questions of enormous significance to the public order of states are being decided by tribunals whose members are appointed by the investor and the government in dispute and whose proceedings, and even whose very existence, may be private, often with little or no opportunity for public comment upon or scrutiny of the proceedings.

This fine study by Dr Van Harten addresses the issues arising from this private adjudication of questions of public order. He analyses the issues of principle arising from this phenomenon, and the measures that are being taken to increase the opportunities for public participation in these arbitrations. Readers may not agree with all of his views and conclusions, but as tribunals struggle with these crucial issues they can only be helped by the clarity and insights of this robust and timely study.

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Preface

This book is an analytical and institutional study of the recently emerged system of investment treaty arbitration. Its central claim is that the system is unlike other regimes of public law in that it uses the model of private arbitration rather than that of a tenured judiciary to decide finally what legislatures, public administrations, and courts may lawfully do in the exercise of regulatory powers. Moreover, for this reason the system is flawed, above all because it submits the sovereign authority and budgets of states to formal control by adjudicators who may be suspected—because they are untenured and because only one class of parties can bring claims—of interpreting investment treaties broadly in order to expand the system's appeal to potential claimants and, in turn, their own prospects for future appointment. And while this perceived bias may be effectively dispelled by the reputations of individual arbitrators for fairness and balance, this is none the less an unreliable basis on which to found a system that could otherwise make an important contribution to the legal system of a global economy.

This is no doubt a controversial claim and it is not one that I expected to make when I embarked on this project. My original aim was to show comprehensively that the system is a 'public law' phenomenon as contrasted against other perspectives on the system, and that it is more akin to domestic administrative or constitutional law than to the other potential comparators of commercial arbitration, human rights, and classical public international law. In constructing the argument, however, and especially in light of comments received from the anonymous reviewers of the book, it became clear that there was a more important case to be made about the system's integrity as a form of adjudicative government. Many criticisms, not all valid, have been levelled against investment treaty arbitration, particularly in the debates since the late 1990s in the United States and Canada about NAFTA arbitration, in many other developed countries about the OECD's proposal for a Multilateral Agreement on Investment, and more recently in those developing and former communist countries that have been most targeted by investor claims. In this book, the objective is to provide a more focused and detailed explanation for why certain criticisms, above all those regarding judicial independence, are particularly germane to the present system, and not to other international regimes, because of its unique use of private arbitration and state liability in the regulatory sphere.

It is not enough to criticize without offering alternatives and so, in the end, the book makes a case for political reform. In particular, the analytical discussion supports and culminates in a proposal for institutional reform that would, it is argued, satisfy the principles of judicial decision-making that are lacking in the present system. The proposal that is elaborated is not the only avenue available to remedy

the system's problems, of course, but in my estimation it would at least introduce an adequate degree of judicial accountability and independence, without which the system's promise of the rule of law in a global economy is vacuous.

The book is aimed at a mixed audience although its tone and orientation is generally critical and academic. An effort has been made to express ideas in an accessible way and not to assume detailed prior knowledge, although the writing may prove dense at times and for this I ask the reader's tolerance and forgiveness. For practitioners, the book offers a framework by which to analyse investment disputes and characterize the adjudicative process, with implications for the interpretation of key concepts and standards and for the use of domestic public law as an analogous source of legal principles and doctrines. Detailed case references are included in Chapters 4, 5, and 6 of the book, in particular regarding the issues of parallel claims and forum-shopping, the core standards of review, and the interpretive stances adopted by different tribunals in cases to date.

It may be helpful to disclose at this stage a few points about referencing. In the notes the broad approach has been to list relevant sources in chronological order although there are exceptions to this, such as where sources that exemplify the point that is made in the body of the text are listed ahead of more general references. With respect to investment treaty cases, I have separated cases pursuant to the North American Free Trade Agreement from those pursuant to other investment treaties where there appeared to be value in doing so, mainly on the ground that NAFTA Chapter 11 is developing its own self-contained and generally more rigorous jurisprudence. Finally, in the references, I have typically erred in favour of inclusion—where the subject-matter has received significant attention elsewhere.

Many (probably the great majority) of investment treaty awards, and all those reviewed in this study, are publicly available although in some cases only via the internet. My practice has been to include award publication details for as many of these five reporters as possible: ICSID Review—Foreign Investment Law Journal (ICSID Rev), International Legal Materials (ILM), International Law Reports (ILR), ICSID Reports (ICSID Rep), and World Trade and Arbitration Materials. In rare cases, details for other reporters are also listed. Where awards or case materials are available only via the internet, I have attempted to refer the reader to as many of the widely used websites as possible, noting the case number or (where no case number is available) the arbitration rules under which the claim was filed. For readability, with respect to investment treaty awards, I refer in the text and bibliography to abbreviated names of websites rather than the pinpoint website address, with the full address details laid out in the List of Key Websites that follows the List of Abbreviations (below). For other documents that are available only by internet, I have included the pinpoint address as of 9 September 2006. Note that investment treaty awards are also broadly classified in the references as relating to the 'Merits', 'Jurisdiction', 'Damages', or other matters, with priority given in this order where an award deals with more than one of these subjects.

Those working in this field would be much the poorer without the freely accessible Investment Treaty News (ITN) newsletter, which is produced by Luke Eric Peterson and funded, as I understand, by public interest organizations and foundations. I have found this service to be a valuable resource. Also, in accessing the text of awards and other materials, my personal preference is to use Andrew Newcombe's 'Investment Treaty Arbitration' website for investment treaty awards and Todd Weiler's 'NAFTA Claims' website for awards and materials in NAFTA arbitration.

