The Impact of Investment Treaty Law on Host States

Enabling Good Governance?

Mavluda Sattorova

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Introduction

I. INTERNATIONAL INVESTMENT LAW: FROM GOOD GOVERNANCE FOR FOREIGN INVESTORS TO GOOD GOVERNANCE FOR ALL

CONTEMPORARY INTERNATIONAL INVESTMENT law has its historical roots in a system that was designed to protect interests of foreigners abroad—to ensure that foreign citizens in host states benefited from governance as good as that they enjoyed in their home states, even if a host state's legal systems fell below the acceptable standard. In his seminal speech in 1910 (which continues to be quoted with reference to the origins of the international minimum standard—one of the core provisions underpinning the modern investment treaty regime) Elihu Root famously articulated this notion of 'good governance for foreign citizens' in the following terms:

> There is a standard of justice, very simple, very fundamental, and of such general acceptance by all civilized countries as to form a part of the international law of the world. The condition upon which any country is entitled to measure the justice due from it to an alien by the justice which it accords to its own citizens is that its system of law and administration shall conform to this general standard. If any country's system of law and administration does not conform to that standard, although the people of the country may be content or compelled to live under it, no other country can be compelled to accept it as furnishing a satisfactory measure of treatment to its citizens.[1]
>
> …
>
> The foreigner is entitled to have the protection and redress which the citizen is entitled to have, and the fact that the citizen may not have insisted upon his rights, and may be content with lax administration which fails to secure them to him, furnishes no reason why the foreigner should not insist upon them and no excuse for denying them to him.[2]

The core of the minimum standard of customary international law advocated by capital-exporting states was a set of norms encapsulating foreign

[1] Elihu Root, 'The Basis of Protection to Citizens Residing Abroad' (1910) 4 *AJIL* 517, 521–22.
[2] ibid 523.

subjects' entitlement to be treated in accordance with good governance precepts endorsed by 'civilised nations.'[3] The early references to the customary minimum standard show its function was primarily to protect aliens from the most egregious failures of governance such as in cases of denial of justice and uncompensated takings of property by host states.[4] As famously summarised by the US Secretary of State Cordell Hull in his historical note to the Mexican Government of 22 August 1938, 'under every rule of law and equity, no government is entitled to expropriate private property, for whatever purpose, without provision for prompt, adequate and effective payment thereof.'[5] Similar safeguards were being routinely incorporated in the early investment protection instruments. For instance, already the nineteenth century Friendship, Commerce and Navigation (FCN) treaties of the United States provided guarantees of '*full and perfect* protection' of property of US subjects abroad (emphasis added).[6]

Although the international minimum standard—an embodiment of the good governance benchmarks endorsed by civilised nations—was portrayed as a standard advantageous to a wider world community, it was designed to protect foreigners at the exclusion of nationals[7] and as such met with opposition from developing states. The most notable historic manifestation of refusal to endorse the international minimum standard was the national standard advocated by Latin American states. The national standard required that foreigners and their property be accorded treatment no more favourable than that accorded to the nationals of the host state.[8] The prominent embodiment of the standard is the Calvo doctrine, a principal tenet of which is the notion that when entering the territory of a host state a foreigner 'submits to local conditions with benefits and burdens' and that to grant a foreigner special treatment 'would be contrary to the principles of territorial jurisdiction and equality.'[9]

The idea of 'good governance for foreign investors' was also contested in the context of an historic opposition to the customary international

[3] See generally Andreas Hans Roth, *The Minimum Standard of International Law Applied to Aliens* (Leiden, A W Sijthoff's Uitgeversmaatschappij, 1949).

[4] ibid. See also Georg Schwarzenberger, *Foreign Investments and International Law* (London, Steven & Sons, 1969).

[5] See Burns H Weston and Frank G Dawson, '"Prompt, adequate, and effective"?: A Universal Standard of Compensation' (1961–1962) 30 *Fordham Law Review* 727, 735.

[6] Kenneth J Vandevelde, *U.S. International Investment Agreements* (Oxford, Oxford University Press, 2009) 20.

[7] Alireza Falsafi, 'The International Minimum Standard of Treatment of Foreign Investors' Property: A Contingent Standard' (2006–2007) 30 *Suffolk Transnational Law Review* 318, 321–22.

[8] Ian Brownlie, *Principles of Public International Law*, 6th edn (Oxford, Oxford University Press, 2003) 501–502.

[9] ibid.

law requirement of compensation for expropriation. In a number of landmark resolutions adopted under the aegis of the United Nations General Assembly, a coalition of newly-decolonised developing countries questioned the fairness and juridical basis of the customary international rules, and re-asserted the primacy of national treatment with regard to the foreigners' entitlement to compensation for expropriated and nationalised property.[10] This contestation reached its pinnacle with the promulgation of the 1974 UN Charter of Economic Rights and Duties of States, which provided that each state had the right to nationalise, expropriate or transfer ownership of foreign property, and that it was for the state to determine appropriate compensation, taking into account relevant national laws and regulations and all circumstances that it considered pertinent.[11]

Despite having encountered an overwhelming resistance from a wider international community, the ideas of special treatment—or 'better governance'—for foreigners have re-entered the corpus of international law through investment treaties. Although rejected by developing states in the UN General Assembly, various expressions of the international minimum standard found their way into bilateral and multilateral agreements on the promotion and protection of investment. As a wave of economic liberalisation processes swept across the globe in 1980s and 1990s, capital-exporting states embarked on negotiation of bilateral investment treaties with developing states. These treaty instruments were designed not just to protect investments from developed into developing countries but also, importantly, to address the prevailing uncertainty over the status of what had been previously postulated as the universally-accepted Hull rule of compensation for expropriation of property by host states.[12] This 'treatification'[13] process resulted in a hitherto unprecedented number of bilateral investment treaties whereby each contracting state committed to abide by a range of standards of treatment, including notably the guarantee against uncompensated expropriation, fair and equitable treatment, and non-discrimination. The salient and hitherto largely unprecedented feature of the investment treaty regime is that it grants foreign investors access to arbitration and the right to bring action directly against the host government.[14]

[10] See eg the UN GA Resolution No 1803 (14 December 1962) and No 3281 (12 December 1984).

