The Emerging System of International Investment Arbitration

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Abstract

The system of international investment arbitration is established by hundreds of investment treaties that have the following key features:

1. States authorize foreign investors (read multinational enterprises) to make and enforce international claims for damages against states in disputes arising from the state's exercise of public authority, without those claims being filtered by the investor's home state or by an international organization;

2. States are subjected to broadly-worded international standards that apply to a wide range of governmental activity, affording arbitration tribunals broad discretion to award damages to investors and thus make decisions about the cost of government, with limited supervision by domestic courts; and

3. Disputes are resolved using a private model of adjudication based on rules of private arbitration and incorporating the enforcement structure of international commercial arbitration.

The argument of this thesis is that investment arbitration, although commonly approached as a reciprocally consensual method of adjudication, should instead be viewed as a unique form of governing arrangement. Investment arbitration is a governing arrangement because it is established by a sovereign act of the state and because it is used to resolve regulatory disputes arising from the exercise of pubic authority. This distinguishes investment arbitration from conventional international adjudication (between states) or international commercial arbitration (between private parties). Further, investment arbitration is unique and open to criticism because it combines the prospective and far-reaching, yet selective, individualization of international claims with the use of a private model of arbitration. This distinguishes investment arbitration from other forms of international adjudication which allow individual claims. Overall, characterizing investment arbitration as a unique form of governing arrangement reveals the importance of the system as a means to control the exercise of public authority in the regulatory sphere.

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Chapter One

Introduction

In March, 2003, an international tribunal in Sweden, established under a bilateral investment treaty, ordered the Czech Republic to pay U.S.$353 million to an investor that owned a Czech television broadcasting business.[1] The investor was a Dutch company, *CME Czech Republic*, owned by cosmetics billionaire Ralph Lauder, an American citizen.[2] The tribunal ordered the damages award after deciding that the Czech government had violated a 1991 investment treaty between the Czech Republic and the Netherlands.[3] After unsuccessfully trying to have the award set aside in the Swedish courts, the Czech government committed to pay the award in full lest it suffer more harm to its reputation among international investors.[4]

Even in the fast-changing environment of international investment arbitration,[5] the *CME* award stood out for two reasons. First was its size: the *CME* award was the largest yet under a flood of investment treaties signed in the last 20

[1] *CME Republic B.V.* v. *Czech Republic* (Merits) (13 September 2001), 14(3) World Trade and Arb. Mat. 109; *CME Republic B.V.* v. *Czech Republic* (Damages) (14 March 2003), 15(4) World Trade and Arb. Mat. 83 and 245 [hereinafter *CME*].
[2] B. Von Hase, "Do the Right Thing" *The [London] Times Magazine* (13 September 2003) 50.
[3] *Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic*, 29 April 1991, online: UNCTAD http://www.unctad.org/sections/dite/iia/docs/bits/czech_netherlands.pdf. The treaty violation arose from the Czech government's regulatory treatment of a Czech television network that was owned by CME. According to the arbitration tribunal, the government in effect destroyed the investment by forcing CME to give up its ownership share.
[4] *CME Republic B.V.* v. *Czech Republic* (SVEA Judgment) (15 May 2003) (C.A. Sweden), 15(5) World Trade and Arb. Mat. 171. 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). L.E. Peterson, "Swedish court affirms award against Czech Republic; damages could be taxable" *Investment Law and Policy Weekly News Bulletin* (16 May 2003).
[5] The term "investment arbitration" (or "investor-state arbitration") refers to compulsory arbitration, pursuant to an investment treaty, between a state and an investor at the instance of the latter. The term "international" investment arbitration is used to distinguish treaty-based investment arbitration from legislation-based and contract-based investment arbitration. In this thesis, references to "investment arbitration" refer to treaty-based (i.e. international) investment arbitration.

years. The award was roughly equal to the Czech annual health care budget.[6] 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.[7] Second, just ten days before the *CME* award was made, a parallel claim for damages by Ralph Lauder himself, based on essentially the same case against the Czech Republic but this time under a Czech-U.S. investment treaty, was dismissed by a separate tribunal.[8] Thus, two conflicting decisions emerged from the same dispute, adjudicated under two similarly-worded investment treaties.[9] Mr. Lauder, the American investor, lost his personal claim on the basis that the breach of the treaty was "too remote to qualify as a relevant cause for the harm".[10] Nevertheless, Mr. Lauder, the Dutch investor, collected damages through a holding company established in the Netherlands.[11]

A. The emerging system of international investment arbitration

The *CME* award is an outcome of an emerging system of international arbitration based on more than two thousand investment treaties, most of which were concluded since the early 1990s.[12] As part of this system, investment treaties have three key features:

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[6] T. Kellner, "The Informer: Call It the Ronald *Lauder* Tax", 171(9) *Forbes Magazine* (28 April 2003).
[7] *CME* (Merits), *supra* note 1, para. 80 (separate opinion).
[8] *Ronald S. Lauder* v. *Czech Republic* (Final Award) (3 September 2001), (2002) 4 World Trade and Arb. Materials 35 [hereinafter *Lauder*].
[9] C.N. Brower, C.H. Brower II, and J.K. Sharpe, "The Coming Crisis in the Global Adjudicative System" (2003) 19 Arb. Int'l 415, 424-8.
[10] *Lauder*, *supra* note 8, para. 235.
[11] 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 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), *supra* note 1, para. 426-33). The Swedish court of appeal was also influenced by the fact that the Czech Republic had refused, at an early stage, the investor's offer to consolidate the two claims: *CME* (SVEA Judgment), *supra* note 4, 210 and 242.
[12] 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).

1. States authorize foreign investors (read multinational enterprises[13]) to make and enforce international claims for damages[14] against states in disputes arising from the state's exercise of public authority, without those claims being filtered by the investor's home state or by an international organization;

2. States are subjected to broadly-worded international standards that apply to a wide range of governmental activity, affording arbitration tribunals broad discretion to award damages to investors and thus make decisions about the cost of government, with limited supervision by domestic courts; and

3. Disputes are resolved using a private model of adjudication based on rules of private arbitration and incorporating the enforcement structure of international commercial arbitration.

Taken together, these features define investment treaties as something more than a mere collection of disparate treaties with distinct dispute settlement procedures. Indeed, they unify them as a generalized adjudicative *system*, one designed to control and discipline states in the regulatory sphere. This system is complex, fragmented, and at times incoherent because of variations among different treaties and, although it has wide geographic coverage, the system falls short of a global system in the absence of a

[13] As defined by the OECD, *OECD Guidelines for Multinational Enterprises*, Revision 2000 (Paris: OECD, 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.

See also S. Timberg, "International Combines and National Sovereigns" (1947) 95 U. Penn. L.R. 575, 577-8; A.A. 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* (Aldershot: Gower, 1986), 80-1.

[14] The term "damages" is used instead of "compensation" to highlight that the money remedy follows from a finding of unlawful conduct: D.W. Bowett, "Claims Between States and Private Entities: The Twilight Zone of International Law" (1986) 35 Cath. U. L. Rev. 929, 937-8.

multilateral investment code or bilateral investment treaties (BITs) between capital-exporting states. Even so, contemporary investment treaties should be approached as part of a system because of what they have in common: the authorization of individual claims for damages using broad jurisdictional concepts and liberal standards of investor protection, based on a private model of adjudication.

The system of investment arbitration has emerged recently through the proliferation of investment treaties in the 1990s, along with growing awareness of investment arbitration among investors.[15] Since the mid-1990s, in particular, investors have used investment arbitration more frequently and in increasingly sophisticated ways. For example, following the *CME* award, other investors threatened claims against the Czech Republic in cases ranging from the collapse of a Czech bank to an unsuccessful bid for a mobile phone network to the seizure of a jet by customs authorities in lieu of back taxes owed by the owner.[16] Under the investment provisions of the *North American Free Trade Agreement* (NAFTA), claims have been launched against each NAFTA state in disputes arising from various governmental activities, including a ban on the export of hazardous wastes by the Canadian Parliament, the creation of an ecological park by a Mexican state government, and the conduct of a jury trial by a U.S. court.[17] Under bilateral investment treaties, through the use of holding companies, foreign investors have been able to bring multiple claims in relation to the same underlying dispute and domestic investors have successfully brought an international claim against their own state.[18] Perhaps most

[15] For a description of the process of investment arbitration, see G.N. Horlick and A.L. Marti, "NAFTA Chapter 11B: A Private Right of Action to Enforce Market Access through Investments" (1997) 14 J. Int'l Arb. 43; UNCTAD, *Dispute Settlement: Investor-State*, UNCTAD Series on Issues in International Investment Agreements (New York: United Nations, 2003), 40-64.

[16] L.E. 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.

[17] *S.D. Myers, Inc.* v. *Government of Canada* (Merits) (12 November 2000), 40 I.L.M. 1408, 15(1) World Trade and Arb. Mat. 184; *Metalclad Corporation* v. *United Mexican States* (Merits) (30 August 2000), 40 I.L.M. 36, 13(1) World Trade and Arb. Mat. 45; *The Loewen Group, Inc. and Raymond L. Loewen* v. *United States of America* (Merits) (26 June 2003), 42 I.L.M. 811, 15(5) World Trade and Arb. Mat. 97.

[18] E.g. *CME* (Merits) and *Lauder*, *supra* note 1 and 8, respectively; *Tokios Tokelės* v. *Ukraine* (Jurisdiction) (29 April 2004), 16(4) World Trade and Arb. Mat. 75 [hereinafter *Tokios*], para. 21 and 38.

dramatically, investors have made roughly 37 claims against Argentina and are seeking tens of billions of dollars in damages arising from the government's response to the country's financial crisis in 1998.[19]

B. The character of investment arbitration

International investment arbitration is commonly approached as a reciprocally consensual method of adjudication between an investor and the state. The argument of this thesis is that investment arbitration should instead be characterized as a unique form of governing arrangement. Investment arbitration – based on investment treaties – is a governing arrangement because it is established by a sovereign act of the state and because it is used to resolve disputes arising from the exercise of public authority; i.e. disputes within the public sphere. As such, the subject matter of investment arbitration is a regulatory dispute arising between the state (acting in a public capacity) and an individual who is subject to the exercise of public authority by the state. This distinguishes investment arbitration from reciprocally consensual adjudication as conventionally used to resolve international disputes (between states) or commercial disputes (between private parties). Investment arbitration engages the regulatory relationship between the state and an individual, rather than a reciprocal relationship between juridical equals.

As a governing arrangement, investment arbitration is unique and open to criticism because it provides for the prospective and far-reaching, yet selective, individualization of international claims based on a private model of adjudication. Investment arbitration entails far-reaching individualization of international claims because states authorize investors directly to bring and enforce international damages claims, often without imposing a duty to exhaust local remedies. This individualization is selective because it applies only to investors. Moreover, investment arbitration is based on a private model of adjudication in that investment treaties adopt rules of arbitration that originate in commercial arbitration and they

[19] M. Kantor, "The New Draft Model U.S. BIT: Noteworthy Developments" (2004) 21 J. Int'l Arb. 383, 393; O.C. Pell, News Release via PR Newswire, "Recent Argentine Legislation and Bondholder Remedies – Memorandum to the Global Committee of Argentina Bondholders" (16 February 2005).

incorporate the enforcement structure of international commercial arbitration. These aspects of investment arbitration distinguish it from other forms of international adjudication that allow individual claims, and they are open to criticism as discussed below.

Distinguishing investment arbitration from both conventional international adjudication and international commercial arbitration highlights the significance of investment arbitration as a governing arrangement. In the first place, investment arbitration can be distinguished from conventional international adjudication between states because it is based on the authorization of individuals to directly bring international claims. The individualization of international adjudication makes it more likely that international claims will be instituted against states and damages awarded to foreign investors.[20] Moreover, individualization under investment treaties is more far-reaching than under other international arrangements which authorize individual claims, such as human rights treaties, because investment treaties typically limit the investor's duty to exhaust local remedies, adopt damages against the state as the remedy, and authorize the direct enforcement of awards by domestic courts in a large number of countries. Also, investment treaties are distinct from historical claims commissions involving international claims on behalf of individuals because they contain a prospective – or *general* – consent by the state to the compulsory arbitration of any future dispute between the state and foreign investors. The broad scope and substance of the general consent arguably subjects the regulatory relationship with foreign investors to binding and enforceable standards to a greater degree than any form of international adjudication since the colonial era.

Investment arbitration should also be distinguished from international commercial arbitration even though investment treaties rely on a private law model of adjudication. In commercial arbitration, when a state consents by contract to the arbitration of a commercial dispute with a private party, the state acts in a private

[20] In *CME*, the U.S. Embassy to the Czech Republic reportedly declined to bring a claim of diplomatic protection on behalf of the investor: B. Kenety, "Nova TV: New Democracy or Old-Fashioned Greed?" *The Prague Post* (12-18 February 1997), citing a U.S. Embassy press release ("The US Embassy wishes to correct the misperception that it may be contemplating a diplomatic intervention, or other 'expression of views' on behalf of TV Nova [CME]. The Embassy does not believe there are grounds for such action. It is our view that the climate for foreign investors in the Czech Republic is generally favorable.").

capacity. In such cases, the arbitration arises not from a regulatory dispute but from a dispute between juridical equals; i.e. between two private parties (one of which happens to be the state) equally capable of possessing legal rights and obligations. In contrast, when a state consents generally by treaty to the compulsory arbitration of investment disputes, the state acts in a sovereign capacity. Only a state can exercise the public authority required to make a general consent. Also, where an investor subsequently consents to investment arbitration by acting on the opportunity provided by the state's general consent, the investor invokes a governing arrangement established by states. Finally, disputes that are resolved through investment arbitration arise from the exercise of public authority by the state, whereas disputes that are resolved through commercial arbitration arise from the state's participation in a commercial relationship with another private party.

The significance of the emerging system of investment arbitration is sometimes underestimated. Characterizing investment arbitration as a unique form of governing arrangement reveals the importance of the system as a means to control the exercise of public authority in the regulatory sphere. Simply put, no other adjudicative system combines all of the elements of international investment arbitration. Recognizing this enables a more informed and precise assessment of the emerging system in the context of contemporary globalization. The argument that investment arbitration is a unique form of governing arrangement is elaborated below.

1. The use of adjudication as governing arrangement

The system of investment arbitration is a governing arrangement which uses compulsory[21] adjudication as a means to determine the legality and appropriateness of the exercise of public authority.[22] A governing arrangement is an instrument or mechanism adopted by the state to manage the relationship between public entities

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[21] M.O. Hudson, *International Tribunals* (Washington: Carnegie Endowment for International Peace and the Brookings Institution, 1944), 75 ("compulsory jurisdiction… may be said to exist only where a particular tribunal, either preexisting or susceptible of being brought into existence without the concurrence of the parties to the dispute, is endowed with power to decide a dispute upon the application of a single party").

[22] M. Damaška, "Activism in Perspective" (1983) 92 Yale L.J. 1189, 1191-2; M. Loughlin, *The Idea of Public Law* (Oxford: OUP, 2003), 5 and 12.

and individuals who are subject to the exercise of public authority. As a governing arrangement, investment arbitration forms part of the collection of institutions and processes that apply to the relationship between those who govern and those who are governed; between public officials and bodies, on the one hand, and private parties who are subject to the state's authority, on the other.[23] In many states, adjudication plays an important and expanding role in regulating relations between individuals and state.[24] One of the purposes of public law is to constrain the exercise of public authority by executive government and, under domestic constitutions, by the legislature.[25] When a judge invokes his or her public law jurisdiction to resolve a dispute between the state and a person or organization that is subject to the exercise of public authority, he or she determines matters such as the legality of governmental activity, the degree to which individuals should be protected from regulation, and the appropriate role of the state.[26] Adjudication is thus part of the governing apparatus.[27]

Because investment treaties are broad in scope and apply liberal standards of investor protection, they impose extensive constraints on government. Indeed, in strict legal terms, investment arbitration tribunals have more authority to award damages against the state than any other court or tribunal, whether domestic or international. As a result, tribunals decide policy matters of broad public concern. By interpreting a treaty and deciding whether to award damages, arbitrators determine the cost and, as such, the viability of government. They rule on the legality of state conduct, evaluate the fairness of governmental decision-making, determine the appropriate scope and content of property rights, and allocate risks and costs between business and society.[28] As a governing arrangement, investment arbitration involves the resolution of conflicts between investors and other individuals and groups,

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[23] An adjudicator's authority to resolve a dispute, like the authority of other individuals who exercise public authority, is a part of the apparatus for governing within a state. Damaška, ibid., 1191-2; Loughlin, ibid., 5 and 88.
[24] M. Shapiro, "The Globalization of Law" (1993) 1 Ind. J. Global Legal Studies 37, 47-50; J.H.H. Weiler, "Epilogue: Towards a Common Law of International Trade" in J.H.H. Weiler, ed., *The EU, the WTO, and the NAFTA* (Oxford: OUP, 2000), 201-2.
[25] Loughlin, *supra* note 22, 30 and 85.
[26] J.H.H. Weiler, *supra* note 24, 202; M. Koskenniemi, "What Is International Law For?" in M.D. Evans, ed., *International Law* (Oxford: OUP, 2004), 99-100.
[27] Loughlin, *supra* note 22, 5 and 88.
[28] F.I. Michelman, "Property, Utility, and Fairness: Comments on the Ethical Foundations of 'Just Compensation' Law" (1967) 80 Harv. L.R. 1165, 1168-9; C. Harlow and R. Rawlings, *Law and Administration* (London: Butterworths, 1997), 605-6.

conflicts that would otherwise be resolved by other means, including adjudication based on domestic public law. For these reasons, investment arbitration has important implications not only for states and investors but for anyone who is legally represented by the state and affected by state regulation of international business.

The characterization of investment arbitration as a governing arrangement draws on assumptions about sovereignty. In the juridical sense, sovereignty is a conceptual framework for understanding the representative relationship between the state and the people in its territory and, as such, for organizing the public sphere.[29] Sovereignty means that the state is treated as the entity that represents a group of people in relation to the members of the group and to other states.[30] Sovereignty is a matter of authority not control; it is a concept not an attribute.[31] In ideal terms, sovereignty implies external autonomy and internal control on the part of the state but neither fully exists in reality.[32] Rather, sovereignty is a tool for thinking about how people are organized as political entities. As such, it is a foundational concept of public international law and domestic public law.[33] As a sovereign in the international sphere, a state is the representative of a population and territory; in the domestic sphere, the state is the repository of the collective authority to make governmental decisions.

The establishment of investment arbitration as a governing arrangement originates in the exercise of public authority by the state, acting as the juridical sovereign. By consenting generally to the international arbitration of regulatory disputes that could arise in its territory, a state exercises public authority that no

[29] F.W. Maitland, "The Crown as Corporation" (1901) 17 L.Q. Rev. 131, 131-3 and 138; Q. Skinner, "Hobbes and the Purely Artificial Person of the State" (1999) 7 J. Pol. Phil. 1, 1-3; I. Brownlie, *Principles of Public International Law*, 6th ed. (Oxford: OUP, 2003), 119 and 289.
[30] R. Jackson, "Sovereignty in World Politics: a Glance at the Conceptual and Historical Landscape" (1999) 47 Pol. Studies 431, 453; Brownlie, ibid., 58 and 497.
[31] A.V. Dicey, *An Introduction to the Study of the Law of the Constitution* [1885] (London: Macmillan, 8th ed. 1915), 27-34; Jackson, ibid., 432-3; A. Sweet Stone, "Islands of Transnational Governance" in M. Shapiro and A. Sweet Stone, eds., *Law, Politics, and Judicialization* (Oxford: OUP, 2002), 323.
[32] S. de Smith and R. Brazier, *Constitutional and Administrative Law*, 8th ed. (London: Penguin, 1998), 97-100; Loughlin, *supra* note 22, 76 and 84.
[33] C. Eagleton, *The Responsibility of States in International Law* (New York: NYU Press, 1928), 4, 28 and 35-6; A. James, *Sovereign Statehood: The Basis of International Society* (London: Allen & Unwin, 1986), 267-9; Loughlin, *supra* note 22, 58-60 and 83; C. Warbrick, "States and Recognition in International Law" in M.D. Evans, ed., *International Law* (Oxford: OUP, 2004), 211-12.

private party can possess.[34] In other words, states act in a sovereign capacity when they consent by treaty to compulsory investment arbitration. Only the state can delegate adjudicative authority over a regulatory dispute in its territory to an international tribunal: this authority is an inherently public authority that flows from the representative nature of the state.[35] Likewise, only the state can authorize the enforcement of a foreign arbitration award by its domestic courts. Thus, the system of investment arbitration depends on the legal authority (as well as coercive power) of the state in order to protect investors and constrain government. For the same reason, the system remains subject to modification by states.[36] This is because states alone have the authority to conclude, abrogate, or amend an investment treaty, even though the exercise of that authority – like all public authority – takes place in a social and political context in which private actors influence and participate in public decision-making.

2. The adjudication of regulatory disputes

The system of investment arbitration uses international adjudication as a governing arrangement for the resolution of regulatory disputes. A regulatory dispute is a dispute between the state and a private individual who is subject to the exercise of public authority by the state. Regulatory disputes can be distinguished from other public disputes (between states or state entities) as well as private disputes (between private parties). This characterization is based on the distinction between the public and the private sphere, a distinction that has its complications.[37] For instance, not all legal

[34] W.I. Jennings, *The Law and the Constitution* (London: University of London Press, 1959), 312; W. Friedmann, *Law in a Changing Society* (London: Stevens & Sons, 1959), 351; E.M. Borchard, "Governmental Responsibility in Tort: VII" (1928) 28 Colum. L. Rev. 577, 610 and 614-15; D. Cohen and J.C. Smith, "Entitlement and the Body Politic: Rethinking Negligence in Public Law" (1986) 64 Can. Bar. Rev. 1, 5-6; Harlow and Rawlings, *supra* note 28, 5 and 41-5.
[35] Dicey, *supra* note 31, 4, 18-19, 68-72, and 103.
[36] D. Schneiderman, "Investment Rules and the New Constitutionalism" (2000) 25 Law & Social Inq. 757, 761-2.
[37] More precisely, it is acknowledged that non-state entities can, of course, exercise public authority (as delegated by the state) and wield power over large numbers of people in important ways. Rather, the categories of public and private are based on a formal distinction between public and private authority as opposed to actual power. See A. Claire Cutler,

disputes are exclusively public or private in nature.[38] On the other hand, most disputes that are subject to investment arbitration do fall squarely within the public sphere and, more precisely, within the regulatory sphere. This is not because the outcome of the dispute is significant to the public at large (although this is often the case) but because the dispute arises from the exercise of public authority. Overlooking this "public" aspect of investment arbitration leads to confusion about the nature of the emerging system.[39] For this reason, abstractions like "governing arrangement" and "regulatory dispute" are important in the characterization of investment arbitration.[40]

To elaborate, a public dispute is a dispute that arises from the exercise of public authority. A public dispute can be international or domestic in nature. International disputes (in the public sphere) include disputes between states and disputes between a state and an international organization (such as the United Nations). Domestic public disputes traditionally include disputes between entities of the state (such as a national ministry or local government) and disputes between the state and a person or organization that is subject to the exercise of public authority by the state. Only this last form of public dispute directly involves a private party as a disputing party alongside the state. Put differently, only this last form of public dispute is "individualized" by the inclusion of an individual as a party to the dispute. For the purposes of this thesis, this form of public dispute is referred to as a regulatory dispute.

A regulatory dispute is a dispute that arises from the relationship between the state and a party who is subject to regulation by the state.[41] A regulatory dispute is a form of public dispute because the dispute arises from the exercise of public authority. In contrast, a private dispute is a dispute between individuals, each acting in a private capacity, even if the relationship between those individuals is itself subject to state

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"Critical Reflections on the Westphalian Assumptions of International Law and Organization: A Crisis of Legitimacy" (2001) 27 Rev. of Int'l Studies 133, 138; D. Mullan and A. Ceddia, "The Impact on Public Law of Privatization, Deregulation, Outsourcing, and Downsizing: A Canadian Perspective" (2003) 10 Ind. J. Global Legal Studies 199, 245.

[38] M.M. Carrow, *The Background of Administrative Law* (Newark: Associated Lawyers, 1948), 14.

[39] E.g. Brower et al., *supra* note 9, 415 (characterizing all investment disputes as commercial disputes).

[40] W. Twining, *Globalisation and Legal Theory* (London: Butterworths, 2000), 11.

[41] Damaška, *supra* note 22, 1191-2.

regulation.[42] In commercial arbitration, a party's consent to arbitration is a consent within the private sphere, not because the consent is irrelevant to the wider community, but because the disputing parties – acting in a private capacity – have agreed to use a particular method of adjudication to resolve their dispute.[43] In other words, they have agreed to remove the adjudication of the dispute from the courts and subject the dispute to private arbitration.

In a regulatory dispute, as in any public dispute, it is impossible for the disputing parties – acting in a private capacity – to consent to an alternative form of adjudication because a public dispute by definition involves the exercise of public authority by the state. Further, and as a result, when the state authorizes the adjudication of a public dispute, the state acts in a sovereign capacity.[44] In authorizing the adjudication, the state makes a policy decision to incorporate that method of adjudication into the state's governing apparatus. Thus, the use of adjudication as a governing arrangement can be distinguished from consensual adjudication in the private sphere because the state acts in a sovereign capacity when it consents to the adjudication and because the relevant disputes arise from the exercise of public authority.

By concluding a treaty that provides for compulsory investment arbitration, a state delegates[45] adjudicative authority over disputes arising from the exercise of public authority in the state's territory to international tribunals. Further, the state delegates the judicial authority to supervise those international tribunals to the courts of a large number of countries.[46] This transfer of authority integrates decision-making by international tribunals and foreign courts into the governing apparatus of the state. The use of investment arbitration as a governing arrangement does not remove

[42] A. Chayes, "The Role of the Judge in Public Law Litigation" (1976) 89 Harv. L.R. 1281, 1282-4.
[43] A.S. Rau, "Integrity in Private Judging" (1997) 38 South Texas L.R. 455, 486-7; A. Redfern and M. Hunter, *Law and Practice of International Commercial Arbitration* (London: Sweet & Maxwell, 1999), 135.
[44] V. Lowe, "Jurisdiction" in M.D. Evans, ed., *International Law* (Oxford: OUP, 2004), 351-2.
[45] The state "delegates" adjudicative authority in the same manner that it delegates any public authority that resides in the state as a representative entity. Dicey, *supra* note 31, 4, 18-19, 68-72, and 103.
[46] See chapter six of this thesis, page 209-11.

governmental decision-making from the regulatory relationship between investors and the state; it changes how and by whom governmental decisions are made.[47]

The adjudication of a regulatory dispute by a domestic court involves the use of adjudication, not as a consensual method of adjudication between private parties, but as a governing arrangement.[48] Based on a conventional characterization of inter-state relations, regulatory disputes were traditionally adjudicated by domestic courts acting on the basis of domestic public law. Domestic public law conventionally dealt with the internal authority of the state: how public authority was constituted, delegated, and exercised within the state's territory.[49] On the other hand, public international law conventionally dealt with the external authority of the state: how relations and disputes among states were governed and resolved.[50] It is true that, in public international law, adjudication was occasionally used to resolve disputes arising from one state's treatment of a national of another state and, in such cases, international adjudication appeared to directly engage the regulatory relationship between a state and foreign nationals who were subject to the exercise of public authority by the state. However, the degree to which this was so was limited by doctrines of sovereign consent and immunity and by the duty to exhaust local remedies. Regulatory disputes in a state's territory were presumed to fall within the exclusive domain of the state's legal system subject to minimum standards of international law,[51] and disputes could not be adjudicated at the international level without the host state's consent.[52] Further, an international claim on behalf of a foreign national had to be brought by the home state and was treated, in principle, as the home state's claim.[53] These rules flowed from assumptions about the exclusive

[47] A.T. Mason, "Judicial Activism: Old and New" (1969) 55 Va. L.R. 385, 385-6; Chayes, *supra* note 42, 1304; Harlow and Rawlings, *supra* note 28, 78-8.
[48] L.L. Fuller, "Consideration and Form" (1941) 41 Colum. L. Rev. 799, 806-8; Chayes, *supra* note 42, 1294-5.
[49] de Smith and Brazier, *supra* note 32, 6-7 and 503; Loughlin, *supra* note 22, 84.
[50] T.J. Lawrence, *The Principles of International Law* (London: Macmillan and Co., 1923), 2-3; M.N. Shaw, *International Law*, 5th ed. (Cambridge: CUP, 2003), 121.
[51] Brownlie, *supra* note 29, 291.
[52] Hudson, *supra* note 21, 69; D.J. Harris, *Cases and Materials on International Law*, 5th ed. (London: Sweet & Maxwell, 1998), 985.
[53] *Mavrommattis Palestine Concessions* (*Greece* v. *Great Britain*) (1924), P.C.I.J. Ser. A, No. 2 [hereinafter *Mavrommattis*], 12; *Administrative Decision No. V* (1924), 7 R.I.A.A. 119, 19 AJIL 612, 626-7 (U.S.-Germany Mixed Claims Commission); *Nottebohm* (*Liechtenstein* v. *Guatemala*),

nature of the state's authority in its territory and they circumscribed international adjudication as a means to resolve regulatory disputes.

Thus, in customary international law, where the regulatory relationship was subject to international adjudication, a dispute was conceptually converted from a regulatory dispute between the host state and an individual into a dispute between juridical equals (i.e. states). The regulatory relationship became a reciprocal relationship. However, with the individualization of international claims, regulatory disputes are carried into the realm of international adjudication, and the state and the aggrieved individual directly face each other as disputing parties. The regulatory relationship becomes subject to an individualized form of international adjudication. Yet, the selectivity of individualization has an important implication: the fact that only investors are able to make international claims disadvantages other individuals who remain dependent on the state to represent their rights and interests in relation to investment disputes that are resolved through international arbitration.

C. The uniqueness of investment arbitration

There is nothing remarkable about the fact that some legal disputes have an international character in that they engage the interests of different states or the interests of nationals of different states, or both. The mere existence of states makes international disputes inevitable. International *investment* disputes have existed for as long as people and organizations in one country have acquired business interests abroad. Economic and social developments in the 19th and 20th Centuries – European industrialization and expansion, the spread of international business and international credit, socialist revolution and Third World decolonization, the creation of new states, the rise and fall of the Soviet bloc – all created conditions in which investment disputes proliferated.[54] To what degree could a state favour domestic industry over foreign competitors? To what minimum standard of treatment were foreign investors entitled under international law? In what circumstances could a government regulate

[1955] I.C.J. Rep. 4, 24; *Barcelona Traction, Light and Power Co. (Belgium* v. *Spain)*, [1970] I.C.J. Rep. 3, 9 I.L.M. 227 [hereinafter *Barcelona Traction*], para. 78-9.

[54] A.A. Fatouros, "International Law and the Third World" (1964) 50 Va. L.R. 783, 783-94; P.T. Muchlinski, *Multinational Enterprises and the Law* (Oxford: Blackwell, 1999), 10-11.

(or expropriate) the property and business of a multinational enterprise? These questions have driven the international law of diplomatic protection for well over a century,[55] culminating in the recent explosion of investment arbitration.[56]

In international law, the adjudication of regulatory disputes that raised issues within the international sphere was conventionally dealt with through dispute resolution between states.[57] Disputes involving the treatment of a foreign national could be the basis for a claim of diplomatic protection by the home state of the foreign national against the host state whose conduct was in question.[58] However, claims of diplomatic protection were usually resolved through negotiation and, rarely, by adjudication between states.[59] Even if the individual was dissatisfied with the result, he or she had no further remedy under international law.[60] Individuals could not act independently of their own state by bringing a claim before an international tribunal.[61] Individuals lacked legal standing to make such claims and international tribunals lacked general jurisdiction to hear them.[62] As such, individuals relied on their home

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[55] C.D. Gray, *Judicial Remedies in International Law* (Oxford: Clarendon, 1987), 11; D. Bodansky and J.R. Crook, "Symposium: The ILC's State Responsibility Articles – Introduction and Overview" (2002) 96 AJIL 773, 776.

[56] From 1996 to June 2005, 149 investor-state claims were registered at the International Centre for the Settlement of Investment Disputes (ICSID) in Washington, D.C., compared to 35 claims in the previous three decades. So recent is the explosion of investment arbitration that UNCTAD (*Trends in International Investment Agreements: An Overview*, UNCTAD Series on Issues in International Investment Agreements (New York: United Nations, 1999), 47) 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 a 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.

[57] Hudson, *supra* note 21, 67-9; J.G. Merrills, *International Dispute Settlement*, 3rd ed. (Cambridge: CUP, 1998), 114-15; J. Collier and V. Lowe, *The Settlement of Disputes in International Law* (Cambridge: CUP, 1999), 6-7.

[58] *Mavrommattis*, *supra* note 53, 12. E.M. Borchard, "Basic Elements of Diplomatic Protection of Citizens Abroad" (1913) 7 AJIL 497, 576; Fatouros, *supra* note 54, 800-4.

[59] Harris, *supra* note 52, 985; J. Merrills, "The Means of Dispute Settlement" in M.D. Evans, ed., *International Law* (Oxford: OUP, 2004), 541.

[60] *Barcelona Traction*, *supra* note 53, 78-9. G.A. Christenson, "The United States-Rumanian Claims Settlement Agreement of March 30, 1960" (1961) 55 AJIL 617, 618-20; Muchlinski, *supra* note 54, 534-6.

[61] Hudson, *supra* note 21, 67-9 and 198; R. McCorquodale, "The Individual and the International Legal System" in M.D. Evans, ed., *International Law* (Oxford: OUP, 2004), 308.

[62] *Mavrommattis*, *supra* note 53, 12. Hudson, *supra* note 21, 67-9 and 198; E.F. Mooney, *Foreign Seizures – Sabbatino and the Act of State Doctrine* (University of Kentucky Press, 1967), 130.

state for representation and, as victims of "the arbitrary whim or caprice of state officials" or "the most flagrant spoliations of private property", they sometimes suffered for this dependence.[63]

However unfair this might appear – from the perspective of protecting individuals from state abuse – it flowed from a central assumption of the international system. As a matter of principle, states are the representatives of their population and territory on the international plane.[64] As state-based representation changes and individuals are allowed to make international claims on their own behalf, important questions arise. For what reasons and in what circumstances should individuals be allowed to make international claims? Should foreign workers be able to claim damages from states that deny them access to all of the rights and privileges of domestic workers? Should refugees be able to make claims against states that refuse them asylum and deport them to torture? Should indigenous peoples have the right make claims against states that expropriated their land?

Though arguably fair and commendable, these potential changes to state-based representation – based on the elevation of the status of individuals to allow them to better defend their rights and interests – are not seriously on the international agenda.[65] With the notable exception of the European Union, states have long resisted allowing individuals to make international claims and, because only states have the authority to change customary rules of international law, such reform has not taken place.[66] This is why international claims by investors in cases like *CME* are groundbreaking. They stand out, not because they reflect a general movement to elevate the individual in the international sphere based on open and independent

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[63] Quoting, respectively, M.S. McDougal, H.D. Lasswell, and L. Chen, "Nationality and Human Rights: The Protection of the Individual in External Arenas" (1973) 83 Yale L.J. 900, 906; W.L. 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.
[64] W.W. Willoughby, *The Fundamental Concepts of Public Law* (New York: Macmillan, 1924), 307.
[65] Important reforms have taken place to elevate the international status of individuals, especially in human rights law, but they differ in their scope and effectiveness from contemporary investment arbitration: D. Shelton, *Remedies in International Human Rights Law* (Oxford: OUP, 1999), 137-8; E.B. Weiss, "Invoking State Responsibility in the Twenty-first Century" (2002) 96 AJIL 798, 809-11 and 815; R. Bachand and S. Rousseau, "International Investment and Human Rights: Political and Legal Issues" (Background paper for Rights & Democracy, 11 June 2003), 14.
[66] Hudson, *supra* note 21, 200-2.

judicial decision-making,[67] but for the opposite reason. Investment arbitration is a highly exceptional – yet ambitious and powerful – arrangement to protect some individuals by constraining government, to the disadvantage of those who might otherwise benefit from governmental activity.[68]

Normally, regulatory disputes are resolved by executive and legislative decision-making, including diplomatic relations between states.[69] Removing such disputes from these forums and subjecting them to investment arbitration allows an adjudicator to determine the legality and appropriateness of governmental activity.[70] In itself, this is nothing new: states often impose legal controls on government that are implemented in rules-based form through adjudication.[71] What is remarkable about the system of investment arbitration is that it combines the prospective and far-reaching individualization of international claims with a private model of international adjudication in order to resolve regulatory disputes.

[67] R. Higgins, "Conceptual Thinking about the Individual in International Law" (1978) 4 Brit. J. Int'l Studies 1, 5-7; Shapiro, *supra* note 24, 47-50.
[68] UNCTAD, *World Investment Report 1996* (Geneva: United Nations, 1997), 161-73; Schneiderman, *supra* note 36, 762-4; UNCTAD (2004), *supra* note 12, 221.
[69] Eagleton, *supra* note 33, 23; Hudson, *supra* note 21, 191-4.
[70] Chayes, *supra* note 42, 1294-5.
[71] E.M. Borchard, "Government Responsibility in Tort, VI" (1927) 36 Yale L.J. 757, 765; M. Loughlin, *Sword and Scales* (Oxford: Hart, 2000), 9-10; M. Shapiro, "Administrative Law Unbounded: Reflections on Government and Governance" (2001) 8 Ind. J. Global Leg. Studies 369, 375-6.

1. The individualization of international claims

Investment arbitration elevates the status of the individual in international adjudication. Individual investors are authorized to bring claims under investment treaties, resulting in the *individualization* of international claims. Moreover, investment arbitration allows investors to obtain damages against the state. By allowing investors to make and enforce damages claims, investment treaties regulate states more intensively than other international regimes that protect individuals by constraining government. Other treaties that protect individuals very rarely allow individual damages claims to remedy a breach of the treaty and those few that do allow damages claims limit them in ways that investment treaties do not. Moreover, in domestic law the scope of state liability (in the regulatory sphere) is typically limited for reasons of legislative autonomy, judicial finality, and administrative discretion.[72] In contrast, investment treaties do not contain broad and express exceptions on these grounds, leaving the matter to the discretion of arbitrators. Thus, investors have more protection, understood in terms of the availability of damages as a public law remedy, under investment treaties than under domestic law. On the whole, investment arbitration involves prospective and far-reaching individualization that provides exceptionally powerful legal protection for investors, but not other individuals.

The individualization of claims depends on the state's consent to the compulsory arbitration of investor claims. Under investment treaties, states consent generally to the arbitration of future investment disputes based on broad jurisdictional concepts and liberal standards of investor protection.[73] The state's consent is not limited to a specific dispute, investor, or investment project. Rather, compulsory arbitration can be initiated by any member of an unknown class of potential claimants in relation to a virtually unlimited range of disputes. Thus, a wide range of regulatory disputes between investors and the state can be subjected to international arbitration at the instance of investors. Further, investment treaties define the scope of the state's consent and the jurisdiction of international tribunals in broad terms.[74] They apply to

[72] Borchard, *supra* note 34, 589 and 593; de Smith and Brazier, *supra* note 32, 601-6.
[73] J. Paulsson, "Arbitration without Privity" (1995) 10 ICSID Rev. 232, 232-3.
[74] T.W. Wälde, "Investment Arbitration Under the Energy Charter Treaty – From Dispute Settlement to Treaty Implementation" (1996) 12 Arb. Int'l 429, 434-6; A.E.L. Tucker, "The

virtually any sovereign act and they define "investment" to include a very wide range of assets. Also, investment treaties frequently define "investor" to include holding companies thus allowing forum-shopping by investors. Finally, investment treaties adopt liberal standards of investor protection in order to regulate the exercise of public authority in relation to investors. This settles – in favour of investor protection – historical controversies about whether and how international law protects foreign business from discriminatory treatment, denials of justice, expropriation, and other forms of interference or regulation by the state.[75]

As a result, investment arbitration engages the regulatory sphere to a greater degree than other forms of international adjudication. This is in part because investors are able directly to threaten and initiate claims, appoint arbitrators, develop legal arguments, negotiate terms of settlement, and receive and enforce awards. Granting this status to investors makes it more likely that international claims will be initiated and ambitiously pursued. Moreover, investment treaties remove customary limits on international adjudication. First, many treaties allow claims by corporations without imposing shareholder nationality restrictions or minimum thresholds of foreign ownership and control.[76] Second, most treaties limit or remove the duty to exhaust local remedies, allowing investors to bring an international claim before domestic courts have resolved the relevant dispute.[77] Taken together, these aspects of investment arbitration intensify the application of international disciplines in the regulatory sphere while making the framework of domestic public law more relevant to international adjudication.

Energy Charter Treaty and 'Compulsory' International State/ Investor Arbitration" (1998) 11 Leiden J. Int'l L. 513, 523-4; P.T. Muchlinski, "The Rise and Fall of the Multilateral Agreement on Investment: Where Now?" (2000) 34 Int'l Law. 1033, 1045-6.

[75] J.F. Williams, "International Law and the Property of Aliens" (1928) 9 Brit. Y.B. Int'l L. 1, 28; A.P. Fachiri, "International Law and the Property of Aliens" (1929) 10 Brit. Y.B. Int'l L. 32, 33-4 and 49-51; B.A. Wortley, *Expropriation in Public International Law* (Cambridge: CUP, 1959), 119-26; Muchlinski, *supra* note 54, 173 and 501-14.

[76] E.g. *Waste Management Inc.* v. *United Mexican States* (Merits) (30 April 2004), 43 I.L.M. 967, 16(4) World Trade and Arb. Mat. 3, para. 80; *Tokios*, *supra* note 18, para. 36; *CMS Gas Transmission Company* v. *The Republic of Argentina* (Jurisdiction) (17 July 2003), 42 I.L.M. 788, para. 47.

[77] E.g. *CME* (Merits), *supra* note 1, para. 410; *CME* (Damages), *supra* note 1, para. 398 and 412-13. UNCTAD, *supra* note 15, 31-7; V.L. Been and J.C. Beauvais, "The Global Fifth Amendment: NAFTA's Investment Protections and the Misguided Quest for an International 'Regulatory Takings' Doctrine" (2003) 78 N.Y.U. L.R. 30, 83-6.

Given the expansion of international adjudication into the regulatory sphere, investment arbitration is analogous – not to conventional international adjudication or international commercial arbitration – but to domestic adjudication under constitutional or administrative law. This means that investment arbitration should be analyzed and conducted with reference to a public law framework – based on principles such as openness and independence in adjudicative decision-making – that are often discarded or subordinated in inter-state adjudication and commercial arbitration. Similarly, the discretionary choices of arbitrators can be evaluated against the backdrop of different styles of public law adjudication, such as liberal normativism and pragmatic functionalism.[78] A public law framework is relevant to investment arbitration because investment arbitration is a governing arrangement rather than a form of reciprocally consensual adjudication between juridical equals.

The individualization of international claims is open to criticism for its selectivity. Access to investment arbitration is restricted to individuals who own sufficient foreign assets to make an investor claim and in most cases those investors are multinational enterprises. Investors who are exclusively domestic, and foreign nationals who do not own foreign assets, obtain no legal protection. A foreign-owned business whose profitability is reduced by state regulation can make a claim under an investment treaty, but a natural person – with foreign nationality – who was imprisoned without trial and tortured cannot. Where wealth constitutes a legal as well as practical condition of access, one is led to ask why the rights and interests of investors should be formally prioritized over other individuals in the governing apparatus.

2. The adoption of a private model of adjudication

The individualization of international adjudication takes a unique form in the case of investment arbitration because investment treaties adopt a private model of adjudication. Claims by investors are resolved by privately-appointed arbitrators based

[78] M. Loughlin, *Public Law and Political Theory* (Oxford: Clarendon, 1992), 59-61.

on rules and procedures that originate in commercial arbitration.[79] Also, to enforce investment arbitration awards, investment treaties incorporate the enforcement system of international commercial arbitration. This reliance on a private model of adjudication has prompted some commentators and adjudicators to approach investment arbitration as a form of international commercial arbitration. However, investment arbitration is a governing arrangement, not a reciprocally consensual method of adjudication between private parties.

Some commentators argue that globalization requires one to look beyond the state and the positive laws of states in order to recognize the emergence of autonomous and transnational legal orders in which non-state actors exercise law-making authority.[80] This view is often advanced in relation to the expansion of international commercial arbitration and *lex mercatoria*.[81] In this context, it is said, states have conceded law-making authority to a global regime in which private arbitrators and business organizations regulate conduct and resolve disputes without authorization by the state.[82] Also, it is said, arbitrators are empowered to apply substantive standards that reflect practices of the international business community rather than the domestic law of any state.[83] This transnational legal order is rooted not in a particular territory but in orders and systems operating beyond the control of states.[84] The transnational law thesis is open to criticism on various grounds,[85]

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[79] Wälde, *supra* note 74, 448; J.A. Soloway, "Environmental Regulation as Expropriation: The Case of NAFTA's Chapter 11" (2000) 33 Can. Bus. L.J. 92, 108.

[80] F. Snyder, "Governing Economic Globalisation: Global Legal Pluralism and European Law" (1999) 5 Eur. L.J. 334, 336 and 340-2; I. Seidl-Hohenveldern, *International Economic Law*, 3rd ed. (The Hague: Kluwer Law International, 1999), 1-3; Cutler, *supra* note 37, 133 and 143-7; Muchlinski, *supra* note 54, 229-37.

[81] P.C. Jessup, *Transnational Law* (New Haven, Yale University Press, 1956), 3-5; W. Mattli, "Private Justice in a Global Economy: From Litigation to Arbitration" (2001) 55 Int'l Org. 919, 923-6 and 944-5; I. Davies, "The New *Lex Mercatoria*: International Interests in Mobile Equipment" (2003) 52 I.C.L.Q. 151, 154-7. See also M. Sornarajah, "The UNCITRAL Model Law: A Third World Viewpoint" (1989) 6 J. Int'l Arb. 7, 16-17; M.J. Mustill, "Arbitration: History and Background" (1989) 6 J. Int'l Arb. 43, 50-1; Y. Dezaley and B. Garth, *Dealing in Virtue: International Commercial Arbitration and the Construction of a Transnational Legal Order* (Chicago: University of Chicago Press, 1996), 3-4 and 120-3.

[82] Shapiro, *supra* note 24, 37-8; G. Teubner, "'Global Bukowina': Legal Pluralism in the World Society" in G. Teubner, ed., *Global Law Without a State* (Aldershot: Dartmouth, 1997), 10-11.

[83] J. Paulsson, "Arbitration Unbound: An Award Detached from the Law of its Country of Origin" (1981) 30 I.C.L.Q. 358, 362.

[84] Teubner, *supra* note 82, 14-15 and 20-1.

although, given the emergence of the system of investment arbitration, one issue stands out. In particular, the transnational law thesis would be more compelling if states' concession of adjudicative authority to international arbitrators and institutions extended beyond the realm of commerce to that of government. This also suggests that the conclusion of over 2,000 investment treaties in which states consent to compulsory private arbitration of regulatory disputes supports the transnational law thesis more clearly than the expansion of commercial arbitration.

The most remarkable and suspect feature of investment arbitration is that, in contrast to adjudication before domestic or international courts, investment arbitration uses a private method of adjudication to resolve disputes in the regulatory sphere. One of the most fundamental aspects of sovereign authority – understood in terms of sovereignty as a juridical concept – is the authority to resolve disputes regarding the legality of the exercise of public authority. The fact that this authority has been delegated from domestic courts to arbitration tribunals rather than an international judicial body means that panels of privately-contracted adjudicators may resolve disputes that fall squarely within the regulatory sphere. Put differently, investment treaties transfer adjudicative authority not simply from domestic to international institutions but also from public to private institutions. This raises concerns about the independence and accountability of the system of investment arbitration, arising from the apprehension that arbitrators tend to favour adjudicative outcomes that are consistent with their commercial interest and professional mandate to promote investment arbitration. Few would argue that globalization calls for the transfer of legislative authority to international committees of skilled and reputable legal drafters, jointly appointed by investors and states. It is also questionable whether private arbitrators should have the authority to resolve regulatory disputes.

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This is not a thesis about international adjudication *per se*. It concerns the use of international adjudication in a novel way. Its object is to explain how investment arbitration may best be understood as a governing arrangement. The thesis does not

[85] M. Koskenniemi, "The Future of Statehood" (1991) 32 Harv. Int'l L.J. 397, 406; Shapiro, *supra* note 24, 37-8; Snyder, *supra* note 80, 341-2; Muchlinski, *supra* note 54, 233-6 and 238-9.

explicitly question the underlying rationale for a state to conclude an investment treaty; rather, the aim is to identify and define the system of investment arbitration, illuminate its character, and highlight some of its implications, thus drawing attention to an important development in contemporary globalization.

In sum: investment arbitration is a unique form of governing arrangement because it uses adjudication to resolve disputes arising from the exercise of public authority in the regulatory sphere. Investment arbitration involves the transfer of adjudicative authority both from domestic to international institutions and from public to private methods of adjudication. In transferring adjudicative authority from domestic to international institutions, investment treaties selectively elevate the individual in international law by allowing investors to make international claims. This makes investment arbitration unique as a form of international adjudication in the degree to which it engages the regulatory sphere. In transferring authority from public courts to private arbitrators, investment treaties transplant rules and structures from the realm of commerce to that of government. The convergence of these movements – based on the combination of prospective and far-reaching individualization with a private model of adjudication – captures the significance of investment arbitration as a governing arrangement.

The use of investment arbitration as a governing arrangement means that important governmental decisions will be made through international adjudication. Indeed, investment arbitration arguably engages the regulatory sphere more than any form of international adjudication outside of the European Union. By itself, this might be a welcome development but the selectivity of investment arbitration and its reliance on a private model of adjudication is problematic. To an unprecedented extent, states have established an international regime that singles out wealth for legal protection while subjecting regulatory disputes about the legality and appropriateness of governmental activity to the discretion of private contractors instead of tenured judges. For these reasons, the emerging system of investment arbitration should be the subject of intense scrutiny.

Chapter Two

Background

The purpose of this chapter is to examine the origins of the emerging system of investment arbitration in order to inform later analysis of the character of that system. In particular, the examination focuses on the evolution of the legal framework of the system, and especially key treaties, so as to highlight the importance of states' consents to the use of international arbitration as a governing arrangement. In adopting this orientation, this chapter diverges from other chapters of the thesis which focus on specific elements of investment arbitration itself.

A. Historical background

In the twentieth century, major capital-exporting states advanced several proposals for a multilateral[1] treaty that would codify liberal standards of investor protection[2] under international law. Some of these proposals would have given investors the ability to make international claims for damages against states. All were ultimately rejected, however, in the face of opposition by capital-importing states.

One example was the proposed International Convention for the Mutual Protection of Private Property Rights in Foreign Countries, aired in 1957 at an economic conference in San Francisco.[3] The proposed code was described by one delegate, Miguel A. Cuaderno (then the Governor of the Central Bank of the Philippines) as allowing private investors to dominate the economic, if not political,

[1] In this thesis, the term "multilateral" is reserved for investment treaties that are open to or intended for signature by any state. Investment treaties concluded between two states are referred to as "bilateral" investment treaties (BITs) and those between more than two states (whether or not as part of a broader trade agreement) as "regional" investment treaties.

[2] Substantive provisions in investment treaties are sometimes divided into standards of "protection" and "liberalization": e.g. UNCTAD, *World Investment Report 1996* (Geneva: United Nations, 1997), 189-94. In this thesis, for simplicity, all such provisions are referred to as standards of investor protection.

[3] A.S. Miller, "Protection of Private Foreign Investment by Multilateral Convention" (1959) 53 AJIL 371.

affairs of underdeveloped nations.[4] Guillermo Belt, representing Cuba, rejected the proposal as "a return to the Gay Nineties".[5] He was referring to the period of international business security and freedom that characterized imperialism and globalization in the late nineteenth century. But he might have been presaging the future, for the 1990s witnessed the emergence of an international regime that has greater scope and potency for protecting investors by controlling governments than any comparable regime since colonial arrangements were dismantled. Investment arbitration lies at the heart of this regime.

The failure of proposed multilateral investment codes in the twentieth century prompted major capital-exporting countries (i.e. the former European colonial powers, the United States, and Japan) and private investor organizations to advance an alternative investor protection regime based on a complex network of treaties and domestic implementing legislation. In particular, two key arbitration treaties – the *New York Convention* of 1958 and the *ICSID Convention* of 1965 – provide for domestic recognition and enforcement[6] of arbitration awards as well as a forum and procedural framework for investment arbitration. Also, over 2,000 investment treaties – both bilateral and regional – establish the consents of states to compulsory investment arbitration. Viewed as a whole, these treaties constitute the emerging system of investment arbitration.

1. The context of post-colonial conflict

International investment law originates in the late nineteenth century, during which most of the world was organized into European empires and large amounts of Western capital flowed abroad.[7] In this period, the legal framework for the resolution of investment disputes was very different from today's. In many cases, regulatory

[4] Miller, ibid., 375, citing *The New York Times* (16 October 1957).
[5] Miller, ibid., citing *Time Magazine* (28 October 1957).
[6] "Recognition" of an arbitration award by a court serves to bar fresh proceedings by the other disputing party; "enforcement" refers to the court's application of legal sanctions, including seizure of property and other assets, forfeit of bank accounts, or imprisonment: A. Redfern and M. Hunter, *Law and Practice of International Commercial Arbitration* (London: Sweet & Maxwell, 1999), 449.
[7] E. Hobsbawm, *Industry and Empire* (London: Penguin, 1968), 129-31; I. Brownlie, *Principles of Public International Law*, 6th ed. (Oxford: OUP, 2003), 500.

authority emanated from an imperial capital.[8] Disputes between investors and local authorities in colonized territories were resolved within the imperial legal system and, when subject to adjudication, they fell within the jurisdiction of imperial courts or administrators.[9] Imperial law regulated the conduct of business across the empire and the law ensured a high level of freedom and protection for investors in order to facilitate the exploitation of colonized areas.[10] Where indigenous organizations or groups interfered with the activities of international business, they faced the authority and power of the empire.

Not all non-European territories were formally colonized in the nineteenth century. Even so, in the context of rapid industrialization and economic growth, European and American business "globalized" by acquiring extensive interests in these territories, and this inevitably led to disputes with local authorities.[11] In some cases, relying on their military superiority, Western powers imposed capitulation treaties on other states, including China, Persia, Egypt, and the Ottoman Empire, in order to open their economies to foreign commerce and industry.[12] Thus, the *Anglo-Turkish Convention of 1838* gave European investors the right to establish themselves in

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[8] A.V. Dicey, *An Introduction to the Study of the Law of the Constitution* [1885] (London: Macmillan, 8th ed. 1915), 51-61; R. Jackson, "Sovereignty in World Politics: a Glance at the Conceptual and Historical Landscape" (1999) 47 Pol. Studies 431, 441-4.

[9] S.M. Hill, (1900) "Growth of International Law in Africa" 16 L.Q.Rev. 249, 256-9; Dicey, ibid., 47 and 55-8.

[10] S.K.B. Asante, *Transnational Investment Law and National Development* (Lagos: University of Lagos, 1981), 24; Y. Ghai, R. Luckham, and F. Snyder, "Introduction" in Y. Ghai, R. Luckham, and F. Snyder, eds., *The Political Economy of Law* (Oxford: OUP, 1987), 8; P.T. Muchlinski, "The Rise and Fall of the Multilateral Agreement on Investment: Where Now?" (2000) 34 Int'l Law. 1033, 1034-5. Governing powers were in many cases granted directly to a chartered colonial company: Hill, ibid., 258-9 and 264; J.H. Latané, "Address" (1907) Am. Soc'ty Int'l L. Proc. 100, 136.

[11] G.S. Jones, "The History of U.S. Imperialism" in R. Blackburn, ed., *Ideology in Social Science* (Glasgow: Fontana/ Collins, 1972), 228-30; Muchlinski, ibid., 1034-5.

[12] W.E. Grigsby, "The Mixed Court of Egypt" (1896) 12 L.Q. Rev. 252; A.M. Latter, "The Government of Foreigners in China" (1903) 19 L.Q.Rev. 316; J.K. Fairbank, *The United States and China* (Cambridge, Mass.: Harvard University Press, 1959), 120-3; W.R. Johnston, *Sovereignty and Protection: A Study of British Jurisdictional Imperialism in the Late Nineteenth Century* (Durham, N.C.: Duke University Press, 1973), 29; C. Lipson, *Standing Guard – Protecting Foreign Capital in the Nineteenth and Twentieth Centuries* (Berkeley: University of California Press, 1985), 13-14; J.A.G. Roberts, *A History of China* (London: Macmillan, 1999), 162-8; A. Anghie, "Finding the Peripheries: Sovereignty and Colonialism in Nineteenth-Century International Law" (1999) 40 Harv. Int'l L.J. 1, 41.

the Ottoman Empire, lowered tariffs, and removed internal barriers to trade.[13] In response, Ottoman control of foreign investors "simply disintegrated" and by the mid-nineteenth century European business had penetrated Ottoman territory and secured extensive concessions in mining, railroad and port construction, coastal navigation, banking, and public utilities.[14] Where a dispute involved a foreign investor, Ottoman court proceedings were supervised by foreign consular officials who had direct judicial authority or veto power over the local judge.[15] Foreign investors maintained the nationality of their home country and their property was protected by its laws.[16] Thus, outside of formally colonized areas, investor protection was ensured by the extraterritorial application of European or American law.[17]

Even in the nineteenth century, some countries managed to escape both formal colonization and extraterritorial law, primarily in Latin America and later Japan.[18] In such circumstances, where the law was not directly imposed by an imperial or foreign power, investment disputes became inter-state disputes.[19] Thus, most of the mixed claims commissions of the time – the ancestors of contemporary investment arbitration – were established to resolve disputes between Western investors and Latin American states.[20] Similarly, as colonial and extraterritorial arrangements were replaced in the twentieth century by less one-sided arrangements, investment disputes increasingly became international disputes.[21]

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[13] C. Issawi, *The Economic History of Turkey 1800-1914* (Chicago: University of Chicago Press, 1980), 5; Lipson, ibid., 13.

[14] Quoting Lipson, ibid., 14.

[15] Alternatively, disputes involving foreigners were subject to the jurisdiction of a mixed court on which foreign judges sat in the majority: Grigsby, *supra* note 12, 253-4. See M.O. Hudson, "The Rendition of the International Mixed Court at Shanghai" (1927) 21 AJIL 451, 454-5.

[16] Johnston, *supra* note 12, 29; Issawi, *supra* note 13, 5; Lipson, *supra* note 12, 13-14.

[17] Muchlinski, *supra* note 10, 1034-5; A.A. Fatouros, "On Domesticating Giants: Further Reflections on the Legal Approach to Transnational Enterprise" (1976) 15 U. Western Ontario L. Rev. 151, 166.

[18] M.J. Farrelly, "Recent Questions of International Law: Japan and European Consular Jurisdiction" (1894) 10 L.Q.R. 254, 266-7; A. Alvarez, "Latin America and International Law" (1909) 3 AJIL 269.

[19] Muchlinksi, *supra* note 10, 1034-5.

[20] Brownlie, *supra* note 7, 500.

[21] W. Peter, *Arbitration and Renegotiation of International Investment Agreements* (The Hague: Kluwer Law International, 1995), 6-7. The new arrangements were based on the European model of bilateral commercial treaties, dating from at least the eighteenth century, which were founded on commitments to mutual recognition of non-discrimination in trade in

After World War Two, in particular, newly independent states sought greater domestic control over their economy and resources, including by requiring the resolution of investment disputes in domestic courts based on domestic law.[22] In the 1960s and 1970s, developing countries asserted the principle of permanent sovereignty over natural resources and proposed a New International Economic Order, both of which were opposed by international business and major capital-exporting states.[23] This demand for sovereign autonomy over economic activity can itself be traced to the Latin American Calvo doctrine[24] and the Drago doctrine[25] of the late nineteenth century, which foreshadowed more recent conflicts between capital-exporting and capital-importing states.[26] As such, although the modern context for investment arbitration differs from the colonial period, the international character of investment disputes is rooted in post-colonial conflicts about foreign

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goods and to the unhindered carrying on of business in each state's territory: R.R. Wilson, "Post-War Commercial Treaties of the United States" (1949) 43 AJIL 262, 263 and 277; H. Walker, "Treaties for the Encouragement and Protection of Foreign Investment: Present United States Practice" (1956) 5 Am. J. Comp. L. 229, 230-1; R. Dolzer and M. Stevens, *Bilateral Investment Treaties* (The Hague: Kluwer Law International, 1995), 10-11.

[22] International Law Commission, *Summary Records of the 9th Session*, 1957, UN Doc. A/CN.4/106, [1957] 1 Y.B. Int'l Law Comm. 155, para. 45-51 (comment by P. Nervo); W. Friedmann, *Law in a Changing Society* (London: Stevens & Sons, 1959), 454-5; A.A. Fatouros, "International Law and the Third World" (1964) 50 Va. L.R. 783, 802-4; A.F. Abbott, "Latin America and International Arbitration Conventions: The Quandary of Non-Ratification" (1976) 17 Harv. Int'l L.J. 131, 136-7.

[23] *Resolution on Permanent Sovereignty Over Natural Resources*, United Nations G.A. Res. 1803 (XVII), UN GAOR, 17th Sess., Supp. No. 17, UN Doc. A/5217 (1962) 15, 57 AJIL 710; *Declaration on the Establishment of a New International Economic Order*, UN GA Res. 3201 (S-VI), UN GAOR, 6th Spec. Sess., Supp. No. 1, UN Doc. A/9559 (1974) 3, 13 I.L.M. 715; *Charter of Economic Rights and Duties of States*, UN GA Res. 3281 (XXIX), UN GAOR, 29th Sess., Supp. No. 31, UN Doc. A/9631 (1974) 50, 14 I.L.M. 251. J. Castaneda, "The Underdeveloped Nations and the Development of International Law" (1961) 15 Int'l Org. 38, 39; K. Hossain, "Introduction" in K. Hossain and S.R. Chowdhury, eds., *Permanent Sovereignty over Natural Resources in International Law* (London: Pinter, 1984), ix-xix.

[24] Asserting that the use of force to protect foreign investors was prohibited and that, upon entering a state's territory, foreign investors had to respect local laws and subject themselves to domestic courts. The only protection to which investors were entitled under international law was the same treatment as that enjoyed by nationals. C. Calvo, *Le Droit International*, 5th ed. (Paris: A. Rousseau, 1896), 118-64; A.S. Hershey, "The Calvo and Drago Doctrines" (1907) 1 AJIL 26; D.R. Shea, *The Calvo Clause* (Minneapolis: University of Minnesota Press, 1955), 9-21.

[25] L. Drago, "State Loans in Their Relations to International Policy" (1907) 1 AJIL 692; Hershey, ibid.

[26] Muchlinski, *supra* note 10, 1035.

ownership and control of local assets.[27] Then, as now, most international capital flows emanated from Europe and the U.S., and foreign-owned assets were predominantly owned by European and American business.[28]

Pressure to establish an international regime for investor protection is thus a integral aspect of the post-colonial era. For much of the twentieth century, international investors could not directly rely on imperial or extraterritorial law for protection, and they had no right to make international claims against the states in whose territory their assets were located.[29] An investment dispute was treated as an inter-state dispute and was settled through diplomacy or, exceptionally, by adjudication between states.[30] Only the home state of an investor could initiate an international claim against a host state and the investor had to accept the outcome agreed to by its state.[31] Thus, investors were at the mercy of their government; their interests were subsumed within the state's consideration of its interest. In some cases, states agreed to use international adjudication to resolve disputes with foreign nationals, but the jurisdiction of international tribunals was usually limited to a specific dispute or historical event. Naturally, this state of affairs was less desirable for international business and for major capital-exporting states. But efforts to enforce international standards of investor protection were viewed by capital-importing states as discriminatory toward domestic investors and as an unacceptable challenge to their autonomy.[32]

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[27] Fatouros, *supra* note 22, 783-94.

[28] The significant historical exception is Japan: P.T. Muchlinski, *Multinational Enterprises and the Law* (Oxford: Blackwell, 1999), 28-9. See D.R. Young, "Governmental Regulation of Foreign Investment" (1969) 47 Texas L.R. 421, 425-6; UNCTAD, *World Investment Report 2004* (Geneva: United Nations, 2004), xviii (developed countries continue to account for over 90% of total outward FDI) and annex table A.I.3, A.III.5, A.III.12, B.2, and B.4.

[29] Fatouros, *supra* note 22, 795-6.

[30] Brownlie, *supra* note 7, 500; J. Merrills, "The Means of Dispute Settlement" in M.D. Evans, ed., *International Law* (Oxford: OUP, 2004), 541.

[31] M.O. Hudson, *International Tribunals* (Washington: Carnegie Endowment for International Peace and the Brookings Institution, 1944), 67-9 and 198; UNCTAD, *Bilateral Investment Treaties in the Mid-1990s* (Geneva: United Nations, 1998), 89-90; Muchlinski, *supra* note 28, 534-6; M.N. Shaw, *International Law*, 5th ed. (Cambridge: CUP, 2003), 722-3; R. McCorquodale, "The Individual and the International Legal System" in M.D. Evans, ed., *International Law* (Oxford: OUP, 2004), 308.

[32] Castaneda, *supra* note 23, 39-41; Abbott, *supra* note 22, 137; S.K.B. Asante, "International Law and Foreign Investment: A Reappraisal" (1988) 37 I.C.L.Q. 588, 591-5; S.K.B. Asante, "International Law and Investments" in M. Bedjaoui, ed., *International Law: Achievements and Prospects* (Paris and Dordrecht: UNESCO and Martinus Nijhoff, 1991), 669-73. Similar

In this context, various proposals have been advanced since the 1920s for a multilateral investment treaty that would enshrine liberal standards of investor protection and thus protect international business from regulation by host states.[33] These included: the 1929 Draft Convention on the Treatment of Foreigners;[34] the 1959 Abs-Shawcross Draft Convention on Investments Abroad;[35] a Uruguay Round proposal for a multilateral investment treaty as part of the World Trade Organization;[36] and the 1998 draft Multilateral Agreement on Investment (MAI) prepared by the Organization for Economic Cooperation (OECD).[37] All of these proposals were rejected by developing countries and in some cases by constituencies within developed states themselves.[38] On the other hand, alternative proposals that enshrined the discretion of host states to regulate investors – especially the proposed

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arguments have been made in the case of developed capital-importing countries: e.g. V.L. Been and J.C. Beauvais, "The Global Fifth Amendment: NAFTA's Investment Protections and the Misguided Quest for an International 'Regulatory Takings' Doctrine" (2003) 78 N.Y.U. L.R. 30, 128-39.

[33] M. Hart, "A Multilateral Agreement on Foreign Direct Investment – Why Now?" (1996) in P. Sauvé and D. Schwanen, eds., *Investment Rules for the Global Economy* (Toronto: C.D. Howe Institute, 1996), 50-6; Muchlinski, *supra* note 28, 573-4; Muchlinski, *supra* note 10, 1035-7.

[34] *Responsibility of States for Damage Caused in Their Territory to the Person or Property of Foreigners*, League of Nations Conference for the Codification of International Law, Bases of Discussion, vol. 3, LN Doc. C.75.M.69.1929.V (1929). E.M. Borchard, "'Responsibility of States,' At the Hague Codification Conference" (1930) 24 AJIL 517, 530; A.K. Kuhn, "The International Conference on the Treatment of Foreigners" (1930) 24 AJIL 570.

[35] H. Abs and H. Shawcross, "The Proposed Convention to Protect Private Foreign Investment" (1960) 9 J. Public L. 115; G. Schwarzenberger, "The Abs-Shawcross Draft Convention on Investments Abroad: A Critical Commentary" (1960) 9 J. Public L. 147; A. Fatouros, "An International Code to Protect Private Investment – Proposals and Perspectives" (1961) 14 U.T.L.J. 77, 89-90; Dolzer and Stevens, *supra* note 21, 2.

[36] P. Civello, "The TRIMS Agreement: A Failed Attempt at Investment Liberalization" (1999) 8 Minn. J. Global Trade 97; S. Dillon, *International Trade and Economic Law in the European Union* (Oxford: Hart, 2002), 100; Muchlinski, *supra* note 10, 1039.

[37] *The MAI Negotiating Text*, OECD, Paris (1998) [hereinafter *MAI*]. E. Smythe, "Domestic and International Sources of Regime Change: Canada and the Negotiation of the OECD Multilateral Agreement on Investment" (Paper presented to the Annual Meeting of the Canadian Political Science Association, St. John's, Nfld, 8 June 1997), 9-10; P. Juillard, "MAI: A European View" (1998) 31 Cornell Int'l L.J. 477, 477.

[38] C. Lalumière and J.-P. Landau, "Report on the Multilateral Agreement on Investment (MAI)" (Interim report to the Government of France, September 1998); S. Picciotto, "A Critical Assessment of the MAI" in S. Picciotto and R. Mayne, eds., *Regulating International Business* (Houndmills: Macmillan, 1999), 99-100; Muchlinski, *supra* note 10, 1035-9; A. Walter, "NGOs, Business, and International Investment: The Multilateral Agreement on Investment, Seattle, and Beyond" (2001) 7 Glob. Governance 51, 58-60.

Havana Charter of 1948[39] – were a non-starter for major capital-exporting states and organizations of private investors.[40]

The failure to conclude a multilateral investment agreement reflects the enduring intensity of the conflict pitting capital-exporting countries and international business against capital-importing states (led in recent years by Brazil, Egypt, India, Malaysia, and Uganda).[41] Even so, it is remarkable that capital-importing states have been willing, especially since the 1990s, to agree to an intrusive regime of investor protection based on compulsory investment arbitration. Indeed, despite the failure to conclude a multilateral code, capital-exporting states have successfully established networks of investment treaties that guarantee a high level of protection for international business.[42] The evolution of this treaty-based regime and the emergence of the system of investment arbitration is discussed later in this chapter, following a review of some explanations for why developing countries have lately consented to so many investment treaties.

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[39] *Final Act of the United Nations Conference on Trade and Employment: Havana Charter for an International Trade Organization*, UN Conference on Trade and Employment, UN Doc. 1948 II.D.4.1 (1948), art. 12, online: WTL http://www.worldtradelaw.net/misc/havana.pdf. C. Wilcox, *A Charter for World Trade* (New York: Macmillan, 1949).

[40] L.H. Woolsey, "The Problem of Foreign Investment" (1948) 42 AJIL 121, 126-8; W. Diebold, "The End of the ITO" in *Essays in International Finance*, no. 16 (Princeton: Princeton University Press, 1952), 18-19; Fatouros, *supra* note 35, 80 and 101; Hart, *supra* note 33, 54. The leading organization of private investors is the International Chamber of Commerce, supported by national organizations such as the U.S. Council on International Business, the National Association of Manufacturers, and the National Foreign Trade Council: e.g. ICC, "Fair Treatment for Foreign Investments: International Code" (ICC Brochure no.129, 1949); National Association of Manufacturers, "The Havana Charter for an International Trade Organization" (1949); National Foreign Trade Council, "Position of the NTC with Respect to the Havana Charter for an ITO" (1950); ICC, "Multilateral rules for investment" (Doc. No. 103/179, Rev., 30 April 1996); ICC, "ICC's expectation regarding a WTO investment agreement" (Policy statement of the ICC Commission on Trade and Investment Policy, 7 March 2003); D.M. Price, Testimony Before the Subcommittee on Trade of the House Committee on Ways and Means, Hearing on the Summit of the Americas and Prospects for Free Trade in the Hemisphere (Statement on behalf of the U.S. Council for International Business, 8 May 2001).

[41] B.A. Wortley, *Expropriation in Public International Law* (Cambridge: CUP, 1959), 119-26; Peter, *supra* note 21, 329-31; Muchlinski, *supra* note 28, 173, 501-14, and 573-4; Shaw, *supra* note 31, 733-7; Muchlinski, *supra* note 10, 1039; J. Hillary, "Divide and Rule: The EU and US Response to Developing Country Alliances at the WTO" (Report for Action Aid International, 2004), 7.

[42] UNCTAD, *supra* note 28, 221.

2. Explanations for the emergence of investment arbitration

The emergence of international investment arbitration converges with trends commonly associated with globalization.[43] These include: the internationalization of economic activity, the development of new communications and transportation technology, the withdrawal of the state from various social and economic activities, the rise of non-state actors, and the transfer of public authority to private organizations.[44] In the case of investment arbitration, probably the two most important trends are the rise of multinational enterprises[45] and the liberalization of international financial markets.[46]

First, in the post-war era, multinational enterprises have assumed an increasingly central role in planning and financing economic activity, extracting natural resources, producing goods, delivering services, employing labour, developing technologies, and marketing products.[47] Today, multinational enterprises organize most cross-border private capital flows – i.e. international investment – often within their own corporate structure.[48] In addition, organized business has exercised significant influence over governmental decision-making in many areas, including the

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[43] D. Held and A. McGrew, "Globalization" (1999) 5 Glob. Governance 483, 490-4; P.T. Muchlinski, "Globalisation and Legal Research" (2003) 37 Int'l Lawyer 221, 221-5.

