

# **Interpretations and Coherence of the Fair and Equitable Treatment Standard in Investment Treaty Arbitration**

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## Abstract

*The fundamental aims of this thesis is to demonstrate problems regarding key forms of liability formulated under the Fair and Equitable Treatment Standard ('FET' hereinafter). These are problems that are likely to occur for developing countries who are attempting to prevent future breaches of the same type illustrated in the current jurisprudence, through developing appropriate responses.*

### Principal Propositions:

*This thesis will propose the following regarding the FET standard:*

1. The FET standard has been used to create rules.
2. The rules created under the FET standard operate on state institutions and state policy creating a framework of administrative liability that is unique as it operates without classic constitution constraints.
3. This form of unique administrative liability of FET confers a governance role on arbitrators, to control state institutions and policy sanctioned by liability, through transplantation of administrative law into the investment treaty framework.
4. This unique administrative liability is applied to developing countries through the investment treaty framework.
5. For reasons of lack of coherence of this unique administrative law and problems faced by developing countries accommodating legal transplants in the law and development movement; developing countries, those most likely to face administrative law claims, may not be able to comply with this unique administrative law.
6. If FET is to create unique rules of administrative liability, investment treaty arbitration must alter its current institutional approach to dispute-resolution under FET in order to, increase legal certainty, be sensitive to both problems faced by the law and development movement regarding legal transplantation and be aware of reasons why national courts may operate with constitutional constraints.

### Brief Note on Methodology

*Tudor's work on the Fair and Equitable Treatment Standard gives a comprehensive account of the origins and content of the standard.<sup>1</sup> The aim here was not to repeat on what was done there but to initial key questions of acceptability regarding the content. Hence although a ten year period of jurisprudence is surveyed, between 1999-2009, the aim here as been to predominantly highlight not only inconsistencies to deal with the important issue of coherence, but also to demonstrate the impact such interpretations may have on investment treaty arbitration as a system of rule-making, along-side issues of compliance of the content by developing states.*

*To this end some focus is given to the following questions, which are considered questions of fundamental importance to the viability of the approach of rule-making under FET in the analysed period: What does this system of rule-making seek to do, and can it achieve those ends? If not, how can it be improved in such a role, if feasible, or is it realistic to detach such a role from it?*

*Hence the method here is to survey the cases and illustrate what rules the FET standard is creating. Then it is to highlight whether these rules can be identified by those who may rely on them, investors, and those who face a burden under them, states. Critically, this approach does **not** weigh approaches in the jurisprudence according to chronological patterns. This is fundamentally because this system was not designed to be a rule-making institution. Thus at present all decisions are of equal validity through both the existing method of identifying sources of international law and a procedural omission of a system of precedent governing what decisions take precedence over others. It is felt that to do this would be not only to create a criteria that does not exist as a matter of law, and to do so would be, as a matter of international law, wrong. It would also undermines the flexibility of afforded to the system of using a vast jurisprudence of international decisions, including previous investment treaty disputes, at its disposal in order to formulate arguments and judgments for both parties and adjudicators, respectively.*

*My approach as outlined above, is thus to bring to the surface key positions in FET jurisprudence that illustrate the scope or rights available under three elements of it: (i) Legitimate Expectations; (ii) Transparency and (iii) Denial of Justice. Under first two, as it shall be seen, claims are posited predominantly with respect to acts of organs of the state. Under the third claims exist with respect to institutions and processes that may exist to deal with the investor's complaints. These elements are chosen as they form the bulk of the current issues dealt with under FET, and due to a limitation of space available here to address the above key questions.*

*The above three elements shall form an empirical basis in order to formulate a discursive and critical narrative that seeks to address the key questions. The steps in this process are outlined briefly below:*

### Stages of the Argument:

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<sup>1</sup> I. Tudor, *The Fair and Equitable Treatment Standard in the International Investment Law* (OUP) (2007).

*The argument proceeds in the following stages:*

*Chapter 1 explores the distinction between adjudication and norm-making, arguing that FET is used to make rules by arbitrators. Chapters 2 to 4 look at the following rules applied by the FET standard: legitimate expectations, transparency, and denial of justice. Chapter 5 and 6 discuss the implications of legitimate expectations and transparency on both investment treaty arbitration and developing countries, and any difficulties that may be encountered in practice. Chapter 7 proposes changes that may assist in dealing with these difficulties.*

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## CONTENTS

Chapter 1. Fair and Equitable Treatment: The Standard.....	P.1
1.1. Introduction. ....	P.1
1.2. Distinguishing between adjudication and law/rule-making. ....	P.4
A. Adjudication. ....	P.4
B. Law-Making in the public sphere. ....	P.17
1.3. Fair and Equitable Treatment an overview. ....	P.19
A. Investment Arbitration as a system of adjudication. ....	P.19
B. Origins and the Nature of FET. ....	P.25
C. FET standards as Rules. ....	P.28
1.4. Initial Concerns and Issues. ....	P.41
 Chapter 2. The doctrine of legitimate expectations in investment treaty arbitration..	P.45
2.1 Introduction. ....	P.46
A. Basic Concepts within the doctrine. ....	P.46
B. Rationales for the doctrine in English Law. ....	P.47
C. Legitimate Expectations and Good Conduct. ....	P.49
2.2 Legitimate Expectations under FET. ....	P.51
A. An overview of Approaches. ....	P.52
B. The ambiguity surrounding the requirement of a direct representation.....	P.57
C. Substantive Aspect.. ....	P.59
D. Contrasting Positions within the scope of rights. ....	P.67
E. Positions of Deference in Investment Treaty Arbitration. ....	P.70
F. Conclusions. ....	P.72
2.3 Legitimate Expectations in English Law. ....	P.75
2.4. Conclusions. ....	P.89
 Chapter 3. Transparency, Consistent Conduct and freedom from arbitrary interference .....	P.93
3.1. Introduction. ....	P.93.
3.2. Transparency as a concept. ....	P.95
3.3. Thresholds for Transparency under FET. ....	P.102
3.4. English law.....	P.102
A. Procedural transparency. ....	P.106
B. Non-disclosure in the Public Interest and the Need for Confidentiality.....	P.107
C. Synopsis.....	P.114

3.5 International Transparency Drivers.....	P.114.
A. Increasing procedural transparency.....	P.115
B. Using international drivers for coherence.....	P.121
3.6 Conclusion.....	P.122
 Chapter 4. Denial of Justice. ....	P.128.
4.1 Introduction. ....	P.129.
4.2 The notion of denial of justice in relation to the minimum standard.....	P.129.
A. Overview. ....	P.130
B. Theoretical Basis and Scope in Customary International Law.....	P.131
C. Illustrating the Customary International Law position.....	P.133
4.3 The local remedies rule. ....	P.139
4.4 Denial of justice in investment treaty arbitration. ....	P.142
A. General expositions as to current approach.....	P.142
B. An overview of Substantive Content.....	P.145
4.5 Conclusions. ....	P.154
 Chapter 5. Consent, Rule-making and coherence. ....	P.161
5.1. Introduction.....	P.162
5.2. Coherence.....	P.163
5.3 The Nature of FET rules.....	P.170
A. Rationales of Public Law.....	P.170
B. A brief history of English public law and administrative state.....	P.174
C. The role of deference.....	P.178
5.4 Rule-Making Issues regarding FET.....	P.180
A. Participation and consent in Rule-Making.....	P.181
B. A Law and Economics Perspective on Transplantation.....	P.188
5.5 Conclusion.....	P.190.
 Chapter 6. Transplants and Governance.....	P.192
6.1. Introduction.....	P.192
6.2. Governance via the Fair Treatment Standard.....	P.192
A. Administrative and Regulatory Governance.....	P.196
B. International Governance and Concerns.....	P.204
6.3. Administrative Rules and Transplantation.....	P.209
6.4. Capacity of states to respond to FET Governance.....	P.226
6.5. The Nature of International Governance under Fair Treatment.....	P.231

6.6. Reforms of FET Governance.....	P.235
-------------------------------------	-------

Chapter 7. Conclusion and Proposed Reforms.....	P.242
---	-------

7.1 Introduction.....	P.242
-----------------------	-------

7.2 Coherence and Remedies. ....	P.224
----------------------------------	-------

A. Coherence.....	P.244
-------------------	-------

B. The Minimum Standard as a tool for coherence. ....	P. 246
---	--------

C. The Case for Deference. ....	P.246
---------------------------------	-------

D. Possibly Expanding the Legal Framework. ....	P.257
---	-------

7.3 Adjudicatory System Changes and Treaty Alterations.....	P.258
---	-------

A. Institutional Transparency.....	P.261
------------------------------------	-------

B. Investment Court. ....	P.262
---------------------------	-------

C. Treaty Alterations. ....	P.264
-----------------------------	-------

7.4 Concluding Remarks. ....	P.270
------------------------------	-------

Table of FET Breaches. ....	P.278
-----------------------------	-------

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Bibliography.....	P.280
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## **Chapter 1**

### **'Fair and Equitable Treatment': The Standard**

#### **1.1. Introduction.**

#### **1.2. Distinguishing between adjudication and law/rule-making.**

##### **A. Adjudication.**

##### **B. Law-Making in the public sphere.**

#### **1.3. Fair and Equitable Treatment an overview.**

##### **A. Investment Arbitration as a system of adjudication.**

##### **B. Origins and the Nature of FET.**

##### **C. FET standards as Rules.**

#### **1.4. Initial Concerns and Issues.**

### **Abstract**

*The aim of this chapter is to show that FET is used by arbitrators to make rules. It will do this by explaining the difference between law-making and adjudication. It will attempt to determine whether the reasoning under FET to find liability is merely an exercise of adjudication determining fairness of a state's actions or, also, an exercise that involves arbitrators creating rules in order to give some substantive meaning to the FET standard.*

*If the latter is demonstrated, it will be questioned whether investment treaty arbitration, a unique dispute resolution process operating without direct governmental or constitutional control, can effectively carry out rule-making in contrast to national legislatures that are equipped with technical expertise, such as professional legal draftsman, and appropriate policy input, to do so.*

*This shall set-up the three stage analysis in this thesis for subsequent chapters: Have arbitrators been able to create workable rules from the perspective of coherency by interpreting FET? and, secondly, What is the precise nature of this rule-making process through FET?, further finally, Can such rules created by arbitrators using FET be complied with by developing states?*



## **1.1.Introduction**

Investment treaty arbitration is a system of resolving disputes between investors and states.<sup>1</sup> Litigation is taken by investors against states for breaches of investment treaties between the investor's state of nationality and the defendant state (the 'host-state' hereinafter).<sup>2</sup> These treaties consist of obligations owed by defendant states to the state of which the investor is a national. One of these obligations is the Fair and Equitable Treatment standard ('FET' hereinafter), which is the standard that concerns this thesis.

The FET standard is textually ambiguous.<sup>3</sup> It is not clear at all, from a literal reading of the standard, whether it should be used to make rules, or to decide disputes on a case by case basis in general abstract terms in relation to whether states have been fair. This has been a matter of choice for arbitrators adjudicating disputes between investors and states, and, as will be demonstrated below, they have chosen the former over the latter.

The purpose of this chapter is to understand that arbitrators have chosen to pro-actively interpret the standard to create law. To illustrate this, the differences between mere adjudication without law-making, adjudication with law-making, and legislative law-making shall be outlined in abstract, before analysing interpretations of FET.

This outline shall include discussion of the key issues that domestic courts face in interpreting ambiguous legislation, a similar problem to that faced by arbitrators dealing with FET. The various safeguards and concerns in relation to domestic courts interpreting legislation shall be highlighted. This will intimate that there are

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<sup>1</sup> A.Redfearn, M.Hunter, N. Blackaby & C. Partasides, *Law and Practice of International Arbitration* 4<sup>th</sup> Ed (Thomson : Sweet & Maxwell) (2004) at p. 474-477

<sup>2</sup> Redfearn & Hunter (n1 above) *ibid.* ; S.W. Schill, *The Multilateralization of international investment law* (Cam U. P) (2009) at p.365-369; Z. Douglas, *The International Law of Investment Claims* (Cam U. P) (2009) at p.17-39.

<sup>3</sup> I. Tudor, *The fair and equitable treatment standard in the international law of foreign investment* (OUP) (1998) at p.126-127.

difficulties and challenges that arbitrators face in interpreting FET. The rest of this work shall assess whether they have met these and other criteria for the interpretations of the FET standard.

This shall lead to the key question in this thesis. This is whether arbitrators have been able to use FET to create rules, and if so whether such rules are clear and workable, and if not whether the safeguards and concerns relevant to domestic courts interpreting ambiguous law need to be applied. This, last issue, shall be discussed at the end of the thesis. This is after, particular FET interpretations have been assessed in relation to three key issues:

- (i) Whether such interpretations are clear and coherent;
- (ii) Whether they can be complied with by states; and
- (iii) Whether any identifiable role conferred upon investment treaty arbitration by FET interpretations is appropriate,<sup>4</sup> bearing in mind that it is, fundamentally, a private dispute resolution process.<sup>5</sup>

On a *prima facie* reading of investment treaties there is no mandate to make rules, only interpret treaties in accordance with the law of treaties. However interpretations, whether determinable as rules or not, may have to bear in mind that many investment treaties consist of both a capital-exporting state (usually a developed country) and a capital-importing state (usually a developing country).<sup>6</sup> This means that investor claimants can frequently be from developed states and the defendants, in the same dispute, can potentially be a developing country. As will be seen investors may demand a certain form of conduct under FET from respondent states that are developing countries. The important issue then may become whether, under FET, these complaints have been turned into rules

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<sup>4</sup> Discussed in Chapter 6.

<sup>5</sup> W. Mattli, 'Private Justice in a Global Economy: From Litigation to Arbitration' (2001) 55(4) *Int. Org.* 919 at p.919-942; G. Van Harten, 'Investment Treaty Arbitration as a species of global administrative law' (2006) 17(1) *EJIL* 121 at p.126

<sup>6</sup> J. W. Salacuse, 'BIT by BIT: The Growth of Bilateral Investment Treaties and their impact on foreign investment in Developing Countries' (1990) 24 *Int'L* 655 at p.655-661.

through interpretations of FET, and if so, whether arbitrators have created such rules so that developing states can: *identify, relate to, and, comply with them*.<sup>7</sup>

For ease of discussion the term ‘adjudication’ here shall include, not exclusively, all forms of dispute resolution, whether domestic or international.

## **1.2.Distinguishing between Adjudication and Rule/Law-Making**

In broad and general terms, subject to exceptions, law-making is different in the processes of adjudication. The latter identifies specific rules applicable to resolve factual disputes, to legislative rule-making which seeks to apply to broader schemes of control of human agency.

The aim of the discussion below is not to weigh the appropriateness of literature aiming to characterise the roles or judges, but to elicit the key aims of judicial processes both at the national level and at the international private level embodied in arbitration. This is to support the argument that the activity of arbitrators in using the FET standard is one of law-making, not adjudication.

### **A. Adjudication**

*The general role of adjudication.*

At its most fundamental level adjudication is about resolving disputes.<sup>8</sup> It plays a similar role irrespective of parties to a dispute, whether between two private parties or two states.<sup>9</sup> Adjudication conducted between private parties can have general benefits for human agency, whether in economic terms or in social terms. For example, in a domestic context, judicial processes can ensure social and

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<sup>7</sup> See, Chapters 5 and 6 for fuller discussions on these issues.

<sup>8</sup> S. Shetreet, ‘Judging in society: The Changing role of courts’ in S. Shetreet Ed., *The role of courts in society* (Martinus Nijhoff) (1988) at p.468; H. J. Abraham, *The Judicial Process* 6<sup>th</sup> Ed (OUP) (1993) at p.93-94.

<sup>9</sup> G. B. Born, *International Commercial Arbitration* (Kluwer) (2009) at p.64.

political stability through the resolution of disputes.<sup>10</sup> Commercial dispute resolution, such as arbitration, can serve an important market-enabling function by enforcing agreements or meeting the costs of breaching them.

This simplistic formulation of the judicial role, has been subject to more complex composite conceptions. These include bringing together political and other behavioural tendencies of judges to take characterisations of adjudication beyond a mere dispute resolution function.<sup>11</sup> Thus when playing its role as an adjudicator of breaches of constitutional provisions, courts may enshrine limits or extend principles such as to act as effective constitutional legislators.<sup>12</sup> An example of this can be found in the broad distinction between judicial activism and judicial conservatism with respect judicial approaches of the U.S. Supreme Court to the U.S. Bill of Rights.<sup>13</sup> Thus in certain cases a realistic view<sup>14</sup> of adjudication is one that concedes that it may also involve understanding values of adjudicators that bear upon the adjudication of a dispute.

This may not be a universal approach, and has to be taken with the caveat that judicial approaches between states differ, and importantly judicial approaches in a

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<sup>10</sup> Tort law provides a classic example of this, though providing individual relief the form of damages, it also assists in bringing about a sense of justice and contentment in those that are harmed. Mass tort claims, such as asbestos litigation, are a good example: M.J. Sacks & P.D. Black, 'Justice, improved the unrecognised benefits of aggregation and sampling in the trial of mass tort claims' (1992) 44 Stan Law. Rev 815 at p.838-841. (This discussion is primarily one of procedure). Though this is not an exclusively domestic idea, see also the idea behind mass-claims processes: See, H. Das, 'The Concept of Mass Claims and the Specificity of Mass Claims Resolution' in Permanent Court of International Arbitration, *Redressing Injustices Through Mass Claims Processes* (OUP) (2006) at p. 5.

<sup>11</sup> C. Guarnieri & P. Pederzoli, *The Power of Judges* (OUP) (2002) at p.68-77

<sup>12</sup> A. Cox, 'Constitutional adjudication and the promotion of human rights' (1966-67) 80 Harv. Law. Rev. 91 at p.91-95; M. Pawa, 'When the Supreme Court restricts constitutional rights, can congress save us? An examination of section 5 of the fourteenth amendment' (1993) 141(3) Un. Pen. Law. Rev. 1029 at p.1029-1034 For a discussion of a restriction of constitutional rights by the court, See

<sup>13</sup> For discussion of this differences, See: M. de S-O-L'E. Lasser, *Judicial Deliberations: A comparative Analysis of Judicial Transparency and Legitimacy* (OUP) (2004) at p.322-360

<sup>14</sup> For a contrasting view of ideal objective judicial approaches that mirror societies values, rather than personal preference, See R. Dworkin, *Law's Empire* (Cambridge: Harv. Uni. Press) (1986) at p.211-213.

state cannot wholly be divorced from the particular constitutional construct of the states they operate in, including the range of judicial dialogues that have been created with respect to certain political and constitutional issues.<sup>15</sup>

*The role of public adjudicators in national contexts in interpreting law.*

As well as dispute resolution, the role of national courts is also to enforce law, and thus lend support to legislative function. This will involve determination of whether a particular legislative provision is applicable, or, where it is not, whether it was intended to be.<sup>16</sup> As far as the latter is concerned, there is scope for error, irrespective of how accurate judicial techniques to determine legislative intention are.<sup>17</sup> Further some judicial determinations on resolving questions of interpretation may amount to a usurpation of legislative function, and, where the determination is at odds with legislative intent, clash with it.

Herein lies a choice between whether courts out not to determine the dispute at all and defer to the legislature in the absence of legislative intention, or whether they should formulate some other technique, such as determining the purpose of the law in question,<sup>18</sup> in order to allow them to resolve the dispute rather than dismiss it. This is not so distinct from arbitrators having to choose between excluding a claim by an investor under FET, and bringing it within the scope of deliberations as to whether it has breached FET.

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<sup>15</sup> A.J. Arnaud. 'From Limited Pluralism to Plural Law. Normative approach versus cultural perspective' (1998) 11(3) Ratio. Juris 246 at p. 253-255.

<sup>16</sup> S. Corcoran, 'Theories of Statutory Interpretation' in S. Corcoran & S. Bottomley, *Interpreting Statutes* (Federation Press) (2005) at p.15.

<sup>17</sup> C.P. Curtis, 'A better theory of legal interpretation' (1949-50) 3 Vand. L. Rev. 407 at p. 409- p.410, & p.415. 'The 'Pepper and Hart' test is used in English law, which allows a court in strict circumstances to look at discussions pertaining to the enactment of a particular rule. (See, *Pepper v. Hart* [1993] AC 593) Broader contextual analysis that includes looking at legislative history is also used by the U.S. Supreme Court, with awareness of not using it to override a viable literal meaning. See, W. N. Eskridge, Jr. 'The New Textualism' (1989-90) 37 UCLA L. Rev. 621 at p.621-625.

<sup>18</sup> As classically advocated by Pound and others, See: R. Pound, 'Common Law and Legislation' (1908) 21 Harv. Law. Rev. 383 at p. 385-6.

In some Western democracies this is left to a matter of choice for the particular adjudicators, and errors of outcome are seen as acceptable flaws, albeit subject to criticism, in the face of overall benefits of adjudicatory activism on interpretation. From a certain realist perspective, the latter is an inescapable fact of the adjudicatory process itself often having to use legislation to decide the dispute.

Despite certain adjudicatory techniques being useful, though not always wholly accurate, processes in determining appropriate interpretations of legislation that fit with intentions of legislature, there are formal oppositions to them. One is a critique relating to a lack of democratic participation in the methods used by adjudicators to find appropriate pathways of legislative intent. At a simplistic level, these formal oppositions argue that as adjudication lacks broader public participation it is thus fundamentally constitutionally illegitimate. This argument lends its support from the orthodox constitutional paradigm on the basis that it is not the function of courts to make law.<sup>19</sup> Other criticisms include that these merely allow adjudicators with a particular agenda to surreptitiously take on a legislative role.<sup>20</sup> This is particularly the case as it is judges, not legislatures that decide whether a law is ambiguous.<sup>21</sup> Further, such a role if encouraged, may result in lackadaisical drafting and creation of laws by legislators.<sup>22</sup>

However, such criticisms can be countered by the fact that it is precisely because one of the fundamental roles of national adjudicators to support legislative function that issues of interpretation appear in front of them. Further it is unrealistic to assume that textual accuracy of legislation is always possible vis-à-vis legislative intent. Thus adjudicators will inherently be left to determine appropriate meanings of legislation, or tidy-up ambiguities, as an inescapable part of the process of adjudicating disputes. This is where a range of judicial techniques to

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<sup>19</sup> See A.V. Dicey, *An Introduction to the Study of the law of the constitution* (Liberty) at p.3-18. discussed below.

<sup>20</sup> J.M. Landis, (1929-30) 43 Harv. L. Rev. 886 at p.886-887.

<sup>21</sup> Landis at p.888.

<sup>22</sup> Curtis at p.411-412.

determine legislative intent have been pursued.<sup>23</sup> These include looking into legislative history also bringing in the broader social, economic and political context of the legislation.<sup>24</sup> Further, the legislative monopoly of legislators ensures that unacceptable interpretations of law, or unacceptable judicial activism, can be controlled by the passage of subsequent legislation and the ability to dismiss adjudicators that persistently undermine legislative will. Such safeguards, in a democracy, ensure that adjudicators do not trump the legislative outcomes of elected legislatures.

However the arguments against judge made law do not end with democratic conceptualisations of sovereignty, as illustrated by the positive law thesis of Parliamentary sovereignty in UK law.<sup>25</sup> In that paradigm the relationship of the court with the legislator is that of enforcer of law for the breaches of legal order, whether created by custom or formal decree and the adjudicator does not carry out any form of law-making.<sup>26</sup> This deference to the legislator by the adjudicator on issues of law-making can be justified, inter alias, due to legislation being subject to a wide range of inputs that standard procedural rules serving as information gateways to adjudicators, despite including evidential rules that permit special witnesses (or experts), do not cater for.<sup>27</sup>

Other problems of adjudication forming a law-making institution also include technical short-comings of being able to make policy that is inherent in legislation.<sup>28</sup> Further, as the primary goal of adjudicators is to resolve disputes with expediency, due to costs of the process, this does not sit comfortably with

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<sup>23</sup> See *Pepper v. Hart* (n 17).

<sup>24</sup> W.N. Eskridge, J.r., 'Dynamic statutory interpretation' (1986-87) 135 U. Pa. L. Rev. 1479 at p.1479-1482; N. Devins & L. Fisher, 'Judicial Exclusivity and Political Instability' (1998) 84 Va. L. Rev. 83 at p.84-86.

<sup>25</sup> One of the classic proponents of this is the seminal constitutional theorist A.V. Dicey. See (n 19 above). See: Holmes, 'The Theory of Legal Interpretation' (1899) 12 Harv. Law. Rev. 417 at p.418-419.

<sup>26</sup> C.D. Breitel, 'The law makers' (1965) 65 Colum. L. Rev. 749 at p.755

<sup>27</sup> Macey, 'Promoting public-regarding legislation through statutory interpretation: An interest group model' (1986) 86 Colum. L. Rev. 223 at p.

<sup>28</sup> A.V. Dicey, *Law and Opinion in England during the 19<sup>th</sup> Century* (Macmillan) (1914) 2<sup>nd</sup> Ed. at p.369

intense appraisals by adjudicators of policy that arises through determining valid interpretations of legislation.

The risk of having outcomes contrary to legislative intent in adjudication, can be justified by the broader public benefits of national adjudicators resolving disputes, so as long as extreme and consistent violations of legislative activity do not occur. Such violations may build a case for restricting adjudicative power to interpret legislation or to determine which are appropriate legislative interpretations. These restrictions on adjudicator's discretions may be justified in order to ensure that public interest in having democratic legislatures, and the legislator's aim inherent in legislation, is preserved.<sup>29</sup>

The criticisms of adjudicatory activism do not import that such behaviour has no role. The benefits of pro-active judicial behaviour in the interpretative process is that it allows the court to support the purpose behind law or regulation by making a finding in favour of the purpose it purports the law to hold.<sup>30</sup> Such behaviour is ascribed as supporting legislatures (the rule of law) and seen to be legitimate adjudicatory function.

*The Problem of 'Interpretative Choice' when faced with an ambiguous clause.*

Adjudicators faced with the language of an ambiguous provision, such as the FET clause ('*Fair and Equitable Treatment*'), have to make a determination as to what the clause entails. In most cases the language of law is clear and its meaning easy to ascertain from taking the written words of the text literally or it is ambiguous law that needs to be subject to adjudicatory reasoning to determine its meaning.<sup>31</sup>

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<sup>29</sup> Posner, 'Legal Formalism, Legal Radicalism and the Interpretation of Statutes and the Constitution' (1987) 37 Case. W. L. Rev. 179 at p.196-97.

<sup>30</sup> E.g., The U.S. Supreme Court's pro-competition approach in the use of dormant commercial clause doctrine to interpret Article 1 of the U.S. Constitution: J. Rossi, 'Transmission siting in deregulated wholesale power markets: Re-imagining the role of courts in resolving federal-state siting impasses' (2005) 15 Duke. Envt'l. L. & Pol. F. 315 at p.323-325; See also, T.J. Peretti, *In Defense of a Political Court* (Princeton Uni. P) (1999) at p.80-91.

<sup>31</sup> Michelmas, 'The Supreme Court, 1985 term- forward: Traces of Self-Government' (1986) 100 Harv. L. Rev. 4 at p.4-5.



However, adjudicators do often engage in matters of political judgment, whether they realise it or not, when they are faced with choices of two or more arguably valid interpretations of a particular law or ambiguous law that needs to be subject to adjudicatory reasoning to determine its meaning. With respect to this problem of 'interpretative choice' they will be forced to employ a range of interpretative techniques if they wish to provide a meaning for the text, rather than dismissing the applicability of the law. These, in broad terms, seek to determine the intention and purpose of legislative drafters. Although determination of 'intention' and 'purpose' share similar methods of discovery, they are, nevertheless, distinct concepts.<sup>32</sup>

Adjudicators can also be influenced by existing domestic political axioms. Thus political issues that divide opinions of citizens may divide judicial approaches to questions of legislative interpretation.<sup>33</sup> To further illustrate using an example, as a result of the political context associated with political-social goals of equality of outcome, there has been a tendency by some judges towards egalitarian distribution in judicial decision-making.<sup>34</sup>

In this process of interpretation of the law, adjudicators choosing one valid interpretation over another essentially act as legislators. On one view adjudicators, in this role as supplementary law-makers, are seen to be useful because they are not subject to the democratic pressures of national legislators and policy-makers.<sup>35</sup> This political decision-making of adjudicators does not mean that the process of adjudication is no longer a neutral setting for disputes. Rather it is a reflective of a paradigm of a particular form of problem that adjudicators face when left open to

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<sup>32</sup> Curtis, p.422-p.424. For an example of erroneously eliding the two together, See Eskridge Jr. at p.1487

<sup>33</sup> W. Mishler & R. S. Sheehan, 'The Supreme Court as a countermajoritarian institution? The impact of public opinion on Supreme Court decisions. (1993) 87(1) Am. Pol. Sc. Rev. 87 at p.90-91.

<sup>34</sup> M. Cappelletti, *The Judicial Process in Comparative Perspective* (OUP) (1989) at p.11-12; J. W. Hurst, 'The functions of courts in the United States' (1980-81) 15(3/4) Law and Soc Rev. 401 at p.444- 457.

<sup>35</sup> H. Fix-Fierro, *Courts, Justice and Efficiency: A socio-legal study of economic rationality in administration* (Hart) (2003) at p. 5.

the problem of ‘interpretative choice’ described above. Neither, in the process of solving this dispute, is it realistic to assume that adjudicators will behave completely independently of particular value-judgments they hold. Some forms of adjudication, for example those involving considerable public interest or conflicting constitutional principles, can bring out such tendencies due to an open scope left to adjudicators to determine the scope of burdens and rights prior to finding for a particular party or dismissing the dispute.<sup>36</sup> This is despite the depoliticisation of the adjudicatory function being strongly supported by having judicial independence and impartiality as key values that ought to be followed in adjudicatory process.

The problems of ‘interpretative choice’ are not always determined by adjudicators solely applying legal methods. Adjudicators can operate with assistance from academic or practical experts in relation to the subject matter of the dispute are called to decide upon.<sup>37</sup> Such broader input may ensure that the solution to the ‘interpretative choice’ is of greater accuracy and thus mitigating the concerns of the legislators.

Following from this, to be effective in determining choices between interpretations adjudicators need to appreciate limitations on their ability to determine both the intention of legislatures, and the consequences of their choice. This may stem from both a democratic deficit in judicial choice and the inability of adjudicators to have appropriate input from relevant policy making groups when making their determinations. Thus where an interpretative choice amounts to policy-formation that is conducted through a range of input mechanisms it

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<sup>36</sup> P. Hughes, ‘The Significance of Public Pressure on Judicial Independence’ in A. Dodek & L. Sossin, *Judicial Independence in Context* (Irwin Law) (2010) at p.259-260.

<sup>37</sup> Hon. Justice G.V. La Forest, ‘Who is listening to Whom? The Discourse between the Canadian Judiciary and Academics’ in B.S Markesinis Ed., *Law Making, Law Finding and Law Shaping* (OUP) (1997) at p.70-77

maybe that the judicial body is incapable of determining all relevant views that may be expressed by the specific legislation at hand,<sup>38</sup> or its implications.