[11] See Burns H Weston, 'The Charter of Economic Rights and Duties of States and the Deprivation of Foreign-Owned Wealth' (1981) 75 *AJIL* 437.

[12] Vandevelde, *U.S. International Investment Agreements*, 25–6.

[13] See generally Jeswald W Salacuse, 'The Treatification of International Investment Law' (2007) 13 *Law and Business Review of the Americas* 155.

[14] See Suria Subedi, *International Investment Law: Reconciling Policy and Principle* (Oxford, Hart Publishing, 2008) 149–50.

Supported by its own bespoke dispute settlement mechanism—the International Centre for Settlement of Investment Disputes founded under the Washington Convention in 1965—the newly-emerged investment treaty regime effectively reaffirmed the historically contested rules on special treatment of foreign investors. The regime was hailed as '[a] 21st century version of the 19th century club of "civilised nations" … though under different labels relating to contemporary notions of proper governance.'[15] Through their participation in bilateral arrangements on investment protection, developing countries were arguably 'sending a strong signal of their commitment to provide a predictable, stable and reliable legal environment for foreign direct investors, to stimulate investors' confidence and boost FDI flows.'[16] The advocates of the investment treaty regime reinforced the idea that one of the principal functions of investment treaty law was to ensure that foreign investors are treated in accordance with stronger, internationally recognised, good governance standards.

Subsequently, however, as the number of investment treaties has surged and investors turned to actively use the investor-state arbitration mechanism to challenge various host state actions, perceptions of the investment treaty regime and its functions have shifted somewhat. In contrast with the traditional customary international law rules on protection of foreign investment, the investment treaty regime possesses unique characteristics that have significantly changed the nature and scope of privileges conferred upon foreign investors. Investment treaties not only grant investors direct standing and right of action for damages against host states, but also allow investors in doing so to sidestep national remedies and to enforce awards against state assets located in other states.[17]

The scope of foreign investment protection and the extent of host state exposure to international adjudication and monetary liability have also dramatically expanded. Expropriation—or for that matter a denial of justice—are no longer primary causes of action to which foreign investors can resort in challenging host state conduct. The recent evolution of the investment treaty regime has been largely defined by the rise of non-expropriatory standards of treatment, such as the guarantee of fair and equitable treatment, the prohibition of arbitrary and discriminatory measures, and umbrella or sanctity of contract clauses. The availability of the whole arsenal of non-expropriatory standards has enhanced

[15] Todds Weiler and Thomas W Walde, 'Investment Arbitration under the Energy Charter Treaty in the Light of New NAFTA Precedents: Towards a Global Code of Conduct for Economic Regulation' (2004) 1 *Transnational Dispute Management* 1.

[16] UNCTAD 1999, UNCTAD Hosts Bilateral Investment Treaty Negotiations by Groups of Fifteen Countries. Press Release, 7 January 1999.

[17] See Gus Van Harten and Martin Loughlin, 'Investment Treaty Arbitration as a Species of Global Administrative Law' (2006) 17 *EJIL* 121, 332.

the protective reach and strength of investment treaties, transforming them into potent instruments that can be deployed by foreign investors against a diverse range of national measures in an infinite variety of socio-economic settings. Lack of transparency, stability, predictability as well as the lack of effective remedies and enforcement mechanisms at a national level can now lead to a host state's liability in damages. For instance, complying with the fair and equitable treatment standard 'may require states to create and maintain highly developed and particularised national institutions. Treating foreign investors equitably … demands a well-run administrative state highly protective of property rights and the expectations of those with capital.'[18] Investment treaty instruments have moved far beyond their original task of safeguarding foreign investors against outright takings of property and denial of justice, and now allow investors to claim redress even for governmental actions displaying 'a relatively lower degree of inappropriateness.'[19]

The shifts in the nature and scope of state responsibility before foreign investors—and the proliferation of the number of investment disputes against host states—has generated concerns on both a national and international scale. One such concern relates to the magnitude of financial consequences of investment arbitration for respondent states. Faced with the large sums that have been awarded to investors and the high cost of the arbitration process, developing countries in particular have found themselves vulnerable due to the detrimental financial impact of the awards on a country's budget.[20] As a study by UNCTAD points out, '[to] expedite payment of the awards, funds may be diverted from important development objectives, such as investment in infrastructure, education, health or other public goods.'[21] To exemplify the scale of financial consequences investment arbitration may entail for host states, in 2004 a claim by a Czech commercial bank against the Slovak Republic resulted in an award totalling approximately US$877 million in favour of the claimant investor.[22] Awards issued by ICSID tribunals against Argentina in 2007 alone exceeded US$600 million.[23] One of the highest awards in

[18] Jose E Alvarez, 'Contemporary Foreign Investment Law: An "Empire of Law" or the "Law of Empire"'? (2008–2009) 60 *Alabama Law Review* 943, 964 (commenting on a dictum from *Tecmed v Mexico*).

[19] *Saluka Investments BV v Czech Republic* (PCA—UNCITRAL, Partial Award, 17 March 2006) para 293.

[20] UNCTAD, *Best Practices in Investment for Development. How to prevent and manage investor-State disputes: Lessons from Peru*, Investment Advisory Series, Series B, number 10 (New York and Geneva, United Nations, 2011) 7.

[21] ibid 7.

[22] *Ceskoslovenska obchodni banka v Slovak Republic* (ICSID Case No ARB/97/4, Award, 29 December 2004) para 374.