The original research for the book was conducted from 2002 to 2006 during my PhD studies in Law at the London School of Economics. Although this book is based on my PhD thesis, it has undergone substantial revision largely in response to the astute comments and criticisms of the anonymous reviewers at Oxford University Press. I also thank Sally McCann, Jodi Towler, and the other members of the editorial team at OUP for their care and attention to the manuscript, and especially John Louth for commissioning and shepherding the book to publication. I am deeply indebted to my PhD supervisors: Martin Loughlin and Deborah Cass, both of whom showed a dedicated interest in my work and provided many fresh ideas and insights. My PhD examiners, Peter Muchlinski and Sol Picciotto, carefully reviewed the thesis, and their thoughtful advice led to numerous improvements. I also benefited from discussions with other faculty members and colleagues; in particular, I thank Joanna Benjamin, Chris Greenwood, Virginia Mantouvalou, Loukas Mistelis, Antoine Romanetti, Rick Rawlings, Ken Shadlen, Gerry Simpson, Francis Snyder, and N'Gunu Tiny. Further, I wish to thank the many practitioners who took the time to speak to me about their work and the system, especially Sir Jeremy Carver, Norah Gallagher, Meg Kinnear, and J Christopher Thomas. All opinions expressed and any errors made in the book are, of course, entirely my own.

During my PhD studies, I received generous financial support from the Social Sciences and Humanities Research Council of Canada, the UK Overseas Research Students Awards Scheme, the LSE Research Studentship Fund, and the Sir Richard Stapley Educational Trust. I also received funding from the William Robson Memorial Fund at LSE towards the publication of my thesis as a book. I am very grateful for this support. Further, I acknowledge that during my PhD studies earlier work of mine on the topic was published in the European Journal of International Law (vol 17, 121, with Martin Loughlin), the Review of International Political Economy (vol 12, 600), Arbitration International (vol 21, 493), and International Trade Law and Regulation (vol 9, 139).

I reserve special thanks firstly to the Honourable Dennis R O'Connor, Associate Justice of the Ontario Court of Appeal, with whom I had the pleasure to work for several years, and to the other judges of the Court of Appeal under whom I clerked, all of whom instilled in me a high level of respect for judicial institutions and for the integrity of individual judges. I also wish to thank the lawyers and other staff with whom I worked on the Walkerton Inquiry and the Arar Inquiry in

Canada, especially Paul Cavalluzzo, Marc David, Ron Foerster, Brian Gover, and Freya Kristjanson for their insights into the practice and the politics of law. My greatest debt is to my family and above all my parents, who have supported and encouraged me in every possible way, and to the inspiring memory of my grandfather, Vic Hugh, to whom this book is dedicated. Lastly, I wish to thank Susanne, whose generosity of spirit and enthusiasm for my work I do not deserve, but very truly appreciate.

Contents

List of Abbreviations

AC	Appeal Cases Law Reports (United Kingdom)
ACHR	American Convention on Human Rights
AJIL	American Journal of International Law
All ER	All England Law Reports
ASEAN	Association of Southeast Asian Nations
B & C	Barnewall & Cresswell's King's Bench Reports (United Kingdom)
B & S	Best & Smith's Queen's Bench Reports (United Kingdom)
BCAC	British Columbia Appeal Cases (Canada)
BC CA	British Columbia Court of Appeal (Canada)
BCLR	British Columbia Law Reports (Canada)
Beav	Beavan's Rolls Court Reports (United Kingdom)
BIT	bilateral investment treaty
CA	Court of Appeal (United Kingdom)
CCC	Canadian Criminal Cases
CELR	Canadian Environmental Law Reports
CIEL	Center for International Environmental Law
CML Rev	Common Market Law Review (Europe)
Cons TS	Consolidated Treaty Series
CPR	Canadian Patent Reporter
CTS	Canadian Treaty Series
CUP	Cambridge University Press
DC The Hague	District Court of the Hague (Netherlands)
DDC	United States District Court for the District of Columbia
DFAIT	Department of Foreign Affairs and International Trade (Canada)
DLR	Dominion Law Reports (Canada)
ECHR	European Convention on Human Rights
ECJ	European Court of Justice
ECLAC	Economic Commission for Latin American and the Caribbean
ECR	European Court Reports
ECtHR	European Court of Human Rights
EJIL	European Journal of International Law
ER	English Reports
ESC	Economic and Social Council (United Nations)
EU	European Union
Eur TS	European Treaty Series
FCR	Federal Court Reports (Canada)
FDI	foreign direct investment
GA	General Assembly (United Nations)
GAOR	Official Records of the General Assembly (United Nations)
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
HL	House of Lords (United Kingdom)