[44] E.g. A.A. Fatouros, "Transnational Enterprise in the Law of State Responsibility" in R.B. Lillich, ed., *International Law of State Responsibility for Injuries to Aliens* (Charlottesville: University Press of Virginia, 1983), 361-3; S. Picciotto, "Introduction: What Rules for the World Economy?" in S. Picciotto and R. Mayne, eds., *Regulating International Business* (Houndmills: Macmillan, 1999), 9-10; Muchlinski, *supra* note 28, 35-8; A.C. Aman, "The Limits of Globalization and the Future of Administrative Law: From Government to Governance" (2001) 8 Ind. J. Global Legal Studies 379, 379-84; S. Sassen, "Globalization or Denationalization?" (2003) 10 Rev. Int'l Pol. Econ. 1, 5-6.

[45] N.S. Rodley, "Corporate Nationality and the Diplomatic Protection of Multinational Enterprises: The *Barcelona Traction* Case" (1971) 47 Indiana L.J. 70, 71-2 and 84-5; Fatouros, *supra* note 17, 154-6; M. Sornarajah, *The International Law on Foreign Investment* (Cambridge: CUP, 1994), 51; Hart, *supra* note 33, 39-44; Muchlinski, *supra* note 28, 25-33.

[46] R. Kozul-Wright and R. Rowthorn, "Spoilt for Choice? Multinational Corporations and the Geography of International Production" (1998) 14 Ox. Rev. Econ. Policy 74, 84-5; C. Deblock and D. Brunelle, "Globalization and New Normative Frameworks – The Multilateral Agreement on Investment", Cahier de recherche 98-2 (Groupe de recherche sur l'intégration continentale, Université de Québec à Montréal, 1998), 5-8; J. Kelsey, "The Denationalization of Money: Embedded Neoliberalism and the Risks of Implosion" (2003) 12 Social & Leg. Studies 155, 158.

[47] J. Dunning, *International Production and the Multinational Enterprise* (London: Allen and Unwin, 1981); UNCTAD, *supra* note 28, xvii.

[48] R.J. Mataloni, Jr., "A Guide to BEA Statistics on U.S. Multinational Companies" (March 1995) Survey Current Bus. 38, 48; Picciotto, *supra* note 44, 6-7.

deregulation of capital flows.[49] As the dominant investors in the international economy, multinational enterprises are the most important actors – other than states – in investment arbitration.

Second, investment treaties are an outcome of the removal of domestic controls on private capital flows and the growth of an international market for investment.[50] Absent the massive expansion of cross-border private capital flows in recent decades, there would be much less pressure for capital-exporting states to secure legal protection for assets owned by their nationals abroad.[51] Similarly, without an international market for private investment, there would be no reason for capital-importing states to seek to attract foreign investors by concluding investment treaties. Finally, most deregulated capital flows are controlled by multinational enterprises, including global financial firms.[52] Thus, the removal of domestic capital controls, linked to the expansion of international business, is a major factor in the growth of investment arbitration.

Against this backdrop, the negotiation of investment treaties clearly involves more than that implied by a simple division of interests between capital-exporting and capital-importing states. In multilateral negotiations, it is sometimes possible to identify negotiating blocs based on this dichotomy, but the position of many capital-importing countries has shifted in favour of opening their economy to foreign investment, in order to carry out what their governments no doubt consider to be a more appropriate development strategy based on integration into the international economy.[53] One should not overlook the role and potential benefits of foreign

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[49] J. Braithwaite and P. Drahos, *Global Business Regulation* (Cambridge: CUP, 2000), 488-91; Walter, *supra* note 38, 52-3; A. Prakash, "Beyond Seattle: Globalization, the Nonmarket Environment and Corporate Strategy" (2002) 9 Rev. Int'l Pol. Econ. 513, 520-1.
[50] Picciotto, *supra* note 44, 7-9; World Bank, *World Development Report 1999/2000* (Oxford: OUP, 2000), 71-2; A. Baines, "Capital Mobility and European Financial and Monetary Integration: A Structural Analysis" (2002) 28 Rev. Int'l Studies 337, 347.
[51] B. Eichengreen et al., "Liberalizing Capital Movements: Some Analytical Issues", Economic Issues No.17 (IMF, 1999).
[52] Peter, *supra* note 21, 381-2 and 388; J. Bhagwati, "The Capital Myth: the Difference between Trade in Widgets and Dollars" (1998) 77(3) For. Affairs 7, 11-12.
[53] Peter, *supra* note 21, 13-14; A.M. Rugman and M. Gestrin, "A Conceptual Framework for a Multilateral Agreement on Investment: Learning from the NAFTA" in P. Sauvé and D. Schwanen, eds., *Investment Rules for the Global Economy* (Toronto: C.D. Howe Institute, 1996), 159-62; UNCTAD, *World Investment Report 2003* (Geneva: United Nations, 2003), 87 and 106.

investment in domestic development and national competitiveness.[54] Moreover, besides well-known investment platforms and tax havens such as Singapore or Bermuda, many Asian and oil rich states are themselves important sources of capital for the West, whereas other former colonies have developed their own centres of capital and multinational enterprises, and they play an important investment role in the regional setting if not the world.[55] Reflecting these conditions, many investment treaties in the 1990s were concluded between conventionally capital-importing countries.

In turn, many capital-exporting states are important destinations of foreign investment. The United States, in particular, has been a major capital-importer as well as exporter.[56] Further, the deregulation of capital flows has facilitated forum-shopping by investors, capital flight, and "round trip" investment, thus exposing all states to a wider range of claims by foreign investors and, as such, to new liabilities.[57] Developed states have been the targets of numerous claims under investment treaties, especially under the *North American Free Trade Agreement* (NAFTA), where a raft of claims against the U.S. by Canadian investors prompted a debate in the U.S. Congress and Administration about the American investment treaty program.[58] To a lesser degree,

[54] M.E. Porter, *The Competitive Advantage of Nations* (New York: The Free Press, 1990), 548-9, 670-1 and 678-80; UNCTAD, ibid., 139, note 138; M.P. Todaro and S.C. Smith, *Economic Development*, 8th ed. (Harlow: Pearson, 2003), 638-44.

[55] UNCTAD, *supra* note 28, xviii (reporting that TNCs from developing countries' share of global FDI flows rose from less than 6% in the mid-1980s to 11% in the late 1990s, before falling to 7% during 2001-03. Some developing countries invest more abroad than some developed ones: Singapore (36% of gross fixed capital formations during 2001-03), Chile (7%), and Malaysia (5%), compared to the U.S. (7%), Germany (4%), and Japan (3%)).

[56] Muchlinski, *supra* note 28, 30; UNCTAD, *supra* note 28, xix (reporting that the U.S. was the world's largest FDI recipient until 2003, when it was surpassed by China).

[57] UNCTAD, *supra* note 28, 238, note 15; G. Xiao, "People's Republic of China's Round-Tripping FDI: Scale, Causes and Implications", Asian Development Bank Institute Discussion Paper No. 6 (ADB, 2004), 6.

[58] This led to the modification of the U.S. Administration's trade negotiating authority under the *Bipartisan Trade Promotion Authority Act of 2002*, Div. B, Title XXI, *Trade Act of 2002*, Pub. L. No. 107-210, 116 U.S.C. 933, s. 2102(3) (2002), and to some limitations on the scope and substance of investor protection in the *Singapore-United States Free Trade Agreement*, 6 May 2003 (2003), online: USTR http://www.ustr.gov/Trade_Agreements/Bilateral/Singapore_FTA/Final_Texts/Section_Index.html; the *Chile-United States Free Trade Agreement*; 6 June 2003 (2003), online: USTR http://www.ustr.gov/Trade_Agreements/Bilateral/Chile_FTA/Final_Texts/Section_Index.html; and the *Central American Free Trade Agreement*, 20 December 1993 (not in force), 32 I.L.M. 605. L. Sek, "Fast-Track Authority for Trade Agreements (Trade Promotion Authority): Background and Developments in the 107th Congress" (CRS Report to U.S.

there are pressures within major capital-exporting states to moderate investor protection in order to preserve space for domestic policy-making in labour regulation and environmental protection. This follows the belated realization in many countries that the implications of investment treaties based on compulsory investment arbitration are more extensive and perhaps less one-sided than once thought.[59] In these circumstances, the distinction between capital-exporting and capital-importing states has been undermined.

Even so, the homogenizing trend can be understated. Is it so surprising that a major industrialized country can be the subject of investor claims in a world of large and diversified multinational enterprises and deregulated capital flows? The broad scope and jurisdictional flexibility of investment treaties facilitates this outcome. Most importantly, the international negotiating agenda for investment treaties is still largely directed by major capital-exporting states.[60] As such, one should not downplay the distinct positions that different states occupy within the system of investment arbitration as well as the dynamic of inter-state competition in a global economy.[61] The most common scenario remains that of the developing country which concludes an investment treaty with a capital-exporting state, for which the developing country is not itself a significant source of investment.[62] In this scenario, the developing country assumes significant liabilities and constraints, backed by the threat of a potentially crippling damages award, without receiving direct legal advantages for its own nationals. Many governments conclude that the benefits of encouraging investment outweigh the liabilities that flow from investment arbitration, but this does

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Congress, 17 January 2002), 1-2; R. Singh, "The Impact of the Central American Free Trade Agreement on Investment Treaty Arbitrations: A Mouse that Roars?" (2004) 21 J. Int'l Arb. 329, 329-34.

[59] D. Brown, "Commentary" in L.R. Dawson, ed., *Whose Rights? The NAFTA Chapter 11 Debate* (Ottawa: Centre for Trade Law and Policy, 2002), 40-1.

[60] Dolzer and Stevens, *supra* note 21, 12; Muchlinski, *supra* note 10, 1049.

[61] Y. Dezaley and B. Garth, *Dealing in Virtue: International Commercial Arbitration and the Construction of a Transnational Legal Order* (Chicago: University of Chicago Press, 1996), 7; P.G. Cerny, "Paradox of the Competition State: the Dynamics of Political Globalization" (1997) 32 Gov't and Opposition 251, 259-67; Smythe, *supra* note 37, 3-4; Kozul-Wright and Rowthorn, *supra* note 46; Deblock and Brunelle, *supra* note 46, 9-10 and 21-4.

[62] Kozul-Wright and Rowthorn, *supra* note 46, 88; J.A. Soloway, "Environmental Regulation as Expropriation: The Case of NAFTA's Chapter 11" (2000) 33 Can. Bus. L.J. 92, 99; UNCTAD, *supra* note 53, 95.

not alter the fact that, in legal terms, the bargain is one-sided.[63] Extended to over 2,000 investment treaties, the present system rigorously regulates capital-importing states without imposing obligations on capital-exporting states in relation to outward investment, or on investors themselves. Moreover, if the purpose is to attract new investment, why do investment treaties apply to existing investments?[64] Why would host state wish to assume extensive new liabilities in relation to investments already secured?

So, why did developing countries sign so many investment treaties in the last two decades? Put differently, why did states exercise their sovereign authority by consenting to investment arbitration and by reducing their ability to regulate multinational enterprises? First, the question of the role of multinational enterprises in the domestic economy has evolved from a somewhat speculative and jingoistic debate in the 1960s and 1970s to a more informed discussion of the costs and benefits of foreign investment.[65] Further, the 1990s witnessed a stronger commitment to economic integration and liberalization in many countries,[66] and in international financial institutions like the World Bank and the International Monetary Fund.[67] This created political conditions favouring the conclusion of investment treaties while prompting other reforms that enable or encourage foreign investment, including the removal of capital controls and widespread privatization of state-owned assets.[68] In many countries, large numbers of BITs were concluded in a short period after governments adopted a liberal economic policy, based on the promotion of foreign investment and a commitment to a high level of investor protection.[69] There is no

[63] Wilson, *supra* note 21, 286; Walker, *supra* note 21, 243-4; UNCTAD, *supra* note 31, 144.
[64] Dolzer and Stevens, *supra* note 21, 46.
[65] T.J. Farer, "Economic Development Agreements: A Functional Analysis" (1971) 10 Colum. J. Transn'l L. 200, 200; Hart, *supra* note 33, 78-84; UNCTAD, *supra* note 2, 131-2; Muchlinski, *supra* note 28, 11; A. Mody and A.P. Murshid, "Growing Up with Capital Flows" (IMF Working Paper, Doc. No. WP/02/75, 2002), 3-5.
[66] Muchlinski, *supra* note 28, 10-11 and 93; Kelsey, *supra* note 46, 158.
[67] UNCTAD, *supra* note 2, 131-2; D. Kalderimis, "IMF Conditionality as Investment Regulation: A Theoretical Analysis" (2004) 13 Social & Leg. Studies 103, 107.
[68] K. Williams, "British Re-Nationalization and Regulation: The Government's Liability to Shareholders" (1993) 14 U. Penn. J. Int'l Bus. L. 243, 243-4; Muchlinski, *supra* note 28, 10-11 and 203-4.
[69] E.g. *CMS Gas Transmission Company* v. *The Republic of Argentina* (Jurisdiction) (17 July 2003), 42 I.L.M. 788 [hereinafter *CMS*], para. 60 (noting that, in the early 1990s, invitations from Argentina to foreign investors to purchase state assets expressly mentioned the protection

hard evidence to show that the conclusion of BITs actually brings in new foreign investment[70] but, even if there was, it is still remarkable that international business has heralded the advantages of investor protection since the 1920s and yet only in the 1980s and 1990s did its lobbying efforts bear real fruit.

This indicates that structural factors coalesced in the 1980s and 1990s to intensify the pressure on developing countries to attract foreign private capital.[71] The most important factors are the legacy of capital flight, tight international credit and Third World debt crisis, the loss of bargaining options after the fall of the Soviet bloc, and reductions in Western official aid.[72] In this context, the increasing mobility of capital put international capital in a stronger position to demand legal concessions from host states. Added to this was pressure from financial institutions, both public and private, and from capital-exporting states.[73] For example, the World Bank and IMF generally link their evaluation of a country's creditworthiness and policy compliance to its level of openness to foreign investment.[74] Also, capital-exporting states have tied the availability of national insurance for foreign investment to the

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available to foreign investors under BITs). Dolzer and Stevens, *supra* note 21, 12; World Bank, *World Development Report 2005* (Washington, D.C.: IBRD, 2004), 176-8.

[70] M. Hallward-Driemeier, "Do Bilateral Investment Treaties Attract Foreign Direct Investment? Only a Bit... and They Could Bite", World Bank Policy Research Working Paper No. 3121 (Washington: World Bank, June 2003), 4-5 and 22-3; J. Hewko, "Foreign Direct Investment – Does the Rule of Law Matter?" (Report to the Carnegie Endowment for International Peace, Rules of Law Series, Report No. 26, April 2002), 6-9; Been and Beauvais, *supra* note 32, 122-4.

[71] Smythe, *supra* note 37, 5-8; K.J. Vandevelde, "Sustainable Liberalism and the International Investment Regime" (1998) 19 Mich. J. Int'l L. 373, 386-90; A. Walter, "Globalisation and Policy Convergence: the Case of Direct Investment Rules" in R.A. Higgott et al., eds., *Non-State Actors and Authority in the Global System* (London: Routledge, 2000).

[72] Fatouros, *supra* note 22, 795; Hart, *supra* note 33, 79; UNCTAD, *Trends in International Investment Agreements: An Overview*, UNCTAD Series on Issues in International Investment Agreements (New York: United Nations, 1999), 29-30; S. Haggard, *Developing Nations and the Politics of Global Integration* (Washington, D.C.: Brookings Institution, 1995), 6-7; C. Thomas, "Balance-of-Payments Crises in the Developing World: Balanced Trade, Finance and Development in the New Economic Order" (2000) 15 Am. U. Int'l L.R. 1249, 1263; M. Sornarajah, *The Settlement of Foreign Investment Disputes* (Boston: Kluwer, 2001), 12.

[73] Peter, *supra* note 21, 388; Bhagwati, *supra* note 52, 11-12.

[74] L.C. Situmbeko and J. Jones Zulu, "Zambia: Condemned to debt" (Report by the World Development Movement, April 2004), 52 (reporting that Zambia's *Investment Act* of 1993, which increased legal protection for foreign investors, was introduced as a condition of a World Bank privatization and structural reform credit that year).

existence of an investment treaty with the recipient state.[75] Overall, these conditions expanded the clout and prestige of private investors in a world of many states, most of whom compete eagerly (or desperately) to attract investment and promote "their own" multinational enterprises.[76]

A particularly compelling explanation for the expansion of investment arbitration lies in the dynamic of inter-state competition.[77] States conclude investment treaties to attract investment, but the degree to which any one treaty makes a state more attractive to investors depends on the degree to which the treaty offers more favourable treatment than that provided by competing investment destinations. States with less to offer in terms of their domestic market, resources, or workforce must compensate by conceding more in terms of legal protection in order to attract investment.[78] The trade off is that these states are then left with a narrower range of policy options to support domestic development or respond to wider competitive pressures in relation to levels of taxation, subsidization, and regulation of capital generally.[79] Cumulatively, the proliferation of investment treaties intensifies the pressures on states to attract capital by liberalizing investment standards. Likewise, the conclusion of a series of "high standard" investment treaties by capital-exporting states in one region pressures other capital-exporting states to obtain comparable protections for their own international firms. As more states accept investor-friendly

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[75] I. Delupis, *Finance and Protection of Investments in Developing Countries* (Epping: Gower Press, 1973), 37 and 136-50; Dolzer and Stevens, *supra* note 21, 12 and 156-7; C.K. Dalrymple, "Politics and Foreign Direct Investment: The Multilateral Investment Guarantee Agency and the Calvo Clause" (1996) 29 Cornell Int'l L.J. 161, 186; Muchlinski, *supra* note 28, 514-19.
[76] K.J. Vandevelde, "The Political Economy of a Bilateral Investment Treaty" (1998) 92 AJIL 621, 633-5; O. Morrissey, "Investment and Competition Policy in the WTO: Issues for Developing Countries" (2001) 20 Development Policy Rev. 63, 64-5.
[77] W.W. Bratton et al., "Introduction: Regulatory Competition and Institutional Evolution" in W.W. Bratton et al., eds., *International Regulatory Competition and Coordination* (Oxford: Clarendon, 1996), 4, 13-14, 49 and 54-5; Y. Dezaley, "Between the State, Law, and the Market: The Social and Professional Stakes in the Construction and Definition of a Regulatory Arena" in W.W. Bratton et al., eds., *International Regulatory Competition and Coordination* (Oxford: Clarendon, 1996), 61-2; S. Picciotto, *supra* note 38, 92-3.
[78] Walter, *supra* note 71; Been and Beauvais, *supra* note 32, 121.
[79] Kozul-Wright and Rowthorn, *supra* note 46, 86-7; S. Sassen, "Losing Control? The State and the New Geography of Power?" (1999) 1 Global Dialogue 78, 83-7; Muchlinski, *supra* note 28, 222-3; R.S. Avi-Yonah, "Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State" (2000) 113 Harv. L.R. 1573, 1575-9; Prakash, *supra* note 49, 514-15.

rules, the bar rises as to what qualifies as a hospitable climate for investment.[80] The result is a bidding up of state concessions to international capital.[81]

No doubt, each individual country will have specific reasons for concluding an investment treaty. Conclusive findings about negotiating trends in the 1990s would require more detailed comparative study of specific countries and treaties, which is beyond the scope of this thesis. The factors identified here are not intended to explain outright the recent wave of investment treaties although they do provide context for the emergence of investment arbitration. The discussion now turns to the evolution of the relevant treaty framework.

B. The evolution of the treaty framework

The emerging system of investment arbitration is based on bilateral and regional investment treaties in which states consent to compulsory investment arbitration. However, these investment treaties also incorporate existing arbitration treaties (most importantly, the *New York Convention* of 1958 and the *ICSID Convention* of 1965) in order to provide an institutional forum and procedural framework for investment arbitration, and to authorize domestic recognition and enforcement[82] of arbitration awards. Such arbitration treaties pre-date contemporary investment treaties because, conventionally, the use of international adjudication to resolve disputes involving private individuals was generally restricted to commercial disputes. For this reason, in this section, the examination of the evolution of the system of investment arbitration begins with a review of the treaty framework for international commercial arbitration. The examination then reviews how the structure of international commercial arbitration was transplanted to the arbitration of investment disputes *in the public sphere*, marking the emergence of investment arbitration as a governing arrangement.

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[80] Been and Beauvais, *supra* note 32, 124. A dynamic of inter-state competition is written into investment treaties themselves through the most-favoured-nation treatment standard, which requires states to make commitments under one investment treaty available under others. This establishes a systemic assumption in favour of expanding protection to investors as a wider group.

[81] A.T. Guzman, "Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties" (1998) 38 Va. J. Int'l L. 639, 671-2.

[82] *Supra* note 6.

1. The establishment of international commercial arbitration

During the twentieth century, states progressively recognized arbitration as an institution for the resolution of commercial disputes. In doing so, their main purpose was not to regulate the exercise of public authority but to facilitate international commerce. In the beginning, 17 states – mostly in Europe – signed the *Geneva Protocol of 1923*[83] which was drawn up at the League of Nations in response to an initiative by the International Chamber of Commerce.[84] In this treaty, states parties agreed to recognize agreements by private parties based in different jurisdictions to submit future disputes between them to binding arbitration.[85] At the same time, states qualified this arrangement by agreeing to enforce an award only if the award was made within their own territory and by limiting the treaty to commercial disputes.[86] This preserved domestic judicial control over the scope of international commercial arbitration, including the degree to which it could displace domestic courts' authority over regulatory disputes; i.e. disputes arising from the exercise of public authority.

The ambit of international commercial arbitration was expanded in the *Geneva Convention of 1927*[87] in which the states parties agreed to enforce arbitration awards made in each other's territory.[88] This internationalized the enforcement of arbitration awards by allowing a successful disputing party to enforce an award against assets of the losing party in the territory of any state party to the treaty.[89] Arbitration awards became portable; they could be used to chase a losing party's assets in different jurisdictions. Nonetheless, international commercial arbitration remained subject to important restrictions.[90] To enforce an award, the successful party had to demonstrate

[83] *Protocol on Arbitration Clauses in Commercial Matters*, 24 September 1923, 20 AJIL 194 (1926) (entered into force 28 July 1924) [hereinafter *Geneva Protocol of 1923*].
[84] A. Nussbaum, "Treaties on Commercial Arbitration" (1942) 56 Harv. L.R. 219, 221-2 and 234-6; Redfern and Hunter, *supra* note 6, 66.
[85] *Geneva Protocol of 1923*, *supra* note 83, art. 1 and 4.
[86] Redfern and Hunter, *supra* note 6, 18 and 136-7.
[87] *Convention on the Execution of Foreign Arbitral Awards*, 26 September 1927, 92 L.N.T.S. 302, 27 AJIL 1 (1929) (entered into force 25 July 1929) [hereinafter *Geneva Convention of 1927*].
[88] Nussbaum, *supra* note 84.
[89] Redfern and Hunter, *supra* note 6, 14-16 and 67.
[90] Redfern and Hunter, *supra* note 6, 67 and 454-5 (noting that the award was enforceable only if (1) the award was made pursuant to an agreement to which the *Geneva Protocol of 1923*

that the award was consistent with the laws of the state in which enforcement was sought as well as the state in which the arbitration was held.[91] Also the subject matter of the award had to be "capable of settlement" under the law of the state in which enforcement was sought.[92] Finally, states retained the right to limit their enforcement obligations to commercial disputes.[93]

In the early 1950s, the International Chamber of Commerce lobbied for a more ambitious treaty to replace the *Geneva Convention of 1927*. In 1958, the *United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards* was concluded in New York (the *New York Convention*).[94] The treaty's negotiating history reflects a tension between expanding the recognition of commercial arbitration and the preservation of domestic judicial autonomy. In the words of the United Nations drafting committee:[95]

> it would be desirable to establish a new convention which, while going further than the Geneva Convention in facilitating the enforcement of foreign arbitral awards, would at the same time maintain generally recognized principles of justice and respect the sovereign rights of States.

To facilitate international commercial arbitration, the *New York Convention* expanded the scope for the enforcement of arbitration awards. The states parties undertook to recognize arbitration agreements that dealt with future disputes arising out of a defined legal relationship, whether or not the relationship was contractual.[96] Also, the *New York Convention* removed the requirement that an award had to comply with the laws of the state in which enforcement was sought. Instead, an award had to comply

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applied and (2) the award was made in the territory of a state party, and (3) the parties to the award were subject to the jurisdiction of one of the states parties to the *Geneva Convention of 1927*).

[91] *Geneva Convention of 1927*, *supra* note 87, art. 1(c).

[92] *Geneva Convention of 1927*, ibid., art. 1(b). Also, the award had to be consistent with the agreement to arbitrate and with the applicable procedural rules (art. 1(c) and 2(c)), and recognition and enforcement had to be consistent with the public policy and the principles of law of the country where enforcement was sought (art. 1(e)).

[93] See the list of reservations by the states parties in (1929) 27 AJIL 1, 11.

[94] *United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 10 June 1958, 330 U.N.T.S. 3 (entered into force 7 June 1959) [hereinafter *New York Convention*]. See A.J. Van den Berg, *The New York Convention of 1958* (Antwerp: Kluwer, 1981).

[95] *Report of the Committee on the Enforcement of International Arbitral Awards*, UN ESC, 19th Sess., UN Doc. E/AC.42/4/Rev.1 (28 March 1955), 5.

[96] *New York Convention*, *supra* note 94, art. II.1 and II.3. Redfern and Hunter, *supra* note 6, 139.

only with the laws of the state in which the arbitration was held, subject to basic standards of consent and due process. By agreeing to enforce awards on this basis, states relinquished judicial control over awards made in other jurisdictions. Mainly for this reason, the *New York Convention* has been described as "the single most important pillar on which the edifice of international arbitration rests" and as "perhaps... the most effective instance of international legislation in the entire history of commercial law".[97] Today, the *New York Convention* has wide geographic coverage: more than 120 states have ratified the treaty, offering a smorgasbord of jurisdictions in which the successful party in an arbitration can seek enforcement of an award against assets of the losing party.

Even so, the *New York Convention* fell short of the International Chamber of Commerce's proposal for a "fully international" award that would be globally enforceable without interference by any domestic court or legislature, even in the jurisdiction where the arbitration was held.[98] Moreover, award enforcement under the *New York Convention* remained limited to disputes that were deemed capable of settlement by arbitration, and to awards that were consistent with the public policy of the country where enforcement was sought.[99] Thus, domestic courts retained broad authority to limit the enforcement of arbitration awards. Finally, the treaty continued to permit states to limit their obligations to commercial disputes.[100]

Domestic courts in different countries interpreted these restrictions on the scope of international commercial arbitration in different ways.[101] This led to renewed efforts to harmonize domestic laws on international commercial arbitration.[102] To this end, in 1985, the UN Commission on International Trade Law (UNCITRAL)

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[97] Quoting, respectively, G. Wetter, "The Present Status of the International Court of Arbitration of the ICC: An Appraisal" (1990) 1 Am. Rev. Int'l Arb. 91, 93; M.J. Mustill, "Arbitration: History and Background" (1989) 6 J. Int'l Arb. 43, 43.
[98] Redfern and Hunter, *supra* note 6, 67, note 58.
[99] *New York Convention*, *supra* note 94, art. II(1) and V(2)(a) and (b).
[100] *New York Convention*, *supra* note 94, art. I(3). This was one of two permitted reservations. The other was a reciprocity reservation by which states could limit recognition to awards made in states that also recognized the treaty. By 2001, 39 of 125 states parties had entered a commercial reservation and 68 had entered a reciprocity reservation.
[101] *Note by the Secretariat: Further Work in respect of International Commercial Arbitration*, UN, UN Doc. A/CN.9/169 (11 May 1979), 109.
[102] *Report of the Secretary-General: Analytical Compilation of Comments by Governments and International Organizations on the Draft Text of a Model Law on International Commercial Arbitration*, UN, UN Doc. A/CN.9/263 and Add. 1-3 (1985) [hereinafter *Comments by Governments*], 84.

produced the Model Law on International Commercial Arbitration.[103] The purpose of the Model Law was to facilitate the recognition and enforcement of foreign arbitration awards. The Model Law can be adopted by states in their domestic legislation to establish a special regime for international commercial arbitration under domestic law.[104] The Model Law requires courts to recognize and enforce an arbitration award "irrespective of the country in which it was made" and without any requirement for reciprocity, subject to minimum requirements of consent and due process.[105] Further, the Model Law adopted flexible definitions of the terms "international" and "commercial" and explicitly gave arbitration tribunals the power to rule on their own jurisdiction.[106] Importantly, the Model Law extended the *New York Convention*'s provisions that limited judicial discretion to refuse recognition and enforcement of an award, in the place of enforcement, to encompass the setting aside of awards in the place of arbitration.[107] In these respects, the Model Law addressed a number of business complaints about domestic judicial supervision of commercial arbitration under the *New York Convention*.[108]

Since the Model Law was published, roughly 40 developed and developing states have used it to reform their legislation on commercial arbitration in order to provide for greater deference by domestic courts to foreign arbitration awards.[109] By

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[103] *Model Law on International Commercial Arbitration*, 21 June 1985, UNCITRAL, UN Doc. A/40/17, Annex I, 24 I.L.M. 1302 [hereinafter UNCITRAL Model Law]. *Comments by Governments*, ibid., 84.
[104] *Report of the Secretary-General: Analytical Commentary on Draft Text of a Model Law on International Commercial Arbitration*, UN, UN Doc. A/CN.9/264 (25 March 1985), 16 Y.B. UNCITRAL 104 [hereinafter *Model Law Report*], 7.
[105] UNCITRAL Model Law, *supra* note 103, art. 34-6. Redfern and Hunter, *supra* note 6, 67.
[106] UNCITRAL Model Law, *supra* note 103, art. 1(3) and 16. art. 1(3).
[107] Mustill, *supra* note 97, 52.
[108] *Report of the Secretary-General: Possible Features of a Model Law on International Commercial Arbitration*, UN, UN Doc. A/CN.9/207 (14 May 1981), (1981) 12 Y.B. UNCITRAL 77.
[109] Mustill, *supra* note 97, 51-3; M. Tenenbaum, "International Arbitration of Trade Disputes in Mexico – The Arrival of the NAFTA and New Reforms to the Commercial Code" (1995) 12 J. Int'l Arb. 53, 59-60 and 73-4; S. Kierstead, "Referral to Arbitration Under Article 8 of the UNCITRAL Model Law: The Canadian Approach" (1998) 31 Can. Bus. L.J. 98, 99-102; L. Biucovic, "Impact of the Adoption of the Model Law in Canada: Creating a New Environment for International Arbitration" (1998) 30 Can. Bus. L.J. 376, 381; K.-H. Böckstiegel, "An Introduction to the New German Arbitration Act Based on the UNCITRAL Model Law" (1998) 14 Arb. Int'l 19, 28-31; Redfern and Hunter, *supra* note 6, 69; H. Smit and V. Pechota, *World Arbitration Reporter*, vol. 2 (Huntington, N.Y.: Juris, 2002); R. Nishikawa, "Arbitration Law Reform in Japan" (2004) 21 J. Int'l Arb. 303, 305-6. The list of grounds upon which an award may be set aside by a domestic court under the

promoting a more uniform approach to enforcement, the Model Law enhanced the portability of awards under the *New York Convention.* That said, states can still limit the Model Law to commercial disputes and thus to the private realm.[110]

Before publishing the Model Law, the UN Commission on International Trade Law sought to promote international commercial arbitration by producing the UNCITRAL Arbitration Rules of 1976.[111] The UNCITRAL Rules are worth a mention because they are often incorporated into investment treaties to provide a procedural framework for investor claims.[112] As such, the UNCITRAL Rules may govern the conduct of investment arbitrations, including important matters such as the appointment of arbitrators, the selection of the jurisdictional seat of the arbitration, the openness of the proceedings, and the binding nature of an award. In general, the UNCITRAL Rules are similar to other sets of arbitration rules[113] that are incorporated into investment treaties.[114] In particular, like other rules, the UNCITRAL Rules were intended for use in contract-based arbitration relating to

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UNCITRAL Model Law, *supra* note 103, art. 36, was imported from the list of grounds upon which an award may be denied recognition and enforcement under the *New York Convention*, *supra* note 94, art. V.

110 UNCITRAL Model Law, *supra* note 103, art. 1(1).

111 *Arbitration Rules of the United Nations Commission on International Trade Law*, UN G.A. Res. 31/98, UN GAOR, 31st Session, Supp. No. 17, UN Doc. A/31/17, c. V, s. C (1976) [hereinafter UNCITRAL Rules], preamble (stating that the UNCITRAL Rules were adopted as a set of "rules for *ad hoc* arbitration that are acceptable in countries with different legal, social and economic systems" and that "would significantly contribute to the development of harmonious economic relations").

112 UNCTAD, *Dispute Settlement: Investor-State*, UNCTAD Series on Issues in International Investment Agreements (New York: United Nations, 2003), 35.

113 ICSID *Rules of Procedure for Arbitration Proceedings* in ICSID, revised 26 September 1984 and 1 January 2003 (original rules 1968), reprinted in *Convention, Regulations and Rules* (Washington: ICSID, 2003) [hereinafter ICSID Rules], 93, online: ICSID www.worldbank.org/icsid/basicdoc/basicdoc.htm; *Rules Governing the Additional Facility for the Administration of Proceedings by the Secretariat of the International Centre for Settlement of Investment Disputes*, revised 1 January 2003 (original rules 1978), 1 ICSID Reports 213 [hereinafter ICSID Additional Facility Rules], online: ICSID www.worldbank.org/icsid/facility-archive/1.htm; *Rules of Arbitration of the International Chamber of Commerce*, revised 1 January 1998 (original rules 1922) [hereinafter ICC Rules], online: ICC www.iccwbo.org/court/english/arbitration/rules.asp; and *Rules of the Arbitration Institute of the Stockholm Chamber of Commerce*, revised 1 April 1999 [hereinafter Stockholm Rules], online: SCC www.sccinstitute.com/uk/Rules.

114 The most important difference between the UNCITRAL Rules and other sets of rules is that the former are not connected to an established institutional structure. Muchlinski, *supra* note 28, 540.

international trade and, as such, they provide a further example of how investment arbitration relies on an adjudicative model that originates in commercial arbitration.[115]

By concluding the *New York Convention*, complemented by the UNCITRAL Model Law and other instruments,[116] states established arbitration as an institution for the resolution of international disputes – primarily commercial in nature – between private parties.[117] As such, international commercial arbitration was conventionally limited to relations within the private sphere. As a private or alternative method of adjudication, arbitration could be subject to the preferences of the disputing parties, thus allowing for the use of rules of confidentiality, and arbitrator appointment and remuneration, that differed from those of public courts.[118] Most importantly, the *New York Convention* established a space in which arbitration could operate beyond the direct control of domestic courts.[119] That said, the extent to which commercial arbitration could be used to resolve public disputes was controlled by domestic courts. In particular, the jurisdiction of a commercial arbitration tribunal did not extend to regulatory disputes arising from the state's exercise of public authority with respect to foreign nationals, including foreign investors. One of the key aspects of the emerging system of investment arbitration is that it extends this private adjudicative model into the public sphere, giving private arbitrators the authority to make governmental decisions. Put differently, international commercial arbitration provided the foundation for the use of a private model of adjudication to resolve regulatory disputes between private individuals and the state.

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[115] E.g. *Report of the Secretary General: Preliminary Draft Set of Arbitration Rules for Optional Use in Ad Hoc Arbitration Relating to International Trade (UNCITRAL Arbitration Rules)*, UN, UN Doc. A/CN.9/97 (4 November 1974), 6 Y.B. UNCITRAL 163, 164.

[116] E.g. *European Convention on International Commercial Arbitration*, 21 April 1961, 484 U.N.T.S. 364 (applying to international arbitrations whether or not the states from which the parties come are European); *Inter-American Convention on International Commercial Arbitration*, 30 January 1975, 14 I.L.M. 336 (modelled on the *New York Convention* and applying to various Latin American countries that have not ratified the *New York Convention*).

[117] Abbott, *supra* note 22, 139; M. Sornarajah, "The UNCITRAL Model Law: A Third World Viewpoint" (1989) 6 J. Int'l Arb. 7, 14; Redfern and Hunter, *supra* note 6, 68-69 and 475-7.

[118] S. de Smith and R. Brazier, *Constitutional and Administrative Law*, 8th ed. (London: Penguin, 1998), 370 and 374.

[119] Redfern and Hunter, *supra* note 6, 137.

2. The expansion into the regulatory sphere

The first multilateral treaty in which states authorized the expansion of compulsory international arbitration to encompass regulatory disputes between states and foreign investors was the *Convention on the Settlement of Investment Disputes* of 1965 (the *ICSID Convention*).[120] Moreover, the *ICSID Convention* played an important role in promoting the use of investment arbitration by establishing a forum – the World Bank's International Centre for Settlement of Investment Disputes (ICSID) – and a set of arbitration rules dedicated to investment arbitration.[121] Importantly, many investment treaties delegate to the ICSID Secretary General the authority to appoint presiding arbitrators of investment arbitration tribunals, where the disputing parties do not otherwise agree.[122] There is also an ICSID Secretariat to register and administer arbitrations, and a process for the annulment of awards which replaces domestic judicial review of investment arbitration awards.[123] More broadly, ICSID was established within the World Bank to add weight to ICSID awards, given the World Bank's influence over international credit.[124]

Before examining the role of the *ICSID Convention* in the expansion of international commercial arbitration into the public realm, it is important to address a key issue in investment arbitration: the state's consent. States can consent to the international arbitration of future investment disputes in three ways: by contract, by domestic legislation, and by treaty.[125] The form of a state's consent is important because it correlates strongly with the positioning of investment arbitration in the private or the public sphere. First, a state can accept a compulsory arbitration clause

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[120] *Convention for the Settlement of Investment Disputes*, 18 March 1965, 4 I.L.M. 524 (entered into force 14 Oct 1966) [hereinafter *ICSID Convention*]. A. Broches, "Development of International Law by the International Bank for Reconstruction and Development" (1965) 59 Am. Soc'ty Int'l L. Proc. 33, 34-8; M. Hirsh, *The Arbitration Mechanism of the International Centre for the Settlement of Investment Disputes* (Dordrecht: Martinus Nijhoff, 1993), 11-15; Muchlinski, *supra* note 28, 540-2; J.G. Merrills, *International Dispute Settlement*, 3rd ed. (Cambridge: CUP, 1998), 113; UNCTAD, *supra* note 43, 115. See generally C. Schreuer, *The ICSID Convention: A Commentary* (Cambridge: CUP, 2001).

[121] ICSID Rules, *supra* note 113. A.R. Parra, "The Role of ICSID in the Settlement of Investment" (1999) 16(1) ICSID News 5.

[122] E.g. NAFTA, *infra* note 156, art. 1124(1).

[123] Muchlinski, *supra* note 28, 551-3.

[124] Delupis, *supra* note 75, 3; Peter, *supra* note 21, 321; Redfern and Hunter, *supra* note 6, 445.

[125] Parra, *supra* note 121; UNCTAD, *supra* note 112, 53.

in a contract with a foreign investor, in which case the state typically acts in a private capacity and the state's consent is limited to a commercial relationship with another private party.[126] Second, a state can consent to investment arbitration by enacting a law that authorizes foreign investors to submit any investment dispute with the state to compulsory international arbitration.[127] Third, a state can conclude a treaty that likewise provides for the compulsory arbitration of disputes with foreign investors.[128] In the latter two cases, the state consents *generally* to compulsory investment arbitration, pursuant to either domestic law or international law.[129] The state's consent is general because it authorizes the compulsory arbitration of any future dispute concerning the state's exercise of public authority in relation to a foreign investor. These issues are discussed in more detail in chapter six of this thesis. Suffice it to say here that the general consent essentially transforms investment arbitration from a sub-category of commercial arbitration, based on a reciprocal legal relationship between the disputing parties, into a type of governing arrangement.

This thesis focuses on treaty-based investment arbitration because it involves the use of investment arbitration as a governing arrangement at the international level. Unlike contract-based investment arbitration, which relies on the specific consents of private parties to a contract, treaty-based investment arbitration is based on a general consent by the state and thus forms part of the state's governing apparatus. Legislation-based investment arbitration, on the other hand, entails the use of international arbitration as a governing arrangement. However, unlike treaty-based

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[126] Early ICSID arbitrations were all founded on consents recorded, in the traditional manner, by a clause in an investment contract. E.g. *Holiday Inns S.A.* v. *Morocco* (Jurisdiction) (12 May 1974), 1 ICSID Rep. 645; *Kaiser Bauxite Company* v. *Jamaica* (Jurisdiction) (6 July 1975), 1 ICSID Rep. 296; *Adriano Gardella* v. *Côte d'Ivoire* (Merits) (29 August 1979), 1 ICSID Rep. 283; *AGIP S.p.A.* v. *People's Republic of Congo* (Merits) (30 November 1979), 1 ICSID Rep. 306, 21 I.L.M. 726.

[127] E.g. *Southern Pacific Properties (Middle East) Ltd.* v. *Arab Republic of Egypt* (Jurisdiction) (14 April 1988), 3 ICSID Rep. 131 [hereinafter *SPP*], 161. See Parra, *supra* note 121 (noting that, during 1965-1999, 30 countries included references to ICSID in domestic investment legislation).

[128] E.g. *Asian Agricultural Products Ltd. (AAPL)* v. *Sri Lanka* (Merits) (27 June 1990), 4 ICSID Rep. 246, 30 I.L.M. 577 [hereinafter *AAPL*], para. 2-6.

[129] J. Paulsson, "Arbitration without Privity" (1995) 10 ICSID Rev. 232, 233 and 240. When the consent is given in domestic legislation, it is subject to domestic law and can be withdrawn or amended according to domestic law: Delupis, *supra* note 75, 27. On the other hand, when the consent is given in a treaty, it is subject to the terms of the treaty and can only be withdrawn or amended with the consent of the states parties or by abrogation of the treaty.

investment arbitration, the state's consent is subject to domestic public law and therefore it does not establish an international obligation on the part of the state to accept compulsory investment arbitration. These aspects of the state's consent distinguish treaty-based investment arbitration as a governing arrangement, established at the international level, and as the subject of this thesis.

This returns us to the *ICSID Convention*. For ICSID to have jurisdiction over an investment dispute, the state and the investor must both consent to the arbitration, whether by contract, statute, or treaty.[130] In the latter two cases, where the authority for international arbitration comes from a state's general consent, ICSID arbitration enters the public sphere in a way that international commercial arbitration under the *New York Convention* never did. Indeed, this is the most important aspect of the *ICSID Convention*: it laid a foundation for states to extend investment arbitration beyond the private realm and use it as a governing arrangement.

In the negotiation of the *New York Convention* during the 1950s there were proposals to expand international commercial arbitration by explicitly broadening the treaty's definition of the term "commercial". These proposals were motivated largely by the growing importance of state entities in international trade.[131] Negotiators from Western states, in particular, pressed for a treaty that would clearly apply, not only to private companies, but also to state agencies when they entered into international contracts.[132] In the end, the treaty applied to state agencies, although states could limit their obligations to disputes arising out of commercial relationships.[133] Also, the treaty

[130] Schreuer, *supra* note 120, 191-224.
[131] Besides this factor, some states and the International Chamber of Commerce took the view that the use of the term commercial in the *Geneva Protocol of 1927* was uncertain and that this made it difficult for the parties to an arbitration agreement to predict whether their agreement would be upheld: e.g. *Comments by Governments on the draft Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, UN ESC, UN Doc. E/2822/Add.4 (3 April 1956), 4 (comment by the United Kingdom); *Report by the Secretary-General on the Recognition and Enforcement of Foreign Arbitral Awards*, Annex I and II, UN ESC, 21st Sess., UN Doc. E/2822 (31 January 1956) [hereinafter *Award Enforcement Report*], 13 (Annex I, comment by Switzerland) and 7 (Annex II, comment by the ICC).
[132] E.g. *Award Enforcement Report*, ibid., 11 (Annex I, comment by Austria).
[133] Although this should not be taken to mean that the treaty was intended to encompass the public sphere for those states that did not make such a reservation. The negotiating history of the *New York Convention* indicates that this was not the intention: e.g. *Report of the Committee on the Enforcement of International Arbitral Awards*, UN ESC, UN Doc. E/AC.42/SR.3 (Third Meeting, 23 March 1955) [hereinafter *Draft Convention Report*], 6 (comment by Belgium);

negotiators reported that the treaty's application to state entities did not need to be expressly limited to cases in which the state was acting in a private capacity because such language "would be superfluous and that a reference in the present report [of the drafting committee] would suffice".[134] Therefore, to the extent the *New York Convention* encompassed disputes involving state entities, it was broadly limited to cases in which the state acted in a private capacity.[135] As such, the *New York Convention* encompassed contract-based investment arbitration, but did not extend to investment arbitration in the public sphere based on the general consent.

Unlike the *New York Convention*, the *ICSID Convention* does not limit ICSID arbitration to commercial disputes between investors and states, thus allowing the use of investment arbitration as a governing arrangement. In particular, the *ICSID Convention* extends the jurisdiction of ICSID tribunals to "any legal dispute arising directly out of an investment"[136] but without defining the term "investment".[137] As a result, the scope of ICSID arbitration is left to the contract, statute, or treaty that authorizes the arbitration and, in most investment treaties, the term "investment" is

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Award Enforcement Report, ibid., 23 (Annex II, comment by the Society of Comparative Legislation) and 5-6 (comment by the ICC).

[134] Quoting *Draft Convention Report*, ibid., 7. The negotiating history of Article I of the *New York Convention* reveals an intention both to extend the treaty to the commercial activities of state agencies and to limit the treaty to the private sphere: e.g. *Award Enforcement Report*, ibid., 11 (Annex I, comment by Austria) and 9 (Annex II, comment by the Society of Comparative Legislation); *Draft Convention Report*, ibid., 7 (comment by Belgium).

[135] Tension about the appropriate scope of international commercial arbitration also arose during negotiation of the UNCITRAL Model Law with respect to definition of the term commercial: *Comments by Governments*, *supra* note 102, 57 (comment by the United States) and 57-8 (comment by UNCTAD). The compromise that was reached was to avoid either defining the term commercial in the text of the Model Law or leaving the definition to domestic law, as in the case of the *New York Convention*. Instead, a footnote was included with art. 1(1) to provide guidance on the possible meaning of the term, which stated, *inter alia*, that commercial relationships included "investment" (*Model Law Report*, *supra* note 104, 11). The inclusion of this language in a footnote rather than the text highlighted the discretion of states to decide for themselves whether to include an expanded definition in their domestic legislation. See also *Model Law Report*, *supra* note 104, 10; *Comments by Governments*, *supra* note 102, 84 (comment by the ICC).

[136] *ICSID Convention*, *supra* note 120, art. 25.

[137] E.g. *First Preliminary Draft of a Convention on the Settlement of Investment Disputes, Annotated Text*, World Bank, UN Doc. SID/63-15 (9 August 1963), 16 (article II, comment), reprinted in ICSID, *Convention on the Settlement of Investment Disputes between States and Nationals of Other States – Documents Concerning the Origins and the Formulation of the Convention*, vol. 2 (World Bank, 1968), 149; World Bank, *Report of the Executive Directors on the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States* (18 March 1965), reprinted in *Convention, Regulations and Rules* (Washington: ICSID, 2003), para. 27.

defined broadly. Thus, the scope of ICSID arbitration – based on investment treaties – extends beyond international commercial arbitration to encompass disputes within the public sphere, including regulatory disputes between investors and the state.[138] The expansion of investment arbitration into the public realm makes the *ICSID Convention* the starting point for the establishment of the system of investment arbitration.

One final aspect of ICSID should be mentioned. Under the *ICSID Convention*, access to ICSID arbitration was originally limited to states, and to investors of those states, that were signatories of the *ICSID Convention*. Thus, where an investor and a state consented to ICSID arbitration, the arbitration could only take place if the investor's home state and the respondent state were parties to the *ICSID Convention*. Naturally, this restricted ICSID's availability and appeal to non-party states and their investors. To remedy this, the ICSID system was opened to disputes involving non-signatory states in 1978 with the creation of the ICSID Additional Facility.[139] The Additional Facility authorized ICSID to administer disputes involving non-signatory states and their investors.[140] It also extended ICSID arbitration to disputes that did not arise directly out of an investment as long as the dispute related to a transaction that had "features that distinguish it from an ordinary commercial transaction".[141] However, the Additional Facility is not governed by the *ICSID Convention* and, as a result, an award under the Additional Facility does not fall within the ICSID

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[138] Put differently, the notion of an investment dispute under the *ICSID Convention* overlaps with the concept of a commercial dispute under the *New York Convention*: *SGS Société Générale de Surveillance* v. *Philippines* (Jurisdiction) (29 January 2004), 16(3) World Trade and Arb. Mat. 91, para. 10.

[139] *Additional Facility Rules*, *supra* note 113. The Additional Facility was established by a majority decision of the ICSID Administrative Council of 27 September 1978: see 1 ICSID Rep. 218.

[140] Ibid., art. 2.

[141] Ibid., art. 2 and 4(3). When it approved the Additional Facility, the ICSID Administrative Council commented that the following transactions are distinguishable from "an ordinary commercial transaction":

> Economic transactions which (a) may or may not, depending on their terms, be regarded by the parties as investments for the purposes of the [ICSID] Convention, which (b) involve long-term relationships or the commitment of substantial resources on the part of either party, and which (c) are of special importance to the economy of the State party, can be clearly distinguished from ordinary commercial transactions. Examples of such transactions can be found in various forms of industrial cooperation agreements and major civil works contracts.

enforcement system.[142] Rather, it is normally enforceable under the *New York Convention* and other instruments of commercial arbitration.[143] In essence, the Additional Facility allows access to ICSID's facilities by states (or their investors) that were unwilling to relinquish ultimate control over investment arbitration to the ICSID enforcement system.

The *ICSID Convention* played an integral part in emergence of investment arbitration because it opened the way for investment treaties that establish the general consents of states to compulsory international arbitration of disputes between states (acting in a public capacity) and private parties, rather than between private parties alone. Yet, one should not overstate the role of the *ICSID Convention*.[144] First, ICSID arbitration does not constitute the full system of investment arbitration because many investment arbitrations take place in forums other than ICSID,[145] under different arbitration rules,[146] and subject to other appointing authorities.[147] Above all, the *ICSID Convention* did not constitute the system of investment arbitration because the treaty did not establish the all-important consents of states to the compulsory arbitration of investment disputes.[148] Thus, while the seed of the system of investment arbitration was planted with the *ICSID Convention*, it did not fully emerge until a large number of investment treaties were concluded.[149]

ICSID Additional Facility Rules, reprinted in (1993) 1 ICSID Rep. 217 at 220 (art. 4(3), commentary).

[142] Ibid., art. 3 and 53. Instead, an Additional Facility arbitration award is subject to the rules of recognition and enforcement of the seat of the arbitration (art. 3, commentary and art. 20).

[143] E.R. Leahy, "Enforcement of Arbitral Awards Issued by the Additional Facility of the International Centre of Settlement of Investment Disputes (ICSID)" (1985) 2 J. Int'l Arb. 15, 15-16.

[144] E.g. P. Malanczuk, "State-State and Investor-State Dispute Settlement in the OECD Draft Multilateral Investment Agreement" (2000) 3 J. Int'l Econ. L. 417, 436-7 (arguing that there is a modern standard as to the non-applicability of the local remedies rule under the *ICSID Convention*, without referring to BITs).

[145] E.g. the International Court of Arbitration of the ICC or the Permanent Court of Arbitration.

[146] *Supra* note 113.

[147] E.g. the President of the International Court of Justice or the Secretary General of the United Nations.

[148] *ICSID Convention*, *supra* note 120, preamble ("Declaring that no Contracting State shall by the mere fact of its ratification, acceptance or approval of this Convention and without its consent be deemed to be under any obligation to submit any particular dispute to conciliation or arbitration").

[149] M.S. Bergman, "Bilateral Investment Protection Treaties: An Examination of the Evolution and Significance of the U.S. Prototype Treaty" (1983) 16 N.Y.U.J. Int'l L. & Pol. 1,

3. The emergence of investment arbitration

The first investment treaties to incorporate states' general consents were a handful of bilateral investment treaties (BITs) signed in the late 1960s.[150] In the 1970s and 1980s, general consents in BITs became more common, though not universal.[151] Only in the 1990s did the inclusion of general consents to investment arbitration – based on broad jurisdictional concepts and liberal investment standards – become the rule.[152] According to the United Nations Conference on Trade and Development (UNCTAD), there are now nearly 2,200 BITs in force, the bulk of which contain general consents by states to compulsory investment arbitration, relying on the *New York Convention* or *ICSID Convention*, or both, for the enforcement of awards.[153] Given that the primary purpose of these treaties is to promote and protect investments between the states parties, the use of investment arbitration ensures a high level of investor protection.[154]

3-4 and 8-9; M. Sornarajah, *The Pursuit of Nationalized Property* (Dordrecht: Martinus Nijhoff, 1986), 38-9; K.J. Vandevelde, "The Bilateral Treaty Program of the United States" (1988) 21 Cornell Int'l L.J. 201; J.W. Salacuse, "BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries" (1990) 14 Int'l Law. 655, 657; Dolzer and Stevens, *supra* note 21, 120 and 126; UNCTAD, *supra* note 31, 8-10; A.R. Parra, "ICSID and Bilateral Investment" (2000) 17(1) ICSID News 7.

150 Dolzer and Stevens, *supra* note 21, 126 (noting that earlier BITs, such as the Germany-Pakistan BIT of 1959, did not provide for compulsory investment arbitration, and that the first BIT to include an ICSID clause was a Netherlands-Indonesia BIT, signed in 1968, followed by Italy-Chad and Italy-Côte d'Ivoire BITs, signed in June and July 1969). At the same time, in 1969, ICSID published a set of model BIT clauses in order to encourage states to consent to treaty-based investment arbitration: *Model Clauses Relating to the Convention on the Settlement of Investment Disputes Designed for Use in Bilateral Investment Agreements* (1969), 8 I.L.M. 1341.

151 UNCTAD, *supra* note 31, 8-10; Parra, *supra* note 149 (noting that the first BITs that incorporated general consents were concluded in the late 1960s. Then, 86 BITs were concluded by European countries during the 1970s, usually including the consent of each state to the submission to ICSID of "any dispute", between the state and a national of the other state party, regarding investment. In the 1980s, another 211 BITs were concluded, including some with developing countries that had previously refrained (such as China), and the U.S. launched its BIT program.).

152 UNCTAD, *supra* note 31, 10 and 89-90; UNCTAD, *supra* note 72, 10 and 45-6.

153 UNCTAD, *supra* note 31, 62-4 and 97-8; Vandevelde, *supra* note 76, 621; Parra, *supra* note 149.

154 Salacuse, *supra* note 149, 659; Vandevelde, *supra* note 76, 628-33; UNCTAD, *supra* note 53, 97, note 22.

The system of international investment arbitration clearly emerged only in the 1990s. Most importantly, in that decade, roughly 1,500 bilateral investment treaties were concluded.[155] Further, a number of groundbreaking regional investment treaties were concluded in the 1990s, including the *North American Free Trade Agreement* (NAFTA)[156] and the *Energy Charter Treaty*,[157] both of which authorized compulsory investment arbitration.[158] Ratifications of the *ICSID Convention*, which had increased gradually in the 1980s, grew more rapidly in the 1990s with the accession of former Soviet Bloc and major developing countries, and ICSID became the leading forum for investment arbitration.[159] Moreover, in the 1990s, investment treaties expanded beyond conventional relationships between capital-exporting and capital-importing states to include many BITs among developing and former Soviet Bloc states.[160] Before the 1990s, nearly all investment treaties were concluded between capital-exporting and capital-importing states, usually based on model BITs adopted by the

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[155] *CMS*, *supra* note 69, para. 45. UNCTAD, *supra* note 72, 44; UNCTAD, *Bilateral Investment Treaties – 1959-1999* (New York: United Nations, 2000), 1 and 4 (reporting that the number of BITs quintupled during the 1990s, from 385 in 1989 to 1,857 by 1999, involving 102 countries in 1989 and 173 countries in 1999); UNCTAD, *supra* note 28, xix (reporting that by 2004 most countries had concluded investment treaties with their principal investment partners). See Parra, *supra* note 149; Juillard, *supra* note 37, 477-8; Malanczuk, *supra* note 144, 420; Muchlinski, *supra* note 10, 1045-6.

[156] *North American Free Trade Agreement*, 17 December 1992, 32 I.L.M. 296 and 605 (entered into force 1 January 1994) [hereinafter NAFTA], art. 1116 and 1117.

[157] *Energy Charter Treaty*, 17 December 1994, 35 I.L.M. 509, art. 26 (adopted by approximately 50 countries, mostly OECD members, central and eastern European countries, and members of the Commonwealth of Independent States; and limited to the energy sector).

[158] Paulsson, *supra* note 129, 233; T.W. Wälde, "Investment Arbitration Under the Energy Charter Treaty – From Dispute Settlement to Treaty Implementation" (1996) 12 Arb. Int'l 429, 434-6. Other regional treaties that authorize compulsory investment arbitration include: *ASEAN Agreement for the Promotion and Protection of Investments*, 15 December 1987, 27 I.L.M. 612; *Protocolo de Colonia para la Promoción y Protección Recíproca de Inversiones en el MERCOSUR*, 17 January 1994, adopted by Mercosur/CMC/Dec No. 11/93, art. 9(2) and (4), online: SICE http://www.sice.oas.org/Trade/MRCSR/colonia/pcolonia_s.asp; *Treaty on Free Trade Between the Republic of Columbia, the Republic of Venezuela and the United Mexican States*, 13 June 1994 (entered into force 1 January 1995), art. 17-17 and 17-18, online: SICE http://www.sice.oas.org/Trade/G3_E/G3E_TOC.asp; *The Dominican Republic – Central America – United States Free Trade Agreement*, 5 August 2004 (not in force), art. 10.17 and 10.18, online: SICE http://www.sice.oas.org/Trade/CAFTA/CAFTADR_e/CAFTADRin_e.asp.

[159] See ICSID www.worldbank.org/icsid/constate/constate.htm (reporting that, by 25 March 2005, 142 states had ratified the *ICSID Convention*, including Turkey (ratification in 1989), China (1993), Argentina (1994), and Venezuela (1995)). However, some significant capital-importing states, such as Brazil, Canada, India, Mexico, and South Africa, have not signed the *ICSID Convention* and others have excluded important economic sectors, such as oil and natural gas, from their consents to ICSID jurisdiction.

[160] UNCTAD, *supra* note 72, 33-4.

major capital-exporting countries.[161] The wide geographic coverage of investment treaties and the corresponding availability of investment arbitration to multinational enterprises has taken investment arbitration beyond a collection of disparate procedures in individual treaties to establish it as a general system of international adjudication within the regulatory sphere.[162] The system is complex, fragmented, and at times incoherent, given variations under different treaties.[163] There are notable variations among investment treaties including differences in scope, the definition of investment standards, and the relevant arbitration rules and arbitration institutions.[164] These differences should not be underestimated as they have important ramifications for how investment arbitration unfolds in specific cases. Further, the system is clearly not a global system, especially in the absence of BITs between capital-exporting states.[165] But there remains an emerging system of investment arbitration – based on investment treaties – which protects investors from the exercise of public authority, whose unifying feature is the use of international investment arbitration as a governing arrangement.[166]

An actual investment arbitration normally begins when the investor provides notice of a claim to the respondent state, to a relevant arbitration institution (such as ICSID), and in some cases to the investor's home state or other states parties to the treaty. In the normal course, once an investor files a claim, a tripartite tribunal is established, consisting of two arbitrators appointed by the investor and the

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[161] Peter, *supra* note 21, 332-3; Juillard, *supra* note 37, 477. After the *ICSID Convention* was concluded, more and more capital-exporting countries adopted policies in favour of BITs with capital-importing states, culminating in the U.S. adoption of a BIT program in 1982: Bergman, *supra* note 149, 3-4; Soloway, *supra* note 62, 99. For texts of model BITs, see UNCTAD, *International Investment Instruments: A Compendium*, vol. 3 (New York: United Nations, 1996).

[162] J.W. Salacuse, "Toward a Global Treaty on Foreign Investment: The Search for a Grand Bargain" in N. Horn, ed., *Arbitrating Foreign Investment Disputes* (The Hague: Kluwer Law International, 2004), 68-70; UNCTAD, *supra* note 28, 221.

[163] UNCTAD, *supra* note 2, 166; D. Schneiderman, "Investment Rules and the New Constitutionalism" (2000) 25 Law & Social Inq. 757, 781.

[164] Paulsson, *supra* note 129, 240; Dolzer and Stevens, *supra* note 21, 64; UNCTAD, *supra* note 31, 139-40; UNCTAD, *supra* note 72, 53-86; UNCTAD, *supra* note 28, 223-4.

[165] M. Shapiro, "The Globalization of Law" (1993) 1 Ind. J. Global Legal Studies 37, 37-8; Malanczuk, *supra* note 144, 436-7; C.N. Brower, C.H. Brower II, and J.K. Sharpe, "The Coming Crisis in the Global Adjudicative System" (2003) 19 Arb. Int'l 415, 415-18.

[166] UNCTAD, *supra* note 72, 45-6; Schneiderman, *supra* note 163, 769-70 and 781; Z. Douglas, "The Hybrid Foundations of Investment Treaty Arbitration" (2003) 74 Brit. Y.B. Int'l L. 151, 159.

respondent state (respectively) and a presiding arbitrator appointed by agreement or by an outside appointing authority. Common appointing authorities include the Secretary General of ICSID, the ICC International Court of Arbitration, and the President of the International Court of Justice.[167] In providing for compulsory arbitration, investment treaties incorporate different sets of arbitration rules. Initially, bilateral investment treaties authorized compulsory arbitration only under the ICSID Rules; however, later treaties incorporated other arbitration rules such as the UNCITRAL Rules, the ICSID Additional Facility Rules, and the ICC Rules.[168] Where a treaty incorporates more than one set of rules, investors typically may choose the rules under which they wish to file a claim, although the different sets of rules are similar in how they govern an arbitration.

Once a tribunal has been constituted, an arbitration generally proceeds as follows.[169] First, the tribunal resolves procedural matters, the most important of which is the selection of the jurisdictional seat of the arbitration, which in turn determines the domestic law that will govern applications to set aside the arbitration agreement or award. The tribunal also resolves other matters, such as the production of documents, the openness of the proceedings, and any challenges to the impartiality of an arbitrator. Once preliminary matters are resolved, the tribunal hears any objections by the respondent state to the tribunal's jurisdiction or to the admissibility of the investor's claim. These objections usually raise various issues, such as whether the claimant qualifies as an "investor" who has made an "investment" under the treaty. Where the tribunal finds that it has jurisdiction, the arbitration proceeds to the merits of the claim as to whether the respondent state has violated a substantive standard of investor protection under the treaty. If the tribunal finds that the state

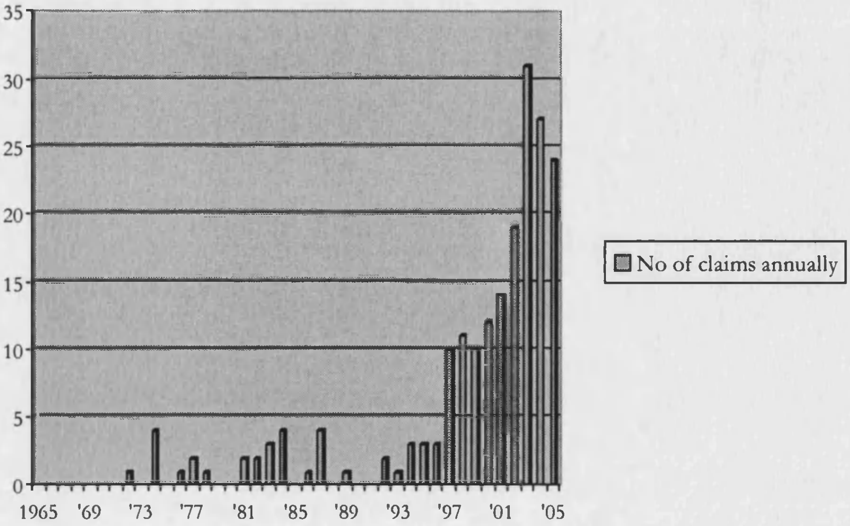
[167] E.g. *Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of India*, 14 March 1994, [1995] U.K.T.S. No. 27, Cmd 2797 (entered into force 6 January 1995), art. 9(3)(c)(ii); NAFTA, *supra* note 156, art. 1124(1).
[168] E.g. NAFTA, *supra* note 156, art. 1120(1) (allowing an investor to choose to file a claim under any of the UNCITRAL Rules, the ICSID Rules, or the ICSID Additional Facility Rules which, in turn, will govern the arbitration); *Energy Charter Treaty*, *supra* note 157, art. 26(4) (allowing an investor to choose from the UNCITRAL Rules, the ICSID Rules, the ICSID Additional Facility Rules, or the Stockholm Rules).
[169] See generally G.N. Horlick and A.L. Marti, "NAFTA Chapter 11B: A Private Right of Action to Enforce Market Access through Investments" (1997) 14 J. Int'l Arb. 43; T.W. Wälde, *supra* note 158, 449-56; M.J. Staff and C.W. Lewis, "Arbitration Under NAFTA Chapter 11: Past, Present, and Future" (2003) 25 Houston J. Int'l L. 301, 308-16; UNCTAD, *supra* note 112, 40-64.

violated the treaty, the tribunal may award damages to the investor, as well as costs to either party. Finally, should the state refuse to comply with an award, the investor may pursue enforcement of the award against the state's assets, most commonly under the *ICSID Convention* or the *New York Convention.*

The fact that the system of investment arbitration only emerged in the 1990s is reflected by the recent explosion of claims by investors under investment treaties. The first ICSID awards based on the general consent of a state were made in 1988 and 1990, pursuant to a statute and a treaty, respectively.[170] All previous ICSID arbitrations were based on arbitration clauses in investment contracts. Since then, the proliferation of investment treaties has fuelled an explosion of investment arbitration, as indicated below in relation to ICSID.

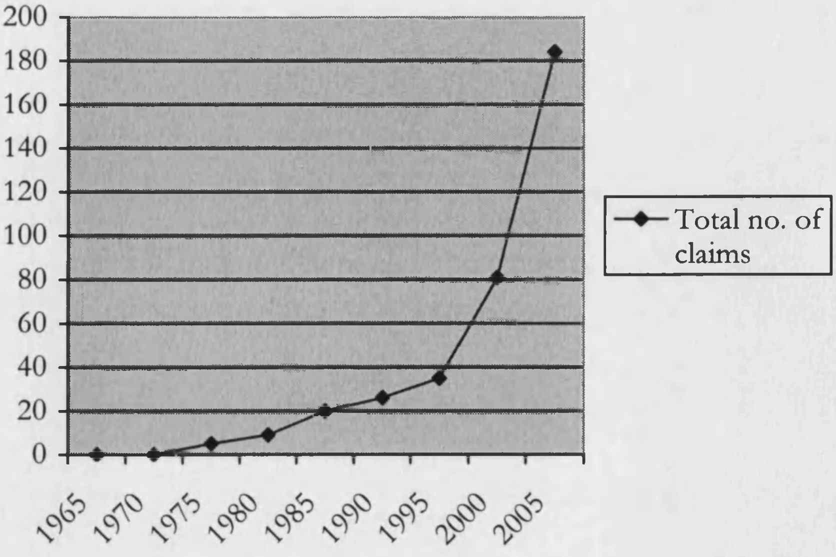
[170] *SPP, supra* note 127; *AAPL, supra* note 128.

Table 1: ICSID claims registered annually: 1965-2005



After 1996, in particular, "the floodgates… seemed to open" in the words of one ICSID staff member.[171] From 1995 to 2004, ICSID registered four times as many claims as the previous 30 years and the growth trend appears to be sustaining. By July 2005 there were 91 claims pending, more than all of the claims registered at ICSID during its entire history until 2001.

Table 2: ICSID claims registered in total: 1965-2005



[171] Parra, *supra* note 149.

The growth of ICSID arbitration is only part of the explosion in investment arbitration.[172] For one, it does not include cases in which an investor and a state have settled a dispute after the investor threatened a claim, but before the claim was registered by ICSID. More importantly, ICSID is the only international arbitration forum that is required to publicize investor claims. Other forums, such as the ICC's International Court of Arbitration or *ad hoc* tribunals established under the UNCITRAL Rules, normally presume that claims should remain confidential unless both disputing parties agree otherwise. Thus, it is impossible to assess the full extent to which the use of investment arbitration has expanded.[173] At a minimum, the experience with respect to ICSID arbitration indicates rapid and continuing growth in investment arbitration.[174]

The explosion of investment arbitration demonstrates that multinational enterprises have become increasingly prepared to use investment arbitration to resolve disputes with states. As such, investment arbitration has become an important means for investors to resist regulation by the state and to pursue compensation for costs that flow from the exercise of public authority. According to one practitioner at the London-based international law firm Herbert Smith:[175]

> I do think... that what we see developing is an unstoppable process. In particular, this is because more and more corporations are becoming aware that, quite apart from what they might have negotiated in their contracts, they may have direct rights of recourse bestowed upon them by the energy of their own governments.... And I suspect that what we have seen emerging in the last five years will be just the tip of the iceberg.

For these reasons, the emergence of the system of investment arbitration is a significant aspect of contemporary globalization.

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[172] Brower et al., *supra* note 165, 416.

[173] An important exception is NAFTA, under which the states parties have adopted a general practice of publishing materials that relate to Chapter 11 arbitration, regardless of the applicable arbitration rules: Free Trade Commission, *Notes of Interpretation of Certain Chapter 11 Provisions* (31 July 2001), 13(6) World Trade and Arb. Mat. 139, art. A, online: DFAIT www.dfait-maeci.gc.ca/tna-nac/NAFTA-Interpr-en.asp.

[174] A. Cosbey et al., "Investment and Sustainable Development" (Report by the International Institute for Sustainable Development, 2004), 15-16.

[175] C. McLachlan, "Commentary: The Broader Context" (2002) 18 Arb. Int'l 339, 343.

C. Chapter 11 of the North American Free Trade Agreement

In this thesis, aspects of the argument are elaborated by examining the text and jurisprudence of the investment chapter (Chapter 11) of the *North American Free Trade Agreement*.[176] Focusing on a single treaty allows for more detailed and comprehensive analysis, while avoiding the confusion that could result from a more varied analysis of arbitrations under multiple investment treaties. NAFTA Chapter 11 provides a useful case study because, like other treaties, it includes consents by the NAFTA states to compulsory investment arbitration based on broad jurisdictional concepts and liberal standards of investor protection.[177] Also, the conclusion of NAFTA Chapter 11 was a watershed in the 1990s' wave of investment treaties because it applies to extensive capital flows between Canada, Mexico, and the United States.[178]

Nevertheless, NAFTA differs from other investment treaties. NAFTA is a regional trade and investment agreement that contains 20 chapters on economic integration, only one of which directly engages investment and investment arbitration. The positioning of the NAFTA investment chapter alongside chapters on trade in goods, intellectual property rights, government procurement, and so on, has implications for how NAFTA Chapter 11 is interpreted and applied.[179] Also, the language used to define core provisions of Chapter 11 – such as the precise definition of the scope of investment arbitration, the wording of the general consents, and the content of the substantive standards – naturally differs from other treaties.[180] For this reason, not all of the conclusions reached about Chapter 11 arbitration apply fully to

[176] NAFTA, *supra* note 156. An investor can bring a claim under the NAFTA compulsory investment arbitration mechanism based on certain substantive obligations of NAFTA Chapter 11 and NAFTA Chapter 15.
[177] Dolzer and Stevens, *supra* note 21, 120-6; Horlick and Marti, *supra* note 169, 43-5; Rugman and Gestrin, *supra* note 53, 162-6; UNCTAD, *supra* note 31, 137-40.
[178] M. Trebilcock and R. Howse, *The Regulation of International Trade* (London: Routledge, 1995), 295-7; Rugman and Gestrin, *supra* note 53, 156-62.
[179] J.C. Thomas, "Investor-State Arbitration Under NAFTA Chapter Eleven" (Paper presented to the NAFTA Chapter 11 Investor-State Disputes: Litigating Against Sovereigns conference, Canadian Bar Association, March 2000), 5-7.
[180] UNCTAD, *supra* note 31, 139-40 (noting that differences in the language of investment treaties reflect the fact the treaties were negotiated in different time periods, with innovations by one country tending to be adopted in later treaties by other countries).

other investment treaties. Each treaty is unique in its language, its negotiating history, and – in the case of trade and investment agreements – the surrounding text.