[23] UNCTAD, *Best Practices in Investment*, 7.

the history of investment arbitration—US$1.77 billion plus pre-and post-award compound interest—was rendered in 2012 in the case of *Occidental v Ecuador*.[24]

Concerns have also been increasingly raised over the alarmingly asymmetric nature of international investment law. Investment treaties grant investors extensive substantive and procedural rights but not obligations, whilst subjecting states to an array of obligations unaccompanied by rights.[25] The creation of the investment treaty regime and the advent of investor-state dispute settlement was traditionally defended by reference to the need to depoliticise dispute settlement and to ensure equality of arms between foreign investors and host states.[26] It was designed to contribute to 'reducing the likelihood of unresolved conflicts between host countries and investors, and in particular by doing so in a manner which would eliminate the risk of a confrontation of the host country and the national State of the investor [sic]'.[27] Nevertheless, the first two decades of investor-state arbitration practice have prompted a growing perception that, 'despite the claims of neutrality and objectivity, both the system of international investment arbitration and the substantive rules of international investment law are deeply embedded in a political framework—but one that operates to the advantage of foreign investors.'[28]

These developments have inevitably prompted a perceived need for a re-conceptualisation of investment treaty law. First, the rapid evolution of investment arbitration practice and the emergence of novel (and at times far-reaching) interpretations of international treaty norms on investment protection have signalled the need to draw a stronger conceptual and methodological foundation to underpin the new regime. Second, numerous studies have questioned the role of investment treaties in advancing economic development of host states—something that has traditionally served as the principal justification for the internationalisation of rules on foreign investment protection.[29] It has been argued that the economic

[24] UNCTAD, Recent Developments In Investor-State Dispute Settlement (ISDS), No 1, April 2014, available at unctad.org/en/PublicationsLibrary/webdiaepcb2014d3_en.pdf.

[25] Jason Webb Yackee, 'Investment Treaties and Investor Corruption: An Emerging Defence for Host States?' (2012) 52 *Virginia Journal of International Law* 723.

[26] Aron Broches, 'Settlement of Investment Disputes' in Aron Broches (ed), *Selected Essays: World Bank, ICSID and Other Subjects of Public and Private International Law* (Dordrecht, Martinus Nijhoff Publishers, 1995) 161, 163.

[27] Aron Broches, 'The Convention on the Settlement of Investment Disputes between States and Nationals of Other States' (1972) (II) *Recueil Des Cours* 136, 337, 343.

[28] Kate Miles, *The Origins of International Investment Law: Empire, Environment and the Safeguarding of Capital* (Cambridge, Cambridge University Press, 2013) 86.

[29] Maria Carkovic and Ross Levine, 'Does foreign direct investment accelerate economic growth?' in Theodore Moran, Edward Graham and Magnus Blomstrom (eds), *Does Foreign Direct Investment Promote Development?* (Institute for International Economics, 2005) 219; Jason W Yackee, 'Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence' (2011) 51 *Virginia Journal of International Law* 397, 399;

development rationale at the heart of investment treaty protection 'does not innately extend to a willingness to attract any kind of foreign capital, at all costs.'[30] As the number of investment claims continues to rise and the development function of the investment treaty regime is being increasingly contested, it was felt that investment arbitration 'must fulfil *some* useful societal function.'[31] Since the functional scope of investment treaties have been pushed beyond their original remit to redress sufficiently serious forms of host state interference with foreign investment, questions were raised about normative justifications for such expansion:

> … if investor-state arbitration is a component of global administrative law, which is in turn concerned with issues of transparency, public participation, and due process, for whom do these 'rule of law' principles operate? Are they solely for the benefit of the investor in their interaction with the host state?[32]

The idea of fostering the rule of law and good governance in developing states has thus been deployed to provide the much-needed normative content as well as additional justification for the evolving investment treaty norms. While traditionally the prevailing view was that international investment law aimed to ensure good governance for foreign investors (in exchange for their capital and know-how), the more recent narratives are premised on the idea of investment treaties altering outcomes not just for foreign investors but for host state communities also. Thus, even if investment treaties are unsuccessful in achieving their instrumental, economic objectives, their existence would still be justified by good governance norms enshrined in substantive standards of treatment that such treaties contain.[33] These good governance standards, although designed to benefit foreign investors, may eventually 'spill over into domestic law and

Eric Neumayer and Laura Spess, 'Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries?' (2005) 33 *World Development* 1567, Karl Sauvant and Lisa Sachs (eds), *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties and Investment Flows* (Oxford, Oxford University Press, 2009). See further Jonathan Bonnitcha, 'Foreign Investment, Development and Governance: What international investment law can learn from the empirical literature on investment' (2016) 7 *Journal of International Dispute Settlement* 31, 36–44.

[30] Omar E García-Bolívar, 'Economic Development at the Core of the International Investment Regime' in Chester Brown and Kate Miles (eds), *Evolution in Investment Treaty Law and Arbitration* (Cambridge, Cambridge University Press, 2011) 587.

[31] Thomas Schultz and Cédric Dupont, 'Investment Arbitration: Promoting the Rule of Law or Over-empowering Investors? A Quantitative Empirical Study' (2014) 25 *EJIL* 1147, 1148.

[32] Miles, *The Origins of International Investment Law*, 332.

[33] Kenneth J Vandevelde, *Bilateral Investment Treaties: History, Policy, and Interpretation* (Oxford, Oxford University Press, 2010) 119; see also Jonathan Bonnitcha, *Substantive Protection under Investment Treaties: A Legal and Economic Analysis* (Oxford, Oxford University Press, 2014) 43.

may set new standards also for the domestic legal system.'[34] Especially in investor-state disputes relating to administrative law of host states, investment arbitration arguably 'may provide a powerful incentive to review and modernize their domestic legal systems.'[35] The mission of investment treaty law is therefore to 'reinforce and on occasion to institute, the rule of law internally' in host states.[36] It has been argued that '… investment treaties aim at binding states into a legal framework that gives them an incentive and a yardstick for transforming their legal systems into ones that are conducive to market-based investment activities and provide the institutions necessary for the functioning of such markets.'[37] This argument is also echoed in Vandevelde's normative claim that investment treaties 'embody norms that all countries committed to the rule of law should follow' and can therefore 'contribute greatly to institutional quality in host countries.'[38] A strong belief in the transformative function of international investment law underpins some of the recent writings of Echandi, who claims that international investment law can act as a deterrent mechanism against short-term policy reversals and assist developing countries in promoting greater effectiveness of the rule of law at the domestic level.[39] Investment treaties can arguably induce this result by subjecting host governments to strict standards, such as the prohibition of arbitrary conduct. Besides, the international investment regime can facilitate the strengthening of the rule of law in developing states through transparency-related commitments.[40] Owing to what has been variously described as the 'halo effect',[41] the 'desideratum effect',[42] or the 'signalling effect',[43] investment

[34] Peter Muchlinski, Federico Ortino and Christoph Schreuer, 'Preface' in Peter Muchlinski, Federico Ortino and Christoph Schreuer (eds), *The Oxford Handbook of International Investment Law* (Oxford, Oxford University Press, 2008) vi.