HLC	Clark & Finnelly's House of Lords Reports (United Kingdom)
ICC	International Chamber of Commerce
ICJ	International Court of Justice
ICLQ	International and Comparative Law Quarterly
ICSID	International Centre for Settlement of Investment Disputes
ICTY	International Criminal Tribunal for the Former Yugoslavia
IHRR	International Human Rights Reports
IJC	International Joint Commission (Canada–United States)
ILC	International Law Commission
ILM	International Legal Materials
ILR	International Law Reports
IMF	International Monetary Fund
ITA	Investment Treaty Arbitration
Iran–US CTR	Iran–US Claims Tribunal Reports
KB	King's Bench Law Reports (United Kingdom)
LN	League of Nations
LNTS	League of Nations Treaty Series
LSE	London School of Economics
MAI	Multilateral Agreement on Investment
MFN	most favoured nation
NAFTA	North American Free Trade Agreement
NC	North Carolina
Nfld	Newfoundland and Labrador
NGO	non-governmental organization
NYU	New York University
OAC	Ontario Appeal Cases (Canada)
OECD	Organization for Economic Co-operation and Development
OLRC	Ontario Law Reform Commission (Canada)
Ont CA	Court of Appeal for Ontario (Canada)
Ont SCJ	Ontario Superior Court of Justice (Canada)
OR	Ontario Reports (Canada)
OUP	Oxford University Press
PCIJ	Permanent Court of International Justice
QB	Queen's Bench Law Reports (United Kingdom)
RIAA	Reports of International Arbitral Awards
RPR	Real Property Reports (Canada)
RSC	Revised Statutes of Canada
S Ct	Supreme Court Reporter (United States)
SCC	Stockholm Chamber of Commerce
SCR	Supreme Court Reports (Canada)
SICE	Sistema de Información sobre Commercio Exterior (Foreign Trade Information System)
Swan	Swanston's Chancery Reports (United Kingdom)
Swed Svea CA	Swedish Svea Court of Appeal
TRIMs	Trade-Related Investment Measures
UAE	United Arab Emirates
UK	United Kingdom

UKTS	United Kingdom Treaty Series
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNTS	United Nations Treaty Series
US	United States of America
US (case citations)	United States Supreme Court Reports
USC	United States Code
USTR	United States Trade Representative
Wheat	Wheaton's Supreme Court Reports (United States)
WLR	Weekly Law Reports (United Kingdom)
WTO	World Trade Organization

List of Key Websites

Department of Foreign Affairs and International Trade (Canada) (DFAIT) www.international.gc.ca/tna-nac/gov-en.asp (awards and documents in NAFTA claims against Canada).

International Centre for the Settlement of Investment Disputes (ICSID) www.worldbank.org/icsid/cases/cases.htm (awards in ICSID arbitrations).

Investment Claims www.investmentclaims.com (awards in investment treaty arbitrations).

Investment Treaty Arbitration (ITA) ita.law.uvic.ca/news.htm (awards in investment treaty arbitrations).

NAFTA Claims www.naftaclaims.com (awards and documents in NAFTA arbitrations).

US State Department www.state.gov/s/l/c3741.htm (awards and documents in NAFTA claims against the United States).

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1

Introduction

Argentina's economy collapsed in December 2001. It had been in a major slump since the Asian financial crisis of 1998, largely because its currency regime—which pegged the peso to the US dollar—had crippled Argentine exporters against their foreign competitors. From mid-2001, (US)$20 billion was moved out of Argentina in speculation of a devaluation of the peso and, in late November, the country's central bank reserves fell by $2 billion in a single day amidst massive capital flight. In response, the government froze bank accounts and imposed wage and capital controls. In turn, on 7 December, the International Monetary Fund blocked the release of $2 billion to Argentina, blaming the government's failure to impose austerity measures and other reforms. This sent the economy into free-fall. Jobs disappeared en masse as hundreds of businesses went bankrupt. Wages of government workers were cut by 40 per cent and $3 billion in private pensions was redirected by the government to service the national debt. Argentinians blockaded streets and beat at the doors of the banks in desperation. Popular insurrection was espoused at 'neighbourhood assemblies' where anger was directed at the 'tens of billions taken away by the power suppliers [and] the profits that the telephone companies gained every year'. In just two weeks at the end of December five presidents were forced from office. That month, 30 people died in street protests and looting, and by January the government was distributing emergency food aid.[1]

In the face of financial catastrophe, the newly appointed government of President Duhalde announced on 6 January 2002 that it would allow the peso to decline in value against the dollar, thus cutting national savings by 70 per cent overnight, and attempt to renegotiate the country's debt 'in order to guarantee the operation of the National State in accordance with available resources'.[2] For many

[1] M Barrow, 'Argentina puts bankers to the test' *The Times* (7 August 2001) 21; P Wheatcroft, 'Argentina loan' *The Times* (23 August 2001) 23; G Gamini, 'Argentina faces debt default as IMF stops loan' *The Times* (7 December 2001) 21; L Paterson, 'Argentina holds make-or-break talks with IMF' *The Times* (8 December 2001) 56; G Gamini, 'Rioters killed as Argentina slides into chaos' *The Times* (20 December 2001) 17; S Calloni, 'Frágil, el equilibrio politico, económico y social en Argentina' *La Jornada* [Mexico] (21 January 2002). See also JF Hornbeck, 'The Argentine Financial Crisis: A Chronology of Events' (US Congressional Research Service Report No RS21130, 31 January 2002).