Yet, one should not lose sight of the forest for the trees. To the extent that NAFTA obligations are subject to compulsory investment arbitration, NAFTA is clearly part of the network of treaties that make up the international system of investment arbitration.[181] The text of NAFTA Chapter 11 was based on the U.S. model bilateral investment treaty and, since NAFTA was concluded, both the U.S. and Canada have used Chapter 11 as the starting point for other investment treaties.[182] To the extent that it uses investment arbitration, NAFTA has more in common with other investment treaties than with international trade regimes. Finally, the inclusion of the NAFTA investment chapter in a broader treaty structure, if anything, limits the scope and intensity of investment arbitration. Therefore, the focus on Chapter 11 tends to moderate, not exaggerate, the significance of the system of investment arbitration as a governing arrangement. For these reasons, Chapter 11 is a useful example of investment arbitration and the conclusions drawn in this thesis are generally applicable to investment arbitration under other treaties.

In fact, NAFTA Chapter 11 is arguably the most important single example of a treaty incorporating investment arbitration. This is because Chapter 11 has generated a large number of publicly-available awards and other materials.[183] Indeed, NAFTA has led to more claims and a more comprehensive body of jurisprudence than any other investment treaty.[184] The early experience under Chapter 11 drew

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[181] Salacuse, *supra* note 162, 35-6; M.-F. Houde and K. Yannaca-Small, *Relationships between International Investment Agreements*, OECD Working Paper on International Investment No. 2004/1 (Organization for Economic Cooperation and Development, May 2004), 5-6.

[182] J.W. Boscariol, "Canada and the New International Investment Regime – Canada's Foreign Investment Protection Agreements" (Presentation to the Canadian Bar Association – Ontario International Law Section, March 1999); P.D. Ehrenhaft, "Chapter 11 and Federalism" (Paper presented to the NAFTA Chapter 11 Investor-State Disputes: Litigating Against Sovereigns conference, Canadian Bar Association, March 2000), 6; Soloway, *supra* note 62, 99-100; M. Kantor, "The New Draft Model U.S. BIT: Noteworthy Developments" (2004) 21 J. Int'l Arb. 382, 382.

[183] Because the NAFTA states have adopted a practice of publishing materials arising from NAFTA Chapter 11 claims, documents on investment arbitration are more accessible in the case of NAFTA. Other treaties typically prohibit publication, according to the applicable arbitration rules, unless authorized by the disputing parties.

[184] There have been 39 notices of intent by investors to submit a claim under NAFTA Chapter 11, of which at least 20 have led to arbitration proceedings. Of these, ten have resulted in final awards on the merits, including two in claims against Canada, five in claims

attention to the availability of investment arbitration and helped trigger the rapid growth in claims under other investment treaties since the mid-1990s.[185] Finally, under Chapter 11, there have been multiple claims against each states party, including multiple claims against significant capital-exporting states (Canada and the United States). As such, the text and jurisprudence of Chapter 11 provide a focused empirical base for broader conclusions about the system of investment arbitration.

Conclusion

The system of investment arbitration did not emerge overnight and from scratch. The trickle of investment treaties in the 1960s that grew into a torrent in the 1990s is itself tied to a diverse collection of treaties, sets of arbitration rules, and implementing statutes. Foremost among these are the *New York Convention* of 1958 and *ICSID Convention* of 1965; the ICSID Rules, ICSID Additional Facility Rules, and UNCITRAL Rules; and the UNCITRAL Model Law. Most of these instruments were not originally intended for adjudication of regulatory disputes in the public sphere. Rather, they were restricted to the arbitration of disputes arising from commercial transactions between private parties. The extension of the model of international commercial arbitration to encompass regulatory disputes between private investors and the state explains, in part, the tendency of some commentators to approach treaty-based investment arbitration as if it were a reciprocally consensual system of dispute resolution. The purpose of this thesis is to establish that investment arbitration is in fact a governing arrangement; that is, an adjudicative instrument adopted by the state to regulate relations between public entities and individuals who are subject to the exercise of public authority. In turn, this thesis is intended to demonstrate that the emergence of the system of investment arbitration, though complex and varied in its content, is an important development. In the next chapter, the uniqueness of investment arbitration is examined in the wider context of public international law.

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against Mexico, and three in claims against the United States. Of the ten awards on the merits to date, damages were awarded in two claims against Canada and two claims against Mexico. Each of the three claims against the United States was unsuccessful.

[185] Been and Beauvais, *supra* note 32, 44-5.

Chapter Three
Individualization

Investment arbitration based on a general consent by the state *individualizes* international adjudication. Individuals – in this case foreign investors – are granted the ability to directly initiate, maintain, and enforce claims against states before arbitration tribunals that are constituted under international law. However, unlike other cases of individualization in international law, the ability of investors to bring international claims is prospective. In other words, the state's consent to arbitration is not limited to an existing dispute or series of disputes arising from a past historical event. Instead, the state consents to the arbitration of any future dispute between the state and a foreign investor, at the instance of the investor. This endows international tribunals with compulsory jurisdiction over any regulatory dispute involving the exercise of public authority by the state.

The purpose of this chapter is to examine the significance of the general consent and the prospective individualization of international claims in treaty-based investment arbitration. As used in this thesis, the term "general consent" refers to a prospective consent by a state to the compulsory arbitration of disputes with investors as a group.[1] The general consent can be distinguished from a specific consent that is limited either to an existing dispute that is known in advance to the party giving the consent, or to disputes arising from a specific legal relationship between private parties. Under investment treaties, the general consent allows foreign investors to trigger the international arbitration of disputes with a host state in the

[1] E.g. under NAFTA Chapter 11 each NAFTA state "consents to the submission of a claim" by investors of another NAFTA state "in accordance with the procedures set out in this Agreement": *North American Free Trade Agreement*, 17 December 1992, 32 I.L.M. 296 and 605 (entered into force 1 January 1994) [hereinafter NAFTA], art. 1116 and 1117 (providing for the general consents of the NAFTA states), and art. 1120(2) (incorporating the applicable arbitration rules, as selected by the investor when filing a claim, as arbitration "procedures"). See J. Paulsson, "Arbitration without Privity" (1995) 10 ICSID Rev. 232, 256; T.W. Wälde, "Investment Arbitration Under the Energy Charter Treaty – From Dispute Settlement to Treaty Implementation" (1996) 12 Arb. Int'l 429, 434-6; A. Afilalo, "Constitutionalization Through the Back Door: A European Perspective on NAFTA's Investment Chapter" (2001) 34 N.Y.U.J. Int'l L. & Pol. 1, 4; J.C. Thomas, "Notes on Investor-State Arbitration in the North American Context" (Address to the International Bar Association conference, San Francisco, 9-14 September 2003), 2-4.

absence of any contract between the investor and the state. As a result, the general consent exposes the state to claims by a broad class of potential claimants in relation to any governmental activity affecting foreign investors.[2] Unlike commercial arbitration, investment arbitration fully engages the regulatory relationship between foreign investors and the state.

The general consent is a significant development in international law and, beyond a small number of human rights treaties, an innovation in international adjudication. Because the general consent is prospective and wide-ranging, individualization under investment treaties has two notable outcomes. First, it results in more frequent and intensive application of international standards to protect investors in the regulatory sphere. Second, it makes the analytical framework of public law – conventionally developed in domestic law – more relevant to international adjudication, particularly in relation to matters of state liability. Further, the far-reaching nature of the general consent, combined with its limitation to "investors", means that only a select group of wealthy individuals – primarily multinational enterprises – are able to benefit from the ability to bring international claims. The discussion in this chapter reviews these two outcomes of individualization, before turning to the role of multinational enterprises as investors and to the implications of forum-shopping for investment arbitration. This is followed by a critical analysis of the claim that investment treaties bestow fundamental rights on investors.

A. The uniqueness of the general consent

By focusing on the general consent one can distinguish investment arbitration from other forms of international adjudication. In particular, investment arbitration can be distinguished from conventional international adjudication between states, and between individuals and states. Investment arbitration is distinct from inter-state adjudication before an international court or tribunal for the straightforward reason that it allows individual claims. Investment arbitration is distinct from historical claims tribunals, before which individuals could make claims against states, because the

[2] Paulsson, ibid., 233.

state's consent is prospective. Further, the individualization of international claims is more far-reaching under investment treaties than in the case of other international arrangements which allow individual claims, such as human rights treaties, because investment treaties typically limit the investor's duty to exhaust local remedies, adopt damages against the state as the main remedy, and authorize the direct enforcement of damages awards by domestic courts in a large number of countries. In terms of the use of international adjudication to resolve public disputes, therefore, the advent of investment arbitration is a unique and significant development.

Customary international law presumes that the resolution of a domestic regulatory dispute involving a foreign national is, in the first place, a matter of domestic law of the host state.[3] States are not subject to compulsory adjudication of disputes within their territory, whether by international tribunals or foreign courts.[4] A dispute arising from one state's treatment of an investor of another state could conventionally trigger a claim of diplomatic protection by the investor's home state,[5] but the investor could not make an independent claim under international law.[6] Moreover, a claim of diplomatic protection by the home state could only be made after the investor had exhausted local remedies in order to give the host state the opportunity to address the investor's complaint before any resort to international law.[7] Even then, the dispute could only be referred to international adjudication with

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[3] *Case Concerning the Payment of Various Serbian Loans Issued In France* (*France* v. *Serbia*) (1921), P.C.I.J. Ser. A, No. 20, para. 41. I. Delupis, *Finance and Protection of Investments in Developing Countries* (Epping: Gower Press, 1973), 123; W. Peter, *Arbitration and Renegotiation of International Investment Agreements* (The Hague: Kluwer Law International, 1995), 167-9 (arguing that the conclusion of the *ICSID Convention* indicates that the dictum in *Serbian Loans* can no longer be upheld in light of the changing structure of international law).

[4] E.g. *Status of Eastern Carelia*, Advisory Opinion (1923), P.C.I.J. Ser. B, No. 5, 27; *Ambatielos Claim* (*Greece* v. *United Kingdom*) (1956), 12 R.I.A.A. 83 [hereinafter *Ambatielos*], 103.

[5] E.g. *Nottebohm* (*Liechtenstein* v. *Guatemala*), [1955] I.C.J. Rep. 4 [hereinafter *Nottebohm*], 23-4; *Barcelona Traction, Light and Power Co.* (*Belgium* v. *Spain*), [1970] I.C.J. Rep. 3, 9 I.L.M. 227 [hereinafter *Barcelona Traction*], para. 35-6. E.M. Borchard, "Basic Elements of Diplomatic Protection of Citizens Abroad" (1913) 7 AJIL 497, 576.

[6] *Mavrommatis Palestine Concessions* (*Greece* v. *Great Britain*) (1924), P.C.I.J. Ser. A, No. 2 [hereinafter *Mavrommatis*], 12. M.O. Hudson, *International Tribunals* (Washington: Carnegie Endowment for International Peace and the Brookings Institution, 1944), 67-9 and 198.

[7] *Ambatielos*, *supra* note 4, 118-19; *Interhandel Case* (*Switzerland* v. *United States*) [1959] I.C.J. Rep. 6 [hereinafter *Interhandel*], 26-7. C. Eagleton, *The Responsibility of States in International Law* (New York: NYU Press, 1928), 70; Hudson, ibid., 189-90; P. Okowa, "Admissibility and the Law on International Responsibility" in M.D. Evans, ed., *International Law* (Oxford: OUP, 2004), 493-4.

the consent of the host state.[8] With one exception, no international tribunal – including the International Court of Justice – has been given general jurisdiction over disputes between states and foreign nationals.[9] Moreover, the reluctance of many states to refer investment disputes to the International Court of Justice has meant that few cases involving the regulatory relationship between states and foreign investors have come before that court.[10] Before the recent proliferation of general consents by states to investment arbitration, international disputes that engaged the regulatory relationship between the state and investors were normally resolved by inter-state diplomacy.

This conventional method of resolving regulatory disputes in the international sphere rests on the assumption that an investor's entitlement to protection under international law in the territory of a foreign state derives from the rights of the investor's home state.[11] In seeking diplomatic protection of one of its nationals, an investor's home state was conventionally assumed to be acting on its own rights, not those of the individual.[12] An investor could participate in the adjudication of the dispute only where the home state and the host state both consented to a process in which the investor was given this capacity.[13] Further, the investor was obliged to

[8] Hudson, ibid., 69; D.J. Harris, *Cases and Materials on International Law*, 5th ed. (London: Sweet & Maxwell, 1998), 985.
[9] The exception is the Central American Court of Justice of 1907 to 1918: see H.M. Hill, "Central American Court of Justice" in R. Dolzer et al., eds., *Encyclopedia of Public International Law*, vol. 1 (Amsterdam: North-Holland Publishing, 1987), 41-2. States may submit generally to the compulsory jurisdiction of the International Court of Justice by filing a declaration to this effect; 65 states had done so as of July 2002.
[10] See *Barcelona Traction*, *supra* note 5; *Elettronica Sicula S.p.A.* (*United States* v. *Italy*), [1989] I.C.J. Rep. 14; and *Anglo-Iranian Oil Company* (*United Kingdom* v. *Iran*) [1952] I.C.J. Rep. 93. L.B. Sohn, "The Role of Arbitration in Recent International Multilateral Treaties" in T.E. Carbonneau, ed., *Resolving Transnational Disputes Through International Arbitration* (Charlottesville: University of Virginia Press, 1984), 26; M. Sornarajah, *The Settlement of Foreign Investment Disputes* (Boston: Kluwer, 2001), 19-20.
[11] *Barcelona Traction*, *supra* note 5, para. 78. M. Whiteman, *Damages in International Law*, vol. 1 (Washington, 1937-43), 82-3.
[12] *Mavrommattis*, *supra* note 6, 12; *Administrative Decision No. V* (1924), 7 R.I.A.A. 119, 19 AJIL 612 [hereinafter *Administrative Decision No. V*], 626-7 (U.S.-Germany Mixed Claims Commission); *Nottebohm*, *supra* note 5, 24; *Barcelona Traction*, *supra* note 5, para. 78-9. But see *Iran-United States No. A/18*, Iran-U.S. Claims Tribunal (Full Tribunal) (1984), 5 Iran-U.S. C.T.R. 251, 23 I.L.M. 489, 498.
[13] In a number of cases, states have consented under diplomatic pressure to adjudicate disputes with foreign nationals after the dispute has arisen, with varying degrees of participation in the proceedings by individuals. Hudson, *supra* note 6, 3-6 and 196-7; I. Brownlie, *Principles of Public International Law*, 6th ed. (Oxford: OUP, 2003), 500 (noting that in

accept any settlement obtained by the home state, which could be limited to partial compensation or none at all at the home state's discretion.[14]

The individualization of claims within the regulatory sphere reflects the uniqueness of investment arbitration in the context of international law. The general consent subjects the regulatory relationship between the state and foreign investors to international standards to a greater extent than any form of regulation based on international adjudication since the colonial era. Historically, individuals were sometimes authorized to make claims against states before claims tribunals created in the aftermath of war or revolution.[15] Thus, it is true that states have allowed individual claims under international law before the general consent, as contained in contemporary investment treaties. Indeed, from the Jay Treaty of 1794[16] to the Iran-U.S. Claims Tribunal,[17] states have authorized international tribunals to resolve regulatory disputes arising from one state's treatment of the nationals of another and,

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the century after 1840 some 60 mixed claims commissions were established to resolve disputes arising from injury to the interests of aliens, including between Mexico and the U.S. in 1839, 1848, 1868, and 1923; between Venezuela and ten other states in 1903, and between Great Britain and the U.S. in 1853, 1871, and 1908). See also e.g. *Compañía del Desarrollo de Santa Elena, S.A.* v. *Republic of Costa Rica* (Merits) (17 February 2000), 15 ICSID Rev. 169 [hereinafter *Santa Elena*] (based on a consent to investment arbitration by Costa Rica after the dispute had arisen, prompted by the United States' blocking of a loan to Costa Rica by the Inter-American bank).

[14] *Administrative Decision No. V*, *supra* note 12, 626-7; *Barcelona Traction*, *supra* note 5, para. 79. B.A. Wortley, *Expropriation in Public International Law* (Cambridge: CUP, 1959), 124 and 146; UNCTAD, *Bilateral Investment Treaties in the Mid-1990s* (Geneva: United Nations, 1998), 89-90.

[15] E.g. the Alabama Claims Arbitration established after the American Civil War, the Mixed Tribunals and Claims Commissions after World War One, the Iran-United States Claims Commission after the Islamic revolution in Iran, and the UN Compensation Commission after the Gulf War of 1990-91. Hudson, *supra* note 6, 3-6 and 196-7; J. Collier and V. Lowe, *The Settlement of Disputes in International Law* (Oxford: OUP, 1999), c. 1 and 3; A. Redfern and M. Hunter, *Law and Practice of International Commercial Arbitration* (London: Sweet & Maxwell, 1999), 60-1.

[16] *Treaty of Amity, Commerce and Navigation between Great Britain and the United States*, 19 November 1794, 52 Cons. T.S. 243 (entered into force 28 October 1795) [hereinafter Jay Treaty]. Hudson, *supra* note 6, 3-4; H. Neufeld, *The International Protection of Private Creditors From the Treaties of Westphalia to the Congress of Vienna* (Leiden: A.W. Sijthoff, 1971), 68-77.

[17] Established by the *Declaration of the Government of the Democratic and Popular Republic of Algeria Concerning the Settlement of Claims by the Government of the United States of America and the Government of the Islamic Republic of Iran (Claims Settlement Declaration)*, 19 January 1981 [hereinafter *Algiers Declaration*], art. II(1). C.D. Gray, *Judicial Remedies in International Law* (Oxford: Clarendon, 1987), 181-5; M. Mohebi, *The International Law Character of the Iran-United States Claims Tribunal* (The Hague: Kluwer Law International, 1991); C.N. Brower and D. Brueschke, *The Iran-United States Claims Tribunal* (The Hague: Kluwer Law International, 1998); R.B. Lillich and D.B. Magraw, *The Iran-United States Tribunal: Its Contribution to the Law of State Responsibility* (Transnational Publishers, 1998).

in some cases, claims could be brought directly by investors. Nevertheless, historical claims tribunals did not involve *generalized* investment arbitration because the authority of such tribunals was retrospective. Adjudicative authority was granted to an international tribunal only after the fact and that authority was limited to disputes arising from a distinct period, series of events, or subject matter.[18] Take the example of the Iran-U.S. Claims Tribunal. In 1981, after the Islamic Revolution of 1979, Iran and the United States consented to the compulsory arbitration of claims by each other's nationals arising out of "debts, contracts…, expropriations or other measures affecting property rights".[19] Foreign nationals could make direct claims before the Tribunal if the claim amounted to (U.S.) $250,000 or more, and if the claim was "outstanding" on 19 January 1981.[20] Thus, the Tribunal had compulsory jurisdiction over certain individual claims, limited to a roughly two-year period following the revolution.

This retrospective consent differs from an advance consent to the arbitration of future disputes. In the case of a retrospective consent, a state is more able to anticipate the significance of its acceptance of compulsory arbitration because the consent is given after the events in question have taken place.[21] By giving a prospective consent in an investment treaty, the state exposes itself, in principle, to claims by any multinational enterprise with an economic interest that is subject to the exercise of public authority by the state. As a result, investment arbitration encompasses future disputes involving an indeterminate class of claimants in relation to a very broad range of governmental activity. From the investor's point of view, to borrow a phrase from commercial arbitration, the general consent is like "a blank cheque which may be cashed for an unknown amount at a future, and as yet unknown, date".[22]

Among others, Legum (who served as U.S. government counsel in early investment arbitrations under NAFTA Chapter 11) has argued that the

[18] C. Kennedy, "Address" (1907) Am. Soc'ty Int'l L. Proc. 100, 110-11; Hudson, *supra* note 6, 3-6 and 11-12.

[19] *Algiers Declaration*, *supra* note 17, art. II.

[20] Ibid.

[21] An agreement to arbitrate concluded after the dispute is typically called a *compromis*. Historically, in many states, this was the only means of consenting to arbitration even in commercial disputes: Redfern and Hunter, *supra* note 15, 21.

[22] Redfern and Hunter, *supra* note 15, 21-2.

individualization of claims under contemporary investment treaties is not a radical departure and that its novelty is overstated.[23] However, all but a few of Legum's examples of other instances in which states have authorized individual claims under international law involve specific consents by states, not general consents.[24] In the case of the Jay Treaty of 1794 – one of Legum's primary examples[25] – the consents to compulsory arbitration by Great Britain and the U.S. were limited to claims by foreign creditors and ship owners that related to events within a discrete period.[26] Further, with respect to creditor claims, the Jay Treaty's process of arbitration led to a lump sum settlement without a single claim being heard, due to disagreements among the state-appointed arbitrators.[27] Legum also identifies bilateral investment treaties (BITs) as evidence that investment arbitration is commonplace but, as argued in chapter two of this thesis, the rapid growth of BITs in the 1990s – and the recent explosion of investor claims – actually highlights the uniqueness of contemporary investment arbitration. Finally, Legum refers to just two historical cases in which states provided a prospective consent to international claims by foreign nationals, both dating from the early twentieth century.[28]

Investment arbitration can also be distinguished from international commercial arbitration. That is, it can be distinguished from international adjudication in the private sphere. This distinction is discussed in detail in chapter six. Suffice it to say here that, when a state consents – by contract – to the compulsory arbitration of a commercial dispute with an investor, the state acts in a private capacity. In such cases, the arbitration deals not with a regulatory dispute but with a private dispute. On the other hand, when a state makes a general consent to compulsory arbitration of

[23] B. Legum, "The Innovation of Investor-State Arbitration Under NAFTA" (2002) 43 Harv. Int'l L.J. 531, 538. See also S.E. Eizenstat, "'Fast Track' needs protections for investors" *The Boston Globe* (2 May 2002).
[24] Legum, ibid., 535-6 (referring to individual claims under a "significant number of treaty regimes", such as the Mixed Claims Tribunals after World War I, the Iran-U.S. Claims Tribunal, and regional human rights tribunals, although conceding that few of these claims were based on prospective consents by the state).
[25] Legum, ibid., 534-5.
[26] Hudson, *supra* note 6, 3.
[27] H.-J. Schlochauer, "Jay Treaty (1794)" in R. Dolzer et al., eds., *Encyclopedia of Public International Law*, vol. 1 (Amsterdam: North-Holland Publishing, 1987), 109-10; Neufeld, *supra* note 16, 70-7.
[28] Legum, *supra* note 23, 536 (noting states' prospective consents in the case of the Central American Court of Justice 1907 and the Upper Silesian Arbitral Tribunal of 1922).

investment disputes – whether by legislation or treaty – the state acts in a sovereign capacity. Only a state can exercise public authority so as to make a general consent. Where an investor consents to investment arbitration by seizing the opportunity afforded by the general consent, the investor takes advantage of a governing arrangement that was established by states.[29]

The uniqueness of the general consent is highlighted by another factor. In chapter two of this thesis, it was mentioned that a state can consent to compulsory investment arbitration by contract, by legislation, or by treaty, and that a contract-based consent is specific to a private law relationship. As it happens, contract-based arbitration is well-established. Until 1984, all arbitration at ICSID was based on mutual consents in an investment contract or an agreement to arbitrate after the dispute had arisen.[30] Moreover, the World Bank's Executive Directors, in their report on the *ICSID Convention*, noted that states could consent to ICSID arbitration not simply by contract but also by legislation.[31] Yet, the Executive Directors did not explicitly mention the possibility of consent by treaty. Moreover, there is scant reference to investment treaties in the negotiating history of the *ICSID Convention*.[32] This supports the view that the explosion of treaty-based investment arbitration since the mid-1990s has caught many states by surprise.[33] For present purposes, the

[29] Redfern and Hunter, *supra* note 15, 61.

[30] Until 1984, all ICSID arbitrations were based on consents recorded in the traditional manner by a clause in an investment contract or a post-dispute *compromis*. Since then, dozens of claims have been submitted to ICSID by investors lacking any prior contractual relationship with the host state and relying on domestic legislation or a treaty to establish the state's consent to international arbitration. The rapid growth in ICSID claims since the mid-1990s further evidences the novelty and significance of the general consent. A.R. Parra, "The Role of ICSID in the Settlement of Investment" (1999) 16(1) ICSID News 5.

[31] World Bank, *Report of the Executive Directors on the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States* (18 March 1965), reprinted in *Convention, Regulations and Rules* (Washington: ICSID, 2003) [hereinafter *ICSID Convention Report*], para. 24.

[32] E.g. *Memorandum of the meeting of the Committee of the Whole, December 27, 1962*, World Bank, UN Doc. SID/62-2 (7 January 1963), 8; and A. Broches, "An Analysis of the Bank's Tentative Proposals and of the Principal Issues Raised Thereby", World Bank, UN Doc. SID/63-2 (18 February 1963), 15; both reprinted in ICSID, *Convention on the Settlement of Investment Disputes between States and Nationals of Other States – Documents Concerning the Origins and the Formulation of the Convention*, vol. 2 (World Bank, 1968), 68 and 85.

[33] E.g. comment of Abner Mivka, former congressman and U.S. federal appeals court chief justice, and member of the *Loewen* tribunal: "If Congress had known that there was anything like this [Chapter 11 arbitration] in NAFTA, they would never have voted for it" (A. Liptak, "Review of U.S. Rulings by NAFTA Tribunals Stirs Worries" *New York Times* (18 April 2004) 20); C. McLachlan, "Commentary: The Broader Context" (2002) 18 Arb. Int'l 339, 340; D.

omission is significant because it points to the uniqueness of investment arbitration based on the general consent.

The uniqueness of the general consent is also reflected in the fact that contemporary investment treaties allow individual claims *for damages*. Individualized damages claims are very rare in international law. Outside of the European Union, no international regime allows individuals to directly seek damages through international adjudication, in response to a state's alleged violation of international law. For example, individual claims were ruled out in the case of the World Trade Organization and non-investment chapters of NAFTA, which limit dispute resolution to adjudication between states based on the remedies of a declaration of illegality and suspension of trade concessions.[34] In other areas of international law, such as humanitarian law and environmental law, states have eschewed adjudication (let alone damages claims by individuals) to enforce international standards or compensate those harmed by unlawful conduct.[35]

Importantly, damages claims by individuals are also the exception in the field of human rights.[36] Despite the expanded protection of human rights since 1945,

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Brown, "Commentary" in L. Ritchie Dawson, ed., *Whose Rights? The NAFTA Chapter 11 Debate* (Ottawa: Centre for Trade Policy and Law, 2002), 40-1.

[34] *Understanding on Rules and Procedures Governing the Settlement of Disputes*, 15 April 1994, 33 I.L.M. 112 [hereinafter *DSU*], para. 19 and 22; NAFTA, *supra* note 1, c. 19 and 20. P.M. Nichols, "Participation of Nongovernmental Parties in the World Trade Organization" (1996) 17 U. Penn. J. Int'l Econ. L. 295, 297-8 and 302-3; B.R. Roland, "The Access of Individuals to International Trade Dispute Settlement" (1996) 13 J. Int'l Arb. 143, 164; S. Dillon, *International Trade and Economic Law in the European Union* (Oxford: Hart, 2002), 372-4.

[35] E.B. Weiss, "Invoking State Responsibility in the Twenty-first Century" (2002) 96 AJIL 798, 811-12; C. Greenwood, "The Law of War (International Humanitarian Law)" in M.D. Evans, ed., *International Law* (Oxford: OUP, 2004), 817. The *United Nations Convention on the Law of the Sea* [21 I.L.M. 1261 (entered into force 16 November 1994), art. 187(c) and 188(2); art. 5(4) and 13(15) (Annex III)] permits individuals to make claims before the International Sea-Bed Disputes Chamber, but only in contractual disputes: R.R. Churchill, "Dispute Settlement in the Law of the Sea" in M.D. Evans, *Remedies in International Law: The Institutional Dilemma* (Oxford: Hart, 1998), 89; Sohn, *supra* note 10, 36-7.

[36] E.g. *International Covenant on Civil and Political Rights*, 16 December 1966, 999 U.N.T.S. 171, 61 AJIL 870 (entered into force 23 March 1976), art. 41 (providing for an optional system of claims by states parties) and (First) Optional Protocol (1966) (providing for an optional system of individual petitions leading to consideration and an expression of views by an international committee, but not individual claims leading to compulsory arbitration or a damages award). D. Shelton, *Remedies in International Human Rights Law* (Oxford: OUP, 1999), 137-8 and 142-7; Weiss, ibid., 809-11; R. Bachand and S. Rousseau, "International Investment and Human Rights: Political and Legal Issues" (Background paper for Rights & Democracy, 11 June 2003), 14.

individual claims for damages are authorized only under the *European Convention on Human Rights*[37] and the *American Convention on Human Rights*.[38] However, in both cases, the ability of individuals to claim damages is more limited than in investment arbitration. Under the *European Convention*, the European Court of Human Rights may afford "just satisfaction" to an individual whose rights were violated, where this is considered necessary by the Court.[39] However, the Court has declined to award damages for various reasons, including the adequacy of non-monetary remedies and the host state's ability to pay.[40] Under the *American Convention*, an individual can receive damages only if the Inter-American Commission on Human Rights brings the claim before the Inter-American Court, and the Commission has refused to bring claims on behalf of corporations.[41] Further, the Inter-American Court has adopted a cautious approach to awarding monetary compensation to remedy human rights violations.[42] Above all, both conventions (unlike investment treaties) impose a duty on individuals to exhaust local remedies before bringing a claim.[43] Finally, neither convention allows individuals to select the rules that govern the claim, to appoint members of the tribunal, or to directly enforce an award against state assets.[44]

Beyond the field of human rights, the only other instance in which individuals can claim damages pursuant to a treaty is under European Community law (EC law). In particular, the *Francovich* doctrine[45] of the European Court of Justice introduced the principle that individuals are entitled to seek damages for an alleged violation of EC

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[37] *European Convention for the Protection of Human Rights and Fundamental Freedoms*, 4 November 1950, Eur. T.S. 5, 213 U.N.T.S. 222 (entered into force 3 September 1953) [hereinafter ECHR], art. 34.
[38] *American Convention on Human Rights*, 1144 U.N.T.S. 123 (entered into force 18 July 1978) [hereinafter ACHR], art. 44.
[39] ECHR, *supra* note 37, art. 41.
[40] Shelton, *supra* note 36, 101, 154-9, and 218-20; J.-P. Costa, "The Provision of Compensation Under Article 41 of the European Convention on Human Rights" (Address to the British Institute of International and Comparative Law, 7 December 2001), 1-3 and 16-17; J.A. Weir, "Human Rights and Damages" (2001) 40 Washburn L.J. 412, 421-9 and 436.
[41] ACHR, *supra* note 38, art. 44. E.g. *Tabacalera Boquerón S.A.* v. *Paraguay* (1997), Inter-Am. Comm. H.R., Rep. No. 47/97, *Annual Report of the Inter-American Commission on Human Rights: 1987*, OEA/Ser.L/V/II.98/Doc.7/rev. (1998) 225, para. 25 and 36. Shelton, *supra* note 36, 169-72.
[42] ACHR, *supra* note 38, art. 63(1). Shelton, *supra* note 36, 221-3.
[43] ECHR, *supra* note 37, art. 35; ACHR, *supra* note 38, art. 46(1).
[44] Shelton, *supra* note 36, 90; Costa, *supra* note 40, 15.
[45] *Francovich and Bonifaci* v. *Republic of Italy* (No. 6 and 9/90), [1991] E.C.R. I-5357, (1993) 2 C.M.L.R. 66 [hereinafter *Francovich*].

law by a member state.[46] Outside of investment arbitration, the *Francovich* doctrine is probably the most ambitious attempt to apply treaty-based state liability in the context of economic integration.[47] Even so, the *Francovich* doctrine is limited by various factors. For one, the Court has limited compensation to cases of "sufficiently serious" state violations of EC law.[48] Also, the Court has stated that "the decisive test" for the imposition of state liability is whether the state "manifestly and gravely disregarded the limits of its discretion" under EC law.[49] Further, under the *Francovich* doctrine, the availability of damages is subject to domestic rules of liability in the state responsible for the violation, subject to certain minimum requirements of effectiveness and non-discrimination.[50] Finally, domestic courts play an important role in determining whether liability should be imposed in specific cases[51] and this has allowed the courts in the United Kingdom, for instance, to refuse compensation out of a fear that claimants "might thereby side-step limitations on liability in domestic tort law".[52]

Notably, the European Court of Justice's requirement for a "sufficiently serious" breach by a member state introduces a fault-based limitation on state

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[46] More precisely, damages must be available as a remedy before the domestic courts of the member states, subject to the overriding jurisdiction of the European Court of Justice in matters of EC law: *Francovich*, ibid., para. 35 and 40. P. Craig and G. De Búrca, *EU Law – Text, Cases, and Materials*, 3rd ed. (Oxford: OUP, 2003), 257-274.

[47] The *Francovich* doctrine applies to legislative acts and omissions (*Brasserie du Pêcheur SA* v. *Germany*; *Secretary of State for Transport, ex parte Factortame Ltd. and Others* (No. 46 & 48/93), (1996) 1 C.M.L.R. 889 [hereinafter *Brasserie du Pêcheur*]), administrative decisions (*R.* v. *Ministry of Agriculture and Fisheries, ex parte Hedley Lomas (Ireland) Ltd.* (No. 5/94), [1996] E.C.R. I-2553), judicial decisions (*Köbler* v. *Austria* (No. C-224/01), [2003] E.C.R. I-10239, 3 C.M.L.R. 28), and acts of sub-national governments (*Salomone Haim* v. *Kassenzahnärztliche Vereinigung Nordrhein* (No. 424/97), [2000] E.C.R. I-5123).

[48] *Brasserie du Pêcheur*, ibid., 990 (finding various fault-based factors relevant to the issue of whether a breach was sufficiently serious, including: the clarity and precision of the rule breached; the measure of discretion left by that rule to the national or Community authorities; whether the infringement and the damage caused was intentional or involuntary; whether any error of law was excusable or inexcusable; the fact that the position taken by a Community institution may have contributed towards the omission; and the adoption or retention of national measures or practices contrary to Community law).

[49] *Laboratoires Pharmaceutiques Bergaderm and Goupil* v. *Commission* (No. 352/98), [2000] E.C.R. I-5291.

[50] *Francovich*, *supra* note 45, para. 43.

[51] *Rewe-Zentral Finanz eG* v. *Lanschwirtschaftskammer für das Saarland* (No. 33/76), [1976] E.C.R. 1989. C. Harlow and R. Rawlings, *Law and Administration* (London: Butterworths, 1997), 632-3; T. Tridimas, "Liability for Breach of Community Law: Growing Up and Mellowing Down? (2001) 38 C.M.L Rev. 301, 317-21 and 331-2.

[52] M. Lunney and K. Oliphant, *Tort Law* (Oxford: OUP, 2000), 524-5.

liability.[53] As well, the role of domestic courts in this area of EC law cushions the impact of state liability on domestic governments.[54] These limiting factors are not present in investment arbitration. Investment treaties do not provide for a minimum threshold of culpability on the part of the state. Also, damages claims are brought directly before an international tribunal and the role of domestic courts is normally circumscribed by arbitration treaties like the *New York Convention*, as implemented by domestic law. As such, the ability of investors to claim damages under investment treaties is more extensive than in the case of the *Francovich* doctrine.

Not only is investment arbitration prospective; it also entails individual claims in a uniquely far-reaching form. In the first place, the general consent to investment arbitration entails a broad waiver of the state's customary immunity from suit before an international tribunal, or before a domestic court that is called upon to enforce an international award.[55] Moreover, under the terms of many investment treaties, investors are not obliged to exhaust local remedies before bringing a claim.[56] Further,

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[53] D. Fairgrieve, "The Human Rights Act 1998, Damages and Tort Law" [2001] Pub. Law 695, 698-9.

[54] Lunney and Oliphant, *supra* note 52, 524-5; Tridimas, *supra* note 51, 317-21 and 331-2; Craig and De Búrca, *supra* note 46, 231-3 and 268.

[55] Under NAFTA Chapter 11, the investor's duty to exhaust local remedies is limited and arguably removed: *Waste Management, Inc.* v. *United Mexican States* (Jurisdiction) (26 June 2002), 41 I.L.M. 1315, 14(6) World Trade and Arb. Mat. 203 [hereinafter *Waste Management No. 2*], para. 29-30; *Waste Management Inc.* v. *United Mexican States* (Merits) (30 April 2004), 43 I.L.M. 967, 16(4) World Trade and Arb. Mat. 3, para. 116; *Mondev International Ltd.* v. *United States of America* (Merits) (11 October 2002), 42 I.L.M. 85, 15(3) World Trade and Arb. Mat. 273 [hereinafter *Mondev*], para. 154; *Marvin Roy Feldman Karpa* v. *United Mexican States* (Merits) (16 December 2002), 15(3) World Trade and Arb. Mat. 157 [hereinafter *Feldman*], para. 71-4. See also *Robert Azinian et al.* v. *United Mexican States* (Merits) (1 November 1999), 39 I.L.M. 537 [hereinafter *Azinian*], para. 97-9; *The Loewen Group, Inc. and Raymond L. Loewen* v. *United States of America* (Merits) (26 June 2003), 42 I.L.M. 811, 15(5) World Trade and Arb. Mat. 97, para. 142-57; *GAMI Investments, Inc.* v. *Government of the United Mexican States* (Merits) (15 November 2004), 17(2) World Trade and Arb. Mat. 127 [hereinafter *GAMI*], para. 29-30, 38, 101-3, and 133. G.R. Delaume, "Sovereign Immunity and Transnational Arbitration" (1987) 3 Arb. Int'l 28, 29-31; W.S. Dodge, "National Courts and International Arbitration: Exhaustion of Remedies and Res Judicata Under Chapter Eleven of NAFTA" (2000) 23 Hast. Int'l & Comp. L.R. 357, 383; Foy, *supra* note 18, 49; P.I. Hansen, "Judicialization and Globalization in the North American Free Trade Agreement" (2003) 38 Tex. Int'l L.J. 489, 498-9.

[56] Under some investment treaties, investors must forego domestic remedies in order to make a claim; under others, they must first exhaust them; under others, they may pursue treaty-based and/ or domestic remedies: e.g. *Emilio Agustín Maffezini* v. *The Kingdom of Spain* (Jurisdiction) (25 January 2000), 16 ICSID Rev. 212, 124 I.L.R. 9, para. 19; *CMS Gas Transmission Company* v. *The Republic of Argentina* (Jurisdiction) (17 July 2003), 42 I.L.M. 788 [hereinafter *CMS*], para. 73; *SGS Société Générale de Surveillance* v. *Pakistan* (Jurisdiction) (6 August 2003), 18 ICSID Rev. 307, 16(2) World Trade and Arb. Mat. 167, para. 151. P.G. Foy,

investors are entitled to select the arbitration rules that govern the claim and to participate in the appointment of arbitrators. Unlike other forms of international adjudication in the public sphere, investment treaties authorize the direct enforcement of awards by investors under the *ICSID Convention* or the *New York Convention*.[57] As a result, investors can seek enforcement of an award against assets of the respondent state in any state that is a party to these treaties. This powerful element of investment arbitration – direct enforceability in over 160 states – makes investment arbitration awards more widely enforceable than any judicial decision by a domestic or international court.[58] Overall, the scope and potency of the ability of investors to make international claims under investment treaties is exceptional.

"Effectiveness of NAFTA's Chapter Eleven Investor-State Arbitration Procedures" (2003) 18 ICSID Rev. 44, 66; UNCTAD, *Dispute Settlement: Investor-State*, UNCTAD Series on Issues in International Investment Agreements (New York: United Nations, 2003), 31-7.

[57] E.g. NAFTA, *supra* note 1, art. 1130 (providing that a Chapter 11 arbitration must be held in the territory of a NAFTA state that is a party to the *New York Convention* unless the disputing parties agree otherwise). E.R. Leahy, "Enforcement of Arbitral Awards Issued by the Additional Facility of the International Centre of Settlement of Investment Disputes (ICSID)" (1985) 2 J. Int'l Arb. 15, 15-16; Redfern and Hunter, *supra* note 15, 474 and 481; UNCTAD, ibid., 62-4.

[58] The issue of enforcement calls for elaboration. First, in refusing to make good on an investment arbitration award, a host state may be subjected to diplomatic and economic pressure from the investment community, international financial institutions, the investor's home state, and other capital-exporting states. Indeed, one reason for the decision to locate ICSID within World Bank was to draw on the World Bank's ability to encourage enforcement by its influence over host states' access to credit (see chapter two of this thesis, note 124). In addition, investment treaties commonly obligate the states parties to recognize and enforce awards under the treaty (e.g. NAFTA, *supra* note 1, art. 1136(2) and (4) [requiring each state party to "abide by and comply with an award without delay" and to "provide for the enforcement of an award in its territory"]). Thus, an investor can directly seek recognition and enforcement of an award by a domestic court – pursuant to the investment treaty and applicable implementing legislation – *in one of the states parties to the treaty* on the basis that the host state's ratification of the treaty constitutes a waiver of its sovereign immunity from enforcement. Finally, where the investment treaty provides for enforcement under the *ICSID Convention* or the *New York Convention*, an investor can seek recognition and enforcement of an award by a domestic court *in any state party to either of these treaties* based on the terms of the treaty and applicable implementing legislation (although enforcement and recognition under the *ICSID Convention* is possible only where both the host state and the investor's home state are parties to that treaty). This method of direct enforcement by investors is exceptionally powerful given the large number of states that are parties to these treaties. Approximately 165 states are parties to either the *New York Convention* or the *ICSID Convention* or both.

To illustrate, NAFTA Chapter 11 refers for purposes of enforcement to both the *ICSID Convention* and the *New York Convention*. The question of which treaty's enforcement structure applies to an arbitration award under Chapter 11 depends on the arbitration rules under which the investor files its claim. Investors may file a claim under one of three sets of

B. Outcomes of individualization

This prospective and far-reaching individualization of international claims has two inter-related outcomes. First, because investment treaties apply international law in order to constrain the exercise of public authority, investment arbitration leads to more frequent and intensive application of international standards to protect investors in the regulatory sphere.[59] This is because the authorization of individual claims, combined with the remedy of damages, makes it more likely that states will be subject to international claims, and that those claims will be vigorously pursued. Moreover, the advent of far-reaching individual claims makes the analytical framework of public law, conventionally developed in domestic adjudication of regulatory disputes, more

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rules: the ICSID Rules, the ICSID Additional Facility Rules, or the UNCITRAL Rules. If an investor selects the ICSID Rules, the arbitration proceeds under the *ICSID Convention*, which provides that an ICSID award has the force of a final court judgment of a state party under its domestic law and that the award cannot be reviewed by domestic courts: *Convention for the Settlement of Investment Disputes*, 18 March 1965, 4 I.L.M. 524 (entered into force 14 Oct 1966) [hereinafter *ICSID Convention*], art. 54 (providing that "Contracting States will recognise an award as if it was a final judgment of a court in that State") and 53(1) (providing that "The award shall be binding on the parties and shall not be subject to any appeal or to any other remedy except those provided for in this Convention. Each party shall abide by and comply with the terms of the award...."). See also *Rules Governing the Additional Facility for the Administration of Proceedings by the Secretariat of the International Centre for Settlement of Investment Disputes*, 27 September 1978, revised 1 January 2003, 1 ICSID Reports 213 [hereinafter ICSID Additional Facility Rules], art. 53(4). Thus, an ICSID award is recognizable and enforceable, independent of the *New York Convention*, although domestic courts may refuse to execute an ICSID award against state assets for reasons of sovereign immunity. (Note that enforcement under the *ICSID Convention* is currently unavailable in investment arbitration under NAFTA Chapter 11 because neither Canada nor Mexico have signed the *ICSID Convention*.)

Alternatively, if the investor selects the ICSID Additional Facility Rules or the UNCITRAL Rules, the Chapter 11 arbitration proceeds under the *New York Convention*, which provides that an award shall be recognized as binding by the states parties to the treaty and that a domestic court may review an award only on limited grounds: *United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 10 June 1958, 330 U.N.T.S. 3 (entered into force 7 June 1959) [hereinafter *New York Convention*], art. I, III, and V. Finally, the award may also be enforced under the *Inter-American Convention on International Commercial Arbitration*, 30 January 1975, 14 I.L.M. 336 [hereinafter *Inter-American Convention*], which contains provisions that are similar to those under the *New York Convention*: art. 1, 4, and 5.

[59] See E. Denza, "The Relationship Between International and National Law" in M.D. Evans, ed., *International Law* (Oxford: OUP, 2004), 415; B. Kingsbury, N. Krisch, and R. Stewart, "The Emergence of Global Administrative Law" (International Law and Justice Working Paper 2004/1, Institute for International Law and Justice, New York University School of Law, 2004), 5-6 and 41-2.

clearly and directly relevant to international adjudication. These outcomes are examined in this section, focusing on the remedy of damages.

By allowing individual claims for damages, investment treaties expand the scope of international adjudication to encompass regulatory disputes that would otherwise be resolved through domestic adjudication. Thus, individualization removes a buffer between international law and the domestic sphere. Under customary international law, the claim of diplomatic protection was that of the home state and individuals had no right to bring a claim on their own behalf.[60] Conventionally, a host state could moderate disputes involving foreign nationals by negotiating with the home state.[61] Diplomatic deals could be cut at the expense of individuals; powerful states could ignore claims on behalf of nationals of weaker states. By authorizing investors to directly advance a claim and seek damages for an alleged violation of international law, investment treaties allow investors to decide when and how to threaten, initiate, or settle a claim.[62] The investor appoints counsel and approves the legal argument. In short, the investor has custody of the claim and can make decisions about the manner and extent to which international adjudication will be used to resolve a regulatory dispute.[63]

In this context, the protection of the investor's interests is not moderated by the home state's consideration of its own interest as a representative entity. When a

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[60] *Administrative Decision No. V*, *supra* note 12, 626-7; *Barcelona Traction*, *supra* note 5, para. 79. Hudson, *supra* note 6, 67-9; P.T. Muchlinski, *Multinational Enterprises and the Law* (Oxford: Blackwell, 1999), 534-6; UNCTAD, *supra* note 14, 89-90; R. McCorquodale, "The Individual and the International Legal System" in M.D. Evans, ed., *International Law* (Oxford: OUP, 2004), 308.

[61] Hudson, *supra* note 6, 191-4; J. Merrills, "The Means of Dispute Settlement" in M.D. Evans, ed., *International Law* (Oxford: OUP, 2004), 541.

[62] Under customary international law, where an award was made by an international tribunal to remedy an international wrong that harmed a foreign national, the home state had the discretion to pass on only part or none of the compensation, and to divide lump sum payments among the home state's nationals: *Administrative Decision No. V*, *supra* note 12, 626-7. G.A. Christenson, "The United States-Rumanian Claims Settlement Agreement of March 30, 1960" (1961) 55 AJIL 617, 618-20; E.F. Mooney, *Foreign Seizures – Sabbatino and the Act of State Doctrine* (Lexington: University of Kentucky Press, 1967), 130. Even after the award was obtained, a state could choose not to enforce the award, leaving the investor without further recourse under international law. In investment arbitration, damages awards are granted to, and enforceable by, investors, making investment arbitration more attractive to investors as a means to obtain compensation.

[63] See R. Baldwin and C. McCrudden, *Regulation and Public Law* (London: Weidenfeld and Nicolson, 1987), 57 and 65.

home state makes decisions about an international claim, those decisions are made on behalf of its people in the context of international relations.[64] At each stage, an international claim is subject to the home state's consideration of its interests and to good faith considerations.[65] These filters are removed by the introduction of individual claims. Investors are private parties, legally responsible only for their own interest.[66] An investor can make a claim without any immediate intervention by the home state to block the claim. Further, the context for an investor's decisions about a claim is the investor's business strategies as opposed to the interests of the home state.[67] Unlike states, investors do not face the prospect of defending a claim.[68] An investor is more likely to argue for an expansive approach to investor protection. Indeed, legal counsel have an incentive to promote investment arbitration in order to generate business,[69] as the market for legal services in international adjudication is greatly expanded by individualization.[70] Thus, investors are likely to bring claims more often and to represent their interests more vigorously than would the home state

[64] *Administrative Decision No. V*, *supra* note 12, 626-7. Hudson, *supra* note 6, 191-4 and 198; D.C. Ohly, "A Functional Analysis of Claimant Eligibility" in R.B. Lillich, ed., *International Law of State Responsibility for Injuries to Aliens* (Charlottesville: University Press of Virginia, 1983), 284.

[65] E.g. *Azinian*, *supra* note 55, para. 104 and 121-4 (noting apparent misrepresentations by the claimant). M.A. Luz, "NAFTA, Investment and the Constitution of Canada: Will the Watertight Compartments Spring a Leak" (2001) 32 Ottawa L.R. 35, 87.

[66] J.C. Thomas, "Investor-State Arbitration Under NAFTA Chapter Eleven" (Paper presented to the NAFTA Chapter 11 Investor-State Disputes: Litigating Against Sovereigns conference, Canadian Bar Association, Toronto, March 2000), 4-5; Foy, *supra* note 56, 50 (commenting that claimants in investment arbitration have no interest in the interpretation of substantive provisions of the treaty; they are interested only in a damages award).

[67] R.K. Paterson, "A New Pandora's Box? Private Remedies for Foreign Investors under the North American Free Trade Agreement" (2000) 8 Willamette J. Int'l L. and Dispute Res. 77, 82.

[68] Paulsson, *supra* note 1, 232; J. Werner, "The Trade Explosion and Some Likely Effects on International Arbitration" (1997) 14 J. Int'l Arb. 5, 6.

[69] This introduces a market dynamic, concerning the initiation of international claims, which encourages law firms to promote investment arbitration among clients. For law firms' promotional material, see e.g. R.D. Bishop, S.D. Dimitroff, and C.S. Miles, "Strategic Options Available When Catastrophe Strikes" (2001) 36 Texas Int'l L.J. 635; Freshfields Bruckhaus Deringer, "The Argentine Crisis – Foreign Investors' Rights" (Report, January 2002); Freshfields Bruckhaus Deringer, "Dispute Resolution in the Caspian Region" (Report, June 2002).

[70] See M. Shapiro, "The Globalization of Law" (1993) 1 Ind. J. Global Legal Studies 37, 59-60.

because investors have no reason to moderate or settle a claim for reasons of public interest.[71]

Moreover, most investment treaties limit or remove the customary rule that a foreign national must exhaust local remedies before an international claim can be brought.[72] There are at least four rationales for this rule.[73] First, foreign nationals were thought to have a duty to take into account the domestic means to redress wrongs. Second, local courts were presumed capable of delivering justice out of respect for the equality and independence of states. Third, where an injury to a foreign national was committed by a private individual or minor official, the exhaustion of local remedies was required to ensure that the wrongful act or denial of justice was the deliberate act of the host state. Fourth, the rule provided an opportunity for the host state's legal system to correct wrongs suffered by foreign nationals. By limiting or removing the local remedies rule, investment treaties limit the state's ability to respond to the mistreatment of investors through its judicial system.[74] They also introduce the prospect of multiple claims in relation to the same underlying dispute, under both an

[71] E.g. *Fireman's Fund Insurance Company* v. *United Mexican States* (Jurisdiction) (17 July 2003), 15(6) World Trade and Arb. Mat. 3 [hereinafter *Fireman's Fund*], para. 64 (rejecting the claimant's submission that "as a general policy consideration, direct investor recourse to arbitration has become the rule in modern investment agreements, although there may be exceptions, and that the value of investor-state arbitral mechanism is so substantial that it should only be foreclosed when that result is unmistakably required by treaty provision"); *Siemens A.G.* v. *The Argentine Republic* (Jurisdiction) (3 August 2004), ICSID Case No. ARB/02/8 [hereinafter *Siemens*], para. 116, 120 and 135 (accepting the claimant's submission that the inclusion of a most-favoured-nation clause in a BIT "implies the right [of the claimant] to select those aspects of provisions in different treaties that favor the [investor] most", thus allowing investors to pick and choose from the provisions of different treaties and to construct them into the most desirable collection of procedural and substantive rights in relation to a claim), online: ITA http://ita.law.uvic.ca/documents/SiemensJurisdiction-English-3August2004.pdf.

[72] UNCTAD, *supra* note 56, 31-7; V.L. Been and J.C. Beauvais, "The Global Fifth Amendment: NAFTA's Investment Protections and the Misguided Quest for an International 'Regulatory Takings' Doctrine" (2003) 78 N.Y.U. L.R. 30, 83-6.

[73] Eagleton, *supra* note 7, 79, 96, and 100; E.M. Borchard, "The Access of Individuals to International Courts" (1930) 24 AJIL 359, 362-3; Okowa, *supra* note 7, 493-4.

[74] Exceptions to the duty to exhaust local remedies are customarily limited to circumstances in which an effective local remedy was unavailable: *Certain Norweigen Loans* (*France* v. *Norway*), [1957] I.C.J. Rep. 9, 39. Wortley, *supra* note 14, 23-4 and 140-2.

investment treaty and domestic law.[75] All of this makes it more likely that disputes traditionally dealt with by domestic courts will be subject to international adjudication.

Conventionally, individuals faced difficulties in attempting to enforce the adjudication of a regulatory dispute, or enforce an award, in domestic courts other than those of the state in which the regulatory dispute arose. Under customary international law, courts commonly declined to rule on the sovereign actions of foreign states (whether for reasons of sovereign immunity, act of state, or non-justiciability).[76] The government of the home state might itself object to the courts ruling on a foreign dispute in order to preserve the government's executive discretion to manage foreign affairs.[77] In contrast, investment treaties incorporate the enforcement structure of the *ICSID Convention* and the *New York Convention*, under which investors can directly seek recognition and enforcement of awards in foreign courts. Thus, unlike judgments of domestic courts, an investment arbitration award is backed by the coercive authority of a large number of states to enforce awards within their territory, based on treaties that mandate the enforcement of foreign arbitration awards.

This collective coercive authority is absent in other cases of international adjudication within the public sphere. For example, human rights treaties that allow individuals damages claims do not authorize the enforcement of awards by domestic courts.[78] Judgments of the International Court of Justice, although binding on states that consent to the Court's jurisdiction, can be enforced only by the UN Security Council.[79] A successful state would depend on the support of a majority of Security Council members, including the five permanent members, to obtain enforcement. In contrast, in investment arbitration, a successful investor can seek enforcement against

[75] E.g. *CMS*, *supra* note 56, para. 78 and 80; *Azurix Corp.* v. *The Argentine Republic* (Jurisdiction) (8 December 2003), 16(2) World Trade and Arb. Mat. 111 [hereinafter *Azurix*], para. 99-100; *Siemens*, *supra* note 71, para. 151 and 160.
[76] E.g. *Blad* v. *Bamfield* (1674), 3 Swan 604, 36 Eng. Rep. 992; *Duke of Brunswick* v. *King of Hannover* (1844), [1848] 6 Beav. 1, 2 H.L.C. 1; *Oetjen* v. *Central Leather Co.*, 246 U.S. 297 (1918), 303-4. Mooney, *supra* note 62, 7-9 and 22; A.F.M. Maniruzzaman, "Internationalization of Foreign Investment Agreements – Some Fundamental Issues of International Law" (2000) 1 J. World Investment 293, 315; Denza, *supra* note 59, 436-8.
[77] *Banco Nacional de Cuba* v. *Sabbatino*, 376 U.S. 398, 3 I.L.M. 381, 398 (1964).
[78] *Supra* note 44; Hudson, *supra* note 6, 128-9.
[79] *Charter of the United Nations*, 26 June 1945, [1945] U.S.T.S. No. 993, [1946] U.K.T.S. No. 67, [1945] Can. T.S. No. 7, art. 94(2) (entered into force 24 October 1945). Harris, *supra* note 8, 989; M.N. Shaw, *International Law*, 5th ed. (Cambridge: CUP, 2003), 996-7.

state assets in the courts of any state party to an applicable arbitration treaty, such as the *ICSID Convention* or the *New York Convention.*

These factors intensify the application of international standards to protect investors in the regulatory sphere. Under customary international law, individual interests are subordinated to the decisions of states and to inter-state dispute resolution. This does not mean that individual rights and interests do not exist under international law. What it means is that individual rights and interests are rarely actionable and enforceable.[80] In turn, the application of international standards to protect individuals is limited. Disputes between states and individuals – i.e. regulatory disputes – are instead resolved through an exclusively domestic process and international adjudication is insulated from considerations that often arise, in domestic courts, in the context of regulatory disputes. However, where investors directly can make international claims, arising from a regulatory dispute, this alters the dynamic of international adjudication. Far-reaching individualization makes it more likely that regulatory disputes involving investors will lead to international adjudication. In turn, governments face greater pressure to abide by international standards of investor protection when they exercise public authority. As mentioned, this altered dynamic advantages investors, but not other individuals who are ineligible to bring claims under investment treaties. As a result, investment arbitration prioritizes the interests of investors in the governing apparatus at the expense of those who would benefit from the regulation of investors.

As a result of this far-reaching yet selective individualization, investment arbitration engages the regulatory sphere in ways that conventional international adjudication does not. In fact, conventional inter-state adjudication – although it generally relates to disputes arising from the exercise of public authority by a state – is more akin to the domestic adjudication of a private dispute than to the domestic adjudication of a regulatory dispute. This is because legal relations between states in the international sphere are more analogous to domestic legal relations between

[80] E.g. *Jurisdiction of the Courts of Danzig*, Advisory Opinion (1928), P.C.I.J. Ser. B, No. 15 [hereinafter *Courts of Danzig*], 17-18; *Lagrand* (Merits) (*Germany* v. *United States*), [2001] I.C.J. Rep. 466, 40 I.L.M. 1069 [hereinafter *Lagrand*], para. 77; *Legal Consequences of the Construction of a Wall in the Occupied Palestinian Territory* (Advisory Opinion) (9 July 2004), I.C.J. General List No. 131 [hereinafter *Construction of a Wall*], para. 147 and 152.

private parties than to those between the state and an individual.[81] Put differently, the relationship between a state and a foreign investor is not a relationship between sovereigns, each representing a political group in the international sphere. Rather, it is a regulatory relationship between the state and a private party who is subject to the exercise of public authority.[82] Through prospective and far-reaching individualization, investment arbitration deals with disputes arising directly from the regulatory relationship and thus engages the regulatory sphere to a much greater degree than conventional international adjudication. In this context, international adjudication resembles the domestic adjudication of individual claims against the state under domestic administrative or constitutional law.[83] However, investors are able to invoke international principles that are unavailable in domestic adjudication of a regulatory dispute.[84] This gives investors an incentive to bring international claims in lieu of, or alongside, domestic remedies since investment arbitration tends to provide greater legal protection from regulation than domestic law, especially in relation to the availability of damages as a public law remedy.

Thus, with far-reaching individualization, the nature of the adjudication is fundamentally transformed. International obligations between states establish actionable rights for investors, but not other individuals. The adjudicator is directly oriented toward the state's treatment of investors in the regulatory sphere rather than the state's legal relations with another state on the international plane. The disputing

[81] T.J. Lawrence, *The Principles of International Law* (London: Macmillan and Co., 1923), 47 and 51; H. Lauterpacht, *Private Sources and Analogies of International Law* (Longmans, Green and Co., 1927), 3-5; V.S. Mani, *International Adjudication* (The Hague: Martinus Nijhoff, 1980), 3-4.
[82] A. Chayes, "The Role of the Judge in Public Law Litigation" (1976) 89 Harv. L.R. 1281, 1294-5 and 1302; D. Cohen and J.C. Smith, "Entitlement and the Body Politic: Rethinking Negligence in Public Law" (1986) 64 Can. Bar. Rev. 1, 7-8; Shelton, *supra* note 36, 39 and 47-50.
[83] Brownlie, *supra* note 13, 503-4; Kingsbury, Krisch, and Stewart, *supra* note 59, 12-13 and 41-2.
[84] E.g. *Feldman*, *supra* note 55, para. 62 (invoking the international principle of estoppel in claims arising from boundary disputes); *Santa Elena*, *supra* note 13, para. 35 (international standard of compensation, calculated without accounting for existing environmental legislation that would restrict the commercial development of expropriated property); *Tecnicas Medioambientales Tecmed, S.A.* v. *United Mexican States* (Merits) (29 May 2003), 43 I.L.M. 133 [hereinafter *Tecmed*], para. 70-1 and 173 (international principle of good faith); *Azurix*, *supra* note 75, para. 34 (international principle of unity of the state). See *Republic of Ecuador* v. *Occidental Exploration and Production Company* (29 April 2005), [2005] E.W.C.H. 774 (Comm. Ct.) [hereinafter *Ecuador* v. *Occidental Petroleum*], para. 32 (international principle of non-justiciability).

parties to the arbitration no longer have reciprocal rights and duties, even though rules and principles developed in the context of inter-state adjudication may still be applied.[85] Finally, the public interest of a sovereign is replaced by the private interests of investors.[86] Overall, this disadvantages any individual who would benefit from state regulation that harms investors.

C. Individual claims and state liability

The expansion of the scope of international adjudication to encompass the regulatory sphere makes the analytical framework of public law, developed in domestic adjudication of regulatory disputes, more relevant to international adjudication.[87] This can be demonstrated by examining the main remedy in investment arbitration: the damages award. In making a claim under an investment treaty, an investor usually seeks damages for harm caused by a state's alleged breach of the treaty's standards of investor protection.[88] Where an arbitration tribunal concludes that a state violated the treaty, the tribunal may award damages to the investor.[89] Awards are compensatory and usually do not include exemplary or punitive damages.[90] That said, damages have a deterrent effect on the state because they sanction state conduct that was found to

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[85] Wälde, *supra* note 1, 435-6 and 447-8.

[86] A.A. Fatouros, "Transnational Enterprise in the Law of State Responsibility" in R.B. Lillich, ed., *International Law of State Responsibility for Injuries to Aliens* (Charlottesville: University Press of Virginia, 1983), 364.

[87] E.g. *Feldman, supra* note 55, para. 61-3 (referring to the domestic law of the NAFTA states on claims of estoppel to block tax enforcement); *Mondev, supra* note 55, para. 149-50 (domestic law on the tortious immunity of public authorities); *S.D. Myers, Inc.* v. *Government of Canada* (Merits) (12 November 2000), 40 I.L.M. 1408, 15(1) World Trade and Arb. Mat. 184 [hereinafter *S.D. Myers*], para. 249 (domestic law on equality rights); *United Parcel Service of America, Inc.* v. *Government of Canada* (Jurisdiction) (22 November 2002) [hereinafter *UPS*], para. 85 (domestic competition law), online: ITA http://ita.law.uvic.ca/documents/UPS-Jurisdiction.pdf. The change here is one of degree given that international tribunals have examined or analogized issues of domestic law in the past: e.g. *Fabiani Case* (*France* v. *Venezuela*) (1896), 10 R.I.A.A. 33 (state responsibility for the official acts of its agents).

[88] E.g. NAFTA, *supra* note 1, art. 1116 and 1117; *Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of India*, 14 March 1994, [1995] U.K.T.S. No. 27, Cmd 2797 (entered into force 6 January 1995), art. 9.

[89] E.g. NAFTA, *supra* note 1, art. 1135.

[90] E.g. NAFTA, *supra* note 1, art. 1135(3).

have been unlawful.[91] As noted, this arrangement for compensating investors and enforcing international law differs from other trade agreements that rely on inter-state adjudication and non-monetary remedies. In contrast to these other international mechanisms, investment treaties establish an individualized regime of state liability to remedy the unlawful exercise of public authority.[92]

Damages are traditionally a private law remedy.[93] The theory of damages is based on a private law conception of the legal relations between disputing parties; i.e. a theoretical framework based on reciprocal relations between juridical equals. Thus, damages are classically awarded in the context of a reciprocal rather than a regulatory relationship. Damages are paid by one party to another for the violation of a legal duty and both the victim and the wrongdoer are protected by the law and liable to sanction. Either disputing party can be the claimant or respondent in a claim.

In the international law of state responsibility, the use of damages (or reparation) as a remedy does not undermine this conceptual framework because a dispute between juridically equal states is broadly analogous to a dispute between private parties (likewise, a contractual dispute between an individual and a state is conventionally treated as private dispute, subject to the law of the contract).[94] In inter-state adjudication, damages are awarded in the context of a dispute between juridical

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[91] C.T. Oliver, "Legal Remedies and Sanctions" in R.B. Lillich, ed., *International Law of State Responsibility for Injuries to Aliens* (Charlottesville: University Press of Virginia, 1983), 61-5; J.H.H. Weiler, "Emerging Issues on Compliance and Effectiveness of Community Law" (1997) 91 ASIL Proc. 172, 173; Shelton, *supra* note 36, 41 and 279; J.A. VanDuzer, "NAFTA Chapter 11 to Date: The Progress of a Work in Progress" in L. Ritchie Dawson, ed., *Whose Rights? The NAFTA Chapter 11 Debate* (Ottawa: Centre for Trade Law and Policy, 2002), 48-9.

[92] Afilalo, *supra* note 1, 6. In this thesis, the term "state liability" is used rather than state responsibility to highlight the distinction between a damages award in investment arbitration and a damages award in conventional international adjudication. In investment arbitration, involving state liability, damages are paid to an individual in the context of a regulatory relationship between the individual and the state. In conventional international adjudication, damages are paid to a state in the context of a reciprocal relationship between two states.

[93] Chayes, *supra* note 82, 1287; Gray, *supra* note 17, 8; Shelton, *supra* note 36, 38-9.

[94] C.N. Gregory, "Expropriation by International Arbitration" (1907) 21 Harv. L.R. 23, 23; W.W. Willoughby, *The Fundamental Concepts of Public Law* (New York: Macmillan, 1924), 322-4; Eagleton, *supra* note 7, 16; Hudson, *supra* note 6, 188; F.A. Mann, "State Contracts and State Responsibility" (1960) 54 AJIL 572, 573 and 582. See Whiteman, *supra* note 11, 6-7; International Law Commission, "Draft Articles on Responsibility of States for Internationally Wrongful Acts", *Report of the International Law Commission on the Work of Its Fifty-third Session*, UN GAOR, 56th Sess., Supp. No. 10, Annex, UN Doc. A/56/10 (2001), 43, art. 42.

equals; i.e. between parties equally capable of possessing legal rights and duties.[95] On the other hand, in investment arbitration, damages are awarded to a private party who is subject to the exercise of public authority by the state.[96] That is, damages are awarded in order to resolve a regulatory dispute and to compensate for harm caused by the unlawful exercise of public authority. Only an investor can make a claim and only the state, acting in a public capacity, can be a respondent to an investor claim. State liability arises in the context of the regulatory relationship. This distinguishes damages awards in investment arbitration from damages awards in private law or inter-state adjudication.

International rules of state responsibility are more expansive than those which typically apply in the domestic law of state liability. For example, international law adopts a flexible approach to the attribution of individual acts to the state, holding states responsible for *ultra vires* acts of its agents in order to encourage active state supervision of public officials.[97] For similar reasons, a claimant state does not have to prove intent on the part of a respondent state in order to establish liability for acts arising from official error.[98] In general, international rules of state responsibility adopt a more liberal approach to fault than do domestic rules of state liability.[99] This more

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[95] J. Dutheil de la Rochère, "Member State Liability for Infringement of European Community Law" (1996) 11 Tul. Euro. Civ. L.F. 1, 10; D. Bodansky and J.R. Crook, "Symposium: The ILC's State Responsibility Articles – Introduction and Overview" (2002) 96 AJIL 773, 775-6 and 785-6; Weiss, *supra* note 35, 798-9; C. Warbrick, "States and Recognition in International Law" in M.D. Evans, ed., *International Law* (Oxford: OUP, 2004), 211-12. But see *Construction of a Wall*, *supra* note 80, 147 and 152 (concluding that states have an obligation, having breached a rule of customary international law that protects individuals, "to make reparation for the damage caused to all the natural or legal persons concerned" and "to compensate, in accordance with the applicable rules of international law, all natural or legal persons having suffered any form of material damage" as a result of the breach); *Janes Claim* (*United States* v. *Mexico*) (1926), 4 R.I.A.A. 82, para. 23-6 (assessing the state's liability for murder of a foreign national in terms of loss to the individuals concerned, rather than the home state, and awarding compensation to the relatives of the deceased).

[96] Eagleton, *supra* note 7, 3, note 2; S.J. Toope, *Mixed International Arbitration – Studies in Arbitration Between States and Private Persons* (Cambridge: Grotius Publications, 1990), 184-7.

[97] *Caire Claim* (*France* v. *Mexico*) (1929), 5 R.I.A.A. 516 [hereinafter *Caire Claim*], 529-30.

[98] *Union Bridge Company Claim* (*United States* v. *Great Britain*) (1924), 6 R.I.A.A. 138, 141-2. See also *Asian Agricultural Products Ltd. (AAPL)* v. *Sri Lanka* (Merits) (27 June 1990), 4 ICSID Rep. 246, 30 I.L.M. 577, para. 69 and 77; *In the Matter of Cross-border Trucking Services* (Merits) (6 February 2001), 13(3) World Trade and Arb. Mat. 121, para. 214.

[99] *Caire Claim*, *supra* note 97, 529-30; *Corfu Channel* (Merits) (*United Kingdom* v. *Albania*), [1949] I.C.J. Rep. 4, 22. See also *Tippetts* v. *TAMS-ATTA* (1985), 6 Iran-U.S. C.T.R. 219, 226. Eagleton, *supra* note 7, 18-20; M.T. Ahmedouamar, "The Liability of the Government in France as a Consequence of its Legal Activities" (1983) 11 Int'l J. Legal Info. 1, 6 and 10; A.

permissive approach to state responsibility under international law reflects the reciprocity of legal relations between states.[100] Each state, in principle, enjoys the protection and assumes the risk that flows from a liberal approach to rules of attribution, intent, and fault.

The reciprocity of rights and duties breaks down in the adjudication of a regulatory dispute between the state and an individual.[101] In a regulatory dispute, the state wields powers and assumes responsibilities that no private person can possess.[102] As a result, the protection of individuals from the exercise of public authority requires the application of norms that uniquely protect individuals from the state. In some cases, individuals may be allowed to claim damages from the state in order to compensate for harm suffered as a result of the unlawful exercise of public authority. But, in claiming damages, the individual invokes rights and entitlements that adhere to the individual against the state and not the other way round.[103] The state alone can exercise public authority over private parties, including foreign investors, in its territory. Likewise, the state has duties that arise only from the exercise of public authority and, as such, that cannot be compared to acts of private parties. Absent the exercise of public authority, the prospect of an individual claim arising out of a regulatory dispute simply does not exist.

Damages awards to individuals for unlawful state conduct raise thorny issues about the scope and purpose of state liability and the appropriate role of government.[104] Should damages be awarded to compensate individuals, or to deter

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Nollkaemper, "Concurrence Between Individual Responsibility and State Responsibility in International Law" (2003) 52 I.C.L.Q. 615, 633.

[100] Lauterpacht, *supra* note 81, 134; Eagleton, *supra* note 7, 5.

[101] Chayes, *supra* note 82, 1302; Fatouros, *supra* note 86, 362-3; D.W. Bowett, "Claims Between States and Private Entities: The Twilight Zone of International Law" (1986) 35 Cath. U. L. Rev. 929, 933-4; W. Twining, *Globalisation and Legal Theory* (London: Butterworths, 2000), 51-3; Shelton, *supra* note 36, 39 and 47-50.

[102] W.I. Jennings, *The Law and the Constitution* (London: University of London Press, 1959), 312; Cohen and Smith, *supra* note 82, 5-6; Harlow and Rawlings, *supra* note 51, 5 and 41-5; Warbrick, *supra* note 95, 231-2.

[103] Toope, *supra* note 96, 388.