[35] Rudolf Dolzer, 'The Impact of International Investment Treaties on Domestic Administrative Law' (2005) 37 *New York University Journal of International Law and Policy* 972.

[36] Bonnitcha, *Substantive Protection*, 31, referring to James Crawford, 'International Law and the Rule of Law' (2003) 24 *Adelaide Law Review* 4.

[37] Stephan W Schill, *The Multilateralization of International Investment Law* (Cambridge, Cambridge University Press, 2009) 377.

[38] Kenneth J Vandevelde, 'Model Bilateral Investment Treaties: The Way Forward' (2012) 18 *Southwestern Journal International Law* 313.

[39] Roberto Echandi, 'What Do Developing Countries Expect from the International Investment Regime?' in Jose E Alvarez and Karl P Sauvant (eds), *The Evolving International Investment Regime: Expectations, Realities, Options* (Oxford, Oxford University Press, 2011) 13.

[40] ibid 13–14.

[41] World Bank, *World Development Report* (New York, Oxford University Press, 2005) 179 ('While ICSID is designed to encourage foreign investment, domestic firms can benefit from the halo effect provided by stronger constraints on arbitrary government action').

[42] Louis B Sohn and R Baxter, *Convention on the International Responsibility of States for Injuries to Aliens. Preliminary Draft with Explanatory Notes* (Cambridge, MA, Harvard Law School, 1959) 28 ('By the establishment of an international minimum standard, the law has not only protected aliens but has also suggested a desideratum for States in their relationships with their own nationals').

[43] Thomas W Walde, 'The "Umbrella Clause" in Investment Arbitration. A Comment on Original Intentions and Recent Cases' (2005) 6 *Journal of World Investment and Trade* 183, 188

treaties are said to act as *catalysts* of governance reforms in host states, providing the investment treaty regime with another raison d'etre and justifying its recent strides.

It was not until the first wave of investment arbitration disputes that the rhetoric of good governance was amplified and expressly embraced *de lege lata*. In a rising tide of investment claims challenging various host government actions and measures, the boundaries of the notion of internationally proscribed conduct have been pushed beyond the familiar. A string of arbitral awards, including the seminal *Metalclad*, *Tecmed*, and *Occidental* awards,[44] proclaimed that transparency, stability, predictability and consistency ought to be construed as elements of the fair and equitable treatment standard. A failure to create and maintain a transparent, stable and predictable regime was found to constitute a sufficient ground for claiming compensation against the host state. Some investment treaties now expressly require a host state to ensure 'effective means of asserting claims and enforcing rights' and to create and maintain 'a legal framework apt to guarantee to investors the continuity of legal treatment.'[45] The rapid uptake of the good governance narratives in the investment treaty practice and academic literature raises questions as to their juridical underpinnings. It necessitates an inquiry into the origins of the good governance rhetoric and the intentions of those who invoke it. What has propelled good governance from a set of normative ideals to enforceable treaty standards? How do host states respond to investment treaty norms? As investment treaty law has largely failed to deliver promised economic development,[46] is it capable of delivering improved governance?

('The example effect of treaty-based contract protection is likely to have an indirect effect also on the treatment of domestic investors, as it signals to the host-State institutions what a proper, international and universal standard of governance is. Such signalling effect provides a benchmark for domestic judicial procedures as well.')

[44] See *Metalclad Corpn v Mexico*, Award, 25 August 2000, ICSID Case No ARB(AF)/97/1, (2001) 40 ILM 36; *Técnicas Medioambientales Tecmed, SA v The United Mexican States*, Award 29 May 2003, 10 ICSID Rep 130, paras 154–64; *Occidental Exploration and Production Company v The Republic of Ecuador* (LCIA Case No UN 3467, Award, 1 July 2004) paras 184–91. Unless otherwise indicated, all cases cited in this chapter are available online at italaw.com. For a critique, see Santiago Montt, *State Liability in Investment Treaty Arbitration: Global Constitutional and Administrative Law in the BIT Generation* (Oxford, Hart Publishing, 2009) 309.

[45] See eg Art II(7) of the Treaty Between the United States of America and the Republic of Ecuador Concerning the Encouragement and Reciprocal Protection of Investment (1997); also Art 10(12) of the Energy Charter Treaty (signed 17 December 1994, entered into force 16 April 1998) 2080 UNTS 100.

[46] See Tienhaara noting that '[m]any African countries that have ratified numerous BITs have remained marginalized in terms of global investment flows': Kyla Tienhaara, *The Expropriation of Environmental Governance: Protecting Foreign Investors at the Expense of Public Policy* (Cambridge, Cambridge University Press, 2009) 59. See also Joseph E Stiglitz, 'Regulating Multinational Corporations: Towards Principles of Cross-Border Legal Frameworks in a Globalized World Balancing Rights with Responsibilities' (2008) 23 *American University International Law Review* 451, 455.

II. CONCEPTUAL FRAMEWORK

A. Why the Good Governance Lens?

Despite being increasingly popular (and contested), the good governance narratives represent only one distinct strand of legal discourse about the evolving functions and objectives of international investment law. One may therefore ponder why this book focuses on this seemingly narrow strand of legal thought. Why the good governance lens? Examining the recent evolution of investment treaty law through a critique of the good governance narratives provides the opportunity to engage with a broad array of issues underpinning the interaction between international investment law and host states, with particular focus on developing countries. It offers a useful conceptual framework to explore and critique international investment law from historical, doctrinal and normative angles, by taking a closer look at the evolution of the juridical foundations of the emerging interpretations, questioning their normative and practical implications, and identifying the shifting roles of various actors involved in the formation and functioning of the investment treaty regime.