*Problems and challenges of interpreting ambiguous law*

Generally law becomes ambiguous when it fails to render any viable meaning after applying the literal rule of interpretation to it.<sup>39</sup> At this juncture that adjudicators can dismiss this aspect of the dispute (or the whole of it where that is the sole aspect of the dispute) for having no basis with respect to the legislation that cannot be interpreted or seek to employ some method to render a useful meaning. From a purist perspective, where the constitutional function, or mandate, of the court is not to make law, they should dismiss the case at this juncture.<sup>40</sup> This is justified on the simplistic basis any interpretation they create is law-making and contrary to a constitutional orthodoxy of the separation of legislative and judicial functions.<sup>41</sup> This is simplistic view purports that there are no possible methods that adjudicators can employ to legitimise their acts with respect to the legislative process. Traditionally courts on many occasions have not done this. Instead they have sought to proffer some interpretation that they can justify with respect to their constitutional position as adjudicators, and not law-makers.<sup>42</sup> This is said to allow courts to offer dispute resolution in the presence of ambiguous legislation thereby fulfilling their judicial role, despite the fact that it has often met with criticisms of judicial politicking.<sup>43</sup>

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<sup>38</sup> See, P. Pettit, 'Collective Intentions' in N. Naffine, R. Owens & J. Williams, Eds., *Intention in Law and Philosophy* (2001) at p.241-249, cited in S. Corcoran, 'Theories of Statutory Interpretation' in S. Corcoran & S. Bottomley, *Interpreting Statutes* (Federation Press) (2005) at p. 17

<sup>39</sup> Also called the 'golden-rule' or 'first-rule' of interpretation in English law, See R. Cross, *Statutory Interpretation* 3<sup>rd</sup> (Ed.) (Butterworths) (1995) at p.5-32.

<sup>40</sup> E. Freund, 'Interpretation of Statutes' (1917) 65 U. Penn. Law. Rev. 207 at p.208-209; One of the classic proponents of this is the seminal constitutional theorist A.V. Dicey. See A.V. Dicey, *An Introduction to the Study of the law of the constitution* (Liberty) ; For a similar articulation, See: Holmes, 'The Theory of Legal Interpretation' (1899) 12 Harv. Law. Rev. 417 at p.418-419.

<sup>41</sup> E. Freund (n 36 above).

<sup>42</sup> W.N. Eskridge, J.r., 'Dynamic statutory interpretation' (1986-87) 135 U. Pa. L. Rev. 1479 at p.1479-1482

<sup>43</sup> N. Devins & L. Fisher, 'Judicial Exclusivity and Political Instability' (1998) 84 Va. L. Rev. 83 at p.84-86

The justifications adjudicators offer can essentially be divided into two camps, though adjudicators may offer both at any given time:<sup>44</sup> (a) The justification that the offered interpretation follows the *intention* of the legislator; and (b) The justification that the offered interpretation follows the *purpose* of the legislator.<sup>45</sup> Both of these justifications use the method of looking at legislative history of the legislation to determine what *intention* and *purpose* are, in order to render constitutional legitimacy to the interpretative process.<sup>46</sup> Generally, this method is used and preferred over broader canvassing of legislative inputs that adjudicators maybe unable to evidentially control, in terms of both efficacy of adjudication and most importantly in terms of reliability, relevant documentation. The credibility of both these justifications, however, does not just depend on the viability of the interpretation that is produced but also on whether such justifications are themselves acceptable. What follows below is a very brief discussion of the latter, the form of justification, and subsequently the former, the method of such justifications.

The primary concern of justifications of judicial action to determine *intention* and *purpose* is one of constitutional legitimacy. This concern is based around the notion that it is not permitted for adjudicators to determine either, and that this is solely a task for legislators. Whilst democratic legislators are empowered to go through the deliberative process of deciding what the goals of legislation should be and whether those goals are desired, courts are not. Though simplistic in its formulation, the significance of this obstacle to such adjudicatory action is not to be underestimated from the point of view that it gives rise to significant concerns

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<sup>44</sup> For distinction, See: B. Currie, 'The Distinterested Third State' 28 Law & Contemp. Prob. 754 at p.761-762; M. H. Redish & T.T. Chung, 'Democratic Theory and the Legislative Process: Mourning the death of originalism in statutory interpretation' (1993-94) 68 Tul. L. Rev. 803 at p.813-815.

<sup>45</sup> For example, determining purpose in interpreting tax-law: See, D.A. Geier, 'Interpreting tax legislation: The Role of purpose' (1995) 2(8) Flor. Tax. Rev. 492 at p.494-497.

<sup>46</sup> Curtis, p.422-p.424. For an example of erroneously eliding the two together, See Eskridge Jr. at p.1487

by legislators where judges are seen to indirectly be usurping their role through their aims of solving interpretative problems.

The methodological problems with justifications of *intention* and *purpose* are chiefly concerned with the accuracy of determining either.<sup>47</sup> Firstly, legislative history is often not a solid indicator of legislative intent or aims of legislators.<sup>48</sup> Informal discussions, which may be of greater relevance, may not be recorded or maybe confidential beyond adjudicatory disclosure. Whilst history of formal deliberations of legislative process, including committee meetings of politicians and civil-servants are useful in providing a context for determining both, such a context runs into evidential difficulties when broadened to the more difficult areas of public input.<sup>49</sup> Thus general public views canvassed by politicians, and other policy-making bodies may not be available in formal stages of legislative deliberation, and thus not subject to adjudicatory contextualisation during the determination of a particular interpretative pathway.<sup>50</sup> Alternatively, they may be justifiably precluded by the rules of evidence on the grounds of direct relevance and reliability, the former being difficult to determine in the case of informal discussions and broader public-policy input into legislation. This means that in realistic terms adjudicatory determinations maybe significantly limited in their ability to determine legislative intention and purpose through being confined to looking at legislative history, and this limitation will be significant where the bulk of relevant information for determining a valid interpretation is outside the formal documentation of legislative history. This cost of evidential control is related to the cost-effectiveness of litigation, unlimited browsing of legislative background

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<sup>47</sup> L. Brilmayer, 'Interest Analysis and the Myth of Legislative Intent' (1979-80) 78 Mich. L. Rev. 392 at p.392-393.

<sup>48</sup> N.S. Zeppos, 'Legislative history and the Interpretation of Statutes: Towards a fact-finding model of statutory interpretation' (1990) 76 Va. L. Rev. 1295 at p.1319-1320; R. I. Nunez, 'Nature of Legislative Intent and the use of legislative documents as extrinsic aids to statutory interpretation: A re-examination' (1972-1973) Calf. West. Law. Rev. 128 at p.128.

<sup>49</sup> These are partly to do determining 'relevance', a key criteria for admissibility (particularly in common law jurisdictions): E.g. I.H. Dennis, *The Law of Evidence* (Sweet & Maxwell) (2002) at p.50-67.

<sup>50</sup> R. I. Nunez (n48 above) at p.130-135.

may involve delving into significant policy detail that is beyond the time and institutional capacity, in terms of personnel, of adjudication.

The methodological problem of weighing up relevance of material that is of relevance in line with rules of evidence, may encourage retrospectively constructing relevance to fit a particular interpretation that an adjudicator wishes to push. Such risks of exposure of judicial preference are thus inherent judicial determination of legislative intentions and goals. There is also a fundamental and distinct concern with respect to determining *purpose* that does not exist with determining *intention*. This is that *purpose* is determined a posteriori, through extrapolation, and may involve a far greater degree of digression from formal evidence of legislative history than determining *intention*.<sup>51</sup> In simple terms, whilst intention is a construction of the legislature, purpose is very much a construction of the adjudicator. Without close methodological control beyond relevance of legislative history, determination of purpose may lead to a significant risk of adjudicatory usurpation of legislative function.

These risks associated with adjudicatory construction of ambiguous legislation continue to engender debates as to the merits and problems of giving adjudicators such a role. They have resulted in stricter tests for engaging in exercises of determination of legislative intention and purpose,<sup>52</sup> and often a re-affirmation of the benefits of reliability of the literal rule, despite problems of guaranteeing that legislators meanings can be reflected in literal interpretations,<sup>53</sup> coupled with the power to dismiss the dispute for lack of express legislative sanction.

### *Procedure and Adjudication*

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<sup>51</sup> Redish & Chung (n 44 above) at p.865-867.

<sup>52</sup> See Restriction of Pepper v. Hart test in English law: S. Vogenaeur, 'A retreat from Pepper v. Hart: A reply to Lord Steyn' (2005) 25(4) OJLS 629 at p.638-654; Redish & Chung at p.840-847.

<sup>53</sup> F. Jerome, 'Words and music: Some remarks on Statutory Interpretation' (1947) 47 Colum. L. Rev. 1259 at p.1260-61.

Effective adjudication requires effective procedure to ensure that parties can place all relevant material before adjudicators. For example, procedural delineations within adjudication, such as different process in dealing with facts and evidence in common-law criminal hearings are part of the overall machinery of effectively determining a dispute. The role of the jury is an important deviation from the judicial fact-finding function, based on the value of attaching common societal values to public participation in criminal and civil adjudicatory outcomes.<sup>54</sup> The existence of juries is based on there being merit for public value judgments to enter into dispute resolution in order to ensure that outcome is line with societal, including cultural views, of the larger public. This is theorised as making the exercise of power over the individual in adjudicatory outcome more acceptable from the perspective of the democratic value of public participation in the exercise of power.

Other adjudicatory tools include the principle of precedent, which are rules not enacted by public legislatures. It is an important tools for judges to solve particular types of despites and ensure there is a consistency in how similar disputes are solved. This is regarded as important from the point of view of acceptance of both the outcome of the adjudicatory process and the adjudicatory process itself. It is important both from the view that there is no partiality over particular disputants and that, as a consequence, adjudication is perceived to be fair. This latter aspect also has a social value of ensuring that there is no preference in outcome between similar adjudications, though brought by different parties.

Further, in precedent based adjudicatory systems the ability to rectify particular aspects of judicial law making is important to ensure coherence and clarity of rules in their creation and application.<sup>55</sup> Due to adjudicatory processes being non-specialist – law-making, detailed deliberation of law over similar disputes is said to

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<sup>54</sup>N. Vidmar, 'A historical and comparative perspective on the common law jury' in N. Vidmar Ed., *World Jury Systems* (OUP) (2000) at p.17-13.

<sup>55</sup> J.H. Merryman, *The Civil Law Tradition* (2<sup>nd</sup> Ed) (Stanford. Uni. Press) (1985) at p.27-32

allow judges to hone in the language and appropriateness of law created through adjudication.

In order to use precedent to clarify rules made in adjudicatory process, adjudicatory flexibility for interpreting prior decisions in English law is unlimited in higher courts. The existence of a hierarchy of adjudicatory law-making facilitates this. Thus higher courts are able to completely reject prior judicial-law making.<sup>56</sup> Although there may be some adjudicatory rule-making in interpretation, textually being clarified through appeal mechanisms in this way, that still cannot give effect the intentions of the legislators. In instances, complex economic ramifications of interpreting tax legislation form an example of this. By contrast some law-making that is better suited to an adjudicatory process than others, for example, the finer details of a rule of equity such as an estoppel. This is because the specifics of its form or content has no general public ramifications, including social and economic impact, and a democratic legislative procedure that involves general public consultation and debate through elected legislative chamber where there are no experts on chancery law is not likely to make the rule more effective.

## **B. Law-Making in the Public Sphere.**

In general terms, law-making is about providing order to human interactions in a diverse amount of fields.<sup>57</sup> How this is carried out depends on the society. To give a facile distinction to illustrate: the order to which a particular society is subject to is a matter for public approval in a democracy, or its rulers in an autocracy.<sup>58</sup> In a democracy, such order is subject to various forms of input, including individuals, groups and institutions, so as to ensure that it is not only effective, but it represents the views of citizens. In a democracy the power to enact laws is given

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<sup>56</sup> Z. Bankowski, D. N. MacCormick & G. Marshall, 'Precedent in the United Kingdom' in D. N. MacCormick & R. S. Summers, *Interpreting Precedents* (Ashgate) (1997) at p.342-343.

<sup>57</sup> R.D. Cooter, 'Structural Adjudication and the New law Merchant: A model of decentralised law' (1994) 14 Int. Rev. Law. Econ. 215 at p.220.

<sup>58</sup> C.D. Breitel, 'The law makers' (1965) 65 Colum. L. Rev. 749 at p.755



to one or more political parties who represent a particular field of views on key matters of public interest. Their empowerment is a result of a competitive electoral discourse that involves successful persuasion, using political marketing, of public opinion. As a result, political parties have become considerably adept at engaging public opinion, professionals and policy institutions in developing policy.

In a democracy the elected government may further engage a range of public policy institutions and other bodies in formulating appropriate policies on a range of public life before formal enactment through the legislative process occurs.<sup>59</sup> This has become increasingly so in the United Kingdom and the United States where government has had an increasing role in the public sphere over the twentieth century (the role of the state in the life of the individual) in contrast to nineteenth century liberal laissez-faire governance. The latter, by contrast, is a model of less intervention of the state in private affairs of individuals and economic agents.

By contrast, as discussed above, adjudicatory law-making does not have such an input by institutional design or public consent. This may be of concern whether adjudicatory law-making is done in the public sphere. This is where judge made rules have a broader impact than parties to the adjudication and affect a range of human agency beyond parties to the particular dispute. In simple terms, parties to a dispute do not generally carry public opinion or interest effectively enough to enable judges to make general law.

In the classic constitutional paradigm of states, the primacy of law making is left to legislators. However, legislators are not the only law-making agents.<sup>60</sup> Private law making, however, is only done at a micro-level, of limited general scope due to the monopoly of legislatures, and its inability to make general social order

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<sup>59</sup> E.g., In the Environmental field, G.T. McDonald & L. Brown, 'Going beyond environmental impact assessment: Environment input to planning and design' (1995) 15(6) *Env. Imp. A. Rev.* 483 at p.493-494.

<sup>60</sup> J.L. Louis, 'Law-making by private groups' (1937-38) 51 *Harv. Law. Rev.* 201 at p. 201-202.

without adequate input.<sup>61</sup> A classic example of private law-making is that of contractual agreements between private agents.

Further, the distinction between adjudication and law-making is one based on utility of separating institutional function. Separation of capacity to make rules corroborated the ability of courts and leg by legislatures to act as organs of institutional accountability upon each other is said to prevent the abuse of power.<sup>62</sup> An effective law-making institution may need a monopoly of law-making power.<sup>63</sup>

Finally it should be borne in mind that in some democratic common-law jurisdictions law-making is done by executive decree thus subject to no democratic control.<sup>64</sup> This is justified on an the exceptional basis that utility of government and state function has often to be placed above democratic mandate, such as in times of war. This concept of the necessity of expediency is also noted by the right to expropriate enshrined in the Hull formula for expropriation, a standard now embedded in the bulk of bilateral investment treaties.<sup>65</sup>

### **1.3 Fair and Equitable Treatment Overview.**

#### **A. Investment Arbitration as a system of adjudication.**

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<sup>61</sup> R.D. Cooter (n 57) at p.215-217. A classic example of limiting laissez-faire activity of corporations is through environmental regulation: See, G. Donnel, S. Hart, & B. Yeung, 'Do corporate global environmental standards create or destroy market value?' (2000) 46(8) Manag. Sc. 1059 at p.1059-1063.

<sup>62</sup> T. Persson, G. Roland & G. Tabellini, 'Separation of powers and political accountability' (1997) 112(4) Qt. Jnl. Econ. 1163 at p.1163-1170.

<sup>63</sup> Glennon at p.758.

<sup>64</sup> In the U.S. efficiency of government function in the form of a Presidential decree can be placed above constitutional values, See: M. J. Glennon, 'Two views of Presidential foreign affairs power: Little v. Barreme or Curtiss-Wright?' (1988) 13 Yale J. Int'l L. 5 at p.11-13.

<sup>65</sup> A.F. Lowenfeld, *International Economic Law* (OUP) (2003) at p.476.

*Basic History and Adjudication.*

Prior to the existence of arbitration for investment disputes for complaints against foreign states, investors usually had to lobby their embassies to attempt to alleviate adverse action by the host-state's government.<sup>66</sup> This was only marginally successful, and not a solid basis of investor protection, as the success of this process very much depended upon the relationship between the two states and the cost to that relationship that lobbying on behalf of one's investor would have. Hence the diplomatic system offered a form of investor protection that was wholly political in nature. It was hoped that with the creation of the World Bank's Investment dispute resolution mechanism (ICSID) that such political investment protection would be put on to a neutral legal dispute resolution footing through arbitration. The added advantage of this system was that it would aid the flow of capital due to the availability of a neutral protection forum, and thus assist in the promotion of capital to developing areas of the world which were high political risk zones for commercial activity.

Further investment treaty arbitration, like general international commercial arbitration, has become popular partly due to perceived bias, and other shortcomings of national courts in the developing world,<sup>67</sup> and the availability of a common, universal and understandable procedure that it offers.<sup>68</sup> As to the former, it was seen that in the developing world, whereas resources, cheap-labour and other opportunities away from competitors were in abundance for foreign investors, an inadequate justice system would preclude the appropriate resolution of important commercial disputes. Concerns regarding justice in the developing world included procedural and substantive delays, uncertainties in outcome where contract law was inadequate, expense and publication of outcome.<sup>69</sup> Bilateral

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<sup>66</sup> C. F. Amerasinghe, *Diplomatic Protection* (OUP) (2008) at p.8-20

<sup>67</sup> Under old colonial regimes native justice was not to be trusted at all, and foreign courts were substituted for national ones to deal with disputes relating to foreigners, See W.E. Grigsby, 'The Mixed Court of Egypt' (1896) 12 L.Q. Rev. 252 at p.252-255

<sup>68</sup> Typically investment treaty arbitration disputes occur under UNCITRAL, ICSID and other common arbitral procedural rules. See, Redfearn and Hunter, (n1 above).

<sup>69</sup> H.P. De Vries, 'International Commercial Arbitration: A substitute for national courts' (1982-83) Tul. L. Rev. 42 at p.43

Investment treaties thus included provisions for dispute resolution through international arbitration.<sup>70</sup> This was also seen as a bonus due to the usage of the usual channel of diplomatic protection for foreign investment causing political embarrassment and risking foreign relations for the state of the foreigner.<sup>71</sup>

From these origins the system of investment treaty arbitration became truly transnational following the proliferation of bilateral investment treaties with provisions for arbitration since the end of the cold war. These offered arbitration as a method of dispute resolution that is possible in a number of locations supported by enforcement of decisions in numerous jurisdictions due the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 ('New York Convention' hereinafter).<sup>72</sup> Further as over 130 states have at least one investment treaty, the continuously forming jurisprudence has a universal transnational application.<sup>73</sup> This, explained further below, is a result of tribunals determining the meaning of very similarly drafted bilateral investment treaties and fundamental provisions that repeat in other investment protection agreements.<sup>74</sup>

On one argument, the rise of investment treaty arbitration is also, particularly, attributable to the need of former colonial powers, and other developed states, to access resources in places where traditional overseas commercial activity took

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<sup>70</sup> Redfearn & Hunter (n1 above). at p.483; S. Greenberg, C.Kee, J.R. Weeramantry, *International Commercial Arbitration* (Cam. U. P) (2011) at p.9-10.

<sup>71</sup> K.J. Vandevelde, 'The BIT program: A Fifteen-Year Appraisal in the Development and Expansion of Bilateral Investment Treaties' (1992) 86 Am. Soc. Int'l Proc. 532 at p.534-535.

<sup>72</sup> See Redfearn & Hunter (n1) at p.523.

<sup>73</sup> UNCTAD, *Bilateral Investment Treaties 1959-2000* UNCTAD/ITE/IIA/2 (UN) (2000) at p.13-20. In the same survey only 11 out of 1,857 bilateral investment treaties (0.59 %) were between developed states at p.10. For a further discussion of proliferation see, Z. Elkins, A. T. Guzman & B.A. Simmons, 'Competing for capital: The Diffusion of Bilateral Investment Treaties, 1960-2000' (2006) 60 Int. Org. 811 at p.814-819.

<sup>74</sup> T.H. Cheng, 'Precedent and Control in Investment Treaty Arbitration' (2007) 30 Ford. Int'l. Jnl. at p. ; S.D. Franck, 'The Nature (2005) 12 U.C. Davis Jnl of Int L. & Pol. 47,

place and as a part of a capital-export strategy in foreign policy both during and following the cold-war.<sup>75</sup>

*Operating Parameters and Procedural Concerns.*

The tribunals operating under ITA are controllable by virtue of the rules of public international law. However, as shall be briefly illustrated here these give a lot of lee-way to arbitrators to determine the parameters of the applicable law and scope of jurisdiction. Further, the only remedy available to states party to an investment treaty is to disengage from treaty obligations with very little ability to influence the scope of the dispute and penalise adjudicators who step beyond acceptable boundaries for the dispute in relation to state acts. This potentially leaves the scope of the dispute unacceptable to states, by the significant discretion given to the arbitrator to define this. Whether this has been done appropriately in relation to FET is one of the key issues discussed later in this thesis.

The functioning controls on tribunals operating under ITA are subject to the rules of treaty interpretation, and any choice of law provisions, which may provide for applicable rules of public international law in determining the dispute, or law of the host-state including its foreign investment law. However, it is predominantly the use of investment treaty arbitration as a source of public international law that is of particular concern here.

This arises due to two reasons: (a) investment treaty disputes being subject to applicable rules of public international law; (b) investment treaty decisions themselves being a valid source of international law.<sup>76</sup> Thus subject to appropriate jurisprudential constructs, arbitrators do have the opportunity to make a coherent

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<sup>75</sup> M. Sornarajah, *The International Law on Foreign Investment* (Cam. Uni. Press) (1996) at p.8-14;

<sup>76</sup> This is particularly so in ICSID proceedings, where Article 42(1) of ICSID states: '*Tribunals may shall decide a dispute in accordance with such rules of law as may be agreed by parties...and such rules of international law as may be applicable*'. In C. H. Schreuer, *The ICSID Convention: A Commentary* (Cam. U. P) (2001) at p.549 & p.542-563. This latter aspect of this provision allows arbitrators and parties to a dispute to proffer preferable arbitral decisions.

body of law using open-textured standards such as FET. This opportunity is supported by the arbitrators having a lot of lee-way in the jurisdiction phase of the dispute under ICSID rules, and no constraints under other rules such as UNCITRAL, to determine the scope of the dispute.

Another factor giving considerable discretion to arbitrators to determine the scope of disputes is that of the rules of interpreting treaties. The key provisions of Articles 31 and 32 of the Vienna Convention on the Law of Treaties 1969 state:<sup>77</sup>

*Article 31(1): 'A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose'.*

*Article 32: 'Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31: (a) leaves the meaning ambiguous or obscure; or (b) leads to a result which is manifestly absurd or unreasonable'.*

The supplementary means are only engaged if upon applying Article 31 one is left with an ambiguity.<sup>78</sup> These provisions allow arbitrators to determine what intentions and purposes of the treaties are in order to interpret the FET standard.<sup>79</sup> This grants arbitrators considerable scope in defining the standard and the breadth of protection to be afforded to the investor under it. Further to this decisions of tribunals under FET can be used, arbitrators, investors and states to decipher the FET clause. This is due to the ICSID convention<sup>80</sup>, and also the

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<sup>77</sup> Article 31 of the Vienna Convention on the Law of Treaties 1969, UN Treaties Series vol. 1115 at p.331; Discussed fully in: I.M. Sinclair, *The Vienna Convention on the Law of Treaties* 2<sup>nd</sup> Ed (Mellaland Schill) (1984) at p.114-159

<sup>78</sup> Sinclair (n76 above); S.L. Sboki, 'Supplementary means of interpretation' in E. Cannizzaro Ed., *The Law of Treaties beyond the Vienna Convention* (OUP) (2011) at p.147.

<sup>79</sup> This problem was noted by McDougal at the time of negotiating the law of treaties, See E. Criddle, 'The Vienna Convention on the Law of Treaties in U.S. Treaty Interpretation' (2003-04) 44 Va. J. Int'l L. 431 at p.441

<sup>80</sup> (see n 75). N.B. Decisions of other forums would be included as decisions here.

method of using international decisions as a supplementary source of international law.<sup>81</sup>

*Operating Parameters and Substantive Concerns.*

Investment treaty arbitration is not subject to constitutional constraints of domestic courts. This would not normally be of concern if the system is similar in processing claims as the International Court of Justice, where states can determine the exact parameters of each dispute.<sup>82</sup> However, as illustrated above this is not the case. As a result of ITA allowing individual claims against the state, it is possible for investors to make a range of complaints under FET about states, including feasibly about the content, or repeal of, primary legislation and domestic constitutional arrangements, and for arbitrators to accept this as within the jurisdictional scope of the dispute. To give a contrasting illustration: English courts did not traditionally have powers of judicial review of administrative action, nor do they at present embark upon ruling primary legislation unfair, even with respect to unwritten constitutional values.<sup>83</sup>

Thus it will be interesting to note by which acts of the defendant state the ambiguous and open-texture of the FET standard is engaged with by arbitrators, and whether it is used to ride rough shod over likely domestic constitutional arrangements by reviewing not just acts of public administrations, but also legislative acts as well. The latter would give them greater powers than courts in jurisdictions with confined constitutional roles for courts such as the U.K.

Further if the latter has been the case, how arbitrators have justified decision-making in the latter, considering that adjudicators have institutional limitations in

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<sup>81</sup> Article 38(1) d of the Statute of the International Court of Justice at <http://www.icj-cij.org>

<sup>82</sup> S. Rosenne, *The Law and Practice of the International Court 1920-2005 Vol II*, 4<sup>th</sup> Ed. (Martinus Nijhoff) (2005) at p.506-507.

<sup>83</sup> J. Limbach, 'The Law-Making Power of the Legislature and the Judicial Review' in B.S Markesinis Ed., *Law Making, Law Finding and Law Shaping* (OUP) (1997) at p.157-159.

determining legislative matters that are in the public sphere.<sup>84</sup> Some commentators have presumed that it is a system of adjudication that is centred on general commercial arbitration, thus private in nature.<sup>85</sup> As shall be seen arbitrators have been offered the opportunity through the types of claim to extend FET to determine matters within the public sphere such as tax, water, gas supply, immigration, media regulation, import licences. Whether they have done so appropriately will determine whether further state control is justified.

## **B. Origins and the Nature of FET.**

The fair and equitable treatment standard first appeared in the Draft Agreement for the International Trade Organisation.<sup>86</sup> It also appears in Freedom, Commerce and Navigation Treaties of the United States in the 1950s.<sup>87</sup> Subsequent appearances include within a proposal for a draft the agreement for investment protection in 1957 by Abs and Shawcross.<sup>88</sup> It is also placed in a model agreement of investment protection proposed by the OECD in 1967.<sup>89</sup> Since then BITs have significantly proliferated, particularly after the end of the Cold War, so that several

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<sup>84</sup> Van Harten highlights this in his work. See, G Van Harten, *Investment Treaty Arbitration and Public Law* (OUP) (2007) at p.143-149; M. Loughlin & G. Van Harten, 'Investment Treaty Arbitration as a species of global administrative law' (2006) 17(1) EJIL 121 at p.131-133.

<sup>85</sup> Douglas in his description of the misses the potential of the system engaging in disputes of a public nature: Z. Douglas, 'The Hybrid Foundations of Investment Treaty Arbitration' (2003) 74 Brit. Y.B. Int'l L. 151 at p.151-160. This is not to say there is not a significant contractual element to investment treaty arbitration: See, J. Crawford, 'Treaty and Contract in Investment Arbitration' (2008) 24(3) Arb. Int'l. 351 at p.360-366.

<sup>86</sup> In Article II(2) of the Havana Charter 1948. See, International Trade Organisation, *The Havana Charter* (1948) at p.2-7.

<sup>87</sup> R.R. Wilson, *United States Commercial Treaties and International Law* (New Orleans: Hauser Press) (1960) at p. 118-122.

<sup>88</sup> See, Article 1 of the Abs-Shawcross Draft as discussed in G. Schwarzenberger, 'The Abs-Shawcross Draft Convention on Investments Abroad: A Critical Commentary' (1960) 9 J. Pub. L. 147 at p.147-158.

<sup>89</sup> OECD, *Draft Convention on the Protection of Foreign Property* (1967)



thousand treaties may now incorporate the standard.<sup>90</sup> The FET provision has a high frequency of appearance in BITs due to the manner in which developing countries, by mirroring behaviour of other developing states for fear of being excluded from investment benefits, sign up to model BITs that include the standard.<sup>91</sup>

There is a matter of debate as to whether the FET standard is no more than a treaty provision that reflects the minimum standard in international law. This approach, of the minimum standard, refers to the standard of treatment of foreign nationals in customary international law that states could not fall foul of. This is elucidated in the *Neer* decision of the Mexican –United States Claims Tribunal:

*“that 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 recognise its insufficiency. Whether the insufficiency proceeds from deficient execution of an intelligent law or from the fact that the laws of country do not empower the authorities to measure up to international standards is immaterial”.*<sup>92</sup>

Note that this elucidation does leave it open for tribunals to determine acts of state organs that are contrary to it, though it sets a very high threshold for a breach. Thus it is not easy for a claimant to satisfy.

FET, by contrast, gives no indication of what the threshold for a breach is and this is left to arbitrators. This can be seen from the following example of a typical FET clause is this one, taken from the 2008 German Model BIT:

‘Article 2 [Admission and Protection of Investments] subsection 2:

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<sup>90</sup> Of Tudor’s sample of 365 BITs only 19 did not have FET thus 0.05%, See I. Tudor, (n 3 above). at p.23. By extrapolation, considering there are at least 3,000 bilateral investment treaties currently in force (See, ) over 2,844 (99.5%) will have the standard.

<sup>91</sup> See, A.T. Guzman ; K. Vandevelde, ‘The political economy of a bilateral investment treaty’ (1998) 92 AJIL 621 at p.626 -629;

<sup>92</sup> *LF. Neer and Pauline Neer v. Mexico (US v. Mexico) (1926) 4 RIAA 60 at p.61-62*

*Each Contracting State shall in its territory in every case accord investments by investors of the other Contracting State fair and equitable treatment as well as full protection under this Treaty*.<sup>93</sup>

The critical thing to note here is that the standard is ‘open-textured’. The language ‘fair and equitable treatment’ does not give any indication as what ‘fair and equitable treatment’ is. It leaves it to arbitrators deciding disputes between investors and states to decide what this is. Depending on what states want from a system of investment arbitration, this can leave too much to arbitrators to decide the level of protection afforded to foreign investors, which may come at a cost to the state.

Partly due to this ‘open-texture’ not being amenable to definition, some commentators have assumed that the fair and equitable treatment standard is not amenable to definition or content. Thus one commentator states:

*‘The standard of fair and equitable treatment is relatively imprecise. Its meaning will often depend on the specific circumstances of the case at issue’*.<sup>94</sup>

This is also the view taken by one leading judge in international law:

*‘the meaning of what fair and equitable treatment is defined when that standard is applied to a specific set of facts’*.<sup>95</sup> .

Another judge states: *‘At the same time, this lack of precision [in the meaning of fair and equitable treatment] may be a virtue rather than a shortcoming. In actual practice, it is*

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<sup>93</sup> At UNCTAD database found at <http://ita.uvic.ca>

<sup>94</sup> G. Sacredoti, ‘Bilateral Treaties and Multilateral Instruments on Investment Protection’ (1997) 269 *Recueil des Cours* 251, at p.346 Cited in C. Schreuer ‘Fair and Equitable Treatment in Arbitral Practice’ (2005) *JWIT* 357 at 364.