[2] Emergency Law No 25.561 (6 January 2002) (Argentina); National Decree No 256/2002 (9 February 2002) (Argentina).

months afterwards, Argentina was mired in severe crisis, described by the *Economist* as 'a decline without parallel' and 'an economic collapse to match the Great Depression of the 1930s'.[3] By November 2002 more than half the population was living in poverty. However, by 2004 the value of the peso stabilized and the economy began to recover. And, early in 2005, the government reached an agreement with bondholders to restructure over $100 billion in debt, paying about 34 cents on the dollar.[4] The reforms of early 2002 thus proved successful in at least averting a total collapse and allowing the country to emerge, in the words of the government, 'with its republican form of government intact'.[5]

Yet an important chapter in this story is still unfolding. Since 2001 foreign investors in Argentina—such as Enron and Azurix of the United States; Vivendi and Suez of France; Siemens of Germany; Gas Natural of Spain; and National Grid of the United Kingdom—have brought dozens of legal claims against the country under an obscure system of international arbitration, established by an array of investment treaties concluded in the 1990s between Argentina and the major capital-exporting states of Western Europe and North America. By 2006 more than 30 claims were pending against Argentina for an estimated $17 billion in claimed compensation, amounting to nearly the entire annual budget of the national government.[6] Many of the firms had purchased assets in the utilities sectors—water, gas, electricity—in the heydey of the privatizations of the early 1990s, when President Carlos Menem and his finance minister, Domingo Cavallo, carried out a shock programme of liberalization, deregulation, and sale of state assets. At the time, the privatization contracts signed by many foreign investors stipulated that utility rates would be denominated in dollar-pegged pesos and that they would rise or fall alongside the US producer price index. Ten years later, at the nadir of the economic crisis, the government ordered utility rates to be translated into devalued pesos and then frozen so that wage earners and businesses could afford basic services. This left the finances of many investors in tatters.

[3] 'A decline without parallel-Argentina's collapse' *The Economist* (2 March 2002); 'Liberty's great advance' *The Economist* (28 June 2003).

[4] U Goni, 'Debt-ridden middle classes ready to desert Argentina' *The Sunday Times* (6 January 2002) 24; T Walker, 'Argentina panics as banks close' *The Sunday Times* (21 April 2002) 25; G Gamini, 'Argentina slides deeper into mire of debt' *The Times* (15 November 2002) 22; T Hennigan, 'Argentina defaults on $2.9 billion debt' *The Times* (10 September 2003) 13; A Thomson, 'Argentina revels in power of peso' *The Financial Times* (30 June 2005) 43.

[5] *CMS Gas Transmission Company v Argentine Republic* (Application for Annulment) (8 September 2005), ICSID Case No ARB/01/8, para 23, online: ITA.

[6] LE Peterson, 'Argentine bondholders girding for multi-billion dollar investment treaty claim' *Investment Law and Policy News Bulletin* (10 June 2005); V Lowe, 'Some Comments on Procedural Weaknesses in International Law' (2004) 98 Am Soc'ty Int'l L Proc 37, 39. One group of foreign bondholders announced that it would bring a claim on behalf of its members for an estimated $25 billion, although the claim apparently never materialized: A Thomson, 'Argentine creditors toughen stance' *The Financial Times* (17 February 2005) 39; OC Pell, White & Case LLP, 'Recent Argentine Legislation and Argentine Bondholders' (Memorandum to the Global Committee of Argentine Bondholders, 15 February 2005).

The question underlying these claims by foreign firms is in a sense very straightforward: who should bear the cost of losses suffered by investors during the crisis and subsequent reforms? Did the Argentine government act rashly or unfairly burden foreign companies in its 'pesofication' of the monetary system? Or were the companies foolish to purchase the assets and assume debt in foreign currency on the risk that an economic collapse might provoke emergency restructuring by the state? An initial answer was provided in May 2005 by the investment treaty tribunal in *CMS v Argentina*, when three arbitrators ordered Argentina to pay $133 million to CMS Energy, a US-based investor in the gas sector.[7] The arbitrators concluded among other things that, regardless of whether the government acted in good faith in adopting policies that harmed CMS Energy's business, Argentina bore an 'objective' responsibility under international law to ensure a stable and predictable business environment for foreign investors, even in the midst of financial meltdown.[8] Further, the arbitrators decided that the investor's right to compensation was not extinguished or moderated by circumstances of public emergency.[9]

In contrasting these controversial findings of the *CMS v Argentina* tribunal against the tumultuous social and economic breakdown in Argentina, my aim is not to argue that the award was incorrect in law and imprudent in policy (although in my view it probably was), but rather to show that private arbitrators have a new-found power to review and discipline states, and to convey an impression of how this power interacts with the lives of ordinary people and the way they are governed. It is true that the raft of claims against Argentina was an exceptionally dramatic episode in the recent expansion of investment treaty arbitration[10] but it remains indicative of a much wider phenomenon.

The system of investment treaty arbitration

Little more than a decade ago, investment treaty arbitration was virtually unknown beyond the circles of those who were involved, one way or another, in the negotiation of investment treaties. The system entered the public mindset in the mid-1990s after several claims were brought by investors under Chapter 11 of the North American Free Trade Agreement (NAFTA) and, eventually, under numerous bilateral investment treaties. Since then, the system has expanded rapidly. In the last ten years investors have launched more than 150 claims under investment treaties, mainly against developing and former communist countries,

[7] *CMS Gas Transmission Company v Argentine Republic* (Merits) (12 May 2005), 44 ILM 1205, 17(5) World Trade and Arb Mat 63 [cited as *CMS v Argentina*], para 53–6.

[8] *CMS v Argentina* (n 7 above) para 274–84.

[9] *CMS v Argentina* (n 7 above) para 387–92.