Just like development, good governance 'has a very powerful and apparently universal appeal: all peoples and societies would surely seek a good governance—in much the same way that all peoples and societies were seen as desiring development.'[47] Just as is the case with economic development, which has long been regarded as one of the primary objectives of investment treaties, the question this book is preoccupied with is not whether fostering good governance is a desirable end. Rather, the question is what the language of good governance masks and whether change in domestic governance can at all be effectuated through international investment norms. Arguably, even the proponents of the good governance language in recent scholarship and doctrine are likely to agree (perhaps reluctantly) that such language supplies the moral and intellectual foundation for conceptualising and using investment treaty norms to 'manage … Third World states and Third World peoples.'[48] Yet there is very little analysis in academic literature on international investment law as to what 'good governance' means for those governed (or managed)—the developing states and host communities. Even less is known about the impact of the investment treaty regime and its good governance mission on host states.

Using the good governance lens provides the opportunity—or even renders it necessary—to evaluate the normative and causal assumptions

[47] Anthony Anghie, 'Civilization and Commerce: The Concept of Governance in Historical Perspective' (2000) 45 *Villanova Law Review* 887, 893.
[48] ibid 893–94.

about the effects of international investment law from an empirical angle and from the point of view of those whose behaviour international investment rules allegedly purport to influence (governments of developing states) and those who the regime promises to benefit through better, improved governance institutions and practices (host communities). This book seeks to make a novel contribution by offering empirical insights drawn from interviews with government officials and analysis of legislative data in developing states. While much has been written on why developing states sign investment treaties,[49] there is a dearth of studies on whether states comply with investment treaty norms and how the latter influence state decision-making. As Bonnitcha points out in his pioneering contribution to the literature on the subject, '[existing debate about investment treaties is relatively immature, in that both proponents and critics pay little attention to the normative and causal assumptions on which their arguments are based.'[50] To quote Broude, while in international law individual actions may be attributed to the state and give rise to state responsibility, ultimately many cases of compliance or non-compliance with international law are made by individuals.[51] Methodological statism ought to be avoided in favour of 'a recognition that states do not make decisions relating to international law; people do, or most often, groups of people.'[52] A critique of international investment law through the good governance lens invites us to go beyond purely legal formalistic analyses, to engage in conversation with government officials, and to take a step towards bridging the gap between the literature on investment treaty law and existing scholarship on law and development, political science and international relations studies on state compliance with international law.

The overarching objective of this book is to unpack existing assumptions concerning the effects of international investment law on host states. It aims to offer novel insights into real rather than abstractly imagined patterns of governmental behaviour in developing countries. By combining doctrinal, empirical, comparative and interdisciplinary approaches and thus unveiling the emerging 'nationally felt'[53] responses to international investment norms, the book aims to facilitate a more informed

[49] See eg Montt, *State Liability*; Andrew T Guzman, 'Why LDCs Sign Treaties that Hurt Them: Explaining the Popularity of Bilateral Investment Treaties' (1997–1998) 38 *Virginia Journal of International Law* 639, and more recently, Lauge N Skovgaard Poulsen, *Bounded Rationality and Economic Diplomacy: The Politics of Investment Treaties in Developing Countries* (Cambridge, Cambridge University Press, 2015).

[50] Bonnitcha, *Substantive Protection under Investment Treaties*, 11.

[51] Tomer Brouder, 'Behavioral International Law' (2015) 163 *University of Pennsylvania Law Review* 1099, 1130.

[52] ibid 1126.

[53] The term is borrowed from Harold Koh, 'How Is International Human Rights Law Enforced?' (1998) 74 *Indiana Law Journal* 1397, 1407.

understanding of present contours and the nature of the interplay between international norms and national realities. This, in turn, will provide a basis for analysing the ways in which such relationship can be optimised, including through reforming the existing norms and the creation of requisite legal and institutional mechanisms.

B. The Impact of Investment Treaty Law on Domestic Governance: Using a Compliance Lens

The principal question of this book is whether investment treaty law can exert a positive influence on host states by fostering greater state compliance with good governance standards. While compliance with international law has generated a considerable body of literature straddling international law and political science scholarship, state compliance with investment treaty law has so far received little attention. As observed by Simmons in her review of scholarship on treaty compliance, despite the evidence suggesting that international treaties have effects on state behaviour, 'large uncertainties remain and the conditions under which they can be effective are poorly understood.'[54] This book seeks to contribute to the existing knowledge by bringing to the fore and evaluating various factors determining the capacity of international investment law to alter the way governments operate. One of the key objectives of this study is to uncover how host states respond to investment treaty rules, ie how they *comply* with good governance prescriptions contained in international investment agreements. An inalienable part of this analysis is to identify which characteristics international investment norms ought to possess to be able to 'weigh the decision processes of states in the direction of compliance'.[55] For our purposes, compliance is understood as a process that goes beyond the formal ratification of international treaty instruments and comprises ex ante internalisation of the norms contained therein as well as ex post adjustment of national legal framework in line with decisions of international arbitral tribunals.

Whilst compliance with international investment norms has not to date been a subject of a comprehensive analysis, in undertaking a fresh inquiry into this subject matter one is aided by a considerable body of literature on compliance produced by scholars of international law and

[54] Leonardo Baccini and Johannes Urpelainen, 'Before Ratification: Understanding the Timing of International Treaty Effects on Domestic Policies' (2014) 58 *International Studies Quarterly* 29, 30.