<sup>95</sup> Opinion of Judge Schwebel in *MTD Equity v. Chile Award* (25 May 2004) ICSID ARB/01/07 at para 109.

*impossible to anticipate in the abstract the range of possible types of infringements upon the investor's legal position*<sup>96</sup>.

These views are entirely arguable due to the 'open-texture' of the standard.

This approach is taken in dispute resolution without any regard to the investment treaties, which generally do not state this. This approach for Professor Scheurer incorporates useful flexibility, over a constructive approach that defines the FET standard to contain certain elements.<sup>97</sup> The opportunity afforded by the latter approach is to increase legal certainty for both the investor and the state by giving a rough criteria as to what FET constitutes. Such a non-proscriptive approach has been argued by tribunals:

*'fair and equitable treatment should be understood to be treatment in an even-handed and just manner, conducive to fostering the promotion of foreign investment. Its terms are framed as a proactive statement – "to promote", "to create", "to stimulate"-rather than prescriptions for a passive behaviour of the State or avoidance of prejudicial conduct to the investors'*.<sup>98</sup>

A third approach, one not entirely precluded due to the 'open-texture' of the standard, is to create rules or yardsticks that the state has to comply with, and following a failure to do so will lead to a breach of the standard. The nature of current interpretations, summarised below and seen in detail later in the thesis, shows that the third approach has found significant ground in the interpretation of FET.<sup>99</sup> It is that approach that shall be the key focus in this work.

### **C. FET Standards as Rules:**

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<sup>96</sup> C. Schreuer 'Fair and Equitable Treatment in Arbitral Practice' (2005) JWIT 357 at 365.

<sup>97</sup> C. Scheurer (n95 above).

<sup>98</sup> MTD Equity (n 94 above) at para 113.

<sup>99</sup> See Tudor (n3 above) at p.154-180

A summary of standards formulated through interpretations of FET is given below. This is preceded by a brief discussion of what rules or law are as opposed to value judgments, to explain why FET standards are rules not the latter.

#### *Attributes of a law.*

A brief and elementary description of what a law is shall be described below in order to support the argument that interpretations under the FET standard are law, not value statements. This determination, outlined below, is based on basic legal positivism.

There is a distinction between a law and a moral, or value judgment. As Hart summarises, discussing Austin and Bentham's legal positivism: '*What both Bentham and Austin were anxious to assert were the following two simple things: First, in the absence of an express constitutional or legal provision, it could not follow from a mere fact that a rule violated standards of morality that it was not a rule of law; and, conversely it could not follow from the mere fact that a rule was morally desirable it was a rule of law*'.<sup>100</sup>

The critical question is how to determine the difference between a law and moral or value. This distinction is provided by a classic example of the positivists view is given by Austin, who describes law as '*a command backed up as a sanction*'.<sup>101</sup> There are two key elements of the nature of law here. The first is that a law, as opposed to a value judgment or moral, is a 'command' in the sense that not only does it have an intended subject (which value-judgments also do), but it also wishes to alter or define the agency of that subject in some way, including prohibiting it from doing certain things.<sup>102</sup> The second attribute of Austin's notion of law is that this must be supported by some recourse for disobedience.<sup>103</sup> A value-judgment is never, by contrast,

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<sup>100</sup> H.L. A. Hart, 'Positivism and the Separation of Law and Morals' (1957) 71 Harv L. Rev. 593 at p.599. For general criticism of Hart's positivism, See: N. Lacey, *A life of H.L. A. Hart, the Nightmare and the Noble Dream* (OUP) (2004) at p.229-234. For a contrasting view that the focus of defining law should be factors of obedience, See: L.L. Fuller, 'Positivism and Fidelity to Law- A reply to Professor Hart' (1957) 71 Harv. L. Rev 630 at p.633-635. Also linking law to human agency to define it- See L.L. Fuller, 'Human Purpose and Natural Law' (1953) 53 J. Philos. 697 at p.697-700. However these are attributive descriptions rather than comprehensive definitions of law.

<sup>101</sup> J. Austin, *The Province of Jurisprudence Determined and The Uses of the Study of Jurisprudence* (Hackett) (1998) at p.9-32.

<sup>102</sup> H.L.A. Hart, *Concept of Law* 2<sup>nd</sup> Ed. (OUP) (1997) at p.19-25.

<sup>103</sup> A classic example being the award of damages following the resolution of private disputes, or criminal imprisonment. E.g. punitive damages as a sanction in private law, See: G.T. Schwartz, 'Deterrence and Punishment in the Common law of punitive damages: A Comment' (1982) 56 St. Cal. L. Rev. 133 at p.133-134. For criminal sentencing,

intended to be sanctioned if it is not followed: it is merely an aspiration of how agency of certain subjects ought to be carried out.

Thus, by contrast, a value-judgment does not and cannot change agency of its subject. As stated, a basic level a formal law is something that prohibits certain conduct or delineates the appropriate boundaries of appropriate conduct.<sup>104</sup> The discussion here shall be left at the basic distinction, as outlined above, and not enlarged into a discussion of ideal attributes of law. For example, a further attribute of a law is that it has to be understood as such by its subject.<sup>105</sup> However, this may be arguably an ideal attribute for a law, rather than something that goes to the heart of whether an intended statement is a rule or not.

Overall, laws have the following characteristics: (i) The desire to change human or institutional agency; (ii) The ability to bring about that change; (iii) The ability to sanction breaches of the law.

#### *FET interpretations*

The relevance of FET in investment treaty arbitration in terms of outlining its legal structure began with the case of *Metalclad* when it became clear that the tribunal was not reflecting minimum standard, or giving a generic synopsis on what the standard would involve, but was rather setting down criteria for the conduct of government organs when dealing with investors.<sup>106</sup> Below is a short synopsis of current standards under FET that states have to comply with:

#### (i) Ensuring all legal requirements for the operation of the investment are accessible to the investor.

In *Metalclad* the requirement of ‘transparency’ was said to include a requirement for making accessible to the investor ‘*all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made, under the Agreement*’.<sup>107</sup>

The requirement of transparency here making sure firstly that the rules are in the public domain so accessible by the investor and that they are clearly drafted. A

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<sup>104</sup> E.g., Using law to limit the boundaries of government action: See, J. Nedelsky, ‘Law, boundaries, and the bounded self’ (1990) 30 *Representations*. 162 at p.162-163.

<sup>105</sup> See L.L. Fuller (cited n.92 *supra*).

<sup>106</sup> *Metalclad Corporation v. United Mexican States* Case No. ARB(AF)/97/1 at para. 99-101.

<sup>107</sup> *Metalclad* (n 105 above) at para 76.

secondary burden on the state would be to comply with requests by the investor for information relating to relevant laws to the investment to the state.

(ii) Ensuring that administrative requirements placed at the start of the investment project are not made more onerous during its operation without prior consultation with the investor and without giving a justification for such a change.

In *Metalclad* the investor obtained permits to run its waste treatment business. Near the completion of the preparation of the business the investor ran into difficulties with State administration. Further, on completion the State encouraged an application for new permits to run the investment, which were not stated to be compulsory. The application was rejected without any hearing or explanation. Thus the tribunal in *Metalclad* stated that: *'The absence of a clear rule as to the requirement or not of a municipal construction permit, as well as the absence of any established practice or procedure of handling applications for a municipal construction permit, amounts to a failure on the part of Mexico to ensure the transparency required by NAFTA'*.<sup>108</sup> The cases of *Wastemanagement* and *Tecmed* also demonstrate this principle. This strand of liability will go towards establishing a burden on the state to ensure that local administration is consistent with respect to the administrative requirements imposed on the investor.

(iii) Revocation of investment permit without justification or arbitrarily and without consultation.

The requirement can be found in municipal administrative law rules of prior consultation<sup>109</sup>. Many investments need local permits in order to satisfy local law in order to function legally in the host-state. The decision of *Incesya* makes it clear that investments that do not satisfy local law or law of the host-state do not enjoy

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<sup>108</sup> *Metalclad* (n98 above) at para 88.

<sup>109</sup> For example, in the English case of *R v. Liverpool Corporation, ex parte Liverpool Taxi Fleet Operators' Association* [1972] 2 QB 299 where it was held that a decision by a government body on how many cab licences to grant per annum could not be done without prior consultation of those cab-drivers likely to be affected by the decision.

the series of rights available under an investment treaty<sup>110</sup>. Thus the investor would be wary of non-compliance. However once local law is satisfied, a change of the law without prior consultation of the investor or done arbitrarily will breach the standard. In *Tecmed* an investment was made in lands and buildings through an auction for a landfill operation. The investor was given a licence for an indefinite period. There was then a revocation of the licence and the investor sued as a result of the loss. The tribunal stated that the host-state was bound to protect the expectations of the investor through its treaty obligations by virtue of the good-faith principle in international law.<sup>111</sup> In *Tecmed* the investor had an expectation that the licence would run indefinitely.

(iv) Freedom from discriminatory conduct by the State or State bodies.

This is an obligation for the State to treat all individuals equally.<sup>112</sup> This obligation under the fair and equitable treatment standard prescribes greater protection than the non-discrimination provision in investment treaties. This is because discrimination under the fair and equitable treatment standard is not fixed by the test of ‘*in like circumstances*’ as is the case with the provision of non-discrimination<sup>113</sup>. This is because the fair and equitable treatment standard is a

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<sup>110</sup> *Inceysa Vallisoletana S.L. v. Republic of El Salvador* ICSID Case No. ARB/03/26 (02/08/06) (Jurisdiction), which denied the investor jurisdiction because it had failed to comply with local laws. Note also *Fraport AG Frankfurt Airport Services Worldwide v. Philippines*, ICSID Case No. ARB/03/25 (16/08/07) (Jurisdiction) on this point.

<sup>111</sup> *Técnicas Medioambientales Tecmed, S.A. v. United Mexican States* ICSID Case No. ARB(AF)/00/2 (29 May 03) (“*Tecmed*” hereinafter) at para: 154. Good faith in treaty law has been described as ‘*the duty of giving effect to the expressed intention of the parties, that is, their intention as expressed in the words used by them in the light of surrounding circumstances*’ in McNair *The Law of Treaties* (Cambridge University Press) (1965) at p. 365. Thus a good faith reading of an investment treaty would be that which ‘*protects and promotes*’ investments as the ‘*basic value*’ of an investment treaty. This is stated in preambles to most treaties: R. Dolzer and M. Stevens, *Bilateral Investment Treaties* (Kluwer Law) (1995) at p.8-22.

<sup>112</sup> Claims in equal treatment to third state nationals ‘in like circumstances’ can also be claimed through a Most-Favoured-Nation (‘MFN’) clause. (See, *Maffezini v. Spain* ICSID ARB 97/9 (20/01/00)(Jurisdiction)).

<sup>113</sup> For in like circumstances see analysis in Feldman, where there the supposed domestic beneficiaries of tax advantages are said to be ‘in like circumstances’ with the investor. The test of ‘in like circumstances’ here is predicated on similarity of business type, namely cigarette export. Perhaps a rationale for keeping non-discrimination protection limited to similar business as domestic legislative framework is likely to be similar and

non-contingent standard. This means that a comparator of how the state treats another national is not needed to assess a finding of discrimination under the standard. Thus, for example, the tribunal in *CMS*, elucidating the notions in *Tecmed* and *Metalclad* made a point about how other industries as compared to the investment were treated differently through the economic crisis in Argentina in 2000 and 2002. With respect to the difference in treatment: ‘*The longer the differentiation is kept the more evident the issue becomes, thus eventually again reinforcing the related finding about the breach of fair and equitable treatment*’.<sup>114</sup>

In *Pope and Talbot*, there was a breach of fair and equitable treatment by virtue of a breach of non-discrimination. A closer look at the facts illustrates that the investor, a lumber exporter, was not ‘*in like circumstances*’ to those businesses it claimed were receiving more favourable treatment, as Canadian businesses did not export lumber. Further the acts of the State complained of were wholly related to prescriptions put in place to maintain an inter-state quota on imports and exports. If *Pope and Talbot* and *CMS* were followed non-discrimination under the fair and equitable treatment standard is clearly a broader notion than direct discrimination enshrined in the national treatment rule. This is because there is no requirement that there be domestic industry comparators which were receiving favourable treatment. In fact without the ‘*in like circumstances*’ limitation to a discrimination claim there is nothing to prevent an investor simply to look at the best business treatment and claiming such treatment. The investor could claim that this is the most ‘*equitable*’ approach in dealing with differences in treatment. As an example, such a claim may be based on a greater administrative efficiency in dealing with permits for other businesses. The burden would thus shift on the state to demonstrate that those differences in nature would justify different treatment. The approached in *Pope and Talbot* and *CMS* would thus place a positive obligation on states to ensure that investors receive the best treatment available in the domestic

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thus disparities of treatment will be fairly attributable. : *Feldman v. Mexico*, ICSID Case No. ARB(AF)/99/1 (NAFTA). (16/12/02) at paras 170-173,

<sup>114</sup> *CMS Gas Transmission Company v. The Argentine Republic*, ICSID Case No. ARB/01/8 (US/Argentina BIT). at para 294.



market<sup>115</sup>. As a limit to the non-discrimination principle, it is clear from the case of *ADF v. US* that pre-existing domestic law, if it forms the basis on which an investor contracts with a State, cannot itself breach fair and equitable treatment despite the fact that it is on its face discriminatory<sup>116</sup>.

(v) Freedom from ‘unexpected and unwarranted conduct’ by the host-state

The case of *Wastemanagement No2* protects the investor against ‘arbitrary’ conduct by the state.<sup>117</sup> Arbitrary conduct is against the general principle of fairness in public law as the investor is not permitted to participate in state-decision making nor is given prior warning of it. Permitting arbitrary conduct leaves the investor at risk of unexpected interference by the host-state making it difficult to calculate and project, amongst other things: business strategy, profit gain and expenditure. It would also permit the state to operate above the rule of law towards the investor causing an imbalance in decision-making power that is likely to put the investor off due to the risk of whimsical action at the behest of the state. This is a form of investment risk that investment treaties seek to remove through ‘*promoting and protecting*’ investments.

In *Metalclad* the tribunal applied the reasoning in *Tecmed* that stated that arbitrary decision making would lead to a breach of fair and equitable treatment. In *Tecmed* a change in the pre-agreed criterion for the functioning of the investment without warning and with no consultation lead to a finding of arbitrary conduct. Thus the tribunal in *Tecmed* stated: ‘*The foreign investor also expects the host State to act consistently, i.e. without arbitrarily revoking any pre-existing decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities*’. However the phrase ‘arbitrary’ is broad and does

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<sup>115</sup> In fact the strands of liability proposed in this chapter, due to the non-contingent nature of fair and equitable treatment, would give the investor greater protection than non-nationals where the legal system of the state is not as protective as the threshold purported in these strands.

<sup>116</sup> As reasoned in *ADF Group Inc. v. United States*, ICSID Case No. ARB (AF)/00/1 (NAFTA) at para 157.

<sup>117</sup> See, *Waste Management, Inc. v. United Mexican States (Number 2)*, ICSID Case No. ARB(AF)/00/3 (NAFTA) at para 98.

not intimate what arbitrary conduct is. Elucidating from these two cases, a more specific definition for this conduct would be ‘*conduct which interferes with the investment which is unexpected and unwarranted*’<sup>118</sup>. As to the threshold for a breach of this obligation the tribunal in *Wastemanagement* said conduct would be arbitrary if it followed domestic law and was still found to: ‘*shock, or at least surprise, a sense of judicial propriety*’<sup>119</sup>.

The case of *Champion trading v. Egypt*<sup>120</sup> illustrates that awareness of the obligation that the host-state imposed would defeat a claim for arbitrary conduct by the host-state. Here all the government measures were available in public and the prices were there for the investors to see.<sup>121</sup> In *PSEG v. Turkey* the state arbitrarily changed the law that governed the contract, in order to lessen the protection afforded to the investor. Arbitrariness here was as a result of the Government’s disregard of the Turkish Constitutional Court’s decision in safeguarding the Claimant’s rights in the form of a Concession as opposed to contracts governed by the private law of Turkey. The Government did a volte-face following the decision of the Court and insisted that the investment contract should be governed by the private law of Turkey.<sup>122</sup> It would be ‘unexpected’ for a legally binding court decision to be annulled by the host-state thus such conduct would breach this strand of the fair and equitable treatment standard.

(vi) That the State must entrench regulations that affect the investment and cannot alter them.

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<sup>118</sup> Thus in *Pope and Talbot* (cited supra) the tribunal stated that arbitrary audit of the investor by the State coupled with threats revoking the operating rights of the investment would constitute a violation of the fair and equitable treatment provision.

<sup>119</sup> At para 98.

<sup>120</sup> *Champion Trading Company, Ameritrade International, Inc., James T. Wabba, John B. Wabba, Timothy T. Wabba v. Egypt* ICSID Case No. ARB/02/9 (27/10/06).

<sup>121</sup> *Champion* (n119 above) at para 164.

<sup>122</sup> *PSEG Global Inc. And Konya Ilgin v. Republic of Turkey* (ICSID Case No. ARB/02/05) (Award 19/01/07). For specifics see outline of Claim at para 224.

The requirement of consistent conduct initially outlined in *Tecmed* is broad and thus inherently ambiguous<sup>123</sup>. There are two strands of liability that have emerged under this head. Firstly, which will be dealt with here, there is a requirement that the host-state must entrench domestic law that lead to the investor investing the host-state. Secondly, which will be dealt with subsequently, the host-state must not renege on representations made to the investor. The first of these forms of investor protection is justified on the basis on the difference between an investor and state in terms of an ability to change the legislative context in which the investment operates. Changes in law that are unexpected may increase investment costs and give rise to difficulties in projection of profits thereby undermining business stability.<sup>124</sup> This is a requirement that follows from protection from ‘*unexpected and unwarranted*’ conduct as defined above<sup>125</sup>. However it grants further protection than that strand. From the case of *PSEG* it can be seen that continuing legislative changes which impact on the contractual or administrative law governing the investment will breach the fair and equitable treatment standard as the investor would not know the nature of his rights or obligations, either as a contracting party or vis-à-vis government administration, in the host-state’s legal system.<sup>126</sup> Thus in order to prevent the investor from being placed in this position the host-state must ensure that the laws are entrenched.

In *Enron v. Argentina* the tribunal stated that expectations as to future conduct based on existing legislation would give rise to breach of the fair and equitable treatment standard if that legislation was subsequently changed<sup>127</sup>. In that case *Enron* claimed that one of the core reasons why it had invested in TGS was the existence of the Convertibility Law that fixed the Argentine Peso to the US

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<sup>123</sup> See also, *Tecmed* (n 110 above).

<sup>124</sup> The Tribunal in *PSEG* (n 121 above) stated with respect to the states unjustifiable use of the legislature to ‘override the judicial decision: ‘*Stability cannot exist in a situation where the law kept changing continuously and endlessly*’. Such changes may also be a result of legal ‘*interpretation and implementation*’ that would thus also have to be consistent (at para 254). Note that such changes may also affect further credit to be acquired by the investor thereby hampering growth. Such conduct cannot said to be conducive to ‘*promoting and protecting*’ investment.

<sup>125</sup> See (n123 above)

<sup>126</sup> *PSEG* (n121 above) at para 250.

<sup>127</sup> *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic* ICSID Case No. ARB/01/3 (22/05/07).

Dollar. In 1999 due to economic crisis, the dollar adjustment was removed. As a result Enron claimed that as a consequence of the dollar adjustment removal it had suffered financial loss. The tribunal stated that changing the Convertibility Law was a breach of the investor's expectations thus a breach of fair and equitable treatment and the umbrella clause.. In *CMS v. Argentina* the investor successfully claimed for losses in profit suffered as a result of Argentina repealing the law that ensured dollar tariffs for Gas supply services. The investor stated that without the dollar tariff it would never have invested, as a shareholder, in Argentina. In *CMS* the tribunal stated the following, further elucidating *Tecmed*, '*the number of treaties, both bilateral and multilateral, that have dealt with this standard also unequivocally shows that fair and equitable treatment is inseparable from stability and predictability*'<sup>128</sup>. The tribunal in *CMS* found that by repealing the dollar conversion the state had breached the fair and equitable treatment standard. Following the decisions in *CMS v Argentina* and *Enron v. Argentina* it is now clear that the initially vague requirement of consistency outlined at the start of the chapter is the specific obligation not to change the regulatory regime that the investor operates under.

(vii) The state must not renege on representations made to the investor.

There is an obligation now under the fair and equitable treatment provision that the host-state must not renege on representations made to an investor. The cases of *Metalclad*, *Tecmed* and *Wastemanagement* all demonstrate this doctrine. They all involve the state either: (i) granting a requisite permit for the operation of the investment, or (ii) stating that it would be granted if certain criterion were fulfilled and then subsequently reneging on this promise. The requirement of not changing representations by the State to the investor has thus far been based on an unhelpful notion of '*investor expectations*'<sup>129</sup>. This notion does not elucidate the

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<sup>128</sup> CMS (n 113 above) at para 276.

<sup>129</sup> In *Tecmed* (n110 above) the tribunal stated that the fair and equitable treatment requirement: "...requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment..." (at para 154). Lord Fraser in *Council for Civil Service Union v. Minister for Civil Service* [1985] A.C. 374 states 'Legitimate...expectation may arise either from an express promise given on behalf of a public authority or from the existence of a regular practice which the claimant can reasonably expect to continue'. (at p.401). P.Elias, 'Legitimate Expectation and Judicial Review' in J Jowell and D Oliver (eds), *New Directions in Judicial Review* (London: Stevens, 1988) 37-50.

core protection strand highlighted here. It causes difficulty as it is exceptionally broad as and involves, to a degree, a subjective analysis as to what the investor ‘expected’ to ensure investment promotion and protection<sup>130</sup>. An expectation, notionally, follows a representation hence not reneging on representations is the key action that the investor needs to be protected against. There are some limits in the case law as to investor protection against a state reneging on its representations to the investor. Now it seems tribunals will not accept vague statements as being the basis of such ‘expectations’. Thus in *PSEG v. Turkey* the tribunal found that there could be no case for a breach of the investor’s ‘expectations’ as there were no identifiable commitments or promises made by the State which give rise to such an expectation<sup>131</sup>. Further, the State’s representation that it needed foreign investment was not a statement that gave rise to a legitimate expectation but more a statement of general policy.<sup>132</sup> Where there are false representations that have been made by the investor that have led to a statement relating to the investment project by the state, the latter cannot be used for the basis of an ‘expectation’ claim under the fair and equitable treatment clause.<sup>133</sup> Further, in *PSEG*, the State’s inconsistency in stating that it was possible to have a branch of a foreign incorporated company for the function of the investment in Turkey and then stating that the investment had to be locally incorporated was a breach of the fair and equitable treatment standard.<sup>134</sup>

(viii) Freedom from bias in conduct towards an investor by the administrative apparatus of the state.

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<sup>130</sup> Broad based expectations of the investor were upheld by the tribunal in the following cases: *Metalclad Corp. v. Mexico*; *ADF Group Inc. v. USA*, 9 January 2003, ICSID Case ARB(AF)/00/1, *Occidental Exploration and Production Company v. Ecuador*, Final Award, 1 July 2004, LCIA Case No. UN3467.

<sup>131</sup> *PSEG* (n 121) above at para 242.

<sup>132</sup> See *PSEG* (n121 above) at para 243.

<sup>133</sup> *International Thunderbird Gaming Corporation v. Mexico*, *UNCITRAL (NAFTA)* 26/01/06. One commentator has stated that prior knowledge that an investor ought to have should mitigate against a finding of fair and equitable treatment. See (see P. Muchilinski ‘Caveat Investor?’ The Relevance of the Conduct of the Investor under the Fair and Equitable Treatment Standard’ (2006) 55 ICLQ 527 at p. 542 .

<sup>134</sup> See *PSEG* (n121 above) at para 248.

In *Azurix* the Tribunal stated that it was clear that the tariff regime and billing rights of the investment, a water supply business, had been politicized by the state because of concerns of water supply pricing in the forthcoming elections by the extant government.<sup>135</sup> The fixing of billing prices caused significant loss for the investor as profits could not be increased to meet the initial set up cost of the investments and continuous expenditure. This breached the fair and equitable treatment standard. However, the tribunal also noted in its finding of a breach that it was significant that, once the service of water supply was transferred to a new business, the new service provider was allowed to raise tariffs. This demonstrated bias against the investor. Further, the Tribunal stated that repeated calls of the state for the non-payment of bills by customers of the investment verged on 'bad faith'.

The case of *Metalclad* can also be read to demonstrate a requirement of non-bias towards the investor. Thus in *Metalclad* after withdrawal of the investor's operating permit the State pursued the investor in local courts without justification and as a result of the failed litigation there was a significant delay in starting up the business. This would be biased conduct prohibited under the fair and equitable treatment standard. It is worth noting, from this decision, that bias can be inherent within government activity working against an investor without simultaneously working in favour of anyone else. Thus this is a distinct obligation than that of the freedom of discrimination requirement. Systemic bias in *Azurix* could be seen from the fact that the subsequent service provider was allowed to do many things, such as regional price variations, that the investor was not.

#### (ix) Application of strands of Public law liability to courts.

It seems from the current jurisprudence that the court, despite being classified as an organ of a state in international law, will be exempt from these strands of public law liability. This is following the case of *Loewen* which did not apply the

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<sup>135</sup> *Azurix v. Argentine Republic* (ICSID Case No. ARB/01/12) (United States/Argentina BIT) at para 378.

denial of justice test in *Neer*.<sup>136</sup> However, it is difficult to see why a court should be exempt from these strands of liability when other government bodies are not or the state is not exempt in carrying out regulatory function (the incumbent duty of those bodies). It is perhaps a failure to see the court as another administrative organ of the State in investment treaty arbitration<sup>137</sup>. This chapter will promote this strand of liability as a part of the fair and equitable treatment standard and state that the *Loewen* decision is wrong.<sup>138</sup>

### Synopsis.

As FET rules have led to a breach of FET in the above cases,<sup>139</sup> the basic Austinian notion of law, as opposed to value-judgment, is satisfied. Further, the enforcement of FET standards is possible due to the existence of the New York Convention.<sup>140</sup> Thus the important requirement of enforcement is satisfied.

Overall, FET standards are laws for the following key reasons: (i) They compel the state to some level of compliance if the state is to avoid similar breaches to other investors; (ii) failure of meeting the standards has led to a breach of the FET standard; (iii) Breaches are able to be enforced through the New York Convention for the violation of FET standards.

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<sup>136</sup> Both the *Mondev* and *Loewen* decisions state that denial of justice claims can be brought under the fair and equitable treatment standard (*Mondev International Ltd. v. United States of America*, ICSID Case No. ARB(AF)/99/2 (NAFTA). (11/10/02) at para 127 and *Loewen Group, Inc. and Raymond L. Loewen v. United States* ICSID Case No. ARB(AF)/98/3. (NAFTA) at para 132). Both claims failed. *Mondev* did not pass the jurisdiction phase as the *Neer* threshold of 'outrageous' failures by the judicial process of the state was used. (see *LF. Neer and Pauline Neer (U.S. v. Mexico)* (1926) 4 RIAA 60 at p.61.

<sup>137</sup> For the purposes of international law a court is recognised as an organ of the state in international law. See Greenwood 'State Responsibility for the Decisions of National Courts' in Fitzmaurice and Sarooshi (eds) *Issues of State Responsibility before International Judicial Institutions* (Hart) (2004) at p.57. See also Article 4 of the International Law Commission's Draft Articles on State Responsibility, in Crawford, *The International Law Commission's Articles on State Responsibility: Introduction, Text and Commentaries* Cambridge University Press (2002).

<sup>138</sup> For criticism of the *Loewen* case see: Rubins, 'Loewen v. United States: The Burial of an Investor-State Arbitration Claim', (2005) 21 *Arbitration Int'l* 1 at p.1-13.

<sup>139</sup> See Table 1 breaches.

<sup>140</sup> See Weeramantry et al (n69 above).

#### **1.4 Initial Concerns and Issues.**

One characterisation of the above rules, argued by Van Harten, is that FET has been used to create a system of public administrative and regulatory accountability delegated to the private sphere of commercial dispute-resolution.<sup>141</sup> This is an extension of the usual private sphere of contractual dispute resolution by arbitration.<sup>142</sup>

By contrast, general private commercial arbitration is subject to territorial restrictions of states, including their rule of law and courts, investment arbitration under the ICSID system is not. This is termed the ‘delocalised’ nature of ICSID, which is a unique freedom from control by national courts amongst arbitration dispute-resolution processes. If a state is liable under ICSID proceedings there is very little a state can do to avoid payment, there is no domestic review of the decision and enforcement available due to the ‘delocalised’ nature of ICSID.<sup>143</sup> The same is not true of private commercial arbitration that is subject to domestic courts controlling its jurisdiction and assessing whether enforcement should be permitted.

As FET does construct laws outside the framework of sovereign powers accountable to domestic legislatures and the above characterisation of public nature of certain disputes is of some value. This is when assessing whether public interest decisions are made by arbitrators without public participation, issues of consent and accountability may arise depending on how the rules are applied. Thus, such concerns shall be met by first seeing how these rules are used in specific cases then making an analysis of the nature of the rules.

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<sup>141</sup> G Van Harten, ‘The Public-Private Distinction in the International Arbitration of Individual Claims Against the State’ [2007] 56 ICLQ at p.371 -373.

<sup>142</sup> G Teubner, ‘Global Bukowina’: Legal Pluralism in the World Society’ in Teubner (ed.) *Global Law Without a State* (Dartmouth: Aldershot) (1997) at p.10-11; G Teubner, ‘Contracting Worlds: The Many Autonomies of Private Law’ (2000) 9 Social & Legal Studies 399 at p. 399- p.402

<sup>143</sup> Note that it is also possible for investment treaty disputes under the UNCITRAL rules. See, Redfearn & Hunter (n1 above).



As well as the public nature of disputes giving rise to issues of accountability, briefly described above, there are also fundamental issues regarding whether the law produced is realistic and workable. These concerns stem from the power given to arbitrators under FET, as described, and the fact that the usual constraints that come on domestic courts when granted such power, such as constitutional restrictions and the ability to refine jurisprudence through a system of precedent or appellate control are absent.<sup>144</sup>

At a primary level, for the laws to work they have to be able to make clear what obligations they involve upon states, and how those obligations arise. In order to do so, not only do these obligations have to be clearly defined, they have to be applied consistently between decisions.

In the absence of a system of precedent, appellate and legislative control such a law-making role under FET creates challenges of legal consistency and coherence.

<sup>145</sup> As discussed the merits of a system of precedent are that they allow clear requirements of how standards are engaged and what their thresholds are to be

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<sup>144</sup> T.H. Cheng, 'Precedent and Control in Investment Treaty Arbitration' (2006-07) 30 Ford. Int'l L.J. 1014 at p.1016 & p.1022-1026.