[104] See C. Harlow, *Compensation and Government Torts* (London: Sweet & Maxwell, 1982), 51; Ontario Law Reform Commission (OLRC), *Report on the Liability of the Crown* (Toronto: OLRC, 1989), 7; C. Harlow, "Francovich and the Problem of the Disobedient State" (1996) 2 Eur. L.J. 199; Dutheil de la Rochère, *supra* note 95; P.W. Hogg and P.J. Monahan, *Liability of the Crown*, 3rd ed. (Toronto: Carswell, 2000), 151.

inappropriate state conduct?[105] Should liability be limited by requirements of malice or fault on the part of the state?[106] Should liability be limited because of the unique nature of the state and the need to maintain flexibility and predictability in government?[107] Should legislative or judicial acts be exempt from liability?[108] These matters have previously been resolved, almost exclusively, by domestic public law. They were part of the reserved domain of domestic jurisdiction.[109] However, with investment arbitration, these matters now come within the discretion of international tribunals. In turn, approaches to state liability that evolved in domestic law are made more relevant to international adjudication.[110]

In the twentieth century, in most countries, the classical doctrine of sovereign immunity from suit and from damages awards was whittled away.[111] In its place, new rules were developed to delineate the scope of state liability as a public law remedy.[112] For example, in the common law tradition, state liability was qualified by the principle of parliamentary sovereignty which limited the legislature's liability where the passage or amendment of laws caused losses to private individuals.[113] Likewise, the liability of

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[105] Gray, *supra* note 17, 151; J.H.H. Weiler, *supra* note 91, 172-3.

[106] C. Morris, "The Role of Criminal Statutes in Negligence Actions" (1949) 49 Col. L Rev. 21, 27-9; H. Street, *Governmental Liability* (Cambridge: CUP, 1953), 66; P.P. Craig, "Compensation in Public Law" (1980) 96 L.Q Rev. 413, 441-3; Harlow (1996), *supra* note 104, 209; Fairgrieve, *supra* note 53, 699-700.

[107] J.M. Evans et al., *Administrative Law – Cases, Text, and Materials*, 4th ed. (Toronto: Emond Montgomery, 1995), 1401.

[108] E.g. R. v. *Treasury ex parte British Telecommunications* (No. 392/93), [1996] 3 W.L.R. 203 [hereinafter *British Telecomm*], para. 40 ("A restrictive approach to state liability is justified.... in particular [because of] the concern to ensure that the exercise of legislative functions is not hindered by the prospect of actions for damages whenever the general interest requires the institutions or member states to adopt measures which may adversely affect individual interests").

[109] Brownlie, *supra* note 13, 291.

[110] Harlow (1996), *supra* note 104, 205-6.

[111] E.g. U.S. *Federal Tort Claims Act*, 28 U.S.C. s. 1346(b), 2671-80; U.S. *Crown Proceedings Act* 1947, c. 44. OLRC, *supra* note 104, 8-11; W.B. Lafferty, "The Persian Gulf War Syndrome: Rethinking Government Tort Liability" (1995) 25 Stetson L.R. 137, 148-9.

[112] E.g. *Blanco* (8 February 1873), Rec. 1er Supp. 61 (recognizing the tort liability of the state in relation to its commercial activities, although noting that state liability is "neither general, nor absolute", reflecting the need to balance the opposing and competing interests at stake). Street, *supra* note 106, 6-24; Ahmedouamar, *supra* note 99, 2-12; Weir, *supra* note 40, 418-20 and 428-9.

[113] Domestic courts may have the authority to award damages to individuals for legislative acts, but typically only in relation to constitutionally-protected rights. E.g. *Guimond* v. *Québec (Procureur général)*, [1996] 3 S.C.R. 347, 138 D.L.R. (4th) 647, para. 15. Street, *supra* note 106, 11,

the judiciary was limited to promote impartiality and finality in judicial decision-making.[114] Administrative acts could generally lead to tort liability on the part of the state, although not where the tort flowed from a policy decision involving the expenditure of public funds.[115] Further, in some cases, state liability could arise from administrative acts in the context of unique public law torts, but these too were subject to limitations on liability.[116] Generally, in common law countries, the claimant had to show fault or malice on the part of a public body or official in order to receive damages, and state liability could not be imposed based on illegality alone.[117] Thus, a series of compromise positions was reached between governmental immunity and the payment of damages to individuals harmed by the exercise of public authority. In every legal system, the resulting balance was specific and complex, reflecting the historical evolution of norms regarding the role of the state in relation to the private sphere.[118]

Under an investment treaty, the award of damages to an investor may be approached as a form of state responsibility on the international plane. However, international rules of state responsibility were developed in the context of reciprocal legal relations among states. Even in claims of diplomatic protections on behalf of a foreign national, the international dispute was formally conceptualized as a legal

45-6, and 70-2; F.L. Morrison, "The Liability of Governments for Legislative Acts in the United States of America" (1998) 46 Am. J. Comp. L. Supp. 531, 543-6.

[114] E.g. *Garnett* v. *Ferrand* (1827), 6 B. & C. 611, 108 E.R. 576, 581 (K.B.); *Fray* v. *Blackburn* (1863), 3 B. & S. 576, 122 E.R. 217, 217 (Q.B.). Street, *supra* note 106, 41-5 and 69-70; Ahmedouamar, *supra* note 99, 6-9; OLRC, *supra* note 104, 18-20.

[115] The state's liability in tort for administrative acts has been limited, e.g., to cases arising from "operational" decisions by the administration, to cases in which liability was warranted for policy reasons; to cases in which non-monetary remedies are unavailable, and to cases involving more than pure economic loss. E.g. *Anns* v. *Merton* (1977), [1978] A.C. 728, 2 All E.R. 492 (H.L.); *Nielsen* v. *Kamloops*, [1984] 2 S.C.R. 2, 10 D.L.R. (4th) 641; *Brown* v. *British Columbia (Minister of Transportation and Highways*, [1994] 1 S.C.R. 420, 112 D.L.R. (4th) 1; *Swinamer* v. *Nova Scotia (Attorney General)*, [1994] 1 S.C.R. 445, 112 D.L.R. (4th) 18; *Dalehite* v. *United States*, 364 U.S. 15 (1953); *Indian Towing Co. v. United States*, 350 U.S. 61 (1955). See Harlow (1982), *supra* note 104, 53; Lunney and Oliphant, *supra* note 52, 501-3.

[116] Such as the requirement, in the case of the public law tort of breach of statutory duty, that the statutory duty be intended to benefit a particular class of the public: Lunney and Oliphant, *supra* note 52, 501-3 and 527; Hogg and Monahan, *supra* note 104, 151. Note that a "public law" tort is one that can only arise from the exercise of public authority.

[117] Hogg and Monahan, *supra* note 104, 147-8; Morrison, *supra* note 113, 533, 537-8, and 541; R.C. Evans, "Damages for Unlawful Administrative Action: The Remedy for Misfeasance in Public Office" (1982) 31 I.C.L.Q. 640; Harlow (1996), *supra* note 104, 209; Fairgrieve, *supra* note 53, 697-8.

[118] Harlow and Rawlings, *supra* note 51, 605-6.

relationship between the host state and the home state of the foreign national.[119] The host state's duty to protect the foreign national was owed to the home state, not to the individual, and – based on Vattel's principle – harm to a foreign national was treated as harm to the home state.[120] In this context, the international law of state responsibility did not confront the circumstances that prompted limitations on state liability in domestic law.[121] There was less need to adapt rules of state responsibility to accommodate the governmental implications of using damages awards as a public law remedy because no sovereign exercised public authority for the world. Only with the individualization of international adjudication in relation to regulatory disputes does the intricate dynamic of state liability fully enter the picture.

With individualization, the international law of state responsibility comes to resemble the domestic law of state liability. This is especially so where an investment treaty limits the duty to exhaust local remedies, thus withdrawing a basic check on the international responsibility of states for the treatment of foreign nationals.[122] However, it is of fundamental importance that investment treaties do not expressly provide for general limitations on state liability in order to temper corrective justice and thus accommodate governmental discretion.[123] Instead, a less compromising form of state liability, originating in reciprocal inter-state relations, is applied to the regulatory relationship between the state and foreign investors. Investment treaties apply damages as a public law remedy without imposing conditions that would otherwise limit state liability under domestic law,[124] and this allows investors to claim damages in circumstances where they otherwise could not under domestic law.[125] Thus, the principle of the unity of the state in international law operates to trump domestic restrictions on state liability for legislative or judicial acts.[126] Likewise, the international principle of reparation is applicable, subordinating state liability to a

[119] Hudson, *supra* note 6, 192-3.
[120] E. Vattel, *Le Droit de gens*, book II, c. VI, s. 74-5 and c. VIII, s. 108-9 (an injury to a citizen is an injury to the state).
[121] Gray, *supra* note 17, 8-9 and 18-19; Brownlie, *supra* note 13, 17.
[122] Eagleton, *supra* note 7, 196; Borchard, *supra* note 73, 364.
[123] K. Roach, "The Limits of Corrective Justice and the Potential of Equity in Constitutional Remedies" (1991) 33 Ariz. L.R. 859, 864-5.
[124] Hogg and Monahan, *supra* note 104, 122 and 149-54.
[125] Been and Beauvais, *supra* note 72, 59-86.
[126] Eagleton, *supra* note 7, 63-9; Bean and Beauvais, *supra* note 72, 81-2.

private law construction of compensation.[127] Investment treaties adopt open-ended language to define standards of investor protection without an express requirement for fault on the part of the state. In these circumstances, the far-reaching character of individual claims, combined with the remedy of damages, opens the door to a very expansive conception of state liability.[128]

Thus, investment arbitration serves as a vehicle to expand the ambit of state liability. Where investors are permitted to claim damages based on rules of state responsibility, they benefit from rules and principles that are usually reserved for claims by states, without assuming the corresponding duties that accompany a state's representative role.[129] As a result, the individualization of international claims presents arbitrators with a choice. Either they artificially apply a reciprocal legal framework to the regulatory relationship between investor and state, or they read general principles to limit the scope of state liability into investment treaties.[130] The former denies the uniqueness of the state as a representative entity, whereas the latter may be seen to conflict with the express language of the treaty.

D. Individual claims and multinational enterprises

It is important to demonstrate that to speak of investors as individuals is misleading. Today's investors are typically sophisticated organizations: combinations of capital that have been legally organized as networks of companies (or other legal entities),

[127] The principle was established in *The Chorzow Factory* (*Germany* v. *Poland*) (1928), P.C.I.J. Ser. A., No. 17, 47, based on "the rules of international law in force between the two States concerned, and not the law governing relations between the State which has committed the wrongful act and the individual who has suffered the damage". Regarding the application of the principle in the adjudication of an investment dispute, see e.g. *Amoco International Finance Corp.* v. *Iran* (1987), 15 Iran-U.S. C.T.R. 189, para. 193; *Metalclad Corporation* v. *United Mexican States* (Merits) (30 August 2000), 40 I.L.M. 36, 13(1) World Trade and Arb. Mat. 45, para. 122; *CME Republic B.V.* v. *Czech Republic* (Merits) (13 September 2001), 14(3) World Trade and Arb. Mat. 109 [hereinafter *CME*], para. 616-17. See also Redfern and Hunter, *supra* note 19, 370-1.

[128] Toope, *supra* note 96, 184-7.

[129] Brownlie, *supra* note 13, 65.

[130] E.g. *British Telecomm*, *supra* note 108, para. 40; *Brasserie du Pêcheur*, *supra* note 47, para 45.

which in this thesis are referred to as multinational enterprises.[131] The central role of multinational enterprises in the organization of international capital flows reflects their role as agents in the process of globalization and makes them key actors in investment arbitration.[132] Moreover, an inherent aspect of the multinational enterprise is the ability to make decisions about the allocation of capital, and about production and distribution, which transcend the boundaries of national regulation.[133] Importantly, the legal characterization of multilateral enterprises as investors – combined with the breadth and flexibility of corporate nationality under many investment treaties – facilitates forum-shopping.[134] This expands the scope of investment arbitration as a governing arrangement by allowing investors to effectively choose the treaty (or treaties) under which they can bring a claim and obtain protection.

In the first place, access to investment arbitration is restricted to multinational enterprises or to very wealthy humans. Under investment treaties, an "investor" is usually a natural or legal person (i.e. a corporation, trust, etc.) who owns foreign assets.[135] Most natural persons, and many companies, do not own foreign assets and therefore do not satisfy this threshold. Among those that do, few own sufficient assets to credibly threaten a claim under an investment treaty. This is because

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[131] This follows OECD terminology: *OECD Guidelines for Multinational Enterprises*, Revision 2000 (Paris: OECD, 2000), 17-18. See A.A. Fatouros, "On Domesticating Giants: Further Reflections on the Legal Approach to Transnational Enterprise" (1976) 15 U. Western Ontario L. Rev. 151, 161-2.

[132] Y. Ghai, R. Luckham, and F. Snyder, "Law and the Internationalization of Capital - Introduction" in Y. Ghai, R. Luckham, and F. Snyder, eds., *The Political Economy of Law* (Oxford: OUP, 1987), 275; S. Picciotto, "Introduction: What Rules for the World Economy?" in S. Picciotto and R. Mayne, eds., *Regulating International Business* (Houndmills: Macmillan, 1999), 6-7.

[133] A.C. Aman, "Globalization, Democracy, and the Need for a New Administrative Law" (2003) 10 Ind. J. Global Legal Studies 125, 137-8.

[134] *Waste Management No. 2* (Merits), *supra* note 55, para. 80; *CME*, *supra* note 127, para. 419.

[135] As discussed in chapter four of this thesis, investment treaties generally define "investment" broadly to include, for example, "any asset". Investment treaties adopt different definitions of "investor" but virtually all make access to investment arbitration available to both natural and legal persons who qualify as investors. In the case of NAFTA Chapter 11, the claimant are usually a foreign corporation, established in one state party to the treaty, that owns assets in another state party to the treaty. The claimant could also be a natural person, public entity, or other business vehicle such as a trust or partnership: NAFTA, *supra* note 1, art. 201 and 1139 (definitions of "enterprise" and "investor of a Party"). See *Azinian*, *supra* note 55, para. 77; *S.D. Myers*, *supra* note 87, para. 222-31; *UPS*, *supra* note 87, para. 6 and 18-21; *Mondev*, *supra* note 55, para. 49-50 and 80; *Waste Management No. 2* (Merits), *supra* note 55, para. 77.

investors must pay for half of the cost of an investment arbitration and the cost is prohibitive.[136] In the *CME* case, for example, the arbitrators' fees were (U.S.) $1.35 million divided equally between the investor and the host state.[137] This practically limits access to investment arbitration to investors who have a significant monetary interest in the outcome of a dispute with a state. In nearly all cases, these are multinational enterprises.[138]

To elaborate, in order to bring a claim under an investment treaty, an investor must also be "foreign". In other words, the claimant must establish that it is a national of a state party to the treaty, other than the host state, whether as a natural or legal person.[139] Under NAFTA Chapter 11 as well as other treaties, a natural person who is an investor in one state party to the treaty must demonstrate that he or she is a national of another state party based on the laws of citizenship of that other state.[140] An investor that is a legal person must show that he or she or it satisfies the home state's relevant laws of incorporation or business establishment.[141] Thus, the question of whether an investor is foreign is determined by the rules of nationality of the investor's home state, not those of the host state.[142] This facilitates forum-shopping

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[136] M.J. Mustill, "Arbitration: History and Background" (1989) 6 J. Int'l Arb. 43, 54; L.E. Peterson, "Bilateral Investment Treaties and Development Policy-Making" (Report for the International Institute for Sustainable Development, November 2004), 24-6.

[137] *CME Republic B.V.* v. *Czech Republic* (Damages) (14 March 2003), 15(4) World Trade and Arb. Mat. 83 and 245 [hereinafter *CME*], para. 650 (summary of decision).

[138] Sornarajah, *supra* note 10, 8; Z. Douglas, "The Hybrid Foundations of Investment Treaty Arbitration" (2003) 74 Brit. Y.B. Int'l L. 151, 152.

[139] *Nottebohm*, *supra* note 5, 24; *Barcelona Traction*, *supra* note 5, para. 70. R. Donner, *The Regulation of Nationality in International Law*, 2d ed. (Ardsley, N.Y.: Transnational Publishers, 1994), 19 and 34-42.

[140] NAFTA, *supra* note 1, art. 1117 and 1138. *Marvin Roy Feldman Karpa* v. *United Mexican States* (Jurisdiction) (6 December 2000), 18 ICSID Rev. 469, para. 24-38. UNCTAD, *Scope and Definition*, UNCTAD Series on Issues in International Investment Agreements (New York: United Nations, 1999), 35.

[141] R. Dolzer and M. Stevens, *Bilateral Investment Treaties* (The Hague: Martinus Nijhoff, 1995), 33-6 (noting that, for companies and other legal entities, BITs rely on three basic criteria to determine nationality: the place of incorporation (e.g. U.S.); the location of seat or actual management of the company (e.g. Germany); and the nationality of controlling shareholders); Muchlinski, *supra* note 60, 622-4.

[142] NAFTA, *supra* note 1, art. 1139 (definition of "enterprise of a Party"). F. Green, "Corporations as Persons, Citizens, and Possessors of Liberty" (1946) 94 U. Pa. L. Rev. 202, 204-5 and 224; R.R. Wilson, "Postwar Commercial Treaties of the United States" (1949) 43 AJIL 262, 265-6; H. Walker, "Treaties for the Encouragement and Protection of Foreign Investment: Present United States Practice" (1956) 5 Am. J. Comp. L. 229, 233.

by investors where the home state has liberal rules of incorporation.[143] Multinational enterprise that do not have a substantial business connection to the home state can nevertheless acquire its nationality by incorporating in its territory.[144] By establishing a holding company in one state party to an investment treaty, a multinational enterprise can acquire separate legal personality and the nationality of that state, and thus obtain protection under the treaty for its assets in other states parties to the treaty.[145]

With respect to forum-shopping, the underlying strategy of multinational enterprises – in adopting the nationality that is most convenient for a particular transaction, tax assessment, or legal claim – is to exploit variations among regulatory regimes in different jurisdictions.[146] This is the flip side of inter-state competition to attract investment: forum-shopping by international capital.[147] Investment treaties offer abundant opportunities for forum shopping because they establish varying levels of legal protection for capital flows between different states – depending on whether

[143] *Waste Management No. 2* (Merits), *supra* note 55, para. 80. See S. Timberg, "International Combines and National Sovereigns" (1947) 95 U. Penn. L.R. 575, 588; Walker, ibid., 232-3, 236, and 238-9; W.W. Bratton et al., "Introduction: Regulatory Competition and Institutional Evolution" in W.W. Bratton et al., eds., *International Regulatory Competition and Coordination* (Oxford: Clarendon, 1996), 21; S. Picciotto, *International Business Taxation* (London: Weidenfeld and Nicolson, 1992), 94-6; W.-H. Roth, "From *Centros* to *Ueberseering*: Free Movement of Companies, Private International Law, and Community Law" (2003) 52 I.C.L.Q. 177, 177-8. Note that some investment treaties, including NAFTA and the *Energy Charter Treaty*, allow a state party – subject to prior notification and consultation – to deny the benefits of the treaty to a foreign investor of another state party, or their investments, that is a company which is owned or controlled by investors of a non- state party and which has no substantial business activities in the state in which it is established: NAFTA, *supra* note 1, art. 1113(2); *Energy Charter Treaty*, 17 December 1994, 35 I.L.M. 509, art. 17(1).

[144] E. Gaillard, "Commentary" (2002) 18 Arb. Int'l 247, 248; G.A. Alvarez and W.W. Park, "The New Face of Investment Arbitration: NAFTA Chapter 11" (2003) 28 Yale J. Int'l L. 365, 372; R.G. Dearden, "Arbitration of Expropriation Disputes between an Investor and the State under the North American Free Trade Agreement" (1995) 29 J. World Trade 113, 115; UNCTAD, *supra* note 140, 37-8.

[145] *Amco Asia Corp.* v. *Indonesia* (Jurisdiction) (25 September 1983), 23 I.L.M. 351, para. 14; *Société Ouest-Africaine des Bétons Industriels* v. *Senegal* (Merits) (25 February 1988), 6 ICSID Rev. 125, 17 Y.B. Com. Arb. 42, 48. See also A. Broches, "Development of International Law by the International Bank for Reconstruction and Development" (1965) 59 Am. Soc'ty Int'l L. Proc. 33, 37 (noting that, during the drafting of the *ICSID Convention*, a number of developing countries objected to foreign-controlled domestic corporations being allowed to make an ICSID claim, but were overruled by capital-exporting states); Douglas, *supra* note 138, 175.

[146] Peter, *supra* note 3, 37-8; Bratton et al., *supra* note 143, 9 and 40-1; R. Palan, "Trying to Have Your Cake and Eating It: How and Why the State System Has Created Offshore" (1998) 42 Int'l Studies Q. 625, 630.

[147] UNCTAD, *Taxation*, UNCTAD Series on Issues in International Investment Agreements (New York: United Nations, 2000), 62; Fatouros, *supra* note 86, 362.

a treaty is in place and on its terms – which in turn creates an incentive for multinational enterprises to adapt their corporate structure to maximize their legal security.[148] By implication, an investor of a state party to an investment treaty might be ultimately owned by an investor of a non-state party[149] or by an investor of the host state itself.[150] The nationality of an investor is not always stable or identifiable because multinational enterprises can adopt different nationalities at different points in their corporate structure.

This flexibility of access to investment arbitration is an essential aspect of investment arbitration as a governing arrangement. The flexible approach to corporate nationality, in particular, overrides rules that would otherwise limit access to the system. In the *Barcelona Traction* case, the International Court of Justice concluded that, under customary international law, a corporation has the nationality of the state in which it is incorporated and in whose territory it has its registered office, and only the state of incorporation can make a claim for diplomatic protection on behalf of the corporation.[151] If this rule was applied in investment arbitration, only the immediate owner of an investment would qualify as an investor for the purposes of bringing an investment treaty claim, barring exceptional circumstances.[152] Therefore, only the immediate foreign owners of investments could make an international claim, and no claim could be brought – by lifting the corporate veil – on behalf of indirect owners of the investment where they had a different nationality.[153] Applied to contemporary investment arbitration, the rule in *Barcelona Traction* would prevent multinational

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[148] M.-F. Houde and K. Yannaca-Small, *Relationships between International Investment Agreements*, OECD Working Paper on International Investment No. 2004/1 (Organization for Economic Cooperation and Development, May 2004), 4.

[149] *Fireman's Fund, supra* note 71, para. 5; *Mondev, supra* note 55, para. 79.

[150] *Wena Hotels Ltd.* v. *Egypt* (Jurisdiction) (25 May 1999), 41 I.L.M. 881, 888; *Tokios Tokelės* v. *Ukraine* (Jurisdiction) (29 April 2004), 16(4) World Trade and Arb. Mat. 75 [hereinafter *Tokios*], para. 21 and 38. But see *Vacuum Salt Products, Ltd.* v. *Republic of Ghana* (Jurisdiction) (16 February 1994), 9 ICSID Rev. 72, 20 Y.B. Comm'l Arb. 11, para. 17-20 and 29-30 (concluding in relation to an investment in Ghana that a company owned 20 percent by Greeks and the remainder by Ghanians was not foreign controlled for the purposes of ICSID jurisdiction).

[151] *Barcelona Traction, supra* note 5, para. 70 and 99-103. N.S. Rodley, "Corporate Nationality and the Diplomatic Protection of Multinational Enterprises: The *Barcelona Traction* Case" (1971) 47 Ind. L.J. 70, 82.

[152] *Barcelona Traction, supra* note 5, para. 64-9 (identifying potential exceptions such as where the corporation has ceased to exist or where the home state lacks the capacity to take action on behalf of the corporation).

[153] Muchlinski, *supra* note 60, 535-6.

enterprises from shopping for protection by requiring a claim to be made from the country in which the first link in the corporate chain of international ownership was located.[154]

The decision in *Barcelona Traction* in 1970 posed a problem for multinational enterprises whose business activities were linked to more than one country, whose ownership was dispersed among shareholders in many countries, and whose corporate structure was fragmented among different countries.[155] Some commentators criticized the ICJ's decision as unworkable.[156] Indeed, *Barcelona Traction* prompted capital-exporting states to expand their BIT programs in the 1980s and 1990s in order to assure legal protection of multinational enterprises.[157] Thus, most investment treaties override *Barcelona Traction* by allowing investment treaty claims by any foreign shareholder of an investment, regardless of whether the shareholder's ownership rights extend through a chain of companies in other jurisdictions.[158] A claim can be made at any point in the chain of international ownership so long as the actual claimant has the nationality of another state party and, under some treaties, so long as the claimant has a minimum amount of ownership or control of the investment.[159] This gives multinational enterprises more flexibility to select the point in their corporate structure from which to launch an investor claim.

One of the ICJ's rationales for its ruling in *Barcelona Traction* was the need to avoid a proliferation of international claims in light of fragmented international ownership of investments in the world economy.[160] The underlying concern was that,

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154 Fatouros, *supra* note 86, 381.
155 Fatouros, *supra* note 86, 367-70; F. Johns, "The Invisibility of the Transnational Corporation: An Analysis of International Law and Legal Theory" (1994) 19 Melb. U. L. Rev. 893, 895-6.
156 Ohly, *supra* note 64, 299-300.
157 *Barcelona Traction, supra* note 5, para. 68. Rodley, *supra* note 151, 84.
158 Dolzer and Stevens, *supra* note 141, 35-6.
159 E.g. *GAMI, supra* note 55, para. 29-30 and 38 (permitting a U.S. shareholder of 14% of a Mexican company's shares to make a claim against Mexico under NAFTA Chapter 11 regarding alleged injuries to the domestic company – as opposed to direct injuries to the shareholder itself – despite the domestic company's pursuit of relief in the Mexican courts); *Waste Management No. 2* (Merits), *supra* note 55, para. 85 ("The nationality of any intermediate holding companies is irrelevant to the present claim"). See also e.g. *Compañía de Aguas del Aconquija S.A. & Vivendi Universal* v. *Argentine Republic* (Annulment) (3 July 2002), 6 ICSID Rep. 340, para. 50; *Azurix, supra* note 75, para. 21 and 42; *CMS, supra* note 56, para. 47 and 55; *Siemens, supra* note 71, para. 137.
160 *Barcelona Traction, supra* note 5, para. 96.

if international claims could be brought on behalf of any foreign shareholder of an investment, then investment disputes would generate large numbers of claims by different states, and multinational enterprises would have an incentive to structure their investments so as to entangle as many powerful states as possible in a potential dispute.[161] This is what has come to pass in contemporary investment arbitration. Under investment treaties, investment disputes have in some cases lead to multiple claims by different investors under different treaties. In *CME*, as discussed in chapter one of this thesis, a U.S. investor used a holding company in the Netherlands to launch parallel claims against the Czech Republic under two separate investment treaties, in relation to the same dispute, and to collect (U.S.) $350 million in damages, even though only one of the claims was successful.[162] In *Tokios*, investors in the Ukraine used a holding company in Lithuania to make a claim against their own

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[161] *Administrative Decision No. V*, *supra* note 12, 613-14. W. Barnes, "Remarks" (1907) Am. Soc'ty Int'l L. Proc. 100, 142; Ohly, *supra* note 64, 283-4; Okowa, *supra* note 7, 484. For example, a well-known risk management strategy of multinational enterprises is to internationalize the economic stake in a business venture, and thus engage the nationals and governments of as many powerful states as possible, in order to have more leverage in the event of a dispute with the host state. This can be illustrated by the case of Kennecott and the nationalization of the Chilean copper industry (Peter, *supra* note 3, 241-3). In the 1960s, Kennecott agreed to sell 51% of its interest in the copper industry to the Chilean government and committed to the terms of a new joint venture based on a 10-year management contract. Kennecott insured, with U.S. AID, the (U.S.) $80 million that Kennecott had committed to the joint venture. Fresh capital was supplied by an Eximbank loan and by the Chilean Copper Corporation. Kennecott also raised funds by concluding long-term contracts for future production with European and Japanese firms, and sold the collection rights on these contracts. Peter, at 242, quotes a Kennecott executive: "The aim of these arrangements is to ensure that nobody expropriates Kennecott without upsetting relations to customers, creditors and governments in three continents". This strategy proved successful when, in the early 1970s, Chilean President Allende proposed to expropriate Kennecott's interest, with payment of partial compensation, due to windfall profits. In response, the assets of the Chilean national airline and Copper Corporation were seized in the United States based on guarantees given by the Chilean state, and European and Asian creditors pressured the Paris Club of creditors to use the renegotiation of Chile's external debt as leverage to secure compensation for Kennecott.

[162] *CME* (Merits), *supra* note 127, para. 396; *CME* (Damages), *supra* note 137, para. 432-3 (concluding that the claimant could make claims under two investment treaties, in relation to the same underlying dispute, by channelling ownership of its investment through a holding company in the Netherlands). UNCTAD, *Most-Favoured-Nation Treatment*, UNCTAD Series on Issues in International Investment Agreements (New York: United Nations, 1999), 11.

state.[163] In both cases, flexible rules of nationality in investment treaties were used to dramatically expand the system of investment arbitration.

As capital moves beyond the domestic sphere, so too does the regulatory relationship between investors and the state. As foreign ownership expands and fragments[164] so too does the risk that the exercise of public authority will trigger an international claim. The ownership of assets in one country will often be split among investors of other countries, leaving the host state unaware of whether and to what extent a particular business activity is protected by an investment treaty.[165] Given that it is sometimes impossible to track foreign ownership, governments are left in a position where they must assume that any economic activity that involves substantial capital within their territory could lead to an international claim under an investment treaty. Moreover, the dynamic of forum-shopping means that investment treaties may protect much more than *actual* flows of capital between the states parties, since actual flows do not necessarily correspond to legal arrangements for the ownership of assets.[166] An investor can become foreign by establishing a holding company or by a paper transfer of assets among companies without any commitment of new capital to the host economy.[167] As such, existing networks of investment treaties create overlapping state obligations that are highly accessible by multinational enterprises. Viewed against a wider canvass, investment arbitration emerges as a governing

[163] *Tokios*, *supra* note 150, para. 21 and 38 (allowing an ICSID claim against the Ukraine by a Lithuanian company that was 99% owned by Ukranian nationals who also comprised 2/3 of the company's management).

[164] E.g. Economic Commission for Latin America and the Caribbean (ECLAC), *Foreign Investment in Latin America and the Caribbean, 2003*, UN Doc. E/04/II/G.54 (2004), 13 (noting continued transnationalization in Latin America, reflected by the growth and concentration of ownership by foreign investors; in 2000-2002, TNCs accounted for 55% of the top 100 manufacturing firms' sales and 37% of the 100 largest banks' assets in the region).

[165] *Waste Management No. 2* (Merits), *supra* note 55, 78-9 (dismissing Mexico's submission that local government entities in Mexico were unaware of the claimant's corporate structure – including the use of holding companies in the Cayman Islands – and that the claimant therefore failed to satisfy the NAFTA definition of "investor"). McLachlan, *supra* note 33, 341; UNCTAD, *supra* note 140, 37.

[166] Peter, *supra* note 3, 17; UNCTAD, *World Investment Report 2004* (Geneva: United Nations, 2004), 238, note 15; G. Xiao, "People's Republic of China's Round-Tripping FDI: Scale, Causes and Implications", Asian Development Bank Institute Discussion Paper No. 6 (ADB, 2004), 2.

[167] E.g. *Fedax N.V.* v. *Republic of Venezuela* (Jurisdiction) (11 July 1997), 37 I.L.M. 1378, 5 ICSID Rep. 186, para. 18 and 24; *Tradex Hellas S.A.* v. *Republic of Albania* (Merits) (29 April 1999), 14 ICSID Rev. 161, para. 109; *Ceskoslovenska Obchodni Banka* v. *Slovak Republic* (Jurisdiction) (24 May 1999), 14 ICSID Rev. 251, para. 78; *Tokios*, *supra* note 150, para. 80-2.

arrangement that applies generally to the regulatory relationship between states and multinational enterprises.

E. Individual claims and investor rights

Earlier in this chapter, the far-reaching individualization of claims under investment treaties was compared to the more limited individualization of claims under human rights treaties. In fact, the individualization of international adjudication has prompted some commentators to regard investment arbitration as itself creating investor rights. In particular, commentators and arbitrators have endorsed this view by comparing investment treaties to the *European Convention on Human Rights* and to international human rights instruments.[168] The investor rights view is connected to the broader argument that recent developments in international economic law, at the European Union and the WTO, have established property and economic rights for individuals so as to advance freedom and prosperity in a liberal international society.[169] This view is contested in the context of investment treaties, as well as the European Union and the WTO.[170]

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[168] E.g. *Mondev*, *supra* note 55, para. 143-4 (citing decisions of the European Court of Human Rights under Article 6(1) of the *European Convention on Human Rights* as providing "guidance by analogy as to the possible scope of NAFTA's guarantee" under Article 1105). See also *S.D. Myers*, *supra* note 87 (Merits – Separate Opinion of B. Schwartz), para. 229; *Tecmed*, *supra* note 84, para. 122; *Azurix*, *supra* note 75, para. 72; *CMS*, *supra* note 56, para. 45; *Siemens*, *supra* note 71, para. 141. R. Lillich, "The Law Governing Disputes Under Economic Development Agreements: Re-examining the Concept of 'Internationalization'" in R. Lillich and C.N. Brower, *International Arbitration in the 21st Century: Towards Judicialization and Uniformity?* (Ardsley, N.Y.: Transnational Publishers, 1994), 67-8; Wälde, *supra* note 1, 434-6 and 444; C.H. Brower II, "Investor-State Disputes Under NAFTA: The Empire Strikes Back" (2001) 40 Colum. J. Transnat'l L. 43, 87-8; C.H. Brower II, "NAFTA's Investment Chapter: Initial Thoughts About Second-Generation Rights" (2003) 36 Vanderbilt J. Transnat'l L. 1533, 1546-8; Alvarez and Park, *supra* note 144, 394; J.P. Trachtman & P.M. Moreman, "Costs and Benefits of Private Participation in WTO Dispute Settlement: Whose Rights Is It Anyway?" (2003) 44 Harv. Int'l L.J. 221, 225; O. Spiermann, "Individual Rights, State Interests and the Power to Waive ICSID Jurisdiction under Bilateral Investment Treaties" (2004) 20 Arb. Int'l 179, 187.

[169] E. Sik, "Concept of Acquired Rights in International Law" (1977) 44 Neth. Int'l L.R. 120, 127-9; Lillich, ibid., 112-13; T. Cottier, "Trade and Human Rights: A Relationship to Discover" (2002) 5 J. Int'l Econ. L. 111, 114-5 and 129-31; E.U. Petersmann, "Taking Human Dignity, Poverty and Empowerment of Individuals More Seriously: Rejoinder to Alston" (2002) 13 Eur. J. Int'l L. 845, 850.

[170] Fatouros, *supra* note 86, 372-3; M. Sornarajah, "Power and Justice in Foreign Investment Arbitration" (1997) 14 J. Int'l Arb. 103, 133; P. Alston, "Resisting the Merger and

To an extent, the use of the language of rights to describe investor claims is an unsurprising outcome of far-reaching individualization, as well as the common tendency to highlight the threats to individuals that originate in state activity, instead of the privileges and benefits.[171] But, to speak of investment treaties as creating investor rights is misleading and ultimately inconsistent with the idea of a human right. Of course, if one defines a "right" as simply a legally enforceable claim,[172] then international standards which are enforceable through investment arbitration clearly pass muster. No international standard that protects individuals would be as enforceable, and thus as obviously a right, as standards that investment treaties adopt to protect investors. On this basis, investment treaties establish individual rights at the international level, although those rights may be limited by the instrumental purposes of the states that conferred them.[173] Even so, the investor rights view goes farther than this by arguing that investment treaties establish more than simply an enforceable claim. Investor rights are given a normative content, consistent with the idea of a human right, in that they are used to enhance the legitimacy of investment arbitration tribunals and to support an interpretive presumption in favour of investor protection.[174] In the result, this view serves to exaggerate the importance of investor interests in investment arbitration.

Acquisition of Human Rights by Trade Law: A Reply to Petersmann" (2002) 13 Eur. J. Int'l L. 815; Afilalo, *supra* note 1, 31-43; P. Juillard, "Freedom of Establishment, Freedom of Capital Movements, and Freedom of Investment" (2000) 15 ICSID Rev. 322, 326-9; D.Z. Cass, *The Constitutionalization of the World Trade Organization* (Oxford: OUP, forthcoming 2005), c. 5.

[171] E.g. M.S. McDougal, H.D. Lasswell, and L. Chen, "The Protection of Aliens From Discrimination and World Public Order: Responsibility of States Conjoined with Human Rights" (1976) 70 AJIL 432, 435-6; P. Allott, "State Responsibility and the Unmaking of International Law" (1988) 29 Harv. Int'l L.J. 1, 14-16. See generally M.M. Carrow, *The Background of Administrative Law* (Newark: Associated Lawyers, 1948), 20-1; P. McAuslan, "Administrative Law, Collective Consumption, and Judicial Policy" (1983) 46 Mod. L.R. 1, 11-12; G. Huscroft, "Rights, Bills of Rights, and the Role of Courts and Legislatures" in G. Huscroft and P. Rishworth, eds., *Litigating Rights* (Oxford: Hart, 2002), 4-5; Bodansky and Crook, *supra* note 95, 775; Kingsbury, Krisch, and Stewart, *supra* note 59, 32-3.

[172] E.g. *ICSID Convention Report*, *supra* note 31, para. 26 (commenting that a "legal dispute", for the purposes of the *ICSID Convention*, concerns "the existence or scope of a legal right or obligation, or the nature or extent of the reparation to be made for breach of a legal obligation").

[173] *UPS*, *supra* note 87, para. 80; *SGS Société Générale de Surveillance* v. *Philippines* (Jurisdiction) (29 January 2004), 16(3) World Trade and Arb. Mat. 91, para. 154.

[174] An obvious parallel is to the liberal interpretation of human rights in favour of the protection of individuals: Human Rights Committee, *General Comment 24 on Reservations to the*

In the first place, although investment treaties contain standards that constrain states in order to protect investors and that identify governmental actions which may require the payment of compensation, they do not use rights-affirming language to describe those standards.[175] Thus, NAFTA Chapter 11 is not called a Bill of Investor Rights. In contrast, human rights instruments usually explicitly state that individuals have "rights" under the treaty.[176] This extends to rights of foreign nationals. For instance, the *Declaration on the Human Rights of Individuals Who are not Nationals of the Country in which They Live* refers to rights of persons living in states of which they are not nationals, including the right to life and security of the person, the right to equality before the courts, and the right to own property.[177] The omission of such language from investment treaties suggests that they were not intended to establish investor rights.[178] Instead, investment arbitration can be seen as a mechanism to enforce standards governing the exercise of public authority. Consistent with an inter-state bargain to allow private enforcement of the treaty through investor claims, the investor is akin to a private attorney general, rather than the victim of a rights violation.[179]

More importantly, there is an important difference between a formal legal right and a human or fundamental right.[180] Human rights are universal in that they protect all persons by the nature of the human condition and our common entitlement to dignity and, as such, they are given higher recognition by the community. As such, human rights treaties typically protect all persons from the prohibited exercise of

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International Covenant on Civil and Political Rights (1994), (1995) 15 H.R.L.J. 464, 2 I.H.R.R. 10, para. 10-11 and 17. See Huscroft, *supra* note 171, 3-4; Nollkaemper, *supra* note 99, 630-1.

[175] *Courts of Danzig*, *supra* note 80, 17-19; *Lagrand*, *supra* note 80, para. 77-8; *Construction of a Wall*, *supra* note 80, para. 126-31, 134, and 137. McDougal, Lasswell, and Chen, *supra* note 171, 460-4; M. Koskenniemi, "What Is International Law For?" in M.D. Evans, ed., *International Law* (Oxford: OUP, 2004), 106.

[176] E.g. *Construction of a Wall*, *supra* note 80, para. 126-31.

[177] *Declaration on the Human Rights of Individuals Who are not Nationals of the Country in which They Live*, GA Res. 40/144, UN GAOR, 40th Sess., Supp. 53, UN Doc. A/40/53 (1985) 252, art. 5.

[178] M. Sornarajah, *The Pursuit of Nationalized Property* (Dordrecht: Martinus Nijhoff, 1986), 31-2; Juillard, *supra* note 184, 338 and 329.

[179] C. Tollefson, "Metalclad v. United Mexican States Revisited: Judicial Oversight of NAFTA's Chapter Eleven Investor-State Claim Process" (2002) 11 Minn. J. Global Trade 183, 203-5; Wälde, *supra* note 1, 435-6 and 444; J.H.H. Weiler, *supra* note 91, 172.

[180] P.P. Craig, "Once Upon a Time in the West: Direct Effect and the Federalization of EEC Law" (1992) 12 Ox. J. Legal Studies 453, 453-8; Weir, *supra* note 40, 419-20 and 445-6; J. Allan, "Rights, Paternalism, Constitutions and Judges" in G. Huscroft and P. Rishworth, eds., *Litigating Rights* (Oxford: Hart, 2002), 34-5.

public authority.[181] Likewise, rights-based systems of state liability are by definition open to any individual.[182] Investor rights, on the other hand, are restricted to those individuals who own sufficient foreign assets to make an investor claim and, in most cases, investors are multinational enterprises.[183] Protection under an investment treaty is limited to foreign nationals *who own investment*.[184] There is no protection for investors who are exclusively domestic or for foreign nationals who do not own foreign assets. Thus, a foreign-owned business whose profitability was reduced by state regulation could make a claim under an investment treaty, but a foreign natural person who was imprisoned, tortured, and then executed without trial could not. A natural person could call upon the *Declaration on the Human Rights of Individuals Who are not Nationals of the Country in which They Live*, for example, to protect himself or herself from abusive and arbitrary treatment by a state, but this declaration – like most human rights instruments – is not enforceable through international adjudication, let alone a damages award.[185]

All systems of individual rights can be criticized on the grounds that "the rich and powerful not only have more rights but also have the means to enforce them".[186] In investment arbitration, though, wealth is a legal as well as practical precondition for accessing investment arbitration. Moreover, the primary class of claimants under investment treaties are multinational enterprises, which can use holding companies to vary the content of the legal protections that they enjoy. Where the enjoyment and enforcement of a right is limited to large combinations of capital, it is difficult to characterize the right as universal given that the great majority of the world population does not have enough wealth to ever contemplate making a claim. More than anything, it is this selectivity of formal access to investment arbitration that undermines the investor rights view.

[181] Shelton, *supra* note 36, 39-40.
[182] Eagleton, *supra* note 7, 139-141; Harlow (1996), *supra* note 104, 204-15.
[183] The cost of an investor claim typically includes not only legal fees but also 50 percent of the fees of the arbitrators as well as administrative fees charged by the arbitration institution (e.g. ICSID charges (U.S.) $7,000 to file a claim). In NAFTA Chapter 11 awards to date, where these arbitration costs were reported by the tribunal, they averaged roughly (U.S.) $1,540,000 per claim.
[184] J.E. Alvarez, "Critical Theory and the North American Free Trade Agreement's Chapter Eleven" (1997) 28 Inter-Am. L.R. 303, 304-5 and 307-8.
[185] *Supra* note 44.
[186] J.A.G. Griffith, "The Brave New World of Sir John Laws" (2000) 63 Mod. L.R. 159, 172-3.

As a human rights system, investment arbitration would establish the right to property and freedom of contract as uniquely actionable human rights, and then only by those with sufficient resources to finance the adjudication.[187] As such, investor rights – as property and economic rights – would conflict with other human rights that depend on action by the state and on the regulation of property and commerce for their realization.[188] In human rights treaties, rights to property and contract are always subject to exceptions relating to the public welfare.[189] If investment treaties are human rights treaties, they appear to contradict the principles of universality and balancing of human rights.[190] For this reason, investor rights conflict with the idea of a human right.

Investment arbitration originates, not in a movement to establish investor rights, but in governmental decision-making. The general consent represents a policy choice in favour of prioritizing to the interests of foreign investors over those of other individuals, by excluding individuals who are not foreign investors from the right to seek damages for harm caused by the exercise of public authority or, indeed, the state's failure to regulate investors.[191] Allowing enforceable international claims by multinational enterprises constrains and deters governmental action that would otherwise benefit other individuals and groups. This includes governmental action to protect human rights – including civil-political rights (e.g. freedom of expression), socio-economic rights (e.g. labour rights), or group rights (e.g. environmental rights) – all of which may require the exercise of public authority for their realization. Governmental action to protect human rights, if found to have violated an investment treaty, might very well generate a damages award against the state.[192]

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[187] Sornarajah, *supra* note 178, 31; J.E. Stiglitz, "The Broken Promise of NAFTA" *The New York Times* (6 January 2004).
[188] Cohen and Smith, *supra* note 82, 12; E. Drake et al., "The Multilateral Agreement on Investment: A Step Backward in International Human Rights" (Report for the Human Rights Clinical Project Program, Harvard Law School, undated); Bachand and Rousseau, *supra* note 36, 18-19; Koskenniemi, *supra* note 175, 109-10.
[189] E.g. *Universal Declaration of Human Rights*, GA Res. 217A (III), UN GAOR, 3rd Sess., Part I, UN Doc. A/810 (1948) 71, art. 17 and 29.
[190] M. DeMerieux, "Deriving Environmental Rights from the European Convention Protecting Human Rights and Fundamental Freedoms" (2001) 21 Ox. J. Legal Studies 521, 539-42.
[191] See Baldwin and McCrudden, *supra* note 63, 65.
[192] E.g. the NAFTA states entered reservations to NAFTA Chapter 11 for future state measures that provide rights or preferences to aboriginal peoples or to socially or

Given that investment treaties do not usually contain human rights exceptions, they prioritize investor interests over the rights of other individuals or groups who are represented by the state in the international sphere and who rely on the state, not only to promote investment, but also to protect them against abuses by multinational enterprises.[193] This prioritization is best understood in terms of government policy, not human rights.

It is ironic that the investor rights thesis is advanced not only by supporters but also by ardent critics of investment arbitration.[194] The position of the former is addressed above. In terms of the critics, the argument that investment treaties create investor rights appears to be designed to emphasize how those treaties inordinately benefit big business. A difficulty with this criticism is that, in spite of its concern for popular sovereignty and democracy, it tends to sideline the role of states in establishing the system of investor arbitration. Large numbers of officials in dozens of countries were presumably not duped into abandoning the public interest when they signed investment treaties, even if awareness of the risks flowing from international obligations was slow to materialize. A less patronizing view is that governments approach investment treaties as instruments of development in light of the perceived benefits of foreign investment. Whether this is a prudent strategy is open to debate, but there is no doubt that foreign investment can provide benefits as well as costs for a host economy.[195] More importantly, if the strategy fails, it can be changed, and the constraints imposed by investment arbitration on such change are over-stated.[196] Ultimately, the prospects for change lie in the political and economic circumstances of globalization, rather than a somewhat obscure system of international adjudication.

economically disadvantaged minorities: NAFTA, *supra* note 1, annex 2. Most investment treaties do not contain express reservations of this sort.

[193] See Griffith, *supra* note 186, 173; Bachand and Rousseau, *supra* note 36, 25.

[194] S. Gill, "Globalization, Market Civilisation and Disciplinary Neo-Liberalism" (1995) 24 Millenium 399, 413; Alvarez, *supra* note 198; C. Tollefson, "Games without Frontiers: Claims and Citizen Submissions Under the NAFTA Regime" (2002) 27 Yale J. Int'l L. 141, 151.

[195] UNCTAD, *World Investment Report 2003* (Geneva: United Nations, 2003), 139, note 21.

[196] E.g. S. Clarkson, "Systemic or Surgical? Possible Cures for NAFTA's Investor-State Dispute Process" (2002) 36 Can. Bus. L.J. 368, 373-81. While investment treaties clearly establish lasting obligations, it cannot be said that they are immutable since states retain the option to withdraw from the treaty. Also, the states parties to an investment treaty may together amend the treaty or, under the threat of abrogation, one state party could seek to re-negotiate the treaty: Wälde, *supra* note 1, 463-4.

Whether adopted by champions or opponents of investment arbitration, the language of investor rights is more polemical than analytical.

Conclusion

Investment arbitration – based on the general consent – is a novel and significant development because of the far-reaching individualization that it entails. For one, investment treaties are distinct from historical claims commissions in which international claims were made on behalf of individuals because investment treaties contain a prospective consent by the state to the arbitration of future disputes between the state and foreign investors. Also, the individualization of international claims under investment treaties is more far-reaching than under other treaties that authorize individual claims, such as human rights treaties, because investment treaties typically limit the investor's duty to exhaust local remedies, adopt damages against the state as the main remedy, and authorize the direct enforcement of damages awards by domestic courts in a large number of countries. Individualization based on the general consent intensifies the application of international standards in the regulatory sphere, making the analytical framework of public law more relevant to international adjudication. Further, individualization transforms a reciprocal legal relationship between states into a regulatory relationship between the state and an individual who is subject to the exercise of public authority. This transformation is the genesis of investment arbitration as a governing arrangement.

The emergence of investment arbitration as a governing arrangement flows from policy decisions by states to prioritize the protection of foreign investors. Under investment treaties, states assume obligations amongst themselves which give investors the ability to claim for damages for violations of treaty-based standards of investor protection. The obligations of one state under the treaty correspond to rights of another.[197] Further, these obligations establish standards which regulate states in order to protect investors.[198] Like other individuals, foreign investors are affected by

[197] Toope, *supra* note 96, 388-9; J.C. Thomas, "A Reply to Professor Brower" (2002) 40 Col. J. Transnat'l L. 433, 460.
[198] *Ecuador* v. *Occidental Petroleum*, *supra* note 84, para. 61. Kingsbury, Krisch, and Stewart, *supra* note 59, 11.

the treaty; however, foreign investors also occupy a privileged position as beneficiaries of the treaty. Even so, as claimants, investors are private parties and the ability to seek damages for a violation of international law – viewed as a legal right[199] – remains a *treaty-based* right. As such, the individualization of claims under investment treaties does not alter the nature of investment arbitration as a governing arrangement because individualization itself depends on the exercise of public authority by the state.

[199] R. Bruno and J.H.H. Weiler, "Access of Private Parties to International Dispute Settlement: A Comparative Analysis", Harvard Jean Monnet Working Paper No. 13/97 (NYU School of Law, 1997).

Chapter Four

Scope and Substance

All treaties constrain states one way or another, and many treaties subject disputes about the meaning of the treaty to compulsory international adjudication.[1] The uniqueness of investment treaties is that they allow investors to make international claims for damages based on a private model of adjudication. However, the extent to which investor claims, damages awards, and the use of a private adjudicative model actually affect governmental decision-making depends on the breadth of the jurisdiction of arbitration tribunals and the content of the standards that govern states in their treatment of investors.[2] Outlining the scope of investment arbitration and the content of the substantive standards[3] of investor protection reveals how investment arbitration controls the exercise of public authority, and its broader significance as a governing arrangement.

In the great majority of investment treaties, the scope of investment arbitration is expansive. Tribunals are authorized to determine their own jurisdiction and jurisdictional concepts – such as "state measure" and "investment" – tend to be defined broadly. Further, the standards by which governmental decision-making is evaluated are drafted in broad language. As a result, investors can bring claims challenging a very wide range of governmental activity.

In this chapter, NAFTA Chapter 11 is used as a case study to examine the language that is used to define concepts relating to the scope and substance of investment arbitration and the extent of its implications for government. NAFTA Chapter 11 is representative of contemporary investment treaties because it contains broadly-framed standards which apply in relation to a wide range of governmental

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[1] G. Marceau and J.P. Trachtman, "The Technical Barriers to Trade Agreement, the Sanitary and Phytosanitary Measures Agreement, and the General Agreement On Tariffs and Trade" (2002) 36 J. World Trade 811, 811.

[2] UNCTAD, *Scope and Definition*, UNCTAD Series on Issues in International Investment Agreements (New York: United Nations, 1999).

[3] The term "standards" rather than "rules" is used to refer to the substantive obligations that states assume in investment treaties in order to reflect the level of generality at which those obligations are expressed. D. Kennedy, "Form and Substance in Private Law Adjudication" (1976) 89 Harv. L. Rev. 1685, 1687-1701; J.P. Trachtman, "The Domain of WTO Dispute Resolution" (1999) 40 Harv. Int'l L.J. 333, 334.

acts and to virtually any investor asset. Nevertheless, there are important variations in the language and structure of different treaties and, as such, the use of NAFTA as a case study is intended to support a broader argument about the character of investment arbitration as a governing arrangement, and not to establish micro findings that apply to all investment treaties in every case.

A. The scope of investment arbitration

The *scope* of investment arbitration encompasses all of the issues that are subject to regulation by the system and that fall within the discretion of investment arbitration tribunals. Thus, the scope of investment arbitration reflects the degree to which adjudicative authority over regulatory disputes is shifted from domestic courts to international arbitrators. In this section, the scope of investment arbitration is explored by examining two key jurisdictional concepts under NAFTA Chapter 11.[4] First, the term "state measure" is reviewed in order to show that a wide range of sovereign acts of the state are subject to challenge and review through investment arbitration. Second, the breadth of the term "investment" is examined to demonstrate that state measures affecting a wide range of economic activity are subject to review. The definition of these concepts in an investment treaty reveals that the main subject of investment arbitration is disputes within the regulatory sphere.

1. State measures

A general consent to the compulsory arbitration of future disputes with investors binds the state in relation to sovereign acts, as opposed to merely private or commercial acts. Typically, investment treaties apply to virtually any sovereign act of

[4] These are not the only aspects of jurisdiction under NAFTA Chapter 11 or other investment treaties. In chapter three of this thesis, it was argued that the concept of "investor" – a jurisdictional concept – is often broad enough to open investment arbitration to multinational enterprises that organize their ownership of assets through an international structure of holding companies. Also, a tribunal's characterization of the treaty's substantive standards of investor protection may be treated as a matter of jurisdiction: *United Parcel Service of America, Inc.* v. *Government of Canada* (Jurisdiction) (22 November 2002) [hereinafter *UPS*], para. 37, online: ITA http://ita.law.uvic.ca/documents/UPS-Jurisdiction.pdf.

the state, including acts of the legislature, the executive, and the judiciary, and to acts of both national and sub-national entities. In the case of NAFTA Chapter 11, the treaty applies to "state measures" which include "any law, regulation, procedure, requirement or practice" of the states parties.[5] As such, Chapter 11 constrains all branches of government, and all levels of government by imputing responsibility for the conduct of sub-national governments to the state as a whole.[6]

Because Chapter 11 tribunals are authorized to award damages to remedy a breach of the treaty, the broad definition of state measures has significant implications for rules of state liability under domestic public law.[7] Take the principle of parliamentary sovereignty (or ultimate authority of the legislature) for example.[8] Under the domestic law of most states, legislative decisions are supreme in law, but for any constraints imposed by the constitution as interpreted by domestic courts.[9] Generally, the courts only award damages against the state for legislative acts in rare

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[5] *North American Free Trade Agreement*, 17 December 1992, 32 I.L.M. 296 and 605 (entered into force 1 January 1994) [hereinafter NAFTA], art. 201(1). See *Ethyl Corporation* v. *Government of Canada* (Jurisdiction) (24 June 1998), 38 I.L.M. 708 [hereinafter *Ethyl*], para. 65; *Waste Management, Inc.* v. *United Mexican States* (Jurisdiction) (2 June 2000), 40 I.L.M. 56 [hereinafter *Waste Management No. 1*], para. 11-14 (dissenting opinion); *Methanex Corporation* v. *United States of America* (Jurisdiction) (7 August 2002), 14(6) World Trade and Arb. Mat. 109 [hereinafter *Methanex*], para. 25-32; *ADF Group Inc.* v. *United States of America* (Merits) (9 January 2003), 15(3) World Trade and Arb. Mat. 55 [hereinafter *ADF*], para. 56-9; *The Loewen Group, Inc. and Raymond L. Loewen* v. *United States of America* (Merits) (26 June 2003), 42 I.L.M. 811, 15(5) World Trade and Arb. Mat. 97 [hereinafter *Loewen*], para. 39-40 and 218; *Waste Management Inc.* v. *United Mexican States* (Merits) (30 April 2004), 43 I.L.M. 967, 16(4) World Trade and Arb. Mat. 3 [hereinafter *Waste Management No. 2*], para. 174.

[6] NAFTA, ibid., art. 105 (providing that the states parties shall "ensure that all necessary measures are taken" to give effect to the treaty, including its observance by sub-national governments, subject to exceptions for certain sub-national measures). See *Metalclad Corporation* v. *United Mexican States* (Merits) (30 August 2000), 40 I.L.M. 36, 13(1) World Trade and Arb. Mat. 45 [hereinafter *Metalclad*], para. 73; *ADF*, ibid., para. 164-5; *Loewen*, ibid., para. 40, 53, and 123. M.A. Luz, "NAFTA, Investment and the Constitution of Canada: Will the Watertight Compartments Spring a Leak" (2001) 32 Ottawa L.R. 35, 84; R.G. Dearden, "Arbitration of Expropriation Disputes between an Investor and the State under the North American Free Trade Agreement" (1995) 29 J. World Trade 113, 121.

[7] See chapter three of this thesis, page 91-3.

[8] F. Pollock, "Sovereignty in English Law" (1894) 8 Harv. L.R. 243, 243-4; A.V. Dicey, *An Introduction to the Study of the Law of the Constitution* [1885] (London: Macmillan, 8th ed. 1915), 3-4 and 36-9; A.W. Bradley, K.D. Ewing, and E.C.S. Wade, *Constitutional and Administrative Law*, 11th ed. (1993), 69; J. Goldsworthy, *The Sovereignty of Parliament* (Oxford: Clarendon, 1999), 1-2.

[9] E.g. *Authorson (Litigation Guardian of)* v. *Canada (Attorney General)*, [2003] 2 S.C.R. 40, 227 D.L.R. (4th) 385, para. 48-57. Dicey, ibid., 4, 18-19, 68-72, and 103; M.T. Ahmedouamar, "The Liability of the Government in France as a Consequence of its Legal Activities" (1983) 11 Int'l J. Legal Info. 1, 5.

cases.[10] However, under Chapter 11, a legislative decision falls within the definition of a state measure and, as such, it is subject to compulsory investment arbitration. Chapter 11 tribunals are authorized to review the passage, amendment, or repeal of any law (or any "regulation, procedure, requirement or practice" of the legislature) for its consistency with the NAFTA standards of investor protection, and they may award damages where the legislature is found to have acted unlawfully.[11] The state cannot plead that its acts were justified under domestic law because by concluding NAFTA the state consented to investment arbitration subject to international law.[12] Thus, the principle of parliamentary sovereignty is modified by the treaty to the extent that the treaty requires legislatures to pass muster before an international tribunal.

There is nothing startling about this from the perspective of international law. The principle of the unity of the state – consistent with the representative role of the state in the international sphere – requires the state to be responsible for the acts of its constituent elements, regardless of how public authority is divided under domestic law. A basic principle of state responsibility under international law is that a state cannot rely on its domestic law and governing structure to avoid an international obligation.[13] What is unusual about investment arbitration is that it prompts the application of these principles in the context of a *regulatory* dispute as opposed to a dispute between states or between private parties. In effect, the individualization of international claims means that, in assuming treaty obligations to other states, the state also makes a *de facto* commitment to any individual who can make a claim under

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[10] J. Mashaw, R. Merrill, and P. Shane, *Administrative Law: The American Public Law System, Cases and Materials*, 3rd ed. (West Publishing, 1992), 992; D. Mullan, "Damages for Violation of Constitutional Rights – A False Spring?" (1995) 6 Nat'l J. Constitutional Law 105, 126; C. Harlow, "Francovich and the Problem of the Disobedient State" (1996) 2 Eur. L.J. 199, 213.
[11] E.g. *Ethyl*, *supra* note 5, para. 65.
[12] E.g. *Mondev International Ltd.* v. *United States of America* (Merits) (11 October 2002), 42 I.L.M. 85, 15(3) World Trade and Arb. Mat. 273 [hereinafter *Mondev*], para. 154 (a local authority's immunity from suit for interference with contractual relations, under domestic law, does not protect a state from NAFTA Chapter 11 claims because NAFTA has its own remedy of investment arbitration to which no local statutory immunity would apply); *Marvin Roy Feldman Karpa* v. *United Mexican States* (Merits) (16 December 2002), 15(3) World Trade and Arb. Mat. 157 [hereinafter *Feldman*], para. 78.
[13] *Vienna Convention on the Law of Treaties*, 22 May 1969, 1155 U.N.T.S. 331 (entered into force 27 January 1980), art. 27. *CMS Gas Transmission Company* v. *The Republic of Argentina* (Jurisdiction) (17 July 2003), 42 I.L.M. 788, para. 108. International Law Commission, "Draft Articles on Responsibility of States for Internationally Wrongful Acts", *Report of the International Law Commission on the Work of Its Fifty-third Session*, UN GAOR, 56th Sess., Supp. No. 10, Annex, UN Doc. A/56/10 (2001), 43 [hereinafter *ILC Draft Articles*], art. 3 and 4.

the treaty. Applied as part of a reciprocal obligation between states, the principle of the unity of the state permits states to make commitments to each other by acting as distinct units in the international sphere.[14] On the other hand, in the context of obligations undertaken by the state in relation to investors, the principle overrides a central feature of modern democracy: legislative supremacy. As such, by allowing individuals to make international claims, investment treaties transform the principle of the unity of the state, from a principle that facilitates inter-state bargains, into one that trumps a domestic rule that would otherwise preclude state liability in the regulatory sphere.

Investment arbitration tribunals apply treaty standards that constrain sovereign acts of a state's legislature, judiciary, and administration.[15] The passage or amendment of legislation is clearly a sovereign act; legislation cannot be enacted by a private party (acting in a private capacity).[16] Likewise, both the adjudication of disputes by a domestic court and governmental decision-making by the administration are inherently sovereign in nature. Because investment treaties apply to sovereign acts, they authorize tribunals to assume jurisdiction over regulatory disputes. By definition, a dispute between the state and an investor that arises from a sovereign act of the state is a regulatory dispute, not a private or commercial dispute. This does not mean that the jurisdiction of arbitration tribunals is unlimited; for example, an investor must still establish that the relevant dispute arises from an investment.[17] Nevertheless,

[14] T.J. Lawrence, *The Principles of International Law* (London: Macmillan and Co., 1923), 51.

[15] Some investment treaties authorize compulsory investment arbitration only in relation to disputes arising from investment contracts between the state and investors. In such cases, it is debatable whether the state acts in a private or in a sovereign capacity by participating in investment arbitration. If the state acted in a private capacity when it assumed contractual obligations to the investor, then it may be said that the state is acting in a private capacity in the treaty-based arbitration of a dispute arising from the contract. Alternatively, because the state acts in a sovereign capacity when it consents generally to compulsory international arbitration under a treaty, it may be said that the state is acting in a sovereign capacity in an arbitration that is authorized by the treaty. This issue highlights a gray area in the extent to which the treaty-based arbitration of disputes arising from a contract engages regulatory disputes in the public sphere (as opposed to commercial disputes in the private sphere). It is unnecessary to resolve the issue here given that so many investment disputes clearly arise from sovereign acts of the state.

[16] See generally C. Harlow and R. Rawlings, *Law and Administration* (London: Butterworths, 1997), 605; M. Loughlin, *The Idea of Public Law* (Oxford: OUP, 2003), 80.

[17] *S.D. Myers, Inc.* v. *Government of Canada* (Merits) (12 November 2000), 40 I.L.M. 1408, 15(1) World Trade and Arb. Mat. 184, para. 222-31; *UPS*, *supra* note 4, para. 118-21; *Mondev*, *supra* note 12, 49-50 and 79-80; *ADF*, *supra* note 5, para. 152-4.

because they require the state to arbitrate disputes arising from sovereign acts, investment treaties establish investment arbitration as a governing arrangement to control the exercise of public authority, as opposed to a consensual method of adjudication between private parties.[18]

2. Investment

Investment treaties limit the jurisdiction of tribunals to disputes that arise from "investment".[19] However, the term investment is usually defined broadly so as to encompass a wide range of economic activity, including economic activity that is not covered by other international trade agreements or by conventional notions of foreign direct investment.[20] The employment of a broad definition of investment means that the arbitration of investment disputes under investment treaties typically involves the arbitration of regulatory disputes.

In conventional trade law, the main subject of regulation was trade in "goods".[21] In this context, international standards applied to state measures that affected tangible products with distinct physical characteristics.[22] As a result, trade rules could be defined in relation to state measures that affected the movement of identifiable tangible products, normally when they crossed a border.[23] This led to a system of trade regulation that was based on elaborate systems of product

[18] B. Kingsbury, N. Krisch, and R. Stewart, "The Emergence of Global Administrative Law" (International Law and Justice Working Paper 2004/1, Institute for International Law and Justice, New York University School of Law, 2004), 22-3.
[19] UNCTAD, *World Investment Report 1996* (Geneva: United Nations, 1997), 173-4; UNCTAD, *supra* note 2, 15-23.
[20] *Feldman*, supra note 12, para. 96; *Fedax N.V.* v. *Republic of Venezuela* (Jurisdiction) (11 July 1997), 37 I.L.M. 1378, 5 ICSID Rep. 186, para. 24; *CMS*, *supra* note 13, para. 52. R. Dolzer and M. Stevens, *Bilateral Investment Treaties* (The Hague: Martinus Nijhoff, 1995), 26; J. Paulsson, "Arbitration without Privity" (1995) 10 ICSID Rev. 232, 238-9; P. Juillard, "MAI: A European View" (1998) 31 Cornell Int'l L.J. 477, 483; C.M. Correa, "Bilateral Investment Agreements: Agents of New Global Standards for the Protection of Intellectual Property Rights?" (Report for GRAIN, August 2004), 6-7.
[21] M.J. Trebilcock and R. Howse, *The Regulation of International Trade* (London: Routledge, 1995), 21 and 25-6.
[22] J.H. Dalhuisen, *Dalhuisen on International Commercial, Financial and Trade Law* (Oxford: Hart, 2000), 351.
[23] L. Ehring, "De Facto Discrimination in WTO Law: National and Most-Favored-Nation Treatment – or Equal Treatment?", Jean Monnet Working Paper No. 12/01 (NYU School of Law, 2001), 1.

classification as well as detailed lists of permissible tariffs and quotas with respect to different categories of products. Over time, states expanded the rules to encompass measures that had the equivalent effect of a tariff or quota and this complicated the matter.[24] Even so, the standards remained connected to cross-border movements of tangible products and thus relatively definable.

Identifying an "investment" is more difficult. Goods are products; investment is a concept.[25] Investment involves decisions, acts, and motives: the contribution of capital to a business venture for profit or return (for example).[26] Also, cross-border investment takes place within a broader environment than the mere movement of tangible things. Walker comments that investment is "a process inextricably woven into the fabric of human affairs generally" and that it is "inadequately dealt with unless set in the total 'climate' in which it is to exist".[27] Thus, a system that controls the exercise of public authority over investment has the potential to impact on a much wider range of economic activity than a system that regulates trade in goods.[28]

Indeed, if the term investment is not narrowly defined using precise language from the start, it has the potential to encompass an extremely wide range of economic activity.[29] Take the example of water.[30] Water could be classified as a good or product that moves across borders; i.e. as bottled water or bulk water. In this case, state

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[24] Trebilcock and Howse, *supra* note 21, 21 and 31-3; J.H. Jackson, *The World Trading System*, 2d ed. (Cambridge, Mass.: MIT Press, 1997), 49-50; J.H.H. Weiler, "Epilogue: Towards a Common Law of International Trade" in J.H.H. Weiler, ed., *The EU, the WTO, and the NAFTA* (Oxford: OUP, 2000), 201 and 205-6.

[25] W. Peter, *Arbitration and Renegotiation of International Investment Agreements* (The Hague: Kluwer Law International, 1995), 18-19.

[26] M. Daly, "Some Taxing Questions for the Multilateral Agreement on Investment (MAI)" (1997) 20 World Economy 787, 788.

[27] H. Walker, "Treaties for the Encouragement and Protection of Foreign Investment: Present United States Practice" (1956) 5 Am. J. Comp. L. 229, 244.

[28] B.B. Ramaiah, "Towards a Multilateral Framework on Investment" (1997) 6 Transn'l Corp. 117, 118-19; A. Afilalo, "Constitutionalization Through the Back Door: A European Perspective on NAFTA's Investment Chapter" (2001) 34 N.Y.U.J. Int'l L. & Pol. 1, 7; UNCTAD, *World Investment Report 2003* (Geneva: United Nations, 2003), 99-101.

[29] A. Landsmeer, "Movement of Capital and Other Freedoms" (2001) 28 Legal Issues of Econ. Integration 57, 67-9.

[30] International Joint Commission, *Protection of the Waters of the Great Lakes – Final Report to the Governments of Canada and the United States* (IJC, February 2002); P.H. Gleick et al., "The New Economy of Water" (Report for the Pacific Institute for Studies in Development, Environment, and Security, 2002), 11-14; A. Ostrovsky, R. Speed, and E. Tuerk, "GATS, Water and the Environment" (Report for the Center for International Environmental Law and the World Wide Fund for Nature, 2003), 23-4.

measures that related to international trade in water as a good would be those that affected the movement of bottled or bulk water across borders. Likewise, investments that related to international trade in water *as a good* would be those in which capital is committed to an endeavour to move water across borders, for a return. The characterization of water as a good – and of investment as the commitment of capital to the trade of water as a good – narrows the range of economic activity that is affected by international standards.

However, by expanding the concept of water-related investment, it is possible to dramatically expand the scope of the economic (and regulatory) activity that is affected. Hydroelectricity, commercial shipping, the manufacture of goods, mining, agriculture: all involve the use of water as an economic activity and all are regulated by the state.[31] All involve the expenditure of capital and all are subject to regulation for reasons of resource management, pollution control, and public health. This reflects the nature of water as an essential resource. It also reveals the significance of applying international standards to water as a good, as an investment relating to a good, or as an investment in general.

The World Trade Organization agreements that impact on investment tend to limit the scope of the concept in significant ways. For example, the *Agreement on Trade-Related Investment Measures* applies only to investments that are themselves related to trade in goods; i.e. to cross-border movement of tangible products.[32] More broadly, the *General Agreement on Trade in Services* applies to "trade in services", including services that are supplied by a foreign company through a commercial presence in the jurisdiction of the consumer.[33] As such, the GATS applies to investments that are

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[31] Ostrovsky et al., ibid., 22.

[32] *Agreement on Trade-Related Aspects of Investment Measures*, 15 April 1994, art. 1, Annex IA of the *Agreement Establishing the World Trade Organization*, Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations (1994), 139; S. Dillon, *International Trade and Economic Law in the European Union* (Oxford: Hart, 2002), 101.

[33] *General Agreement on Trade in Services*, 15 April 1994, 33 I.L.M. 44 [hereinafter GATS], art. I(2) ("For the purposes of this Agreement, trade in services is defined as the supply of a service: ... (c) by a service supplier of one Member, through commercial presence in the territory of any other Member; ..."). WTO Secretariat, "An Introduction to the GATS" (October 1999), 3, online: WTO http://www.wto.org/english/tratop_e/serv_e/gsintr_e.doc; UNCTAD, *World Investment Report 2004* (Geneva: United Nations, 2004), 222-3.

connected to intangible products.[34] Even so, unlike investment treaties, the GATS is a bottom-up (or positive list) agreement under which states must expressly consent to the application of GATS standards in specific sectors and modes of supply.[35] If investment treaties were bottom-up treaties, like the GATS, then states could limit their commitments to particular sectors of investment and, where a state did not make express commitments in a sector, it would be assumed that the treaty did not apply.

However, investment treaties are top down (or negative list) agreements since states may not limit their obligations to specific sectors of economic activity. Instead, investment treaties apply generally to any form of investment that is not expressly excluded from the treaty. This makes the definition of investment vital to delineating the scope of the treaty and of investment arbitration. Over time, investment treaties have tended to expand the definition of investment so that it now covers a very wide range of economic and regulatory activity connected to foreign-owned or controlled assets.[36]

NAFTA Chapter 11 provides an example of a broad definition of "investment":[37]

> investment means:
>
> (a) an enterprise;
>
> (b) an equity security of an enterprise;
>
> (c) a debt security of an enterprise
>
> (i) where the enterprise is an affiliate of the investor, or

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[34] Dalhuisen, *supra* note 22, 351; UNCTAD, ibid., 145.

[35] The GATS is a bottom-up agreement because its most significant obligations only apply to those service sectors positively identified by the state party. UNCTAD, *supra* note 28, 148-9.

[36] Over time, the definition of investment in investment treaties has expanded to include e.g. "associated activities" of investment and short-term capital flows. J.E. Pattison "The United States-Egypt Bilateral Investment Treaty: A Prototype for Future Negotiations" (1983) 16 Cornell Int'l L.J. 305, 316-17; Dolzer and Stevens, *supra* note 20, 27-31; UNCTAD, *supra* note 28, 99-101.