[55] Abram Chayes and Antonia Handler Chayes, *The New Sovereignty: Compliance with International Regulatory Agreements* (Cambridge MA, Harvard University Press, 1995) 112.

political science.[56] In evaluating how host states respond to investment treaty prescriptions of good governance, a distinction must be made between compliance and effectiveness: host states may formally ratify investment treaties and comply with its dispute settlement awards whilst failing to honour the treaty obligation requiring them to refrain from mistreating investors in their daily practices. Investment treaties may be effective in forcing states to comply with provisions on the enforcement of awards rendered by dispute settlement bodies, but ineffective as far as the broader impact on domestic governance institutions and practices is concerned. For instance, host states may over-value foreign investors and refrain from harming them but fail to extend the same treatment to domestic investors,[57] and thus fall short of maintaining good governance across the board.

Compliance should also be disaggregated from implementation. Implementation is only a step on the way to compliance, and may comprise

> the enactment of legislation or the promulgation of regulations or a change in official policy, any of which may be combined with the activities of international institutions in monitoring and assisting national governments in putting their international commitments into practice.[58]

This book seeks to go beyond the formal expressions of implementation of investment treaty rules such as treaty ratification and enforcement of investment arbitration awards rendered in disputes brought under such treaties. As observed by Hathaway in her analysis of state compliance with human rights treaties, the ratification of a treaty, whilst constituting an implementation measure, may serve as a substitute for actual improvements in domestic practices.[59] Similar behaviour can be observed in connection with ratification of international investment treaties: with some minor exceptions, contracting state parties tend to signal their commitment to implementing such treaties through ratification whilst undertaking no or few measures to transpose investment treaty rules into domestic legal practice.

[56] See ibid, also Beth A Simmons, 'International Law and State Behavior: Commitment and Compliance in International Monetary Affairs' (2000) 94(4) *American Political Science Review* 819; Oona Hathaway, 'Between Power and Principle: An Integrated Theory of International Law' (2005) 72 *University of Chicago Law Review* 469; Thomas M Franck, 'Legitimacy in the International System' (1988) 82 *AJIL* 705; Harold Hongju Koh, 'Why Do Nations Obey International Law' (1977)106 *Yale Law Journal* 2599.

[57] Jonathan Bonnitcha, 'Outline of a Normative Framework for Evaluating Interpretations of Investment Treaty Protections' in Chester Brown and Kate Miles (eds), *Evolution in Investment Treaty Law and Arbitration* (Cambridge, Cambridge University Press, 2011) 128.

[58] Mary E Footer, 'Some Theoretical and Legal Perspectives on WTO Compliance' (2007) 38 *Netherlands Yearbook of International Law* 61, 66.

[59] Oona A Hathaway, 'Do Human Rights Treaties Make a Difference?' (2002) 111 *Yale Law Journal* 1935, 2005.

One aspect of implementation that falls squarely within the scope of our analysis concerns the ex post adjustment of national legal rules by host states following their exposure to investment treaty sanctions. Contracting state parties may formally enact domestic laws and regulations as a means of implementing investment treaty rules, yet such implementation measures may not lead to compliance with the letter and spirit of investment treaties in the practice of domestic institutions. Unlike the promulgation of national laws and regulations immediately following the signing of a treaty, the adjustment of national legal rules subsequent to the state's involvement in investor-state dispute settlement under the said treaty is more likely to reflect a change in host state behaviour which: (1) is precipitated by real as opposed to formal participation in the treaty regime; and (2) involves a more conscious decision-making in the sense of the host state government being more aware of the scale and consequences of treaty obligations and sanctions, and elaborating on the meaning of these norms and what they require in particular circumstances. By elucidating some of the actions and processes observed in developing states in the aftermath of their encounter with investment treaty law, this book seeks to uncover the hitherto less visible factors that may ultimately lead to compliance as 'a state of conformity or identity between an actor's behaviour and a specified rule'.[60] The crucial question is whether host state compliance with good governance standards for foreign investors can result in good governance for all.

III. OUTLINE OF CHAPTERS

Chapter 2 proceeds with tracing the emergence of good governance narratives in investment treaty practice and arbitral jurisprudence. It critically evaluates the doctrinal foundations and internal coherence of the argument which postulates that host states should be held liable for a failure to ensure compliance with good governance standards in domestic practices. The overarching aim is not to offer a comprehensive analysis of treaty practice and arbitral jurisprudence, but rather to expose cracks in the good governance narratives of international investment law by identifying and highlighting insufficiency in their legal foundations. It is argued that notwithstanding the proliferation of arbitral awards construing the fair and equitable treatment standard as an obligation to create and maintain a transparent, stable, predictable and consistent legal framework, such interpretation is not adequately supported by historical and doctrinal evidence pertaining to the evolution of the fair and

[60] Kal Raustiala, 'Compliance and Effectiveness in International Regulatory Cooperation' (2000) 32 *Case Western Reserve Journal of International Law* 387, 388.

equitable treatment standard. The interpretations of other 'good governance' standards, such as an investment treaty obligation to provide an effective means of asserting claims and enforcing rights are similarly questionable both for their insufficient legal underpinnings and their normative implications. Extending the scope of state responsibility in international law to such forms of governmental conduct as a failure to provide effective laws and to ensure time-efficient administration of justice drastically changes the function and scope of investment treaty law. Harnessing the language of good governance to justify the expansive interpretation of investment treaty rules is unlikely divert attention from the shortcomings of legal and normative reasoning underpinning the relevant arbitral awards. Rather, it may further heighten concerns over the regime's legitimacy and credibility.

Despite having recurred in various arbitral decisions and scholarly writings, the claim that investment treaties promote the rule of law and improve governance at a national level has not (yet) been supported either theoretically or through empirical appraisal. Chapter 3 intends to fill this gap by tapping into empirical data in examining the interplay between investment treaty disciplines and governmental conduct. The good governance narratives of international investment law are grounded in a set of assumptions about how host states *should* respond to investment treaty norms. It is presumed that the imposition of monetary liability on host states for a breach of good governance standards will not only deter host states from mistreating foreign investors but also encourage them to proactively reform legal and bureaucratic practices. For such deterrent and transformative effects to exist, however, government officials in host states need to be aware of the existence and meaning of investment treaty prescriptions. Furthermore, national legal and regulatory measures should be in place to discourage individual government officials from acting in breach of those prescriptions. To what extent are government officials actually aware of and influenced by investment treaty disciplines in making their decisions vis-à-vis foreign investors? Does the imposition of monetary sanctions on the host states prompt them to address the governance failures lying at the roots of investor-state disputes and to enhance accountability of relevant government agencies and officials? How do host states respond or react to their experience of defending themselves in investor-state disputes?