<sup>145</sup> Tudor's work is not an identification of legal consistency (n3 above); Other critiques do not do this sufficiently: S.D. Franck, 'Legi'; B. Choudhary's attempt at defining the fair and equitable treatment standard by looking at the standard through some cases does not explore how key components of those standards are at odds with one another. See B. Choudhary 'Evolution or Devolution? Defining Fair and Equitable Treatment in International Law' (2005) JWIT 297 A not so dissimilar approach is taken by Ian Laird in 'Recent Developments In NAFTA Article 1105' in *NAFTA Investment law and Arbitration: Past Issues, Current Practice, Future Prospects* ed T. Weiler (2004) Transnational Publisher. Other writings fail at classification: see S. Vasciannie 'The Fair and Equitable Treatment Standard in International Investment Law and Practice' (1999) BYIL 99 at p.130-145 (In section titled content). One sees in Vasciannie's analysis in 1999 that he noted only two identifiable cases where the standard was used and that he failed to classify them. The deficiencies in Vasciannie's analysis are partly attributable to very recent surge in use of the standard. Some aspects of the recent surge is identified by Klein Bronfman. However Klein Bronfman's work fails to classify the content as strands of liability and the delineations therein are still subject to ambiguities. (see Klein Bronfman, M. 'Fair and Equitable Treatment: An Evolving Standard' (2006) 10 Max Planck UNYB 609). A similar broad approach has been followed in McLachlan, Shore, Weiniger *International Investment Arbitration Substantive Principles* (2007) OUP at paras 7.101-7.140.

created through a series of adjudicatory improvements over time. What follows in this thesis is now an assessment of legal clarity, or coherence. Subsidiary to this other arguably important attributes of FET rules to make them workable shall be discussed.

The most important of these subsidiary requirements is the likelihood that such law can be complied with by respondent states many of whom are developing countries. Many of the laws created under the FET standard give the investor rights against administrative and regulatory processes of the state. In some states where administrative bodies are undeveloped or non-existent there may be difficulties of compliance with these rules. The use of FET in a similar vein to judicial review, but without constitutional constraints, can potentially give investors greater rights than domestic nationals. Considering that investment treaties that include FET, may also incorporate non-discrimination (national treatment) provisions to ensure the aims of giving investors equal rights (but no more) to domestic nationals,<sup>146</sup> this would shift general protection of the investor as one of positive-discrimination or *preference* over and above national treatment.

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What follows after this chapter is a discussion of how such rules have been applied, particularly in terms of identifying in that discussion inconsistencies and variances between fundamental aspects of those rules in different cases. This is part of an assessment of one of the key yardstick for workability argued in this thesis: legal coherence of FET rules.

Overall, three key facts will be looked at following the discussion on jurisprudence.

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<sup>146</sup> Sample investment treaties are given at the UNCTAD database available on : <http://ita.uvic.ca>

- (a) The importance of coherence or clarity of the rule- *whether the rules can be ascertained by states, and investors now that FET is used to create rules.*
- (b) Capacity to comply with the rule-*whether the rules can be complied with by their intended subjects, including likelihood of states being able to meet the costs of implementation, considering both that many are developing countries and many of whom may not have developed national institutions and professional administrators.*
- (c) The effect of the rules on the characteristics and perception of the rule-maker-*Does it turn the rule-making body into something that the subjects themselves would not want governing them. This is an analysis of the nature of legislative action under FET and shall be explored in Chapter 6.*

These factors, including reasons for their choice, will be explained, explored and elaborated in Chapters 5 and 6 and accountability in Chapter 7. Any feasible alterations stemming from the substantive law and a subsequent analysis will also be discussed in chapter 7. What follows now is a discussion of the substantive law.

## Chapter 2-The doctrine of legitimate expectations in investment treaty arbitration

### 2.1 Introduction.

- A. Basic Concepts within the doctrine.
- B. Rationales for the doctrine in English Law.
- C. Legitimate Expectations and Good Conduct.

### 2.2 Legitimate Expectations under FET.

- A. An overview of Approaches.
- B. The ambiguity surrounding the requirement of a direct representation.
- C. Protection from changes of representation.
- D. Contrasting Positions within the scope of rights.
- E. Positions of Deference in Investment Treaty Arbitration.
- F. Conclusions.

### 2.3 Legitimate Expectations in English Law.

### 2.4. Conclusions.

### *Abstract*

*This chapter will illustrate how the doctrine of legitimate expectations is used in investment treaty arbitration. It will try to ascertain whether the use of the doctrine in investment treaty arbitration lacks coherence. To demonstrate whether there is incoherence of the doctrine this chapter will analyse whether there is sufficient variance and inconsistencies between decisions on key attributes of the doctrine. This will be done as to how much protection decisions give to investors under the doctrine, including whether they protected from changes in law or policy by the state. It will also determine whether there are clear requirements as to how the doctrine are engaged. It will also give a comparison of the approach of English law to the doctrine, to show whether deference to the legislature acting as a constitutional constraint and a system of precedent have resulted in coherence of the doctrine in English law.*

## 2.1 Introduction.

The doctrine of legitimate expectations is a doctrine of public law that law protects individuals from changes to representations made by Government bodies. This is by giving individuals a right to participate in administrative decision-making, though this can potentially extend to giving individuals a right to a particular decision of the body or a particular national policy.<sup>1</sup>

### A. Basic Concepts within the doctrine.

The scope of the doctrine theoretically can cover both the protection of substantive and procedural rights.

By substantive protection it is meant that the doctrine protects the individual by forcing the Government body to make good its representation to the individual by altering or keeping its policy, or law, where it harms an individual's interests.

By way of contrast, procedural legitimate expectations offer a more limited form of protection by affording rights of effective participation, where there is a change of position by the state.<sup>2</sup> This includes a right to be heard prior to a decision being made by a Government body and a right to make representations during the decision-making process.<sup>3</sup> The absence of such an opportunity to participate in administrative decision making may lead to compensation.<sup>4</sup>

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<sup>1</sup> See C. Forsyth, 'The Provenance and Protection of Legitimate Expectations' [1988] CLJ 238, at p.239; John Hlophe's (1987) 104 SALJ 165 at p.165-171; P.Elias, 'Legitimate Expectation and Judicial Review' in J Jowell and D Oliver (eds), *New Directions in Judicial Review* (London: Stevens, 1988) at p. 37-50. P.Craig, 'Legitimate Expectations: A Conceptual Analysis' (1992) 108 LQR 79 at p.82-82; P. Craig & S. Schonberg, 'Substantive Legitimate Expectations after Coughlan' (2000) PL 684 at p.684-689.

<sup>2</sup> R.Singh, 'Making Legitimate Use of Legitimate Expectations' (1994) 144 NLJ 1215 at p.1215(1);

<sup>3</sup> C. Forsyth, 'The Provenance and Protection of Legitimate Expectations' [1988] CLJ 238 at p.253-254.

<sup>4</sup> E.g., *S.D. Myers Inc. v. Government (NAFTA)* (UNICTIRAL) of Canada 8 ICSID Rep. 3 at p.114-115.

## B. Rationales for the doctrine in English Law.

The rationales in English law shall be outlined below in order to appreciate the reasons for using the doctrine in investment treaty arbitration to engage state responsibility.

The rationale for the doctrine in English law reflects the core rationales for judicial review. This is ensuring the rule of law by subjecting the acts of state organs to judicial process, and protecting individuals from arbitrary decisions from Government bodies by ensuring the decisions are reasoned out through reflecting individual concerns.<sup>5</sup> The importance of maintaining the rule of law is deeply rooted in the idea of public law and its key aim to serve the public interest by providing *useful* accountability of government action.<sup>6</sup>

The legitimate expectations doctrine in English Law, is a part of a process of judicial review of administrative action. This is concerned with the manner in which a decision is made. A classic example of this is the *Wednesbury* doctrine of ‘reasonable’ decision-making in English law, that is concerned on whether administrative discretion is exercised properly, but whether the policy that granted such a discretion is appropriate. Thus the *Wednesbury* doctrine does not go so far as to determine whether such decisions as a matter of policy ought to have been made, but rather is concerned with the appropriateness of the administrators conduct with respect to a judicial yardstick.<sup>7</sup>

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<sup>5</sup>For a short discussion of rationales of legitimate expectations see Schonberg, *Legitimate Expectations in Administrative Law* (2000) at p.7 See also Lord Denning MR, *Freedom under the law* (Hamlyn Lecture) (1949) at p.126. For a full discussion of municipal judicial review purposes, See Chapter 1. For similar aspirations for international law, See B. Kingsbury, N. Krisch & R.B. Stewart, ‘Forward: Global Governance as Administration-National and Transnational Approaches to Global Administrative Law’ (2005) 68 Law & Cont Prob 1 at p.4

<sup>6</sup> See, T.R.S. Allan, ‘Legislative supremacy and the rule of law: Democracy and constitutionalism’ (1985) 44 Camb. L.J. 111 at p.112-115. Lord Woolf ‘Protection of the Public a New Challenge’ Hamlyn Lecture (1990) at p.12 and p.16.

<sup>7</sup> In the U.S. this is possible for courts only so far as the U.S. Constitution permits for the vindication of constitutional rights and procedure. See, W.E. Nelson, ‘Deference and the limits of deference in the Constitutional jurisprudence of justice by Byron. R. White (1986-88) 58 U. Colo. L. Rev. 347 at p.355-356.

A broader inquiry that looked into the powers given to the decision-maker would breach constitutional convention, and lead to judicial usurpation of legislative function without public consent.<sup>8</sup> Such action would lead the court's decision potentially constitutionally illegitimate. Public law doctrines in English law, such as legitimate expectations, cannot operate to review law or policy of States due to the judicial usurpation of legislative function inherent in such an approach.<sup>9</sup> Further, public law is mindful not to fetter the decision-making discretion of Government bodies by adversely affecting their mandate contrary to the law, so that the execution of important Government policy is not affected.<sup>10</sup> Thus judicial review of policy and legislation, without a constitutional mandate, is an effective restriction on the scope of review, which provides a reasonably clear and workable boundary for adjudication propriety of administrative action.

As Allan states, in relation to this limitation: *'the predictability of official decisions will normally be furthered by adherence to settled rules; but though predictability may enhance individual security and autonomy, it should sometimes be sacrificed for the flexibility needed to attain important goals'*.<sup>11</sup> The argument here is that predictability of Government conduct ought to be secondary to the achievement of policy objectives within the law. The overriding function of government in the majority interest, ought not on a utility basis, be fettered by maintaining promises to individuals or policies individuals rely on. From this perspective the prevention of injustice caused in a particular case by the state reneging on policy cannot be allowed or it will override the decision to renege itself. The latter is assumed by English courts, which are constitutionally precluded from reviewing it, to be in the public interest.

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<sup>8</sup> This has been argued to be a natural state of affairs in Western democracies. Farazmand argues that Governance functions of policy and law are often carried out by non-elected institutions at the necessary cost of electoral choice or accountability. See A. Farazmand *Modern Systems of Government Exploring the Role of Bureaucrats and Politicians* (SAGE publishing) (1997) at p.xiii.

<sup>9</sup> For discussion about possibilities, see R.Pagone, 'Estoppel in Public Law: Theory, Fact and Fiction' (1984) UNSWLJ 267, 275-6.

<sup>10</sup> This is also the approach in other common law countries. See Chief Justice McLachlin of the Canadian Supreme Court in B. McLachlin, 'Rules and discretion in the Governance of Canada' (1992) 56 Sask. L. Rev. 167 at p.168

<sup>11</sup> (n6 above) *Ibid* at p.130.

This reflects a reality of domestic governance that on occasion representations, policies and promises that individuals rely on have to be changed. It will be interesting to see if this is a position used for the doctrine with respect to investors, considering that the protection of foreign investment is a key host-state policy taken up when taking on investment treaty obligations. Thus in the case of investors potentially claiming substantive rights, there is a conflict of two government policies, the need to protect the investor and the public interest in reneging on the representation. It will be interesting to see if tribunals have been faced with substantive claims under legitimate expectations, whether they have been sensitive to one or another and how they have balanced out these potentially competing interests.

### **C. Legitimate expectations and Good Conduct.**

Rights to participation in administrative decision-making that affect the individual provided by legitimate expectations improve administrative function. They allow adverse decisions to be more acceptable, and prevent the exercise of discretion that harms individuals, where such a prevention does not undermine government policy.

Where the doctrine grants procedural rights, these may include individuals having an opportunity to be informed of the change of position and be permitted to participate in the decision-making process.<sup>12</sup> The administrator or state agent can then decide to communicate the policy or representations of the individual to the relevant policy-maker or factor these representations into her decision. This would improve standards of administration, and move the process away from perceived arbitrary decision-making by allowing administrators to explain to individuals why public interest has overridden their individual concerns and

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<sup>12</sup> A right claimed by investors under the fair and equitable treatment standard, see for example *CMS v. Argentina* ICSID Case No. ARB/01/08 (Award Merits) and *Impreglio v. Pakistan* (Claim for Jurisdiction ICSID ARB/03/3).



ensures adverse individual impact is taken into decision-making. In this way the existence of procedural rights improve administrative outcome.<sup>13</sup>

Legitimate expectations granting a substantive rights to individuals may cause government bodies to ensure that representations made to individuals, including those regarding law and policy, are met. This in turn ensures certainty for the individual about the position of the state. It is, however, also possible that a search of legal certainty may restrict executive action and the discretion of policy-makers. As Allan suggests, the doctrine may need to strike a balance between the competing issue of legal certainty and the general public interest.

The need to value the need for policy and law change by the state, occurs due to changes in various social issues and available revenue.<sup>14</sup> If investment treaty arbitration demonstrates a risk of arbitrators adversely interfering with these exigencies, a restriction of the doctrine to procedural rights may be more prudent from a utility basis. This is distinct from a restriction based on the preservation of democratic consent inherent in a separation of powers justification for procedural rights.

Using the doctrine in investor-state relationships to include of a right to be told of why a decision is changed is important. It may be integral to good commercial planning. Further, the doctrine can be useful to counter administrators hiding key information and policy-changes from investors for the sake of administrative efficiency, where it allows information access for individuals. This latter potential benefit has to be weighed against what Schonberg calls the '*chilling effect*' that the doctrine can bring upon administrators.<sup>15</sup>

This 'chilling effect' would occur as a result of Government departments not publishing certain information due to individuals relying on it, where the

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<sup>13</sup> See F. Ansell, 'Unauthorised Conduct of Government Agents: A restrictive rule of equitable estoppel against the Government' (1986) Univ Chicago LR 1026 at p.1026-1031. G. Wignall 'Legitimate Expectation and the Abuse of Power' (1994) NLJ 1038. D.J. Galligan, '*The Nature and Function of Policies within discretionary power*' (1976) PL 332 at p.332-343.

<sup>14</sup> See discussion of deference in Chapter 7.

<sup>15</sup> See Schonberg (n5 above) at p.17 et subsq.

doctrine operates to grant rights in the absence of specific representations to individuals, and individuals choose to rely on published information. It may also occur as result of granting substantive rights under legitimate expectations. Administrators and policy-makers, may hide important information that would be useful to individuals to avoid lengthy decision-making as a result of individual participation. This would be adversely affect any benefits to domestic administrative conduct that the use of the doctrine can bring in creating a more transparent administrative process.

This ‘chilling effect’ is not, however, entirely convincing. Schonberg acknowledges that there is no empirical evidence for it and it is based on a possible hypothetical behaviour of the state.<sup>16</sup>

Overall the doctrine improves administrative processes by allowing both administrators, through individual representations, to be better informed. It also allows individuals to improve their understanding of administrative process through participation and by affording them an opportunity to make representations.

## **2.2. Legitimate Expectations in Investment Treaty Arbitration**

### **A. Overview of Operation.**

The doctrine of legitimate expectations is a key part of the fair and equitable treatment standard. It has been said:

*‘the standard of fair and equitable treatment is...closely tied to the notion of legitimate expectations which is the dominant element of the standard’.*<sup>17</sup>

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<sup>16</sup> Ibid.

<sup>17</sup> Saluka Investments BV (The Netherlands) v. Czech Republic (Partial Award) (UNCITRAL) (17 03/06) at para 302.

This point is also made by the *EDF* tribunal:

*‘The Tribunal shares the view expressed by other tribunals that one of the major components of the FET standard is the parties’ legitimate and reasonable expectations with respect to the investment they have made.’*<sup>18</sup>

The doctrine’s operation is summarised by Professor Wälde in *Thunderbird v. Mexico*, in the following terms:

*“the concept of ‘legitimate expectations’ relates, (within the context of the NAFTA framework), to a situation where a contracting party’s conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct, such that failure by the NAFTA Party to honour those expectations could cause the investor (or investment) to suffer damages.”*<sup>19</sup>

According to Professor Wälde the expectations have to be ‘reasonable’ through looking at the state’s conduct, and the investor has to have relied on them. The latter is some positive act by the state to show the investment was motivated by the host-state’s policies, representations or law.

What forms the basis of an expectation is outlined in *Tecmed*:

*‘the foreign investor also **expects** the host State to act consistently, i.e. without arbitrarily revoking any pre-existing decisions or permits issued by the State that were*

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<sup>18</sup> EDF (Services) Limited v Romania ICSID Case No. ARB/05/13 (Award on 8 October (2009) at para 216.

<sup>19</sup> T. Wälde, dissent in: *International Thunderbird Gaming Corporation v. Mexico*, UNCITRAL (NAFTA) 26/01/06. at para 147

*relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities’.*<sup>20</sup>

The investor may have under the doctrine substantive rights to a host-state’s laws and policy remaining the same unless the state can provide a reason for changing them, as indicated by the use of the word ‘arbitrary’. The importance of reliance is also emphasised here.

However this statement of the *Tecmed* tribunal also leaves it open to the investor to undertake a subjective claim as to what it ‘expected’.<sup>21</sup> Thus the tribunal in the *Tecmed* case stated that FET:

*“...requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment...”*<sup>22</sup>

This appears to be at odds with the objectivity in the ‘reasonable expectation’ approach of Professor Wälde described above. Similarly, Professor Wälde in his opinion in *Thunderbird* emphasises that the expectation must be based on a positive act of the state.

*‘an investor should be protected against unexpected and detrimental **changes of policy** if the investor has carried out significant investment with a reasonable public authority initiated assurance in the stability of such a policy’.*<sup>23</sup>

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<sup>20</sup> *Tecnicas Medioambientales Tecmed, S.A. v. Mexico* Award of May 29, 2003 (2004) 43 ILM 133 para. 154

<sup>21</sup> Broad based expectations of the investor where upheld by the tribunal in the following cases: *Metalclad Corp. v. Mexico* ICSID Case No. ARB(AF)/97/1 (NAFTA) (20/08/00); *ADF Group Inc. v. USA*, 9 January 2003, ICSID Case ARB(AF)/00/1, *Occidental Exploration and Production Company v. Ecuador*, Final Award, 1 July 2004, LCIA Case No. UN3467.

<sup>22</sup> *Tecmed*, Award of May 29, 2003 (2004) 43 ILM 133 para. 154. This dictum has been repeated in *Eureko v. Poland* (Partial Award) (19/08/05) at para 235, *Occidental Exploration and Production Co v. Ecuador* LCIA UN.647 at para 185 and in *Saluka* (n17 above) at para 302.

The *Tecmed* approach may leave it to the investor to bring a claim for an expectation that is reasonable as Professor Wälde states, but one where a state could not have intended to make to the investor.

In addition to the *Tecmed* statement above stating that ‘arbitrary’ changes of positions by the state would fall foul of the doctrine (thus requiring the host-state to show how a state’s action can be justified), the *Thunderbird* decision leaves an appropriate margin of deference to the state’s need to change its policies. It states with respect to any regulation that could be passed:

*‘[in reference to Chapter 11 of NAFTA] Mexico has in this context a **wide regulatory ‘space’ for regulation**; in the regulation of the gambling industry, governments have particularly **wide scope of regulation** reflecting national views on public morals. Mexico can permit or prohibit any forms of gambling as far as the NAFTA is concerned. It can change its regulatory policy and it has a wide discretion with respect to how it carries out such policies and administrative conduct’.*<sup>24</sup>

As to how wide this actually is, is unclear. The tribunal in stating ‘*wide regulatory ‘space’ for regulation*’ may leave it open to arbitral tribunals to determine what the boundaries of that regulatory space are.<sup>25</sup> The tribunal in the *Thunderbird* decision also appreciated that the scope of investment protection in NAFTA is overridden by the state’s need to criminalise certain conduct.<sup>26</sup>

Contrary to this statement in *Thunderbird* and the subjective rights sanctioned by *Tecmed*, in *GAMI* the tribunal stated: ‘*To repeat: NAFTA arbitrations have no mandate to evaluate laws and regulations that predate the decision*’.<sup>27</sup> This statement does not preclude policy review following that juncture, however as *Tecmed* and

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<sup>23</sup> *Thunderbird v. Mexico* (n20 above) (Separate Opinion) at para 30.

<sup>24</sup> *Thunderbird* (n20) majority decision at Para 147.

<sup>25</sup> This form of adjudication, has been described by Van Harten as ‘regulatory adjudication’, in *Investment Treaty Arbitration and Public law* at p.119. See also Chapter 6 on regulatory governance.

<sup>26</sup> (n 20 above).

<sup>27</sup> *GAMI v Mexico (NAFTA)* (2005) 44 ILM para 93

*Thunderbird* grant rights based on host-state policy prior to an investment occurring, this position is clearly in conflict.

Tribunals have given a warning about subjective and broad approaches to the doctrine. The tribunal in *Saluka* to some degree clarifies this:

*‘This Tribunal would observe, however, [referring to Tecmed, supra] that while it subscribes to the general thrust of these and similar statements, it may be that, if their terms were to be taken too literally, they would impose upon host States’ obligations which would be inappropriate and **unrealistic**.*

*Moreover, the scope of the Treaty’s protection of foreign investment against unfair and inequitable treatment cannot **exclusively** be determined by foreign investors’ **subjective** motivations and considerations. Their expectations, in order for them to be protected, must rise to the level of legitimacy and reasonableness in light of the circumstances.’<sup>28</sup>*

*Saluka* thus adds some objectivity to the basis of the expectation, but it does not preclude the investor’s formulation of what it expected in the absence of a direct assurance. A realistic appraisal of what ‘reasonableness’ is provided in *Thunderbird*. There echoing Professor Allan, Professor Wälde states:

*‘Such a protection is, however, not unconditional or ever lasting. It leads to a balancing process between the needs for flexible public policy and legitimate reliance on investment backed expectations’<sup>29</sup>*

Thus there needs to be a judicious and balanced approach taking the state’s policy exigencies into consideration.<sup>30</sup>

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<sup>28</sup> *Saluka Investments BV (The Netherlands) v. Czech Republic (Partial Award)* (UNCITRAL) (17 03/06) at para 304.

<sup>29</sup> *Thunderbird v. Mexico* (n20 above) separate opinion at para 30.

<sup>30</sup> See also, *S.D. Myers v. Government of Canada UNCITRAL (Partial Award 13.11.00)* at para 261.

As to scope of review available to the tribunal the approach outlined in *Tecmed* gives a wide scope to tribunals. It may open the door to not just revocation of permits claims under the doctrine but may also bring into the ambit of the doctrine mere changes of Government policy that cause fiscal loss to the investor. Such a broad approach, if undertaken, would potentially give the arbitral tribunal power to review all Government policy that may impact on the investor, and not just look at whether revocation of permits was justified. This would also provide a strong form of risk minimisation to the investor. However it may be greater than that constitutionally afforded to domestic nationals, as would be the case if the national were English (explained below), and potentially allow protection of the investor to override important national policy exigencies.

## **B. The ambiguity surrounding the requirement of a direct representation**

The requirement of a direct representation by a state to create a legitimate expectation has not been clearly elucidated by tribunals.<sup>31</sup> The implications of having a strict requirement is that a state will know when it will be made good on its promise and can prepare appropriate contingencies to address the impact of making good the representation. It will also put the investor on a certain footing, that only a clear representation is a promise that the state will keep. In the absence of this specific requirement the state may be faced with claims for policy representations that it is not subsequently able to keep due to unforeseen competing public interests.

However, in investment treaty arbitration decisions are not consistent with respect to a strict requirement for a direct representation made to an investor to engage the doctrine. Some decisions intimate a requirements, others allow the investor to base his expectation on policy that it feels induced him into the contract. This approach is the one taken, for example, by the *Tecmed* tribunal.<sup>32</sup> Though this was done through the omission of not having a direct requirement.

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<sup>31</sup> Thus in *Saluka*, an investor who held shares in a bank had a legitimate expectation that the state would treat the bank fair and equitably. (n28 above) at para 309.

<sup>32</sup> *Tecmed*, (n20 above) at para. 154 (quoted above).

In the case of *Suez, Sociedad and Interaguas* there were no direct representations made to the Claimant as to the dollar peso conversion law in the Argentine Republic.<sup>33</sup> The Claimant designed its case on the basis of two circumstances in which it felt, subjectively, gave rise to a legitimate expectation. The first was the existence of bilateral investment treaties, not just the specific treaty concerning the sending state of the investment. Secondly the existence of the law itself, the claimant felt had induced it to invest.<sup>34</sup> There is no direct representation by the state.

In *Saluka v. Czech Republic* the tribunal leaves also open the possibility of the investor's expectations being based on law, policy or any other Government rule or conduct that the investor feels that has aggrieved him, without a requirement of a specific representation.<sup>35</sup> A different position as to a requirement of representations was also vaguely intimated by the tribunal in *Waste Management I*:

*'the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant'*<sup>36</sup>

The tribunal in *PSEG* stated that tribunals will not accept vague statements as being the basis of such 'expectations'. In *PSEG v. Turkey* the tribunal found that there could be no case for a breach of the investor's 'expectations' as there were no identifiable commitments or promises made by the State which give rise to such an expectation.<sup>37</sup> In this case there was no backdrop

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<sup>33</sup> *Suez, Sociedad General de Aguas de Barcelona S.A., and InterAguas Servicios Integrales del Agua S.A. v. The Argentine Republic*, ICSID Case No. ARB/03/17 (Jurisdiction)

<sup>34</sup> *Suez* (n33 above) at paras 20-23, 31.

<sup>35</sup> n1 (supra). This was also the approach in *Tecmed* (n 20). This approach has been mentioned and agreed with in *Azurix*: *'The expectations as shown in that case [Tecmed] are not necessarily based on a contract but on assurances explicit or implicit, or on representations, made by the State which the investor took into account in making the investment'*. (*Azurix* at para 318).

<sup>36</sup> *Wastemanagement Inc v. United Mexican States*, ICSID Case no Arb(AF)/98/2 (Jurisdiction) (2 June 2000), 40 I.L.M. 56. (The claim was rejected on the jurisdiction phase for failures to waive domestic proceedings appropriately under NAFTA Article 1121).

<sup>37</sup> *PSEG Global Inc. And Konya Ilgin v. Republic of Turkey* (ICSID Case No. ARB/02/05) (Award 19/01/07) at para 242.



of legislation on which to base the formation of expectations on as in the Argentine cases concerning the peso-conversion law. The tribunal also noted that the State's representation that it needed foreign investment was not a statement that gave rise to a legitimate expectation to certain rights by implication, but was more a statement of general policy.<sup>38</sup> It thus did not extrapolate to create rights on this aspect as the claimant wished.

The tribunal in *EDF* echoed a similar approach by saying: *'legitimate expectations cannot be solely the subjective expectations of the investor'*.<sup>39</sup> In similarly terms the EDF tribunal also stated *'(Except) Where specific promises or representations are made by the State to the investor the latter may not rely on a bilateral investment treaty as a kind of insurance policy against the risk of any changes in the Host-state's legal and economic framework. Such expectation would be neither legitimate nor reasonable'*.<sup>40</sup>

Also, where there are false representations that have been made by the investor that have led to a statement relating to the investment project by the state, the latter cannot be used for the basis of an 'expectation' claim under the fair and equitable treatment clause.<sup>41</sup> Overall the requirements of specific representations is not a concrete one, and it maybe the investor will succeed depending very much on the way the tribunal exercises its discretion on this important aspect of the doctrine. It leaves it open to investors to pick and choose which policy alteration may harm them, thus broadening the potential to harm public interest.

### **C. Protection from changes of representation.**

Investment arbitral jurisprudence demonstrates that the doctrine of legitimate operations can operate potentially in two ways.

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<sup>38</sup> See PSEG (n37 above) at para 243.

<sup>39</sup> EDF (n18 above). para 215.

<sup>40</sup> EDF (n 18 above) at para 217.

<sup>41</sup> *Thunderbird (n 19 above)*. One commentator has stated that prior knowledge that an investor ought to have should mitigate against a finding of fair and equitable treatment. See P. Muchilinski 'Caveat Investor? The Relevance of the Conduct of the Investor under the Fair and Equitable Treatment Standard' (2006) 55 ICLQ 527 at p. 542.

The first is to protect the investor from representations or promises made by the state and then later not followed. This includes protection of the investor against a breach of a promise of a licence that permits the operation of the investment in the host state. This has been illustrated by the cases of *Metalclad* and *Tecmed*.<sup>42</sup> The second circumstance in which it applies is to give substantive rights to the investor against changes of Government law or policy. This is where the Government has created circumstances through a legal or policy framework that has encouraged the investor to make the investment and the investor has relied upon this.

#### *Protection from changes of representations*

The first paradigm outlined above, the doctrine operates to protect the investor from changes in representations by the State. Thus in *PSEG v. Argentina* the State's inconsistency in stating that it was possible to have a branch of a foreign incorporated company for the function of the investment in Turkey and then stating that the investment had to be locally incorporated was a breach of the fair and equitable treatment standard.<sup>43</sup> Thus the tribunal stated:

*'Thirdly, the Tribunal also finds that the fair and equitable treatment obligation was seriously breached by what has been described above as the "roller-coaster" effect of the continuing legislative changes. This is particularly the case of the requirements relating, in law or practice, to the continuous change in the conditions governing the corporate status of the Project, and the constant alternation between private law status and administrative concessions that went back and forth. This was also the case, to a more limited extent, of the changes in tax legislation'.*<sup>44</sup>

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<sup>42</sup> See synopsis of FET interpretations in Chapter 1.

<sup>43</sup> See *PSEG* (n37 above) at para 248-250.

<sup>44</sup> *PSEG* (n37 above) at para 250.

This approach is to stop frequent legal changes undermining the investment. Changes in law after the investment starts operating that cause it losses will result in a breach of the fair and equitable treatment standard. This is irrespective of a finding on expropriation.<sup>45</sup> As shall be seen from the later comparative analysis both the first, second and third operation of the doctrine goes beyond the municipal application of the doctrine. Thus in the first circumstance there is an obligation now under the fair and equitable treatment provision that the host-state must not revoke the grant of permits given to an investor to operate the investment.

The cases of *Metalclad*, and *Tecmed* are also examples of this. They involve the state either: (i) granting a requisite permit for the operation of the investment, or (ii) stating that it would be granted if certain criterion were fulfilled and then subsequently reneging on this promise.<sup>46</sup> Thus in *Metalclad* the claimant stated that Mexico, through its local Government interfered with the development of its hazardous landfill waste project. Prior to the purchase of the investment by the claimant there was a meeting of the claimant and local officials in which the claimant was given the assurance it could operate the investment.<sup>47</sup> The Claimant was told that the local permit requirements had been satisfied, but not at the federal level. The Claimant was told, however, that a permit at the federal level could be obtained if the claimant could satisfy federal and state laws.<sup>48</sup> The Claimant had purchased the investment on the basis of the above statements. Following the claimants purchase of the investment the provincial Governor publicly denounced the investment and there was no licence given to operate the

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<sup>45</sup> PSEG (n 37 above) at para 278-279. Though the decision made a finding of fair and equitable treatment there was no finding of expropriation, hence losses did not have to amount to a taking or 'loss of control' of the investment.