[10] The term 'investment treaty arbitration' (or 'investor–state arbitration') refers to compulsory arbitration, pursuant to an investment treaty, between a state and an investor at the option of the latter. The term also distinguishes 'treaty' arbitration from the contract- or legislation-based variants of investment arbitration.

and most are still pending. This has generated a fourteen-fold spike in the rate of claims at the World Bank's Centre for Settlement of Investment Disputes (ICSID), for example.[11] Moreover, the subject-matter of claims under investment treaties has engaged a very diverse range of business and regulatory concerns. Under NAFTA, claims were brought against Canada, Mexico, or the US in disputes arising from a Canadian parliamentary ban on hazardous waste exports, a Mexican state governor's designation of an ecological park, and a Mississippi judge's conduct of a jury trial.[12] Under bilateral investment treaties, tribunals have been established to resolve disputes involving the issuance of radio broadcasting licences in the Ukraine, the annulment of permits for an industrial plant in Peru, and the denial of VAT refunds in the oil sector in Ecuador.[13]

The question at the heart of this book is what is the essential character and significance of this new system? In response, three claims are advanced. The first is that the advent of investment treaty arbitration is a revolutionary development in international adjudication. The second is that the system's crucial importance is that—unlike any other form of international arbitration—it is a method of public law adjudication, meaning that it is used to resolve *regulatory* disputes between individuals and the state as opposed to reciprocal disputes between private parties or between states. Third, and most troubling, is that the system's unique use of private arbitration in the regulatory sphere conflicts with cherished principles of judicial accountability and independence in democratic societies; in effect, it taints the integrity of the legal system by contracting out the judicial function in public law.

The more detailed argument in support of these claims may be summarized as follows. States, by concluding investment treaties that allow foreign investors (for the most part multinational firms[14]) to advance international claims against

[11] During the 10 years from 1996 to 2005, 166 claims by investors were registered at ICSID, compared to 35 in the previous 30 years. So recent is the explosion of claims under investment treaties that the UN Conference on Trade and Development could not long ago report: 'There is very little known on the use that countries and investors have made of [bilateral investment treaties]: they have been invoked in few international arbitrations, and presumably in diplomatic correspondence and investor demands. Their most significant function appears to be that of providing signals of an attitude favouring FDI.' UNCTAD, *Trends in International Investment Agreements: An Overview* (UNCTAD Series on Issues in International Investment Agreements, 1999) 47.

[12] *SD Myers, Inc v Government of Canada* (Merits) (13 November 2000), 40 ILM 1408, 15(1) World Trade and Arb Mat 184; *Metalclad Corporation v United Mexican States* (Merits) (30 August 2000), 16 ICSID Rev 168, 40 ILM 36, 5 ICSID Rep 212, 13(1) World Trade and Arb Mat 45; *Loewen Group, Inc and Raymond L Loewen v United States of America* (Merits) (26 June 2003), 42 ILM 811, 7 ICSID Rep 442, 15(5) World Trade and Arb Mat 97.

[13] *Lemire (Joseph Charles) v Ukraine* (Settlement), ICSID Case No ARB(AF)/98/1, online: ITA; *Empresas Lucchetti, SA and Lucchetti Peru, SA v Republic of Peru* (Jurisdiction) (7 February 2005), 19 ICSID Rev 359, 17(3) World Trade and Arb Mat 161, para 18–21; *Occidental Exploration and Production Company v Republic of Ecuador* (Merits) (1 July 2004), 17(1) World Trade and Arb Mat 165, para 32.

[14] However extensive their actual business operations, foreign investors are typically complex legal entities organized as networks of companies (or other legal entities) which I shall refer to as multinational firms or multinational enterprises. As defined by the Organization for Economic Co-operation

states have given arbitrators the authority to resolve regulatory disputes between investors and the state. This authority is in certain respects more powerful than that of any court, domestic or international, because the system piggybacks on the rules and structure of international commercial arbitration instead of adopting a more conventional court-based model. First, as with the public law competence of the courts, arbitrators have comprehensive jurisdiction to review sovereign acts of the state by applying broadly worded standards of review that are open to a range of interpretations and, as such, they are empowered to resolve core matters of public law. Second, because investment treaties utilize the enforcement structure of the New York Convention and the ICSID Convention, the awards of arbitrators are more widely enforceable than any other adjudicative decision in public law. Third, the laws of the major enforcing countries in North America and Europe were revised in the 1980s and 1990s (for the distinct objective of promoting international commercial arbitration) to direct domestic courts to defer to foreign arbitration awards; as a result, arbitrators interpret and apply public law with limited court supervision. Finally, arbitrators are able to award damages as a public law remedy without having to apply the various limitations on state liability that evolved in domestic legal systems to balance the objectives of deterrence and compensation against the competing principles of democratic choice and governmental discretion.

In doing this, states have enabled privately contracted adjudicators to determine the legality of sovereign acts and to award public funds to businesses that sustain loss as a result of government regulation. This undermines basic hallmarks of judicial accountability, openness, and independence. Above all, the lack of security of tenure of arbitrators in a one-sided system of state liability, in which only investors bring the claims and only states pay damages for breach of the treaties, makes the adjudicator dependent on prospective claimants and thus biased, in an objective sense, against respondent governments. That is, because they receive appointments only if investors bring claims, arbitrators may reasonably be perceived as having a financial stake in interpreting investment treaties so as to