[37] NAFTA, *supra* note 5, art. 1139. See *S.D. Myers* (Merits), *supra* note 17, para. 229-32; *Pope & Talbot Inc. v. Government of Canada* (Merits, Phase 1) (26 June 2000), 13(4) World Trade and Arb. Mat. 19 [hereinafter *Pope & Talbot*], para. 97-8; *Mondev*, *supra* note 12, 49-50 and 79-80; *ADF*, *supra* note 5, para. 152-4; *Feldman*, *supra* note 12, para. 96. See also e.g. *Energy Charter Treaty*, 17 December 1994, 35 I.L.M. 509, art. 1(5) and 1(6)(f).

(ii) where the original maturity of the debt security is at least three years,

but does not include a debt security, regardless of original maturity, of a state enterprise;

(d) a loan to an enterprise

(i) where the enterprise is an affiliate of the investor, or

(ii) where the original maturity of the debt security is at least three years,

but does not include a loan, regardless of original maturity, to a state enterprise;

(e) an interest in an enterprise that entitles the owner to share in income or profits of the enterprise;

(f) an interest in an enterprise that entitles the owner to share in the assets of that enterprise on dissolution, other than a debt security or a loan excluded from subparagraph (c) or (d);

(g) real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes; and

(h) interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory, such as under

(i) contracts involving the presence of an investor's property in the territory of the Party, including turnkey or construction contracts, or concessions, or

(ii) contracts where remuneration depends substantially on the production, revenues or profits of an enterprise;

but investment does not mean,

(i) claims to money that arise solely from

(i) commercial contracts for the sale of goods or services by a national or enterprise in the territory of a Party to an enterprise in the territory of another Party, or

(ii) the extension of credit in connection with a commercial transaction, such as trade financing, other than a loan covered by subparagraph (d); or

(iii) any other claims to money,

that do not involve the kinds of interests set out in subparagraphs (a) through (h).

This definition is central to the wide scope of investment arbitration under NAFTA. The definition is not limited to tangible property, as under the customary law of diplomatic protection, but includes "intangible [property] acquired in the expectation or used for the purpose of economic benefit or other business purposes".[38] The definition includes any asset that is legally or beneficially owned, directly or indirectly, by an investor, thus capturing interests beyond full and direct ownership.[39] The definition includes enterprises as well as interests in enterprises, thus capturing foreign-owned domestic companies including the interests of minority shareholders in those companies.[40] The definition includes rights and privileges granted by the state such as licenses, permits, and concessions as well as intellectual property rights.[41] Overall, although the definition contains notable exceptions (such as certain forms of commercial contracts), it is broadly-framed, reflecting a trend among investment treaties.

Moreover, the NAFTA definition is broader than conventional notions of foreign direct investment (FDI).[42] In economic analysis, FDI is generally defined as cross-border investment that involves control of foreign assets.[43] This distinguishes FDI from portfolio investment which involves the contribution of capital without

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[38] The inclusion of intangible property is significant because relevant customary standards of substantive international law evolved in the context of tangible property. For example, the customary minimum standard of treatment traditionally limited the scope of protected property rights to tangible assets: A.H. Roth, *The Minimum Standard of International Law Applied to Aliens* (Leiden, 1949), 185-6.

[39] B.A. Wortley, *Expropriation in Public International Law* (Cambridge: CUP, 1959), 11; B. Appleton, *Navigating NAFTA* (Scarborough: Carswell, 1994), 80-1.

[40] This overrides *Barcelona Traction* to the extent that that case bars claims of diplomatic protection on behalf of the foreign owner of a domestically-incorporated enterprise: *Barcelona Traction, Light and Power Co. (Belgium* v. *Spain)*, [1970] I.C.J. Rep. 3, 9 I.L.M. 227, para. 70 and 99-103. See *GAMI Investments, Inc.* v. *Government of the United Mexican States* (Merits) (15 November 2004), 17(2) World Trade and Arb. Mat. 127 [hereinafter *GAMI*], para. 29-30 and 38; *Emilio Agustín Maffezini* v. *The Kingdom of Spain* (Jurisdiction) (25 January 2000), 16 ICSID Rev. 212, 124 I.L.R. 9 [hereinafter *Maffezini*], para. 65; *Azurix Corp.* v. *The Argentine Republic* (Jurisdiction) (8 December 2003), 16(2) World Trade and Arb. Mat. 111, para. 60.

[41] G.R. Delaume, "ICSID Arbitration and the Courts" (1983) 77 AJIL 784, 795; Correa, *supra* note 20, 7-9; M.-F. Houde and K. Yannaca-Small, *Relationships between International Investment Agreements*, OECD Working Paper on International Investment No. 2004/1 (Organization for Economic Cooperation and Development, May 2004), 7.

[42] Peter, *supra* note 25, 17; Trebilcock and Howse, *supra* note 21, 274; P.T. Muchlinski, *Multinational Enterprises and the Law* (Oxford: Blackwell, 1999), 620.

[43] International Monetary Fund (IMF), *Foreign Direct Investment Statistics – How Countries Measure FDI* (IMF, 2001), 4 and 23.

foreign control or managerial influence. Economic statistics on investment distinguish between these two types of capital flows and analysis of the costs and benefits of foreign investment tends to focus on FDI.[44] However, the definition of investment in most investment treaties encompasses portfolio investment as well as FDI and this dramatically expands the scope of investment arbitration.[45] In particular, this constrains a state's ability to control portfolio investment and, in light of the volatility of short-term capital flows, this imposes potentially catastrophic risks on the state – relating to its financial stability – that do not arise in the context of FDI.[46] For this reason, many investment treaties include exceptions for capital controls imposed in a balance of payments crisis.[47]

The breadth of the NAFTA definition of investment means that investment arbitration under NAFTA Chapter 11 encompasses other areas of trade liberalization under the treaty, including trade in goods and trade in services.[48] For instance, a state measure that affects trade in goods may also affect investment where a foreign national has committed capital to the production, distribution, transport, or sale of a traded product.[49] Likewise, the cross-border provision of a service always involves, at some stage, the commitment of capital.[50] This creates potential overlaps between Chapter 11 and other NAFTA chapters, and between the different methods of dispute resolution that are used in different parts of the treaty. It is highly significant whether the NAFTA standards of investor protection (under Chapter 11) apply to state measures that affect trade in goods or services (under other NAFTA chapters)

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[44] E.g. A. Mody and A.P. Murshid, "Growing Up with Capital Flows", IMF Working Paper WP/02/75 (IMF, 2002), 5 and 24.

[45] IMF, *supra* note 43, 7; Wortley, *supra* note 39, 38-9 and 46-7.

[46] Mody and Murshid, *supra* note 44, 6; UNCTAD, *supra* note 28, 100; J. Bhagwati, "The Capital Myth: the Difference between Trade in Widgets and Dollars" (1998) 77(3) For. Affairs 7, 7-8; World Bank, *World Development Report 1999/2000* (Oxford: OUP, 2000), 73-5.

[47] Dolzer and Stevens, *supra* note 20, 85-6.

[48] Landsmeer, *supra* note 29, 60-1; Afilalo, *supra* note 28, 5; Houde and Yannaca-Small, *supra* note 41, 6-7.

[49] *Pope & Talbot Inc.* v. *Government of Canada* (Jurisdiction) (26 January 2000), para. 26 and 33, online: DFAIT http://www.dfait-maeci.gc.ca/tna-nac/documents/pubdoc6.pdf; *Ethyl*, *supra* note 5, para. 62; *ADF*, *supra* note 5, para. 155.

[50] E.g. *S.D. Myers* (Merits), *supra* note 17, para. 93 and 226; *S.D. Myers* (Damages) (21 October 2002), 15(1) World Trade and Arb. Mat. 103, para. 86 and 97-8 (characterizing, as investment, a cross-border service provider's commitment of capital to foreign sales and marketing).

since only the former are subject to compulsory investment arbitration and the remedy of damages against the state.

In a number of Chapter 11 arbitrations, the respondent state has argued that the tribunal lacked jurisdiction where the subject matter of the dispute was covered by other NAFTA chapters.[51] Accepting this argument would have limited the overlap between investment arbitration and the inter-state dispute resolution methods that apply under other chapters of the treaty. However, this argument has been rejected by tribunals on the basis that the NAFTA states' obligations under the treaty are cumulative.[52] In reaching this conclusion, tribunals relied on the broad NAFTA definition of investment as well as WTO jurisprudence that narrows the definition of a conflict between trade obligations.[53] As a result, investments that are incidental to trade in goods or services can nevertheless lead to claim under Chapter 11.

This overlap between Chapter 11 and other NAFTA chapters is an overlap within the regulatory sphere: sovereign acts that are subject to inter-state adjudication because they affect trade in goods or services are also subject to investment arbitration. Yet, a broad definition of investment can also extend the scope of investment arbitration into the private sphere. This occurs where the term investment is defined to include commercial disputes arising from private acts of the state (although tied by the investment treaty to an international obligation to another state).[54] Under some treaties, investors can claim that the state has breached a general treaty obligation to respect or abide by all of its duties to foreign investors.[55] Many

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[51] *Ethyl*, *supra* note 5, para. 62; *Pope & Talbot* (Jurisdiction), *supra* note 49, para. 19; *S.D. Myers* (Merits), *supra* note 17, para. 289; *ADF*, *supra* note 5, para. 155.

[52] *Pope & Talbot* (Jurisdiction), *supra* note 49, para. 25-6; *S.D. Myers* (Merits), *supra* note 17, para. 294 and 299.

[53] *Pope & Talbot* (Jurisdiction), *supra* note 49, para. 25-6; *S.D. Myers* (Merits), *supra* note 17, para. 291-5 and 299; *S.D. Myers* (Damages), *supra* note 50, para. 130-8.

[54] E.g. *Occidental Exploration and Production Company* v. *Republic of Ecuador* (Merits) (1 July 2004), London Court of International Arbitration Administered Case No. UN 3467, para. 44, online: ITA http://ita.law.uvic.ca/documents/Oxy-EcuadorFinalAward_001.pdf. K.-P. Berger, *International Economic Arbitration* (Deventer: Kluwer, 1993), 64; Paulsson, *supra* note 20, 238-9; Dolzer and Stevens, *supra* note 20, 14.

[55] E.g. *Accord entre la Confédération suisse et la République islamique du Pakistan concernant la promotion et la protection réciroque*, 11 July 1995, No. 0.975.262.3 (entered into force 6 May 1996), art. 11. NAFTA Chapter 11 requires a breach of a treaty standard, beyond a simple breach of contract: *Robert Azinian et al.* v. *United Mexican States* (Merits) (1 November 1999), 39 I.L.M. 537 [hereinafter *Azinian*], para. 83-4; *Waste Management No. 2* (Merits), *supra* note 5, para. 73 and 116. However, the NAFTA definition of "investment" does include contractual rights:

investment treaties – unlike NAFTA – contain an "umbrella clause" that incorporates the states parties' contractual obligations to investors under domestic law as international obligations under the treaty.[56] An overlap arises with the private sphere because, by concluding a contract with an investor, a state acts in a private capacity, and the state's contractual obligations are treated as private obligations subject to the law of the contract rather than international law.[57] Further, an arbitration authorized by the mutual consents of the parties to a contract is a consensual method of adjudication between private parties (acting in a private capacity), even if one of the parties is a state. Finally, in customary international law, the breach of a contract by a state does not amount to a violation of international law and the right of diplomatic protection only arises if there is a separate breach of an international obligation, such as a denial of justice, in the provision of domestic remedies allowing the investor to enforce the contract.[58]

Where an investment treaty requires that the states parties generally abide by their obligations to foreign investors, this potentially transforms the state's contractual obligations (owed to a private investor) into international obligations (owed to another state).[59] In such cases, the use of investment arbitration leads to the international adjudication of disputes arising from the state's commercial transactions with foreign investors. Put differently, some investment treaties define investment broadly enough to capture the commercial as well as the regulatory relationship

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NAFTA, *supra* note 5, art. 1139. See *Salini Costruttori S.P.A. and Italstrade S.P.A.* v. *Kingdom of Morocco* (Jurisdiction) (23 July 2001), 42 I.L.M. 609 [hereinafter *Salini*], para. 49.

[56] *SGS Société Générale de Surveillance* v. *Pakistan* (Jurisdiction) (6 August 2003), 18 ICSID Rev. 307, 16(2) World Trade and Arb. Mat. 167 [hereinafter *SGS* v. *Pakistan*], para. 99; *SGS Société Générale de Surveillance* v. *Philippines* (Jurisdiction) (29 January 2004), 16(3) World Trade and Arb. Mat. 91 [hereinafter *SGS* v. *Philippines*], para. 90, 113, and 132.

[57] F.A. Mann, "State Contracts and State Responsibility" (1960) 54 AJIL 572, 573 and 582.

[58] P.C. Jessup, "Responsibility of States for Injuries to Individuals" (1946) 46 Colum. L.R. 903, 913; Mann, ibid., 573-4.

[59] *Azinian, supra* note 55, para. 87. See also *SGS* v. *Pakistan, supra* note 56, para. 156; *SGS* v. *Philippines, supra* note 56, para. 128. D.W. Bowett, "Claims Between States and Private Entities: The Twilight Zone of International Law" (1986) 35 Cath. U. L. Rev. 929, 936; T.W. Wälde, "Investment Arbitration Under the Energy Charter Treaty – From Dispute Settlement to Treaty Implementation" (1996) 12 Arb. Int'l 429, 454-5; A.E.L. Tucker, "The Energy Charter Treaty and 'Compulsory' International State/ Investor Arbitration" (1998) 11 Leiden J. Int'l L. 513, 523-4; A.T. Guzman, "Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties" (1998) 38 Va. J. Int'l L. 639, 655-6.

between investors and the state.[60] This brings investment arbitration full circle. Having expanded beyond the realm of commercial arbitration to include the arbitration of regulatory disputes, the scope of investment arbitration returns to engulf contractual disputes that would otherwise be subject to the law of the contract. International adjudication becomes an alternative method of international redress for investors in the private as well as the regulatory sphere. Investors may choose to adjudicate a commercial dispute with the state under the relevant provisions of the contract or under the treaty, or perhaps both, just as they may choose to adjudicate a regulatory dispute under domestic or international law.

The term investment need not be defined in an all-encompassing way. It can be limited by attaching qualifiers, such as the requirement that an investment must provide a benefit to the host economy.[61] A number of ICSID tribunals have concluded that, for a dispute to fall within ICSID's jurisdiction, the relevant transaction must reflect typical features of investment, including: a certain duration, a regularity of profit and return, an element of risk for both sides, a substantial commitment, and a contribution to the host state's development.[62] However, the *ICSID Convention* itself does not expressly limit the term investment in this way.[63] Thus, the definition of investment is ultimately resolved when the state consents to investment arbitration, opening the door to the broad definitions adopted in contemporary investment treaties. By defining investment to encompass "every asset" of an investor – including short-term capital flows, concessionary rights and intellectual property rights – investment treaties regulate the exercise of public authority over economic activity in general.

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[60] This naturally depends on the wording of the treaty. Some investment treaties expressly exclude contractual claims from treaty-based investment arbitration where the contract provides for alternative means of dispute resolution, whereas others contain an umbrella clause as discussed above.

[61] Alternatively, an investment treaty might impose an obligation on investors to reinvest the proceeds of a damages award as part of a duty to mitigate losses: Bowett, *supra* note 59, 941.

[62] *Fedax, supra* note 20, para. 43; *Salini, supra* note 55, para. 52; *Autopista Concesionada de Venezuela* v. *Bolivarian Republic of Venezuela* (Jurisdiction) (27 September 2001), 16 ICSID Rev. 469, para. 101; *SGS* v. *Pakistan, supra* note 56, para. 133, note 153; *SGS* v. *Philippines, supra* note 56, para. 45.

[63] J.T. Schmidt, "Arbitration Under the Auspices of the International Centre for the Settlement of Investment Disputes" (1976) 17 Harv. Int'l L.J. 90, 99-100.

Dolzer and Stevens comment that the purpose of a broad definition of investment is "to ensure flexibility in the application of the treaty, given that the meaning of investment may change in the future".[64] Thus, the broader the definition, the more likely it is that treaty standards will apply to the exercise of public authority. A broad definition expands the discretion of arbitration tribunals to assume jurisdiction over investor claims. A broad definition also expands the state's potential liability to investors. For states, the question is: what types of economic activity qualify as investments and thus engage international obligations of the state? Does market share amount to investment?[65] Does the mere establishment of a sales office?[66] What interests of multinational enterprises are *not* investments?[67] For state officials, faced with a broad definition of investment in an investment treaty, it is prudent to assume that virtually any regulatory activity that impacts on a multinational enterprise could lead to investment arbitration and state liability.[68] This reflects the use of investment arbitration as a governing arrangement.

B. The substance of investment arbitration

Investment treaties would do little to regulate states if they did not apply rigorous substantive constraints to the exercise of public authority by the state. As such, the standards of investor protection in an investment treaty – linked to broad jurisdictional concepts like "state measure" and "investment" – play a key role in the regulatory control function of investment arbitration. It is by reference to the substantive standards that an investor frames a claim that the state has breached the treaty. Thus, the standards inform and justify the assessment of state conduct and

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[64] Dolzer and Stevens, *supra* note 20, 26.

[65] *Pope & Talbot* (Merits, Phase 1), *supra* note 37, para. 96-8. See also *S.D. Myers* (U.S. Submission) (18 September 2001), para. 5, online: State Department http://www.state.gov/documents/organization/6029.pdf.

[66] *Supra* note 50. J.A. Soloway, "Environmental Regulation as Expropriation: The Case of NAFTA's Chapter 11" (2000) 33 Can. Bus. L.J. 92, 123.

[67] E.g. some bilateral investment treaties expressly require that the investment be made in the territory of the host state: *SGS* v. *Philippines*, *supra* note 56, para. 99.

[68] P. Malanczuk, "State-State and Investor-State Dispute Settlement in the OECD Draft Multilateral Investment Agreement" (2000) 3 J. Int'l Econ. L. 417, 437-8; P. Ryan, "David v. Goliath" (2002) 11 *National* 30, 36 (citing Peter Kirby of Fasken Martineau: it is "practically impossible" to predict what government action will be questioned next under Chapter 11).

determine the treaty's impact on government. By interpreting these standards, tribunals specify and elaborate on the constraints imposed by investment treaties.

In this section, three core standards of investor protection – national treatment, the minimum standard of treatment, and compensation for expropriation[69] – are reviewed, using NAFTA as an example.[70] Under NAFTA Chapter 11, these core standards oblige the NAFTA states to:

> treat foreign (NAFTA-based) investors/ investments no less favourably than domestic investors who are "in like circumstances" (national treatment),[71]
>
> treat foreign investments "in accordance with international law" including "fair and equitable treatment" and "full protection and security" (the minimum standard of treatment);[72] and
>
> compensate investors for direct or indirect expropriation of an investment, or any measure "tantamount to" an expropriation (compensation for expropriation).[73]

[69] These are the standards that are most frequently called upon in investor claims under NAFTA and other investment treaties. Other treaty standards of investor protection oblige states to provide most-favoured-nation treatment to investors; to remove restrictions on capital flows and profit repatriation; to refrain from imposing performance requirements concerning the export of goods produced, the use of local materials, and the employment of local staff; to guarantee free movement of directors and senior management; and to require states to abide by any other commitments to foreign investors. Like the three core standards that are discussed here, these other standards regulate the exercise of public authority in relation to investors. However, these other standards tend to be more specifically defined, making their impact less uncertain than that of the core standards discussed here. An exception is most-favoured-nation (MFN) treatment, which obliges host states to treat foreign investors no less favourably than other foreign investors in like circumstances, and which is open to widely divergent interpretations. In particular, MFN treatment may be broadly interpreted to require a state to provide, not only substantive standards included its other investment treaties, but also procedural advantages such as access to compulsory investment arbitration. See *Maffezini*, *supra* note 40, para. 40-2 and 64; *Tecnicas Medioambientales Tecmed, S.A.* v. *United Mexican States* (Merits) (29 May 2003), 43 I.L.M. 133 [hereinafter *Tecmed*], para. 69; *Siemens A.G.* v. *The Argentine Republic* (Jurisdiction) (3 August 2004), ICSID Case No. ARB/02/8 [hereinafter *Siemens*], para. 32 and 102-3, online: ITA http://ita.law.uvic.ca/documents/SiemensJurisdiction-English-3August2004.pdf.

[70] Most NAFTA Chapter 11 standards and all of these core standards are contained in the majority of investment treaties, although the language used to define them varies. That said, unlike NAFTA and U.S.-modeled BITs, a significant number of BITs do not extend national treatment to the pre-establishment stage of an investment (i.e. to the period before an investor has entered the host economy) or apply express prohibitions on performance requirements. See UNCTAD, *supra* note 19, 182-4 and 189-92; UNCTAD, *Bilateral Investment Treaties in the Mid-1990s* (Geneva: United Nations, 1998), 137-8; UNCTAD, *supra* note 28, 102 and 108.

[71] NAFTA, *supra* note 5, art. 1102.

[72] NAFTA, *supra* note 5, art. 1105.

These standards draw upon principles that are well-established in international law, although because they are defined using broad language they tend to impose relatively intrusive constraints on states. Further, in contemporary investment treaties, the standards are typically defined using language that is broad enough to capture general regulatory activity that does not directly target or predominantly affect foreign investors. For this reason, the standards have the potential to impact on virtually any governmental activity, including economic regulation, taxation, regional development, cultural diversity, land use planning, public health and environmental protection.[74]

Under NAFTA Chapter 11, the core standards expand on comparable standards under customary international law and domestic public law.[75] Moreover, investors have argued for the standards to be interpreted expansively and in some cases tribunals have obliged. The intent here is not to argue for a particular interpretation of the standards but rather to shed light on the plausible range of meanings that can be attached to each. In doing so, the aim is to illustrate the potential implications of an expansive interpretation for government and, as such, to highlight the significance of investment arbitration as a governing arrangement.

1. National treatment

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[73] NAFTA, *supra* note 5, art. 1110.

[74] UNCTAD, *supra* note 19, 184-9; D. Schneiderman, "Investment Rules and the New Constitutionalism" (2000) 25 Law & Social Inq. 757, 771-2; J. Werksman, K.A. Baumert, and N.K. Dubash, "Will International Investment Rules Obstruct Climate Protection Policies?" (Report for the World Resources Institute, April 2001); W.W. Park, "Arbitration and the Fisc: NAFTA's 'Tax Veto'" (2001) 2 Chi. J. Int'l L. 231, 236-8; T. Epps and C.M. Flood, "Have We Traded Away the Opportunity for Innovative Health Care Reform? The Implications of the NAFTA for Medicare" (2002) 47 McGill L.J. 747, 781-7; J.R. Johnson, "How Will International Trade Agreements Affect Canadian Health Care?" (Discussion Paper No. 22 for the Commission on the Future of Health Care in Canada, September 2002), 9-17 and 26-32.

[75] See V.L. Been and J.C. Beauvais, "The Global Fifth Amendment: NAFTA's Investment Protections and the Misguided Quest for an International 'Regulatory Takings' Doctrine" (2003) 78 N.Y.U. L.R. 30, 50-1 and 59-60. This is especially so because a violation of the treaty leads to a damages award rather than conventional public law remedies: M. Lunney and K. Oliphant, *Tort Law* (Oxford: OUP, 2000), 527.

The first core standard – national treatment – is more limited under customary international law than under many investment treaties, including NAFTA. Under customary international law, a state may favour domestic over foreign investors so long as the state does not discriminate against foreign investors once they have been allowed into the host economy.[76] In contrast, under NAFTA, the states parties must not favour domestic over foreign investors or prohibit the entry of a foreign investor into the host economy.[77] In principle, foreign investors must be treated at least as favourably as domestic investors who are in like circumstances. Alternatively: investors cannot be discriminated against because they are foreign.

The NAFTA standard of national treatment is contained in Article 1102:

> 1. Each Party shall accord to investors of another Party treatment no less favourable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.
>
> 2. Each Party shall accord to investments of another Party treatment no less favourable than that it accords, in like circumstances, to its investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.
>
> . . . .

National treatment is a fundamental norm in international economic law and public law generally.[78] However, its application in the field of investment is relatively recent.[79] Also, applied to investment – in the context of individualization – the scope

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[76] J.B. Moore, *Digest of International Law*, vol. 4 (Washington: U.S. Government Printing Office, 1906), 67; UNCTAD, *supra* note 28, 102.

[77] NAFTA, *supra* note 5, art. 1102. Many BITs do not extend national treatment to the pre-establishment stage of an investment: *supra* note 70.

[78] H. Neufeld, *The International Protection of Private Creditors From the Treaties of Westphalia to the Congress of Vienna* (Leiden: A.W. Sijthoff, 1971), 96; M.S. McDougal, H.D. Lasswell, and L. Chen, "The Protection of Aliens From Discrimination and World Public Order: Responsibility of States Conjoined with Human Rights" (1976) 70 AJIL 432, 443; J.H.H. Weiler, *supra* note 24, 201.

[79] Dolzer and Stevens, *supra* note 20, 57; UNCTAD, *National Treatment*, UNCTAD Series on Issues in International Investment Agreements (New York: United Nations, 1999), 9-13; H. Mann and K. von Moltke, "NAFTA's Chapter 11 and the Environment: Addressing the Impacts of the Investor-State Process on the Environment" (Working Paper for the International Institute for Sustainable Development, 1999), 12.

of national treatment is potentially vast.[80] For this reason, the NAFTA standard had created interpretive challenges in some cases.[81]

By definition, national treatment is a relative standard in that it measures a state's treatment of foreign investors against the treatment of similarly situated domestic investors. Thus, at the heart of national treatment is the fundamental maxim that like cases should be treated alike, as well as the dilemma of how to identify appropriate criteria for comparison.[82] Which domestic investors are in like circumstances to those of the foreign investor?[83] Does the fact that domestic investors operate in an economically depressed region distinguish them from foreign investors who operate in wealthy regions? What if the domestic investor has a better record of employing disadvantaged minorities or uses an environmentally-friendly production process; are these legitimate grounds upon which to favour domestic investors? Are U.S.-owned producers of canola seed pesticides that contain lindane in like circumstances to Canadian-owned producers of canola seed pesticides that are lindane-free?[84] Or are they similarly situated so long as they produce substitute products? From the start, tribunals must distinguish between like and unlike circumstances. The more broadly a tribunal defines likeness, the more national treatment constrains governments' ability to differentiate between economic actors for reasons of public policy.

Already, the interpretation of national treatment emerges as a complex and value-laden task.[85] But this does not end the matter. Arbitration tribunals must also

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[80] Dolzer and Stevens, *supra* note 20, 62 (noting that, for a state to violate national treatment under customary international law, the state measure had to reflect an intention to harm a foreign national); R.K. Paterson, "A New Pandora's Box? Private Remedies for Foreign Investors under the North American Free Trade Agreement" (2000) 8 Willamette J. Int'l L. and Dispute Res. 77, 95; Afilalo, *supra* note 28, 5.
[81] E.g. *Feldman*, *supra* note 12, para. 166-7. J.H.H. Weiler, *supra* note 24, 213-14.
[82] M. Loughlin, *Sword and Scales* (Oxford: Hart, 2000), 20.
[83] Dolzer and Stevens, *supra* note 20, 63.
[84] See *Crompton Corp.* v. *Government of Canada* (Notice of Claim) (6 November 2001), para. 28-9, online: DFAIT http://www.dfait-maeci.gc.ca/tna-nac/documents/CROMPTON-CORP.pdf.
[85] J.R. Johnson, "Essential Disciplines of the National Treatment Obligation Under NAFTA Chapter Eleven" (Report on investment protection for the Ad Hoc Experts Group on Investment Rules, Department of Foreign Affairs and International Trade, 2 December 2001), online: DFAIT http://www.dfait-maeci.gc.ca/tna-nac/treatment-en.asp; J.A. VanDuzer, "NAFTA Chapter 11 to Date: The Progress of a Work in Progress" in L. Ritchie

determine how far to cast the comparative net. Does a foreign investor have to show that any less favourable treatment of investor reflects a pattern of conduct in the state's treatment of foreign investors *as a group*?[86] Or can a violation arise from the circumstances of a single investor?[87] On a narrow reading of the standard, a foreign investor would have to show that any less favourable treatment was not an isolated event.[88] On a broad reading, a state violates national treatment whenever it treats a foreign investor less favourably than a single domestic investor, in a single instance.[89] There is a wide gap between the ramifications, for governments, of these interpretations. But the issue is vital because it determines the degree to which governments must alter their regulatory activity in order to avoid liability.

National treatment is especially complex because it captures *de facto* as well as *de jure* discrimination.[90] A violation of the standard may occur when a state measure, though neutral on its face, has a discriminatory effect on foreign investors relative to their domestic counterparts.[91] In its original form as a standard to regulate trade in goods, the purpose of prohibiting *de facto* discrimination was to counter disguised protectionism against imported products.[92] Transplanted to the circumstances of a single investor (as opposed to a group of investors), *de facto* discrimination creates a possibility of over-inclusion by capturing regulation which only incidentally affects the foreign investor.[93] Applied broadly, *de facto* discrimination could bar any exercise of public authority that differentiated between investors.[94] Yet, most governmental activity inherently involves differentiation among the subjects of regulation and, if all

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Dawson, ed., *Whose Rights? The NAFTA Chapter 11 Debate* (Ottawa: Centre for Trade Law and Policy, 2002), 72-3; Mann and von Moltke, *supra* note 79, 28-32.

[86] *ILC Draft Articles*, *supra* note 13, art. 15.

[87] *Feldman*, *supra* note 12, para. 181 (award) and p. 269 (dissenting opinion).

[88] Johnson, *supra* note 85, 8-10.

[89] *Pope & Talbot Inc. v. Government of Canada* (Merits, Phase 2) (10 April 2001), 13(4) World Trade and Arb. Mat. 61, para. 70-2. P.G. Foy, "Effectiveness of NAFTA's Chapter Eleven Investor-State Arbitration Procedures" (2003) 18 ICSID Rev. 44, 49.

[90] E.g. *Feldman*, *supra* note 12, para. 169. Contrast *In the Matter of Cross-border Trucking Services* (Merits) (6 February 2001), 13(3) World Trade and Arb. Mat. 121, para. 291-2.

[91] UNCTAD, *supra* note 79, 40-1.

[92] Jackson, *supra* note 24, 216-18; Ehring, *supra* note 23, 1-2.

[93] Paterson, *supra* note 80, 95 (commenting that, in the trade in goods context, discrimination is always based on nationality because imports are, by definition, of a different origin than the "like domestic product").

[94] Johnson, *supra* note 85, 4.

such differentiation was prohibited, then investment treaties would scorch a very wide swath of the regulatory landscape.[95]

Importantly, the meaning of the standards of investor protection is affected and often expanded by individualization. In NAFTA Chapter 11 claims, investors have advocated far-reaching interpretations of national treatment, arguing – for instance – that the term "like circumstances" should be read broadly and that incidental *de facto* discrimination violates the treaty.[96] This is not surprising. Allowing investors to make international claims in the context of the regulatory relationship gives a private party the discretion to make arguments in its own interest, unburdened by considerations of the public interest or by the possibility of having to defend a similar claim. Investors can be expected to argue for broad interpretations in order to expand their opportunities to receive damages. What is noteworthy is that by allowing investors to make these arguments (although they are often rejected by tribunals) investment treaties create an adjudicative environment in which arbitrators are enabled to adopt more expansive readings of the treaty, should they so choose, even where this conflicts with the submissions of the states parties.[97]

The use of adjudication as a governing arrangement grants discretionary authority to adjudicators to constrain the exercise of public authority. On a narrow reading, national treatment affects a wide range of governmental measures, although within limits based on, e.g., intent or negligence on the part of the state. On an expansive reading, national treatment imposes liability on states in isolated cases of differential treatment, where a general regulation incidentally harms a foreign investor relative to a domestic investor.[98] In chapter five of this thesis, one tribunal's broad

[95] J. Bhagwati, "Afterword: The Question of Linkage" (2002) 96 AJIL 126, 129-30.
[96] E.g. *Ethyl* (Investor's Submission) (2 October 1997), para. 31, online: DFAIT http://www.dfait-maeci.gc.ca/tna-nac/documents/ethyl3.pdf; *S.D. Myers* (Investor's Submission) (20 July 1999), para. 77, online: DFAIT http://www.dfait-maeci.gc.ca/tna-nac/documents/July201999.pdf; *Pope & Talbot* (Investor's Submission) (28 January 2000), para. 53-7 and 72, online: DFAIT http://www.dfait-maeci.gc.ca/tna-nac/documents/A-1.pdf; *UPS* (Investor's Submission) (23 March 2005), para. 515-16, 521, 528, and 536-7, online: DFAIT http://www.dfait-maeci.gc.ca/tna-nac/documents/UPSMarch-05.pdf.
[97] E.g. *Pope & Talbot* (Merits, Phase 2), *supra* note 89, para. 79 (rejecting the submissions of the NAFTA Parties that Article 1102 is limited to the prohibition of discrimination *on the basis of nationality*); *GAMI*, *supra* note 40, para. 29-30. But see *ADF*, *supra* note 5, para. 177.
[98] *Pope & Talbot* (Merits, Phase 2), *supra* note 89, para. 78-9; *Feldman*, *supra* note 12, para. 181 (award) and p. 269 (dissenting opinion).

interpretation of national treatment is examined in more detail. Suffice it to say here that in interpreting the NAFTA standards tribunals have substantial discretion.

2. The minimum standard of treatment

The assertion of a minimum standard of treatment for foreign nationals under international law has a contentious history.[99] Since the nineteenth century, capital-exporting states traditionally asserted a minimum standard of fair treatment and protection for foreign investors, although the content of the standard was not always consistent or precise.[100] On the other hand, former colonies and developing countries argued that the minimum standard was restricted to non-discrimination based on equal access to domestic remedies once a foreign national was allowed into a state's territory.[101] Investment treaties establish a minimum standard that goes beyond simple non-discrimination, reflecting a position historically preferred by capital-exporting states.[102]

The NAFTA minimum standard of treatment is contained in Article 1105:

> 1. Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.
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> ....

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[99] M.N. Shaw, *International Law*, 5th ed. (Cambridge: CUP, 2003), 733-7; Center for International Environmental Law (CIEL), "International Law on Investment: The Minimum Standard of Treatment (MST)" (Issue Brief, August 2003), 1-2; I. Brownlie, *Principles of Public International Law*, 6th ed. (Oxford: OUP, 2003), 503-5.

[100] E. Root, "Elihu Root's Services to International Law" (1910) 4 ASIL Proc. 16, 21; C. Eagleton, *The Responsibility of States in International Law* (New York: NYU Press, 1928), 109; Neufeld, *supra* note 78, 98; McDougal, Lasswell, and Chen, *supra* note 78, 446-51; J.C. Thomas, "Reflections on Article 1105 of NAFTA: History, State Practice and the Influence of Commentators" (2002) 17 ICSID Rev. 21, 39-51.

[101] *Responsibility of States for Damage Caused in Their Territory to the Person or Property of Foreigners*, League of Nations Conference for the Codification of International Law, Bases of Discussion, vol. 3, LN Doc. C.75.M.69.1929.V (1929), 15. E. Borchard, "The 'Minimum Standard' of Treatment of Aliens" (1940) Mich. L.R. 445, 445-7 and 450-1; M. Sornarajah, *The Pursuit of Nationalized Property* (Dordrecht, Martinus Nijhoff, 1986), 29.

[102] *Mondev*, *supra* note 12, para. 120.

This standard represents an absolute minimum standard of treatment that a NAFTA state must provide to foreign investors. That is, regardless of the treatment that a NAFTA state provides to its own investors, the treatment of foreign investors must not fall below the floor that is set by Article 1105, which includes "fair and equitable treatment" and "full protection and security". Thus, on a broad interpretation, a tribunal could find that a state breached NAFTA where its conduct was unfair or inequitable under international law.[103] The meaning of these adjectives does not leap from the page. Thus, as in the case of national treatment, the minimum standard of treatment is stated in broad and ambiguous terms.[104]

Under customary international law, the minimum standard of treatment was not particularly stringent. Academic works typically refer to the 1926 decision of the U.S.-Mexico General Claims Commission in *Neer* v. *United Mexican States*, which described the standard as such:[105]

> ... the treatment of an alien, in order to constitute an international delinquency should amount to an outrage, to bad faith, to wilful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency.

This conveys a sense of egregiousness in the type of state conduct that violates the customary standard.[106] However, investors have argued for a broader interpretation of NAFTA Article 1105; one that incorporates standards contained in other treaties, for example, without applying customary limits on a state's general duty of fair treatment and full protection.[107]

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[103] UNCTAD, *Fair and Equitable Treatment*, UNCTAD Series on Issues in International Investment Agreements (New York: United Nations, 1999), 10-12.
[104] Dolzer and Stevens, *supra* note 20, 58-9; Thomas, *supra* note 100, 22.
[105] *Neer Claim* (*United States* v. *Mexico*) (1926), 4 R.I.A.A. 60, 61-2. See Eagleton, *supra* note 100, 84.; J.L. Brierly, *The Law of Nations*, 5th ed. (Oxford: OUP, 1955), 221-2; G. Schwarzenberger, *International Law as Applied by International Courts and Tribunals*, vol. 1, 3rd ed. (London: Stevens & Sons, 1957), 200; P. Malanczuk, *Akehurst's Modern Introduction to International Law*, 7th ed. (London: Routledge, 1997), 261; Brownlie, *supra* note 99, 503.
[106] Schwarzenberger, ibid., 201; A.A. Fatouros, "International Economic Development and the Illusion of Legal Certainty" (1963) 57 ASIL Proc. 117, 117-18; Thomas, *supra* note 100, 29-39.
[107] E.g. *Pope & Talbot* (Merits, Phase 2), *supra* note 89, para. 107; *S.D. Myers* (Merits), *supra* note 17, para. 134; *UPS*, *supra* note 4, para. 81-2.

In the early days of Chapter 11 arbitration, some tribunals adopted broad readings of the minimum standard that went well beyond customary international law.[108] For example, in *Metalclad*, the tribunal imposed as part of the minimum standard a general duty on the NAFTA states to ensure transparency in the regulation of investment.[109] The tribunal required the NAFTA states to ensure that "all relevant legal requirements" were made clear to foreign investors and to correct "any scope for misunderstanding or confusion".[110] In *Pope & Talbot*, the tribunal rejected Canada's argument that the standard required evidence of state conduct that crossed a high threshold of impropriety based on *Neer*.[111] Instead, the tribunal adopted a broad reading which encompassed "the fairness elements under ordinary standards applied in [the domestic law of] NAFTA countries.... without any threshold limitation that the conduct complained of be 'egregious,' 'outrageous,' or 'shocking,' or otherwise extraordinary".[112] The NAFTA states objected to the *Pope & Talbot* tribunal's approach[113] and later tribunals adopted a more restrained approach.[114] Even so, the early experience in the interpretation of Article 1105 revealed that arbitrators were prepared to assume wide-ranging authority to sanction governmental activity using broadly-framed standards of investor protection.

Broad interpretations of the minimum standard of treatment have major implications for governments. Governments often make controversial decisions when exercising public authority; indeed, controversy is inherent in the act of governing. In making policy decisions, governments may appear to misapprehend facts, apply

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[108] *Metalclad*, *supra* note 6, para. 74-6; *Pope & Talbot* (Merits, Phase 2), *supra* note 89, para. 110 and 115-18; *S.D. Myers* (Merits), *supra* note 17, para. 266. CIEL, *supra* note 99, 3-5; Thomas, *supra* note 100, 113-14; C. Tollefson, "Metalclad v. United Mexican States Revisited: Judicial Oversight of NAFTA's Chapter Eleven Investor-State Claim Process" (2002) 11 Minn. J. Global Trade 183, 207-13 and 224-5.

[109] *Metalclad*, *supra* note 6, para. 76. See also *United Mexican States* v. *Metalclad Corporation* (2001), 89 B.C.L.R. (3d) 359, 38 C.E.L.R. 284, 13(5) World Trade and Arb. Mat. 219 [hereinafter *United Mexican States*], para. 68-73 (concluding that the *Metalclad* tribunal exceeded its jurisdiction by grounding its interpretation of Article 1105 in transparency obligations contained in parts of NAFTA that were not subject to investment arbitration).

[110] *Metalclad*, *supra* note 6, para. 76.

[111] *Pope & Talbot* (Merits, Phase 2), *supra* note 89, para. 108 and 118. See also *Pope & Talbot* (Canada's Submissions) (10 October 2000), para. 235-40, online: DFAIT http://www.dfait-maeci.gc.ca/tna-nac/documents/B-2.pdf.

[112] *Pope & Talbot* (Merits, Phase 2), *supra* note 89, para. 118.

[113] E.g. *Mondev*, *supra* note 12, para. 106 and 108-10.

[114] *ADF*, *supra* note 5, para. 179-86; *Mondev*, *supra* note 12, para. 111; *Loewen*, *supra* note 5, para. 131-3; *Waste Management No. 2* (Merits), *supra* note 5, para. 98.

misguided theories, emphasize wrong-headed priorities, or adopt counterproductive responses to problems. Under international law, the ordinary forum to resolve disputes arising from these decisions is the domestic political and legal system.[115] An expansive reading of NAFTA Article 1105 transforms the customary standard from a protection of last resort for foreign nationals into a general guarantee of fairness, equity, and due process.[116]

3. Expropriation

Another historically disputed question in international law is whether, and the extent to which, a state must compensate foreign investors for an expropriation of their assets.[117] In the post-colonial era, the debate over the international law of expropriation has pitted the Western powers seeking to protect the foreign assets of their nationals against newly independent states aspiring to assert autonomy over their economy and resources.[118] This debate reflects a deeper conflict about the relationship between property, the collectivity, and the state.[119] In the domestic law of all countries, and under human rights treaties, the conflict has a varied legal history,

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[115] *S.D. Myers* (Merits), *supra* note 17, para. 261. See also *Middle East Cement Shipping and Handling Co. S.A.* v. *Arab Republic of Egypt* (Merits) (12 April 2002), 18 ICSID Rev. 602, para. 155.

[116] J.C. Thomas, "The Experience of NAFTA Chapter 11 Tribunals To Date: A Practitioner's Perspective" in L. Ritchie Dawson, ed., *Whose Rights? The NAFTA Chapter 11 Debate* (Ottawa: Centre for Trade Law and Policy, 2002), 113-14.

[117] J.F. Williams, "International Law and the Property of Aliens" (1928) 9 Brit. Y.B. Int'l L. 1, 28; A.P. Fachiri, "International Law and the Property of Aliens" (1929) 10 Brit. Y.B. Int'l L. 32, 33-4 and 49-51; Wortley, *supra* note 39, 119-26; E.F. Mooney, *Foreign Seizures – Sabbatino and the Act of State Doctrine* (Lexington: University of Kentucky Press, 1967), 85; N. Girvan, *Corporate Imperialism: Conflict and Expropriation* (New York: M.E. Sharpe, 1978), 200; R. Dolzer, "New Foundations of the Law of Expropriation of Alien Property" (1981) 75 AJIL 553, 557-72; Peter, *supra* note 25, 173-6; Muchlinski, *supra* note 42, 501-14; E. Lauterpacht, "International Law and Private Foreign Investment" (1997) 4 Indiana J. Global Legal Studies 259, 263-7.

[118] F.S. Dunn, "International Law and Private Property Rights" (1928) 28 Colum. L. Rev. 166, 177-80; S. Friedman, *Expropriation in International Law* (Westport, Conn.: Greenwood Press, 1953), 4; S.K.B. Asante, *Transnational Investment Law and National Development* (Lagos: University of Lagos, 1981), 31-2; C. Lipson, *Standing Guard – Protecting Foreign Capital in the Nineteenth and Twentieth Centuries* (Berkeley: University of California Press, 1985), 29-30.

[119] C.F. Randolph, "The Eminent Domain" (1887) 3 L.Q. Rev. 314; F.I. Michelman, "Property, Utility, and Fairness: Comments on the Ethical Foundations of 'Just Compensation' Law" (1967) 80 Harv. L.R. 1165, 1202; L.S. Underkuffler-Freund, "Takings and the Nature of Property" (1996) 9 Can. J. Law & Jur. 161.

especially in relation to questions of the definition of property, the recognition of a constitutional right to property, the distinction between expropriation and regulation, the existence and extent of police powers, the incorporation of exceptions for emergency situations such as war or financial crisis, and the extension of property protection to include compensation for non-material loss.[120] In contemporary investment treaties, these issues have been brought within the discretion of arbitration tribunals, applying a treaty standard of compensation for expropriation.

To review further: in terms of the standard of compensation that must be paid for an expropriation, capital-importing states historically asserted a right to expropriate property within their territory on payment of "just" or "appropriate" compensation, calculating the value of the property by assessing – not only its market value – but also the host state's ability to pay or any unjust enrichment by the investor.[121] In contrast, major capital-exporting states advanced market-based standards such as the Hull standard[122] of "full, prompt, and adequate"

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[120] E.g. (United Kingdom) *Attorney General* v. *De Keyser's Royal Hotel, Ltd.*, [1920] A.C. 508 (H.L.); *Gallagher* v. *Lynn*, [1937] A.C. 863 (H.L.); *France Fenwick and Co.* v. *R.*, [1927] 1 K.B. 458, 467 ("A mere negative prohibition, though it involves interference with an owner's enjoyment of property, does not... carry with it at Common Law any right to compensation"); H. Street, *Governmental Liability* (Cambridge: CUP, 1953), 120-4. (United States) U.S. Const. amend. V; *Pennsylvania Central Transportation Company* v. *City of New York*, 438 U.S. 104 (1978); *Lucas* v. *South Carolina Coastal Council*, 505 U.S. 1003 (1992); E.V. Abbot, "The Police Power and the Right to Compensation" (1889) 3 Harv. L.R. 189; R.A. Epstein, *Takings: Private Property and the Power of Eminent Domain* (Cambridge: Harvard University Press, 1985); W.A. Fischel, *Regulatory Takings: Law, Economics, and Politics* (Cambridge: Harvard University Press, 1995). (Canada) *Manitoba Fisheries Ltd.* v. *R.*, [1979] 1 S.C.R. 101, 88 D.L.R. (3d) 462; *British Columbia* v. *Tener*, [1985] 1 S.C.R. 533, 17 D.L.R. (4th) 1; *A&L Investments Ltd.* v. *Ontario (Minister of Housing)* (1993), 13 O.R. (3d) 799, 32 R.P.R. (2d) 1 (C.A. Ont.); Ontario Law Reform Commission, *Report on the Basis for Compensation on Expropriation* (Toronto: OLRC, 1967); E.C.E. Todd, *The Law of Expropriation and Compensation in Canada*, 2d ed. (Toronto: Carswell, 1992), 1-7. (Europe) E.g. *Sporrong and Lönnroth* v. *Sweden*, Eur. Ct. H.R. Ser. A, No. 52, [1983] E.H.R.R. 35; *Hauer* v. *Rheinland-Pfatz* (No. 44/79), [1979] E.C.R. 3727, (1980) 3 C.M.L.R. 42; M. Antinori, "Does Lochner Live in Luxembourg? An Analysis of the Property Rights Jurisprudence of the European Court of Justice" (1995) 18 Fordham Int'l L.J. 1778, 1803-5. (International) Friedman, *supra* note 118, 10; Wortley, *supra* note 39, 52; Muchlinski, *supra* note 42, 501-4.

[121] A.A. Fatouros, "International Law and the Third World" (1964) 50 Va. L.R. 783, 808-9; K.B. Asante, "International Law and Foreign Investment: A Reappraisal" (1988) 37 I.C.L.Q. 588, 591; G.L. Sandrino, "The NAFTA Investment Chapter and Foreign Direct Investment in Mexico: A Third World Perspective" (1994) 27 Vand. J. Tranat'l L. 259, 319.

[122] The Hull standard is named after U.S. Secretary of State Cordell Hull, who elaborated the standard in correspondence with the Mexican Government responding to Mexico's nationalization of U.S. oil companies in 1938: the correspondence is reprinted in 3 G.H.

compensation.[123] Virtually all investment treaties require payment of compensation for expropriation and most (including NAFTA) apply the Hull standard as a minimum.[124] Indeed, by adopting a broad definition of investment, some investment treaties afford protection that goes beyond the Hull standard.[125]

Under NAFTA Article 1110:[126]

> 1. No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment, except:
>
> for a public purpose;
> on a non-discriminatory basis;
> in accordance with due process of law and Article 1105(1); and
> on payment of compensation in accordance with paragraphs 2 to 6.
>
> ....

Thus, any expropriation by a NAFTA state (and any measure that is "tantamount to expropriation") must be for a public purpose, non-discriminatory, in accordance with due process, and accompanied by full, prompt, and adequate compensation. An expropriation that fails to meet these requirements breaches the treaty and would entitle an investor to damages.

The NAFTA standard clearly requires compensation for direct seizures or nationalizations of property by the state. For instance, if NAFTA applied to the

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Hackworth, *Digest of International Law* (Washington: U.S. Government Printing Office, 1940-44), 655-65.

[123] P.M. Norton, "A Law of the Future or a Law of the Past? Modern Tribunals and the International Law of Expropriation" (1991) 85 AJIL 474, 475-9.

[124] I. Delupis, *Finance and Protection of Investments in Developing Countries* (Epping: Gower Press, 1973), 39-41 (noting the absence of protection against "creeping" expropriation in earlier BITs); Dolzer and Stevens, *supra* note 20, 98 (noting that many BITs provide for a more general formula than the Hull standard, such as "just" compensation; and that most refer to "expropriation" or "nationalization", although some to "taking", "dispossession", "deprivation", or "privation"); L.A. O'Connor, "The International Law of Expropriation of Foreign-Owned Property: The Compensation Requirement and the Role of the Taking State" (1983) 6 Loyola L.A. Int'l & Comp. L.J. 355, 357-8 and 393.

[125] Guzman, *supra* note 59, 680-1.

[126] NAFTA, *supra* note 5, art. 1110 (providing further that actual compensation must be equivalent to the fair market value of the investment on the date of the expropriation and must not reflect changes in value arising because the intended expropriation became known earlier. To determine fair market value, Article 1110 provides for valuation based on value as a going concern, asset value including declared tax value of tangible property, and other appropriate criteria).

Mexican oil industry, it would have prohibited Mexico's nationalization of U.S. oil companies in 1938, which was followed by delayed payment of partial compensation.[127] Thus, in itself, the requirement for full, prompt and adequate compensation in the event of a direct seizure has major implications for states seeking to pursue a state-led development strategy. Even so, for governments the obligations that flow from this aspect of the standard are at least relatively determinable and predictable.[128]

However, the expropriation standard goes beyond direct seizures of assets, although to an uncertain extent.[129] In particular, the standard applies to measures "tantamount to... expropriation". A broad reading of this term would require compensation for any exercise of public authority that incidentally reduced the value of an investment. Anticipating this possibility, critics of NAFTA Chapter 11 have condemned the expropriation standard as a backdoor takings doctrine that would cost out proactive regulation in public health and environmental protection.[130] Some pro-investor commentators have adopted a similar view, arguing that Article 1110 went beyond common law rules on expropriation by requiring compensation for mere prohibitions and constructive takings, including any unreasonable interference with the use, enjoyment, or disposal of the property of investors.[131] Finally, investors themselves obviously have favoured an expansive interpretation.[132] For example, in *Pope & Talbot*, the investor argued that Article 1110 "provides the broadest protection for the investments of foreign investors who may suffer harm by being deprived of their fundamental investment rights" and that the term 'tantamount to... expropriation' includes "even nondiscriminatory measures of general application which have the effect of substantially interfering with the investments of investors".[133]

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[127] Delupis, *supra* note 124, 103; T. Levi, "NAFTA's Provision for Compensation in the Event of Expropriation: A Reassessment of the 'Prompt, Adequate and Effective' Standard" (1995) 31 Stanf. J. Int'l L. 423, 426-9.
[128] J.H.H. Weiler, *supra* note 24, 201 and 209-10.
[129] Been and Beauvais, *supra* note 75, 51-9.
[130] Ibid., 132-5; S. Ganguly, "The Investor-State Dispute Mechanism (ISDM) and a Sovereign's Power to Protect Public Health" (1999) 38 Colum. J. Transnat'l L. 113, 119.
[131] Dearden, *supra* note 6, 117-21.
[132] E.g. *Waste Management No. 2* (Merits), *supra* note 5, para. 145. See e.g. *CME Republic B.V.* v. *Czech Republic* (Merits) (13 September 2001), 14(3) World Trade and Arb. Mat. 109, para. 150. I.A. Laird, "NAFTA Chapter 11 Meets Chicken Little" (2001) 2 Chi. J. Int'l L. 223, 226.
[133] *Pope & Talbot* (Merits, Phase 1), *supra* note 37, para. 83-4.

Some Chapter 11 tribunals have tended toward this expansive view.[134] An especially broad reading of the standard was adopted by the *Metalclad* tribunal, which concluded that expropriation under NAFTA included:[135]

> ... not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.

Other tribunals have narrowed the standard by distinguishing expropriation from regulation or from breach of contract, and by limiting the "tantamount" expropriation to indirect or creeping expropriation.[136] However, this approach tends to boomerang back to the dilemma of how to differentiate (non-compensable) regulation or commerce from (compensable) indirect or creeping expropriation.[137] For governments, the priority is to be able to distinguish in advance between state measures that expropriate and those that do not, in order to anticipate the cost of government. But, left to resolution through investment arbitration, it will be difficult to reach any stable definition of expropriation for years to come.[138] The point here is not to ask whether the security that Article 1110 ensures for investors is desirable,

[134] *Pope & Talbot* (Merits, Phase 1), *supra* note 37, para. 99; *Waste Management No. 2* (Merits), *supra* note 5, para. 143-5; *GAMI*, *supra* note 40, para. 131. See e.g. *Compañía del Desarrollo de Santa Elena, S.A.* v. *Republic of Costa Rica* (Merits) (17 February 2000), 5 ICSID Rep. 172, 13(1) World Trade and Arb. Mat. 81, para. 71-2 and 76 (concluding that the fact that a measure was taken for the public purpose of environmental protection made no difference as to the amount of compensation); *Tecmed*, *supra* note 69, para. 113-15 and 121 (concluding that regulatory actions that are beneficial to society as a whole are not excluded from the duty to pay compensation).

[135] *Metalclad*, *supra* note 6, para. 103. See also *United Mexican States*, *supra* note 109, para. 99 (characterizing the *Metalclad* tribunal's interpretation as "sufficiently broad to include a legitimate rezoning of property by a municipality or other zoning authority").

[136] *Azinian*, *supra* note 55, para. 90; *Pope & Talbot* (Merits, Phase 1), *supra* note 37, para. 104; *S.D. Myers* (Merits), *supra* note 17, para. 281-2 and 285-6; *Feldman*, *supra* note 12, para. 100 and 103; *Waste Management No. 2* (Merits), *supra* note 5, para. 175.

[137] B.H. Weston, "'Constructive Takings' Under International Law: A Modest Foray into the Problem of Creeping Expropriation" (1975) 16 Virg. J. Int'l L. 103; R. Dolzer, "Indirect Expropriation of Alien Property" (1986) 1 ICSID Rev. 41, 59; Soloway, *supra* note 66, 101-4; L.Y. Fortier, "Caveat Investor: The Meaning of 'Expropriation' and the Protection Afforded Investors Under NAFTA" (2003) 20(1) ICSID News 1.

[138] D.M. Price, (2001) "NAFTA Chapter 11 – Investor-State Dispute Settlement: Frankenstein or Safety Valve?" 26 Can-U.S. L.J. 107, 111.

although this is no doubt an important question. Rather, the point is that, given the breadth of the standards of investor protection, the state makes a major policy decision when it adopts investment arbitration as a governing arrangement.

Conclusion

Investment arbitration is designed to control the conduct of states in relation to the economic activities of investors. Absent strict limits on the scope and substance of investment arbitration, one must speak of investment arbitration as controlling the regulation of international business in general.[139] In terms of its scope, the system of investment arbitration controls the exercise of public authority with respect to virtually any asset of a foreign investor. In terms of substance, the system adopts standards that significantly constrain the discretion of states to regulate international business, although on a narrow interpretation these standards do preserve flexibility for governments based on rules of customary international law. Alternatively, on a broad interpretation, the core standards of investor protection under investment treaties would have a dramatic impact on governmental decision-making.

The breadth and intensity of these constraints means that the implications of investment arbitration for governments are both significant and uncertain. The ambiguity of key terms introduces a realistic possibility that any exercise of public authority relating to foreign investors could result in a damages award against the state. Many treaties impose obligations the meaning of which is ambiguous.[140] But under investment treaties the prospect of state liability raises the stakes. Linked to the wide-ranging scope and substance of investment arbitration, as well as individualization, the prospect of state liability injects entirely new fiscal liabilities into the governing

[139] Kingsbury, Krisch, and Stewart, *supra* note 18, 22-3.
[140] K.W. Abbott et al., "The Concept of Legalization" in J.L. Goldstein, *Legalization and World Politics* (Cambridge: MIT Press, 2001), 30.

process.[141] One is prompted to ask how much regulatory chill is warranted to protect investors.[142]

In this regard, the critical issue is the degree to which investment treaties increase the likelihood of state liability in relation to general governmental activity. However, this issue is not resolved until a tribunal has ruled in the first instance on an investor claim. Expropriation may or may not include regulatory takings. The minimum standard of treatment may or may not impose a broad guarantee of regulatory fairness or economic due process. National treatment may or may not require states to take positive steps to ensure equal treatment of foreign investors. The resulting uncertainty undermines the claim, made by promoters of investment arbitration as a means to enforce international standards, that state liability will rationally deter disobedience.[143] Instead, the system relies almost entirely on arbitrators to interpret and apply investment treaties in ways that are reasonably predictable for states, as well as investors. This discretionary role of arbitrators is examined in the next chapter.

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[141] S. Picciotto, "A Critical Assessment of the MAI" in S. Picciotto and R. Mayne, eds., *Regulating International Business* (Houndmills: Macmillan, 1999), 86; D.J. Levinson, "Making Government Pay: Markets, Politics, and the Allocation of Constitutional Costs" (2000) 67 U. Chicago L.R. 345, 347-8 and 415-16.

[142] UNCTAD, *supra* note 28, 145-6.

[143] E.g. World Bank, *World Development Report 2005* (Washington, D.C.: IBRD, 2004), 179. See Kennedy, *supra* note 3, 1692-3; Harlow, *supra* note 10, 209; Lunney and Oliphant, *supra* note 75, 522.

Chapter Five

Approaches and Interpretations

In investment arbitration, arbitrators have broad authority to adjudicate regulatory disputes. Investment treaties rely on arbitrators to resolve important questions about what the treaty means and about the role of investment arbitration as a governing arrangement. Above all, because of their authority to award damages against the state, arbitrators have wide-ranging discretion to make governmental decisions.[1] Arbitration tribunals determine the legality of sovereign acts and the cost and viability of government.[2] They decide the appropriate role of the state with respect to international business and, by implication, investment arbitration awards resolve wider conflicts of rights and interests between investors and those who benefit from the regulation of investors.[3]

The argument of this chapter is that arbitrators make policy choices when they interpret investment treaties. Adjudication is not simply a process of rational interpretation to sensibly and consistently apply rules that govern conduct in specific cases.[4] That said, different adjudicative processes vary in the degree to which they afford discretion to adjudicators, based on the degree of specificity of the language used to define the rules and standards and to delineate the circumstances to which

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[1] K.C. Davis, *Discretionary Justice* (Urbana, Ill.: University of Illinois Press, 1969), 4-5; C. Harlow and R. Rawlings, *Law and Administration* (London: Butterworths, 1997), 633-4.

[2] As discussed in chapter three of this thesis, page 91-3, domestic legal systems limit state liability to individuals who are harmed by governmental activity. To adopt a broad conception of state liability in investment arbitration is a significant departure. To what extent will arbitrators take investment arbitration down this road?

[3] D. Cohen and J.C. Smith, "Entitlement and the Body Politic: Rethinking Negligence in Public Law" (1986) 64 Can. Bar. Rev. 1, 9-10; M. Loughlin, *The Idea of Public Law* (Oxford: OUP, 2003), 148; M. Koskenniemi, "What Is International Law For?" in M.D. Evans, ed., *International Law* (Oxford: OUP, 2004), 99-100.

[4] G. Ganz, "Allocation of Decision-Making Functions" (1972) Pub. L. 215, 215-16; L.L. Fuller, "The Forms and Limits of Adjudication" (1978) 92 Harv. L. Rev. 353, 373; J.P. Trachtman, "The Domain of WTO Dispute Resolution" (1999) 40 Harv. Int'l L.J. 333, 336-7. Accepting the discretionary role of the adjudicator complicates the claim that Chapter 11 arbitration is "a rule-based system that will be elaborated and enforced uniformly and consistently in each of the three NAFTA countries" (C.N. Brower and L.A. Steven, "Who Then Should Judge? Developing the International Rule of Law under NAFTA Chapter 11" (2001) 2 Chi. J. Int'l L. 193, 196).

they apply.[5] Under investment treaties, the scope and substance of investment arbitration is expressed at a very high level of generality and this gives substantial interpretive discretion to tribunals.[6] In turn, this provides a great deal of space for arbitrators to make policy decisions about the appropriate role of government in relation to investors.[7] Of course, any adjudicator who resolves a regulatory dispute may be called upon to make policy choices of profound significance.[8] But the wide discretion of arbitrators stands out, positioning them as important sovereign decision-makers in any state that adopts investment arbitration as a governing arrangement.

A. Approaches to investment arbitration

In NAFTA Chapter 11 awards, the interpretative choices of tribunals reveal two general approaches to the role of investment arbitration. Both approaches reflect traditions in public law adjudication of regulatory disputes and both represent ideals of what public law should do. The first – the *private protection* approach – characterizes investment arbitration as a system designed to comprehensively and presumptively protect investors from government interference. The second – the *public function* approach – characterizes investment arbitration as an exceptional remedy for grave

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5 D. Kennedy, "Form and Substance in Private Law Adjudication" (1976) 89 Harv. L. Rev. 1685, 1687-9; Trachtman, *supra* note 4, 337-8.

6 E.g. *Marvin Roy Feldman Karpa* v. *United Mexican States* (Merits) (16 December 2002), 15(3) World Trade and Arb. Mat. 157 [hereinafter *Feldman*], para. 98. See also e.g. *SGS Société Générale de Surveillance* v. *Pakistan* (Jurisdiction) (6 August 2003), 18 ICSID Rev. 307, 16 World Trade and Arb. Mat. 167 [hereinafter *SGS* v. *Pakistan*], para. 150.

7 F.I. Michelman, "Property, Utility, and Fairness: Comments on the Ethical Foundations of 'Just Compensation' Law" (1967) 80 Harv. L.R. 1165, 1168-71; E. Schwartz and J. Paulsson, "Confronting Political and Regulatory Risks Associated with Private Investment in Infrastructure in Developing Countries: The Role of International Dispute Settlement Mechanism" (Draft presentation to the Private Infrastructure for Development conference, Rome, 8-10 September 1999), 3; M. Sornarajah, *The Settlement of Foreign Investment Disputes* (Boston: Kluwer, 2001), 16.

8 A.V. Dicey, *An Introduction to the Study of the Law of the Constitution* [1885] (London: Macmillan, 8th ed. 1915), 100-4; A. Chayes, "The Role of the Judge in Public Law Litigation" (1976) 89 Harv. L.R. 1281, 1304; P.N. Bhagwati, "Judicial Activism and Public Interest Litigation" (1985) 23 Colum. J. Transnat'l L. 561, 562-3; J.A.G. Griffith, "The Brave New World of Sir John Laws" (2000) 63 Mod. L.R. 159, 160 and 163; M. Shapiro, "Administrative Law Unbounded: Reflections on Government and Governance" (2001) 8 Ind. J. Global Leg. Studies 369, 369-70.

abuses of authority by states. These are simplified categories, no doubt, but they are useful as ideal type groupings for identifying the policy choices of arbitrators.[9]

1. The private protection approach

The private protection approach begins with the rights and interests of investors. It emphasizes the purpose of investment arbitration as being to protect investors from arbitrary, discriminatory, and other inappropriate or undesirable treatment by states.[10] This is consistent with the broad scope and substance of investment treaties and above all with the states' obligation to compensate investors for harm suffered as a result of international wrongs. The ability to bring an international claim gives effect to investor rights by allowing a neutral tribunal to resolve disputes and award damages directly to individuals.[11] Investment arbitration promotes investor security and the rule of law in the exercise of public authority through an expansive conception of state liability.[12] As such, state liability should not be limited by fault-based thresholds or other general conditions; illegality should suffice.[13]

[9] M. Loughlin, *Public Law and Political Theory* (Oxford: Clarendon, 1992), 59-61.

[10] J. Byrne, "NAFTA Dispute Resolution: Implementing True Rule-Based Diplomacy Through Direct Access" (2000) 35 Texas Int'l L.J. 415, 416-20; M.M. Hart and W.A. Dymond, "NAFTA Chapter 11: Precedents, Principles, and Prospects" in L.R. Dawson, ed., *Whose Rights? The NAFTA Chapter 11 Debate* (Ottawa: Centre for Trade Law and Policy, 2002), 149-51; T. Weiler, "NAFTA Investment Arbitration and the Growth of International Economic Law" (2002) 3 Bus. Law Int'l 158, 189; R.G. Dearden, "Arbitration of Expropriation Disputes between an Investor and the State under the North American Free Trade Agreement" (1995) 29 J. World Trade 113, 113; C.H. Brower II, "Investor-State Disputes Under NAFTA: The Empire Strikes Back" (2001) 40 Colum. J. Transnat'l L. 43, 77-80 and 88; I.A. Laird, "NAFTA Chapter 11 Meets Chicken Little" (2001) 2 Chi. J. Int'l L. 223, 229.

[11] *Azurix Corp.* v. *The Argentine Republic* (Jurisdiction) (8 December 2003), 16(2) World Trade and Arb. Mat. 111 [hereinafter *Azurix*], para. 72; *CMS Gas Transmission Company* v. *The Republic of Argentina* (Jurisdiction) (17 July 2003), 42 I.L.M. 788, para. 28 and 45; *Siemens A.G.* v. *The Argentine Republic* (Jurisdiction) (3 August 2004), ICSID Case No. ARB/02/8 [hereinafter *Siemens*], para. 102 and 141, online: ITA http://ita.law.uvic.ca/documents/SiemensJurisdiction-English-3August2004.pdf. R. Bruno and J.H.H. Weiler, "Access of Private Parties to International Dispute Settlement: A Comparative Analysis", Harvard Jean Monnet Working Paper 13/97 (NYU School of Law, 1997).

[12] *Metalclad Corporation* v. *United Mexican States* (Merits) (30 August 2000), 40 I.L.M. 36, 13(1) World Trade and Arb. Mat. 45 [hereinafter *Metalclad*], para. 76, 89, and 99; *CME Republic B.V.* v. *Czech Republic* (Merits) (13 September 2001), 14(3) World Trade and Arb. Mat. 109

The private protection approach tends to resolve doubts arising from silence or ambiguity in the text of an investment treaty in favour of investor protection.[14] This makes for an expansive approach to the jurisdiction of tribunals.[15] With respect to the investment standards, ambiguity favours the availability of compensation and states should be required to answer for official conduct wherever there is *prima facie* evidence of harm to an investor.[16] Encouraging investor security take precedence over other policy concerns such as potential disruption of government, the wider coherence of rules under different treaties, or the legitimacy of economic

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[hereinafter *CME*], para. 522. Laird, *supra* note 10, 229; Brower and Steven, *supra* note 4, 195-7.

[13] *Waste Management Inc.* v. *United Mexican States* (Merits) (30 April 2004), 43 I.L.M. 967, 16(4) World Trade and Arb. Mat. 3 [hereinafter *Waste Management No. 2*], para. 79; *GAMI Investments, Inc.* v. *Government of the United Mexican States* (Merits) (15 November 2004), 17(2) World Trade and Arb. Mat. 127 [hereinafter *GAMI*], para. 94. See e.g. *Asian Agricultural Products Ltd. (AAPL)* v. *Sri Lanka* (Merits) (27 June 1990), 4 ICSID Rep. 246, 30 I.L.M. 577, para. 69 and 77; *Tecnicas Medioambientales Tecmed, S.A.* v. *United Mexican States* (Merits) (29 May 2003), 43 I.L.M. 133 [hereinafter *Tecmed*], para. 70-1.

[14] *Waste Management, Inc.* v. *United Mexican States* (Jurisdiction) (2 June 2000), 40 I.L.M. 56 [hereinafter *Waste Management No. 1*], para. 33-4 (dissenting opinion); *Waste Management No. 2* (Merits), *supra* note 13, para. 85. See e.g. *Wena Hotels Ltd.* v. *Egypt* (Jurisdiction) (25 May 1999), 41 I.L.M. 881, 888; *Ceskoslovenska Obchodni Banka* v. *Slovak Republic* (Jurisdiction) (24 May 1999), 14 ICSID Rev. 251 [hereinafter *CSOB*], para. 57; *SGS Société Générale de Surveillance* v. *Philippines* (Jurisdiction) (29 January 2004), 16(3) World Trade and Arb. Mat. 91 [hereinafter *SGS* v. *Philippines*], para. 116 ("The object and purpose of the BIT supports an effective interpretation of Article X(2). The BIT is a treaty for the promotion and reciprocal protection of investments. According to the preamble it is intended 'to create and maintain favourable conditions for investments by investors of one Contracting Party in the territory of another'. It is legitimate to resolve uncertainties in its interpretation so as to favour the protection of covered investments"); *Tokios Tokelės* v. *Ukraine* (Jurisdiction) (29 April 2004), 16(4) World Trade and Arb. Mat. 75, para. 31-2 and 52; *Siemens*, *supra* note 11, para. 85. R. Dolzer and M. Stevens, *Bilateral Investment Treaties* (The Hague: Martinus Nijhoff, 1995), 17; W.S. Dodge "National Courts and International Arbitration: Exhaustion of Remedies and Res Judicata Under Chapter Eleven of NAFTA" (2000) 23 Hast. Int'l & Comp. L.R. 357, 383.

[15] *Ethyl Corporation* v. *Government of Canada* (Jurisdiction) (24 June 1998), 38 I.L.M. 708 [hereinafter *Ethyl*], para. 91; *Pope & Talbot Inc.* v. *Government of Canada* (Jurisdiction) (26 January 2000) [hereinafter *Pope & Talbot*], para. 25-6 and 33, online: DFAIT http://www.dfait-maeci.gc.ca/tna-nac/documents/pubdoc6.pdf. See e.g. *Emilio Agustín Maffezini* v. *Kingdom of Spain* (Jurisdiction) (25 January 2000), 16 ICSID Rev. 212, 124 I.L.R. 9, para. 52-7 and 64 (finding jurisdiction based on the extension of MFN treatment to the dispute settlement provisions of another BIT); *CSOB*, ibid., para. 64; *Siemens*, *supra* note 11, para. 120.

[16] *Feldman*, *supra* note 6, para. 173 and 176-8. Dolzer and Stevens, *supra* note 14, 60; Dearden, *supra* note 10, 119-20.

integration.[17] The governmental function of an investment treaty is subordinate to international norms based on concepts of private adjudication and individualized justice, including investor rights and the need to limit state abuse.[18]

Underlying the private protection approach is a normative justification for investor protection: many commentators who advocate the private protection approach treat investor protection as an end in itself.[19] That said, investor protection is also advocated as a means to advance efficiency and welfare maximization in the global economy.[20] Thus, investor protection is given an instrumental role tied to general economic rationales for liberalizing capital flows. From this perspective, investor protection benefits states and their populations more or less as a rule. Not only does foreign investment expand the pool of capital available to fuel domestic development, it also delivers new skills and technology, intensifies competition, and opens markets abroad.[21] Even if foreign investment does not deliver demonstrable

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[17] *Metalclad*, *supra* note 12, para. 76; *Waste Management No. 2* (Merits), *supra* note 13, para. 78-85; *GAMI*, *supra* note 13, para. 94. *Compañía del Desarrollo de Santa Elena, S.A.* v. *Republic of Costa Rica* (Merits) (17 February 2000), 15 ICSID Rev. 169, 39 I.L.M. 317 [hereinafter *Santa Elena*], para. 71-2; *CME*, *supra* note 12, para. 419, 602, and 613; *Siemens*, *supra* note 11, para. 120. T. Weiler, *supra* note 10, 173; R.K. Paterson, "A New Pandora's Box? Private Remedies for Foreign Investors under the North American Free Trade Agreement" (2000) 8 Willamette J. Int'l L. and Dispute Res. 77, 120; C.N. Brower, C.H. Brower II, and J.K. Sharpe, "The Coming Crisis in the Global Adjudicative System" (2003) 19 Arb. Int'l 415, 428-35.