<sup>46</sup> In *Tecmed* the tribunal stated that the fair and equitable treatment requirement: "...requires the Contracting Parties to provide to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investor to make the investment..." (n20 above) (at para 154).

For history and application to investment treaty arbitration see Stephen Fietta 'International Thunderbird Gaming Corporation v. The United Mexican States: an indication of the limits of the "legitimate expectation" basis of claim under Article 1105 of NAFTA?' (2006) 7(3) JWIT 423 at p.423-430.

<sup>47</sup> *Metalclad* (n21 above) at paras 27-33.

<sup>48</sup> *Metalclad* (n21 above) at para 33.

landfill.<sup>49</sup> A further requirement for a municipal construction permit was imposed by the local Government in order to run the state. The permit was subsequently not granted.<sup>50</sup>

The tribunal appreciated that the reasons for not granting the permit were due to (i) lack of support in the local community and (ii) ecological concerns related to permit were not related to the problems of physical construction of the landfill, these were not sound grounds for denial. However the tribunal then said that the only ground on which the permit could be denied was if there was a physical defect in constructing the landfill. The tribunal did not feel that the state's environmental impact concerns were serious and substituted its own views on permit requirements.<sup>51</sup> Finding a breach of FET the tribunal emphasised that internal law, such as the ecological decree, cannot be used as a basis to override treaty obligations.<sup>52</sup>

In *Tecmed* the claimant purchased 99% of the shares in Cytrar, a municipal corporation. The Claimant purchased facilities relating to a landfill site to deal with hazardous waste. A Government body called the Hazardous Waste and the National Ecology Institute of Mexico) refused to grant a renewal of the licence to operate the investment. The claim included relief for permission to operate the land-fill site.<sup>53</sup>

The Tribunal stated that the non-grant of permit was a breach of the claimant's legitimate expectations. The tribunal stated that the fair and equitable treatment standard poses a requirement of taking into consideration the basic expectations that were taken into consideration by the foreign investor making the investment.<sup>54</sup> These expectations include the following: (i) That the state to act in a consistent manner. (ii) No arbitrary revocation of per-existing decisions or permits that were issued by the state that were relied upon by the investor.<sup>55</sup> This

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<sup>49</sup> Metalclad (n21 above) at para 37.

<sup>50</sup> Metalclad (n21 above) at paras 50-52.

<sup>51</sup> Metalclad (n21 above) at paras 92-93.

<sup>52</sup> This was justified by reference to Article 26 and Article 27 of the Vienna Convention on the Law of Treaties 1969. at para 100.

<sup>53</sup> Tecmed (n20 above) at para 39.

<sup>54</sup> Tecmed (n20 above) at para 154.

<sup>55</sup> Ibid.

relating of consistency to expectations precludes a state from changing its position on a policy basis. The second element of arbitrariness gives tribunals the implicit power to quash policy or law that may take the investor by surprise.

Like *Metalclad*, the tribunal in *Tecmed* did not defer to the law and policy of the state by granting the importance of the state's ecological concerns over the investor's rights. The need of a state to protect policy-concerns can be seen from the case of *Wastemanagement II*. This decision concerned a dispute that was fundamentally contractual in nature. The tribunal deferred to the financial limitations of the state to meet its obligations under the contract due to a fiscal crisis.

In *Wastemanagement II* the tribunal took into consideration that there was a financial crisis in Mexico in 1994 that affected the city this lead to a decline of revenues.<sup>56</sup> The tribunal did not find the acts of the federal bank to not pay the investor, on the basis of financial difficulty, to constitute a breach the investor's expectations.<sup>57</sup> The tribunal also noted that the city was under financial difficulties and performed part of its contractual obligations. This did not amount to a grossly arbitrary conduct or gross unfairness.<sup>58</sup> Thus there was no breach of Article 1105 by the city.

In *Wastemanagement II* there is an objective approach to the doctrine, by taking a wholistic approach on the facts as to whether the doctrine should be engaged and ensuring that the investor is accountable for its own business choices. Thus failure of the business to convince its customers to use its system and that the state's financial losses due to economic difficulty was something that the investor as a commercial risk had, in the tribunals, view had to take into consideration as a part of the decision to make its investment.<sup>59</sup> Not all cases follow the same vein. There is no fixed position in case law as to whether

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<sup>56</sup> *Tecmed* (n20 above) at para 101.

<sup>57</sup> *Tecmed* (n20 above) 102.

<sup>58</sup> *Tecmed* (n20 above) at para 115.

<sup>59</sup> However a different result may be feasible under the MIGA not yet signed or ratified by states: '*foreign investors on the other hand, need a greater measure of security and protection against non-commercial risks in the face of growing economic and political uncertainties*' See, I F. I, Shihata, 'The Multilateral Investment Guarantee Agency' (1986) 80 Am. Socy Intl L. Proc. 21'- It is questionable whether such non-commercial risks include protection from political and economic changes in a state.

economic necessity can be used to avoid policy and legal obligations to investors.<sup>60</sup>

*Substantive rights against changes of law or policy.*

In *CMS v. Argentina* and *Sempra v. Argentina* on a similar basis the tribunal held that a breach of legitimate expectations occurred when Argentina repealed the dollar-peso conversion law. The tribunal's held that changing the legal framework that investors had relied upon on to make their investment would breach their legitimate expectations. In these cases tribunals also stated that international law defence of necessity would not protect a state from repealing laws contrary to FET.<sup>61</sup> This is quite a distinct conclusion to the deferential approach to the state's fiscal need in *Wastemanagemetn II*.

In the investment treaty arbitration case of *Azurix v. Argentina* the fair and equitable treatment standard was held to be violated due to the investor's water-supply business being fettered by pricing concerns.<sup>62</sup> These concerns of the public became a part of general political elections when one party promised affordable water supply. Following such entrenchment of pricing the investor suffered loss. When determining the breach the tribunal focussed on the electoral concerns of the public relating to affordable water supply. The tribunals decision on granting the investor due process rights amounted to estopping the state from changing its position with respect to the prices despite a electoral concern of voters of affordable water-supply.<sup>63</sup>

This approach impacts on any public-interest factor a state may have in relation to changing its policy to the investor. It also overrides the choice and views of local inhabitants to have their views taken into consideration b their Government. It thus precludes any claim based on a substantive legitimate

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<sup>60</sup> See *Sempra Energy Intl. v. Argentina* ICSID Case No. ARB/02/16 at paras 330-350.

<sup>61</sup> *CMS Gas Transmission Company v. The Argentine Republic*, ICSID Case No. ARB/01/8 (US/Argentina BIT) (12/05/05), at paras 317-331. The fair and equitable treatment aspect was still upheld on the hearing of the Respondent's annulment application, *CMS Gas Transmission Company v. Argentine Republic* (ICSID Case No. ARB/01/8) (Annulment Proceeding).

<sup>62</sup> *Azurix v. Argentine Republic*, ICSID Case No. ARB/01/1 (Award 14/07/06).

<sup>63</sup> *Azurix* (n63 above) at para 372-278.

expectation through an electoral or judicial process they may have. It prevents a state from taking fiscal measures that may impact on the investment that are needed for social concerns.

In *Enron v. Argentina* the dollar-peso conversion law was changed and as a result of the change the investor suffered loss.<sup>64</sup> The tribunal granted damages on the basis that the investor had a legitimate expectation that the law would not change. Enron owned shares as part of an indirect investment in TGS, an Argentine Gas Transport Company. Enron claimed that one of the core reasons why it had invested in TGS was the existence of the Convertibility Law which fixed the Argentine Peso to the US Dollar. It argued that the removal of this adjustment breached its expectations that the law would remain the same and consequently caused it financial loss. The tribunal upheld the claim on the basis that the investor had a legitimate expectation that the Convertibility Law would not be repealed.

There are fundamental concerns of the state at play here. The first is related to the regulatory powers of the State; and as a subsidiary, the regulatory powers of the State in a time of economic crisis. The Tribunal, in its reasoning on the fair and equitable treatment issue found that by removing the dollar adjustment law, and thus changing the regulatory regime the Argentine Republic had breached the investor's legitimate expectations. The Tribunal stated:

*'however strong the regulatory powers of the State might be they are still governed by the law and the obligation to protect the rights required to individuals'.<sup>65</sup>*

The tribunal intimates it will review the law-making powers of the state and that the doctrine gave the individual investor rights that could be asserted as against the state's laws. The tribunal did not think it pertinent that Argentina was in an economic crisis and had to change the law. This approach has been followed in numerous awards against Argentina.<sup>66</sup> To avoid liability to the investor the state

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<sup>64</sup> Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic, ICSID Case No. ARB/01/3 (Award 22/05/07)

<sup>65</sup> Enron (n64 above) at para 220).

<sup>66</sup> See, for example, CMS (n61 above) (Decision on fair and equitable treatment upheld in annulment proceedings- see CMS Gas Transmission Company v. Argentine Republic ICSID Case No. ARB/01/08 Annulment Decision (25/09/07at para 85. LG&E v. Argentina, ICSID Case No. ARB/02/1 (United

will thus have to avoid economic mismanagement so that it can meet investor obligations. In this instance FET is playing a governance role by setting standards of economic management.

In another case of policy based expectations, *Occidental v. Ecuador*, the foreign investor was found to have a legitimate expectation that laws that may grant tax imbursement remained the same, changing the rules by the state would result in a breach of the investor's expectations of a stable and consistent legal environment.<sup>67</sup> The use of the doctrine in these cases suggests that the scope of review of the arbitral court extends to law and policy.

Liability in the Argentine cases being based on the notion that the investor was encouraged by the laws and legal framework in place in the state. Such a protection is only usually achieved through lobbying processes by businesses in democratic regimes in the West. Thus arbitration here is turning what is often a political process into a form of legal protection. In times of economic necessity a business's case for a law to be passed or not repealed would usually have to compete with other policy priorities. This approach, due to investment treaty obligations on states, may grant foreign investors an advantage in these times over domestic businesses and competitors. Overriding national policy priorities through this use of the doctrine is of questionable legitimacy, as there is no full evaluation of competing national priorities.

On the other hand, if the opposite position were held, the onus would fall heavily on the investor to ensure that the area of policy representation being made by the Government body was capable of being met. In turn, business planning would have to cater for changes in a states legal and administrative apparatus.<sup>68</sup>

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States/Argentina BIT) (25/07/07). *Sempra Energy International v. The Argentine Republic* ICSID Case No. ARB/02/16 ((US/Argentina BIT) (Merits 27/09/07).

<sup>67</sup> *Occidental v. Ecuador* (UNCITRAL) (01/07/04) (Award) states at para 191, that tax laws must remain the same.

<sup>68</sup> The imposition of commercial risk to the investor would improve investment strategy and move commercial risk away from the state under the doctrine and to the investor. These issues are discussed fully in a separate chapter as a part of the overall current impact of investment arbitral review on commercial risk. For a broad premises of corporate governance-see D.D. Prentice 'Some aspects of corporate governances' in D.D. Prentice & P.R.J Holland ed *Contemporary Issues in Corporate Governance* (OUP) (1993)



The investor would have to ascertain which areas of the State's policies are most subject to change as a part of its investment strategy in order to ascertain likely costs and benefits. This may reduce investment in high-risk areas for the state, thus precluding key areas of growth through the lack of foreign capital.

To meet this behavioural change states may wish to give far more specific guarantees at the treaty level of policy and legal protection to say they are reducing this particular risk. This is despite any countervailing public interest cost and risk to the state arising from this legal entrenchment. However, at the moment, arbitrators are usurping this decision for states and allocating risks and burdens using legitimate expectations, thus creating a fundamental issue of legitimacy through this usurpation. Thus if it was a representation on a particular policy area that is known to be subject to change the investor could either seek re-affirmation of the representation or not undertake such a risk.<sup>69</sup>

#### **D. Contrasting Positions within the scope of rights.**

The doctrine of legitimate expectations in investment treaty arbitration is broader than its application in English law. For example, the cases of *Tecmed v. Mexico* and *Metalclad v. Mexico* apply the doctrine to prevent a state from going back on a representation, and rejecting the basis that the state has a pressing social or environmental concern for doing so despite a strong case by the state.<sup>70</sup> In the cases of *CMS v. Argentina*, *Sempra v. Argentina*, *Enron v. Argentina* the tribunals applied the doctrine to ensure that a state could not change a law where that change would have a detrimental fiscal impact on the investment.<sup>71</sup> This was despite the fact that in those cases there was a severe economic emergency in the Respondent state that justified the change in law. In *Occidental v. Ecuador* there was

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at p.27. Note also P. Hertner 'Corporate Governance and Multinational Enterprises in historical perspective' in K.J. Hopt, H. Kanda, M.J. Roe, E. Wymeersch & S. Prigge *Comparative Corporate Governance – the state of the art and emerging research* (OUP) (1998) at p.42-43.

<sup>69</sup> See, Muchilinski (n41 above).

<sup>70</sup> *Tecmed* (n20 above); *Metalclad* (n1 above).

<sup>71</sup> *CMS* (n66 above). *Enron* (n65 above). *Sempra* (n60 above) at para 113.

a legitimate expectation to a VAT refund and the state could not pass a law to do away with it.<sup>72</sup> This usage of public law is beyond the usual constitutional constraints that apply to domestic courts.

However, the jurisprudence is by no means uniform. In *Wastemanagement II v. Mexico* the local Government failed to, inter alia, pay the investor for the local cleaning services the investor provided under the contract with the investor. No breach of the fair and equitable treatment standard was found. This was on the basis that contractual disputes could not give rise to a NAFTA claim.<sup>73</sup> In that case the tribunal did not raise the doctrine to counteract the contractual misbehaviour by the State despite the fact that non-payment for services rendered by the investor undermined the investment. Nor was a relationship between the two ascertained.

By way of contrast to *CMS, Sempra & Enron* where tribunals stated that economic necessity could not mean that the state could renege on obligations to the investor, the tribunal in *Wastemanagement II* stated that such behaviour was acceptable as that Federal State of Mexico was undergoing financial difficulty at the time.

In a sharp contrast to *Tecmed* and *Metalclad*, the tribunal in *Methanex v. US* permitted the state to discriminate against an investor and pass a law that precluded the operation of a foreign investment where it had a pressing environmental concern.<sup>74</sup> The lack of findings of breaches in the decisions in *Wastemanagement II* and *Methanex* were also based on the notion that the investor

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<sup>72</sup> Occidental (n67 above) at para 185. The tribunal importantly stated that investor had an expectation that the state would not ‘alter the *legal and business environment in which the investment is made*’ at para 191.

<sup>73</sup> *Wastemanagement II v. Mexico* ICSID ARB/(AF)/00/3 (NAFTA). In similar vein the tribunal in *AMTO* held that mere commercial losses, including non-payment of debts under contracts is not enough to meet a breach of the fair and equitable treatment standard. See *AMTO v. Ukraine* SCC No.080/2005 (ECT) at para 108. By complete contrast, though the tribunal in *Azurix* does not consider it important that expectations are based on contract or law to give rise to them- *Azurix v. Argentina* ICSID Case No. ARB/01/12 at para 318.

<sup>74</sup> *Methanex Corporation v. U.S.A* (UNCITRAL) (NAFTA) (Judgment 03/08/05). For a detailed commentary, See T. Weiler, ‘Methanex Corporation v. U.S.A. Turning the point on NAFTA Chapter Eleven?’ (2005) 6 JWIT 903 at p.903-914.

has to take the risk of the market he is entering in. The latter decision made it clear that the investor ought to know or assumed to have taken a commercial risk if a particular state concerned has policy concerns that may impact on the investment. This is similar to the decision in *Wastemanagement II* where the investor is to have taken the risk of the state being in financial difficulty and thus unable to meet its financial obligations to the investor.

Some restrictions to the to the doctrine are seen in the *Continental Casualty v. Argentina*<sup>75</sup> and *Duke Energy Electroquil v. Ecuador*<sup>76</sup> cases. However it is important to note that in *Duke Energy* the basis on which the right of legitimate expectations can be formed has been narrowed (e.g. by incorporating a requirement of express promises)<sup>77</sup>, the substantive right – to the status quo of law or policy- has not been changed.<sup>78</sup> In *Continental Casualty* the tribunal did point out that the investor would need to be aware of the likelihood of the state being able to maintain laws. However this obligation on the investor (that would in effect act as a state defence to a legitimate expectations claim) would only arise in extreme circumstances, such as national emergencies.<sup>79</sup> By implication this feasible defence would not extend to cover other necessary legislation by the state, which if repealed could still form liability under the doctrine.

A conservative position, in strict contrast to the expansive usage of the doctrine in *CMS*, *Azurix* and *Sempra* to cover extant law at the time when the investment is made, is given by the tribunal in *EDF*. It states:

*‘The idea that legitimate expectations, and therefore FET, imply the stability of the legal and business framework, may not be correct if stated in an overly-broad and unqualified formulation. The FET might then mean the virtual freezing of the legal regulation of economic*

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<sup>75</sup> *Continental Casualty Company v. The Argentine Republic* ICSID Case No. ARB/03/9

<sup>76</sup> *Duke Energy Electroquil Partners & Republic of Ecuador* ICSID Case No. ARB/04/19

<sup>77</sup> See *Duke Energy Electroquil Partners & Republic of Ecuador* ICSID Case No. ARB/04/19 at paras 355-361

<sup>78</sup> In *Duke Energy* the tribunal affirms the substantive right before going into narrower grounds on which a claim can be formed (See para 355).

<sup>79</sup> *Continental Casualty Company v. The Argentine Republic* ICSID Case No. ARB/03/9 at para 262.

*activities, in contrast with the State's normal regulatory power and the evolutionary character of economic life.*<sup>80</sup>

This approach preserves general regulatory activity of the state, the importance of which was intimated by Professor Wälde in *Thunderbird*. It also is realistic in its appraisal of the state's need to change its position vis-à-vis changing economic circumstances. This approach would have led to a different outcome in the *Azurix* dispute. As to using the doctrine as possible estoppel on the state to prevent it from changing the law, the *EDF* tribunal states: *Further, in the Tribunal's view, the FET obligation cannot serve the same purpose as stabilisation clauses specifically granted to foreign investors*.<sup>81</sup> This is what *CMS* in effect did using the doctrine. This is an usurpation of the state's direct right to contract with the investor by including such a protection through the treaty.

## **E. Positions of Deference in Investment Treaty Arbitration**

However, decisions in investment treaty arbitration have not been wholly without respect to deferring to a state's rights to pass laws or regulate.

In *Methanex* a tribunal adjudicating under NAFTA could see no reason why California's ban of the investor's product in the host-state was a breach of NAFTA considering that there were environmental and social concerns over the investor's products.

Importantly, on its holding on expropriation the tribunal stated that The tribunal said that expropriation could occur by removal of '*representations made by the host-state that are reasonably relied on by the Claimant*'.<sup>82</sup> This did not occur here. This is because the tribunal felt that *Methanex* entered into a '*political economy*' that was '*widely known , if not notorious*' for its environmental and health protection institutions. The tribunal emphasised that the claimant ought to know of this regulatory and institutional process.<sup>83</sup> Similarly, in the *MTD* case the tribunal stated that investors could not complain of changes of policy in the ground if had

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<sup>80</sup> EDF (n18 above) at para 217.

<sup>81</sup> EDF (n18 above) at para 218.

<sup>82</sup> Wastemanagement (n36 above) at para 98).

<sup>83</sup> *Methanex* (n74 above) at (IV-D-5 paras 9 &10)..

not investigated the likelihood of a high frequency of those changes prior to making its investment.<sup>84</sup>

This is a contrasting position to the allocation of risk to *Enron*. *Methanex* intimates there is some onus on the investor to know of the risks of the market he is entering into. From one perspective, the tribunal was not willing to hold state responsible for the investor's choice in investing into a market that was at risk. Whether this is fair on the investor may be dependent on the level of commercial risk that investment treaties were supposed to guard against. However, despite an adverse finding of the investor from a legitimacy point of view, it must be noted that the tribunal is still involved in the allocation of risk.

If the *Methanex* approach was taken in the case of *Azurix* the result would be quite different. This would most likely prevent an investor claim as the investor would be taken to have known of the risks of investing in a market area that is likely to be highly politicised. Thus the price of water-supply in an Argentine province, being a key part of the lifestyle of domestic nationals is inextricably going to raise social concerns. The approach in *Methanex* questions the approach in *Azurix* as to whether the investor's rights should prevail over law-making that deals with a pressing social concern, or whether it should be perceived to be an investment risk. If the latter approach is taken it would place the claim beyond adjudication, and move the fair and equitable treatment standard away from the sphere of legal or policy review. It would leave states free to act freely in the law of policy sphere, without the constraints of investor risks, as the state would know that the investor would be aware of the risks of that market.

Similarly the tribunal in *Lauder* said regarding a state's right to regulate media: '*There can not be any inconsistent conduct in a regulatory body taking the necessary actions to enforce the law, absent any specific-taking that it will refrain from doing so*'.<sup>85</sup> Similarly the tribunal in *Genin* recognised the state's need to regulate its banking sector when faced with economic turbulence. Thus the tribunal stated: '*The tribunal further accepts*

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<sup>84</sup> MTD Equity Sdn Bhd & another v. The Republic of Chile (2005) 44 ILM 91 at para 117.

<sup>85</sup> *Lauder v. Czech Republic* (Award) 9 ICSID Rep 62 at para 108.

*the Respondent [States] explanation that the circumstances of political transition prevailing in Estonia at the time justified heightened scrutiny of the banking sector. Such a regulation by a state reflects a clear and legitimate public purpose*'.<sup>86</sup> Thus it was said that the bank had good reason to revoke the licence.

These passages indicate that when faced with genuine regulatory activity or policy concerns of the state, the investor may not have a successful claim for substantive legitimate expectations.

## **F. Conclusions**

The field of jurisprudence is moving towards a requirement of fixed representation for a claim for legitimate expectation. However, as there is no system of precedent, an investor could feasibly pick the *Tecmed* decision and succeed on formulating an expectation on policy without the state being aware of it. This leaves Respondent states under some legal uncertainty with respect to when these obligations will be engaged

It can also be seen that under the second operation of the doctrine there is a broad power to judicially review law, policy and administrative conduct of the host-state. However, as seen in the last section it is not the case that investment treaty arbitration panels do not defer at all to the law or policy of host states. Thus there are different arguments available to the investor as to scope of review over regulation, law and policy. In some cases (*CMS*, *Azurix*, *Enron*) there is not a scope for the state to justify, due to the outcome in the investor's favour on legitimate expectations, a shift in position due to genuine policy concerns (though state necessity to do so for an economic emergency, is arguably, not clearly, within such the ambit of a genuine concern). In others, as the last section shows, demonstrates that legitimate regulatory action and policy changes by the state is something the investor will not get protection from. As there are arguments for a broader position of protection in the former position, in terms of encouraging capital through its protection, as well as an important need for states to have

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<sup>86</sup> Genin, Eastern Credit Limited Inc and As Baltoil v. Republic of Estonia (Award) (2001) 6 ICSID Rep 236 at paras 299-302.

policy changes (thus building a case for deference), legal certainty as to scope of protection remains unclear until this battle is suitably resolved. Though as the English law position below shows, deference does solve this problem through assuming that the state's right to act in the policy sphere is absolute. However this approach may come at a cost of genuine investor complaints when it has relied on a particular policy being intact when making its investment.

As far as direct representations are concerned, the above jurisprudence also demonstrates that when there is a direct application for a licence by an investor and then there is a refusal to grant it by the state, that will breach the doctrine. Also a revocation of an existing licence that is requisite for an investment to function will also be in breach of the doctrine.<sup>87</sup>

In some cases where the investor has not taken steps to come to a settlement of the dispute with a state institution, there will not be such a breach.<sup>88</sup> Further where the investor enters into a sector that is known for its high-level of regulatory activity, the investor will be taken to have taken the risk of regulatory investments into consideration. Thus it will not be possible to sue on such a basis.<sup>89</sup>

If the existing jurisprudence is complementary, one way *Methanex* might be differentiated from *Tecmed* and *Metalclad* is from the view that the investor in the latter cases may not have been known to the investor that ecological concerns may result in regulatory changes. Thus the investor in those cases could be taken to have not accepted such a risk. *Tecmed*, *Methanex*, and *Metalclad* show different levels of deference to state policy in the NAFTA context. There is thus little truth in the following statement being the uniform approach of NAFTA tribunals:

*'It is a fact of life everywhere that individuals may be disappointed in their dealings with public authorities...NAFTA was not intended to provide foreign*

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<sup>87</sup> as per *Tecmed* (n20 above) and *Metalclad*, (n21 above).

<sup>88</sup> *Waste Management, Inc. v. United Mexican States* (Number 2), ICSID Case No. ARB(AF)/00/3 (NAFTA). (30/04/04)

<sup>89</sup> as per *Methanex*, (n74 above).

*investors with blanket protection from this kind of disappointment, and nothing in its terms so provides*.<sup>90</sup>

This comparator to the *Tecmed and Metalclad* cases is a reminder that the open-textured drafting of investment treaty standards can lead to different approaches.<sup>91</sup>

### **2.3 Legitimate Expectations in English Law:**

In English law the doctrine will be acting under constitutional constraints that would prevent the individual from relying on state policy or laws as a basis of a claim on legitimate expectations. It will be interesting to see how English law has balanced state needs with individual rights, and whether deference, and a working system of precedent, gives clarity to the two areas of ambiguity seen with FET. These are ambiguity surrounding the scope of review and ambiguity surrounding the requirement for a direct representation.

Generally, as opposed to the investment treaty arbitration use of the doctrine as described above, there is a far narrower scope of review under English law, due to constitutional constraints operating on courts. In no instances has the doctrine given the individual a right to claim against changes in the State's law or policy. Barring one circumstance, English law has not compelled a Government body to issue licences or revoke them where a representation has been made to the contrary. In that instant the compulsion was only a result of the body acting inconsistently with existing Government policy<sup>92</sup>.

Overall the procedural rights limitation of the doctrine demonstrates a characteristic of the doctrine in English law as one of significant deference to the

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<sup>90</sup> *Azinian v. United Mexican States*, 39 ILM 537 (2000) at p.549.

<sup>91</sup> This has led to some baseless conjecture as to what the intentions of state-parties to NAFTA might have been, See, e.g: 'A.K. Bjorklund 'Contract without privity: Sovereign Offer and Investor Acceptance' (2001) 2 Chi. J. Int'l 183. reflecting on the different approaches and the Azinian tribunal's statement. (n90 above).

<sup>92</sup> *R v. North and East Devon Health Authority, ex parte Coughlan* [2001] QB 213.



policy-maker. This proposition is based on the fact that no substantive right is granted under the doctrine to entrench Government law or policy. The analysis below demonstrates that in a range of policy areas where representations have been made by Government bodies and revoked, the decision of the court has never touched on the policy or law behind the decision-makers actions.

As English law operates under a doctrine of precedent, the position of the scope of rights available under the doctrine has been fixed by the decision of the House of Lords in *Findlay*. Following the House of Lords decision in *Findlay* the doctrine in English law has been tightly contained so as to only contain procedural rights. Any variations from this strict limitation have been overruled.

A meander from this position in the judgment of Sedley J in *Hamble* that was quickly overruled by the Court of Appeal in *ex parte Hargreaves*<sup>93</sup>. Looking at a range of some of the key decisions there is a marked deference to a range of policy areas. Although all policy areas are not covered by the case law the courts in the UK have not interfered with criminal justice policy, tax-policy, fishing policy, immigration policy and education policy. The only decision that stems away from the paradigm of deference is that of *ex p Coughlan* which granted substantive legitimate expectations. This, however, this was expressly justified as being within the existing legal framework.<sup>94</sup> Even this decision, the substantive grant was granted on the basis that it existed within existing law. This is opposed to a method of granting it by preventing a change in law as seen in investment arbitration.

As Lord Hoffmann has clearly stated:

*‘There is of course an analogy between a private law estoppel and the public law concept of legitimate expectation created by a public authority...But it is no more than an*

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<sup>93</sup> The material issues in these cases are elucidated below.

<sup>94</sup> *ex parte Coughlan* [2001] QB 213 at p.230 (paras 23-25).

*analogy because remedies against public authorities have to take into account the interest of the general public which the authority exists to promote’.*<sup>95</sup>

The doctrine of legitimate expectations may be engaged whenever there is a representation made to an individual by a Government body<sup>96</sup>. The leading case of *Findlay* the application before the House of Lords concerned a custom by the Home Secretary, to release prisoners automatically if the parole board provided a recommendation of release. The Home Secretary changed this policy to release prisoners in only exceptional circumstances. The applicants applied for judicial review on the basis that the change of policy had defeated their expectation of early release under the previous scheme.

The Home Secretary’s rationale of taking into consideration of the need for ‘*deterrence, retribution and the need to maintain public confidence in the administration of criminal justice*’, was accepted by House of Lords to defeat the claim<sup>97</sup>. The decision stated that the Home Secretary had a right to change his mind due to policy concerns and right of legitimate expectation to procedural rights of a fair hearing and the substantive right- i.e. Lord Scarman expressly rejected that there was legitimate expectation that the Home Secretary act *legally* within the ambit of prior existing legislation. As Lord Scarman stated:

*‘any other view would entail the conclusion that the unfettered discretion conferred by the statute upon the minister can in some cases be restricted so as to hamper, or even to prevent, changes of policy’.* (ibid) The reason for the court leaving this discretion untouched was as follows: *‘Bearing in mind the complexity of the issues*

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<sup>95</sup> R v. East Sussex CC, ex parte Reprotech Ltd [2002] UKHL 8 at para 34. Cited in S. Wilken *The law of waiver, variation and estoppel* 2nd Ed. (OUP) (2002) at para 1.08. This follows the approach in English administrative law not to cater for policy review, but limits review to the very acts of Government bodies, thus following the law of legality (see Chapter 1). Thus: ‘...once the legitimacy of the expectation is established, the court will have the task of weighing the requirements of fairness against any overriding interest relied upon for the change of policy.’ per Lord Woolf In ex p Coughlan (cited supra) at para 57.

<sup>96</sup> Lord Fraser in *Council for Civil Service Union v. Minister for Civil Service* [1985] A.C. 374 states ‘*Legitimate...expectation may arise either from an express promise given on behalf of a public authority or from the existence of a regular practice which the claimant can reasonably expect to continue*’. (at p.401).

<sup>97</sup> [1985] A.C. 318 at page 333.

*which the Secretary of State has to consider and the importance of the public interest in the administration of parole I cannot think that Parliament intended the discretion to be restricted in this way'. (ibid).*

From this perspective, Sedley J's reasoning in *ex p Hamble* is an outlier. In *Hamble* English law broadens the scope of review to policy, leaving the door open to substantive review. *Hamble* concerned the policy of having quotas on trawler licences to protect fishing stocks. This policy, based in European law fishing restrictions, resulted in the custom of the sale of trawler licences by virtue of volume of ship. The applicants bought a ship in view of obtaining a licence. Following their purchase the Minister changed the quota policy making it impossible for the applicants to obtain a licence for their ship.