and Development (OECD) in its *Guidelines for Multinational Enterprises* (2000) 17–18, multinational enterprises: 'usually comprise companies or other entities established in more than one country and so linked that they may co-ordinate their operations in various ways. While one or more of these entities may be able to exercise a significant influence over the activities of others, their degree of autonomy within the enterprise may vary widely from one multinational enterprise to another. Ownership may be private, state or mixed.' An inherent aspect of multinational firms is their ability to make decisions about the allocation of capital and about production and distribution that transcend the boundaries of national regulation. The integral part played by such firms in organizing capital flows reflects their role as agents of globalization and makes them central actors in investment arbitration. S Timberg, 'International Combines and National Sovereigns' (1947) 95 U Penn L Rev 575, 577–8; AA Fatouros, 'On Domesticating Giants: Further Reflections on the Legal Approach to Transnational Enterprise' (1976) 15 U Western Ontario L Rev 151, 152–4; M Wilkins, 'Defining a Firm: History and Theory' in P Hertner and G Jones (eds) *Multinationals: Theory and History* (1986) 80–1; S Picciotto, 'Introduction: What Rules for the World Economy?' in S Picciotto and R Mayne (eds) *Regulating International Business* (1999) 6–7.

expand the system's compensatory promise for investors. And while the domestic courts of either the host or the home state may be seen to be biased in the resolution of an international investment dispute, it is a step backward to replace them with adjudicators who are perceptibly dependent on private interests in ways that tenured judges are not.

The scope and complexity of the system

Three additional points may be highlighted at this introductory stage. The first is that, while investment treaty arbitration is not a *global* regime in the absence of bilateral investment treaties (BITs) between major capital-exporting states or a multilateral investment code, it should none the less be understood as an international system that is elaborate and well entrenched, that has wide geographic scope, and that governs the bulk of the capital flows into developing and former communist countries. In particular, the system is constituted by the hundreds of bilateral and regional investment treaties currently in force (and mostly concluded in the 1990s[15]) that share three key characteristics. First, each treaty that is part of the system authorizes foreign investors to make and seek enforcement of claims for money damages against the state parties without the claims being vetted by the investor's home state or by an international organization. Second, sovereign acts of the states parties are subjected to broad standards of review that apply to a wide range of governmental activity, giving arbitrators a comprehensive jurisdiction to award compensation to international business in the regulatory sphere. Third, disputes are resolved using a private model of adjudication that originates in the rules and enforcement structure of international commercial arbitration, presenting major challenges to public law principles of judicial accountability, openness, and independence. By consenting to an array of treaties that share these characteristics, most states have by now plugged themselves into the system and, in so doing, they have integrated into their governing apparatus a uniquely international and privately modelled system of public law adjudication.

This leads to the second point that I wish to highlight at this stage. It is that the significance of the system in relation to public law must not be underestimated, although the sheer complexity of the system—incorporating, as it does, a multitude of investment treaties, several major conventions on international arbitration, various sets of arbitration rules, and the domestic arbitration laws of as many as 165 countries—may tend to mask its character in this respect. A review of a recent and quite infamous case may offer a glimpse of this complexity as well as the power that the system bestows on arbitrators. In March 2003 a tribunal

[15] UNCTAD, *Bilateral Investment Treaties—1959–1999* (New York: United Nations, 2000) 1 (the number of bilateral investment treaties rose from 385 in 1989 to 1,857 by 1999); UNCTAD, *World Investment Report 2004* (New York: United Nations, 2004) 221 (2,265 bilateral investment treaties were concluded by the end of 2003, involving 175 countries).

constituted in Sweden ordered the Czech Republic to pay (US)$353 million to an investor that owned a Czech TV broadcasting business.[16] The investor was a Dutch company, CME Czech Republic, that was in turn owned by the cosmetics billionaire Ralph Lauder, an American citizen.[17] The tribunal ordered the Czech Republic to pay damages to Mr Lauder's company after finding that the Czech government, by issuing regulatory advice that prompted CME to divest itself of a popular TV station, had violated the country's bilateral investment treaty with the Netherlands.[18] After failing to have the award set aside in the Swedish courts, the Czechs committed to pay it in full, lest they suffer yet more harm to their reputation in the capital markets.[19] Further, following the claim, other foreign firms brought or threatened claims against the Czech Republic in cases ranging from the collapse of a domestic bank, to an unsuccessful bid for a mobile telephone network, to the seizure of a jet by Czech customs authorities in lieu of back taxes owed by the foreign owner.[20]

For present purposes, the *CME* case is significant for two reasons. First, the case is revealing because the award of $353 million placed an enormous strain on the public finances of the Czech Republic. The amount was roughly equal to the country's entire health-care budget[21] and, adjusted for population size and gross national income, it was equivalent to an award of $19 billion against the United Kingdom, $26 billion against Germany, or $131 billion against the United States.[22] Second, just ten days before the award was issued, a parallel claim by

[16] *CME Czech Republic BV v Czech Republic* (Merits) (13 September 2001), 14(3) World Trade and Arb Mat 109 [cited as *CME* (Merits)].

[17] B Von Hase, 'Do the Right Thing' *The Time Magazine* [London] (13 September 2003) 50.

[18] Agreement on encouragement and reciprocal protection of investments between the Kingdom of the Netherlands and the Czech and Slovak Republic (the Netherlands–Czech Republic BIT) (22 October 1991; entered into force 1 December 1992). The treaty violation arose from the Czech government's regulatory treatment of a Czech TV network that was owned by CME. According to the tribunal, the government in effect destroyed the investment by issuing an interpretation of the law that forced CME to give up its ownership share.