[18] *Pope & Talbot Inc.* v. *Government of Canada* (Damages) (31 May 2002), 41 I.L.M. 1347, 14(6) World Trade and Arb. Mat. 44, para. 25-42; *CME*, *supra* note 12, para. 511-16. F. Orrego Vicuña, "Arbitration in a New International Alternative Dispute Resolution" (2001) 18(2) ICSID News 1.

[19] *Metalclad*, *supra* note 12, para. 75-6, 89, and 99; *Pope & Talbot Inc. v. Government of Canada* (Merits, Phase 2) (10 April 2001), 13(4) World Trade and Arb. Mat. 61, para. 42, 72, and 116. Brower, *supra* note 10, 87-8; R. Lillich, "The Law Governing Disputes Under Economic Development Agreements: Re-examining the Concept of 'Internationalization'" in R. Lillich and C.N. Brower, *International Arbitration in the 21st Century: Towards Judicialization and Uniformity?* (Ardsley, N.Y.: Transnational Publishers, 1994), 67-8; C.N. Brower II, "NAFTA's Investment Chapter: Initial Thoughts About Second-Generation Rights" (2003) 36 Vanderbilt J. Transnat'l L. 1533, 1546-8.

[20] P.S. Gibbs, "Prospects for Sustainable Liberalization of Foreign Investment Laws as a Concomitant of Hemispheric Integration in the Americas" (1996) 28 Inter-Am. L.R. 95, 97, 115, and 122; A.M. Rugman and M. Gestrin, "A Conceptual Framework for a Multilateral Agreement on Investment: Learning from the NAFTA" in P. Sauvé and D. Schwanen, eds., *Investment Rules for the Global Economy* (Toronto: C.D. Howe Institute, 1996), 151-5; K.J. Vandevelde, "The Political Economy of a Bilateral Investment Treaty" (1998) 92 AJIL 621, 636-41.

[21] S. Rao and A. Ahmad, "Formal and Informal Investment Barriers in the G-7 Countries" in P. Sauvé and D. Schwanen, eds., *Investment Rules for the Global Economy* (Toronto: C.D. Howe

benefits on the short term, a state's consent to high level investor protection signals its commitment to free markets.[22] As a general rule, investment treaties should be interpreted in favour of investor protection and there is little need for detailed inquiry into the implications of a particular interpretation for governments.[23]

Generally speaking, the private protection approach is consistent with a liberal normative tradition in public law, drawing on writers such as Hayek and Nozick.[24] It supports the idea that rights precede the state and that it is possible to articulate and apply rationally-justifiable guiding principles of social order.[25] Moreover, the approach reflects the view that an ideal society is permissive rather than purposive, and that the chief responsibility of government is "the specific and limited activity of establishing and enforcing general rules of conduct which enable people to pursue their activities with the minimum degree of frustration".[26] Investment treaties are a recent and very effective incarnation of longstanding efforts to use law and adjudication – including the remedy of damages – to constrain the state and protect private rights and freedoms.[27]

Institute, 1996), 176-7; UNCTAD, *World Investment Report 2003* (Geneva: United Nations, 2003), 139, note 138.

[22] Dolzer and Stevens, *supra* note 14, 12; UNCTAD, *Trends in International Investment Agreements: An Overview*, UNCTAD Series on Issues in International Investment Agreements (New York: United Nations, 1999), 47.

[23] E.g. *Siemens*, *supra* note 11, para. 81. D.F. Donovan, "Introduction to Articles – Dallas Workshop on Arbitrating with Sovereigns" (2002) 18 Arb. Int'l 229, 229; T. Weiler, *supra* note 10, 181.

[24] F. von Hayek, *The Road to Serfdom* (Chicago: University of Chicago Press, 1944); F. von Hayek, *Law Legislation and Liberty*, vol. 1 (London: Routledge and Kegan Paul, 1973); R. Nozick, *Anarchy, State and Utopia* (Oxford: Blackwell, 1974). See Harlow and Rawlings, *supra* note 1, 37-9; Loughlin, *supra* note 9, 60-1 and 91-9.

[25] Loughlin, *supra* note 9, 88; D. Shelton, *Remedies in International Human Rights Law* (Oxford: OUP, 1999), 53-4.

[26] Loughlin, *supra* note 9, 89.

[27] E.g. Cooley, "Labor and Capital Before the Law" (1884) 139 North Am. Rev. 37. See M.M. Carrow, *The Background of Administrative Law* (Newark: Associated Lawyers, 1948), 20-1; P. Cane, "Public Law and Private Law: A Study of the Analysis and Use of a Legal Concept" in J. Eckelaar and J. Bell, eds., Oxford Essays in Jurisprudence, 3rd series (Oxford: Clarendon, 1987), 59-60; Harlow and Rawlings, *supra* note 1, 606 and 619-20; W.A. Fischel, *Regulatory Takings: Law, Economics, and Politics* (Cambridge: Harvard University Press, 1995), 7.

2. The public function approach

The public function approach begins not with investors but with states. It emphasizes the role of states in concluding and implementing the treaties that establish investment arbitration.[28] Investor protection is provided for a public purpose because all investment treaties originate in the exercise of public authority.[29] Private parties have powers under investment treaties but these powers are authorized or delegated, by states, for a policy reason.[30] Also, the regulation of the exercise of public authority – through investment arbitration – should not undermine the general viability of government.[31] The exercise of public authority is not objectionable, absent evidence of an abuse of authority that specifically targets foreign investors.[32] Investment

[28] *ADF Group Inc.* v. *United States of America* (Merits) (9 January 2003), 15(3) World Trade and Arb. Mat. 55 [hereinafter *ADF*], para. 177; *The Loewen Group, Inc. and Raymond L. Loewen* v. *United States of America* (Merits) (26 June 2003), 42 I.L.M. 811, 15(5) World Trade and Arb. Mat. 97 [hereinafter *Loewen*], para. 222-3 and 233.
[29] E.g. *North American Free Trade Agreement*, 17 December 1992, 32 I.L.M. 296 and 605 (entered into force 1 January 1994) [hereinafter NAFTA], preamble (describing the purpose of the treaty as being to encourage economic opportunities, growth, competition, and employment in the NAFTA states). *Loewen*, ibid., para. 222; *Salini Costruttori S.P.A. and Italstrade S.P.A.* v. *Kingdom of Morocco* (Jurisdiction) (23 July 2001), 42 I.L.M. 609, para. 52. A.A. Fatouros, "Transnational Enterprise in the Law of State Responsibility" in R.B. Lillich, ed., *International Law of State Responsibility for Injuries to Aliens* (Charlottesville: University Press of Virginia, 1983), 364; P.I. Hansen, "Judicialization and Globalization in the North American Free Trade Agreement" (2003) 38 Texas Int'l L.J. 489, 502-3.
[30] *SGS* v. *Philippines*, *supra* note 14, para. 154. See *Lagrand* (Merits) (*Germany* v. *United States*), [2001] I.C.J. Rep. 466, 40 I.L.M. 1069, para. 77-8 ("Although under modern international law, treaties may confer rights, substantive and procedural, on individuals, they will normally do so in order to achieve some public interest").
[31] *Robert Azinian et al.* v. *United Mexican States* (Merits) (1 November 1999), 39 I.L.M. 537 [hereinafter *Azinian*], para. 87; *S.D. Myers, Inc.* v. *Government of Canada* (Merits) (12 November 2000), 40 I.L.M. 1408, 15(1) World Trade and Arb. Mat. 184, para. 261-3 and 282; *ADF*, *supra* note 28, para. 170 and 173; *Loewen*, *supra* note 28, para. 242; *Waste Management No. 2* (Merits), *supra* note 13, para. 161. J. Kurtz, "A General Investment Agreement in the WTO? Lessons from Chapter 11 of NAFTA and the OECD Multilateral Agreement on Investment", Jean Monnet Working Paper (NYU School of Law, 2002), 69; D. Brown, "Commentary" in L. Ritchie Dawson, ed., *Whose Rights? The NAFTA Chapter 11 Debate* (Ottawa: Centre for Trade Policy and Law, 2002), 40-1; J.A. VanDuzer, "NAFTA Chapter 11 to Date: The Progress of a Work in Progress" in L. Ritchie Dawson, ed., *Whose Rights? The NAFTA Chapter 11 Debate* (Ottawa: Centre for Trade Law and Policy, 2002), 95.
[32] *ADF*, *supra* note 28, para. 156-7; *Loewen*, *supra* note 28, para. 135; *Waste Management No. 2* (Merits), *supra* note 13, para. 115 and 130-2.

arbitration should be used to deter state conduct that flaunts international standards, but not to sanction general regulation.[33]

In investment arbitration, the public function approach imposes limits on the jurisdiction of tribunals by looking to the precise language of the treaty.[34] Customary international law does not permit individuals to make claims against states; thus, clear language is required for a state to be found to have consented to such claims.[35] Investment arbitration is an exceptional remedy reserved for clear violations of the treaty.[36] Because states are the main subjects of regulation, tribunals should interpret investment treaties to promote predictability not only for investors but also for governments.[37] Tribunals may need to consider wider concerns such as public opposition to a particular investment, the development of the host state, social and environmental priorities, and the coherence and legitimacy of integration.[38] State

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[33] J.A. McKinney, *Created from NAFTA – The Structure, Function, and Significance of the Treaty's Related Institutions* (Armonk, N.Y.: M.E. Sharpe, 2000), 230-1; J.H.H. Weiler, "Emerging Issues on Compliance and Effectiveness of Community Law" (1997) 91 ASIL Proc. 172, 173-4.

[34] *Methanex Corporation* v. *United States of America* (Jurisdiction) (7 August 2002), 14(6) World Trade and Arb. Mat. 109 [hereinafter *Methanex*], para. 106; *ADF*, *supra* note 28, para. 147; *Loewen*, *supra* note 28, para. 234; *Waste Management No. 1*, *supra* note 14, para. 27-8 and 31; *United Parcel Service of America, Inc.* v. *Government of Canada* (Jurisdiction) (22 November 2002) [hereinafter *UPS*], para. 68, online: ITA http://ita.law.uvic.ca/documents/UPS-Jurisdiction.pdf.

[35] *Azinian*, *supra* note 31, para. 82-4; *UPS*, ibid., para. 60-9; *Loewen*, *supra* note 28, para. 226; *Fireman's Fund Insurance Company* v. *United Mexican States* (Jurisdiction) (17 July 2003), 15(6) World Trade and Arb. Mat. 3, para. 64. *SGS* v. *Pakistan*, *supra* note 6, para. 161, 167, and 171; *Tokios*, *supra* note 14, para. 8 (dissenting opinion).

[36] *Azinian*, *supra* note 31, para. 90; *ADF*, *supra* note 28, para. 157, 184, and 191; *Loewen*, *supra* note 28, para. 242; *Waste Management No. 2* (Merits), *supra* note 13, para. 115, 130, and 139; *GAMI*, *supra* note 13, para. 83-4, 104, 108, and 114. A.A. Fatouros, "International Economic Development and the Illusion of Legal Certainty" (1963) 57 ASIL Proc. 117, 124; J.C. Thomas, "Investor-State Arbitration Under NAFTA Chapter Eleven" (Paper presented to the NAFTA Chapter 11 Investor-State Disputes: Litigating Against Sovereigns conference, Canadian Bar Association, Toronto, March 2000), 42; P.T. Muchlinski, "The Rise and Fall of the Multilateral Agreement on Investment: Where Now?" (2000) 34 Int'l Law. 1033, 1051-2.

[37] *Methanex*, *supra* note 34, para. 130 and 137-8. *SGS* v. *Pakistan*, *supra* note 6, para. 167. J.C. Thomas, "Reflections on Article 1105 of NAFTA: History, State Practice and the Influence of Commentators" (2002) 17 ICSID Rev. 21, 29; Center for International Environmental Law (CIEL), "International Law on Investment: The Minimum Standard of Treatment (MST)" (CIEL Issue Brief, August 2003), 6-7.

[38] *Waste Management No. 2* (Merits), *supra* note 13, para. 101 and 111-12; *Loewen*, *supra* note 28, para. 242. See e.g. *Salini*, *supra* note 29, para. 52; *SGS* v. *Pakistan*, *supra* note 6, para. 167-8; *Tecmed*, *supra* note 13, para. 133 and 146-8. A.A. Fatouros, "International Law and the Third World" (1964) 50 Va. L.R. 783, 813-14; McKinney, *supra* note 33, 231; C. Tollefson, "Games without Frontiers: Claims and Citizen Submissions Under the NAFTA Regime" (2002) 27

liability is tied to the public purpose of the treaty and, given the governmental implications of state liability, tribunals should exercise prudence in awarding damages.[39] Where an investor suffers harm as a result of the non-culpable exercise of public authority, this may simply be part of the risk inherent in the investor's decision to carry on business abroad.[40]

The public function approach is justified by the principle of respect for the states' consent.[41] It recognizes that an important purpose of investment treaties is to provide protection for investors in order to encourage investment. However, the public function approach is more likely to look for evidence of the benefits of investor protection for the host economy and not rely solely on references to a liberal conception of the international economy.[42] Investment should not be encouraged at the expense of domestic government, which retains ultimate responsibility for the public welfare.[43] Investor protection is a means to a public end and it should not undermine the viability of the state itself.[44]

Yale J. Int'l L. 141, 153; J. Werner, "Some Comments on the NAFTA Chapter 11 Case – *ADF Group Inc. and United States of America*" (2003) 4 J. World Investment 113, 123-4; UNCTAD, *supra* note 21, 117.

[39] *Azinian, supra* note 31, para. 99; *Loewen, supra* note 28, para. 242. See e.g. *CME Republic B.V.* v. *Czech Republic* (Damages) (14 March 2003), 15(4) World Trade and Arb. Mat. 83 and 245 [hereinafter *CME*], para. 74-8 (separate opinion); *SGS* v. *Pakistan, supra* note 6, para. 171.

[40] *Azinian, supra* note 31, para. 83; *Waste Management No. 2* (Merits), *supra* note 13, para. 114 and 177; *GAMI, supra* note 13, para. 85. See also *Barcelona Traction, Light and Power Co. (Belgium* v. *Spain*), [1970] I.C.J. Rep. 3, 9 I.L.M. 227 [hereinafter *Barcelona Traction*], para. 87; *Emilio Agustín Maffezini* v. *The Kingdom of Spain* (Merits) (13 November 2000), 16 ICSID Rev. 248, 124 I.L.R. 35, para. 64. W.L. 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, 129-30; C. Eagleton, *The Responsibility of States in International Law* (New York: NYU Press, 1928), 159.

[41] *Loewen, supra* note 28, para. 230, 233-4, and 238. *Tokios, supra* note 14, para. 16 (dissenting opinion). Thomas, *supra* note 36, 16-19 and 29-30; Schwartz and Paulsson, *supra* note 7, 13-14.

[42] Fatouros, *supra* note 36, 117-18 and 122.

[43] *Azinian, supra* note 31, para. 87; *ADF, supra* note 28, para. 170 and 173; *Loewen, supra* note 28, para. 242; *Waste Management No. 2* (Merits), *supra* note 13, para. 161; *GAMI, supra* note 13, para. 114.

[44] *CME, supra* note 39, para. 75 and 78 (separate opinion). D. Rodrik, *The Global Governance of Trade As If Development Really Mattered* (Report for the UN Development Programme, October 2001), 22.

The public function approach is consistent with a realist and functionalist tradition in public law.[45] In this tradition, legal rights emanate from the state and the law is viewed as positivist and goal-oriented.[46] Thus, the public function approach is more consistent with approaches that characterize public law as a facilitator of government rather than a control mechanism.[47] This theoretical tradition is skeptical of the use of adjudication to control the state, and it adopts a moderated view of the idea of the rule of law and the application of corrective justice in the public sphere.[48]

B. The policy choices of arbitrators

The balance of this chapter explores these approaches to investment arbitration in the context of NAFTA Chapter 11. At the outset, it is worth noting that these approaches involve more than a simple presumption in favour of an expansive or restrictive interpretation of investment treaties even though it may appear, in some cases, that tribunals implicitly adopt such a presumption.[49] Rather, the approaches are intended to suggest how interpretive quandaries can be resolved by arbitrators in different ways, with divergent implications for investors, states, and those formally

[45] E.g. W.I. Jennings, *The Law and the Constitution*, 5th ed. (London: University of London Press, 1959), 60-1, 78-9, and 217; J. Griffith and H. Street, *Principles of Administrative Law*, 5th ed. (London: Pitman, 1973), 4; R. Dussault and L. Bourgeat, *Administrative Law – A Treatise* (Toronto: Carswell, 1985), 7-8. See Harlow and Rawlings, *supra* note 1, 67-75; Loughlin, *supra* note 9, 131, 134 and 168-9.

[46] Fatouros, *supra* note 38, 813-14; Loughlin, *supra* note 9, 60-1 and 133-7; Loughlin, *supra* note 3, 86.

[47] Carrow, *supra* note 27, 15 and 22-3; J. Willis, "Canadian Administrative Law in Retrospect" (1974) 24 U.T.L.J. 225, 229; C. Sunstein, "In Defense of the Hard Look: Judicial Activism and Administrative Law" (1984) 7 Harv. J. L. & Pub. Policy 51, 58-9; Dussault and Bourgeat, *supra* note 45, 3; Cane, *supra* note 27, 59-60; Harlow and Rawlings, *supra* note 1, 67-72.

[48] Fatouros, *supra* note 36, 124-5; Davis, *supra* note 1, 25-6; Chayes, *supra* note 8, 1302 and 1316; K. Roach, "The Limits of Corrective Justice and the Potential of Equity in Constitutional Remedies" (1991) 33 Ariz. L.R. 859; T. Bingham, *The Business of Judging* (Oxford: OUP, 2000), 35.

[49] A number of tribunals have rejected the view that NAFTA should presumptively be interpreted either expansively or restrictively: *Ethyl*, *supra* note 15, para. 55-6; *The Loewen Group, Inc. and Raymond L. Loewen* v. *United States of America* (Jurisdiction) (5 January 2001), ICSID Case No. ARB(AF)/98/3, para. 51, online: State Department http://www.state.gov/documents/organization/3921.pdf; *Methanex*, *supra* note 34, para. 103-5; *UPS*, *supra* note 34, para. 40; *Fireman's Fund*, *supra* note 35, para. 64. See also *Southern Pacific Properties (Middle East) Ltd.* v. *Arab Republic of Egypt* (Jurisdiction) (14 April 1988), 3 ICSID Rep. 131, para. 63.

represented by states. Some Chapter 11 tribunals have used different interpretive techniques to resolve issues arising from silence or ambiguity in the treaty text. As argued below, tribunals that favour the private protection approach have interpreted ambiguity in the definition of the NAFTA standards in favour of investor protection and, as such, in favour of arbitrator discretion to award damages. In contrast, other tribunals have adopted the public function approach by applying customary rules of international law so as to limit state liability.

In this discussion, the focus is on those Chapter 11 awards that most clearly reflect either the private protection or the public function approach. In particular, the *Pope & Talbot* tribunal is highlighted as the clearest example of how ambiguity in the NAFTA text allows tribunals to make policy choices in favour of investor protection.[50] On the other hand, the *Loewen* tribunal most clearly shows how textual ambiguity leaves room for tribunals to limit the state's consent to investment arbitration, consistent with the public function approach. More than other Chapter 11 awards, the decisions of these tribunals stand out as examples of the discretionary choices of arbitrators. That said, they also exemplify broader tendencies in investment arbitration in that their reasoning is echoed by other tribunals and by commentators, and in the submissions of investors or states.

The starting point for the interpretation of an investment treaty is Article 31 of the *Vienna Convention on the Law of Treaties*, which adopts an essentially textual approach to treaty interpretation, although leaving room for a teleological approach based on the corollary principles of integration and contemporaneity.[51] Article 31 directs adjudicators to interpret the text of a treaty, first, by determining the ordinary

[50] *Feldman*, *supra* note 6, para. 195-7 (distinguishing *S.D. Myers* and *Pope & Talbot*: "It is obvious that in both of these earlier cases, which as here involved non-expropriation violations of Chapter 11, the tribunals exercised considerable discretion in fashioning what they believed to be reasonable approaches to damages consistent with the requirements of NAFTA").

[51] *Vienna Convention on the Law of Treaties*, 22 May 1969, 1155 U.N.T.S. 331 (entered into force 27 January 1980) [hereinafter *Vienna Convention*], art. 31. See *In the Matter of Cross-border Trucking Services* (Merits) (6 February 2001), 13(3) World Trade and Arb. Mat. 121, para. 220-2; *Methanex*, *supra* note 34, para. 97-9; *UPS*, *supra* note 34, para. 43-6 and 63; I. Sinclair, *The Vienna Convention and the Law of Treaties* (Manchester: Manchester University Press, 1984), 130 ("reference to the object and purpose of the treaty is, as it were, a secondary or ancillary process in the application of the general rules on interpretation"); M. Lennard, "Navigating by the Stars: Interpreting the WTO Agreements" (2002) 5 J. Int'l Econ. L. 17, 28-9.

meaning of the words used by the states parties.[52] If an issue can be resolved by examining the ordinary meaning, then this should end the inquiry.[53] On the other hand, where the text is not clear on its face, an adjudicator must seek out the intentions of the states parties by looking at the context surrounding the relevant provision and the treaty, as well as the object and purpose of the treaty.[54] Engaging in this wider search for meaning sometimes requires an adjudicator to resolve doubts arising from silence or ambiguity.[55] In such cases, the adjudicator must often choose from alternative interpretations to determine the states parties' obligations.

The tendency for a legal text to be ambiguous is sometimes exaggerated.[56] In most cases, legal language is sufficiently clear to foreclose reasonable dispute about its meaning and, as such, the formalist proposition that rules can be rationally and consistently applied should not be dismissed as a meaningless concept. Even so, any interpretive process confronts moments of genuine contradiction and doubt. In investment arbitration, these moments are relatively common because key provisions in investment treaties are expressed at a high level of generality and because international adjudication is not normally used to resolve regulatory disputes.[57] On its face, NAFTA Chapter 11 – like other investment treaties – often supports a range of readings and this multiplies and inflates the interpretive choices open to tribunals.[58]

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[52] International Law Commission, *Commentary to its Final Draft Articles*, Commentary to draft article 27, [1966] 2 Y.B. Int'l L. Comm., para. 12 (describing as the "very essence of the textual approach" the principle that "the parties are to be presumed to have that intention which appears from the ordinary meaning of the terms used by them").

[53] WTO Appellate Body, *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products*, WTO Doc. WT/DS50/AB/R (24 August 1998), para. 45.

[54] *Vienna Convention*, *supra* note 51, art. 31(1).

[55] First, the adjudicator must determine whether the text is ambiguous, and then resolve the ambiguity one way or another. In the process, the adjudicator can give different degrees of weight to the context of the provision, relative to the treaty text, or even search for textual ambiguity in order to look to the treaty's "object and purpose" and thereby obtain greater discretion. See G.G. Fitzmaurice, "The Law and Procedure of the International Court of Justice: Treaty Interpretation and Certain Other Treaty Points" (1951) 28 Brit. Y.B. Int'l L. 1, 7-8; I. Brownlie, *Principles of Public International Law*, 6th ed. (Oxford: OUP, 2003), 607.

[56] E.g. Trachtman, *supra* note 4, 339 (downplaying the importance of the text as the first indicator of intention).

[57] T. Wälde and S. Dow, "Treaties and Regulatory Risk in Infrastructure Investment" (2000) 34(2) J. World Trade 1, 45. See Loughlin, *supra* note 9, 92.

[58] *Feldman*, *supra* note 6, para. 98 (the language of NAFTA Article 1110 is "of such generality as to be difficult to apply in specific cases"). See also e.g. *SGS* v. *Pakistan*, *supra* note 6, para. 150. K. McGuire, "Commentary" in L. Ritchie Dawson, ed., *Whose Rights? The NAFTA Chapter 11 Debate* (Ottawa: Centre for Trade Policy and Law, 2002), 171-2.

Arbitrators are implicitly required (sometimes they appear eager) to assess the underlying rationales for investor protection in relation to alternative readings, each reasonably defensible because of silence or ambiguity in the text. Textual ambiguity enhances arbitrator discretion, allowing divergent conceptions of investment arbitration to emerge.

1. Expanding the standards of investor protection: the Pope & Talbot award

In defining the NAFTA standards of investor protection, a number of Chapter 11 tribunals have interpreted ambiguous language in a way that expands the authority of arbitrators to award damages to investors, and thus in favour of investor protection. Examples of this private protection approach to investment arbitration are reviewed in this section, focusing on the *Pope & Talbot* tribunal.

a. National treatment

The rule of national treatment under NAFTA Article 1102 exemplifies the interpretive discretion that is available to Chapter 11 arbitrators. As discussed in chapter four of this thesis, the complexity of national treatment under Article 1102 arises from the ambiguity of the term "in like circumstances" and from the need for a tribunal to determine how far to cast the comparative net in evaluating differential treatment between foreign and domestic investors. Also, Article 1102 can be interpreted as prohibiting *de facto* as well as *de jure* discrimination, making it possible for a tribunal to review a very wide range of governmental policies that have discriminatory effects on investors.

In the *Pope & Talbot* dispute, the investor was a company based in Oregon that operated three sawmills in British Columbia, Canada. The investor's claim under Chapter 11 related to Canada's implementation of the Canada-United States *Softwood Lumber Agreement* of 1996.[59] Softwood lumber has long been a source of conflict

[59] *Softwood Lumber Agreement between the Government of Canada and the Government of the United States of America*, Washington, 29 May 1996, C.T.S. 1996/16, 35 I.L.M. 1195 (entered into force 29 May 1996).

between Canada and the United States, primarily relating to which country would be the host to value-added processing of raw logs.[60] This historical dispute was temporarily resolved by the *Softwood Lumber Agreement* in which Canada agreed (under the threat of U.S. trade retaliation) to limit exports of softwood lumber to the U.S. To carry out this commitment, Canada imposed a quota on exports of softwood lumber from the Canadian provinces that were targeted by the U.S. for trade retaliation. The quota was allocated among these provinces based on their past export levels to the U.S. Each province then distributed its share of the quota among producers in the province.

In its Chapter 11 claim, the investor in *Pope & Talbot* claimed, among other things, that Canada violated national treatment by instituting export controls under the *Softwood Lumber Agreement* in some provinces but not others.[61] The investor's sawmills were in British Columbia which was subject to the export controls. Thus, the investor's operations were treated less favourably than sawmills in other provinces where the export controls did not apply. This, the investor argued, violated Article 1102.[62] In a strict sense the investor's claim was true: by differentiating between investments according to the province in which they were located, Canada's export controls were *de facto* discriminatory.[63] However, in context, Canada's differentiation between provinces was logical because of the circumstances of the underlying dispute with the U.S. During the period that led to the *Softwood Lumber Agreement*, the U.S. targeted some but not all provinces for trade retaliation.[64] But for this threat, Canada would not have imposed export controls in the first place. Thus, the export controls were logically limited to those provinces that were subject to the U.S. threat of retaliation, including British Columbia. Moreover, Canada applied the export controls

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[60] R.W. Gorte, "Softwood Lumber Imports: The 1996 U.S.-Canada Agreement", United States Congressional Research Service Report No. 96-540 (13 June 1996), 1-2.
[61] *Pope & Talbot* (Investor's Submissions) (28 January 2000), para. 80-90, online: DFAIT http://www.dfait-maeci.gc.ca/tna-nac/documents/A-1.pdf.
[62] Ibid.
[63] The investor's claim in *Pope & Talbot* appeared to be one of *de facto* discrimination since Canada's export controls did not explicitly target foreign investors, although the tribunal declined to characterize the claim as one of either *de facto* or *de jure* discrimination: *Pope & Talbot* (Merits, Phase 2), *supra* note 19, para. 70.
[64] The U.S. targeted softwood lumber imported from Canadian provinces that the U.S. claimed unfairly subsidized softwood lumber production through their forest management practices: Gorte, *supra* note 60, 1-2.

in the same manner to all of the lumber operations in British Columbia whether foreign or domestic: all were subject to the limits on exports to the U.S.

Viewed from a public function perspective, the investor's argument was tenuous given that the purpose of the *Softwood Lumber Agreement* was to maintain trade flows. Without the export controls under the *Softwood Lumber Agreement*, the investor would have had less access to the U.S. market or none at all. Accepting the investor's claim would have the perverse effect of exempting the investor from general limits that were placed on the Canadian industry as a whole in furtherance of continued international trade. In these circumstances, the investor's arguments were like those of the heart attack victim who, after being saved by emergency CPR, then sues the paramedic for bruised ribs.

Adopting the private protection approach, the *Pope & Talbot* tribunal accepted the investor's submissions that Canada's differentiation between provinces violated national treatment. Before examining this finding, though, let us look more closely at the options that were available to the tribunal had it chosen to reject the investor's argument. Doing so highlights the policy choices underlying the interpretation of Article 1102. For one, the *Pope & Talbot* tribunal could have rejected the investor's claim by adopting Canada's argument – supported by the other NAFTA states including the investor's home state – that a violation of Article 1102 based on *de facto* discrimination must be connected to the nationality of the affected investor or investment.[65] According to this view it was insufficient for Canada's export controls to have a less favourable effect on the investor in *Pope & Talbot*. To violate Article 1102, any less favourable effect had to be linked to the investor's nationality and since the investor did not establish this, it was argued, the claim should fail.[66]

Alternatively, the panel could have adopted a proportionality-based approach to *de facto* discrimination. Adopting this approach, Canada argued, the investor should

[65] *Pope & Talbot* (Merits, Phase 2), *supra* note 19, para. 79; *Pope & Talbot* (Canada's Submission) (29 March 2000), para. 171 and 194; (Mexico's Submissions) (3 April 2000), para. 67-70; (U.S. Submissions) (7 April 2000), para. 3 and 6; online: DFAIT http://www.dfait-maeci.gc.ca/tna-nac/phases-en.asp#1. See also J.H.H. Weiler, "Epilogue: Towards a Common Law of International Trade" in J.H.H. Weiler, ed., *The EU, the WTO, and the NAFTA* (Oxford: OUP, 2000), 209-10.

[66] As an alternative, the investor needed to show that the softwood lumber industry in British Columbia had a higher proportion of foreign investors than provinces that received more favourable treatment. Since this was not the case, Canada argued, the claim should fail.

be required to show that any less favourable effect of Canada's export controls was experienced by a minimum proportion of foreign lumber operations in the softwood industry.[67] In other words, the investor should have to show that any discriminatory effect exceeded a reasonable quantitative threshold. This approach was not without its difficulties. As the tribunal noted, it depended on an analysis of foreign investors and investments in the Canadian industry.[68] But the utility of this approach was that it made Article 1102 more predictable for governments faced with the task of applying NAFTA to myriad domestic policies and programs that might affect investors.[69]

These interpretations of national treatment were open to the *Pope & Talbot* tribunal because of the ambiguous language of Article 1102. However, the tribunal rejected them on the basis that they depended on an unfeasible contextual inquiry and created too high a burden for investors to meet.[70] For instance, the tribunal concluded that the analysis required for the quantitative approach was impractical because the relevant industry included "more than 500 softwood lumber quota holders operating in Canada".[71] Also, the tribunal concluded that applying a threshold of proportionality to Article 1102, even as a mere indicator of protectionism, would "hamstring foreign owned investments seeking to vindicate their Article 1102 rights".[72] Finally, the tribunal said that the NAFTA states' argument that *de facto* discrimination must be linked to nationality "would tend to excuse discrimination that is not facially directed at foreign owned investments".[73] In each case, the tribunal avoided fettering its discretion even where it was urged to do so by the NAFTA states.[74]

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[67] *Pope & Talbot* (Merits, Phase 2), *supra* note 19, para. 44.
[68] Ibid., para. 71.
[69] J.H.H. Weiler, *supra* note 65, 209-10.
[70] Yet, two pages after rejecting Canada's quantitative approach to *de facto* discrimination as impractical, the tribunal engaged in a similarly contextual analysis of whether investors were in "like circumstances". The tribunal concluded, *supra* note 19, para. 75, that the resolution of this issue "will require evaluation of the entire fact setting surrounding, in the case, the genesis and application of the [*Softwood Lumber Agreement*]". It is a technique of flexible interpretation, in itself, to conclude that the need for a contextual analysis is impractical in relation to the analysis of *de facto* discrimination, but not "like circumstances".
[71] Ibid., para. 71.
[72] Ibid., para. 72.
[73] Ibid., para. 79.
[74] Ibid.

Instead, the tribunal adopted an expansive interpretation of Article 1102 by concluding that *any difference in treatment* between a foreign and domestic investment, however exceptional in the wider context, was a presumptive violation of Article 1102.[75] Once the tribunal concluded that the investor in *Pope & Talbot* had overcome this low threshold, it then asked whether differences in Canada's treatment of the investor were justified. According to the tribunal, differences in treatment would be justified where:[76]

> .... they have a reasonable nexus to rational government policies that (1) do not distinguish, on their face or *de facto*, between foreign-owned and domestic companies, and (2) do not otherwise unduly undermine the investment liberalizing objectives of NAFTA.

Thus, the tribunal fashioned a broad exception to its "presumptive violation" interpretation of Article 1102 based on the rationality and reasonableness of government decision-making.[77] Relying on this exception, the tribunal found that Canada's implementation of the *Softwood Lumber Agreement* did not violate national treatment. This allowed the tribunal to avoid the over-inclusive implications of the investor's claim, but only by adopting an exception that was as broad as the original concept of *de facto* discrimination. When confronted by textual ambiguity the tribunal preferred an expansive approach to arbitrator discretion in order to further investor protection.[78]

The *Pope & Talbot* tribunal's interpretation of Article 1102 can be contrasted with tribunals that tend toward the public function approach. For instance, the *ADF* tribunal adopted a narrower view of national treatment.[79] Rather than emphasizing

[75] Ibid., para. 78. See J.R. Johnson, "How Will International Trade Agreements Affect Canadian Health Care?" (Discussion Paper No. 22 for the Commission on the Future of Health Care in Canada, September 2002), 10-11.

[76] *Pope & Talbot* (Merits, Phase 2), *supra* note 19, para. 78. See also *Tecmed*, *supra* note 13, para. 122 (adopting a broad definition of expropriation, accompanied by a broad exception for proportionate regulatory measures).

[77] For a critical reaction to this interpretation, from a private protection perspective, see T. Weiler, *supra* note 10, 173.

[78] J.H.H. Weiler, *supra* note 65, 213-14.

[79] *ADF*, *supra* note 28, para. 157. See also *Mondev International Ltd.* v. *United States of America* (Merits) (11 October 2002), 42 I.L.M. 85, 15(3) World Trade and Arb. Mat. 273 [hereinafter *Mondev*], para. 65; *Loewen*, *supra* note 28, para. 139 and 156; *Feldman*, *supra* note 6, 258-70 (dissenting opinion); GAMI, *supra* note 13, para. 114.

the tribunal's authority to seek out discriminatory effects of a regulatory measure, the *ADF* tribunal held the investor to a higher burden of proof in establishing a *prima facie* case. Specifically, the *ADF* tribunal rejected a claim by a Canadian steel producer that the United States' *Buy America* program violated national treatment, finding that the investor's evidence of discrimination was:[80]

> not sufficient to show what the relevant competitive situation of Canadian fabricators and U.S. fabricators was in general, nor was it evidence of the comparative costs of steel fabrication in the U.S. and Canadian facilities, in particular.

Thus, the claim was rejected for lack of evidence of systemic discrimination, despite the outwardly protectionist character of the *Buy America* program.[81] In contrast, the *Pope & Talbot* tribunal's presumptive violation test virtually removed the *prima facie* evidentiary burden in circumstances that had no obvious connection to protectionism. The *ADF* tribunal's more restrained approach reflects different assumptions about what NAFTA Chapter 11 was intended to do and about the extent of discretion that it grants to Chapter 11 tribunals.[82] That is, it reflects a policy choice about the degree to which investment arbitration should be used to constrain governmental activity.

b. The minimum standard of treatment

The investor in *Pope & Talbot* also argued that Canada violated the NAFTA minimum standard of treatment (Article 1105) in the course of Canada's implementation of the *Softwood Lumber Agreement* and related treatment of the investor's sawmills in British Columbia.[83] Article 1105 requires that the NAFTA states, among other things,

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[80] *ADF*, *supra* note 28, para. 157.

[81] Ibid. See Werner, *supra* note 38, 122 (commenting that the tribunal's decision "leaves a somewhat bitter taste" given the disproportionate impact of the *Buy America* requirements on foreign steel manufacturers).

[82] J.H.H. Weiler, *supra* note 65, 225-6, citing *Keck & Mithouard* (No. C-267 and 268/91), [1993] E.C.R. I-6097, para. 16.

[83] *Pope & Talbot* (Merits, Phase 2), *supra* note 19, para. 120-7, 150-1, 156 and 182. See also *Pope & Talbot Inc. v. Government of Canada* (Merits, Phase 1) (26 June 2000), 13(4) World Trade and Arb. Mat. 19, para. 79-80 and 104-5 (dismissing the investor's claims that Canada violated NAFTA Articles 1106 (performance requirements) and 1110 (expropriation)). The

provide a minimum standard of treatment that is "in accordance with international law", leading to the question in *Pope & Talbot* of the meaning of the term "international law".[84] The text of Article 1105 is arguably ambiguous on this point because it does not precisely lay out the elements of international law that are applicable under NAFTA, other than general references to "fair and equitable treatment" and "full protection and security". Further, the text does not expressly state whether these phrases – or Article 1105 as a whole – reflect the minimum standard under *customary* international law alone or whether they also include other sources of international law. Historically, the debate about the minimum standard for foreign nationals was rooted in customary international law and this might have provided a basis for the *Pope & Talbot* tribunal to conclude that the meaning of "international law" in Article 1105 was limited to customary international law.[85] Yet, the text leaves an opening, however narrow, for other interpretations.

Consistent with the view that textual ambiguity should be interpreted in favour of investor protection, the investor in *Pope & Talbot* argued that Article 1105 went beyond customary international law to incorporate standards from other sources of international law.[86] This "additive theory" posited that, because Article 1105 did not explicitly exclude additional sources of international law, the NAFTA standard included all of the sources of international law referred to in Article 38 of the *Statute of the International Court of Justice*.[87] On this reading, the NAFTA standard emerges as a broad guarantee of fair treatment and economic due process.[88] From a public function perspective, given the implications of this interpretation for governments, one would expect the *Pope & Talbot* tribunal to tread carefully. In particular, one might expect the tribunal to accept the unanimous submissions of the NAFTA states

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focus here is on the tribunal's analysis of the investor's claims under Articles 1102 and 1105 because they most clearly demonstrate the private protection approach.

[84] *Pope & Talbot* (Merits, Phase 2), *supra* note 19, para. 107-10.

[85] *Mondev*, *supra* note 79, para. 121; *Azinian*, *supra* note 31, para. 92 (dismissing the investor's claim under Article 1105 as indistinguishable from the more specific claim under Article 1110). See Thomas, *supra* note 37, 22-7.

[86] See Dolzer and Stevens, *supra* note 14, 58-9.

[87] *Statute of the International Court of Justice*, 59 Stat. 1055, art. 38(1).

[88] Thomas, *supra* note 37, 29; Fischel, *supra* note 27, 7.

that Article 1105 was limited to customary international law and that the investor's argument should be rejected.[89]

Instead, favouring the private protection approach, the *Pope & Talbot* tribunal rejected the NAFTA states' submissions in favour of the additive theory of Article 1105.[90] But the additive theory raised a number of problems. For instance, one source of international law beyond customary international law is treaties, but this source raises doubts about the additive theory. If the NAFTA states intended to incorporate standards from other treaties into NAFTA by way of Article 1105, why did they not say so explicitly? Elsewhere in NAFTA the states parties do just this by listing the specific treaties that are relevant to particular provisions.[91] It is difficult to contend that the states parties intended to bring standards from other treaties into NAFTA through Article 1105 without mentioning those treaties, especially since there are hundreds of treaties that contain standards conceivably relevant to the treatment of investors.[92]

This presented a significant difficulty with respect to the additive theory. However, the *Pope & Talbot* tribunal did not mention it. Instead, the tribunal adopted the additive theory based on the observation that the model bilateral investment treaties of seven countries, including the U.S., contain broad wording resembling Article 1105 and that the prevalence of this wording supported the additive theory.[93] An initial problem with this analysis was that BITs containing language similar to Article 1105 are a relatively recent phenomenon and therefore lack an established history of interpretation. Also, the wording used to define minimum standards of treatment in BITs varies widely, falling short of any precise or well-accepted

[89] *Pope & Talbot* (Canada's Submissions) (10 October 2000), para. 208-14; (Mexico's Submissions) (1 December 2000), 3-5; (U.S. Submissions) (1 November 2000), para. 2-8; online: DFAIT http://www.dfait-maeci.gc.ca/tna-nac/phases-en.asp#1.
[90] *Pope & Talbot* (Merits, Phase 2), *supra* note 19, para. 113-18.
[91] E.g. NAFTA, *supra* note 29, art. 1701 (expressly incorporating substantive standards from four international conventions relating to intellectual property rights).
[92] Take the example of international human rights treaties. Direct enforcement of those treaties by private parties is generally either not permitted or strictly limited. It is dubious to conclude that the NAFTA states intended to enforce standards contained in human rights treaties, for investors alone, through investment arbitration pursuant to NAFTA, art. 1105. But the additive theory makes the argument tenable. See *Mondev*, *supra* note 79, para. 121.
[93] *Pope & Talbot* (Merits, Phase 2), *supra* note 19, para. 110-18. The model BITs examined were those of Canada, the United Kingdom, Belgium, Luxembourg, France, and Switzerland.

meaning.[94] Thus, from the outset, the *Pope & Talbot* tribunal's proposition to resolve ambiguous language in Article 1105 by looking to ambiguous language in other treaties was tenuous.

The tribunal overcame this by itself interpreting the model BITs that it had identified as relevant, concluding that they also adopted an additive minimum standard.[95] This the tribunal did without reviewing the specific and varied wording in the BITs or their negotiating history, and without accepting the United States' contrary interpretation of its own model BIT on the grounds that there was academic opinion to the contrary. The tribunal also rejected the U.S. submission that, regardless of the BITs, Chapter 11 was limited to the customary standard on the ground that the U.S. did not provide enough evidence to support its "suggestions".[96] As a result, the U.S. submission did not "enjoy the kind of deference that might otherwise be accorded to representations by parties to an international agreement".[97] Instead, the tribunal concluded that Article 1105 must logically establish the same additive standard that the tribunal had read into the model BITs: "A contrary reading", the tribunal said, "would do violence to the BIT language".[98]

Having adopted the additive theory, the tribunal then defined Article 1105 in broad terms.[99] The tribunal rejected Canada's claim that the minimum standard required evidence of state conduct crossing a high threshold of impropriety.[100] Instead, the tribunal concluded that the standard encompassed "the fairness elements under ordinary standards applied in NAFTA countries... without any threshold limitation that the conduct complained of be 'egregious,' 'outrageous,' or 'shocking,' or otherwise extraordinary".[101] Applying this broadly-framed standard, the tribunal found that Canada breached Article 1105 by its treatment of the investor's lumber operations after the investor's Chapter 11 claim was initiated, while rejecting all of the

[94] UNCTAD, *Fair and Equitable Treatment*, UNCTAD Series on Issues in International Investment Agreements (New York: United Nations, 1999), 22-41.
[95] *Pope & Talbot* (Merits, Phase 2), *supra* note 19, para. 111-13.
[96] Ibid., para. 114.
[97] Ibid.
[98] Ibid., para. 113.
[99] Ibid., para. 118.
[100] Ibid. See *Pope & Talbot* (Canada's Submissions), *supra* note 89, para. 235-40.
[101] Ibid., para. 118.

investor's other claims.[102] In general, the tribunal interpreted Article 1105 in a way that considerably widened its authority to sanction state conduct by awarding damages to investors.[103]

After the *Pope & Talbot* tribunal and another tribunal[104] adopted expansive readings of Article 1105, the NAFTA states intervened by jointly interpreting the treaty.[105] On July 31, 2001, the NAFTA Free Trade Commission issued a statement that Article 1105 "prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another [NAFTA] Party".[106] This effectively overruled the *Pope & Talbot* tribunal's expansive interpretation of Article 1105. What was the outcome of this joint interpretation? The NAFTA text clearly states that the Free Trade Commission has the authority to issue an interpretation of NAFTA that "shall be binding" on Chapter 11 tribunals.[107] However, the *Pope & Talbot* tribunal – which had not yet issued its damages award – was reluctant to adopt the joint interpretation. The tribunal responded first by engaging in an exchange of letters with Canada's lawyers and, in time, with those of the other NAFTA states.[108] The tribunal also adopted the creative argument put forward by the investor that the Free Trade Commission's statement was an "amendment" rather than an "interpretation" of

[102] The tribunal, ibid., para. 121, 123, 125, 128, 155, and 185, dismissed the balance of the investor's claims that Canada violated NAFTA Article 1105. The violation of Article 1105 that was found, para. 156-81, arose from Canada's treatment of the investor's investment during a process to verify alleged discrepancies regarding the investor's reports of its production and sales levels.

[103] On the other hand, the tribunal awarded the investor only a small amount of damages of (U.S.) $460,000 and $120,000 in costs, thus limiting the impact of its approach to Article 1105 in the circumstances of the case: *Pope & Talbot* (Damages), *supra* note 18, para. 88-90; *Pope & Talbot* (Costs) (26 November 2002), para. 18, online: DFAIT http://www.dfait-maeci.gc.ca/tna-nac/documents/CostsAward26Nov02.pdf.

[104] *S.D. Myers* (Merits), *supra* note 31, para. 266 (concluding that a breach of Article 1102 also amounted to a violation of Article 1105).

[105] NAFTA, *supra* note 29, art. 1131(2). The Free Trade Commission is made up of Canada's minister of foreign trade, the U.S. trade representative, and Mexico's secretary of trade and industrial development.

[106] Free Trade Commission, *Notes of Interpretation of Certain Chapter 11 Provisions* (31 July 2001), 13(6) World Trade and Arb. Mat. 139, art. B(1), online: DFAIT www.dfait-maeci.gc.ca/tna-nac/NAFTA-Interpr-en.asp.

[107] NAFTA, *supra* note 29, art. 1131(2).

[108] *Pope & Talbot* (Letters of Lord Dervaird, Presiding Arbitrator) (14 August 2001 and 17 September 2001), online: DFAIT http://www.dfait-maeci.gc.ca/tna-nac/phases-en.asp#1.

NAFTA and thus not binding.[109] Here, the tribunal went so far as to assume authority over the conduct of the states parties as a group and to interpret NAFTA provisions that are excluded from investment arbitration under Chapter 11.[110] In the end, the tribunal accepted the binding nature of the joint interpretation, but to maintain the original result in the arbitration the tribunal concluded that Canada's conduct violated the *clarified* minimum standard based on customary international law alone.[111]

Subsequent tribunals rejected or distanced themselves from the *Pope & Talbot* tribunal's approach to Article 1105 and to the Free Trade Commission's interpretation.[112] For example, with respect to the argument that Chapter 11 tribunals have an implicit authority to overrule the Free Trade Commission as part of their duty to determine the governing law of a dispute, the *ADF* tribunal concluded that "such a theory of implied or incidental authority, fairly promptly, will tend to degrade and set at naught the binding and overriding character of FTC interpretations".[113] Even so, the reading of Article 1105 that was adopted in *Pope & Talbot* showed that arbitrators may take a flexible approach in favour of investor protection when exercising their authority to scrutinize state conduct and award damages.

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[109] *Pope & Talbot* (Damages), *supra* note 18, para. 16. See also Brower, *supra* note 10, 56-7, note 71; T. Weiler, *supra* note 10, 180-85; CIEL, *supra* note 37, 5.

[110] The tribunal's analysis required it to interpret NAFTA Article 2202, which deals with the amendment of NAFTA. However, the tribunal found that it had the authority to interpret any NAFTA provision on the basis that the tribunal was required "to decide the issues in dispute in accordance with NAFTA and applicable rules of international law", despite the clear language of Article 1131(2) that a Free Trade Commission interpretation is binding: *Pope & Talbot* (Damages), *supra* note 18, para. 23.

[111] *Pope & Talbot* (Damages), *supra* note 18, para. 67-9.

[112] *Mondev*, *supra* note 79, para. 111 and 121; *UPS*, *supra* note 34, para. 94-7; *ADF*, *supra* note 28, para. 177-8 and 183; *Waste Management No. 2* (Merits), *supra* note 13, para. 98.

[113] *ADF*, *supra* note 28, para. 177.

2. Limiting the state's consent: the Loewen award

The focus thus far has been on interpretations of Chapter 11 that reflect the private protection approach to investment arbitration. This is in part because the boldest examples of flexible interpretation of NAFTA are provided by tribunals favouring the private protection approach, led by *Pope & Talbot.* However, tribunals that favour the public function approach have also used techniques of flexible interpretation to narrow the role of investment arbitration. Such tribunals tend to adopt a presumption that, in the absence of express treaty language to the contrary, textual ambiguity should be resolved in accordance with rules of customary international law. Thus, where a state has not clearly consented to a particular form of investor claim, the dispute remains within the domestic domain and the tribunal is not authorized to adjudicate.[114] Under Chapter 11, the clearest example of this technique and of the public function approach is the *Loewen* tribunal.[115]

The dispute in *Loewen* arose after a Canadian funeral home company had what could be called a near death experience in Mississippi, following a massive jury award of (U.S.) $500 million against the company.[116] The Canadian investor claimed that the judicial process that led to the jury award violated the NAFTA minimum standard (Article 1105).[117] The sheer size of the jury award, combined with a Mississippi requirement that the investor post (U.S.) $625 million before being able to appeal, prompted the investor to settle the dispute on very unfavourable terms. This in turn contributed to the investor's bankruptcy.

The *Loewen* tribunal agreed that the Mississippi trial judge failed to properly conduct the trial by allowing the plaintiff to appeal to the jury's biases against the Canadian investor based on nationality, race, and class.[118] The tribunal found that

[114] WTO Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones)*, WTO Doc. WT/DS26/AB/R and WT/DS48/AB/R (16 January 1998), para. 70, note 154 (interpretive principle of *in dubio mitius*). See *SGS* v *Pakistan*, *supra* note 6, para. 171. Brownlie, *supra* note 55, 291.

[115] See *Azinian*, *supra* note 31, para. 83, 87, and 99; *Methanex*, *supra* note 34, para. 137-8 and 154; *Mondev*, *supra* note 79, para. 121; *ADF*, *supra* note 28, para. 154, 187, and 191.

[116] *Loewen*, *supra* note 28, para. 39.

[117] Ibid., para. 139 and 141 (dismissing independent claims of violations of NAFTA Articles 1102 and 1110, respectively).

[118] Ibid., para. 70.

"[b]y any standard of measurement" the trial was "a disgrace", and that the judge's failure to ensure due process amounted to an international denial of justice which violated NAFTA Article 1105.[119] Nevertheless, the *Loewen* tribunal dismissed the investor's claim for two reasons. First, the tribunal found that the investor did not maintain continuous foreign nationality from the date of the events giving rise to the claim through to the resolution of the claim.[120] This was because, after initiating bankruptcy proceedings in the U.S., the investor transferred all of its assets – with the sole exception of its rights in the NAFTA claim – to a U.S. company. Second, the *Loewen* tribunal concluded that the investor had not exhausted all reasonably available local remedies by failing to pursue an appeal to the U.S. Supreme Court.[121] In reaching these conclusions, the tribunal used a particular interpretive technique: it resolved ambiguity in the NAFTA text by resorting, by default, to rules of customary international law, which are part of the governing law of Chapter 11.[122]

a. The requirement of continuous foreign nationality

To make a Chapter 11 claim, an investor must be a foreign investor.[123] That is, the investor must be a national of a NAFTA state other than the NAFTA state against which the claim is made. Investors cannot, in principle, make a claim against their own state. Further, investors must have *continuous* foreign nationality. Consistent with customary international law, the investor must maintain the foreign nationality of a NAFTA state without interruption from the date of the events giving rise to the claim until an appropriate endpoint.[124] In *Loewen*, the tribunal had to determine whether the investor's foreign nationality had lasted until an appropriate endpoint. But what was this endpoint? Did the investor have to maintain foreign nationality until the submission or until the final resolution of the claim?

[119] Ibid., para. 119.
[120] Ibid., para. 222.
[121] Ibid., para. 217.
[122] NAFTA, *supra* note 29, art. 1131(1). See also *Barcelona Traction, supra* note 40, para. 51-2.
[123] NAFTA, *supra* note 29, art. 1101(1), 1116(1), and 1117(1).
[124] *Administrative Decision No. V* (1924), 7 R.I.A.A. 119, 613-14 (U.S.-Germany Mixed Claims Commission). D.C. Ohly, "A Functional Analysis of Claimant Eligibility" in R.B. Lillich, ed., *International Law of State Responsibility for Injuries to Aliens* (Charlottesville: University Press of Virginia, 1983), 283-4.

On this, the NAFTA text is unclear. Unlike other investment treaties, NAFTA contains no express waiver of the requirement for continuous foreign nationality after the initiation of a claim.[125] In *Loewen*, the investor argued that the requirement to maintain continuous foreign nationality lasted only until the submission of the claim. As such, the investor's standing to maintain the claim was not affected by the investor's reorganization of its business structure and, specifically, by the transfer of assets to a U.S. company. The *Loewen* tribunal rejected this argument in favour of the view that the investor had to maintain continuous foreign nationality until the resolution of the claim. Therefore, the investor's claim became invalid when its corporate reorganization broke the chain of foreign nationality.[126] Further, the tribunal concluded that – although a cause of the investor's bankruptcy and corporate reorganization was the Mississippi jury award itself – this did not call for any relaxation of the requirement to maintain continuous foreign nationality. In reaching this conclusion, the tribunal referred to the strict limits of the NAFTA states' consents to Chapter 11 arbitration based on the treaty text, stating: "this is an international tribunal whose jurisdiction stems from and is limited to the words of the NAFTA treaty".[127] And: "NAFTA does not recognize [the investor's] business choices as a substitute for its jurisdictional requirements under its provisions and under international law".[128]

This interpretation of the duty to maintain continuous foreign nationality can be contrasted with other Chapter 11 awards that deal with similar issues, including the *Mondev* tribunal.[129] The facts in *Mondev* are convoluted. A Canadian investor made a Chapter 11 claim against the U.S. flowing from a failed real estate development contract between the investor and both the city of Boston and a city development agency. The deal collapsed and a U.S. bank foreclosed the investor's mortgage on the real estate project. In turn, the investor sued the city and the development agency, and obtained a jury verdict in its favour. However, the trial judge overruled the finding of liability on the part of the development agency because the agency was immune from

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[125] NAFTA, *supra* note 29, art. 1116 and 1117. *Loewen*, *supra* note 28, para. 226.
[126] *Loewen*, ibid., para. 220 and 234.
[127] Ibid., para. 234.
[128] Ibid., para. 238.
[129] *Mondev*, *supra* note 79, para. 88-91. See also *Waste Management No. 2* (Merits), *supra* note 13, para. 85.

liability under state law. On appeal, the finding of immunity for the development agency was upheld and, worse for the investor, the trial judge's finding of liability on the part of the city was overturned. The investor petitioned for a rehearing of the appeal and for a hearing by the U.S. Supreme Court, but both were denied.[130]

The investor's claim under NAFTA Chapter 11 was dismissed by the *Mondev* tribunal for reasons that are irrelevant here. What is significant, however, is the *Mondev* tribunal's response to a jurisdictional objection raised by the United States. The U.S. argued that, once the U.S. bank foreclosed the investor's mortgage, the investor no longer had any right of action in relation to the real estate project.[131] The *Mondev* tribunal concluded that it was unnecessary to decide this issue, in part because to do so would interfere with the ability of investors to rely on Chapter 11 following the failure of an investment. According to the tribunal:[132]

> Article 1105, and even more so Article 1110, will frequently have to be applied after the investment in question has failed. In most cases, the dispute submitted to arbitration will concern precisely the question of responsibility for that failure. *To require the claimant to maintain a continuing status as an investor under the law of the host State at the time the arbitration is commenced would tend to frustrate the very purpose of Chapter 11*, which is to provide protection to investors against wrongful conduct including uncompensated expropriation of their investment and to do so throughout the lifetime of an investment up to the moment of its "sale or other disposition" (Article 1102(2)). On that basis, the Tribunal concludes that *NAFTA should be interpreted broadly to cover any legal claims arising out of the treatment of an investment* as defined in Article 1139, *whether or not the investment subsists as such at the time of the treatment which is complained of.*

The issue in *Mondev* related to the claimant's status as an investor, as opposed to the *Loewen* case in which the issue was the claimant's status as a *foreign* investor. However, in both cases the question was whether aspects of the state's consent to arbitration should be interpreted flexibly, in favour of investor protection, or cautiously in light of customary international law. The *Mondev* tribunal adopted a flexible interpretation of the concept of an "investor" by relaxing the requirement to own an investment until the submission of a Chapter 11 claim. In particular, the tribunal concluded that the investor's failure "to maintain a continuing status as an investor... at the time the

[130] *Mondev*, ibid., para. 1.
[131] Ibid., para. 54.
[132] Ibid., para. 91 [emphasis added].

arbitration is commenced" should not interfere with the investor's claim. In contrast, the *Loewen* tribunal adopted a narrow reading of the concept of "foreign" by requiring the investor to hold continuous foreign nationality, not only until submission of the claim, but until its resolution. Moreover, in *Loewen*, the reorganization of the investor's corporate structure – like the foreclosure in *Mondev* – was prompted by an alleged violation of an investment treaty by the state, and the *Loewen* tribunal went much further than *Mondev* by finding that the investor had actually suffered "a miscarriage of justice amounting to a manifest injustice". Even so, the investor's entire claim was defeated because the investor failed to maintain continuous foreign nationality. In *Mondev*, on the other hand, the tribunal characterized the proposed duty of the claimant to maintain continuous status as an investor as a "technical question" that could "frustrate the very purpose of Chapter 11".

Underlying these different outcomes are contrasting approaches to ambiguity in the NAFTA text. Consistent with the public function approach, the *Loewen* tribunal interpreted ambiguity in the meaning of "foreign" in a way that limited the NAFTA states' consents to investment arbitration on the assumption that clear and explicit language is required to override an established rule of customary international law. In contrast, the *Mondev* tribunal interpreted ambiguity in the meaning of "investor" so as to facilitate investor claims in line with the tribunal's characterization of the purpose of NAFTA. In each case, the tribunal made a policy choice through its exercise of interpretative discretion.

b. The duty to exhaust local remedies

The *Loewen* tribunal went on to conclude that, even if the investor had maintained continuous foreign nationality, the tribunal would still have dismissed the claim because the investor did not exhaust local remedies. Under NAFTA Chapter 11, an investor is expressly required to both consent to investment arbitration and waive the investor's right to alternative domestic remedies.[133] However, NAFTA is ambiguous on its face as to whether the relevant NAFTA provision (Article 1121) amounts to a waiver by the NAFTA states of the investor's duty to exhaust local remedies *before* a

[133] NAFTA, *supra* note 29, art. 1121. See chapter six of this thesis, page 204-7.

Chapter 11 claim.[134] One plausible reading of Article 1121 is that it entirely removes the duty to exhaust local remedies.[135] However, in *Loewen*, the tribunal adopted a more nuanced reading by differentiating between the procedural and substantive aspects of the duty to exhaust local remedies under customary international law. On the one hand, the tribunal left open the possibility that the duty to exhaust local remedies, as a procedural precondition for an international claim, is removed by Article 1121.[136] On the other hand, the *Loewen* tribunal found that the duty is also part of some NAFTA standards of investor protection, including the minimum standard of treatment (Article 1105).[137] Thus, based on customary international law, the duty to exhaust local remedies remained applicable to the investor's claim as a substantive element of the minimum standard.

This issue was especially important in *Loewen* because the alleged breach of the NAFTA minimum standard arose from a judicial decision of the host state. In that context, the *Loewen* tribunal required the investor to show that the investor had exhausted all reasonably available opportunities to obtain justice from the host state's courts.[138] The investor's failure to do so was fatal to the claim, regardless of the investor's consent and waiver under Article 1121. According to the tribunal, there was no violation of the NAFTA minimum standard because, under customary international law, a state is not responsible for a denial of justice to an individual unless final action has been taken by the state's judicial system as a whole.[139]

In reaching this conclusion, the *Loewen* tribunal emphasized the importance of the duty to exhaust local remedies in the definition of the minimum standard under customary international law. The tribunal said:[140]

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[134] *Waste Management, Inc.* v. *United Mexican States* (Jurisdiction) (26 June 2002), 41 I.L.M. 1315, 14(6) World Trade and Arb. Mat. 203 [hereinafter *Waste Management No. 2*], para. 30.
[135] *Waste Management No. 2* (Jurisdiction), ibid., para. 30. See also *Feldman, supra* note 6, para. 71-4.
[136] *Loewen, supra* note 28, para. 149.
[137] Ibid., para. 153-6. See also *Waste Management No. 2* (Merits), *supra* note 13, para. 116 and 174; *GAMI, supra* note 13, para. 133. Contrast *CME, supra* note 39, para. 398 and 412-13.
[138] *Loewen, supra* note 28, para. 153 and 215 (concluding that the investor did not adequately explain why it settled the case that led to the jury award instead of pursuing other legal options, including an appeal to the U.S. Supreme Court. By failing to show why these other options were not reasonably available, the investor failed to establish a violation of the minimum standard for which the U.S. was responsible).
[139] Ibid.
[140] Ibid., para. 154.

> No instance has been drawn to our attention in which an international tribunal has held a State responsible for a breach of international law constituted by a lower court decision when there was available an effective and adequate appeal within the State's legal system.

In addition, the tribunal stressed the need for clear language in NAFTA to override an important customary rule:[141]

> An important principle of international law should not be held to have been tacitly dispensed with by international agreement, in the absence of words making clear an intention to do so.... Such an intention may be exhibited by express provisions which are at variance with the continued operation of the relevant principle of international law.
>
> ....
>
> Nor is there any basis for implying any dispensation of that requirement. It would be strange indeed if sub silentio the international rule were to be swept away....

Thus, the tribunal relied on the presumption that, in the absence of clear language to the contrary, the interpretation of NAFTA Chapter 11 requires the careful application of customary international law. Although Chapter 11 may allow an investor to bring a claim after waiving alternative domestic remedies, this does not excuse the investor from the duty to exhaust local remedies in relation to a claim of a denial of justice under Article 1105. To allow an investor to make a claim in such circumstances, the *Loewen* tribunal concluded, would create serious problems in domestic legal systems.[142] As such, the *Loewen* tribunal declined to expand its authority to award damages to protect investors and encourage investment. Rather, the tribunal restricted the reach of investment arbitration in order to avoid disrupting an important sovereign activity carried out by domestic courts.[143]

In *Loewen*, the investor's bankruptcy was precipitated by the outcome of a trial that was grossly unfair. Also, there were clear business reasons, stemming from U.S.

[141] Ibid., para. 160 and 162. See also *SGS* v. *Pakistan*, *supra* note 6, para. 169. Contrast *SGS* v. *Philippines*, *supra* note 14, para. 122; *Tokios*, *supra* note 14, para. 52.
[142] *Loewen*, *supra* note 28, para. 162.
[143] See also *Azinian*, *supra* note 31, para. 87 and 99; *Waste Management No. 2* (Merits), *supra* note 13, para. 116 and 128-30.

bankruptcy law, for the investor to reorganize its corporate structure in the way that it did. Therefore, it was perhaps harsh for the tribunal to conclude that the investor's reorganization led to the "spontaneous disappearance" of the investor's cause of action. Reacting to the award, Mr. Loewen said:[144]

> I am deeply disappointed that the Tribunal has dismissed the NAFTA claims. I take some comfort in the fact that they found that the outrageous verdict and judicial rulings in Mississippi were a manifest injustice under international law. As they suggest, there was no clearer case for the ideals of NAFTA to be given teeth, but the Tribunal has elected to leave investors confronted by a bewildering series of procedural obstacles and technical requirements that frustrate NAFTA's goal of free trade and investment.

The *Loewen* tribunal itself acknowledged that, in spite of the "injustices which were suffered by Loewen and Mr. Raymond Loewen in the Courts of Mississippi... they emerge from the present long and costly proceedings with no remedy at all".[145] Even so, the tribunal found that this result was warranted in light of the nature of the investor's claim, which fell within the realm of public international law rather than commercial arbitration. In what amounts to an elaboration of the public function approach, the tribunal said:[146]

> Far from fulfilling the purposes of NAFTA, an intervention on our part would compromise them by obscuring the crucial separation between the international obligations of the State under NAFTA, of which the fair treatment of foreign investors in the judicial sphere is but one aspect, and the much broader domestic responsibilities of every nation towards litigants of whatever origin who appear before its domestic courts. Subject to explicit international agreement permitting external control or review, these latter responsibilities are for each individual state to regulate according to its own chosen appreciation of the ends of justice. As we have sought to make clear, we find nothing in NAFTA to justify the exercise by this Tribunal of an appellate function parallel to that which belongs to the courts of the host nation. In the last resort, a failure by that nation to provide adequate means of remedy may amount to an international wrong but only in the last resort.... Too great a readiness to step from outside into the domestic arena, attributing the shape of an international wrong to what is really a local error (however

[144] Fasken Martineau, News Release, "Raymond Loewen Responds to Decision on NAFTA Claim" (8 July 2003).
[145] *Loewen*, *supra* note 28, para. 241.
[146] Ibid., para. 242. See also *Empresas Lucchetti, S.A.* v. *Lucchetti Peru, S.A.* (Merits) (7 February 2005), ICSID Case No. ARB/03/04, para. 61, online: ICSID http://www.worldbank.org/icsid/cases/lucchetti-award.pdf.

> serious), will damage both the integrity of the domestic judicial system and the viability of NAFTA itself. The natural instinct, when someone observes a miscarriage of justice, is to step in and try to put it right, but the interests of the international investing community demand that we must observe the principles which we have been appointed to apply, and stay our hands.

Thus, the tribunal emphasized that investment arbitration originates in the obligations of the NAFTA states assumed amongst themselves, not in direct obligations of the host state to investors. A state's obligations to investors are part of the "broader domestic responsibilities" of any state toward all individuals in its territory and the scope of Chapter 11 does not go beyond these obligations. Although NAFTA protects investors from regulatory abuse to encourage investment, this does not mean that the treaty was intended to compensate investors for any injustice at the hands of the state. Rather, Chapter 11 offers a last resort to remedy international wrongs, one that should be approached cautiously in light of the availability of domestic remedies. This more restrained approach to investment arbitration was clearly influenced by the fact that the case arose from a judicial decision. In particular, the tribunal reasoned that arbitrators must respect the "integrity of the domestic judicial system" and should not adopt an appellate function. Put differently, tribunals should respect the autonomy of the judicial process of the state even in the face of a serious abuse that is linked to the foreign nationality of an investor. Too ambitious an approach to investment arbitration could threaten the "integrity of the domestic judicial system" and the "viability of NAFTA itself". By staying their hands, the tribunal subordinated investor protection to the public function of Chapter 11.

Conclusion

The use of international adjudication to regulate the exercise of public authority entails policy choices about the role of government. Each investor claim raises questions about the nature and degree of investor protection that an investment treaty provides. Did the host state consent to the investors' claim in relation to the specific investment? Should the dispute remain within the exclusive domain of domestic courts? Does the investment benefit the host economy? Did the state treat the investor fairly? Was a reduction in the value of the investment caused by legitimate regulation? Is the purpose of damages to deter unlawful conduct or compensate investors? What degree of fault should be attached to state liability? Is the claim a matter of business risk or international wrong? Answers to these questions are less clear although more pressing where international adjudication is compulsory – in the context of a regulatory dispute – and where the remedy is a damages award against the state.

Drafters of investment treaties cannot anticipate all of the potential claims that may arise in investment arbitration.[147] An element of discretion and policy choice is inherent in any adjudicative process and reasonable people will differ about how much discretion is appropriate.[148] Even so, the extent of the discretion delegated to arbitrators is striking.[149] As a result, the scope and substance of investment arbitration is relatively unclear, as illustrated by the different approaches of tribunals to the NAFTA standards of investor protection and to the NAFTA states' consents. The explosion of claims under a bilateral investment treaties exacerbates an overall lack of coherence in the system of investment arbitration.[150] Even so, where a state has

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[147] S. de Smith and R. Brazier, *Constitutional and Administrative Law*, 8th ed. (London: Penguin, 1998), 19.

[148] *Mondev*, *supra* note 79, para. 127. Fuller, *supra* note 4, 373; Harlow and Rawlings, *supra* note 1, 100-7; Trachtman, *supra* note 4, 344.

[149] P.G. Foy, "Effectiveness of NAFTA's Chapter Eleven Investor-State Arbitration Procedures" (2003) 18 ICSID Rev. 44, 51.

[150] E.g. *SGS* v. *Pakistan*, *supra* note 6, para. 168 and 171 (treating a dispute resolution clause in an investment contract as a jurisdictional limit on BIT arbitration) versus *SGS* v. *Philippines*, *supra* note 14, para. 97 (treating such a clause as an issue of admissibility and distinguishing *SGS* v. *Pakistan* "on issues of the interpretation of arguably similar language": "In the Tribunal's view, although different tribunals constituted under the ICSID system should in general seek to act consistently with each other, in the end it must be for each tribunal to

inadvertently breached a provision that was vague on its face or subject to inconsistent interpretations by past tribunals, the state may nevertheless be required to pay damages.[151]

For investors, interpretive uncertainty is undesirable because it makes it difficult to anticipate the extent to which an investor will be entitled to compensation.[152] As a result, an investor might initiate a claim that turns out to be unfounded, wasting time and money, where the tribunal interprets an ambiguous provision more narrowly than anticipated. But, by a long shot, the greater hazard of uncertainty is for states.[153] States alone can be ordered to pay damages for breaching the treaty and, for small states especially, unanticipated liabilities under investment treaties could be crippling. Multinational enterprises can weigh the costs and benefits of investment arbitration before making a claim; in this regard, states are at their mercy. This reflects the dynamic of state liability in the context of the regulatory relationship. As discussed in the next chapter, what is most significant about investment treaties is that such important policy choices about state liability in the regulatory sphere are assigned to arbitrators, based on a private model of adjudication.

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exercise its competence in accordance with the applicable law, which will by definition be different for each BIT and each Respondent State").

[151] NAFTA, *supra* note 29, art. 1135.

[152] L.Y. Fortier, "Caveat Investor: The Meaning of "Expropriation" and the Protection Afforded Investors Under NAFTA" (2003) 20(1) ICSID News 11.

[153] V.L. Been and J.C. Beauvais, "The Global Fifth Amendment: NAFTA's Investment Protections and the Misguided Quest for an International 'Regulatory Takings' Doctrine" (2003) 78 N.Y.U. L.R. 30, 125-6.

Chapter Six

From Contract to Governing Arrangement

Contemporary investment treaties rely on a private model of adjudication and, in form, investment arbitration may appear little different from commercial arbitration.[1] Like commercial arbitration, treaty-based investment arbitration involves a claim by a private party before a tribunal of private arbitrators appointed by the disputing parties. The proceedings are governed by rules that originate in commercial arbitration. The primary remedy is a damages award that can be enforced under the *New York Convention* and other instruments of international commercial arbitration. Even so, it is a mistake to confuse investment arbitration, pursuant to a treaty, with commercial arbitration.

Commercial arbitration is a matter of private law, constituted by an agreement between private parties, acting in a private capacity, to arbitrate disputes between themselves.[2] The authority for commercial arbitration is private authority in that it originates in the autonomy of individuals to order their private affairs as they wish.[3] Investment arbitration, on the other hand, originates in the authority of the state to use adjudication to resolve disputes arising from the exercise of public authority; i.e. disputes within the regulatory sphere.[4] As such, investment arbitration is constituted by a sovereign act – as opposed to a private act – of the state.

Under investment treaties, the exercise of public authority is represented above all by the state's consent to compulsory arbitration. A private party's consent to commercial arbitration is specific to the dispute or to the private relationship in which the dispute has arisen. In contrast, the state, by consenting generally to investment arbitration, agrees to the compulsory arbitration of future disputes with investors.[5] Giving a general consent requires the exercise of public authority in order to delegate

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[1] A. Chayes, "The Role of the Judge in Public Law Litigation" (1976) 89 Harv. L.R. 1281, 1282-4; A. Redfern and M. Hunter, *Law and Practice of International Commercial Arbitration* (London: Sweet & Maxwell, 1999), 1-11.
[2] Redfern and Hunter, ibid., 135.
[3] Ibid., 135
[4] E.V. Abbot, "The Police Power and the Right to Compensation" (1889) 3 Harv. L.R. 189; L.L. Fuller, "Consideration and Form" (1941) 41 Colum. L. Rev. 799, 806-8; Chayes, *supra* note 1, 1294-5 and 1302.
[5] Redfern and Hunter, *supra* note 1, 61.

adjudicative authority over regulatory disputes to international tribunals and ultimately to the domestic courts of a large number of countries.