Sedley J said that the applicants did not have substantive legitimate expectations as the Minister had followed a policy change '*within a band of rational policy choices*' on the basis that it would be unfair to leave the applicants following a purchase without a licence.<sup>98</sup> The decision is sound from the basis that in light of the pressing policy needs of the Minister to control quotas, for example to preserve fish-stocks, this was an unnecessary restriction placed by the court. However, on a more careful analysis the judgment appears to bring the choice of policy of the Minister within the ambit of judicial review.

Inherent in Sedley's approach is the judicial desire to review policy. This approach is characterised by forcing the Minister to justify his change of position, in order to ensure the change of policy is a rational one. Though it is an expected part of public law that executive decisions should be rational, it is more questionable whether it is in the field of judicial competence to determine policy rationales.

The court, of course, cannot qualitatively assess public interest in the administration of parole. Any such approach also has the risk of being based on

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<sup>98</sup> at *R v. Minister of Agriculture Fisheries and Food Ex parte Hamble (Overseas) Fisheries* [1995] 2 All ER 714 at p.723b.

judicial intuition as opposed to qualitative assessment.<sup>99</sup> This is an assumption that the court takes into account when deciding whether to grant substantive protection under the doctrine. This assumption is deferential in effect to the legislature-it is an intuitive deference to the law-maker and its determination of public interest.

Thus there is policy deference to the legislature's criminal justice policy. A prisoner cannot claim a legitimate expectation on the basis of a change of release policy. All a prisoner could have is the procedural right that his case for release would be heard. This approach was confirmed in the case of *ex parte Hargreaves*.<sup>100</sup> In *Hargreaves* the English court of appeal did not grant legitimate expectations that would fetter the ministers discretion to change sentencing policy from considerations of release from a third of sentence being served to half.

Thus there could be no substantive legitimate expectation that such a policy would not be changed. The Court of Appeal also stated that the approach by Sedley J in *Hamble*, described above, was dubious in its approach of leaving the grant a substantive legitimate expectation feasible on the basis of fairness.<sup>101</sup>

Leaning towards the substantive doctrine has been marked by judicial trepidation. The case of *MFK Underwriting Agents Ltd* concerned investments made by numerous tax-payers on the basis of tax benefits arising out of existing UK tax policy<sup>102</sup>. This policy allowed viable investment in dollar securities as long as the sale of such securities was taxable as capital and not as income, the latter being subject to a greater tax burden. The UK Revenue then decided to change policy by taxing income on such sales and not capital. The decision rejected the

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<sup>99</sup> For views on the limits of judicial reasoning see- M.D. McCormick 'The role of intuition in judicial decision-making' (2005) 42 Hous. L. Rev 1381 at p.1381-1392. For a case of caution of judicial approaches to review in the early days of the American system, due to the subject matter of Government decision-making see Davison - 'Administration and judicial self-limitation' (1936) 4 Geo. Wash. L. Rev 291 at p.292-298.

<sup>100</sup> R v. Home Secretary *ex parte Hargreaves* [1997] 1 WLR 906

<sup>101</sup> Hirst L.J. stated that he agreed with counsel that Sedley J judgment in *Hamble* was 'heresy' though gives no reason why. [1997] WLR 906, at 921 e-f. For *Hamble* see R v. Ministry of Agriculture, Fisheries and Food, *ex p Hamble Fisheries* [1995] 2 All ER 714, particularly at ps. 731-732.

<sup>102</sup> R v Inland Revenue Commissioners, *ex p MFK Underwriting Agents Ltd* [1990] 1 WLR 1545.

application that the change of decision by the revenue was illegal. As to legitimate expectations Bingham L.J. left open the possibility of the doctrine of substantive legitimate expectation in the narrow circumstance where the claimant seeking the expectation had made it known to the revenue of his specific position and the revenue had made specific assurances to that individual based on the individual's assurances.<sup>103</sup>

However it is not clear from the decision why this approach is suitable from the general rule, and the judge does not appreciate that the doctrine in that instance approaches a similar use to that of an estoppel<sup>104</sup>. The approach is, however, reluctant and is still marked by judicial deference to the policy-maker. To put it in other words, unless a specific representation is made to an individual following the individual's consultation with the public body, for the purposes of tax policy there will be no legitimate expectation binding the revenue.

This demonstrates deference to the policy maker. The court could have reasoned broadly and permitted a breach of legitimate expectation for the change of policy, leaving the burden on the Government to ensure that it met its assurances to all individuals by having an open period of application for compensation. Bingham L.J.'s approach of specific representations is still stricter than that seen in investment arbitration. This is because in investment treaty arbitration as present the legitimate expectation claims are based on incidental impact of the policy change and not by direct representation.

Bingham L.J. in *MFK Underwriting* was wary of the fairness element in the doctrine of legitimate expectation should operate to protect the state as much as the individual:

*'But fairness is not a one-way street. It imports the notion of equitableness, of fair and open dealing, to which the authority is as much entitled to as the citizen'*.<sup>105</sup>

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<sup>103</sup> [1990] 1 WLR 1545 at p.1569 B-H

<sup>104</sup> The position has been made clear by Lord Hoffmann's *ex parte Reprotech* (n95 above).

<sup>105</sup> (n104 above) at p. 1570 A-B

This questions whether it is feasible to grant an expectation when there is a change of circumstances and where there is no direct assurance given to the investor, as that would not necessarily be fair on the state. A mere existence of a treaty and existing legal framework in the creation of legitimate expectations can be perceived as giving rise to an unfair claim against the state.

The approach of favouring procedural rights over substantive rights has also been preferred in the sphere of immigration policy. Thus in *AG of Honk Kong v. Ng Yuen Shiu* the Hong Kong government had stated that it would interview non-Chinese applications for immigration and later reneged on this representation.<sup>106</sup> It was held by the Privy Council to have breached a legitimate expectation of interviewing that it had created by its representation. That this was only the right to be interviewed, a due process right, as opposed to a decision on the question of immigration, demonstrates that the court in that instance was not willing to adjudicate in the policy-sphere.

Judicial deference in the application of the doctrine is also given to immigration policy. The principle of legitimate expectations first appeared in English law in the case of *Schmidt v. Secretary of State for Home Affairs*.<sup>107</sup> Schmidt was a foreign national who had been given leave to enter the United Kingdom and study scientology for a limited period. There was an existing policy to allow foreign nationals to study at a recognised educational establishment. Though initially her chosen institution was recognised by the Government it later declared that the institution was unsound and harmful due to its practice. Thus the Government reneged on its promise to renew Schmidt's stay that it had granted on entry. Schmidt's application to hold the Government to its representation was dismissed by the Court of Appeal. In a classic statement of deference, based on public interest, to the policy-maker Lord Denning stated:

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<sup>106</sup> *AG of Honk Kong v. Ng Yuen Shiu* [1983] 2 A.C. 629

<sup>107</sup> *Schmidt v. Secretary of State for Home Affairs* [1969] 2 Ch 149

*'I think that the Minister can exercise his power for any purpose which he considers to be for the public good or for the interests of the people of this country'.<sup>108</sup>*

Lord Denning MR stated that those that came under the immigration laws of a legitimate expectation to the procedural right to making representations.<sup>109</sup> It might be said that in such circumstances there is little point in having a procedural right, where there is no legal avenue for protection of the individual via policy change. However as the rule of law theory justification for public demonstrates, that the value of participation here is that ensures the perception of freedom of natural justice and preserves individual autonomy. These are values that may be important to an economic agent, the investor, in investment treaty arbitration as much as they are to a private individual.

The case of *Coughlan* forced a health authority to uphold a promise to keep a nursing home for life on the doctrine of legitimate expectation. However, even the successful application of the doctrine in this case was based on the principle of legality. The health authority created a policy of only providing specialist nursing services, general nursing services would be provided by local authorities. This resulted in nursing services promised to the applicant in a home 'for life' to be withdrawn. The Court of Appeal dismissed the appeal by the Health Authority stating that a distinction between general and specialist nursing was vague and contrary to the obligation placed by law on the health authority to provide nursing services. The Court of appeal stated the applicant had a legitimate expectation that the promise of nursing services in the home would be kept and there was a legal obligation on the health authority to do so.

The court gave two circumstances in which a substantive legitimate expectation may be held. This would be where a breach of a promise: (i) was so unfair as to amount to an abuse of power and (ii) there was no overriding public interest in departing from the decision as a result of mere financial loss.

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<sup>108</sup> (n107 above) p.169

<sup>109</sup> (n107 above) per Denning MR at p.171

It should be noted that the Court did not uphold the legitimate expectation over the existing legislation. This possibility did not arise as the law did not leave much discretion in the provision of nursing care to the health authority. The decision itself is highly questionable considering the revenue constraints upon local authorities in providing health services. The decision in essence removes the scope for the health authority to make distinctions in services where a limitation on revenue exists.

If the individual has not acted fairly in English law then there will be no legitimate expectation. In *Ex parte Camacq* the revenue decided to change its position on tax when it discovered that the proposed scheme was not for a bona fide or legitimate purpose. The court said that the revenue could revoke its authorisation.<sup>110</sup> The court will not uphold a legitimate expectation with respect to a representation and where the applicant acquired the representation from the tax body by not disclosing all the relevant facts. The court here did analyse whether it was appropriate for the revenue to revoke its authorisation, but this was done by analysing whether such an act was within the powers granted to the revenue by statute. Thus the analysis of whether it was fair to revoke was done within the doctrine of legality.

The court is also deferential to the state in the case of state employment contracts. The case of *Hughes v. Department of Health and Social Security* concerned a change of date as to the retirement dates of certain classes of civil servants.<sup>111</sup> A representation by Government departments to their civil servants to employ them beyond the age of 60 could be changed and the expectation could only exist as

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<sup>110</sup> R v. Inland Revenue Commissioners *Ex parte Camacq Corporation et al* [1990] 1 W.L.R. 191

<sup>111</sup> *Hughes v. Department of Health and Social Security* [1985] A.C. 776 Note Lord Diplock's classic statement of deference at p.788 B-C: '[the expectation] remains the case only so long as the departmental circular announcing that administrative policy to the employees affected by it remains in force. Administrative policies may change with changing circumstances, including changes in the political complexion of governments. The liberty to make such changes is something that is inherent in our constitutional form of Government. When a change in administrative policy takes place and is communicated in a departmental circular...any reasonable expectations that may have been aroused by them by any previous circular are destroyed'.



long as such policies existed and would terminate where there was a change of policy. The effect of this decision is that when law or policy is changed, expectations based on those law or policies will desist. There can be no expectation that such policies will continue in the future, as that would allow the doctrine to entrench the policy making discretion of the Government. This would mean that the relevant Minister would not be able to change age of employment policy if there was a need to do so on the basis of limited revenue.

The case of *Bhatt Murphy v. Independent Assessor* concerned the existence of a Government compensation scheme which was subsequently abolished.<sup>112</sup> The applicants applied for compensation following the abolishment and their application was rejected on the basis they should have started the application prior to the scheme being abolished. The applicants claimed that they had a legitimate expectation based on the existence of a scheme and the Government was under a duty to consult them as to abolishment. The court stated that the mere existence of Government scheme was not by itself sufficient to create a legitimate expectation that the scheme would be continued. Further, the minister was entitled to abolish it without consultation or notice.

The tribunal stated however, applying *Coughlan*, that the protection of procedural legitimate expectations in English law had to be one based on a focussed representation to the individual. The individual cannot rely on mere existence of policy remaining stagnant to create legitimate expectation where that policy was not aimed at the individual. This is a contrast to a pseudo-estoppel approach in investment treaty arbitration where the investor can rely on law or policy where it is not clearly focussed on the investor.

Thus, in contrast, the Argentine cases broad provisions of law to allow capital flow created a legitimate expectations that such policy would remain the same. It can be seen from this perspective that the doctrine in investment arbitration goes further. That an investor has an expectation that Government policy will remain the same. The doctrine of legitimate expectations in English

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<sup>112</sup> Regina (Bhatt Murphy (a Firm) and Others v. Independent Assessor Regina (Niaz et al) v. SSHD (TLR 21/07/08)

public law is characterised by deference to law or policy maker. As it gives no substantive right, it follows the fundamental principle of 'legality' that underpins public law. This is made clear by the case of *Findlay*. A core part of this reasoning is the importance that English Public law gives pre-eminent regard to the inherent discretion granted to ministers' by the relevant law. That courts do not interfere with the powers that are granted, but only the manner in which they are exercised.

The limitation of the doctrine to procedural rights demonstrates that policy areas are beyond the reach of the doctrine in English law. This means that the scope of review is restricted to procedural failings or the manner in which the decision is undertaken rather than the policy upon which the decision is taken. Thus the investment treaty decisions in the Argentine cases would not give rise to a breach of the doctrine. It is an inherent policy deference that limits the application of legitimate expectations doctrine in English law. This deference is characterised mainly by two elements:

- (i) the public body has given reasons for its decisions (the reasons themselves are reviewable by an English court on the grounds of 'rationality'). The law or policy under which the decision-making power is given is never reviewed.
- (ii) Upholding the expectations does not go contrary to the powers granted to the public authority. In other words if upholding the representation would breach the limits of powers granted to the public authority.

It can be seen from contrasting the English approach to the investment treaty arbitration approach that there is a greater scope of review in arbitral review by permitting a substantive doctrine of legitimate expectations. The judicial approach in English law recognised that there are important reasons for Government flexibility for changing the policy was given as follows. Thus in cases such as *Re Findlay* the unfairness of the individual applicants was overridden by '*the aim of improving public safety and increasing public confidence in the administration of justice*'. This highlights the deferential approach by English courts.

## EU Law:

What follows is not a comprehensive account, but one that intimates the paradigm of administrative deference.

The doctrine in EC law has been closely linked to the doctrine of legal certainty. In the leading case of *SNUPAT* the ECJ recognised that there were limits to the principles of legal certainty and legitimate expectations. The court stated that these doctrines could not override the exigencies of policy making by the Community. In this case the policy dealt with steel tariffs:

*‘That allegation disregards the fact that the principle of respect for legal certainty, important as it may be, cannot be applied in an absolute manner, but that its application must be combined with that of the principle of legality; the question which of these principles should prevail in each particular case depends upon a comparison of the public interest with the private interests in question, that is to say:*

*on the one hand, the interest of the beneficiaries and especially the fact that they might assume in good faith that they did not have to pay contributions on the ferrous scrap in question, and might arrange their affairs in reliance on the continuance of this position*

*on the other hand, the interest of the community in ensuring the proper working of the equalization scheme, which depends on the joint liability of all understandings consuming ferrous scrap; this interest makes it necessary to ensure that other contributors do not permanently suffer the financial consequences of an exemption illegally granted to their competitors’.*<sup>113</sup>

This approach of deference to the principle of legality has been the paradigm approach by the court in subsequent cases. Thus in the *Algera* case the applicant had been promised a job by a community institution and then having taking legal

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<sup>113</sup> [1961] ECR 53 at p. 87.

action against the community with respect to another matter, was denied a job.<sup>114</sup> The Court decided that if such a right once granted could not be revoked, so long as it was within the field of legality.<sup>115</sup> The deference to legality is inherent in the decision of *Euroagri* where the court stated that aid policy that was in itself illegal could not result in a decision that could not later be revoked, irrespective of the expectations it had created.<sup>116</sup>

The case of *Durbeck* involved the passage of a Community regulation that suspended the free circulation of certain types of apples from certain countries such as Chile.<sup>117</sup> *Durbeck* wished to release certain apples into the market but was precluded from doing so by the relevant authorities. The Community passed the law after the community apple producers sought a protective measure when the policy was originally announced. It was noted by the ECJ that the measures affected those who had apples that were about to be released and existing contracts in relation to apples in transit. For this reason there was a specific provision in the Regulation (Article 3(3) of EEC No. 2702/72) to deal with apples in transit as it was conceded that those individuals would have a legitimate expectation that their contracts would be fulfilled.

The ECJ noted that the protective measure in the regulation could only protect those who the Community with its limited data might be affected. The ECJ then reviewed the information available to the Community to pass the measure.<sup>118</sup> It appreciated that the community had knowledge of the risk of excess apples flooding the community market. The community also had knowledge of pricing trends that would affect the disposal of apples in the future. The Court rejected *Durbeck's* application that it had a legitimate expectation to continue trading in the proscribed apples. It reaffirmed its position in the *Tomadin* case that

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<sup>114</sup> (Cases 7/56 and 3-7/57, *Algera v. Common Assembly* [1957] ECR 39

<sup>115</sup> at p.55. This principle was confirmed in the case of *Verli- Wallace v. Commission* [1983] ECR 2711.

<sup>116</sup> *Euroagri Srl v. Commission* [2004] ECR II-369 at para 87.

<sup>117</sup> *Durbeck v Hauptzollamt Frankfurt am Main-Flughafen* (C-112/80) [1981] ECR 1095

<sup>118</sup> *Durbeck* at (n118 above) at p. 1115.

there are limits to the legitimate expectations doctrine for the individual where there is a greater community interest at stake:

*'the field of application of this principle cannot be extended to the point of generally preventing new rules from applying to the future effects of situations which arose under earlier rules in the absence of obligations entered into with the public authorities...this is particularly true in a field such as the common organisation of markets, the purpose of which necessarily involves constant adjustment to the variations of the economic situation in the various agricultural sectors'.<sup>119</sup>*

The ECJ here has deferred to the community's ability to pass measures to protect the single market.

The position in EC law poses an interesting comparator, as like investment treaty arbitration, EC law is a treaty-based system. The distinction here, to investment treaty arbitration, is that these policy areas are within the Treaty. The Contracting Parties to the Treaty have delegated such legislative or policy-making functions to the European Commission. No such delegation of powers is written into investment treaties. As described in Chapter 1 there is an absence of delegated policy-making in the express drafting of bilateral and multi-lateral investment treaties, such as NAFTA.

## 2.4 Conclusions

The scope of review is considerable under legitimate expectations. No decision in English law has gone as far as to demand from the state a change in policy to meet an individual injustice caused by a decision to revoke a representation by a Government body. Further, English law the courts does not engage the doctrine of legitimate expectation to create substantive rights or grant

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<sup>119</sup> Case 84/78 Tomadini [1979] ECR 1801 which deferred to Community agricultural policy when the doctrine was raised at p. 1815.

compensation by virtue of changes of the law on the breach of an individual's legitimate expectation.

In English public law accountability is provided *within* an existing framework of law and policy. It is not the constitutional role of English public law to provide accountability for law or policy itself. Such processes may be unique to the each state and providing a level of accountability as appropriate.<sup>120</sup>

The operation of the doctrine in investment arbitration, as in English law, also operates to grant the investor procedural rights when a government body carries out a decision. The fourth is not wholly explored thus far in the jurisprudence but involves the grant of public law procedural rights of participation and due-process in a manner similar to the municipal operation of the doctrine. Thus the tribunal in *Rumeli & Telsim v. Kazakhstan* states:

*‘as emphasised by the AMCO I and II decisions, regardless of the examination of the substantive grounds relied upon by a State agency in the framework of the revocation of a licence. “the mere lack of due process would have been an insuperable obstacle to the lawfulness of the revocation”’.*<sup>121</sup>

Not all formulations in investment treaty arbitration support substantive rights. There is a balanced approach intimated in investment treaty arbitration by the *Saluka* tribunal. After reviewing the approach in the *CME*, *Tecmed*,

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<sup>120</sup> For an account of the plurality of systems of Government in the world and problems of governance, See G R. Wilkinson & S.Hughes ed, *Global governance: critical perspectives* (Routledge) (2002). Note also RD Grillo, *Pluralism and the Politics of Difference: State, Culture, and Ethnicity in Comparative Perspective* (OUP) Clarendon Press (1998) at p.1-14. For problems this causes in international law- See, D. Donoho, ‘Relativism versus universalism in Human Rights: The Search for Meaningful standards’ (1991) 27 Stanf. L.J 345 at p.345-349. B. Graefrath, ‘The Application of International Human Rights standards to states with different economic, social and cultural systems, in *The United Nations after forty years: human rights* (1986) cited in R. Higgins *Problems and Processes International Law and How we use it* OUP (2004) at p.96-96 ftns, 3&4. See also P. Klingeld, ‘Defending the plurality of states: Cloots, Kant and Rawls’ (2006) 32 (Oct) Social Theory and Practice 559 at p.559-567.

<sup>121</sup> *Rumeli Telekom A.S. & Telsim Mobil Telekomikasyon Hizmetleri A.S. v. Kazakhstan ICSID ARB/05/16* (Award 29/07/08) at para 327. Here the tribunal stated that there was a wrongful termination of contract by the Respondent states as it had not, as promised, taken into consideration reports as to contractual performance by the investor.

Wastemanagement and OPEC decisions, the tribunal stated this regarding legitimate expectations:

*'If their terms were taken too literally, they would impose upon host-states obligations which would be inappropriate and unrealistic...their expectations [of the investor], in order for them to be protected must give rise to the level of legitimacy and reasonableness in light of the circumstances...No investor may reasonably expect that the circumstances prevailing at the time of the investment remain totally unchanged'*<sup>122</sup>

This is perhaps a more realistic and fairer way of constructing the substance of the rights, so that states can meet their public policy exigencies without excessive fear of liability to investors. However, it just one preferable elucidation that can be picked by investors and states over others.

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Overall, it has been seen that under FET there are decisions that grant the investor the right to particular policies or law, and do not just compensate the investor for legislative and policy changes or limit the doctrine to rights of participation in administrative process. There are also contrasting decisions that suggest that the grant of such rights to the investor are not appropriate. Further, investment arbitration has not made it clear that for an expectation to arise legitimately it has to be based exclusively on an express representation to the investor. These inconsistencies leave the outcome of investment treaty litigation difficult to predict due to key requirements to satisfy the doctrine being unclear. It shall be seen that in English law these ambiguities have been reduced due to clear requirements as to how the doctrine is engaged and clarity as to the scope of the doctrine. This is through the creation of ascertainable legal requirements to engage the doctrine and clarity as to the constitutional boundaries of review.

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<sup>122</sup> Saluka (n17 above) at paras 304-305. The tribunal then emphasised the limits of the tribunals adjudicatory powers quoting the passage from S.D. Myers that it was not to tribunals role to interfere in the regulatory sphere of the state (n4 above) at para 293. (Saluka (n17 above) at para 305).

Further the analysis of the constitutionally restricted approach in English law demonstrates that 'deference' affords public interest protection in the application of this doctrine. This approach of legislative deference to implicitly preserve majoritarian consent in law and policy. Arguably, from this perspective, the doctrine has also maintained the democratic integrity of judicial review of state action. This protection of majoritarian or public interest through deference is not a clear position under the FET, through its review on occasions of law and policy.

To improve coherence, it can be seen from determinations of tribunals that the doctrine of in investment arbitration requires the following: (i) the use of a discretionary deference to the legislature; (ii) the requirement of a clear state act upon which an expectation can be based; (iii) the development of a consistent range of procedural rights that can be afforded to the investor; (iv) a consistent position as to the scope of the doctrine-I.E. Whether it includes the right to overrule law and policy. These will all mitigate against the incoherence necessary for a legitimate use of the doctrine so that rights and obligations can be easily determined. This will increase predictability and efficaciousness of the doctrine that will increase its coherence. The EU Law approach of deference may also assist here as a model for emulation.



**Chapter 3:**  
**‘Transparency, Consistent Conduct and freedom from arbitrary  
interference’.**

**3.1. Introduction.**

**3.2. Transparency as a concept.**

**3.3. Thresholds for Transparency under FET.**

**3.4. English law**

**A. Procedural transparency.**

**B. Non-disclosure in the Public Interest and the Need for  
Confidentiality**

**C. Synopsis**

**3.5 International Transparency Drivers**

**A. Increasing procedural transparency**

**B. Using international drivers for coherence**

**3.6 Conclusion**

**Abstract**

*This chapter will look at the FET interpretation of transparency and see whether the burden it places on states is realistic. It shall also look at general coherence of the rule under FET by illustrating two contrasting positions regarding the rule. It shall also suggest how improvements to the rule could be made, if necessary, by incorporating work of other international institutions on transparency.*

**3.1. Introduction.**

The requirement of transparency is a rule created under the FET standard in order to assist investors in their dealings with state organs. This chapter will argue that transparency under the FET is illegitimate due to both the lack of coherence and the inability of many developing states to comply with the standard in some of the current formulations. English public law shall be used as a reference to

demonstrate how transparency under FET can become more coherent, and develop more specific and useful rights for investors in dealing with public administration.

Transparency as defined by arbitrators under FET will also be analysed in respect of international drives towards transparency in government processes. It will be seen that transparency drives, both in investment arbitration and other international spheres, involve evolving and changing administrative practices. This comes at a cost and burden to the host-state, and thus creates a fundamental question of whether states can comply with it, due to a variety of resources of available to different contracting parties for the purposes of state administration.

The outline of the investment arbitration jurisprudence in this chapter demonstrates that there is no clear approach of what level of transparency is required by the state in its dealings with the investor in order to avoid a breach of FET. There are two different approaches in general. One that plays an extremely high level of obligation upon the host-state, and one that places a lower level of obligation upon the host-state. Both of these are far more onerous than current practices in England, a developed state, which spends a significant sum on the upkeep of public administration.<sup>1</sup> It is also arguable that they are comparatively more onerous than in other international agreements and best practices recommended by FDI [Foreign and Direct Investment] promotion organizations such as the OECD, as discussed below.

Further, the disparity between these standards demonstrates that arbitrators have both ignored the level of transparency needed to protect and promote investments and are at odds, between decisions, as to which levels are appropriate.

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<sup>1</sup> Payment of salaries and pensions in the civil service totaled £7,000 Million in the United Kingdom in the 1980s: See, J. Pierre, *Bureaucracy in the Modern State: Introduction to comparative public administration* (Edward Elgar) (1995) at p.100-101.

To illustrate how the use of the doctrine could be rendered more coherent, rights available to individuals to participate in administrative decision-making enshrined in English Administrative law shall be illustrated. It shall be seen that, in places, English administrative jurisprudence is much more aware of limitations to administrative capacity than current elucidations of transparency under FET. By way of contrast to FET transparency, English law offers a cost-effective solution to transparency deficiencies by requiring participation in state processes that affect the investor. It also works outside the sphere of legislative activity that consists of public interest decision-making, hence reducing the likelihood of conflict between costs of investor rights and processes of government for nationals. It thus offers a solution that is more legitimate in terms of its cost and its respect for the public sphere.

The rationale for using transparency as a part of FET is to assist FET in a governance role to improve state institutions in their relations with foreign investment. It shall be seen that this is a weak system of governance using transparency as it does not appreciate costs and availability of resources for transparency drives as developing countries, and the institutional development, including training of administrators that has to be undertaken to meet these objectives.

### **3.2 Transparency as a concept.**

Transparency is a value often wished for in interactions between the state and its citizens, and also between private individuals interacting in fields such as the commercial market.<sup>2</sup> Transparency of the state is a concept based on democratic theory that values disclosure of the operation of Government as a means of

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<sup>2</sup> For market-transparency, See R. Bloomfield & M. O'Hara, 'Market transparency: Who wins and Who Loses?' (1999) 12(1) Rev. Fin. Stud 5 at p.5-7. (Note, Bloomfield and O'Hara argue, *ibid*, that market transparency comes at a cost to certain transactions that may benefit from some confidentiality.

securing accountability.<sup>3</sup> It is an idea rooted in political philosophy that concerns itself primarily with ensuring that subjects knew not just who was ruling them, but how they were being ruled.<sup>4</sup> The key to transparent policy is the idea that those who are affected by policy decisions must know about them. Transparency is said to also counteract government tendencies to distort certain impact of policies so as to increase their acceptability, so that their real affects can be ascertained.<sup>5</sup> This may be very important for investor activity, as well as for domestic nationals who value democratic processes.

Transparency increases the security of investments through the availability of knowledge of state practices. By contrast, for the domestic national transparency increases the legitimacy of the democratic governing process through implicitly saying that the government has nothing to hide.<sup>6</sup> These rationales are summarized in the APEC leader's statement with respect to transparency stating that it:

*'...is a basic principle underlying trade liberalization and facilitation, where removal of barriers to trade is in large part only meaningful to the extent that the members of the public know what laws, regulations, procedures and administrative rulings affect their interests, can facilitate in their development'.<sup>7</sup>*

Though this statement relates to transparent governing processes for domestic entrepreneurs, FET has given this right to participate in domestic policy-making to a foreign investor. Looking at the monetary costs of transparency for states and

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<sup>3</sup> P.S. Kim, J. Halligan, N. Cho, C.H. Oh, A.M. Eikenberry, 'Towards Participatory and Transparent Governance: Report on the Sixth Global Forum on Reinventing Government' (2005) 65(6) Pub. Admin. Rev. 646 at p.649

<sup>4</sup> D. Held, *Democracy and the global order: From modern state to cosmopolitan governance* (Polity) (1995) at p.6-12.

<sup>5</sup> OECD, 'Public Sector Transparency and the International Investor' (2003) (OECD) at p.23

<sup>6</sup> B. Friedman, 'The use and the meaning of words in central banking inflation targeting, credibility and transparency' in P. Mizen, (ed.), *Essays in honour of Charles Goodhart. Volume 1: Central banking, monetary theory and practice*. (Elgar) (2003) at p.118-121.

<sup>7</sup> APEC, 'APEC Leaders statement to implement APEC Transparency Standards' (October 2002) in OECD (n5 above) at p.17

that other international instruments normally expressly include such a right, it is likely to be far beyond what State Parties to investment treaties intended.

Generally, accountability within governing processes is seen as being the key to good democratic governance.<sup>8</sup> This is not possible without visibility of processes that can render them subject to public and individual approval. Thus transparency of governance is crucial to ensure that processes of regulation, administration and legislation are reflective of citizen's needs and wishes. This idea of accountability of state action to the individual by opening state procedure to individual participation is a key role that British public law places through its imposition of appropriate procedure for public bodies to take account views of individuals affected by state decision-making.<sup>9</sup>

It is important to note that when extending these rights to foreign investors, one is also opening the question of whether to extend the possibility of choice of outcome of state process to those investors would be acceptable to domestic nationals, particularly in the developing world where they would not have similar rights. This may lead to a lack of local acceptance of the investor, where there is a perception of preference over domestic nationals.<sup>10</sup> Whilst English law grants only rights of procedure not outcome, at present investors may be able to claim, under the legitimate expectations doctrine, a particular outcome of a state process as well as a right to participate within it. From this perspective the inclusion of transparency under FET should be seen as another tool of ITA's governance role of domestic institutions, working side by side with legitimate expectations.

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<sup>8</sup> This is said to be a key part of global governance: H. Blair, 'Participation and Accountability at the Periphery: Democratic local Governance in Six Countries' (2000) 28(1) World Development 21, at p.21 & p.27; N. Woods, 'Good governance in International Organisation' (1999) 5 Glob. Governance. 39 at p.43-49.

<sup>9</sup> A. Tomkins, *The idea of public law* (OUP) (2003) at p.229-338.

<sup>10</sup> This perception is seen in the field of intellectual property rights: See, De Long, 'Impact of Foreign Direct Investment on Indigenous culture: An intellectual property perspective' (1997-98) 23 N.C. J. Int'l & Comp. Reg. 229; P.L. Tsai, 'Foreign Direct Investment and income inequality: Further Evidence' (1995) 23(3) World. Dev. 469 at p.469-470.