[19] *CME Czech Republic BV v Czech Republic* (2003) 15(5) World Trade and Arb Mat 171 [cited as *CME* (Judgment)] (Svea Svea CA). The Czech Republic applied to set aside the award before the Swedish court of appeal, rather than the Czech courts, because Sweden had been chosen by the arbitration tribunal as the legal seat of the arbitration (the actual hearings were held in Düsseldorf, Germany). LE Peterson, 'Swedish court affirms award against Czech Republic; damages could be taxable' *Investment Law and Policy Weekly News Bulletin* (16 May 2003).

[20] *Saluka Investments BV v Czech Republic* (Merits) (17 March 2006), 18(3) World Trade and Arb Mat 166. S François-Poncet and C Mouawad, 'Final Arbitral Award Rendered in 2003 in SCC Case 49/2002' (2004) 2004:1 Stockholm Arbitration Report 141; LE Peterson, 'Investors emboldened by arbitral verdict against Czech Republic' *Investment Law and Policy Weekly News Bulletin* (11 April 2003); Z Kawaciukova, 'State ordered to pay 10 billion Kc' *The Prague Post* (19 March 2003); R Anderson, 'Tribunal to rule on Czech bank failure' *Financial Times* (8 April 2005) 27.

[21] T Kellner, 'The Informer: Call It the Ronald Lauder Tax', 171(9) *Forbes Magazine* (28 April 2003).

[22] *CME Czech Republic BV v Czech Republic* (Damages) (14 March 2003), 15(4) World Trade and Arb. Mat. 83 and 245, para 80 (separate opinion of I Brownlie). As an aside, in 2006 Ralph Lauder reportedly paid $135 million for Gustav Klimt's *Portrait of Adele Bloch-Bauer I*, the highest price ever paid for a painting: C Vogel, 'Lauder Pays $135 Million, a Record, for a Klimt Portrait' *The New York Times* (19 June 2006).

Mr Lauder himself based on the same case against the Czech Republic, but initiated six months earlier under a Czech-United States investment treaty, was *dismissed* by a separate tribunal.[23] In reviewing the conduct of the Czech broadcasting authorities—very soon after to be condemned by the *CME* tribunal as 'interference', 'coercion', and an 'intentional undermining' of Mr Lauder's investment[24]—this earlier tribunal concluded that it 'did not see any inconsistent conduct on the part of the Media Council which would amount to an unfair and inequitable treatment', that Mr Lauder's allegation was 'rather vague', and that Mr Lauder had acquiesced in his regulatory treatment by failing to 'commence any administrative or other proceedings before the appropriate courts of the Czech Republic in the course of which the issue of the overall attitude of the Media Council in this affair . . . could be addressed and decided'.[25] Thus, two starkly conflicting decisions were issued in the same dispute under similarly worded investment treaties. Mr Lauder, the American investor, lost his personal claim on the basis that the Czech Republic's breach of the treaty was 'too remote to qualify as a relevant cause for the harm'.[26] But Mr Lauder, the Dutch investor, was able to collect damages through a holding company in the Netherlands.[27]

As such, the case demonstrated two peculiarities of the system as a public law phenomenon: its invitation to forum-shopping by investors and, by implication, its vulnerability to the troubling outcome of conflicting awards; as well as the potentially severe fiscal consequences of the power of arbitrators to decide that a state has broken the law and to punish it by ordering payment of compensation to a foreign investor.

The exceptionality of the system

The third point to stress at this stage is that the system is a highly exceptional development in the context of international law. Of course, it is not surprising that disputes may arise between foreign investors and states in a global economy. International investment disputes have existed for as long as people in one country acquired business interests in another, and much of the great social and economic change of the nineteenth and twentieth centuries—European industrialization, the growth of international business, socialist revolution and Third World decolonization, the establishment of new states, the rise and fall of the Soviet Union—expanded the conditions in which investment disputes could

[23] *Lauder (Ronald S) v Czech Republic* (Final Award) (3 September 2001), (2002) 4 World Trade and Arb Materials 35 [cited as *Lauder*].
[24] *CME* (Merits) (n 16 above) para 582, 593, and 611.
[25] *Lauder* (n 23 above) para 261, 273, 287, and 295.
[26] *Lauder* (n 23 above) para 235.
[27] The Czech Republic's application to set aside the award on this point was rejected by the Swedish court of appeal on the basis that Ralph Lauder and CME—the Dutch company controlled by Mr Lauder—were different parties and that their claims could therefore proceed concurrently, even though the substance of the claims was the same: *CME* (Merits) (n 16 above) para 426–33. The Swedish court of appeal was also influenced by the fact that the Czech Republic had refused, at an

arise.[28] To what minimum standard of treatment are foreign investors entitled under international law? To what degree can states support their own industries at the expense of outside competition? Under what conditions can a government expropriate, or regulate, the property of a multinational firm? These questions have driven and plagued debates about international law for well over a century.