A. The use of a private model of adjudication

Investment treaties rely on a private model of adjudication in three respects. First, the claim is resolved by private arbitrators, two of whom are appointed by the disputing parties.[6] Second, the arbitration is governed by procedural rules that originate in private arbitration.[7] Third, the award is enforceable under the enforcement structure of international commercial arbitration based on the *New York Convention* and other instruments.[8] In each case, the states parties to the treaty have extended a private model of adjudication that was originally intended for commercial disputes into the public domain.

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[6] The presiding arbitrator is normally appointed, in the absence of agreement between the disputing parties, by a designated appointing authority.

[7] E.g. ICSID *Rules of Procedure for Arbitration Proceedings* in ICSID, revised 26 September 1984 and 1 January 2003 (original rules 1968), reprinted in *Convention, Regulations and Rules* (Washington: ICSID, 2003), 93 [hereinafter ICSID Rules]; *Arbitration Rules of the United Nations Commission on International Trade Law*, UN G.A. Res. 31/98, UN GAOR, 31st Session, Supp. No. 17, UN Doc. A/31/17, c. V, s. C (1976) [hereinafter UNCITRAL Rules]; and *Rules of Arbitration of the International Chamber of Commerce*, revised 1 January 1998 (original rules 1922) [hereinafter ICC Rules], online: ICC www.iccwbo.org/court/english/arbitration/rules.asp. See *North American Free Trade Agreement*, 17 December 1992, 32 I.L.M. 296 and 605 (entered into force 1 January 1994) [hereinafter NAFTA], art. 1120(1) (giving investors the choice of filing a claim under the ICSID Rules, the ICSID Additional Facility Rules, or the UNCITRAL Rules).

[8] *United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 10 June 1958, 330 U.N.T.S. 3 (entered into force 7 June 1959) [hereinafter *New York Convention*]; *Inter-American Convention on International Commercial Arbitration*, 30 January 1975, 14 I.L.M. 336 [hereinafter *Inter-American Convention*]; *Model Law on International Commercial Arbitration*, 21 June 1985, UNCITRAL, UN Doc. A/40/17, Annex I, 24 I.L.M. 1302 [hereinafter UNCITRAL Model Law].

Arbitrations pursuant to the ICSID Rules are subject to recognition and enforcement under the *Convention for the Settlement of Investment Disputes*, 18 March 1965, 4 I.L.M. 524 (entered into force 14 Oct 1966) [hereinafter *ICSID Convention*], which provides an enforcement structure for investment arbitration generally, as opposed to an enforcement structure that was clearly originally intended for international commercial arbitration alone. However, all other investment arbitrations – including those pursuant to the ICSID Additional Facility Rules, the UNCITRAL Rules, and the ICC Rules – are subject to recognition and enforcement under the *New York Convention* and other instruments of international commercial arbitration. See chapter three of this thesis, page 79-80, note 58.

The extension of a private model into the public domain is demonstrated by the incorporation into investment treaties of the enforcement structure of the *New York Convention*. The *New York Convention* was intended to govern arbitration in the private sphere and, as such, states could limit their obligations under the treaty to those arising from commercial disputes.[9] Thus, the *New York Convention* preserved domestic judicial control over the scope of international arbitration. In investment arbitration, though, the requirement that an award must arise from a commercial dispute to be enforceable under the *New York Convention* undermines the enforceability of investment arbitration awards in the arbitration of disputes arising from the exercise of public authority.[10] That is, a domestic court could refuse to recognize and enforce an award on the basis that the award did not arise from a commercial dispute. To address this, NAFTA (like other investment treaties) expressly provides:[11]

> A claim that is submitted to arbitration under this Section shall be considered to arise out of a commercial relationship or transaction for purposes of Article I of the New York Convention and Article I of the Inter-American Convention.

Thus, NAFTA provides that Chapter 11 disputes – for enforcement purposes – are to be treated as disputes arising from a commercial relationship. This limits the authority

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[9] *New York Convention*, ibid., art. I. *Report of the Committee on the Enforcement of International Arbitral Awards*, UN ESC, UN Doc. E/AC.42/SR.1-3, 5-6 (First Meeting, 1 March 1955) and 7-8 (Second Meeting, 23 March 1955) [hereinafter *Report of the Committee*]. See chapter two of this thesis, page 53-4, note 132-4.

[10] *New York Convention*, ibid., art. I(3). E.g. *United Nations Foreign Arbitral Awards Convention Act*, R.S.C. 1985, c.16, s. 4(1) ("The Convention applies only to difference arising out of commercial legal relationships, whether contractual or not"); *Federal Arbitration Act*, 9 U.S.C. c. 2 [hereinafter *Federal Arbitration Act*], s. 202. See *ADF Group Inc.* v. *United States of America* (Procedural Order No. 2) (11 July 2001), para. 12, online: State Department http://www.state.gov/documents/organization/5965.pdf (noting the claimant's argument that U.S. arbitration law is uncertain as to whether it calls for judicial deference to investment arbitration awards, given that such awards may not be regarded as commercial arbitration awards).

[11] NAFTA, *supra* note 7, art. 1136(7). The relevant "purposes" of Article I of the *New York Convention* and Article I of the *Inter-American Convention* are to allow the states parties to those treaties to limit their obligations to recognize and enforce awards to the arbitration of commercial disputes. In addition, NAFTA – and many other investment treaties – expressly provide that the states parties' consents to compulsory investment arbitration shall also satisfy the consent requirements of other arbitration treaties, including the *New York Convention*, the *ICSID Convention*, and the *Inter-American Convention*: NAFTA, art. 1122(2).

of a domestic court to decline to enforce a Chapter 11 award on the grounds that doing so would unduly intrude on the exclusive jurisdiction of domestic courts in the public sphere.[12] More broadly, the provision establishes an obligation for the NAFTA states to refrain from characterizing an investment arbitration award as a non-commercial award under domestic law in order to deny recognition and enforcement. This facilitates the extension of the enforcement structure of the *New York Convention*, originally intended for the private sphere, to arbitration in the regulatory sphere.

1. Tensions arising from the use of a private model

The use of a private model of adjudication to resolve regulatory disputes has created tensions in investment arbitration. One tension involves the role of private arbitrators. As discussed in chapter five of this thesis, arbitrators make policy decisions when they interpret investment treaties. However, arbitrators are usually practicing lawyers or academics and they compete for appointments in an international market for adjudicative services.[13] Thus, arbitrators are not part of a tenured judiciary, appointed by a public institution for a set term and financially independent of the parties, including non-judicial branches of government.[14] Unlike judges, arbitrators have a

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[12] *ADF* (Procedural Order No. 2), *supra* note 10, 7 (noting that the NAFTA states have taken the position that NAFTA Article 1136(7) deems arbitrations under NAFTA Chapter 11 to be commercial strictly for the purpose of recognition and enforcement of award, and specifically not for the purposes of court review of awards).

[13] J. Werner, "The Trade Explosion and Some Likely Effects on International Arbitration" (1997) 14 J. Int'l Arb. 5, 10; Y. Dezaley and B.G. Garth, *Dealing in Virtue: International Commercial Arbitration and the Construction of a Transnational Legal Order* (Chicago: University of Chicago Press, 1996), 33; Y. Dezaley, "Between the State, Law, and the Market: The Social and Professional Stakes in the Construction and Definition of a Regulatory Arena" in W.W. Bratton et al., eds., *International Regulatory Competition and Coordination* (Oxford: Clarendon, 1996), 84-6; A.S. Rau, "Integrity in Private Judging" (1997) 38 South Texas L.R. 455, 488, 496-7, and 521.

[14] E.g. *European Convention for the Protection of Human Rights and Fundamental Freedoms*, 4 November 1950, Eur. T.S. 5, 213 U.N.T.S. 222 (entered into force 3 September 1953) [hereinafter ECHR], art. 22 (providing for the election of judges by the Parliamentary Assembly of the Council of Europe by a majority of votes from a list of three candidates nominated by the state party whose judge is to be elected) and art. 23.1 and 24 (providing that judges are elected for a six year period unless the other judges decide by two-thirds majority that the judge has ceased to fulfil the required conditions). J.H. Ralston, "Some Suggestions as to the Permanent Court of Arbitration" (1907) 1 AJIL 321, 322-4 and 328-9;

commercial interest to provide "an efficacious and economically valuable service for clients".[15] Unlike judges, arbitrators are not barred from political or professional activities that are incompatible with their independence and impartiality.[16] Indeed, many arbitrators provide other legal services to investors and states, including in other investment disputes. It is not uncommon for prominent figures in investment arbitration to sit as an arbitrator in one case, while representing an investor or state in another, while generally advising other clients on investment law.[17] Thus, in principle, arbitrators appear more susceptible than judges to influence by concerns about their reputation and by the need to secure future business.[18]

S. de Smith and R. Brazier, *Constitutional and Administrative Law*, 8th ed. (London: Penguin, 1998), 370 and 374.

[15] R. Wai, "Transnational Liftoff and Juridical Touchdown: The Regulatory Function of Private International Law in an Era of Globalization" (2002) 40 Colum. J. Transnat'l L. 209, 217. See Redfern and Hunter, *supra* note 1, 209-10 (noting that, in the early 1990s, a practice emerged for shortlisted prospective party-nominated arbitrators to be interviewed by representatives of the prospective appointer. Commenting further that "the analogy between a judge and an arbitrator in this context should not be taken too far. A judge is a servant of the state and has responsibilities flowing from public policy which go beyond those of an arbitrator, whose responsibilities may be determined by the parties or by an arbitral institution under whose auspices the particular arbitration is being held.").

[16] NAFTA establishes a code of conduct for arbitrators under NAFTA Chapters 19 and 20, but not Chapter 11. Chapter 11 arbitrators are required to be independent from the appointing party but there are no express rules e.g. barring *ex parte* contacts with the appointing party, barring post-arbitration retainers, or imposing an ongoing duty to disclose. Compare ECHR, *supra* note 14, art 21.1 (providing that judges "shall be of high moral character and must either possess the qualifications required for appointment to high judicial office or be jurisconsults of recognised competence") and art. 21.3 (providing that judges, during their term of office, "shall not engage in any activity which is incompatible with their independence, impartiality or with the demands of a full-time office"). J.G. Wetter, *The International Arbitral Process – Public and Private*, vol. 3 (Dobbs Ferry, N.Y.: Oceana Publications, 1979), 355; Rau, *supra* note 13, 493-4; interview with J.C. Thomas (19 February 2004) The Mandarin Knightsbridge Hotel, London.

[17] *Republic of Ghana* v. *Telekom Malaysia Berhad*, D.C. The Hague, 18 October 2004 and 5 November 2004, No. HA/RK 2004.667 and HA/RK 2004.788 (concluding that a party-nominated arbitrator in an investment arbitration under the UNCITRAL Rules could not concurrently act as counsel to an unrelated party in an ICSID annulment proceeding that raised similar legal issues). See *Compañía de Aguas del Aconquija S.A. & Vivendi Universal* v. *Argentine Republic* (Decision on Challenge to the President) (3 October 2001), 17 ICSID Rev. 168, para. 21, citing *Amco Asia Corp.* v. *Republic of Indonesia* (Decision) (24 June 1982), ICSID Case No. ARB/81/1 [unpublished]. See also Dezaley and Garth, *supra* note 13, 49-50; A. Cosbey et al., "Investment and Sustainable Development" (Report for the International Institute for Sustainable Development, 2004), 6; O. Guglielmino, "Analista señala arbitrariedad del sistema judicial; Demandas inverosímiles" *La Nación* [Argentina] (17 January 2005).

[18] Rau, *supra* note 13, 488 and 521; A.F. Lowenfeld, "The Party-Appointed Arbitrator in International Controversies: Some Reflections" (1995) 30 Tex. Int'l L.J. 59, 65.

This supports the conclusion that arbitrators are less independent and neutral than judges.[19] The business opportunities of arbitrators directly reflect the popularity of investment arbitration. The greater the utility of investment arbitration for investors, the more claims will be filed, the greater the demand for arbitrators.[20] In this light, one can reasonably connect the tendency of tribunals to interpret their own jurisdiction expansively to the commercial interests of arbitrators.[21] How often would claimants in the courts succeed if judges depended on them for business? How clogged would the courts be if judges, like arbitrators, were paid by the case or by the day? As such, it is argued, arbitrators will attempt to make arbitration useful and attractive to multinational enterprises so long as this does not undermine the system in general. Thus, it is said, many arbitrators have a bias in favour of expanding the scope and remedial power of investment arbitration.[22] Along the same lines, it is argued that many arbitrators cannot credibly resolve the matters of public concern that arise in investment arbitration, especially where their background is in commercial law and given their distance from those affected by their decisions.[23]

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[19] L. Fuller, "The Forms and Limits of Adjudication" (1978) 92 Harv. L.R. 353, 396; Rau, *supra* note 13, 493-5; "The Secret Trade Courts", Editorial *New York Times* (27 September 2004) 26.

[20] M. Sornarajah, "Power and Justice in Foreign Investment Arbitration" (1997) 14 J. Int'l Arb. 103, 117.

[21] G. Jaenicke, "The Prospects for International Arbitration: Disputes Between States and Private Enterprises" in A.H.A. Soons, *International Arbitration: Past and Prospects* (Dordrecht, Martinus Nijhoff, 1990), 158; A.F.M. Maniruzzaman, "Internationalization of Foreign Investment Agreements – Some Fundamental Issues of International Law" (2000) 1 J. World Investment 293, 311 ("Although it is expected that an international arbitral tribunal will have a sympathetic ear to the pleading of international law by a foreign investor..."); E. Gaillard, "Commentary" (2002) 18 Arb. Int'l 247, 249; C. McLachlan, "Commentary: The Broader Context" (2002) 18 Arb. Int'l 339, 340.

[22] S. Picciotto, "A Critical Assessment of the MAI" in S. Picciotto and R. Mayne, eds., *Regulating International Business* (Houndmills: Macmillan, 1999), 94; M. Sornarajah, "The Clash of Globalisations and the International Law on Foreign Investment" (Presentation to the Centre for Trade Policy and Law, Ottawa, 12 September 2002), 15, online: CTPL http://www.carleton.ca/ctpl/pdf/papers/sornarajah.pdf, 18.

[23] S.J. Toope, *Mixed International Arbitration – Studies in Arbitration Between States and Private Persons* (Cambridge: Grotius Publications, 1990), 391; B. Stern, "Comments – International Economic Relations and the MAI Dispute Settlement System" (1999) 16 J. Int'l Arb. 118, 127; H. Mann and K. von Moltke, "NAFTA's Chapter 11 and the Environment: Addressing the Impacts of the Investor-State Process on the Environment" (Working Paper for the International Institute for Sustainable Development, 1999), 19-23; J.A. Soloway, "Environmental Regulation as Expropriation: The Case of NAFTA's Chapter 11" (2000) 33 Can. Bus. L.J. 92, 124-6; Sornarajah, ibid., 16.

Notably, tribunals that tend toward the public function approach to investment arbitration are often presided over by former judges.[24]

These criticisms should not be misconstrued. Many arbitrators have an outstanding reputation and their skills and objectivity are beyond repute. In private arbitration, the commercial interests of arbitrators may be a plus where the disputing parties have freely and knowingly consented to the process and where the underlying reciprocity of the adjudication causes both parties to bear the risk of potential bias.[25] The issue here is the nature of investment arbitration as a *public* institution and the role of a private model of adjudication in the resolution of regulatory disputes. No matter how well arbitrators do their job, an investment arbitration award will always be open to an apprehension of institutional bias against the state given that expansive interpretations of the treaty and the heightened prospect of state liability clearly promote investment arbitration. Moreover, arbitrators make decisions about the cost and appropriate role of government with important implications for legislative, administrative, and judicial decision-making. Few would argue that domestic legislative authority should be transferred to an international committee of skilled and reputable legal drafters, jointly appointed by investors and states. Why should the authority to resolve regulatory disputes be delegated to private adjudicators?

Let us turn to the arbitration rules. The rules that are most often used in investment arbitration are the ICSID Rules, the ICSID Additional Facility Rules, the UNCITRAL Rules, the ICC Rules, and the Stockholm Rules.[26] Each of these sets of rules originates in a private model of adjudication; i.e. in the adjudication of disputes between private parties (even if one of those parties is the state, acting in a private

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[24] E.g. *The Loewen Group, Inc. and Raymond L. Loewen* v. *United States of America* (Merits) (26 June 2003), 42 I.L.M. 811, 15(5) World Trade and Arb. Mat. 97 [hereinafter *Loewen*], para. 222-3 and 233 (presided over by Sir Anthony Mason); *ADF Group Inc.* v. *United States of America* (Merits) (9 January 2003), 15(3) World Trade and Arb. Mat. 55 (Judge F.P. Feliciano); *SGS Société Générale de Surveillance* v. *Pakistan* (Jurisdiction) (6 August 2003), 18 ICSID Rev. 307, 16(2) World Trade and Arb. Mat. 167 (Judge F.P. Feliciano).

[25] Rau, *supra* note 13, 523-4.

[26] ICSID Rules, *supra* note 7; *Rules Governing the Additional Facility for the Administration of Proceedings by the Secretariat of the International Centre for Settlement of Investment Disputes*, revised 1 January 2003 (original rules 1978), 1 ICSID Reports 213 [hereinafter ICSID Additional Facility Rules], online: ICSID www.worldbank.org/icsid/facility-archive/1.htm; UNCITRAL Rules, *supra* note 7; ICC Rules, *supra* note 7; and *Rules of the Arbitration Institute of the Stockholm Chamber of Commerce*, revised 1 April 1999 [hereinafter Stockholm Rules], online: SCC www.sccinstitute.com/uk/Rules.

capacity). Also, some aspects of these sets of rules, because they are based on private law principles, are out of place in the adjudication of public disputes. For example, a fundamental principle of public law adjudication for both domestic and international courts is openness.[27] That is, adjudication in the public courts should take place in public, with limited exceptions,[28] and relevant documents and decisions should be a matter of public record. If public law adjudication was not fully transparent in this way, it would not be subject to public scrutiny and matters affecting the wider community could be decided in secret. Openness in the adjudication of regulatory disputes is a precondition for the public accountability of decision-making.

These principles of openness and accountability conflict with rules of confidentiality that govern private arbitration based on party autonomy.[29] In commercial arbitration it is normally assumed that the existence of an arbitration, the identity of the arbitrators, the materials submitted, the arguments made, and the award itself should remain confidential unless the disputing parties agree otherwise.[30] This may be appropriate in the context of a commercial dispute that relates only to the parties and that does not engage matters of broad public concern.[31] In investment arbitration, though, the incorporation of rules of confidentiality from commercial arbitration means that public disputes are resolved in private.[32]

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[27] E.g. ECHR, *supra* note 14, art. 40 (providing that hearings of the court shall take place in public and that documents deposited with the Registry made accessible to public). B. Legum, "Federalism, NAFTA Chapter Eleven and the Jay Treaty of 1783" (2001) 18(1) ICSID News 6.

[28] Such as for reasons of public interest privilege, national security, and business confidentiality.

[29] Cosbey et al., *supra* note 17, 4-5; M. Stevens, "Confidentiality Revisited" (2000) 17(1) ICSID News 2, 2.

[30] E.g. *ICSID Convention*, *supra* note 8, art. 48(5); ICSID *Administrative and Financial Regulations*, reprinted in *Convention, Regulations and Rules* (Washington: ICSID, 2003), 51, reg. 22(2); ICSID Rules, *supra* note 7, rule 48(4) and 6(2); ICSID Additional Facility Rules, *supra* note 26, art. 4(5) and art. 13(2) and 53(3) (Schedule C); UNCITRAL Rules, *supra* note 26, art. 25(4) and 32(5).

[31] The primary rationale for allowing confidentiality in international commercial arbitration is respect for party autonomy: *Report of the Secretary-General: Revised Draft Set of Arbitration Rules for Optional Use in Ad Hoc Arbitration Relating to International Trade (UNCITRAL Arbitration Rules)*, UN, UN Doc. A/CN.9/112/Add.1 (12 December 1975), 7 Y.B. UNCITRAL 166, 175 (art. 22(4), commentary); *Report of the Secretary-General: Analytical Commentary on Draft Text of a Model Law on International Commercial Arbitration*, UN, UN Doc. A/CN.9/264 (25 March 1985), 16 Y.B. UNCITRAL 104 [hereinafter *Model Law Report*], 124 (art. 19, commentary).

[32] NAFTA, *supra* note 7, annex 1137:4 (providing that, in a NAFTA Chapter 11 claim against Canada or the United States, either the host state or the investor can make an award public).

Under NAFTA, the issue of confidentiality arose in a number of early Chapter 11 arbitrations leading to different approaches by tribunals.[33] The NAFTA text does not itself resolve the question of openness one way or the other, although the applicable arbitration rules appear to support a presumption in favour of confidentiality.[34] Applying these rules, a number of Chapter 11 tribunals declined to publish materials or permit public access to proceedings without the consent of the parties to the dispute.[35] However, in 2002, the NAFTA states intervened by announcing that they would publish all documents submitted to or issued by Chapter 11 tribunals, and that they interpreted NAFTA so as not to prevent the NAFTA states from releasing materials relating to Chapter 11 claims against them.[36] Thus, the arbitration rules were subordinated to the NAFTA states' interpretation of the treaty. Even so, confidentiality remains the dominant principle in investment arbitration under other investment treaties.[37]

The use of a private model of adjudication also causes tension in relation to the accountability of arbitration tribunals to domestic courts. As mentioned,

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Because this provision applied only to the publication of awards, it left open the possibility that other materials relating to a Chapter 11 claim could not be released without the consent of both the respondent state and the investor. This state of affairs was addressed by the Free Trade Commission's interpretation of 31 July 2001: *infra* note 36). P.I. Hansen, "Judicialization and Globalization in the North American Free Trade Agreement" (2003) 38 Texas Int'l L.J. 489, 500-1; B. Legum, "Trends and Challenges in Investor-State Arbitration" (2003) 19 Arb. Int'l 143, 145.

[33] See *S.D. Myers, Inc.* v. *Government of Canada* (Procedural Order No. 3 and 11) (10 June 1999 and 11 November 1999) [hereinafter *S.D. Myers*], online: DFAIT http://www.dfait-maeci.gc.ca/tna-nac/documents/myers5.pdf; *Pope & Talbot Inc.* v. *Government of Canada* (Merits, Phase 2) (10 April 2001), 13(4) World Trade and Arb. Mat. 61 [hereinafter *Pope & Talbot*], para. 17. Compare *Marvin Roy Feldman Karpa* v. *United Mexican States* (Procedural Order No. 5) (6 December 2000), para. 10-11, online: Ministry of Economy http://www.economia-snci.gob.mx/sphp_pages/importa/sol_contro/consultoria/Casos_Mexico/Marvin/ordenes/Order_5.pdf.

[34] UNCITRAL Rules, *supra* note 26, art. 32(5) ("The award may be made public only with the consent of both parties"); ICSID Additional Facility Rules, *supra* note 26, art. 44(2).

[35] *Ethyl Corporation* v. *Government of Canada* (Procedural Order, 13 October 1997 and subsequent Procedural Order, undated), para. 9 and para. 2-3, online: DFAIT http://www.dfait-maeci.gc.ca/tna-nac/documents/ethyl5.pdf; *S.D. Myers*, *supra* note 33; *Pope & Talbot*, supra note 33; *Pope & Talbot Inc. v. Government of Canada* (Merits, Phase 2) (10 April 2001), 13(4) World Trade and Arb. Mat. 61, para. 17.

[36] Free Trade Commission, *Notes of Interpretation of Certain Chapter 11 Provisions* (31 July 2001), 13(6) World Trade and Arb. Mat. 139, art. A, online: DFAIT www.dfait-maeci.gc.ca/tna-nac/NAFTA-Interpr-en.asp.

[37] Stevens, *supra* note 29, 2.

investment treaties incorporate the enforcement structure of international commercial arbitration, which governs the recognition and enforcement (and execution[38]) of awards. Reliance on this structure fragments and restricts judicial supervision of investment arbitration. Judicial supervision is fragmented because investors can pursue enforcement of an award in any state that is a party to the *New York Convention* or other relevant treaty, thus dividing supervisory responsibility among the courts of a large number of countries.[39] Judicial supervision is restricted because the enforcement structure limits the setting aside or non-recognition of awards by domestic courts to the grounds enumerated in the treaty or relevant legislation. In international commercial arbitration, restricting judicial supervision was justified on the rationale that the courts should not interfere with choices of private parties to resolve commercial disputes in an alternative forum of their choosing. However, in the case of investment arbitration, the enforcement structure tends to disperse and insulate the authority of tribunals.

Moreover, the use of the structure of international commercial arbitration gives arbitrators and investors direct control over the accountability of investment arbitration tribunals to the courts. Tribunals often choose the legal seat of the arbitration,[40] thus selecting the domestic law that will apply to an application to pre-empt the arbitration or set aside an award.[41] Investors decide where to seek

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[38] Once an award has been recognized and enforced by the courts of a state party to the *ICSID Convention*, the *New York Convention*, or the *Inter-American Convention*, it is subject to execution against the respondent state's assets in the enforcing state's territory.

[39] *Republic of Ecuador* v. *Occidental Exploration and Production Company* (29 April 2005), [2005] E.W.C.H. 774, para. 76 and 84 (Comm. Ct.). C.N. Brower, C.H. Brower II, and J.K. Sharpe, "The Coming Crisis in the Global Adjudicative System" (2003) 19 Arb. Int'l 415, 419.

[40] E.g. NAFTA, *supra* note 7, art. 1130 (providing that tribunals "shall hold an arbitration in the territory of a [NAFTA state] that is a party to the New York Convention" unless the disputing parties agree otherwise). Also, tribunals are normally required to select the seat of the arbitration in accordance with the arbitration rules under which the investor claim is filed. The UNCITRAL Rules (*supra* note 26, art. 16(1)) and ICSID Additional Facility Rules (*supra* note 26, art. 21 of sched. C) grant tribunals the authority to choose the seat of the arbitration unless the parties agree otherwise. Arbitrations under the ICSID Rules are held at the seat of the ICSID, in Washington D.C., unless the parties agree to hold the arbitration at an institution with which ICSID has made arrangements (*ICSID Convention*, *supra* note 8, art. 62-3) or at another institution with the approval of the tribunal (ICSID Rules, *supra* note 26, rule 13(3)).

[41] W. Peter, *Arbitration and Renegotiation of International Investment Agreements* (The Hague: Kluwer Law International, 1995), 284-5; W.M. Reismann, *Systems of Control in International Adjudication and Arbitration* (Durham: Duke University Press, 1992), 127.

enforcement of an award, thus determining the domestic law that will apply to the enforcement of the award.[42] In both cases, arbitrators and investors can choose from a variety of jurisdictions in which domestic law provides for differing levels of deference to foreign arbitration awards. Moreover, in their efforts to attract international arbitration business, states typically attempt to raise their appeal to arbitrators by adopting liberal rules of enforcement for foreign awards.[43]

In sum, the use of a private model of adjudication has created tensions in investment arbitration. Private arbitrators are open to the reproach that their decisions are influenced by their own business interests. Confidentiality provisions in the arbitration rules require public disputes to be adjudicated in private. The recognition and enforcement of awards based on the existing legal structure of international commercial arbitration reduces the accountability of tribunals to domestic courts. In each respect, the use of a private model undermines the independence, openness, and accountability of investment arbitration. But this is so only if one accepts that investment arbitration is a method of public law adjudication. In fact, the use of a private model has prompted commentators and adjudicators to characterize investment arbitration as a form of international commercial arbitration.

2. The confusion of investment arbitration for private arbitration

Investment arbitration has been approached by some as a form of international commercial arbitration.[44] This approach treats the investor and the state simply as disputing parties in a private arbitration and, in so doing, it neglects the origins of investment arbitration in the exercise of public authority. Two instances in which an arbitration under NAFTA Chapter 11 was approached in this way are reviewed below.

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[42] Typically, this decision would be driven, first, by the location of assets of the state and, secondly, by the enforceability of awards in that jurisdiction.

[43] Peter, *supra* note 41, 284-5; M.J. Mustill, "Arbitration: History and Background" (1989) 6 J. Int'l Arb. 43, 50; Dezaley and Garth, *supra* note 13, 7; Y. Dezaley, *supra* note 13, 84-6.

[44] W. Mattli, "Private Justice in a Global Economy: From Litigation to Arbitration" (2001) 55 Int'l Org. 919, 945; D.F. Donovan, "Introduction to Articles – Dallas Workshop on Arbitrating with Sovereigns" (2002) 18 Arb. Int'l 229, 229; G.A. Alvarez and W.W. Park, "The New Face of Investment Arbitration: NAFTA Chapter 11" (2003) 28 Yale J. Int'l L. 365, 393; Brower et al., *supra* note 39, 415 and 432-5. See Toope, *supra* note 23, 389 (noting the tendency to approach investment arbitration "purely as a subcategory of international commercial arbitration and thus infused with the values of that process").

In each instance, the misapprehension of investment arbitration led to over-emphasis of rules and principles of commercial arbitration at the expense of principles that usually apply to the adjudication of a regulatory dispute.

The *Pope & Talbot* dispute was discussed in chapter five of this thesis. In that dispute, the tribunal awarded damages to a U.S. investor after concluding that Canada's implementation of the *Softwood Lumber Agreement* violated the NAFTA minimum standard of treatment (Article 1105). To reach this conclusion, the *Pope & Talbot* tribunal interpreted the NAFTA minimum standard broadly and this interpretation was later rejected by the NAFTA states through a Free Trade Commission interpretation.[45] In response, the *Pope & Talbot* tribunal pursued an exchange of letters with Canada (the respondent state) and the other NAFTA states about the validity of the Free Trade Commission interpretation. For example, the tribunal asked Canada to explain how the interpretation should be applied and whether it should be viewed to have retroactive effect.[46] The tribunal also challenged Canada to clarify the circumstances in which the interpretation was issued by the Free Trade Commission, asking to be informed of "what caused the Commission to take action in this manner and what the members were told about the effects of their action on this case".[47] Finally, the tribunal took the position that it was improper for Canada, as a party to the dispute, to also participate in the deliberations of the Free Trade Commission.[48] The tribunal stated that this violated the "rule of international law that no one shall be judge in his own case".[49]

The concerns expressed by the *Pope & Talbot* tribunal demonstrates a misconception regarding the character of a Chapter 11 dispute. The tribunal's concerns may have been pertinent had the tribunal been a commercial arbitration tribunal, interpreting the contract that authorized the arbitration based on the intentions of the disputing parties. But the authority of a Chapter 11 tribunal

[45] Free Trade Commission, *supra* note 36.
[46] *Pope & Talbot* (Letters of Lord Dervaird, Presiding Arbitrator) (14 August 2001 and 17 September 2001), online: DFAIT http://www.dfait-maeci.gc.ca/tna-nac/phases-en.asp#1.
[47] *Pope & Talbot* (Letter, 17 September 2001), ibid., 2.
[48] *Pope & Talbot Inc. v. Government of Canada* (Damages) (31 May 2002), 41 I.L.M. 1347, 14(6) World Trade and Arb. Mat. 44, para. 13.
[49] Ibid.

originates in an agreement between states.[50] Chapter 11 tribunals are authorized by a treaty and by the general consents of the states parties. Thus, the authority of a tribunal is bounded by the terms of the treaty which expressly provides that the NAFTA states – acting through the Free Trade Commission – can issue a binding interpretation of the treaty.[51] This necessarily implies that the NAFTA states could take part in the Free Trade Commission while responding to a Chapter 11 claim. Indeed, it is difficult to see how else the NAFTA states could interpret the treaty other than in the context of ongoing claims. However unfair this might seem from a private law perspective, a Chapter 11 tribunal must apply a Free Trade Commission interpretation because states are entitled to attach conditions to their consent to investment arbitration.[52]

The irony of the overlapping functions of the state manifests itself in domestic and international law. As the repository of public authority, the state acts in a range of legal capacities based on a separation of powers.[53] In the domestic sphere, different branches of the state's governing apparatus may wield authority over one another: a decision of the administration may be overturned by the courts who are in turn subject to parliamentary supremacy. Likewise, in the international sphere, a state may be held accountable to an international tribunal that is in turn subject to the authority of the states parties to a treaty. In NAFTA Chapter 11, this irony emerges in the dual role of each NAFTA state as both respondent to investor claims and interpreter of the treaty. The *Pope & Talbot* tribunal questioned the validity of the Free Trade Commission's interpretation because the tribunal saw Canada as merely a disputing party in a private arbitration. But there was more to Canada's role. Canada was participating in an adjudicative system that Canada had itself established as part of a

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[50] J. Paulsson, "Arbitration without Privity" (1995) 10 ICSID Rev. 232, 232.

[51] NAFTA, *supra* note 7, art. 1131(2).

[52] At the oral hearings in *Pope & Talbot*, the presiding arbitrator reportedly asked whether the NAFTA Parties "can simply interpret [the treaty] as widely, as bizarrely… as they like, and that must be binding on all future tribunals" (*Pope & Talbot* (Investor's Submissions) (14 December 2001), para. 29, online: DFAIT http://www.dfait-maeci.gc.ca/tna-nac/documents/C-8.pdf). The answer must be yes: the NAFTA makes no provision for a tribunal to sit in judgment of the NAFTA Parties no matter how wrong their interpretation might appear to the tribunal.

[53] W.W. Willoughby, *The Fundamental Concepts of Public Law* (New York: Macmillan, 1924), 49-50; E. Barendt, "Separation of Powers and Constitutional Government" (1995) Pub. L. 599, 601.

bargain with the other NAFTA states, and over which Canada exercised authority based on the treaty. From a public law perspective there was no basis for the *Pope & Talbot* tribunal to question the structure of NAFTA by doubting the validity of the Free Trade Commission's interpretation. The tribunal mistook Canada's sovereign acts – as a participant in the arbitration and the Free Trade Commission – for the acts of a private party.

Another example of the misapprehension of Chapter 11 arbitration as commercial arbitration is provided by the Federal Court of Canada's decision to reject an application to set aside the *S.D. Myers* award under Chapter 11.[54] In that decision, Kelen J. adopted a deferential approach to Chapter 11 tribunals based on principles of international commercial arbitration. According to Kelen J.:[55]

> Courts restrain themselves from exercising judicial review with respect to international arbitration tribunals so as to be sensitive to the need of a system for predictability in the resolution of disputes and to preserve the autonomy of the arbitration forum *selected by the parties.*

Once again, this characterization of Chapter 11 arbitration fails to account for its public law origins. In international commercial arbitration, the need to "preserve the autonomy of the arbitration forum selected by the parties" arises from the disputing parties' agreement to arbitrate a dispute between them. In treaty-based investment arbitration, however, the arbitration forum was not chosen by the parties to the dispute. Rather, it was chosen by the Parties to the treaty via their general consents to compulsory arbitration. Only after the Parties to the treaty created this arbitration forum could an investor choose to make a claim.

Elsewhere in his decision, Kelen J. compared the respondent state's duty to raise jurisdictional objections at an early stage to the domestic legal duty of a party – under the Canadian *Federal Court Act* – to raise constitutional issues in the initial notice of claim.[56] In fact, these duties operate quite differently, revealing the uniqueness of

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[54] *Attorney General of Canada* v. *S.D. Myers, Inc*, [2004] 3 F.C.R. 368, 5 C.E.L.R. (3d) 166 (F.C.T.D.), Kelen J. [hereinafter *A.G.* v. *S.D. Myers*]. See *S.D. Myers Inc.* v. *Government of Canada* (Merits) (13 November 2000), 40 I.L.M. 1408, 15(1) World Trade and Arb. Mat. 184.

[55] Ibid., para. 38 [emphasis added]. Note that Kelen J. also acknowledged the distinction between "international arbitration between two private parties" and "investor-State arbitration".

[56] Ibid., para. 54.

investment arbitration. The *Federal Court Act* requirement to raise a constitutional issue at an early stage falls on the individual who claims that the constitution was violated. The main purpose of the rule is to allow the state to respond to constitutional claims in the first instance and to participate in the calling of evidence. In contrast, the duty to object that an investment arbitration tribunal lacks jurisdiction can *only* fall on the respondent state. This is because only the state has reason to object to a tribunal's overly broad interpretation of the tribunal's jurisdiction. For investors, an overly broad interpretation of jurisdiction facilitates the bringing of a claim. Thus, in investment arbitration, the duty to object works to the advantage of the claimant while, in a constitutional challenge, the rule advantages the state.

In analogizing these respective duties, Kelen J. effectively equated the state, in investment arbitration, to a private party under domestic law. In doing so, Kelen J. appeared not to identify an important distinction between investment arbitration and commercial arbitration. In treaty-based investment arbitration, the state *only* acts as the respondent to a claim that the state has breached a treaty. In other words, the state only acts in a public capacity. On the other hand, in commercial arbitration, the state acts in a private capacity. This distinction is elaborated below. Here the point is simply that the role of the state in investment arbitration should not be analogized to that of a private party in domestic adjudication.

Other tribunals have distinguished investment arbitration from international commercial arbitration.[57] In particular, the *Loewen* tribunal described Chapter 11 arbitration in these terms:[58]

> It is true that some aspects of the resolution of disputes arising in relation to private international commerce are imported into the NAFTA system…, and that the handling of disputes within that system by professionals experienced

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[57] E.g. *Loewen, supra* note 24, para. 233; *United Parcel Service of America Inc.* v. *Government of Canada* (Participation by *Amici Curiae*) (17 October 2001), para. 70, online: DFAIT http://www.dfait-maeci.gc.ca/tna-nac/documents/IntVent_oct.pdf. See e.g. *Banro American Resources, Inc. and Société Aurifère du Kivu et du Maniema S.A.R.L.* v. *Democratic Republic of the Congo* (Jurisdiction) (1 September 2000), 17 ICSID Rev. 382, para. 24; *CME Republic B.V.* v. *Czech Republic* (Damages) (14 March 2003), 15(4) World Trade and Arb. Mat. 83 and 245, para. 74 (separate opinion); *SGS Société Générale de Surveillance* v. *Philippines* (Jurisdiction) (29 January 2004), 16(3) World Trade and Arb. Mat. 91 [hereinafter *SGS* v. *Philippines*], para. 142; *Tokios Tokelės* v. *Ukraine* (Jurisdiction) (29 April 2004), 16(4) World Trade and Arb. Mat. 75, para. 24 and 28 (dissenting opinion).

[58] *Loewen, supra* note 24, para. 233.

> in the handling of major international arbitrations has tended in practice to make a NAFTA arbitration look like a more familiar kind of process. But this apparent resemblance is misleading. The two forms of process, and the rights which they enforce, have nothing in common. There is no warrant for transferring rules derived from private law into a field of international law where claimants are permitted for convenience to enforce what are in origin the rights of Party states.

Thus, principles of private arbitration were considered irrelevant to investment arbitration despite the use of a private model of adjudication. The *Loewen* tribunal supported this conclusion by positioning investment arbitration in the context of public international law:[59]

> Rights of action under private law arise from personal obligations (albeit they may be owed by or to a State) brought into existence by domestic law and enforceable through domestic tribunals and courts. NAFTA claims have a quite different character, stemming from a corner of public international law in which, by treaty, the power of States under that law to take international measures for the correction of wrongs done to its nationals has been replaced by an ad hoc definition of certain kinds of wrong, coupled with specialist means of compensation. These means are both distinct from and exclusive of the remedies for wrongful acts under private law....

Whatever one's views of the *Loewen* award as a whole, in these passages the tribunal captured an essential element of treaty-based investment arbitration. The tribunal showed an appreciation for the uniqueness of the use of international adjudication beyond the domain of "wrongful acts under private law". Also, the tribunal acknowledged that the use of a private model of adjudication does not alter the public nature of the dispute. The significance of using a private model lies in the form, not the substance, of the adjudication.

B. Distinguishing investment arbitration from commercial arbitration

At root, the misapprehension of investment arbitration as international commercial arbitration confuses public for private authority. This is demonstrated by the role of the general consent in transforming international arbitration from a reciprocally

[59] Ibid.

consensual method of adjudication into a governing arrangement. Historically, international arbitration between private parties was limited to commercial disputes.[60] This held true even where the arbitration involved a dispute between an investor and a state: by agreeing to an arbitration clause in a contract, the state acted in a private capacity[61] as part of a commercial relationship.[62] In these circumstances, the scope of investment arbitration – culminating in the recognition and enforcement of an award – was limited to the private sphere. As discussed in chapter two of this thesis, states have only recently expanded the model of international commercial arbitration to the regulatory sphere.

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[60] See chapter two of this thesis, page 53-4, note 132-4.

[61] In some cases, the contract might arguably go beyond the private sphere, such as in the case of a long term concession that impacted fundamentally on the host state's economy: S.K.B. Asante, *Transnational Investment Law and National Development* (Lagos: University of Lagos, 1981), 65 and 69.

[62] What emerges from the drafting history of the *New York Convention* is an intent to ensure that the treaty would apply to contracts involving states agencies, but not encompass the wider public sphere: *Report of the Committee*, *supra* note 9, 5 and 8 (Second Meeting, 23 March 1955) and 6 (Third Meeting, 23 March 1955). Likewise, the drafting of the UNCITRAL Model Law indicates an intention to define "commerce" so as to capture commercial activities of state entities but not to apply arbitration within the public sphere: *Model Law Report*, *supra* note 31, 10-11; *Report of the Secretary-General: Possible Features of a Model Law on International Commercial Arbitration*, UN, UN Doc. A/CN.9/207 (14 May 1981), (1981) 12 Y.B. UNCITRAL 77 [hereinafter *Preliminary Model Law Report*], 82-3. An original draft of Article I of the UNCITRAL Model Law which proposed that the Model Law apply to "economic" rather than "commercial" transactions was rejected: *Note by the Secretariat: Model Law on International Commercial Arbitration: Draft Articles 1 to 24 on Scope of Application, Arbitration Agreement, Arbitrators, and Arbitral Procedure*, UN, UN Doc. A/CN.9/WG.II/WP.37 (1982), 51.

1. The nature of commercial arbitration

Commercial arbitration is a private form of adjudication authorized by the will of the disputing parties.[63] As a matter of private law, commercial arbitration is governed by private law principles beginning with the supremacy of party autonomy, which is the normative starting point for commercial arbitration.[64] The principle of party autonomy posits that voluntary decisions of individuals about their affairs should be respected and enforced by the state. Honouring party autonomy means respecting the decision of individuals who, in doing business, agree to arbitrate disputes that could arise between them. The mutual consent of the parties creates an "agreement to arbitrate" which is the "foundation stone" of international commercial arbitration.[65] The arbitration exists as a result of the agreement of the parties and the authority for the arbitration is a matter of contract.[66]

Commercial arbitration arose as an alternative to the public courts.[67] Individuals could agree to have disputes between them resolved by private arbitrators rather than by judges. The use of arbitration may be preferred because it is faster and cheaper than the courts, governed by rules chosen by the parties, or kept confidential.[68] At the international level, arbitration could also be used to fill gaps between legal systems and avoid problems in enforcing of decisions of foreign courts.[69] For states, one reason to endorse international commercial arbitration was to facilitate the efficient resolution of cross-border business disputes.[70] International

[63] *Preliminary Model Law Report*, ibid., 78 ("Probably the most important principle on which the model law should be based is the freedom of the parties in order to facilitate the proper functioning of international commercial arbitration according to their expectations. This would allow them to freely submit their disputes to arbitration and to tailor the 'rules of the game' to their specific needs."). See also UNCITRAL Model Law, *supra* note 8, art. 19(1).
[64] Fuller, *supra* note 4, 806-8; Redfern and Hunter, *supra* note 1, 7 and 247; L.Y. Fortier, "Delimiting the Spheres of Judicial and Arbitral Power" (2000) 80 Can. Bar Rev. 143, 147-8.
[65] Redfern and Hunter, *supra* note 1, 135.
[66] Fuller, *supra* note 19, 392-3; Rau, *supra* note 13, 486-7; Redfern and Hunter, *supra* note 1, 8. But see H.-L. Yu and L. Shore, "Independence, Impartiality, and Immunity of Arbitrators – U.S. and English Perspectives" (2003) 52 I.C.L.Q 935, 965-7.
[67] Dezaley and Garth, *supra* note 13, 27-30.
[68] United States, Department of Commerce, Office of the Chief Counsel for International Commerce, *International Arbitration* (1998); Redfern and Hunter, *supra* note 1, 23-5.
[69] Redfern and Hunter, *supra* note 1, 12-13.
[70] *Report of the Committee* (First Meeting, 1 March 1955), *supra* note 9, 5-6.

commercial arbitration could be structured so as to take place in a neutral jurisdiction that did not favour one private party over the other.[71] This facilitated commerce by building confidence among actors from different countries in the prospect for fair, prompt, and effective adjudication.

The principle of party autonomy calls for the parties' agreement to arbitrate to be respected by states and, in particular, by domestic courts.[72] Thus: the agreement to arbitrate should be honoured by the home state of each disputing party, and by other states. The arbitration process should be insulated from oversight by domestic courts within the bounds of consent and basic procedural fairness.[73] Where the arbitration falls within the scope of the agreement to arbitrate, an application by the unsuccessful party to stay the arbitration or set aside an award should be dismissed.[74] Likewise, an award should be recognized and enforced by the courts so long as the process was not seriously unfair and so long as the arbitration did not exceed the scope of the parties' agreement.[75] As a general principle, no one state's conception of justice or policy should be imposed where it conflicts with the parties' agreement to arbitrate.[76]

This does not mean that the state does not exercise public authority in relation to private arbitration.[77] Arbitration depends on the coercive power of the state to permit the enforcement of awards.[78] For this reason, the state may override agreements to arbitrate in order to limit the use of private adjudication for various

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[71] Here, "neutrality" refers to neutrality between the disputing parties, not between the state and an investor in the context of a regulatory dispute: see chapter seven of this thesis, page 228-9.

[72] *Preliminary Model Law Report*, *supra* note 62, 78. See also Lord Saville, "Denning Lecture 1995: Arbitration and the Courts" (1995) 61 Arbitration – J. Institute of Chartered Arbitrators 157, 157.

[73] A. Bucher, "Court Intervention in Arbitration" in R. Lillich and C.N. Brower, eds., International Arbitration in the 21st Century: Towards Judicialization and Uniformity? (Ardsley, N.Y.: Transnational Publishers, 1994), 29; Redfern and Hunter, *supra* note 1, 280-1.

[74] E.g. *Gulf Canada Resources Ltd.* v. *Arochem International Inc.* (1992), 66 B.C.L.R. (2d) 113, 43 C.P.R. (3d) 390, para. 43. Redfern and Hunter, *supra* note 1, 260; S. Kierstead, "Referral to Arbitration Under Article 8 of the UNCITRAL Model Law: The Canadian Approach" (1998) 31 Can. Bus. L.J. 98, 101-2.

[75] Redfern and Hunter, *supra* note 1, 70 and 135.

[76] Rau, *supra* note 13, 539; Redfern and Hunter, *supra* note 1, 431-2 and 471-4.

[77] Fuller, *supra* note 4, 808-9; Reismann, *supra* note 41, 1; D.M. Gruner, "Accounting for the Public Interest in International Arbitration: The Need for Procedural and Structural Reform" (2003) 41 Colum. J. Transnat'l L. 923, 924; E.H. Bouzari, "The Public Policy Exception to Enforcement of International Arbitral Awards: Implications for Post-NAFTA Jurisprudence" (1995) 30 Texas Int'l L.J. 205, 214 and 221.

[78] Redfern and Hunter, *supra* note 1, 11 and 341; Yu and Shore, *supra* note 66, 964.

reasons, such as to protect the interests of the weaker party, third parties, or the public interest.[79] That said, most states – in part to facilitate international commerce – have decided to limit their involvement with respect to private agreements to arbitrate.[80] For this reason, the decision to consent to compulsory arbitration is portentous: "By agreeing to arbitrate, parties give up one of the basic rights of the citizens of any civilised community – that is to say, the right to go to their own courts of law".[81]

This conceptual framework characterizes commercial arbitration as an autonomous system that is separate from the public sphere. So long as a dispute exists within the private sphere, individuals can choose an alternative forum for the resolution of disputes between them. In turn, the courts should show deference to commercial arbitration, starting with the recognition of agreements to arbitrate and ending with the execution of an award. However, this approach is irrelevant to treaty-based investment arbitration. In investment treaties, states incorporate aspects of the rules and structure of private arbitration. Nevertheless, the authority for investment arbitration originates in the consents of states, acting in a sovereign capacity.

2. Arbitration as contract: the specific consent

Private arbitration, and the principle of party autonomy, originates in the consent of private parties, acting in a private capacity. Private parties consent to arbitration by agreeing to arbitrate an existing or future dispute. The agreement to arbitrate can be concluded either after the dispute has arisen or in advance. Where the consent is given after the dispute has arisen, the consent is specific to the dispute. Where the consent is given in advance, the consent is specific to the relationship between the parties. In either case, the consent is limited to a particular dispute or private relationship.

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[79] *Czarnikow* v. *Roth, Schmidt & Co.* [1922] 2 K.B. 478, 488. O.M. Fiss, "Against Settlement" (1984) 93 Yale L.J. 1073, 1085-6; Rau, *supra* note 13, 512; M.A. Scodro, "Arbitrating Novel Legal Questions: A Recommendation for Reform" (1996) 105 Yale L.J. 1927, 1947-9.

[80] As demonstrated by the number of states that have ratified the *New York Convention* (more than 120) and passed domestic legislation based on the UNCITRAL Model Law (more than 40).

[81] Redfern and Hunter, *supra* note 1, 5 and 22.

The degree of specificity of a consent to arbitration affects the jurisdiction of an arbitration tribunal.[82] It also reflects the degree to which the disputing parties have conceded their right to adjudicate in the courts. In principle, arbitration that is authorized by an agreement to arbitrate based on a specific consent cannot go beyond the private relationship between the disputing parties. That is, the subject matter of the dispute cannot in principle engage matters that affect the interests of either third parties or the state in the regulatory sphere. This is because neither third parties nor the state (acting in a public capacity) have consented to the arbitration.[83]

This does not mean that a state cannot specifically consent to private arbitration. On the contrary, a state can consent to private arbitration just like any other private party when the state acts in a private capacity. Public officials may contract with a company for the supply of goods or services and agree to arbitrate disputes arising from the contract.[84] Where the state consents to arbitration in a contract, the arbitration is a form of commercial arbitration (albeit unique in that it involves the state acting as a private party).[85] The state's consent flows from the state's entry into private domain and forms part of an agreement to arbitrate with another private party.[86] Likewise, the state's consent is specific either to the dispute or to the relevant commercial relationship. In principle, the consent does not affect third parties, investors in general, or the public at large, since the consent is limited to a private relationship.

International commercial arbitration may encompass disputes between a state and a foreign investor. In such cases, the arbitration is a form of contract-based

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[82] Redfern and Hunter, *supra* note 1, 8.

[83] In some cases a private arbitration may affect third parties or the state, although the degree to which this is the case is usually regulated by the state. Since the 1980s, the U.S. Supreme Court has adopted a pro-arbitration stance by allowing the arbitration of disputes that engage the interests of third parties and the general public: *Mitsubishi Motors Corp.* v. *Soler Chrysler Plymouth Inc.*, 473 U.S. 614, 627-37 (1985) [hereinafter *Mitsubishi*].

[84] E.g. *Baccus* v. *S.R.L. Servicio Nacional del Trigo*, [1957] 1 Q.B. 438 (C.A.) (regarding the arbitration of a dispute arising from a sales contract between a private company and an agency of the Spanish government).

[85] J.P. Carver, "The Strengths and Weaknesses of International Arbitration Involving a State as a Party: Practical Implications" (1985) 1 Arb. Int'l 179, 180; Toope, *supra* note 23, 391-400; C. Larsen, "International Commercial Arbitration", *ASIL Insights* (April 1997), 1, online: ASIL http://www.asil.org/insights/insight97041.pdf.

[86] See *Bank of United States* v. *Planter's Bank of Georgia*, 9 Wheat. 904, 907 (U.S. 1824); *Trendtex Trading Corp.* v. *Central Bank of Nigeria*, [1977] Q.B. 529, 557-8 (C.A.) [hereinafter *Trendtex*].

investment arbitration pursuant to a commercial relationship.[87] The arbitration is authorized by the consents of each party, acting in a private capacity. Contracts between states and foreign investors – variably called investment agreements, economic development agreements, or state contracts – often include arbitration clauses.[88] Most such contracts involve the state acting in a private capacity.[89] In contract-based investment arbitration, the principle of party autonomy plays a central role because the dispute is between private parties. The dispute is an investment dispute within the private sphere. Put differently, the dispute is a commercial dispute that happens to involve the state (acting in a private capacity) as a disputing party.

A specific consent to the arbitration of an investment dispute could have important implications for governmental decision-making. But these implications are dwarfed by the implications of a *general* consent to investment arbitration, whether in legislation or a treaty. Contract-based investment arbitration is far more predictable and manageable than other forms of investment arbitration because its subject is confined to a specific dispute, investor, or project, and because the contracting parties and the disputing parties are the same.[90] Thus, the state has a relatively clear sense of what it has agreed to arbitrate. Further, because the state acts in a private capacity when it consents, contract-based investment arbitration is also less likely to engage matters of public concern.

[87] Redfern and Hunter, *supra* note 1, 53.
[88] Peter, *supra* note 41, 1-2.
[89] Asante, *supra* note 61, 65 and 69; M. Sornarajah, *The Settlement of Foreign Investment Disputes* (Boston: Kluwer, 2001), 5.
[90] J. Merrills, "The Means of Dispute Settlement" in M.D. Evans, ed., *International Law* (Oxford: OUP, 2004), 539.

3. Arbitration as governing arrangement: the general consent

In investment treaties, states consent generally to the compulsory arbitration of disputes with foreign investors *as a group*.[91] The consent is open to any natural or legal person who satisfies the conditions for bringing a claim. This opens investment arbitration to a class of potential claimants whose identity is unknown to the state at the time of the state's consent.[92] It also opens investment arbitration to a wide range of potential disputes arising from any exercise of public authority that affects the assets of a foreign investor. The general consent transforms international arbitration from a form of private and reciprocally consensual adjudication into a governing arrangement.

In making a general consent, the state does not act in a private capacity. Rather, the state exercises public authority that the state alone possesses as a representative entity in the international sphere.[93] Only the state, acting in a sovereign capacity, can consent generally to arbitration because only the state has the authority to regulate individuals in its territory, and to authorize the compulsory adjudication of disputes between the state and individuals who are subject to public authority. A general consent is unlike the consent of any private party because it is an exercise of public authority. For this reason, investment arbitration – based on the general consent – should be characterized as a governing arrangement.[94]

In an insightful article, Paulsson described treaty-based investment arbitration as "arbitration without privity".[95] This label has been widely adopted.[96] However, it is

[91] Paulsson, *supra* note 50, 256; T.W. Wälde, "Investment Arbitration Under the Energy Charter Treaty – From Dispute Settlement to Treaty Implementation" (1996) 12 Arb. Int'l 429, 434-6.
[92] Paulsson, *supra* note 50, 233.
[93] Willoughby, *supra* note 53, 307; W.I. Jennings, *The Law and the Constitution* (London: University of London Press, 1959), 312; W. Friedmann, *Law in a Changing Society* (London: Stevens & Sons, 1959), 351; D. Cohen and J.C. Smith, "Entitlement and the Body Politic: Rethinking Negligence in Public Law" (1986) 64 Can. Bar. Rev. 1, 5-6.
[94] C. Harlow and R. Rawlings, *Law and Administration* (London: Butterworths, 1997), 5 and 41-5; D. Lemieux and A. Stuhec, *Review of Administrative Action Under NAFTA* (Scarborough: Carswell, 1999), 151-2; C. Warbrick, "States and Recognition in International Law" in M.D. Evans, ed., *International Law* (Oxford: OUP, 2004), 231-2; M. Loughlin, *The Idea of Public Law* (Oxford: OUP, 2003), 6, 78, and 82.
[95] Paulsson, *supra* note 50.

misleading because it likens the general consent of a state (arbitration without privity) to the specific consent of a private party in commercial arbitration (arbitration with privity). The analytical framework remains one of private law: although investment arbitration via the general consent lacks privity, it is still based on an agreement to arbitrate between the disputing parties.[97] Alternatively, the general consent is sometimes described as a "standing offer" by the state to arbitrate disputes with investors.[98] The offer is standing because investors can make a claim at any time. Although this label is also somewhat misleading, since it too borrows from the language of private law, it does hint at the degree to which the general consent opens international adjudication to a wide class of potential claimants and disputes.

One way to illustrate the significance of the general consent is to consider how a state, by the vehicle of the specific consent, could commit to the level of investor protection (and state liability) that flows from a general consent. To commit to a comparable level of protection, the state would have to conclude a separate agreement to arbitrate with each foreign investor in its territory, and with each foreign investor considering entering its territory.[99] Thus, for Mexico to achieve a comparable outcome to its general consent to investment arbitration in NAFTA, Mexico would have to conclude separate contracts with every natural or legal person with U.S. or Canadian nationality who directly or indirectly owns or controls (or who was seeking to directly or indirectly own or control) assets in Mexico. The suggestion that Mexico might do so is absurd, revealing the sheer scope of the obligations and liabilities that flow from the general consent. It also highlights how the label "arbitration without privity" downplays the role of investment arbitration as a governing arrangement by characterizing the general consent as a type of blanket contractual obligation, on the

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[96] E.g. Werner, *supra* note 13, 6; A.K. Bjorklund, "Contract Without Privity: Sovereign Offer and Investor Acceptance" (2001) 2 Chi. J. Int'l L. 183; A.R. Parra, "ICSID and Bilateral Investment" (2000) 17(1) ICSID News 7. But see Sornarajah, *supra* note 20, 127.
[97] See generally Redfern and Hunter, *supra* note 1, 65.
[98] J.C. Thomas, "Investor-State Arbitration Under NAFTA Chapter Eleven" (Paper presented to the NAFTA Chapter 11 Investor-State Disputes: Litigating Against Sovereigns conference, Canadian Bar Association, Toronto, March 2000), 17-18; C. Schreuer, *The ICSID Convention: A Commentary* (Cambridge: CUP, 2001), 210; O. Spiermann, "Individual Rights, State Interests and the Power to Waive ICSID Jurisdiction under Bilateral Investment Treaties" (2004) 20 Arb. Int'l 179, 180.
[99] Many investment treaties include, in the definition of investor, those entities that are seeking to make an investment in the host state: e.g. NAFTA, *supra* note 7, art. 1139 ("investor of a Party").

part of the state, to all existing and future investors. In effect, the label reduces the state's relationship with investors to an essentially commercial relationship, negating the state's regulatory role.

Some commentators distinguish investment arbitration from commercial arbitration by looking to the implications of investment arbitration awards for the general public.[100] Because it originates in the exercise of public authority, investment arbitration does tend to engage matters of public concern that go well beyond those arising from the state's entry into commercial relationships.[101] Unlike consensual adjudication between private parties, the adjudication of a regulatory dispute determines the legality and appropriateness of the exercise of public authority in particular cases, often with important implications for wider governmental decision-making and activity. For this reason, the adjudication of a regulatory dispute is more likely to engage matters of public concern. Even so, this is a less compelling basis for distinguishing investment arbitration from commercial arbitration because it introduces the question of why, in some cases, the resolution of a regulatory dispute through investment arbitration has less significant implications for the public at large than the resolution of a commercial dispute.[102] Thus, it is debatable whether the *Feldman* tribunal's award under NAFTA Chapter 11 of (U.S.) $1.7 million in damages against Mexico, for Mexico's decision not to rebate taxes to cigarette exporters,[103] is more significant for Mexicans than the resolution of a contractual dispute worth hundreds of millions of dollars between Mexico's state oil company and a major foreign buyer. In exceptional cases, some disputes in the private sphere affect the public interest to a greater degree than some investment disputes in the public sphere. It is therefore more difficult to characterize an investment dispute as essentially public or private based on the subject matter of the dispute than to do so based on the fact

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[100] C. Tollefson, "Metalclad v. United Mexican States Revisited: Judicial Oversight of NAFTA's Chapter Eleven Investor-State Claim Process" (2002) 11 Minn. J. Global Trade 183, 204-5.

[101] C.H. Brower II, "Investor-State Disputes Under NAFTA: The Empire Strikes Back" (2001) 40 Colum. J. Transnat'l L. 43, 45; Brower et al., *supra* note 39, 418.

[102] Fuller, *supra* note 19, 357.

[103] *Marvin Feldman* v. *Mexico* (Merits) (16 December 2002), 15(3) World Trade and Arb. Mat. 157.

that the dispute arises from the exercise of public authority and the adjudication is authorized by a sovereign act of the state.[104]

That said, the implications of investment arbitration awards reveal the significance for governments of the general consent.[105] A host state's diverse regulatory relationships with foreign investors engage matters of pubic concern that go well beyond those raised by a commercial relationship pursuant to an investment contract. The general consent removes decision-making about regulatory law and policy from the exclusive domain of domestic courts and places it within the discretion of arbitration tribunals. This allows private arbitrators to decide whether and how public authority may be used to restrict capital transfers, tax business, establish standards, control land use, establish product standards, deliver services, regulate technology use, and so on.[106] Importantly, the general consent also delegates judicial supervision of those arbitrators to foreign courts. The decision of a state to shift governmental discretion to international tribunals, and ultimately to foreign courts, is major policy choice in its own right, beyond any official decision to a contract with an investor. In fact, it is widely acknowledged that investment arbitration engages matters of public concern.[107] To illustrate, during the NAFTA Chapter 11 arbitration in *Methanex*, in which the U.S. was the respondent, the hearings on jurisdiction were attended by no less than nine U.S. government departments and agencies.[108]

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[104] Adjudicative authority is the authority to order a final remedy or sanction backed by the coercive power of the state and, as such, all adjudication involves the exercise of public authority, even where it deals with legal relationships in the private sphere that do not raise matters of public concern.

[105] For a taste of the debate on the degree to which treaty-based investment arbitration constrains the state, and on the costs and benefits, see e.g. M. Barlow and T. Clark, *MAI: The Multilateral Agreement on Investment and the Threat to Canadian Sovereignty* (Toronto: Stoddart: 1997); D. Schneidermann, "Investment Rules and the New Constitutionalism" (2000) 25 Law and Social Inquiry 757; C.N. Brower and L.A. Steven, "Who Then Should Judge? Developing the International Rule of Law under NAFTA Chapter 11" (2001) 2 Chi. J. Int'l L. 193; I.A. Laird, "NAFTA Chapter 11 Meets Chicken Little" (2001) 2 Chi. J. Int'l L. 223.

[106] See chapter four of this thesis, page 127, note 74.

[107] Werner, *supra* note 13, 9-10; E. Obadia, "ICSID, Investment Treaties and Arbitration: Current and Emerging Issues" (2001) 18(2) ICSID News 4, 4; B.M. Cremades and D.J.A. Cairns, "The Brave New World of Global Arbitration" (2002) 3 J. World Investment 173, 208; J. Werner, "Making Investment Arbitration More Certain – A Modest Proposal" (2003) 4 J. World Investment 767.

[108] Department of State, U.S. Trade Representative, Department of Commerce, Department of Justice, Department of Treasury, Department of Labor, Environmental Protection Agency,

One may object to the underlying distinction between sovereign acts (*jure imperii*) and commercial acts (*jure gestionis*) of the state. But this distinction, although sometimes difficult to nail down in specific cases, is nevertheless central to every domestic legal system and to public international law, just as the recognition of the state as a unique entity is central to the organization of modern society.[109] Public law is based on the premise that there is authority that the state alone – acting through public officials and institutions – can exercise, and that the state has corresponding obligations that do not exist for private individuals.[110]

This is demonstrated by the principle of sovereign immunity.[111] The principle of sovereign immunity under customary international law is that one state's authority, within its territory, is not subject to adjudication in another state's courts.[112] However, many states recognize an exception from this principle for acts of the state that are non-sovereign or commercial in nature. According to this restrictive doctrine of sovereign immunity, these acts of the state are not entitled to immunity.[113] Public officials and institutions in states that recognize this restrictive doctrine apply varying legal tests to distinguish between sovereign and commercial acts of the state.[114] Yet,

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California Environmental Protection Agency, and California State Water Resources Control Board: *Methanex Corporation* v. *United States of America* (Jurisdiction) (7 August 2002), 14(6) World Trade and Arb. Mat. 109, para. 16.

[109] E.g. International Law Commission, "Draft Articles on Responsibility of States for Internationally Wrongful Acts", *Report of the International Law Commission on the Work of Its Fifty-third Session*, UN GAOR, 56th Sess., Supp. No. 10, UN Doc. A/56/10 (2001), 43, art. 4 and 5. See also *Claim against the Empire of Iran* (1963), 45 I.L.R. 57, 80 (Ger. Fed. Const. Ct.); *I Congreso del Partido*, [1983] 1 A.C. 244, 267 (H.L.) [hereinafter *Congreso del Partido*]. E.M. Borchard, "Governmental Responsibility in Tort: VII" (1928) 28 Colum. L. Rev. 577, 588-9 and 595-602; V. Lowe, "Jurisdiction" in M.D. Evans, ed., *International Law* (Oxford: OUP, 2004), 351-2.

[110] F.W. Maitland, "The Crown as Corporation" (1901) 17 L.Q. Rev. 131, 133; H. Street, *Governmental Liability* (Cambridge: CUP, 1953), 14-15; Friedmann, *supra* note 93, 351; Cohen and Smith, *supra* note 93, 5-6 and 12-13; Harlow and Rawlings, *supra* note 94, 8-9; de Smith and Brazier, *supra* note 14, 608.

[111] See M.N. Shaw, *International Law*, 5th ed. (Cambridge: CUP, 2003), 621-38.

[112] R. Von Hennigs, "European Convention on State Immunity and Other International Aspects of Sovereignty Immunity" (2001), 9 Willamette J. Int'l L. & Disp. Resol. 185, 186-7.

[113] *Trendtex*, *supra* note 86, 557-8. G.R. Delaume, "Sovereign Immunity and Transnational Arbitration" (1987) 3 Arb. Int'l 28, 28-9; Shaw, *supra* note 111, 628-38 and 640-6.

[114] *European Convention on State Immunity*, 16 May 1972, 74 Euro. T.S., 11 I.L.M. 470, art. 7(1) (entered into force 11 June 1976); *Foreign Sovereign Immunities Act*, 28 U.S.C., 847 F. Supp. 61, s. 1605(a) (1976) (U.S.); *State Immunity Act 1978*, c. 33, s. 3 (U.K.). The most commonly applied test is for the court to examine the nature of the act and to ask whether it is one that could be performed only by the state. A supplementary test is for the court to look at the purpose

even where the scope of a sovereign act is defined narrowly, there remains a distinction between the public and the private sphere to permit the differentiation between those acts that are entitled to immunity and those that are not. A state's general consent to investment arbitration entails the waiver of sovereign immunity from jurisdiction in foreign courts (though not necessarily from pre-judgment attachment or execution of an award against the state's assets).[115] That a waiver of sovereign immunity is required to recognize and enforce investment arbitration awards reinforces the conclusion that investment arbitration exists within the public sphere, and that it is a unique form of governing arrangement based on a private model of adjudication.

Investment treaties use international adjudication to control sovereign acts of states in the context of the regulatory relationship between the state and foreign investors. This makes investment arbitration a governing arrangement as opposed to a reciprocally consensual method of adjudication. Only the state can exercise public authority over investors in the regulatory sphere and only the state can subject the exercise of public authority to compulsory adjudication. Investment arbitration is defined by the role played by public authority in its establishment and in the origins of investment disputes. Because investment disputes arise from the exercise of public authority, they are of interest to the general public, although the reverse is not always true. The mere fact that a dispute raises public concern does not mean that the dispute arose from a sovereign act of the state.

4. The investor's consent

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of the act and whether, in its origins, the act related to governmental objectives in the exercise of public authority: *Congreso del Partido*, *supra* note 109, 267; *Kuwait Airways Co.* v. *Iraqi Airways Co.* (1995), 1 W.L.R. 1147, 1160; *Waste Management Inc.* v. *United Mexican States* (Merits) (30 April 2004), 43 I.L.M. 967, 16(4) World Trade and Arb. Mat. 3 [hereinafter *Waste Management No. 2*], para. 75. P.L. Lee, "Central Banks and Sovereign Immunity" (2003) 41 Colum. J. Transnat'l L. 327, 340-3.

[115] A state can waive sovereign immunity under international law and, in principle, giving a general consent in an investment treaty amounts to a waiver of a state's immunity from suit before an international tribunal or domestic court: e.g. *State Immunity Act 1978*, ibid., s. 9. See chapter three of this thesis, page 78, note 55.

Treaty-based investment arbitration is distinguishable from international commercial arbitration given the nature of the state's consent. However, some commentators and arbitrators look to the investor's consent to locate investment arbitration within the private sphere.[116] They do so, in particular, by merging the investor's consent with the state's consent in order to create a classical agreement to arbitrate as understood in commercial arbitration. This conceptual approach is critically analyzed in this section.

The investor's consent is best viewed as the acceptance of an opportunity provided by states to foreign investors as a group. In particular, the investor's consent accepts an opportunity to seek damages via international arbitration for a state's alleged breach of an international standard. The investor's consent has no significance absent the original consent of the state. This differentiates the investor's consent in treaty-based investment arbitration from the consent of a private party in commercial arbitration. In investment arbitration, the investor's consent is made possible by an inter-state bargain rather than a private agreement, and it relates to a regulatory dispute rather than a commercial dispute.

To illustrate further, in investment arbitration, an investor must decide whether to resort to investment arbitration only after a dispute has arisen. The investor's consent is thus retrospective; i.e. it is specific to a dispute arising from the regulatory relationship.[117] Unlike the state, the investor does not accept compulsory arbitration of any future dispute that arises with the host state (although the investor's home state could enter such a consent on behalf of its nationals). Moreover, the investor does not consent to compulsory arbitration of disputes arising from acts of the investor. Tribunals do not have general jurisdiction to award damages against investors for violations of international standards that regulate business. Generally speaking, only states are sanctioned and only investors are compensated.[118] Indeed, as

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[116] E.g. Schreuer, *supra* note 98, 233. See also Rau, *supra* note 13, 386-7; Toope, *supra* note 23, 389.

[117] The investor's consent is akin to a party's conclusion of an agreement to arbitrate – or *compromis* – after a dispute has arisen. See also *Compañía del Desarrollo de Santa Elena, S.A.* v. *Republic of Costa Rica* (Merits) (17 February 2000), 5 ICSID Rep. 172, 13(1) World Trade and Arb. Mat. 81 (providing an example of an ICSID arbitration based on a host state's specific consent to the arbitration, given after the dispute had arisen). M. Habicht, *Post-War Treaties for the Pacific Settlement of International Disputes* (Cambridge: Harvard University Press, 1931), 1041-3.

[118] This is "generally speaking" only because some investment treaties allow counter-claims by the respondent state after an investor has made a claim under the treaty.

private parties, investors cannot consent generally to investment arbitration, as does the state.[119] As private parties, investors are subject to the exercise of public authority by the state; the opposite is never true. For a foreign investor to be sanctioned via compulsory international arbitration in the context of a regulatory dispute would require the consent of the investor's home state, not the investor. In treaty-based investment arbitration, the investor's consent is always specific, just as the state's consent is always general.

This does not make the investor's consent insignificant. Depending on the terms of the relevant treaty, the submission of a dispute to investment arbitration has important legal ramifications for the investor as well as the state. Above all, it may affect the availability of alternative remedies under domestic or international law. In the case of NAFTA, to make a Chapter 11 claim, an investor is required to waive legal remedies in the host state and in the other NAFTA states.[120] This waiver has two elements. First, the investor must waive the right to pursue domestic proceedings. Put differently, the investor cannot seek protection from the exercise of public authority by the host state through adjudication in a NAFTA state (including the investor's home state). Second, the investor retains the right to pursue domestic legal proceedings, in the host state alone, that do not involve the payment of damages.[121] Thus, the investor may seek domestic remedies other than a damages award, in the host state, but cannot seek damages before both a Chapter 11 tribunal and a domestic court.