Chapter 3 engages with these questions by situating the good governance narratives within the emerging empirical data, including the findings obtained by this author through interviews with government officials and the analysis of national legislation in five developing states (Kazakhstan, Nigeria, Turkey, Ukraine and Uzbekistan). Notwithstanding their relatively limited scale, the case studies offer potentially illuminating insights. For instance, it transpires that even after the host states

encountered investment arbitration in a respondent capacity, many government officials tended to remain unaware of investment treaty law and its implications. Even where government officials learnt about investment treaty law from their involvement in investor-state arbitration, such learning has not been translated into legal reforms. The interviews also reveal that, despite having gained a certain awareness and knowledge of investment treaty law, some host states continue to neglect the possible repercussions of their actions under that law. In some cases, rather than encouraging states to embark on governance reforms, dissatisfaction with investment arbitration may propel host states to seek retroactive changes in national laws on investment protection, and to withdraw from the investment treaty regime altogether.

Chapter 3 also examines the emerging trend towards the creation of national investment promotion and dispute settlement agencies, as illustrated in Brazil, Colombia, Kazakhstan, Peru, and Ukraine. Could the newly-established investment ombudsmen and similar dispute prevention bodies be a manifestation of a reformist impulse triggered by the host states learning from their encounter with investment treaty law, as predicted by the proponents of the good governance narratives? Both the analysis of national legislation, comparative studies and interviews are instructive insofar as they confirm no direct links between the creation of national investment ombudsmen and investment promotion agencies and investment treaty law. Rather, these policy developments appear to owe their origins to the investment facilitation agenda actively pursued by international institutions and Western donor organisations. Chapter 3 questions whether the involvement of international organisations in shaping national responses carries an enabling effect on governance in host states or whether it effectively prevents host states from formulating and implementing their own choices with respect to investment protection, promotion and dispute settlement.

The choice of questions addressed in the rest of the book has been inspired by the findings from our empirical case studies. Interviews with government officials have exposed a host of issues underpinning the interplay between international norms and national experiences. When sharing their views about international investment law and its good governance promise, our respondents expressed various degrees of hopefulness, scepticism, indifference, suspicion and resentment over international rules and actors and the latter's efforts to bring about change in the national realm. The key themes that emerged from the interviews form the basis of discussion in the remainder of the book.

Take, for instance, the assumption that the imposition of monetary liability will deter host states from breaching investment treaty prescriptions. The interviews with government officials (and evidence from investment arbitration jurisprudence) reveal that the pain of complying with

damages awards does not necessarily produce either a deterrent effect or act as an incentive to proactively comply with investment treaty standards of good governance. Notwithstanding the threat of adverse financial consequences, host governments may choose to breach investment treaty norms in cases where they find it economically and politically more expedient. Chapter 4 examines whether investment treaty rules on liability are *by design* capable of inducing host states into compliance with treaty prescriptions on good governance. Can good governance at all be fostered through the externally imposed and crippling financial sanctions on host states? Law and development scholarship demonstrates that the use of financial incentives and sanctions in pushing for legal and institutional reforms has often resulted in expedited legislative changes but left no room for the internalisation of such reforms. Indeed, as one interviewee in our empirical case study put it, developing countries 'have perfect laws and perfect constitution, they simply don't work.'[61]

Existing studies show that financial sanctions may produce the desired effect on state behaviour but only if carefully designed and accompanied by effective communication and monitoring mechanisms. Are investment treaty remedies designed so as to deter future treaty breaches by host states? Investment treaties do not specifically require contracting states to adopt measures to foster and maintain good governance. Rather, they require that host states provide a set level of compensation for a failure to abide by good governance standards vis-à-vis foreign investors. When analysed from an historical and doctrinal perspective, and compared with other international regimes such as WTO law, the long-standing preference for monetary redress and the fact that the latter has rarely been accompanied by other remedies suggests that the primary goal investment treaty law has always been to indemnify the foreign investor, not to induce host states into compliance with investment treaty standards of good governance. Where the costs of breaching investment treaty provisions are less than the host state's gain from the same breach, the availability of monetary remedies may in fact render it considerably more attractive for the host state to choose breach over compliance. As long as the injured investor is compensated for its losses, investment treaty law implicitly allows host states to effectively opt out from the obligation to treat foreign investors in accordance with good governance standards. Chapter 4 explores the prospects and challenges of resorting to other forms of redress, such as the remedy of specific performance and injunction, in facilitating greater compliance with investment treaty norms.

Another question that has been prompted by our conversation with government officials in developing states is whether international investment law possesses the necessary characteristics to inspire domestic changes at

[61] Interview DFI.

the national level, to weigh the decision-making processes of host states in the direction of compliance. Drawing on investment treaty practice, investment arbitration jurisprudence as well as insights from the empirical case studies, Chapter 5 argues that investment treaty law, in its current form, lacks some of the vital characteristics necessary for its purported mission to act as a mechanism signalling what the universally acceptable standards of good governance are.[62] The much-criticised lack of clarity, consistency and predictability of investment treaty law is antithetical to the rule of law requirements.[63]

Chapter 5 also explores whether by effectively insulating foreign investors from the shortcomings of domestic regimes and by substituting the latter with an arguably stronger and more effective international alternative, the investment treaty regime reduces the incentive for host states to improve domestic governance institutions and practices. Since investor-state arbitration allows investors to escape the jurisdiction of domestic courts,[64] national judiciaries are not merely deprived of incentives to compete with international tribunals and enhance the quality of their governance outputs, but they are also effectively barred from otherwise embedding international standards of good governance in the legal and bureaucratic practices of host states. The empirical evidence also suggests that, due to its emphasis on the idea of foreign investors deserving special protection, the investment treaty regime contributes to a fragmentation of the national judicial and regulatory landscape and the emergence of special decision-making bodies and units specifically tasked with shielding foreign investors from the vicissitudes of dealing with national law and institutions. Rather than encouraging a comprehensive reform of national governance institutions and practices, host governments appear to favour 'good governance foreign investors' solutions. The externalisation and internationalisation of foreign investment protection tends to have an emasculating effect on national actors and institutions, hampering the emergence of local, home-grown expertise and of 'internally-felt' governance reforms.