On the other hand, it is most surprising that individual investors can now, rather suddenly in the historical context, trigger the compulsory arbitration of international investment disputes. For most of the twentieth century, international courts and tribunals rarely had jurisdiction over disputes concerning state regulation of foreign nationals. Students of international law will be well aware that such disputes were customarily resolved by dispute resolution between states.[29] This might result in a claim of diplomatic protection by the home state of a foreign national against the state whose conduct was in doubt, but such claims were typically settled by negotiation and, exceptionally, by adjudication between states. Moreover, once the states involved arrived at a resolution, individuals were left without further remedy under international law.[30] Thus, foreign investors like other foreign nationals relied on their home state to represent their interests in the international sphere and, faced with 'the arbitrary whim or caprice of state officials' or 'the most flagrant spoliations of private property', they sometimes suffered greatly for this dependence.[31]

These customary arrangements may appear unfair but it should be remembered that they follow from an elemental principle of international society; that is, that a state is the legal representative of the population of its territory.[32] As the legal framework of state-based representation is altered by states, and individuals are allowed to bring claims on their own behalf, some very important questions arise. One set of questions, not the primary focus of this book, springs from the selectivity of such a system. If foreign investors are permitted to claim compensation under international law, why not a migrant worker who is denied access to

early stage, the investor's effort to consolidate the two claims: *CME* (Judgment) (n 19 above) 210 and 242.

[28] AA Fatouros, 'International Law and the Third World' (1964) 50 Virg L Rev 783, 783–94; PT Muchlinski, *Multinational Enterprises and the Law* (Oxford: Blackwell, 1999) 10–11.

[29] JG Merrills, *International Dispute Settlement* (3rd edn, Cambridge: CUP, 1998) 114–15; J Collier and V Lowe, *The Settlement of Disputes in International Law* (Cambridge: CUP, 1999) 6–7.

[30] JL Brierly, *The Law of Nations* (6th edn, Oxford: Clarendon Press, 1963) 277 ('He has no remedy of his own, and the state to which he belongs may be unwilling to take up his case for reasons which have nothing to do with its merits; and even if it is willing to do so, there may be interminable delays before, if ever, the defendant state can be induced to let the matter go to arbitration . . . ').

[31] Quoting, respectively, MS McDougal, HD Lasswell, and L Chen, 'Nationality and Human Rights: The Protection of the Individual in External Arenas' (1973) 83 Yale LJ 900, 906; WL Penfield, 'Address: Is the Forcible Collection of Contract Debts in the Interest of International Justice and Peace?' (1907) 1 Am Soc'ty Int'l L Proc 129, 131.

[32] WW Willoughby, *The Fundamental Concepts of Public Law* (New York: Macmillan, 1924) 307; B Kingsbury, 'Sovereignty and Inequality' (1998) 9 EJIL 599, 601 (noting that state sovereignty is the 'means by which people can express, and be deemed to have expressed, consent to the application of international legal norms and to international institutional competences').

the rights and entitlements of domestic employees, or a refugee who is denied asylum and deported to torture, or an indigenous people whose land is polluted and livelihood destroyed by a multinational firm? None of these alternative scenarios is on the political agenda and, beyond the European Union, nearly all states have strongly resisted the idea of allowing non-investors any such legal status.[33] At present, therefore, the advent of investment treaty arbitration stands out, not as the vanguard of a broad movement to protect individuals in international law, but as an anomalous and exceptionally potent system that protects one class of individuals by constraining the governments that continue to represent everyone else. Designed in this way, the system disadvantages those individuals who stand to benefit from business regulation that is now foreclosed by investment treaties or from other public initiatives, the cost of which is made too high or uncertain by the threat of investor claims.

For these reasons, it is right to subject investment treaty arbitration to careful scrutiny in light of its character not simply as an international system but as a unique form of public law adjudication; that is, as a treaty-based regime that uses rules and structures of international law and private arbitration to make governmental choices regarding the regulatory relationship between individuals and the state. Towards this end, much of this book inquires into the system as it stands: after reviewing the system's historical background in Chapter 2, Chapters 3–5 deal with the fundamental distinction between investment treaty arbitration and commercial arbitration, with the wide-ranging governmental discretion that is wielded by arbitrators, and with the novelty of the system in international law. On the other hand, as is by now fairly clear, the book also incorporates an edge of criticism of the system; from this perspective, Chapter 6 evaluates, and for the most part rejects, the interpretive approaches adopted by arbitrators to date, and Chapter 7 presents the argument that the system fails to satisfy basic standards of judging in public law and elaborates a proposal for reform.

In this last regard, it should be emphasized that the target of criticism in this book is neither the global economy nor foreign investors nor the employment of international law and adjudication to strengthen the confidence of international business or resolve regulatory disputes involving the state. Rather, the target of criticism is the particular way in which states have used a private method of international adjudication to resolve claims that should be finally determined by

[33] Important reforms have taken place to elevate the international status of individuals, especially in human rights law, but they differ greatly in their scope and effectiveness from the right of investors to bring claims under investment treaties; moreover even in EU law, individuals must exhaust local remedies before bringing a claim against a state, whereas many investment treaties remove this duty. D Shelton, *Remedies in International Human Rights Law* (Oxford: OUP, 1999) 137–8; EB Weiss, 'Invoking State Responsibility in the Twenty-first Century' (2002) 96 AJIL 798, 809–11 and 815; J Thornton, 'Environmental Liability—A Shrinking Mirage or the Most Realistic Attempt So Far' (2003) J Planning & Enviro L 272. On the duty to exhaust local remedies, see J Paulsson, *Denial of Justice in International Law* (Cambridge: CUP, 2005) 8–9; as well as the discussion in Ch 5 below, p 110–13.

courts, whether domestic or international. Consensual arbitration is broadly suitable as a means to settle disputes between companies or between states, but it is fundamentally inadequate as a substitute for the public courts in the regulatory domain. As I shall argue, the courts *and only the courts* should have the final authority to interpret the law that binds sovereign power and to stipulate the appropriate remedies for sovereign wrongs that lead to business loss.