From one point of view the inclusion of the transparency rule under FET is acceptable, if one does not see direct consent to laws by states as important. This is because transparency is also important in the commercial context of allowing markets and commercial activities to function effectively. It is important to investment decisions as it allows investors to manage liability, losses and credit through increased predictability that knowledge through information process brings.<sup>11</sup> Transparency of government policy-making allows investors, and private citizens to see where special interest groups have preference, and how much policy making takes into consideration its affects upon private parties.<sup>12</sup> Transparency in public administration is important to the economic development of state, and is often valued by economic development strategists working to increase growth in developing economies.<sup>13</sup> As foreign investment has a public impact transparency of investor-state relationships, not yet considered by FET standard, may be important for investor acceptance in the host-state.<sup>14</sup> It may also alleviate perceptions of unfair practices by foreign investors in transition economies.<sup>15</sup>

Transparent institutional practices include the effective collection of data and its publication.<sup>16</sup> This assists individuals wanting to know how state action affects them. For example, efficient land registration in states is fundamental to the

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<sup>11</sup> Z. Drabek & W. Payne, 'The impact of transparency on foreign direct investment' (2002) 17(4) Jnl. Economic Integration 777 at p.777-779

<sup>12</sup> Such exacerbation of private preferences can be seen in the process of non-transparent public procurement: S.J. Evenett & B.M. Hockman, 'Government procurement: market access, transparency, and multi-national trade rules' (2005) 21(1) Eu. Jnl. Pol. Econ 163 at p.163-166. Investor claimants in investment treaty arbitration have acquired their rights by public-procurement: E.g. The airport works tender process in ADC Affiliate Ltd & ADC & ADMC Management Ltd v. The Republic of Hungary (ICSID Case No. Arb/03/16) (02/10/06) at p.16-17.

<sup>13</sup> OECD (n5 above) at p.17

<sup>14</sup> See, D. Szablowski, *Transnational Law and Local Struggles: Mining Communities and the World Bank* (Hart) (2007) at p.1-23.

<sup>15</sup> J. Hellman, G. Jones & D. Kaufmann, 'Are foreign investors and multinationals engaging in corrupt practices in transition economies?' (2000) (May/June) *Transition* (IBRD) 4 at p.4-6

<sup>16</sup> B.M. Hoeckman & P.C. Mavroidis, 'WTO dispute settlement, transparency and surveillance' (2000) 23(4) *World Econ.* 527 at p.527-535.

workings of the property market.<sup>17</sup> Where the investor has to rely on public administration, information gathering and accessibility may be critical to an investment's success. Transparency is thus a market-enabling value in governance as it creates market stability and assists regulatory compliance by ensuring that regulatory burdens are known by market agents.<sup>18</sup>

Where regulation is key to the market's functioning, transparency can also assist in ensuring that the market is sustainable by increasing compliance of commercial agents through knowledge. Transparency for the investor will be important where there is regulatory activity constricting investor action, such as environmental protection so that the investor can factor in regulatory compliance costs.<sup>19</sup> It will also be requisite where there are permits and other administrative requirements that the investor has to fulfill.<sup>20</sup>

Transparency is also developed in contract law of prior-disclosure in high-risk contracts.<sup>21</sup> Due to perception of significant risks of political action causing loss of capital in unknown markets, an investor may thus wish special disclosure of government practices.<sup>22</sup>

Good commercial practice by the investor involves a risk appreciation, particularly if there are credit undertakings, state transparency will be vital to the risk determinant process. Foreign investors find transparency desirable as working in a

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<sup>17</sup> G. Feder & A. Nishio, 'The benefits of land registration and titling: Economic and Social Perspectives' (1998) 15(1) Land. Use. Pol. 25 at p.25-31.

<sup>18</sup> K. Koedjik & J. Kremers, 'Market opening, regulation and growth in Europe' (1996) 23(11) Econ. Pol. 443 at p.443-451.

<sup>19</sup> As, for example, in the Methanex case. See, Methanex v. U.S.A. (UNCITRAL) (NAFTA) (3/08/05)

<sup>20</sup> As seen in the Metalclad case: Metalclad v. Mexico ICSID Case No.ARB (AF) 97/1 (NAFTA).

<sup>21</sup> In the common law these are termed contracts 'uberrimae fidei?', See E. M. Holmes, 'A contextual study of commercial good faith disclosure in contract formation' (1978) 39(3) U. Pitt. L. Rev 381 at p.411; Steyn 'Reasonable Expectations'

<sup>22</sup> C.J. Choi, S.H. Lee, J.B. Kim, 'A note on counter-trade: contractual uncertainty and transaction governance in emerging economies' (1999) 30(1) Jnl. Int Bus. Stud. 189 at p.189-201. E. M. Holmes, 'A contextual study of commercial good faith disclosure in contract formation' (1978) 39(3) U. Pitt. L. Rev 381 at p.411

foreign country is often alien territory, and access to laws and regulations can be a key to regulatory compliance.<sup>23</sup> This does not mean that the investor does not have to be proactive in finding information however the success of this action is dependent upon the transparency of states administrative and policy-making framework.

Unfortunately, there is no obligation upon the investor, under FET, to collect and frame information. The current legal framework leaves information availability solely as a state burden. This may leave open liability where the investor has a lackadaisical attitude to information collection, and lead to bad investor practice of not seeking out and planning for adverse regulation and state policy. This also leaves a significant obligation upon the state to provide relevant information to the investor. By way of contrast a less paternalistic approach, may be one where information collection cost is left predominantly with the investor and he is responsible for the risks of information collection. The benefits of such an obligation on the investor, and whether it is an off-putting cost to investment need to be empirically analyzed. This may result in a more balanced and fairer approach of constructing transparency.

Such choices in legal position for states, as to what degree of burden of information production costs in transparency, would be available to states if they had a far greater input in deciding the legal framework of FET, rather than leaving it to arbitrators. Further, the cost of transparency as a defence may wish to be explored by the transparency law-maker to ensure liability is not found unfairly on developing states who cannot afford to provide the investor with transparent state practices in their institutional practices where there may be resulting harm to the investor.

This is fair from the point of view that the level of transparency obtained by a state's governing process is limited by its administrative framework, particularly

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<sup>23</sup> R. Wolfe, 'Regulatory transparency, developing countries and the WTO' (2003) 2(2) World. Trad. Rev. 157 at p.157-161.



the ability of that framework to collect and create access channels between the information and users. This is dependent on quality of administrative personnel skills and, increasingly, availability of information technology in both the developed and developing world. Different states have different levels and methods of accountability of government acts.<sup>24</sup> Further developing countries generally have weaker administrative institutions in terms of speed and efficiency, and often lack accountability and transparency of bureaucrats.<sup>25</sup> These differences are important when attempting to construct a workable law of transparency that the state can actually adhere to.

The OECD has stated that global transparency drivers must understand the distinctive features of national transparency practices. Communication of existing policy needs an administrative set-up to both collect and impart information.<sup>26</sup> The creation of a requirement of transparency will require empirical input as to the differences of administrative culture between states may be likely to produce different forms of information and prioritise different forms of information presentation. For example, contrasting regulatory administration in the USA to Denmark, the latter does have less information collecting processes resulting in less transparency of regulatory operations due to the lack of adversarial culture amongst commercial entities that constantly challenge the state.<sup>27</sup> Further the collection and preparation of information is a cost burden on public administration that some states simply may not be able to meet.<sup>28</sup>

Transparency ought to also apply to investment treaty arbitration, so as to increase the legitimacy of the system through removal of any perception of double standards. Transparency is also said to be important to legitimate governance for

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<sup>24</sup> H. Blair, 'Participation and Accountability at the Periphery: Democratic local Governance in Six Countries' (2000) 28(1) *World Development* 21 at p.31-32.

<sup>25</sup> P. Bardham, 'The Journal of Economic Perspectives' (2002) 16(4) *Jnl. Econ. Perspectives* 185 at p.189-190.

<sup>26</sup> OECD (n5 above) at p.11

<sup>27</sup> OECD (n5 above) at p.24

<sup>28</sup> OECD (n5 above) at p.31

other transnational legal processes such as the EU and WTO.<sup>29</sup> Thus the legal role played by the *fair treatment* standard may also build up a concomitant requirement for institutional transparency in investment treaty arbitration.<sup>30</sup> This is not wholly present at the moment. This requirement may include open adjudication in arbitration, as opposed to the current closed-door private arbitration. It may also mean greater involvement from affected parties<sup>31</sup>, and civil society, and require the important publication of awards so that both investors and states can see trends in obligations.<sup>32</sup>

### **3.3. Thresholds for Transparency under FET**

In investment treaty arbitration there is a high threshold obligation, and a more generic lower, less onerous, obligation. The high threshold spells out specific things that a host-state has to do to comply with transparency under the FET. The high threshold under transparency is detailed below.

#### **High or Onerous Obligation:**

*‘The Foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations. Any and all State actions conforming to such criteria should relate not only to the guidelines,*

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<sup>29</sup> P. Nanz & J. Steffek, ‘Global Governance, participation and the public sphere’ (2004) 39(2) Government & Opp. 314 at p.314; T.W. Pogge, ‘Creating Supra-National Institutions Democratically: Reflections on the European Union’s ‘Democratic Deficit’’ (1997) 5(2) Jnl. Pol. Philos. 163 at p.163-165

<sup>30</sup> Nanz & Steffek, (n29 above) at p.319-320.

<sup>31</sup> At present NGO participation is restricted by rules of relevancy and permission, see T. Ishikawa, ‘Third party participation in Investment Treaty Arbitration’ (2001) 59(2) ICLQ 413 at p.413-p.417.

<sup>32</sup> J.A. Scholte, ‘Civil Society and Democracy in Global Governance’ (2002) 8 Global Governance 281 at p.281-293.

*directives or requirements issued, or the resolutions approved there under, but also to the goals underlying such regulations’.*<sup>33</sup>

This threshold places a positive obligation, an obligation to act, upon the state. It thus envisages liability on omission. The state has to ensure access to all rules and regulations that affect the foreign investment. This means that as well as having a system whereby such rules and regulations can be accessed, it must also spend revenue to calculate which rules affect foreign investors and collate and publish them. In practice, the state will have the onerous task of being wary of which foreign investors are present in its territory and what they are doing so that it can identify how they will be affected by current and future regulations. It is possible to construe this passage as having no burden to act on the investor. In this case the state may have to do a lot of work of identifying regulatory risk on the investor’s behalf and communicating that risk to the investor. Considering the cost of such an administrative framework, it is unclear how developing states might have consented implicitly to such a burdensome rule.

By contrast, a different approach is seen in *Wastemanagement II* that intimates only procedural transparency in administrative process, which is similar to participation rights seen in English public law, as seen below.

### **Low Obligation:**

*‘the minimum standard of treatment of fair and equitable treatment is infringed by...a complete lack of transparency and candour in an administrative process.’*<sup>34</sup>

By contrast to the ‘High Obligation’, the criteria in *Wastemanagement II* is much less onerous for the state and a much harder one for the claimant to satisfy. It relates to openness of administrative procedure when carrying out decisions, such

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<sup>33</sup> Técnicas Medioambientales Tecmed v. United Mexican States ICSID Case No. ARB/00/02 (29/05/03) at para 154

<sup>34</sup> Wastemanagement (No2) v. United Mexican States ICSID Case No. ARB/99/4 (30/04/04) at para 98

as permit grants, that involve the investor. Here the investor will have rights of participation that involve being notified of administrative requirements and to make submissions to administrators when there are decisions that affect the investment. In contrast to the 'High Obligation' it is not about transparency of regulation, laws and on-going government policy-making. Nor does it involve a positive obligation to publish laws, though the phrase '*a complete lack of transparency*' is ambiguous and does not clarify as to what exactly transparency involves for the state and is thus incoherent in determining rights and obligations.

It is though similar to the minimum standard in that it a breach only occurs through a significant failure by the state, not a lesser threshold through the more specific criteria laid out in the 'High obligation'.

The high threshold, with respect to the English law below, would grant the investor rights over domestic nationals in public policy. Further, it will also be seen that English law does not require '*complete...candour in administrative process*' as with the low threshold obligation of transparency under FET.

A low standard was also envisaged in *S.D. Myers*. There arbitrator Schwarz applied WTO jurisprudence that stated that the state had to provide '*certain minimum standards for transparency and procedural fairness*'.<sup>35</sup> Critical to the breach of fair treatment in *Myers* is that *Myers* was not given access to the administrative process that other competitors were and there was a lack of opportunity to participate in key Government decision-making when important issues in relation to the investment were being determined.

As well as incoherence as to rights and obligations on the investor and state caused by having two quite distinct obligations, as outlined above, there is also a lack of agreement as whether transparency has any role to play under FET. Thus, for example, following the *Metalclad* award the Supreme Court of British

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<sup>35</sup> *S.D. Myers v. Canada (NAFTA)* (UNCITRAL) (12/11/00), Separate Opinion at para 249.

Columbia, a domestic court, set aside the award on Article 1105 for expressing the requirement of Transparency as a part of Article 1105.<sup>36</sup>

In *Metalclad* the tribunal said that the fair and equitable treatment, included the notion of ‘transparency’.<sup>37</sup> The absence of a clear requirement of a municipal construction permit by the local administration and no explanation of the procedure or practice as to how to deal with applications for permits was a breach of the transparency requirement of NAFTA.<sup>38</sup> The Supreme Court of British Columbia was faced with a challenge on the NAFTA tribunal’s interpretation of transparency and the fair treatment standard.

The challenge was based on an excess of jurisdiction of *Metalclad* tribunal on two grounds: (i) Transparency was wrongly included in an Article 1105 conclusion and, (ii) The tribunal went beyond existing transparency obligations in NAFTA and created new obligations.<sup>39</sup> The domestic courts agreed with these general propositions. It stated that the NAFTA arbitrators did not have a basis in customary international law to state that transparency had become a part of the customary law of foreign investment.<sup>40</sup> On this basis the inclusion of transparency under FET is questionable. This further causes a problem of coherence in so far as it is not clear whether the obligation exists at all.

Further, the Canadian court reviewing ‘transparency’ differed with the separate opinion in the *S.D. Myers*, which stated that transparency could be included in NAFTA on the basis that ‘international law’ in Article 1105 could be interpreted in an exploratory manner so that it reflected what international obligations ought to be.<sup>41</sup> The Canadian federal court did *not* agree that transparency in investor-

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<sup>36</sup> United Mexican States v. Metalclad (2001) B.C.S.C 664 at para 70.

<sup>37</sup> (n36 above) at para 76.

<sup>38</sup> (n 36 above) at para 88.

<sup>39</sup> (n 36 above) at para 66.

<sup>40</sup> (n 36 above) at para 68.

<sup>41</sup> (n 36 above) para 68; *S.D. Myers* separate opinion (n 35 above).

state relations was one of the objectives of NAFTA.<sup>42</sup> The court distinguished between NAFTA Article 1105 where in its view obligations were, via a literal interpretation, rooted in extant customary international law, and general bilateral investment treaties that were distinct instruments<sup>43</sup>, thus indicating that NAFTA parties could not have consented to ‘transparency’ as being a part of FET.<sup>44</sup>

Overall this leaves the nature and extent of obligations under the ‘transparency’ unclear in investment arbitration, as to what the threshold is, and whether they are included in the NAFTA’s Article 1105 FET provision. thus there is a legitimacy issue regarding the clarity of the law. As to the latter point, the review by the Canadian domestic court of *Metalclad* has only so much weight. This is particularly because a national court’s views regarding the approach of an international tribunal can only have so much value in legal terms in international law.

As a matter of international law, national courts cannot determine obligations between sovereign states. This intimates, bearing in mind that tribunals have ignored FTC interpretations in the past made by state parties, a renewed statement of position by states as to whether transparency is an obligation they undertake towards investors and to what degree. Further, the national court still upheld the bulk of damages against Mexico despite rejecting the arbitrator’s position as to the law.<sup>45</sup>

### **3.4. English law**

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<sup>42</sup> (n 36 above) at para 71.

<sup>43</sup> Key to this reasoning was that unlike general bilateral investment treaties, Article 1105 NAFTA included an express reference to limit that obligation to ‘international law’. (n 36 above) at para. 65.

<sup>44</sup> (n 36 above) at para 65.

<sup>45</sup> C. Tollefson, ‘*Metalclad v. United Mexican States Revisited: Judicial Oversight of NAFTA’s Chapter Eleven Investor State-Claims Process*’ (2002) Min. J. Glob. Trad. 183 at p.197

Procedural transparency in English law is provided below as an example of how ITA could develop transparency under the 'Low obligation'. This is closer to the minimum standard of treatment, outlined by the *Neer* decision, that is currently accepted in international law. Thus giving rise to lessor concerns of legitimacy than the 'High obligation' approach as compliance would be less costly. However, the minimum standard does not include protection on the basis of transparency, thus even the low threshold still raises issues of state consent. Procedural rights of participation in administrative process are available in the public law of many states, will increase the coherence of transparency obligations and demonstrate how specific jurisprudence can assist both states and investors in determining their rights.

Due to the detailed tests of procedural rights, public body obligations, and the availability of defences, English law provides some guidance as to how FET transparency obligations could become more coherent. Though English law is replete with myriad examples of participatory rights, a few fundamental illustrations will assist in demonstrating how transparency under FET could become more coherent.

### **A. Procedural transparency.**

In English law procedural transparency is centered around rights of participation for the individual in public administration. Participation is said to be critical to the openness of administration.<sup>46</sup> Three key rights of participation in administrative process exist in English law: (i) Prior Disclosure and notice of state decision-making; (ii) Participation and Consultation; and a (iii) Duty to give reasons. However, as will be seen, these rights have not been granted without limits.

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<sup>46</sup> For relationship between participation and transparency see, for example : P. Nanz & J. Steffek, 'Global Governance, participation and the public sphere' (2001) 32(2) Govt. & Opp. 314 at p.320-328; C. Harlow, 'Global Administrative law: The quest for principles and values' (2006) 17(1) EJIL 187 at p.204-205; D.M. Curtin, 'Transparency and Political Participation in the EU Governance: A role for civil society' (1999) 3(4) Cult. Val. 445 at p.445-453; S.Charnovitz, 'Transparency and Participation in the World Trade Organisation' (2003-04) 56 Rut. Law. Rev. 927 at p.939-944.

English courts have on occasion been aware of limitations that such duties can impose on administrative bodies and the problems administrative bodies may face with an absolute duty to disclose. The latter will often conflict with the need for administrative bodies to maintain confidentiality in their relationships with other private and public persons for their function.<sup>47</sup>

The development of 'freedom of information' is a significant recent movement in English public law. This has been developed much later in the twentieth century than transparency in American administrative law.<sup>48</sup> As Birkinshaw has stated in relation to the U.S, '*Freedom of information is often part of a legislative framework providing for open Government, so that, in the USA, for instance, laws open up meetings of Government agencies and their advisory committees to public scrutiny and participation*'.<sup>49</sup> Transparency in the U.S. is enshrined in the U.S Freedom of Information Act 1966.

The U.S. Act was designed to assist democratic governance, by ensuring 'public knowledge' of government action.<sup>50</sup> Section 3 of the U.S. Freedom of Information Act states:

*'each [Government] agency, on request for identifiable records made in accordance with published rules stating the time, place, fees to the extent authorized by statute, and procedure to be followed, shall make the records promptly available to any person'.*

It was designed to reduce the denials of disclosure under the Administrative Procedure Act.<sup>51</sup> In terms of the level of obligation it is similar to the high

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<sup>47</sup> This point is not always appreciated when dealing with competing interests in administration and disclosure requests, See G. Larry Engel 'Introduction: Information Disclosure policies and practices of federal administrative agencies' (1973-1974) 68(2) NW. U.L. Rev. 184 at p.184-185. An example of a disclosure conflict is in the public interest in a private persons tax return on appropriate payment, B.I. Bittker, 'Federal Income Tax Returns-Confidentiality vs. Public Disclosure' (1980-81) 20 Washburn L.J. 479, at p.479-480.

<sup>48</sup> See, P. Craig, *Administrative Law* (Sweet & Maxwell) (2008) at p.224-228.

<sup>49</sup> P. Birkinshaw, 'Freedom of Information' (1997) Parliam. Aff. 166 at p.166; The British Freedom of Information Act 2000 was passed in 2000, the U.S. one in 1966: Freedom of Information Act 1966, 5 U.S.C. s.552 (1966).

<sup>50</sup> E.L. Richardson, 'Freedom of Information' (1973-74) 20 Loy. Law. Rev. 45 at p.45, 46.



threshold obligation under FET. The cost of information requests under the U.S. Act has proliferated since the Act was passed. By 1981 some estimates put the cost at \$250 million, a price few developing countries today could afford in terms of cost or to prioritise over other policy needs.<sup>52</sup>

English law has developed significant case law to ensure transparent public participation through the development of rights of participation. Investment treaty arbitration can further develop the investment protection role by incorporating such rights for investors.

State bodies have been given standards by which administrative requirements are to apply to individuals. Thus in the *Save Britain's Heritage Case* the English court stated that the requirements given by administrators that individuals were supposed to satisfy in relation to planning policy had to be '*proper, adequate and intelligible*'.<sup>53</sup> This is so that individuals could be in full knowledge of requirements they have to comply with. Similarly, in *Duggan* it was held that a prisoner was entitled to have information and facts relating to a decision to maintain him within a certain categorization of prisoners from the Home Secretary. This categorization would have affected his rights during incarceration.<sup>54</sup> Similarly to the *S.D. Myers* decision the Canadian Supreme Court in *Ontario Women's Teachers Association* held that where a public consultation that affected an individual's employment rights, it would have to ensure that the individuals be informed of the nature of the proceedings against them.<sup>55</sup>

Even in sensitive areas such as child abuse, English courts have made it clear that local administrators have to be open and disclose all relevant material. Thus in *K*

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<sup>51</sup> Engel (n47 above) at p.188-189.

<sup>52</sup> P. M. Wald, 'Freedom of Information Act: A short case study in the Perils and Paybacks of Legislating Democratic Values' (1984) 33 Emry. L. J. 649 at p.660.

<sup>53</sup> *Save Britain's Heritage v. Number One Poultry Ltd* [1991] 1 W.L.R. 153 at p.166.

<sup>54</sup> *R v. Secretary of State for the Home Department, ex p. Duggan* [1994] 3 All. ER. 277 at p.278

<sup>55</sup> *Federation of Women's Teachers Association of Ontario v. Ontario (Human Rights Commission)* (1988) 67 QR (2d) 492- (The case concerned a public inquiry into discrimination claims).

*and Hampshire County Council* a local administrator investigating parental child abuse, had to disclose confidential medical reports given to him in order to determine whether action should be pursued against parents.<sup>56</sup> The court overrode the need for local administrators to maintain a special working relationship with their medical officers under the rules of administrative confidentiality.

The right of participation in public decision-making in English common law was developed in the nineteenth century.<sup>57</sup> In the seminal case of *Cooper*, Justice Byles stated ‘*although there are no positive words in a statute requiring that the party shall be heard yet the justice of the common-law will supply the omission of the legislature*’.<sup>58</sup>

Echoing this sentiment over a hundred years later, Lord Mustill stated in the case of *Doody*: ‘*Fairness will very often require that a person who is adversely affected by the decision will have an opportunity to make representations on his own behalf either before the decision is taken with a view to procuring its modification, or both...since the person affected usually cannot make worthwhile representation without knowing what factors may weigh against his interests fairness will very often require that he is informed the gist of the case he has to answer*’.<sup>59</sup>

Further, the lack of effective participation of the individual in a decision that affects him (not a policy decision, but a specific decision) by a public body will afford the individual the remedy of quashing of the decision. Thus the importance of consultation as key component of accountability of public institutions is also recognized. In the *ex parte N* case it was held that a government body had to consult parents regarding the closure of school that affected their children.<sup>60</sup>

Another example of the need to consult is where the state denies the exercise of a public right in law, over a private interest the courts will demand a public inquiry.

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<sup>56</sup> *R. Hampshire County Council, ex parte K et al* [1990] 2 QB 71 at p.77 (Though the decision is limited by documents protected by public immunity, *ibid*).

<sup>57</sup> J. Baker, *Introduction to English Legal History* (Butterworths) (2002) at p.147-151.

<sup>58</sup> *Cooper v. Wandsworth Board of Works* (1863) 14 C.B. (N.S) 180 at p.192.

<sup>59</sup> *R v. Secretary of State for the Home Department, ex p. Doody* [1994] 1 AC 531 at p.550 F-H.

<sup>60</sup> *R. v. Lambeth L.B.C., ex p. N* [1996] E.L.R. 299

Thus in *Emery* where there was a refusal by the state to exercise a legal discretion to provide public access to land, for imposition on a private estate, the state had to conduct a public consultation before refusal to exercise grant of access.<sup>61</sup>

Similarly, in *Wainright* the Court of Appeal held that not only did the local authority have to notify the public of matters affecting them, but it had to do so in a manner that ensured that all parties that were affected were notified. Thus the local authority had failed to comply with its statutory duty to give public notice of a proposal to install a pedestrian crossing where it had put just one letter through the letterboxes of houses, many of which contained four separate flats.<sup>62</sup> Thus there are clear rights of public consultation and effective notice of decisions and administrative requirements in English law. ITA could incorporate these rights depending on the ability of the state to grant them.

### **B. Non-Disclosure in the Public Interest and the Need for Confidentiality.**

As seen above, there is a strong requirement of disclosure of material that affects individuals in public administrative decision-making, so that adequate opportunity is given to the individual to respond.

However where speed and efficiency are critical parts of administrative process, the courts do not like excessive burdens of disclosure to delay administrative process. Thus the Court of Appeal overturned Sedley J's judgment in *Abdi*, where Sedley J lay a burden on the Home Secretary to disclose matters supporting a deportation decision and also against it.<sup>63</sup> The Court of Appeal stated that the courts should not add burdens on administration, where the aims of the

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<sup>61</sup> R v. Secretary of State for Wales, ex. p. Emery [1996] 4 All. ER. 1

<sup>62</sup> R (on the application of Wainright) v. Richmond upon Thames LBC (002) 99 L.S.G. 29 (CA); (Times; 16/01/02)).

<sup>63</sup> R v. Secretary of State for the Home Department, ex p. Abdi (The Times, March 10 1994)

administration apparatus is to resolve public policy matters, here the determination of aliens rights, quickly.<sup>64</sup>

In some English law cases courts will defer to government and administrative bodies decisions not too disclose. English law will also look at whether it is practical for the public authorities to allow participation in administration where the numbers of persons affected by the decision are so great that it would not be possible due to administrative limitations to hear them all. Further, there will be no duty of consultation for the administrative body if such a consultation precludes the administrative body from carrying out its function. For example, in the case of *Bates* changing the rules for practicing lawyers would have required excessive consultation in execution.<sup>65</sup> This may be an important provision to include into an investment treaty law of transparency, as it will allow states to bypass investor consultation where such a consultation undermines a public policy being effectively executed by a public body.

To activate such a defence fairly, states would have to show the tribunal how exactly investor consultation would harm a particular administrative function, rather than merely use it as an excuse to avoid the investor.

Examples of this in English law can be seen where English courts will also not grant a remedy when it affects the speed and efficiency of works of public administrative bodies. Thus in *ex p. Argyll Group* where the court refuse to grant a remedy on the different ground for a misuse of administrative discretion because it felt it would affect the efficiency of the work of the Monopolies and Merger Commission.<sup>66</sup> English courts have also appreciated limits to the workings of administrative process.

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<sup>64</sup> R v. Secretary of State for the Home Department, *ex p. Abdi* (The Times, April 25 1994)

<sup>65</sup> *Bates v. Lord Hailsham of St. Marylebone* [1972] Ch 1373

<sup>66</sup> R v. Monopolies and Mergers Commission, *ex p. Argyll group* [1986] 1 W.L.R. 763 at p.764.

Thus in *Darshan Kaur* the court held that a lack of translators at a public meeting was not improper due to the impossibility of providing public translators for all languages.<sup>67</sup> Further English Courts have also been sensitive to the idea that in some circumstances it may be unfair to pro-long administrative consultation just to ensure all views are gathered. Thus in *Williams* it was held that where the closure of a school by way of amalgamation into another school was carried out by a public body, it would adversely affect the pupils if there was a delay and prolonged consultation.<sup>68</sup> All of these impacts can be incorporated into the ITA transparency law to make it more sensitive to limitations of institutional practices of the host-state.

General national interest measures are deferred to by English public law. Thus there is a right of the state to non-disclosure of information related to state function where it is in the interests of national security. Thus in *Hosenball* the House of Lords denied an American investigative journalist all information relating a deportation order made against him on the grounds of national security.<sup>69</sup> As Lord Lane put it: *‘There are occasions, though they are rare, when what are more generally the rights of an individual must be subordinated to the protection of the realm’*.<sup>70</sup>

There is also a doctrine of ‘Public Immunity’ of documents in English law, whereby the state can deny access to documents. This approach of non-disclosure of documents could also be included into transparency under ITA to protect sensitive areas of policy-making from claims before policy has fully formed, or to preserve state confidentiality. The powers of interim-relief available to investors under ITA may further justify its incorporation, so as to protect states from revealing unwanted issues in the public-sphere.

### **C. Synopsis**

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<sup>67</sup> R v. Birmingham C.C., ex. parte Darshan Kaur [1991] C.O.D. 21 (DC)

<sup>68</sup> R v. Secretary of State for Wales, ex parte Williams [1997] E.L.R. 100

<sup>69</sup> R. v. Secretary of State for Home Affairs, ex p. Hosenball [1977] 1 W.L.R. 766,

<sup>70</sup> (n68 above) at p.783-4.

Overall, English law is more coherent through developing specific rights of participation in administrative process than the vague rule of transparency developed under FET. It provides a right to clear administrative requirements (*Save Britain's Heritage*); a right to be consulted where there is a decision that affects an individual (*Wainright*). Available defences include not conducting a full consultation where that undermines the administrative function of a state organ (*ex parte Argyll Group*; *Bates*; *Darshan Kaur*) and deference to important state exigencies such as national security (*Hosenball*). This is an important pragmatism that may be useful to developing states that are struggling to comply with the current obligations under both the high and low FET transparency rule.

This deference to the limitations of state administration could be incorporated in subsequent elucidations of FET, where state consent is granted, to render FET transparency more coherent.

### **3.5. International Transparency Drivers**

To appreciate some of the costs and logistical difficulties of the high threshold transparency, the position of international transparency drives under the OECD provides a useful context. There is significant soft-law support by international institutions seeking more transparent practices of governments in the developing world. The OECD has been a key player in this, particularly due to the benefits of transparent planning in the developing world being used to predict political risk by foreign investors.

The OECD is an organisation that furthers economic policy of capital-exporting states. It is an inter-governmental organisation whose functions include the formulation of policies for states to improve governance towards foreign investment. The OECD is a driver in regulatory reform amongst its members, and

it sees increasing transparency of regulation as a key part of improving state governance of markets.<sup>71</sup>

The articulation of ‘transparency’ by investment arbitration tribunals can be improved by taking into consideration the work of the OECD. The OECD has analysed transparency requirements in eight different international approaches, and found disparities between burdens outlined.<sup>72</sup> Whilst six of the eight provided for open access to laws and regulations, and five timely publication of measures; only three of the eight approaches provided for publication of procedures for investment permits and licences. This places huge opportunities for arbitrators under FET to carefully craft transparency requirements to make these approaches more cohesive into law that contains these rights.