Contrary to assumptions that foreign investors can foster good governance by lobbying host governments or otherwise pushing for reform, the emerging evidence from investment arbitration practice and the interviews reveal genuine grounds for concern over the negative impact of foreign investment on governance in host states. Through their contribution to

[62] Using the phrase from Walde, 'The "Umbrella Clause" in Investment Arbitration', 188.

[63] Benjamin K Guthrie, 'Beyond Investment Protection: An Examination of the Potential Influence of Investment Treaties on Domestic Rule of Law' (2012–2013) 45 *New York University Journal of International Law and Politics* 1151, 1196.

[64] Christoph Schreuer, 'Calvo's Grandchildren: The Return of Local Remedies in Investment Arbitration' (2005) 4 *Law and Practice International Courts and Tribunals* 1.

normalising corruption, bribery and regulatory capture, foreign investors may at times entrench poor governance in host states. Chapter 5 argues that the actual impact of the investment treaty regime on governance in host states would depend on the stance the regime takes on investor misconduct. If investment treaty instruments and arbitral tribunals turn a blind eye to illegal acts perpetrated by foreign investors in host states, including the instances of bribery and other forms of corruption, the investment treaty regime could be complicit in encouraging and perpetuating inadequate and undesirable patterns of behaviour by governments and foreign investors. Regrettably, the bulk of existing investment treaty instruments do not contain provisions to expressly address investor misconduct. Investment treaty law has long been criticised for is its asymmetric nature—for providing investor with rights, but not imposing any obligations. A failure to address lack of investor accountability in international investment agreements is starkly at odds with the investment treaty regime's proclaimed commitment to the ideals of rule of law and good governance.

When analysing the interaction between international investment law and those whose existence it purportedly aims to benefit through its promise of improved governance, one is reminded of the words of Cotterrell:

> Can international law be even more 'soulless' insofar as its links to networks of community are more indirect and potentially contradictory even than those of national law? With its vast, but abstract, potentially worldwide jurisdictional reach and its—so to speak—'high altitude' trajectory in 'thin legal air' far above most social life, could international law appear twice removed from the conditions of existence of the regulated insofar as it regulates mainly the relations of states and their agencies *rather than* social relations among their populations?[65]

Not only does investment treaty law remain far removed from the conditions of those it regulates, but it is also intrinsically inimical to the ideals of promoting democracy, participation, and political and socio-cultural rights of citizens. The regime's resistance to accommodate these ideals can be discerned both in the process of making investment treaty rules and their application in investor-state arbitration.

Chapter 6 will focus on the investment treaty regime's failure to embrace and maintain more inclusive and participatory approaches. Notwithstanding an emerging consensus that global norms of good governance should encompass such principles as accountability and an individual right of participation, investment treaty law remains largely indifferent to socio-political enablement in host states and instead stresses the need to insulate foreign investors from the national political process. Those who are

[65] Roger Cotterrell, 'Transnational networks of community and international economic law' in Amanda Perry-Kessaris (ed), *Socio-legal Approaches to International Economic Law: Text, Context, Subtext* (Abingdon, Routledge, 2013) 142.

expected to benefit from improved governance, which investment treaty law promises to deliver, remain largely excluded from the processes of formation, interpretation and application of investment protection rules. Developing states are particularly disadvantaged due to long-standing barriers hindering their meaningful input in the formation and change of investment treaty rules, including the so-called universally acceptable standards of good governance. Due to long-standing power asymmetries and the investment treaty regime's failure to offer legal and institutional means to address such asymmetries, developing countries traditionally end up as rule-takers, signing investment treaties that follow the developed state partner's model agreement. Likewise, developing countries are startlingly under-represented in the ranks of those who are vested with the task of interpreting and applying investment treaty rules. As recent empirical studies demonstrate, the rules on arbitrator appointment perpetuate a highly unequal system that hampers an input by developing countries into shaping investment arbitration jurisprudence.[66]

Can investment treaty law foster good governance if it forecloses any input from the general public and other stakeholders? With a few notable exceptions, even in developed states investment treaties continue to be drafted and negotiated in the absence of a meaningful political debate, with limited or at times non-existent public participation. Do recent moves towards greater transparency and stakeholder participation in the process of drafting and negotiating international investment agreements of the EU herald the dawn of a new era? Chapter 6 draws attention to the manner in which the Commission conducted the public consultation, its decision on the citizens' initiative concerning the Transatlantic Trade and Investment Partnership, and the European Parliament's ambivalence over (and its failure to mount effective opposition to) investor-state dispute settlement. Notwithstanding the significant strides made by the EU institutions towards a more participatory and democratic investment treaty-making, it is questioned whether the latest reforms carry an enabling effect or merely represent institutional efforts to create an illusion of participation to deflect the growing opposition to, and domestic contestation of, the investment treaty regime. To foster good governance in host states, investment treaty law must embrace the ideas of socio-political enablement and provide legal means to nurture, rather than impede, the emergence of robust domestic constituencies and their participation in the making and implementation of investment treaty norms.

[66] See eg Sergio Puig, 'Social Capital in the Arbitration Market' (2014) 25 *EJIL* 387; Michael Waibel, 'Abitrator Selection: Towards Greater State Control' in Andreas Kulick (ed), *Reassertion of Control over the Investment Treaty Regime* (Cambridge, Cambridge University Press, 2016) 333.