Under NAFTA, the investor's waiver establishes the exclusivity of investment arbitration as a means for investors to seek damages and, in the case of NAFTA states other than the host state, as a legal remedy for resolving the investor's claim in

[119] For an investor to consent generally to compulsory international arbitration, the investor would have to exercise public authority over foreign nationals. However, an investor can only exercise public authority where such authority has been delegated to the investor by a state. To illustrate, colonial companies were historically given wide-ranging powers to govern foreign territories on behalf of the home state. In such circumstances, the investor acts as a public entity and any general consent made by the investor would be on behalf of the home state. M.J. Farrelly, "Recent Questions of International Law: The British Government and the Chartered Companies in Africa" (1894) 10 L.Q.R. 254, 263.

[120] NAFTA, *supra* note 7, art. 1121. See *Waste Management, Inc.* v. *United Mexican States* (Jurisdiction) (2 June 2000), 40 I.L.M. 56 [hereinafter *Waste Management No. 1*], para. 18-30.

[121] In particular, the investor may pursue "proceedings for injunctive, declaratory or other extraordinary relief, not involving the payment of damages".

relation to the relevant acts of the state.[122] Investment arbitration under NAFTA is exclusive because it bars domestic proceedings and because it finally resolves a damages claim arising out of a particular regulatory dispute.[123] The investor's waiver thus establishes that the protection available through Chapter 11 arbitration takes the place of the protection otherwise available through domestic proceedings in a foreign NAFTA state or through the remedy of damages in the host state. For the host state, this exclusivity prevents investors from going to foreign courts to resolve regulatory disputes in the territory of the host state and limits the prospect of state liability to that of a damage award by a Chapter 11 tribunal.[124]

Thus, the investor's consent is important because it requires the investor to relinquish rights that the investor would otherwise possess under domestic law. Put differently, to access investment arbitration, investors must conform to the conditions attached to such access by the NAFTA states. These conditions are part of the bargain struck by Canada, Mexico, and the U.S. when they concluded NAFTA.[125] Chapter 11 is an element of that bargain, one that established international arbitration as a governing arrangement.[126] As discussed in chapter three of this thesis, the investor's consent is more akin to the decision of an individual to seek damages against the state under domestic public law than to the decision of an individual to seek damages against another individual under domestic private law, or to the consent

[122] But see *Waste Management No. 1*, *supra* note 120, para. 13-14 and 59 (dissenting opinion); *GAMI Investments, Inc.* v. *Government of the United Mexican States* (Merits) (15 November 2004), 17(2) World Trade and Arb. Mat. 127, para. 38. See also *Middle East Cement Shipping and Handling Co. S.A.* v. *Arab Republic of Egypt* (Merits) (12 April 2002), 18 ICSID Rev. 602, para. 71; *CMS Gas Transmission Company* v. *The Republic of Argentina* (Jurisdiction) (17 July 2003), 42 I.L.M. 788, para. 80.
[123] Finality is a component of exclusivity. *Waste Management, Inc.* v. *United Mexican States* (Jurisdiction) (26 June 2002), 41 I.L.M. 1315, 14(6) World Trade and Arb. Mat. 203, para. 27.
[124] Investors sometimes seek judicial relief before the courts of their own state in the event of a regulatory dispute abroad. To illustrate, the Iran-U.S. Claims Tribunal was established as part of an agreement to release American hostages held in Iran in January 1981, in return for the release of Iranian assets that were frozen in the U.S. and the suspension – by presidential order – of hundreds of commercial lawsuits that were pending in the U.S. in relation to Iran. A fund of one billion dollars was released by the U.S. to a "depository bank", to be held in escrow, and amounts awarded to U.S. claimants by the tribunal were discharged from that account, which Iran undertook to keep topped up: Redfern and Hunter, *supra* note 1, 59.
[125] S. Clarkson, "Systemic or Surgical? Possible Cures for NAFTA's Investor-State Dispute Process" (2002) 36 Can. Bus. L.J. 368, 373.
[126] Many aspects of NAFTA Chapter 11 arbitration work to the advantage of investors in the context of the regulatory relationship with host states; however, the exclusivity of the system clearly works against investors, to the advantage of the host state.

of a private party in commercial arbitration. The investor's consent is subject to conditions based, not on an agreement entered into by the investor, but on an inter-state bargain. It is a consent of privilege rather than reciprocal obligation.

C. The exercise of public authority by arbitration tribunals

Acting on the general consent, an investment arbitration tribunal exercises authority that is delegated by states. This authority ultimately resides in the authority of the state to adjudicate disputes in its territory.[127] Regulatory disputes are normally adjudicated by domestic courts pursuant to domestic law.[128] In some cases, such disputes might be resolved by specialized domestic tribunals, subject to court supervision.[129] The general consent allows regulatory disputes to be adjudicated by an international tribunal endowed with the authority to determine the legality of the state's exercise of public authority. This is by definition a matter of public law, whether resolved by resort to domestic or international law.

Once an investor provides notice of a claim under an investment treaty, a tribunal is constituted to adjudicate the claim.[130] The tribunal has the authority to rule on its own jurisdiction and to admit the claim.[131] The tribunal also has the authority to select the jurisdictional seat of the arbitration and, consequently, the domestic law under which the arbitration takes place.[132] Upon finding that it has jurisdiction, a tribunal determines the facts of the dispute and applies the applicable law in order to resolve issues arising from the facts.[133] If the tribunal finds that the state breached an applicable treaty standard, the tribunal may award damages to the investor;

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[127] Yu and Shore, *supra* note 66, 965-6; Loughlin, *supra* note 94, 80.
[128] I. Delupis, *Finance and Protection of Investments in Developing Countries* (Epping: Gower Press, 1973), 123; Peter, *supra* note 41, 167-9; Lemieux and Stuhec, *supra* note 94, 146.
[129] de Smith and Brazier, *supra* note 14, 581-4.
[130] NAFTA, *supra* note 7, art. 1123 and 1124.
[131] *ICSID Convention*, *supra* note 8, art. 41; UNCITRAL Model Law, *supra* note 8, art. 16; UNCITRAL Rules, *supra* note 26, art. 21(1) and (2); ICSID Additional Facility Rules, *supra* note 26, art. 46. See also *Model Law Report*, *supra* note 31, 37; Redfern and Hunter, *supra* note 1, 264.
[132] UNCITRAL Rules, *supra* note 26, art. 16(1); ICSID Additional Facility Rules, *supra* note 26, art. 21 (Schedule C); UNCITRAL Model Law, *supra* note 8, art. 20.
[133] NAFTA, *supra* note 7, art. 1131.

alternatively, the tribunal may dismiss the claim.[134] An award is binding on the investor and the respondent state and, although it does not establish binding precedent, it may have persuasive value in future cases.[135] Further, an award is insulated from judicial review by domestic courts.[136] Overall, this process is part of an adjudicative system in which arbitrators act in a public capacity to resolve investment disputes.

In exercising this adjudicative authority, tribunals depend, not only on states' legal authority to authorize the resolution of disputes within their territory, but also on their coercive power to enforce awards in domestic courts.[137] The force of an arbitration award ultimately rests on its domestic enforceability.[138] Without the prospect of domestic enforcement, investors would rely on the voluntary payment of awards by states (albeit under pressure from other states, the World Bank, financial firms, and so on).[139] Without individualized enforcement, investment arbitration would resemble conventional forms of international dispute resolution in which states reach diplomatic solutions without any direct involvement by the individuals whose rights and interests are at stake. Investment arbitration would have more in common with mediation or conciliation than with adjudication.[140] Besides the actual enforcement of awards, tribunals may also rely on the authority of domestic courts in other respects, such as to order a party to respect an arbitration agreement,[141] to compel attendance of witnesses or production of documents,[142] to enforce interim measures,[143] or as an ultimate resort in case of a deadlock.[144] On the whole,

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[134] Ibid., art. 1135.
[135] Ibid., art. 1136(2) and 1136(4).
[136] *Infra* notes 155-6.
[137] Dezaley and Garth, *supra* note 13, 120-3; Redfern and Hunter, *supra* note 1, 249-51; Yu and Shore, *supra* note 66, 967.
[138] Under investment treaties, this enforceability is based on the consent of the states parties to permit the enforcement of investment arbitration awards pursuant to the *ICSID Convention*, the *New York Convention*, and/ or the *Inter-American Convention*. See chapter three of this thesis, page 79-80, note 58.
[139] Delupis, *supra* note 128, 3; Peter, *supra* note 41, 321; Redfern and Hunter, *supra* note 1, 445.
[140] Habicht, *supra* note 117, 1035.
[141] UNCITRAL Model Law, *supra* note 8, art. 8 and 11(4).
[142] Ibid., art. 6, 8, and 27.
[143] NAFTA, *supra* note 7, art. 1134; ibid., art. 17.
[144] UNCITRAL Model Law, *supra* note 8, art. 11(4) (appointment of arbitrators). *Preliminary Model Law Report*, *supra* note 62, 78.

investment arbitration is a governing arrangement, established by treaty, and based on the authority and power of states.[145]

Let us examine how awards can be enforced by investors under the *New York Convention.*[146] At the outset, one must distinguish between the seat of the arbitration and the place of enforcement. The *seat of the arbitration* is the place in which the arbitration is located, by the arbitration tribunal for purposes of domestic jurisdiction.[147] Under the *New York Convention,* an arbitration is subject to supervision by domestic courts in the seat of the arbitration, and a respondent state may apply to set aside an award only in the courts in that seat based on its domestic law. Importantly, this law determines the level of supervision that a court may carry out.[148]

The *place of enforcement* is the jurisdiction in which an investor seeks enforcement (including execution) of the award against assets of the respondent state. Under the *New York Convention,* for an award to be executed, it must be recognized and enforced by the courts in the place of enforcement, but not necessarily in the seat of the arbitration.[149] Also, a court in the place of enforcement has the discretion to refuse to recognize and enforce an award based on the limited grounds stipulated in the *New York Convention.*[150] This arguably includes the discretion to recognize and enforce an award even if the award was set aside in the seat of the arbitration.[151] Thus, an investor can seek enforcement of an award against assets of the respondent state before the courts in any state party to the *New York Convention* regardless of whether

[145] Redfern and Hunter, *supra* note 1, 342.
[146] At present, Chapter 11 awards are enforceable under the *New York Convention* and the *Inter-American Convention,* but not the *ICSID Convention,* because neither Canada nor Mexico have signed the *ICSID Convention.*
[147] Under NAFTA Chapter 11, a tribunal must locate the seat of an arbitration in a NAFTA state that is a party to the *New York Convention*: NAFTA, *supra* note 7, art. 1130. To June 2005, eight arbitrations under NAFTA Chapter 11 have been located in Canada, seven in the United States, and none in Mexico.
[148] *Federal Arbitration Act, supra* note 10, c. 1, s. 10; *Commercial Arbitration Act,* R.S.C. 1985, c.17 (2nd Supp.) [hereinafter *Commercial Arbitration Act*], art. 34 (Schedule, Commercial Arbitration Code); *Código de Comercio,* Tit. IV, c. 1-9 (Commercial Arbitration), as amended 1989 and 1993 [hereinafter *Código de Comercio*], art. 1457. The domestic law of the seat of the arbitration may also determine other issues, such as whether the arbitration agreement was valid (in the absence of an agreement of the parties to apply another law to determine this issue); and whether composition of the arbitration tribunal and the arbitration procedure were lawful (in the absence an agreement of the parties on these matters).
[149] *New York Convention, supra* note 8, art. V.
[150] Ibid. See also UNCITRAL Model Law, *supra* note 8, art. 34 and 35.
[151] *New York Convention, supra* note 8, art. V(1)(e).

the courts of either the respondent state or the seat of the arbitration have upheld the award.[152] That said, most courts would likely be reluctant to recognize and enforce an award that was set aside by a court in the seat of the arbitration.[153]

Thus, awards can normally be reviewed by the courts in the seat of the arbitration and in the place of enforcement, subject to the relevant treaties and legislation.[154] As it stands, many states have enacted legislation implementing the *New York Convention* which directs domestic courts to defer to foreign arbitration awards.[155] Also, the trend in the jurisprudence, at least in North America and Europe, is to show a high level of deference.[156] For these reasons, investment arbitration tribunals are insulated from court review in the seat of the arbitration.[157]

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[152] E.g. *Sonatrach* v. *Ford Bacon & Davis Inc.* (1990), 11 Y.B. Comm'l Arb. 370; *Hilmarton I* (1995), 20 Y.B. Comm'l Arb. 663; *Chromalloy Aeroservices* v. *Arab Republic of Egypt*, 939 F.Supp. 907 (D.D.C. 1996), 12(4) Int'l Arb. R. B-1 (April 1997). Reismann, *supra* note 41, 113-16; Brower et al., *supra* note 39, 428.

[153] Redfern and Hunter, *supra* note 1, 415 and 484-5.

[154] *ICSID Convention*, *supra* note 8, art. 53-55; *New York Convention*, *supra* note 8, art. V; *Inter-American Convention*, *supra* note 8, art. 4-5. E.g. UNCITRAL Model Law, *supra* note 8, art. 34-35; *Model Law Report*, *supra* note 31, para. 44.

[155] E.g. *Federal Arbitration Act* (U.S.), *supra* note 10 (governing actions in a U.S. federal court to vacate awards (c. 1, s. 10) and to recognize and enforce awards under the *New York Convention* (c. 2, s. 207) and the *Inter-American Convention* (c. 3, s. 304)); *Commercial Arbitration Act* (Canada), *supra* note 148, art. 34-36 (Schedule); *Código de Comercio* (Mexico), *supra* note 148, art. 1415-1463. Many U.S. states have adopted arbitration laws based on the Uniform Arbitration Act, itself modelled on the *Federal Arbitration Act*, and some have adopted arbitration statutes based on the UNCITRAL Model Law. Canadian federal and provincial legislation (with the exception of Québec) and the relevant provisions of Mexico's *Código de Comercio* are also based on the UNCITRAL Model Law. See also Mustill, *supra* note 43, 51-3; Kierstead, *supra* note 74, 100-2; Reismann, *supra* note 41, 125-6; NAFTA Advisory Committee on Private Commercial Disputes, *Summary of U.S. Arbitration Law* by D. Enix-Ross and D.W. Rivkin (June 1995), 1; M. Tenenbaum, "International Arbitration of Trade Disputes in Mexico – The Arrival of the NAFTA and New Reforms to the Commercial Code" (1995) 12 J. Int'l Arb. 53, 59-60 and 73-4; K.-H. Böckstiegel, "An Introduction to the New German Arbitration Act Based on the UNCITRAL Model Law" (1998) 14 Arb. Int'l 19, 28-31; R. Nishikawa, "Arbitration Law Reform in Japan" (2004) 21 J. Int'l Arb. 303, 305-6.

[156] E.g. *Bremen* v. *Zapata Offshore Co.*, 407 U.S. 1, 92 S.Ct. 1907 (1972); *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506 (1974); *Mitsubishi*, *supra* note 83; *Shearson/American Express, Inc.* v. *McMahon*, 482 U.S. 220 (1987); *Quintette Coal Ltd.* v. *Nippon Steel Corp.* (1990), 50 B.C.L.R. (2d) 207 (C.A.); *Gulf Resources Ltd.* v. *Arochem International Inc.* (1992), 11 B.C.A.C. 145, 43 C.P.R. (3d) 390; *Corporation Transnacional de Inversiones* v. *STET International* (1999), 45 O.R. (3d) 183 (S.C.), aff'd 49 O.R. (3d) 414 (C.A.). Scodro, *supra* note 79, 1929-37; C. Reymond, "The Channel Tunnel Case and the Law of International Arbitration" (1993) 109 L.Q. Rev. 337, 341; Redfern and Hunter, *supra* note 1, 286 and 342.

[157] *United Mexican States* v. *Metalclad Corporation* (2001), 89 B.C.L.R. (3d) 359, 38 C.E.L.R. 284, 13(5) World Trade and Arb. Mat. 219, para. 50-6; *United Mexican States* v. *Marvin Roy Feldman Karpa* (2003), 16(2) World Trade and Arb. Mat. 167, para. 77-86 (Ont. S.C.J.), aff'd 193

This review of enforcement under the *New York Convention* reveals the significance of investment arbitration as a governing arrangement. Investment arbitration entails the delegation of authority, not only to international tribunals, but also to the courts of the seat of the arbitration and any prospective place of enforcement. Where an investment arbitration tribunal chooses the respondent state as the seat of the arbitration, the tribunal is subject to supervision by the courts of that state, subject to its domestic law. Where a foreign state is chosen as the seat of the arbitration, the arbitration is subject to supervision by foreign courts, subject to foreign domestic law.[158] Also, in investment arbitration, investors may seek enforcement of an award in any state party to the *New York Convention* (or other arbitration treaties, including the *ICSID Convention*). This means that the states parties to an investment treaty, by consenting investment arbitration, have delegated authority over the adjudication of regulatory disputes within their territory to the domestic courts of over 160 states.[159]

O.A.C. 216, 248 D.L.R. (4th) 443, para. 34-43 (Ont. C.A.); *A.G.* v. *S.G. Myers*, *supra* note 54, para. 42-4.

[158] Further, where the foreign state in question is the home state of the investor, then the tribunal is supervised by the courts of the home state. In such cases, investment arbitration is reminiscent of the capitulation treaties of the nineteenth and early twentieth centuries, which subjected nationals of colonial powers to their home state's laws, and exempted them from local laws, in the territory of foreign states, such as China and the Ottoman Empire. See chapter two of this thesis, page 31-2.

[159] Gaillard, *supra* note 21, 248. Approximately 165 states are parties to either the *New York Convention* or the *ICSID Convention* or both.

Conclusion

Investment arbitration is a governing arrangement established under international law. An investment arbitration tribunal is a semi-autonomous international body that exercises authority within the public sphere. Tribunals are semi-autonomous because their decisions are insulated from court supervision; they are international because their authority derives from a treaty. But for the establishment of tribunals on the international plane, they would be akin to semi-autonomous domestic tribunals that resolve regulatory disputes. The international dimension of investment arbitration distinguishes investment arbitration tribunals from domestic tribunals constituted under public law. The international dimension also alters how regulatory disputes are resolved under investment treaties in that a tribunal can be established under the law of one state to resolve a regulatory dispute involving another state. However, the distinction between the international and domestic dimension of a tribunal – established under public law – is less significant than the distinction between treaty-based investment arbitration and commercial arbitration. In short, the international dimension of investment arbitration does not alter its character as a governing arrangement.

Chapter Seven

Conclusion

For much of the twentieth century, the role of the individual in international adjudication was limited to the private sphere of commercial arbitration. This was because, in cases of diplomatic protection under international law, individuals relied on their own state for representation. The advent of investment arbitration has of course expanded the role of individuals by allowing investors to make international claims. But what is the precise character of this new phenomenon?

The argument of this thesis is that investment arbitration should be characterized as a unique form of governing arrangement. Investment arbitration is a governing arrangement because it is established by a sovereign act of the state and because it is used to resolve disputes arising from the exercise of public authority. Thus, the subject matter of investment arbitration is a regulatory dispute arising between the state (acting in a public capacity) and an individual who is subject to the exercise of public authority by the state. This distinguishes investment arbitration from reciprocally consensual adjudication, as conventionally used to resolve international disputes (between states) and commercial disputes (between private parties). Investment arbitration engages the regulatory relationship between the state and an individual rather than a reciprocal relationship between juridical equals.

As a governing arrangement, investment arbitration involves the adjudication of complex and contentious disputes that would otherwise be resolved by legislatures or executive governments.[1] But this does not make investment arbitration unique; many forms of adjudication do the same. Nor is investment arbitration unique because it involves the *international* adjudication of disputes that would otherwise be resolved through diplomacy.[2] Indeed, the fact that investment arbitration removes sensitive disputes from the domestic legal systems of the host state and the home

[1] L.L. Fuller, "Adjudication and the Rule of Law" (1960) 54 A.S.I.L. Proc. 1, 1-5; L.L. Fuller, "The Forms and Limits of Adjudication" (1978) 92 Harv. L. Rev. 353, 354 and 363; J. Goldsworthy, *The Sovereignty of Parliament* (Oxford: Clarendon, 1999), 277-8.
[2] J.H.H. Weiler, "The Rule of Lawyers and the Ethos of Diplomats: Reflections on the Internal and External Legitimacy of WTO Dispute Settlement", Harvard Jean Monnet Working Paper No. 9/00 (NYU School of Law, 2000), 4-10.

state is in some ways a positive development. What is novel and problematic about investment arbitration is that it combines the prospective and far-reaching, yet selective, individualization of international claims with the use of a private model of adjudication, in order to resolve regulatory disputes.

Investment arbitration may appear similar to other forms of international adjudication. For instance, investment treaties rely on a private model of adjudication that was inherited primarily from the *New York Convention.* Likewise, investment treaties apply international standards to resolve disputes in a manner that is reminiscent of historical claims commissions which allowed claims by or on behalf of foreign nationals. Yet, investment arbitration differs from both international commercial arbitration and conventional international adjudication. First, investment arbitration engages disputes in the public sphere rather than the private sphere and, second, investment arbitration is based on states' prospective and far-reaching consent to compulsory international adjudication. In both respects, investment arbitration is best approached in the context of the regulatory relationship, rather than a reciprocal relationship, between the state and the individual.[3] For this reason more than any other, investment arbitration is a unique feature of contemporary globalization.

Investment arbitration involves the transfer of authority from *domestic to international* and from *public to private.* These will be examined in turn. The transfer of authority from domestic to international involves the delegation of adjudicative authority, normally the exclusive domain of domestic courts, to international tribunals. Further, because investment arbitration awards are enforceable under the *New York Convention* and other arbitration treaties, investment arbitration involves the transfer of adjudicative authority to the courts of 160 states, in order to allow enforcement of awards against foreign state assets that are located in the enforcing state's territory. This establishes investment arbitration as a (fragmented) international system based

[3] *CME Republic B.V.* v. *Czech Republic* (Damages) (14 March 2003), 15(4) World Trade and Arb. Mat. 83 and 245, para. 74 (separate opinion). M.O. Hudson, *International Tribunals* (Washington: Carnegie Endowment for International Peace and the Brookings Institution, 1944), 193; D.W. Bowett, "Claims Between States and Private Entities: The Twilight Zone of International Law" (1986) 35 Cath. U. L. Rev. 929, 933-4; D. Cohen and J.C. Smith, "Entitlement and the Body Politic: Rethinking Negligence in Public Law" (1986) 64 Can. Bar. Rev. 1, 7-8.

on the delegation of authority to international tribunals whose awards are enforceable by the courts in many countries.

The transfer of authority from domestic to international also occurs through the individualization of international claims. Based on overlapping networks of investment treaties, individualization transforms international obligations between states into a complex but generalized system that is designed to regulate states' treatment of multinational enterprises. Virtually all investment treaties are broad in scope and apply liberal standards of investor protection. Many treaties endorse forum-shopping while limiting the duty of investors to exhaust local remedies. Viewed as a system, investment treaties greatly expand the scope of state liability in the regulatory sphere by extending state liability to legislative and judicial acts and by allowing damages awards in the absence of fault.[4] As a result, investment arbitration affects the viability and anticipated cost of any governmental measure that could significantly "harm" international business. Further, awards in favour of investors are internationally enforceable pursuant to the *New York Convention* and other treaties. In short, individualization selectively intensifies the application of international standards in the regulatory sphere, putting investment arbitration at the core of a system to control the exercise of public authority as it affects investors. These elements take investment arbitration well beyond other governing arrangements – with the possible exception of the European Union – that allow the international adjudication of individual claims.

In an era of expanding international economic activity, the movement from international to domestic is an unsurprising and often welcome development. But one must ask whether all manifestations of this movement are appropriate. This brings us to the transfer of authority *from public to private* institutions. In the modern democratic state, domestic courts have a "monopoly" over the adjudication of public disputes for well-established and straightforward reasons. The adjudicative supremacy of the courts is an expression of the principles of independence, openness, and balanced representation in judicial (i.e. sovereign) decision-making. Put differently, where adjudication is used as a governing arrangement it is based on the normative

[4] C. Harlow, "Francovich and the Problem of the Disobedient State" (1996) 2 Eur. L.J. 199, 205-6 and 208; P. Hogg and P. Monahan, *The Liability of the Crown*, 3rd ed. (Toronto: Carswell, 2000), 122 and 149-54.

framework of public law.[5] It would be remarkable if individual claims for damages under a domestic constitution or the *Universal Declaration on Human Rights* were resolved, not in public hearings before a judge, but in confidence by privately-appointed arbitrators. Even if the disputing parties – the individual and the state – agreed to do so, they could not themselves decide to eschew public law principles for the simple reason that their dispute raises matters of public concern about the role of the state as representative of a political group. Yet, investment arbitration transfers adjudicative authority not only from domestic to international institutions but also from public to private decision-makers.

Although investment arbitration involves the transfer of public authority to private arbitrators, it depends on the public authority and coercive power of the state.[6] Investment arbitration originates in the authority of states to establish a governing arrangement that controls the exercise of public authority. Because investment arbitration is treaty-based, it relies on the authority of states to allow individual claims, establish the authority of arbitrators, apply binding standards, resolve issues of scope and access, and provide for damages as a remedy. In doing these things, states exercise sovereign authority so as to condition the future use of sovereign power by their own public authorities and by those of other states. Likewise, it is public international law – not private law – that governs the jurisdiction of tribunals, the admissibility of claims, the resolution of the merits of the dispute, and the enforcement of awards. Notably, investment treaties authorize public institutions to carry out key functions, including the appointment of presiding arbitrators. Where a respondent state does not abide by an investment arbitration award, the award is enforceable only by domestic courts subject to domestic law.[7] Where the states parties to an investment treaty object to its interpretation by tribunals, they can collectively amend the treaty or, in the case of NAFTA, jointly issue an interpretation that overrides the adjudicative process.

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[5] The normative framework of public law carries with it public law rules and principles that arise from the recognition of the representative nature of the state, as juridical sovereign, and from the recognition by judges of their role as officers of the state. A. Chayes, "The Role of the Judge in Public Law Litigation" (1976) 89 Harv. L.R. 1281, 1284.
[6] A. Stone Sweet, "Islands of Transnational Governance" in M. Shapiro and A. Stone Sweet, eds., *On Law, Politics and Judicialization* (Oxford: OUP, 2002).
[7] *Report of the Secretary-General: Possible Features of a Model Law on International Commercial Arbitration*, UN, UN Doc. A/CN.9/207 (14 May 1981), (1981) 12 Y.B. UNCITRAL 77, 78.

Thus, it is important to recognize the role of the state in reforms that accompany contemporary globalization.[8] Recognizing the role of the state draws attention to the variable impacts of investment arbitration on different states and on different groups of states.[9] The division of countries into categories of capital-exporting and capital-importing has become less clear cut in recent decades, but these categories are still relevant. The pressure to establish and maintain the system of investment arbitration clearly originates in major capital-exporting states, whose governments drafted and promoted the model treaties on which most investment treaties are based. Further, today's predominant capital-importing states were once, in the colonial period, subject to foreign legal systems and foreign courts.[10] This history still resonates in much of the world and it continues to inform reactions to investment arbitration.[11]

Contemporary investment treaties differ from colonial and extraterritorial legal regimes. They are not commonly won by the threat of force and they apply international law rather than foreign law to regulate states. They subject disputes to

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[8] M. Koskenniemi, "The Future of Statehood" (1991) 32 Harv. Int'l L.J. 397, 406; S. Picciotto, "The Regulatory Criss-Cross: Interaction between Jurisdictions and The Construction of Global Regulatory Networks" in W.W. Bratton et al., eds., *International Regulatory Competition and Coordination* (Oxford: Clarendon, 1996), 120-2; F. Snyder, "Governing Economic Globalisation: Global Legal Pluralism and European Law" (1999) 5 Eur. L.J. 334, 341-2; S. Sassen, "Globalization or Denationalization?" (2003) 10 Rev. Int'l Pol. Econ. 1, 8.

[9] M. Koskenniemi, "What Is International Law For?" in M.D. Evans, ed., *International Law* (Oxford: OUP, 2004), 96.

[10] A. Anghie, "Finding the Peripheries: Sovereignty and Colonialism in Nineteenth-Century International Law" (1999) 40 Harv. Int'l L.J. 1, 41.

[11] M. Sornarajah, "Power and Justice in Foreign Investment Arbitration" (1997) 14 J. Int'l Arb. 103, 103-4; E. Schwartz and J. Paulsson, "Confronting Political and Regulatory Risks Associated with Private Investment in Infrastructure in Developing Countries: The Role of International Dispute Settlement Mechanism" (Draft presentation to the Private Infrastructure for Development conference, Rome, 8-10 September 1999), 4-5; A. Redfern and M. Hunter, *Law and Practice of International Commercial Arbitration* (London: Sweet & Maxwell, 1999), 289-90 (reproducing the 1984 comments of an African judge of the International Court of Justice: "... the notion that there is a system of international justice will not be shared by some countries, notably those of Africa, Asia and Latin America, who still see arbitration as a foreign judicial institution which is imposed upon them.... In Africa, governmental authorities and, in consequence, the judges, are hostile to international arbitration and no distinction is made between that and foreign arbitration. In addition, as everybody knows, in fact arbitration is seldom freely agreed to by developing countries. It is often agreed to in contracts of adhesion the signature of which is essential to the survival of these countries. Rendered abroad by foreigners, what is more, imposed, arbitration will only gradually obtain total Third World recognition.").

adjudication by international tribunals, not imperial courts or foreign consuls. On the other hand, investment treaties typically apply standards of investor protection based on a Western conception of international law that was resisted by newly independent countries, and most arbitrators are Western professionals.[12] So, while investment arbitration is a unique phenomenon, one should not lose sight of its ancestry or the fact that the adjudication of investment disputes in much of the world originally followed in the wake of foreign invasion and occupation.[13] This history contributes to enduring suspicion in the Third World for international arbitration.[14]

Against this backdrop, the recent wave of investment treaties concluded by (and among) capital-importing states is a significant historical event. The flood of general consents by capital-importing states to investment arbitration after decades of opposition to multilateral investment rules shows how contemporary globalization has altered states' views of foreign investment and their approaches to international law. Investment arbitration is now widely regarded as a means to encourage cross-border investment by instilling greater confidence that international business will be protected from interference by domestic government. The 1990s' wave of investment treaties testifies to the widespread, though far from universal,[15] endorsement of this policy by governments all over the world.

Yet, this only brings us to the beginning of the process of interpreting and implementing investment treaties. One must look beyond a simplified vision of investment arbitration as international adjudication and inquire into its particular method of governmental decision-making.[16] Above all, what do we mean by "investor protection"?[17] Asking this question highlights the policy choices that arise in the

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[12] G.M. Wilner, "Acceptance of Arbitration by Developing Countries" in T.E. Carbonneau, ed., *Resolving Transnational Disputes Through International Arbitration* (Charlottesville: University of Virginia Press, 1984), 286.

[13] A.A. Fatouros, "International Law and the Third World" (1964) 50 Va. L.R. 783, 817-18.

[14] Hudson, *supra* note 3, 457; W. Peter, *Arbitration and Renegotiation of International Investment Agreements* (The Hague: Kluwer Law International, 1995), 205; M. Sornarajah, "The Climate of International Arbitration" (1991) 8 J. Int'l Arb. 47, 63.

[15] In particular, major capital-exporting states have rarely concluded investment treaties between themselves and significant hold outs remain among important capital-importing states, such as Brazil.

[16] N. Komesar, *Imperfect Alternatives – Choosing Institutions in Law, Economics and Public Policy* (Chicago: University of Chicago Press, 1994), 3.

[17] A.A. Fatouros, "International Economic Development and the Illusion of Legal Certainty" (1963) 57 ASIL Proc. 117, 121; Komesar, ibid., 5.

actual adjudication of investment disputes. Should the protection of investors take precedence in all cases of textual ambiguity and interpretive doubt, or is it appropriate to apply treaties in a way that defers to domestic institutions and preserves governmental discretion? Most investment treaties make clear that outright nationalizations of foreign-owned assets must be accompanied by the payment of full compensation, but is compensation required for general regulation to protect public health or the environment? Investment treaties may prohibit socialism but do they bar social democracy? These questions highlight the discretionary role of arbitrators in delivering on the promise of international adjudication as a neutral and rules-based system.[18] With this promise comes the decision to use international adjudication as a governing arrangement. The idea of a neutral, rules-based system begs the question: what are the rules and how will they be interpreted and applied in specific cases? This leads us to two common criticisms of investment arbitration: its lack of coherence and its lack of accountability.

First, the lack of coherence.[19] The interpretation of investment treaties is a matter of concern, not only for investors seeking to plan their business activities under the law, but for all individuals who are represented by the state and who are affected by the system's sanction or deterrence of regulatory measures. Thus, there is a wider interest in the clarity and coherence of the law than in commercial arbitration. Yet, because there are so many investment treaties, establishing complex networks of variable but overlapping international obligations, it is unavoidable that tribunals will interpret jurisdictional concepts and substantive standards in different ways. One can look to domestic courts to inject greater coherence into the system, but the role of the courts is divided among many jurisdictions which themselves apply varying standards of review. Typically, domestic courts defer to arbitrators. For these reasons,

[18] Fatouros, ibid., 123; S.J. Toope, *Mixed International Arbitration – Studies in Arbitration Between States and Private Persons* (Cambridge: Grotius Publications, 1990), 397-8; UNCTAD, *World Investment Report 2003* (Geneva: United Nations, 2003), 86; P.T. Muchlinski, *Multinational Enterprises and the Law* (Oxford: Blackwell, 1999), 11. See also e.g. *North American Free Trade Agreement*, 17 December 1992, 32 I.L.M. 296 and 605 (entered into force 1 January 1994) [hereinafter NAFTA], art. 1115 (referring to "due process before an impartial tribunal" as a purpose of Chapter 11 arbitration).

[19] Hudson, *supra* note 3, 197; A. Cosbey et al., "Investment and Sustainable Development" (Report for the International Institute for Sustainable Development, 2004), 6-7; C.N. Brower, C.H. Brower II, and J.K. Sharpe, "The Coming Crisis in the Global Adjudicative System" (2003) 19 Arb. Int'l 415, 429-30.

investment arbitration is at present characterized by uncertainty for both states and investors, though the financial implications for states are more serious.[20] There is a grain of truth in the quip that investment arbitration is becoming a legal casino in which investors and states roll the dice on whether a tribunal will award damages.[21] It may be that states will find it necessary to create an appellate body with general jurisdiction over many investment treaties or risk collapse of the system under the pressure of fiscal uncertainty.[22] But this is a matter of policy. Whether or not states decide to establish an appellate body, the nature of investment arbitration as a governing arrangement will not much change.

The second criticism of investment arbitration, the lack of accountability, flows from the use a private model of adjudication to resolve public disputes.[23] In public law, the notion of accountability in adjudicative decision-making goes beyond accountability to the disputing parties as overseen by the state. In public law, the conduct of the adjudicator is a matter of interest to the wider community because of it determines the legality of sovereign acts. However, in investment arbitration, the use of a private model of adjudication to resolve regulatory disputes undermines principles that typically apply in public law adjudication, including principles of independence, openness, and balanced representation. For one, investment arbitration tribunals are not independent and impartial decision-makers, if we understand these concepts to mean freedom from dependence on executive governments or private entities, and from any interest in the outcome of the dispute. Arbitrators are not independent and impartial in this sense because their income depends on future

[20] B. Legum, "Trends and Challenges in Investor-State Arbitration" (2003) 19 Arb. Int'l 143, 146-7.
[21] J. Werner, "Making Investment Arbitration More Certain – A Modest Proposal" (2003) 4 J. World Investment 767, 782.
[22] J.P. Fitzpatrick, "The Future of the North American Free Trade Agreement: A Comparative Analysis of the Role of Regional Economic Institutions and the Harmonization of Law in North America and Western Europe" (1996) 19 Houston J. Int'l L. 1, 91-3; D.P. Steger, "The Appellate Body and its contribution to WTO dispute settlement" in D.L.M. Kennedy and J.D. Southwick, eds., *The Political Economy of International Trade Law* (Cambridge: CUP, 2002), 493-5; M. Kantor, "The New Draft Model U.S. BIT: Noteworthy Developments" (2004) 21 J. Int'l Arb. 383, 391-2.
[23] J.A. Soloway, "Environmental Regulation as Expropriation: The Case of NAFTA's Chapter 11" (2000) 33 Can. Bus. L.J. 92, 108-11; H. Mann and K. von Moltke, "Protecting Investor Rights and the Public Good: Assessing NAFTA's Chapter 11" (Report for the International Institute for Sustainable Development, 2002), 21; Brower et al., *supra* note 19, 418; Cosbey et al., *supra* note 19, 4-8.

appointments from governments or companies and because they have a commercial interest in the appeal of investment arbitration to investors. Investment arbitration is a governing arrangement in which the conduct of states is scrutinized not by judges but by businessmen.

Similar criticisms can be levelled in relation to the confidentiality and lack of balanced representation in investment arbitration.[24] In the courts, the presumption is that cases are heard in public to allow public access and, consequently, to ensure public accountability. Under investment treaties, arbitrations often take place in private. Even at the International Centre for the Settlement of Investment Disputes, awards are publicized only with the consent of the disputing parties, and other materials are not released at all. Moreover, the rules of appointment in courts usually promote representative diversity among judges. In investment arbitration, the great majority of arbitrators are from Western Europe or North America and virtually all are men. Each of these criticisms, especially the matter of independence, is tied to the accountability of investment arbitration because each limits the degree to which the public has access to and confidence in the process.

Some commentators champion investment arbitration on the basis that it removes sensitive disputes from the political realm and subjects them to the rule of law. For instance, Brower and Steven advocate arbitration under NAFTA Chapter 11 in these terms:[25]

> What the NAFTA Parties set out to accomplish – the protection and promotion of investment through the uniform application of rules and guarantees in all three NAFTA countries – can best be sustained through the enforcement of Chapter 11 *by independent and impartial international tribunals.*

No doubt there are advantages to the use of adjudication as a governing arrangement (even if there is a tendency to exaggerate the degree to which adjudication is insulated from politics). But Brower and Steven's description of investment arbitration neglects

[24] V.L. Been and J.C. Beauvais, "The Global Fifth Amendment: NAFTA's Investment Protections and the Misguided Quest for an International 'Regulatory Takings' Doctrine" (2003) 78 N.Y.U. L.R. 30, 46-7.

[25] C.N. Brower and L.A. Steven, "Who Then Should Judge? Developing the International Rule of Law under NAFTA Chapter 11" (2001) 2 Chi. J. Int'l L. 193, 200 [emphasis added]. See also J. Byrne, "NAFTA Dispute Resolution: Implementing True Rule-Based Diplomacy Through Direct Access" (2000) 35 Texas Int'l L.J. 415, 415-16 and 428-29.

a key aspect of the system: the reliance on a private model of adjudication to resolve disputes that arise within the public domain. As a result, Brower and Steven disregard the fact that arbitrators lack accountability precisely because they are not appointed and paid, by states, as members of an independent judicial body. Instead, they limit considerations of independence and impartiality to freedom from the disputing parties, reflecting the assumption that investment arbitration is a private method of adjudication. By conceptualizing the relationship between investor and state as a relationship between equals, Brower and Steven avoid the more rigorous standards of independence and accountability that apply in public courts.[26] In a public dispute, it is doubtful whether the rule of law can exist without an independent judiciary.[27]

A broader claim is often made that investment arbitration will depoliticize investment disputes.[28] This myth is commonly associated with the use of adjudication in the public sphere, especially when connected to economic reform.[29] In fact, the use of adjudication as a governing arrangement does not remove policy discretion from decision-making; it merely shifts discretion around.[30] It is more accurate to say that investment arbitration is an attempt to legalize the political issues that inevitably arise in investment disputes. Just as the judicialization of domestic decision-making politicizes the judiciary, so too will individualization politicize international arbitration.[31] Politicization is an unavoidable outcome of the transfer of regulatory

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[26] Independence should mean freedom from financial dependence on the disputing parties, including both investors and executive governments. S. de Smith and R. Brazier, *Constitutional and Administrative Law*, 8th ed. (London: Penguin, 1998), 370 and 374; M. Loughlin, *Sword and Scales* (Oxford: Hart, 2000), 60.

[27] F.A. Hayek, *The Political Ideal of the Rule of Law* (Lecture to the National Bank of Egypt, Cairo, 1955), 38; J. Rawls, *A Theory of Justice* (1972), 210.

[28] *Banro American Resources, Inc. and Société Aurifère du Kivu et du Maniema S.A.R.L.* v. *Democratic Republic of the Congo* (Jurisdiction) (1 September 2000), 17 ICSID Rev. 382, para. 16. J.A. McKinney, *Created from NAFTA – The Structure, Function, and Significance of the Treaty's Related Institutions* (Armonk, N.Y.: M.E. Sharpe, 2000), 21-2; Brower et al., *supra* note 19, 430.

[29] F.I. Michelman, "Property, Utility, and Fairness: Comments on the Ethical Foundations of 'Just Compensation' Law" (1967) 80 Harv. L.R. 1165, 1168-71; M. Loughlin, "Law and Politics in the Conversation of Mankind" (Presentation to the Faculty of Law, University of Toronto, 1997), 4 and 9.

[30] R. Goodin, "Welfare, Rights and Discretion" (1986) 6 Ox. J. Legal Stud. 232, 232; Harlow, *supra* note 4, 211; C. Harlow and R. Rawlings, *Law and Administration* (London: Butterworths, 1997), 106-7.

[31] Hudson, *supra* note 3, 248-9; M. Shapiro, "The Globalization of Law" (1993) 1 Ind. J. Global Legal Studies 37, 47-50; Goldsworthy, *supra* note 1, 3; J.A.G. Griffith, "The Brave New World of Sir John Laws" (2000) 63 Mod. L.R. 159, 159, 163 and 165.

disputes from the world of diplomacy to adjudication. Indeed, the use of a private model of adjudication exacerbates the politicization of investment arbitration because the use of private arbitrators, rather than tenured judges, makes it less likely that decisions of arbitrators will be viewed as independent and credible.

All of that said, if viewed as an ill, the reliance on a private model of adjudication could be remedied by states. Under NAFTA, Canada, Mexico and the United States – acting collectively – simply imposed the principle of openness on Chapter 11 tribunals.[32] They also acted to override some of the more startling interpretations of the treaty by tribunals. Should they so decide, the states parties to any investment treaty could direct, e.g., that arbitrators be appointed from a roster of sitting judges. Or, states could establish a representative body of tenured investor-state adjudicators, paid and otherwise supported by a publicly-funded international organization and subject to institutional rules that apply to judges.[33] These reforms would take much of the wind from the sails of critics of investment arbitration whose most compelling argument stems from the role of private arbitrators. But again it is for states to decide whether they are persuaded by these arguments and to act accordingly.

At present, states evidently prefer arbitrators over judges in the context of investment disputes and there are plausible reasons for doing so. States may wish to avoid the expense of new judicial institutions or they may welcome the cost of private arbitration in order to deter claims.[34] Some capital-exporting states are suspicious of the International Court of Justice in the field of international economic law, whereas capital-importing states no doubt prefer international arbitration to the extraterritorial law and foreign courts.[35] Treaty negotiators may wish to avoid the sensitivities

[32] See also R. Singh, "The Impact of the Central American Free Trade Agreement on Investment Treaty Arbitrations: A Mouse that Roars?" (2004) 21 J. Int'l Arb. 329, 335-8.
[33] J.H. Ralston, "Some Suggestions as to the Permanent Court of Arbitration" (1907) 1 AJIL 321, 323-4; S. Timberg, "An International Trade Tribunal – A Step Forward Short of Surrender of Sovereignty" (1945) 33 Geo. L.J. 373, 386.
[34] T.J. Farer, "Economic Development Agreements: A Functional Analysis" (1971) 10 Col. J. Transnat'l L. 200, 238; Brower and Steven, *supra* note 25, 196, note 7.
[35] C. Osakwe, "The Soviet Position on International Arbitration as a Method of Resolving Transnational Disputes" in T.E. Carbonneau, ed., *Resolving Transnational Disputes Through International Arbitration* (Charlottesville: University of Virginia Press, 1984), 184-5; M. Sornarajah, *The Settlement of Foreign Investment Disputes* (Boston: Kluwer, 2001), 19-20.

associated with new international or regional courts:[36] few politicians have lost elections because of their support for international arbitration. States may wish to give the clearest possible signal to foreign investors that they will abide by international disciplines favouring private business.[37] Whatever the reason, states alone can reform or withdraw from the system, just as they created it.

Thus, it is inaccurate to portray investment arbitration in terms of the retreat of the state or the demise of sovereignty (understood as a juridical concept arising from the representative role of the state).[38] Investment arbitration should be seen as a system that was established by states for a public purpose and that affects states and groups of states in different ways, some of which are beneficial to individuals and organizations in a particular state and others not. The selectivity of access to the system of investment arbitration shifts bargaining power in favour of multinational enterprises and away from others who remain dependent on the state as their legal representative in the international sphere. Even so, the main avenue available to non-investors to reform how international adjudication is used as a governing arrangement is the same as that which is available to investors: the state.

On the other hand, investment arbitration has the potential to transform the juridical concept of sovereignty in one key respect. As a result, investment arbitration provides a rare example of how contemporary globalization can undermine the state, understood as a unique entity with rights and duties that no private party can possess.[39] This challenge does not arise from investment treaties *per se* but from the nature of the adjudicative process of investment arbitration based on the use of a private model of adjudication in the regulatory sphere. In particular, the *form* of individualization of international claims has prompted some adjudicators to adopt a private law framework in the context of investment arbitration, and to treat the regulatory relationship between the state and investors as if it were a reciprocal

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[36] H.T. King et al., "Dispute Settlement Under the North American Free Trade Agreement" (1992) 26 Int'l Lawyer 855, 861; A. Porges, "Step by Step to an International Trade Court" in D.L.M. Kennedy and J.D. Southwick, eds., *The Political Economy of International Trade Law* (Cambridge: CUP, 2002), 535-6.

[37] R. Dolzer and M. Stevens, *Bilateral Investment Treaties* (The Hague: Martinus Nijhoff, 1995), 12; Soloway, *supra* note 23, 112-13.

[38] R. Jackson, "Sovereignty in World Politics" (1999) 47 Pol. Studies 431, 432-4 and 453.

[39] M. Loughlin, *The Idea of Public Law* (Oxford: OUP, 2003), 79-80.

relationship between juridical equals.[40] In particular, both tribunals and courts have regarded the specific consent of the investor and the general consent of the state as if they constituted an agreement to arbitrate just like any commercial arbitration.[41] This characterization of the legal relationship underlying investment arbitration is conceptually transformative because it fundamentally alters the nature of the rights and duties of states.[42] When an adjudicator approaches the rights of an investor under

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[40] E.g. *Siemens A.G.* v. *The Argentine Republic* (Jurisdiction) (3 August 2004), ICSID Case No. ARB/02/8, para. 63, online: ITA http://ita.law.uvic.ca/documents/SiemensJurisdiction-English-3August2004.pdf (reproducing the claimant's submissions that the power to bring a claim under an investment treaty is "a classical part of management" of an enterprise). J. Paulsson, "Arbitration without Privity" (1995) 10 ICSID Rev. 232, 243 ("The possibility of direct action – international arbitration without privity – allows the true complainant to face the true defendant. This has the immense merit of clarity and realism; these, and not eloquent proclamations, are the prerequisites of confidence in the legal process."); N. Gal-Or, "Private Party Direct Access: A Comparison of the NAFTA and EU Disciplines" (1998) 21 B.C. Int'l & Comp. L.R. 1, 40 (advocating investment arbitration as a means to regulate states and characterizing treaty-based investment arbitration as follows: "...arbitration is arguably the preferable course to ensure states' compliance with international agreements. Arbitration is based on the prerequisite *that the parties to the dispute mutually consent to settle their disagreement.* Therefore, *unlike the formal adjudication procedure*, which is independent of the parties' will and is imposed on them, the arbitral award is more likely to be effectively enforced...." [emphasis added]); C. Schreuer, "Commentary on the ICSID Convention" (1996) 11 ICSID Rev. 336, 391; D.M. Price, "NAFTA Chapter 11 – Investor-State Dispute Settlement: Frankenstein or Safety Valve?" (2001) 26 Can-U.S. L.J. 107, 112 (commenting that the idea of bilateral investment treaties and NAFTA Chapter 11 was to take investor-state disputes "out of the political realm and put the more into the realm of commercial arbitration"); Brower et al., *supra* note 19, 415; Z. Douglas, "The Hybrid Foundations of Investment Treaty Arbitration" (2003) 74 Brit. Y.B. Int'l L. 151, 221-2 and 237. See generally Bowett, *supra* note 3, 933-4; Cohen and Smith, *supra* note 3, 7-8.

[41] E.g. *Ethyl Corporation* v. *Government of Canada* (Jurisdiction) (24 June 1998), 38 I.L.M. 708, para. 59-60; *SGS Société Générale de Surveillance* v. *Philippines* (Jurisdiction) (29 January 2004), 16(3) World Trade and Arb. Mat. 91, para. 145 (characterizing "as two agreements of the same character between the same parties": (1) an investment contract between host state and investor and (2) a subsequent agreement constituted by the general consent of the host state to ICSID arbitration (in a bilateral investment treaty) "in association with the Request for Arbitration" of the investor); *Plama Consortium Limited* v. *Republic of Bulgaria* (Jurisdiction) (8 February 2005), ICSID Case No. ARB/03/24, para. 198, online: ICSID http://www.worldbank.org/icsid/cases/plama-decision.pdf. Thus, investment arbitration is conceptualized based on an agreement to arbitrate between investor and state, as juridical equals, to remove their dispute from the courts in favour of a forum and law of their choosing. See also e.g. *Ceskoslovenska Obchodni Banka* v. *Slovak Republic* (Jurisdiction) (24 May 1999), 14 ICSID Rev. 251 [hereinafter *CSOB*], para. 34; *Tecnicas Medioambientales Tecmed, S.A.* v. *United Mexican States* (Merits) (29 May 2003) , 43 I.L.M. 133, para. 70-1 and 173 (applying the international minimum standard and good faith considerations as if the arbitration was based on an investor-state bargain). See generally Toope, *supra* note 18, 389.

[42] W. Friedmann, *Law in a Changing Society*, 2nd ed. (New York: Columbia University Press, 1964), 276-7; Harlow and Rawlings, *supra* note 30, 41-5.

an investment treaty as rights that are owed in the context of a reciprocal relationship with the state, this means one of two things. Either it reduces the state to the status of a private party or it elevates the investor to a quasi-sovereign status of formal equality with the state, but without any sovereign responsibilities.[43] In both cases, this approach to the investor-state relationship negates the concept of the state as a unique entity endowed with authority that no private party can possess.[44] Taken to its logical outcome, it ignores the regulatory relationship and destroys the notion of public law based on the recognition of the uniqueness of the state.

This conceptual approach is enabled by the use of a private model of adjudication. The use of a private model allows rules and principles that originate in private law to be applied in the context of a regulatory dispute, to the exclusion of a public law framework. By characterizing the regulatory relationship as a reciprocal relationship, some adjudicators have eschewed public law principles, not because of an express inter-state agreement directing them to do so, but out of a misguided respect for the principle of party autonomy. Thus: interpretation of the treaty should be based on the intent of the disputing parties (rather than the states parties).[45] Or: the courts should defer to the decisions of arbitration tribunals for reasons of party autonomy (rather than legislative intent or international comity).[46] Or: it is appropriate for investment arbitration to be kept confidential in deference to the disputing parties

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[43] A.A. Fatouros, "Transnational Enterprise in the Law of State Responsibility" in R.B. Lillich, ed., *International Law of State Responsibility for Injuries to Aliens* (Charlottesville: University Press of Virginia, 1983), 385.

[44] This is reminiscent of the debate about whether contracts between foreign investors and host states could be "internationalized", thus elevating contractual obligations between private parties (one of which was the state) to the status of international obligations falling within the pubic sphere. See *Texaco Overseas Petroleum Co. and California Asiatic Oil Co.* v. *Libya* (Merits) (1977), 53 I.L.R. 389, 17 I.L.M. 1, para. 40-7. Bowett, *supra* note 3, 931; M. Sornarajah, "The UNCITRAL Model Law: A Third World Viewpoint" (1989) 6 J. Int'l Arb. 7, 18; Toope, *supra* note 18, 387; R. Lillich, "The Law Governing Disputes Under Economic Development Agreements: Re-examining the Concept of 'Internationalization'" in R. Lillich and C.N. Brower, *International Arbitration in the 21st Century: Towards Judicialization and Uniformity?* (Ardsley, N.Y.: Transnational Publishers, 1994), 64; Muchlinski, *supra* note 18, 494-6.

[45] *Pope & Talbot Inc. v. Government of Canada* (Merits, Phase 2) (10 April 2001), 13(4) World Trade and Arb. Mat. 61 [hereinafter *Pope & Talbot*], para. 79; *CSOB*, *supra* note 41, para. 49-55. Douglas, *supra* note 40, 168.

[46] *United Mexican States* v. *Marvin Roy Feldman Karpa* (2003), 16(2) World Trade and Arb. Mat. 167, para. 84-5 (Ont. S.C.J.), aff'd 193 O.A.C. 216, 248 D.L.R. (4th) 443, para. 39 (Ont. C.A.); W.W. Park, "Duty and Discretion in International Arbitration" (1999) 93 AJIL 805, 808-10.

(rather than because the states parties so agreed in clear and express terms).[47] Or: a host state's interference with an investor's business in breach of an investment treaty is akin to a private law tort.[48] In general, the characterization of the investor-state relationship as a reciprocal relationship enables the adjudicator to give precedence to the form of investment arbitration as a private method of adjudication over its substance as public law. The general consents of states are reduced to consents of private parties and the private model of adjudication comes to dominate the treaty. The fact that private arbitrators can execute this transformation of juridical sovereignty and re-draw the boundaries of the regulatory sphere, with little judicial supervision, is a perilous aspect of investment arbitration, one that follows from the transfer to private contractors of an authority that was for well over a century the exclusive bailiwick of tenured judges.

The characterization of the regulatory relationship as a reciprocal relationship is conceptually wrong. It confuses the inter-state bargain underlying an investment treaty with an agreement between an investor and the state.[49] It may be that the states incorporated a private model of adjudication into investment treaties, but these rules play a subordinate and facilitative role. They were not originally intended to apply in the circumstances of a regulatory dispute[50] and, as such, they should be discarded where they conflict with the treaty, or where the treaty is silent or ambiguous and they conflict with customary rules of international law. Private law is less relevant to investment arbitration than rules and principles that are common to the domestic public law of the states parties to an investment treaty. On this point, it is worth reiterating the key difference between treaty-based investment arbitration and international commercial arbitration. The authority for commercial arbitration flows from the consent of the disputing parties to resolve their dispute through private

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[47] F. Orrego Vicuña, "Arbitration in a New International Alternative Dispute Resolution" (2001) 18(2) ICSID News 1.

[48] *CME Republic B.V.* v. *Czech Republic* (Merits) (13 September 2001), 14(3) World Trade and Arb. Mat. 109, para. 582. Douglas, *supra* note 40, 180, note 149.

[49] Bowett, *supra* note 3, 933-4. See *Republic of Ecuador* v. *Occidental Exploration and Production Company* (29 April 2005), [2005] E.W.C.H. 774, para. 61 and 80 (Comm. Ct.).

[50] *The Loewen Group, Inc. and Raymond L. Loewen* v. *United States of America* (Merits) (26 June 2003), 42 I.L.M. 811, 15(5) World Trade and Arb. Mat. 97 [hereinafter *Loewen*], para. 233; *United Parcel Service of America, Inc.* v. *Government of Canada* (Participation by *Amici Curiae*) (17 October 2001), para. 70, online: DFAIT http://www.dfait-maeci.gc.ca/tna-nac/documents/IntVent_oct.pdf.

arbitration. In contrast, the authority for investment arbitration comes from the (treaty-based) general consents of states as part of an inter-state bargain. The general consent – both prospective and open-ended – is a sovereign act of the state as the legal representative of its population; it is not an act of a disputing party, acting in a private capacity. Thus, the jurisdiction of an investment arbitration tribunal flows from an instrument of public international law, not private law, and the law governing the arbitration is that of the treaty rather than a contract.

Because investment arbitration is not a form of private adjudication, the principle of autonomy – as understood in international commercial arbitration – has no place in treaty-based investment arbitration. In investment arbitration, the investor does not agree with the host state to resolve a regulatory dispute through investment arbitration. Instead, the investor acts upon an opportunity, provided by an earlier inter-state bargain, to make an international claim for damages arising out of the exercise of public authority. The investor's consent is most clearly analogous to an individual's decision under domestic law to go to court to resolve a grievance against the state. The investor's claim triggers the establishment of a tribunal and delineates the nature of the dispute, but it remains a personal rather than a sovereign consent.

An initial antidote to this characterization of investment arbitration is to reinvigorate the actual reciprocal relationship that underlies investment treaties: the inter-state bargain.[51] Put differently, the promise of investment arbitration as a form of international adjudication lies in the idea of neutrality between states, not between investors and states. By understanding investment arbitration as a bargain between states, subject to international law, one advances the neutrality of investment arbitration as an *international* institution. By analogizing investment arbitration to international commercial arbitration, on the other hand, one promotes the neutrality of investment arbitration as a *private* order between state and investor.[52] The former is a legitimate founding principle, the latter is an inappropriate policy choice. In

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[51] E.g. NAFTA, *supra* note 18, art. 1115 (describing the purpose of Chapter 11 arbitration as being "to assure equal treatment *among investors* of the Parties in accordance with the principle of international reciprocity and due process before an impartial procedure" [emphasis added]). The reference is to equal treatment among investors, not between investors and states; and to international reciprocity and due process, not reciprocity between private parties and respect for party autonomy.

[52] E.g. C.H. Brower II, "Investor-State Disputes Under NAFTA: The Empire Strikes Back" (2001) 40 Colum. J. Transnat'l L. 43, 72-3; Brower and Steven, *supra* note 25, 196.

investment arbitration, the neutrality of the inter-state bargain requires the equal treatment of foreign investors relative to each other and regardless of the power and influence of an investor's home state. Likewise, neutrality requires the equal treatment of governments relative to each other and regardless of the power or influence of the host state. What neutrality does *not* require is equal treatment between investors and governments. Investment arbitration is a matter of *pacta sunt servanda* between the states parties, not between the disputing parties.

For this reason, public international law takes precedence over the use of a private model of adjudication. In defining the nature of the inter-state bargain, adjudicators should look to the intentions of the states parties to the treaty. Where the states parties to the treaty make unanimous submissions about how the treaty should be interpreted, a tribunal should adopt their view as a matter of course.[53] Further, the tribunal should not adopt an interpretation in favour of investor protection that goes beyond the submissions of the home state of the investor.[54] This is because investors are not parties to investment arbitration as an inter-state bargain. Of course, most investment treaties favour the historical position of capital-exporting states and, as such, they favour investor protection, but there remains significant room for interpretive flexibility.

Two general interpretive approaches to the role of investment arbitration can be identified. The private protection approach emphasizes investor protection as the dominant purpose of investment treaties; in contrast, the public function approach gives more consideration to the ongoing role of governmental decision-making. Each of these approaches faces a basic problem arising from the expansion of international

[53] *ADF Group Inc.* v. *United States of America* (Merits) (9 January 2003), 15(3) World Trade and Arb. Mat. 55, para. 177 (concluding in relation to the unanimous submissions of the NAFTA states parties: ".... we have the Parties themselves – all the Parties – speaking to the Tribunal. No more authentic and authoritative source of instruction on what the Parties intended to convey in a particular provision of NAFTA, is possible."). See also *Methanex Corporation* v. *United States of America* (Jurisdiction) (7 August 2002), 14(6) World Trade and Arb. Mat. 109, para. 130-4 and 147; *United Parcel Service of America, Inc.* v. *Government of Canada* (Jurisdiction) (22 November 2002), para. 59, 79, and 96, online: DFAIT http://www.dfait-maeci.gc.ca/tna-nac/documents/Jurisdiction%20Award.22Nov02.pdf.

[54] E.g. *Pope & Talbot*, *supra* note 45, para. 114; *GAMI Investments, Inc.* v. *Government of the United Mexican States* (Merits) (15 November 2004), 17(2) World Trade and Arb. Mat. 127, para. 29-30 (both tribunals rejecting the submissions of the investor's home state (the U.S.) in favour of a more ambitious interpretation of NAFTA advanced by the investor).

adjudication into the regulatory sphere and, for different reasons, each approach tends to undermine investment arbitration as an inter-state bargain.

First, the private protection approach undermines the inter-state bargain by emphasizing a purpose of investment treaties over the text of the treaty, interpreted in context, including the context of customary international law. As a result, the private protection approach tends to eschew a textual approach to treaty interpretation, in favour of the tribunal's judgment of 'object and purpose' and in conflict with the *Vienna Convention on Treaties*. This jeopardizes the credibility of investment arbitration for states while advancing its utility for claimants. Further, this risks making investment arbitration the sop of international business, thus jeopardizing the viability and longevity of the system to the extent that it depends on the support or compliance of states. Applied rigorously, the private protection approach negates the uniqueness of the state by treating the regulatory relationship between investor and state as a reciprocal relationship.

The public function approach undermines the inter-state bargain by accommodating states in order to protect the system of investment arbitration.[55] That is, the public function approach limits state liability where a damages award might disrupt government or generate controversy among decision-makers and the public, especially in powerful states. This sacrifices the reciprocity of investment arbitration by creating pressure to tread softly on the governments of major capital-exporting states, while championing investor protection as a means to discipline less powerful states. The inter-state bargain gives way to the accommodation of powerful states according to the degree to which their support is thought necessary to maintain the institution.[56] If this approach becomes commonplace, investment arbitration will be associated with a bias in favour of both international business and capital-exporting states. Investment treaties will become the new capitulation treaties.[57]

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[55] *Robert Azinian et al.* v. *United Mexican States* (Merits) (1 November 1999), 14 ICSID Rev. 538, 39 I.L.M. 537, para. 87 and 99; *Loewen, supra* note 50, para. 242. Paulsson, *supra* note 40, 257; G.A. Alvarez and W.W. Park, "The New Face of Investment Arbitration: NAFTA Chapter 11" (2003) 28 Yale J. Int'l L. 365, 399; J. Werner, "Some Comments on the NAFTA Chapter 11 Case – *ADF Group Inc. and United States of America*" (2003) 4 J. World Investment 113, 123-4.

[56] Paulsson, *supra* note 40, 246 and 257.

[57] E.g. M. Sornarajah, "The Clash of Globalisations and the International Law on Foreign Investment" (Presentation to the Centre for Trade Policy and Law, Ottawa, 12 September

Adjudicators should reject approaches that give priority to private law principles or the selective accommodation of the powerful. At worst, the private protection approach co-opts globalization as a trojan horse for a private method of government, while the public function approach harkens back to an age of indirect colonialism. The first brings the triumph of the private model of adjudication; the latter constructs a formally (as well as practically[58]) unequal treaty-based governing arrangement. The way to avoid these pitfalls is to apply the analytical framework of public law to the adjudication of regulatory disputes in the context of the inter-state bargain.[59] International adjudication of regulatory disputes is best analogized to the adjudication of claims by individuals in domestic public law, where governmental decision-making is assessed in light of the unique rights and duties of the state.[60]

In investment arbitration, the conventional adjudicative framework of international law – based on the inter-state bargain – is correct but not itself sufficient. This is because the prospective and far-reaching individualization of claims under investment treaties requires adaptation of the conventional framework by the incorporation of public law principles. Far-reaching individualization transforms international adjudication by expanding the degree to which it engages the regulatory sphere thus making the analytical framework of public law more relevant to investment arbitration. In adjudication between states (as in commercial arbitration between private parties), the public law framework is less applicable because the underlying legal relationship is reciprocal.[61] In contrast, investment arbitration involves the direct adjudication of regulatory disputes between the state and individuals who are subject to the exercise of public authority. For this reason, principles of international law that originate in the adjudication of disputes arising

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2002), 18, online: CTPL http://www.carleton.ca/ctpl/pdf/papers/sornarajah.pdf; B. Kingsbury, N. Krisch, and R. Stewart, "The Emergence of Global Administrative Law" (International Law and Justice Working Paper 2004/1, Institute for International Law and Justice, New York University School of Law, 2004), 38.

[58] R.R. Wilson, "Postwar Commercial Treaties of the United States" (1949) 43 AJIL 262, 286; H. Walker, "Treaties for the Encouragement and Protection of Foreign Investment: Present United States Practice" (1956) 5 Am. J. Comp. L. 229, 243-4; Anghie, *supra* note 10, 41.

[59] Chayes, *supra* note 5, 1284; K. Roach, "The Limits of Corrective Justice and the Potential of Equity in Constitutional Remedies" (1991) 33 Ariz. L.R. 859, 860; Jackson, *supra* note 38, 454; Legum, *supra* note 20, 147.

[60] Harlow and Rawlings, *supra* note 30, 41-2.

[61] V.S. Mani, *International Adjudication* (The Hague: Martinus Nijhoff, 1980), 3-4.

from a reciprocal relationship between states must be modified or jettisoned. Perhaps most importantly, it is necessary to differentiate between state liability in investment arbitration and state responsibility in conventional international adjudication. In international law, rules of state responsibility are often defined more expansively than domestic rules of state liability because in international law damages are typically awarded in disputes between juridical equals. In this context, liberal rules of state responsibility apply equally to the disputing parties.[62] Investment arbitration, on the other hand, leads to damages awards in favour of investors and against the state but not the other way around. This calls for sensitivity to the governmental implications of damages awards.

In all domestic legal systems, there is a regulatory space in which individuals cannot receive damages for unlawful state conduct and it would be surprising if this space did not exist at the international level.[63] However, when sovereign acts of the state are equated to the acts of a private party, investment arbitration infringes upon this fiscally risk-free domain. In determining the extent to which such a domain exists in the international sphere, adjudicators should bear in mind the limits of international adjudication in the resolution of regulatory disputes, where damages are used as a public law remedy.[64] It is unfortunate that some arbitrators (and many commentators) tend to act like lions when protecting investors but like ostriches when faced with the implications for governments. This has the potential to hijack the system of investment arbitration for a private lobby.[65] It positions investment arbitration as a

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[62] M.N. Shaw, *International Law*, 5th ed. (Cambridge: CUP, 2003), 192-3.
[63] Most, if not all, proponents of treating the state as a private person for purposes of state liability nonetheless accept limits on state liability in light of the uniqueness of public authority: e.g. Hogg and Monahan, *supra* note 4, 151-3.
[64] Cohen and Smith, *supra* note 3, 8 and 11-12; R. Baldwin and C. McCrudden, *Regulation and Public Law* (London: Weidenfeld and Nicolson, 1987), 60-1; Harlow, *supra* note 4, 220; J.H.H. Weiler, "Emerging Issues on Compliance and Effectiveness of Community Law" (1997) 91 ASIL Proc. 172, 173-4; Loughlin, *supra* note 39, 48-52; J.H.H. Weiler, "Epilogue: Towards a Common Law of International Trade" in J.H.H. Weiler, ed., *The EU, the WTO, and the NAFTA* (Oxford: OUP, 2000), 230; J. Merrills, "The Means of Dispute Settlement" in M.D. Evans, ed., *International Law* (Oxford: OUP, 2004), 545.
[65] E.g. Vicuña, *supra* note 47 (professor and president of the World Bank Administrative Tribunal; member of the ICSID Panels of Conciliators and Arbitrators; arguing against making investment arbitrations public on the basis that they would more closely resemble ordinary public court proceedings and thus cease to be an alternative); Brower et al., *supra* note 19, 430-5. See J.E. Alvarez, "Critical Theory and the North American Free Trade Agreement's Chapter Eleven" (1997) 28 U. Miami Inter-Am. L. Rev. 303, 307-8.

regime in which the public sphere is governed by rules of private law that are skewed in favour of international business at the expense of other individuals.[66] Again, it is difficult to isolate these decisions from the interests of arbitrators to expand the system of investment arbitration as a commercial enterprise.

A purpose of this thesis is to establish that the use of investment arbitration as a governing arrangement calls for the application of a public law framework in investment arbitration. There has been little attempt to elaborate the specific implications or elements of a public law framework because doing so would require careful review of how rules and principles of public law in different countries govern the myriad issues that arise in the adjudication of regulatory disputes between individuals and the state. For purposes of illustration, it may be useful to make clear that adopting a public law framework entails the application of rules and principles of public law that have developed in domestic public law and, to a lesser extent, in international law in those cases in which international adjudication directly engages regulatory disputes. For instance, given the use of damages as a public law remedy in investment arbitration, adjudicators may find it appropriate to adopt general limits on state liability that are consistent with limits on state liability in the domestic public law of the investor's home state and the host state.[67] Likewise, adjudicators may find it appropriate to afford a margin of appreciation for discretionary policy-making by domestic institutions[68] and to defer to governmental decisions that are not specifically abusive or discriminatory.[69] This would preserve a reasonably predictable space for the exercise of public authority, undeterred by the prospect of a retrospective damages award. That said, this thesis is concerned not with how a public law

[66] W. Twining, *Globalisation and Legal Theory* (London: Butterworths, 2000), 51; W.W. Bratton et al., "Introduction: Regulatory Competition and Institutional Evolution" in W.W. Bratton et al., eds., *International Regulatory Competition and Coordination* (Oxford: Clarendon, 1996), 3; A. Claire Cutler, "Critical Reflections on the Westphalian Assumptions of International Law and Organization: A Crisis of Legitimacy" (2001) 27 Rev. Int'l Studies 133, 143-50; F. Snyder, "The Gatekeeper: The European Courts and WTO Law" (2003) 40 C.M.L. Rev. 313, 365.
[67] C.D. Gray, *Judicial Remedies in International Law* (Oxford: Clarendon, 1987), 9.
[68] R.S.J. Macdonald, "The Margin of Appreciation" in R.S.J. Macdonald, F. Matscher and H. Petzold, eds., *The European System for the Protection of Human Rights* (Dordrecht: Martinus Nijhoff, 1993), 122-4; J.H.H. Weiler (2000), *supra* note 64, 202-3; J.A. Weir, "Human Rights and Damages" (2001) 40 Washburn L.J. 412, 433-4.
[69] E.g. *S.D. Myers, Inc.* v. *Government of Canada* (Merits) (12 November 2000), 40 I.L.M. 1408, 15(1) World Trade and Arb. Mat. 184, para. 261-3. See Harlow and Rawlings, *supra* note 30, 96-7; J.H.H. Weiler (2000), *supra* note 64, 207-10.

framework should be applied in specific cases, but with the identification of investment arbitration as a governing arrangement as opposed to a reciprocally consensual method of adjudication.

The rapid conclusion of so many investment treaties in the 1990s attests to a broad convergence of opinion among states about the use of law to protect investment in support of international commerce and a liberal international economy.[70] Indeed, it is a major diplomatic failure of the twentieth century that adjudication did not play a more integral and balanced role in earlier stages of the world economy.[71] But states should not be assumed by the mere conclusion of broadly-framed investment treaties to have mandated a radical transformation of the juridical nature of the state, even if states have subjected the exercise of public authority to new methods of control. Inherent in the decision of states to use adjudication as a governing arrangement is the recognition of an ongoing role for government. Investment treaties constrain the policy options of domestic governments without establishing international institutions to regulate multinational enterprises.[72] Thus, the state remains the primary repository of regulatory authority in a world that requires proactive and robust government for reasons beyond investor protection.[73] In these circumstances, it is appropriate to adopt a deferential and accommodating stance toward governments. Otherwise, investment arbitration may become a vehicle for colonizing the public sphere with a private method of government and for formally subordinating the rights and interests of those who are represented by states alone on the global stage.

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[70] A.A. Fatouros, *Government Guarantees to Foreign Investors* (New York: Columbia University Press, 1962), 63; S.K.B. Asante, *Transnational Investment Law and National Development* (Lagos: University of Lagos, 1981), 73 and 109.

[71] A.A. Fatouros, "An International Code to Protect Private Investment – Proposals and Perspectives" (1961) 14 U.T.L.J. 77, 101.

[72] A.C. Aman, "Globalization, Democracy, and the Need for a New Administrative Law" (2003) 10 Ind. J. Global Legal Studies 125, 139-40.

[73] Fatouros, *supra* note 43, 364-5; R. Kozul-Wright and R. Rowthorn, "Spoilt for Choice? Multinational Corporations and the Geography of International Production" (1998) 14 Ox. Rev. Econ. Pol. 74, 84-5; S. Picciotto, "Introduction: What Rules for the World Economy?" in S. Picciotto and R. Mayne, eds., *Regulating International Business* (Houndmills: Macmillan, 1999), 4-5 and 19-20; D. Rodrik, *The Global Governance of Trade As If Development Really Mattered* (Report for the UN Development Programme, October 2001), 15-16 and 27; UNCTAD, *World Investment Report 2004* (New York: United Nations, 2004), 233 and 236; Kingsbury, Krisch, and Stewart, *supra* note 57, 15.

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