One method for bringing about transparency proposed by the OECD strategy involves three phases: (i) Overcoming political obstacles to collecting and dissemination, (ii) improving Government institutions in their capacity to collect data; (iii) increasing access to information avenues for private agents.<sup>73</sup> The latter includes formulating systems for official documentation.<sup>74</sup> However ITA in its present state as an adjudicatory mechanism does not at present have the capacity to do this.

### **A. Increasing Procedural Transparency**

Costs relating to transparency are present when one considers that communication channels have to be built between central policy-making in government to local administrations and individuals. The OECD, appreciating the importance of communication, has also encouraged the creation of

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<sup>71</sup> OECD, (n5 above) at p.26

<sup>72</sup> The drivers assessed by the OECD were: (i) The Draft MAI (Multilateral Agreement on Investment); (ii) OECD Declaration on Transparency; (iii) GATS; (iv) NAFTA; (V) German Model BIT; (VI) US Model BIT; (VII) APEC Standard; (VIII) OECD Codes, in (n5 above) at p. 22.

<sup>73</sup> OECD, (n 5 above) at p.8

<sup>74</sup> OECD, (n 5 above) at p.18.

communication channels to give out information to local administration.<sup>75</sup> Bringing together international drivers, the OECD recommends some good standards for procedural transparency. These include: (a) prompt publication of rules; (b) dealing promptly with requests for information; (c) prior notification of information that is useful to the investor. Similarly, APEC (the Asia-Pacific Economic Co-operation) has also taken measures to implement its standards on transparency.<sup>76</sup> These concern advance publication and availability of administrative procedures and regulatory frameworks that affect an investor. These would prevent adverse commercial impacts of the type seen in the *Tecmed* and *Metalclad* cases.

The OECD does appreciate that transparency of national institutions ought to reflect culture, history and values of governing processes.<sup>77</sup> Some states may value openness in public relations with citizens to a greater degree than others, and a plurality of approaches on this front may be at odds with uniform transparency rules created under FET that may be applied against all respondent states. As the OECD has noted, there does need to be greater international collaboration if a definition of transparency that is legitimate and acceptable to all is to be achieved.<sup>78</sup>

However, as national disparities with respect to affordability of providing transparency exist, transparency will very much depend on what state the investor is in. Further, the OECD has also stated that new information technologies may place a more exacting burden on some states from investors for information in contrast to others.<sup>79</sup> As information technologies are costly and improving

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<sup>75</sup> OECD, (n 5 above) at p.9

<sup>76</sup> APEC, 'Implementation of APEC Transparency Standards' (APEC, Committee on Trade and Investment; 2007 Annual Report) found at [http://www.apec.org/apec/apec\\_groups/committee\\_on\\_trade/transparency\\_stds.html](http://www.apec.org/apec/apec_groups/committee_on_trade/transparency_stds.html)

<sup>77</sup> OECD, (n 5 above) at p.11; To illustrate there are different approaches to public administrative reforms between states in southern Asian countries: R. Samarasinghe, Q. Alam, J. Teicher, 'The New public management reforms in Asia: a comparison of South and Southeast Asian Countries' (2008) 74(1) Int. Rev. Admin. Sci. 25 at p.25-37.

<sup>78</sup> OECD, (n 5 above)

<sup>79</sup> (n 77 above).



constantly, this will exacerbate transparency gaps between developing and developed states.<sup>80</sup> They may not have access to modern ‘information technology’, now vital to regulatory transparency, within administrative institutions.<sup>81</sup> In some developing countries institutional capacity building for information technology usage is still underway, and debates as to the appropriate institutional structures of usage are still ongoing.<sup>82</sup> The former Committee on International Investment and Multi-national Enterprises (‘CIME’) of the OECD has recommended that states engage corporate stakeholders in administrative capacity building- a process that itself requires a certain level of public administrative management.<sup>83</sup> The OECD wishes to see foreign-investors having clearly defined rights of transparency in public administrative processes.<sup>84</sup>

Direct information access at the host-state is not the only source of information for the investor. State to state information channels that feed into National Investment Protection Agencies may also be a useful tool of information gathering by the investor in its own state about the host-state.<sup>85</sup> Further, states may wish to further this inter-state information collection to assist the economic benefits of investment treaties.<sup>86</sup> The OECD also notes that the practice of ‘prior

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<sup>80</sup> E.g. Basic information availability through information technology is limited in rural areas of India: P.D. Kaushik, ‘Information Technology and broad-based development: Preliminary Lessons from North India’ (2004) 32(4) World. Dev. 591 at p.595

<sup>81</sup> South American states have put into play policy to improve IT use by administrative bodies in the mid- late 1990s, See R. Montealegre, ‘A temporal model of institutional interventions for information technology adoption in less developed countries’ (1999) 16 (1) Journal of Management Information Systems 207 at p.207-217.

<sup>82</sup> D. Ernst & B.A. Lundvall, ‘Information technology in the learning economy: challenges for developing countries’ in E.S. Reinert, ‘Globalisation, economic development and inequality: an alternative perspective’ (Edward Elgar) (2004) at p.258-261 & p.266. It is also stated that the U.S. method of using IT for information collection is more formal and institutional as opposed to an informal process in use in Japan. *Ibid*, at p.279.

<sup>83</sup> OECD, (n 5 above) at p.9 & p.18.

<sup>85</sup> R.S. Rajan, ‘Measures to Attract FDI: Investment Promotion, Incentives and Policy Intervention’ (2004) 39(1) Econ. Pol. Wkly. 12 at p.12-16.

<sup>86</sup> Vandevelde, ‘The political economy of a bilateral investment treaty’ (1998) 92 AJIL 621 at p. 621, and p.621-630.

notification and comment' is not uniform amongst all OECD states, and is seen as best-practice.<sup>87</sup>

There is also a negative impact on public interest, which questions the legitimacy of the inclusion of transparency. The OECD has also noted the *crowding out* potential of investor transparency.<sup>88</sup> This is that investors will monopolise information gathering and presentation processes of public administration to the detriment of private citizens. In reality this may only be likely to occur where the investor's rights to information are so burdensome that they effectively stop public administration in the public interest. Arbitrators have not considered such a potentiality, albeit it occurring in extremis.

Another high cost aspect of transparency to the investor is the importance simplifying policy and laws for investor digestibility. The OECD advocates a system of making existing policy and regulation more transparent. This includes condensing and simplifying policy and law. It also advocates 'plain language drafting' so that alien technical terms to the investor do not make documentation inaccessible.<sup>89</sup> This requires highly skilled legal draftsmen that are scarce, if not absent, in many parts of the developing world.<sup>90</sup> It must also have a channel of communication with private investors to determine which formats of information are most useful.<sup>91</sup> A register or other formal basis for recording regulation is also recommended. This would assist in meeting the burden set by the *Tecmed* tribunal, though again coming with a cost for developing states.

The OECD also wishes transparency to be linked to general good administrative conduct. Here an incorporation of standards of procedural participation, similar to those in English law, may be useful to states- if they wish it. Amongst its members the OECD has pointed out that there are no explicit standards and

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<sup>87</sup> OECD, (n 5 above) at p.21

<sup>88</sup> *Ibid.*

<sup>89</sup> OECD, (n 5 above) at p.24.

<sup>90</sup> W.L. Andreen, 'Environmental Law and International Assistance: The Challenge of Strengthening Environmental Law in the Developing World' (2000) 25 Colum. J. Env'tl. L. 17 at p.27-32.

<sup>91</sup> OECD, (n 5 above) at p.24

procedures for decision-making of administrative bodies.<sup>92</sup> These guidelines should ideally extend to non-government bodies that relevant state administrative work is outsourced.

The OECD also states that limiting administrative discretion to regulatory and administrative bodies can reduce uncertainty in decision-making, as it makes administrative alteration of central state policy less likely. This may be a more cost effective system for developing states, who may not have administrators who can make effective decisions, and it reduces the need for local transparency where transparency of central government processes exists. The OECD 'best practice' discourse also includes demands to remove invalid rules and laws quickly from legislative and regulatory publications that the investor is likely to use.<sup>93</sup> Internet publication of laws is also best practice and all NAFTA parties have published laws online to some extent for investor accessibility.<sup>94</sup> Ideally states should have proactive 'Investment Protection and Promotion Agencies'

Amongst OECD members several of whom who are developed states, there are deficiencies of transparency. Thus, for example, the openness of licencing for business in the telecommunications industry of OECD members is said to be poor.<sup>95</sup> Transparency requirements are also not uniform across all sectors, thus in the UK, a developed state, for example, transparency requirements do not apply to independent regulators such as OFCOM.<sup>96</sup> This would fall foul of the *Tecmed* threshold of transparency created under FET.

Most of WTO agreements have transparency provisions. For example, The WTO arrangement for trade in services also has transparency guidelines for states for

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<sup>92</sup> OECD, (n 5 above) at p.29

<sup>93</sup> OECD, (n 5 above) at p.39.

<sup>94</sup> OECD, (n 5 above) at p.39; who miss the developing regulatory transparency amongst in NAFTA

<sup>95</sup> OECD, (n 5 above) at p.30

<sup>96</sup> OECD, 'Public Sector Transparency and the International Investor' (2003) at p.30; D. Freedman, 'Dynamics of power in Contemporary media policy-making' (2006) 28(6) Media. Culture Soc 907 at p.907-916.

laws that impact on cross-border services. Article III of GATS requires members to provide prompt publication of all measures relevant to rights trade of cross-border services.<sup>97</sup> Other GATS rights provide minimum access on the basis that nationals are provided.<sup>98</sup> This is justified on the basis that the lack of such information may affect movement of services across borders.

Under GATS, the Council for Trade in Services has to be notified of any changes to existing laws and regulations or administrative guidelines that affect trade in services. Article IV on GATS has the objective of creating more transparent regulatory implementation and enforcement methods. The Trade Policy Review Mechanism in the WTO is also an important instrument in maintaining transparency relating to overseas investment risk, as it makes national policy accessible to information seekers.<sup>99</sup> The WTO has also developed sector specific transparency obligations for the telecommunications sector. Two key aspects of this are: (a) the public availability of licensing criteria; and (b) the creation of an independent regulator.<sup>100</sup> It is important to note that this is occurred after detailed negotiations and consent from states,<sup>101</sup> this opportunity is not currently afforded to states under FET law-making on transparency.

The WTO is also attempting to create more transparent procedures for government procurement activity, and is seeking state support for doing so. This latter aspect may be particularly relevant to investment arbitration, and claims have been brought by investors that have achieved their permits in the host-state

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<sup>97</sup> Article III GATS; For example of impact of transparent trade regulations, See S. Robertson, 'WTO/GATS and the global education services industry' (2003)1(3) *Globalisation, Societies and Education* 259 at p.259-268.

<sup>98</sup> See, Article XVIII General Agreement on Trades in Services in J.H. Dalhuisen, *Dalhuisen on International Commercial, Financial and Trade Law* (Hart) (2000) at p.325.

<sup>99</sup> J.F. Francois, 'Trade Policy Transparency and Investor Confidence: Some implications for an effective trade policy review mechanism' (2001) 9(2) *Rev. Intl. Econ.* 303 at p.303-310.

<sup>100</sup> M. Fredebeul-Krein & A. Freytag, 'Telecommunications and WTO discipline: An assessment of the WTO agreement on telecommunications services' (1997) 21(6) *Telec. Pol.* 477 at p.477-485.

<sup>101</sup> R. Wolfe, 'Regulatory Transparency, developing countries and the WTO' (2003) *World. Trade. Rev.* 157 at p.164-165.

through tender.<sup>102</sup> Though again the current system of law-making under FET needs to incorporate states into the negotiating and law-making framework.

### **B. Using international drivers for coherence.**

Alongside participation rights detailed above in English law, the OECD synopsis provides for a coherent legal framework for transparency. These are, however, high-level obligations that developing countries may struggle to comply with. The OECD developed five critical areas of reform for ideal regulatory practices:

- (a) Codification of laws and regulations.
- (b) Publication of register the of law and regulations.
- (c) Creating registers of regulation existing and proposed.
- (d) Plain language drafting of regulations.
- (e) Consultation with interesting parties.
- (f) Measures used to communicate regulations.<sup>103</sup>

The OECD has also developed further principles for regulatory bodies to communicate information to commercial entities:

- (a) Publication of consolidated register of all subordinate regulation currently in force.
- (b) Provision that only sub-ordinate regulation in the registry are enforceable.
- (c) Public access via the Internet to the text of all or most primary laws.
- (d) A general policy requiring 'plain language' drafting.
- (e) Guidance on plain language drafting issued.

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<sup>102</sup> Fraport AG Frankfurt Airport Services Worldwide v. Philippines ICSID Case No. ARB/03/25 (16/08/07) at para 84.

<sup>103</sup> OECD (n5 above) at p.26-27.

These requirements create more transparent regulatory systems by ensuring that the investor is not taken by surprise by government requirements. They may wish to be given by some states to attract foreign capital, where the benefits of foreign capital outweigh the costs of such administrative reform. This is not possible at present due to transparency being construed by arbitrators in a particular dispute at hand.

### **3.6. Conclusion**

Transparency can be described in development as the openness of public administration, with respect to allowing private persons the ability to discover the framework of operations within which policy is conducted, the ability to discover conflicts of interests within a policy framework and to access information affecting the commercial operations of the private economic agent.<sup>104</sup> It is based on democratic theories of government which originate in the West.

Transparency for the investor can be justified from the perspective that there is a significant amount of government conduct that affects the private investors that the investors need to be aware of to plan for adverse commercial consequences of government conduct. As the OECD states:

*‘Governments also affect resource allocation through such policies as procurement, competition, state-owned enterprise, subsidies, infrastructure development, regulation and tax-expenditures’.*<sup>105</sup>

As Government policy often favours those that created it, there may be an inherent bias against the foreign investor in the policy machine.<sup>106</sup>

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<sup>104</sup> Extrapolated OECD (n5 above) at p.17.

<sup>105</sup> OECD (n5 above) p.17.

<sup>106</sup> OECD, ‘Regulatory Policies in OECD Countries: From Interventionism to Regulatory Governance’, (OECD) (2002) at p.1-24.

Overall, the creation of obligations of transparency of the specific type mentioned in *Tecmed* ought to be very much subject to express state consent, considering the obligation the rule places on host-states. There may be some implied consent, if arbitrators were given powers to make law of transparency on the basis that it is important for effective market activity. It permits citizens and investors to be informed of governmental activities, be it those of central or local administration.

There are three key justifications for transparent government for states. The first is one of ideal governance, based on a particular ethical framework for Government. The second is a rule of law one. Without openness of operations of public administrations it is much more difficult to make their actions accountable by way of administrative law. The third is an economic one. This is based on the importance of information to decreasing uncertainty in the activity of contractual agents, and thus increasing the likelihood of contract.

Transparency is rooted in democratic theory that concerns itself with accountability of institutions of the state and its leaders.<sup>107</sup> It is based on the right of citizens to be informed of government activity that affects them. Thus policy-making and law-making is carried out in a manner in which citizens can access information relating to its occurrence and in a form that is understandable.<sup>108</sup> It has also been argued that public participation and consultation improves compliance with regulatory systems.<sup>109</sup>

The rationale for its use in investment protection is that availability of information about government policy and regulation that will impact on the investor will decrease uncertainty through giving the investor an opportunity to assess risk prior to entering into contracts and moving capital.

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<sup>107</sup> A.N. Licht, C. Goldschmidt, S.H. Schwartz, 'Culture rules: The foundations of the rule of law and other norms of governance' (2007) 35(4) *Jnl. Corp. Econ.* 659 at p.665

<sup>108</sup> Institutional reform to make the European Union more democratic has included information sharing and openness of institutional practice as a part of transparency drives. See, A. Méritier, 'Composite democracy in Europe: the role of Transparency and access to information' (2003) 10 (5) *Jnl. Eu. Pub. Pol.* 814 at p.815.

<sup>109</sup> OECD (n5 above) at p.9.

The OECD is also aware of the need to work through limitations on states capacity to gather and assemble information. Thus not all laws and regulatory information may be given to the investor for the time pressure it will place upon other work by the administrative body.<sup>110</sup> This has to be incorporated into ITA law-making.

Arbitrators in both the high and low threshold elucidations have not taken into consideration the ability of developing country capital exporters to comply with such administrative burdens. The other issue is that there are no available defences developed for the state to justify non-disclosure or closed Government operations. These ought to be incorporated into the ITA law of transparency to make it realistic with respect to developing states ability to comply with it.

Broader investor burdens may also increase the acceptability of foreign investment on the ground. These can be divided into (a) Burdens to have transparent investment practices on the state and investor; (b) Burden for the investor to seek information. The latter may be particularly important in some developing states where administrative infrastructure is weak.

There is also a case of deficiency from the general custom as to the method of consent. Where transparency is incorporated into agreements, as seen with the WTO where there is an express provision providing for it, thus in its absence it may not be said that they consent to this. This is supported by the express inclusion of 'transparency' in some Free Trade Agreements.

A few have incorporated regulations towards a transparent framework for trade. For example, both the Australian-Singapore Free Trade Agreement and the US-Singapore Free Trade Agreement provide obligations for transparent publication of laws, regulations and administrative rulings.<sup>111</sup> Further there is an inter-state

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<sup>110</sup> OECD (n5 above) at p.10.

<sup>111</sup> OECD (n5 above) at p.30 & at p.42



transparency requirement in these agreements, whereby parties have to inform each other of developments that affect their ability to meet their obligations. Thus the exclusion of a given treaty provision in investment treaty indicates that states were quite unprepared to give their institutions transparency for foreign investors. Thus constructions and findings of liability on this basis have been unfair.

### *Burdens Regarding Investment Transparency*

#### A. Burden to Have Transparency Investment Practices on the State and Investor.

There is also no requirement for investor transparency in the public interest. For example, foreign investment in domestic land deals in the developing world are shrouded in secrecy and are not well-monitored, transparent nor beneficial to local communities.<sup>112</sup> Public awareness of investment-state relationships is critically dependent upon access to information and ability to process information. Local people often do not understand the process, or their obligations, rights and opportunities, which may raise objections. Locals may not be consulted or even aware that their government is negotiating contracts for land until after the deals have been finalized. Such transparency in investment dealings, created by ITA as state obligations, could bring a degree of public acceptability towards foreign investments.

As openness of public administration increases public accountability it assists the maintenance and development of the rule of law.

The fair and equitable treatment requirement of transparency could also be interpreted to place burdens of transparency upon the investor. Often foreign investments have a hidden, latent, impacts upon states and local inhabitants that were unforeseen at the time of initial investment. The investor may have to

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<sup>112</sup> L. Cotula, S. Vermeulen, R. Leonard & J. Keely, *Land Grab or Development Opportunity?: Agricultural Investment and International Land Deals in Africa* (FAO, IIED, IFAD) (2009) at p.63-72.

demonstrate local impact of investment, including economic impact.<sup>113</sup> This includes an analysis of local employment losses and gains as a result of foreign investment activity.

#### B. Burdens on the Investor to Seek Information.

FET could also encourage proactive investor activity to assist states in creating transparent administration. For example, investors could encourage networks in the state that lobby governments for regulatory change to improve clarity of the publication of relevant information. Arbitrators may wish to use this to articulate good conduct by investor, or alternatively create such an obligation upon investors, in order to ensure a fair share of responsibility for information gathering between investors and the state.

If arbitrators decide to create a burden under FET, it would be on the investor to discharge, by showing that they have used all requisite tools of information collection, before the burden shifts on the state to defend a lack of transparency in its regulatory framework. Good guidance for investors, however, may be preferable by arbitrators if placing such a requirement as an obligation may discourage investors from investing. However, this burden may be a part of good commercial practice that sustains the investors activity, and this in turn would be beneficial for the host-state seeking capital.

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Overall it is unclear what the exact threshold for the transparency rule is. Further it is unlikely that the rules of transparency can be complied with in either formulation by developing states that have weak state infrastructure and not

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<sup>113</sup> OECD (n5 above) at p. 23

enough revenue available to train and equip administration to meet the burdens set by the law.

Investor input may be of limited use on the ideal transparency law. The OECD has stated that private commercial entities are not necessarily best sources of guidance on good state practice in transparency due to the need to succeed in market competition making their claims disinterested.<sup>114</sup> Hence rules produced directly as result of determining adjudication where the investor has claimed of transparency flaws in the state may not be the best system of determining the appropriate standard. A more detailed system of law-formation that takes into consideration state-capacity to comply with transparent practices may be more requisite.

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<sup>114</sup> OECD, 'Public Sector Transparency and the International Investor' (2003) at p.21

## **Chapter Four**

### **Denial of Justice**

#### **4.1 Introduction**

#### **4.2 The notion of denial of justice in relation to the minimum standard.**

##### **A. Overview**

##### **B. Theoretical Basis and Scope in Customary International Law**

##### **C. Illustrating the Customary International Law position**

#### **4.3 The local remedies rule.**

#### **4.4 Denial of justice in investment treaty arbitration.**

##### **A. General expositions as to current approach**

##### **B. An overview of Substantive Content**

#### **4.5 Conclusions.**

### **Abstract.**

*This chapter will analyse whether arbitrators have used the FET standard to develop further rules for domestic courts, as they have done for host-state administration through the legitimate expectations and transparency rules. Further, if they have done so, whether the standards produced for domestic courts are clear and cogent. It will also be questioned whether such rules, if produced, are done realistically bearing in mind the host-state's ability to comply with them.*

*The denial of justice rule can potentially be used in investment treaty arbitration to review the conduct of judges in municipal proceedings. It may also permit the investment arbitral tribunal to review the capacity and ability of municipal justice systems to accommodate claims by the investor. Under FET it may also permit tribunals to set appropriate rules for application of law by municipal courts. However, implementing such rules may come at a price to domestic nationals and at a burdensome cost to the host-state. This chapter illustrates the scope of review of investment arbitration using this rule and whether it has formulated standards, and done so appropriately considering practical concerns such as these.*

## **4.1 Introduction**

The denial of justice rule has been incorporated into the fair and equitable treatment.<sup>1</sup> Denial of justice is a rule of customary international law that grants investors protection from certain difficulties encountered in the host-state's courts including denial of access, and 'improper' administration of justice.<sup>2</sup>

The law of denial of justice may be linked to other breaches of international law by a state concerning the ability of the foreign investor to obtain redress for complaints.<sup>3</sup>

Potentially a claim under denial of justice would allow international tribunals to review the conduct and decisions of municipal courts. This review gives the tribunal an opportunity of assessing the conduct of the host-state's courts vis-à-vis international standards, and other standards that investment treaty arbitration deems fit.<sup>4</sup> It feasibly allows investment treaty arbitration to determine what appropriate conduct of municipal courts is. The benefits of developing standards for conduct of municipal legal systems will not only be to the investor but also for the rule of law for domestic nationals.

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<sup>1</sup> *Mondev International Ltd v. USA* ICSID Case No. ARB/AF/99 (11/10/02) at para 120.

<sup>2</sup> See Professor Greenwood, Second Opinion in *Loewen: Loewen Group, Inc. and Raymond L. Loewen v. United States*, ICSID Case No. ARB(AF)/98/3. (NAFTA). (Award, Merits) (26/06/03), at para 132; See Rubens 'Loewen v. United States: The Burial of an Investor-State Arbitration Claim' (2005) 21(1) *Arb. Int'l* at p.1-14.

<sup>3</sup> The conduct of municipal courts of a state will engage a states' liability in international law: '*A governmental authority surely cannot be faulted for acting in a manner validated by its courts unless the courts themselves are disavowed at the international level.*' *Azinian v. Mexico* at para 97. In the law of state responsibility states are liable for the actions of their courts where those courts impinge on international obligations, See J. Crawford, *The International Law Commission's Draft Articles on State Responsibility: Text, Cases & Materials* (Cam. Uni. P). at p.94-98.

<sup>4</sup> This is so where the fair and equitable treatment standard is seen as an open right for tribunals to decide what is fair, and thus use the denial of justice norm to create standards for municipal justice. See: I Tudor, *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment* (OUP) (2008)- at p.56. International standards, include those enshrined in human rights instruments, such as speedy and effective trials. See, M. Shaw, *International Law* 6<sup>th</sup> Ed (Cam. Uni. P) (2008) at p.348.

Thus, this chapter will outline the jurisprudence on the denial of justice in investment treaty arbitration to see how it has been applied by tribunals and to what extent it differs from the customary international law position.

## **4.2 Denial of Justice in general international law.**

### **A. Overview:**

The origins of denial of justice come from the treatment to be given to an alien in a host-state where the alien has a complaint relating to acts of that state or of private entities in the host-state.<sup>5</sup> After seeking redress in local courts, the alien, if not satisfied with the outcome, could seek the remedy of his or her state.<sup>6</sup> This was under the process of diplomatic protection.<sup>7</sup> The standard of protection that applied in these circumstances was known as the minimum standard.

In the early 20<sup>th</sup> Century, it was not precisely clear as to what the minimum standard actually entailed.<sup>8</sup> The law of denial of justice was illustrated and formed in early jurisprudence when recourse to diplomatic protection of the interests of foreign nationals resulted in ad-hoc inter-state arbitration.<sup>9</sup> For some the modern

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<sup>5</sup> A. Freeman, *The International responsibility of states for denial of justice* (Kraus Reprint (1970) at p.1-17; Tudor *The Fair and Equitable Treatment Standard* (OUP) (2008) at p.61; Borchard, *The Diplomatic Protection of Citizens Abroad or the Law of International Claims* (Banks Law) (1915) at p.330. Borchard states that denial of justice encompasses two concepts: (i) misconduct by any State organs vis-à-vis aliens or (ii) misconduct of the judicial branch of a state-*ibid*. Note, one uses the phrase 'alien' instead of 'national' as not all foreigners in a host-state had nationality when such complaints were made in the early 20<sup>th</sup> C.

<sup>6</sup> The requirement of seeking local courts first, called the local remedies rule, has been an important part of customary international law of the treatment of aliens. See, and below s.5.3.

<sup>7</sup> Amerasinghe, *Diplomatic Protection* (OUP) (2008) at p.37

<sup>8</sup> A.H. Roth, *The Minimum Standard of International law, Applied to Aliens* (A.W. SIJTHOFF/Leiden) (1949) at p.86.

<sup>9</sup> K. Grzybowski 'Interpretation of decisions of international tribunals' (1941) 35 AJIL 482 at p.483-587; who does not liken the pacific settlement in the middle ages to the settlement of international disputes by arbitration developing in the mid 19<sup>th</sup> C, such as in the Mexican Claims Commission of 1839. Increase in inter-state arbitration led to proposals for an international tribunal towards the end of the 19<sup>th</sup> C- L. Levi 'Draft

rule of freedom from a denial of justice developed as a part of the international law of state responsibility to foreign nationals, which provided the minimum standard of treatment of aliens in the host-state.<sup>10</sup>

Minimum standard elucidations have been based on broad and vague references to contemporaneous best-practices. Thus denial of justice has also been described in these terms with respect to the outcome of processes of justice that the alien pursues: ‘*if it unreasonably defeats from the principles of justice recognised by the principal legal systems of the world*’.<sup>11</sup> On another reading this standard was the treatment that a state would give its own nationals or ‘national treatment’, however the standard that came to be accepted, and which governed the success of a claim of denial of justice is the formulation of the minimum standard in the Neer decision.<sup>12</sup>

Whether denial of justice under the FET standard has gone beyond the minimum standard will be discussed below. Despite the incorporation of denial of justice under FET, it is not clear whether it should be restricted to the high threshold for a breach set by the minimum standard. The tribunal in *Wastemangement II* stated that NAFTA must **not** be interpreted with the general law of diplomatic protection in mind.<sup>13</sup> Further this is also said to be the case by the International Court of Justice in *Diallo*, where a distinction is made between investment treaty law and the general international law of diplomatic protection to illustrate that levels of protection for foreign nationals were different under each system.<sup>14</sup>

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Project of a Council and High Court of International Arbitration’ in *Arbitration Treaties and Tribunals* (Int’l Arb & Peace Assc ) (London) (1889)) at p.11.

<sup>10</sup> G Roha, ‘Is the Law of State Responsibility of States for Injuries to Aliens a Part of Universal International Law?’ (1961) AJIL 863 at p.864-891.

<sup>11</sup> See Guerrero Report in the 1961 Draft Convention on the International Responsibility of States for Injuries to Aliens (1961) 55 AJIL 548 at p.551.

<sup>12</sup> Neer and Pauline Neer (US v. Mexico) (1926) 4 RIAA 60 at p. Roth describes the Neer test as ‘*one of the strongest expressions of the minimum standard*’ at p.95-96.

<sup>13</sup> *Wastemangement v. United Mexican States* (No.2) ICSID Case No. ARB(AF)/00/3(NAFTA) at para 85.

<sup>14</sup> See Joint Dissent of Yusuf & Al-Khasawneh in *Ahmad Sado Diallo (Republic of Guinea v. DRC)*, ICJ Judgment, (10/11/10). General List 103. at p.21.

## B. Theoretical Basis and Scope in Customary International Law.

The doctrine can be rationalised as assisting relations between states. This based on the presumption that a state has concerns for its citizens, and this concern extends to their activities overseas.<sup>15</sup> As states are composed of their citizens, there is an intrinsic value to each citizen which can be expressed not only in economic terms of human capital, but also on moral terms of responsibility of state action. As Vattel says '*Who ever ill-treats a citizen indirectly injures the state, which must protect the citizen*'.<sup>16</sup> This concern of states extends to valuing justice for its citizens and it sees the grant of justice towards its citizen as symbolic of respect of the host-state to itself.<sup>17</sup>

There may be a case however to interpret the denial of justice rule as part of the minimum standard more onerously on states in the investment treaty context. As investment treaties are specific obligations that can, controversially, said to involve a policy agenda of capital promotion,<sup>18</sup> this may justify interpretations that give more specific guidelines as to the manner of redress to be afforded to aliens.

As a result of the large jurisprudential content concerning denial of justice, it eludes precise definition.<sup>19</sup> In simple terms it is correct to say that there is a right of freedom from denial of justice as the state must not breach the customary international law obligation to not deny justice to foreigners, this includes resort through courts and other means of redress, including administrative processes.

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<sup>15</sup> This approach was exemplified by the British Foreign Secretary Lord Palmerston in the 19<sup>th</sup> Century: G. Hicks, 'Don Pacifico, Democracy and Danger: The Protectionist Party Critique of British Foreign Policy' (2004) 26(3) Int. Hist. Rev. 515 at p.515-540.

<sup>16</sup> Vattel, *Law of Nations* (AMS Press) (1982) at p. 136.

<sup>17</sup> For reciprocity as a concept in international law, See: F. Parisi & N. Ghei, 'The Role of reciprocity in international law' (2003-04) 36 Corn. Int'l L.J. 93 at p.119-123. Note also the importance of justice to the function of a state is a corner-stone of jurisprudential study. One definition equates justice to adjudication fulfilling social values and goals: '*Adjudication is the social process by which judges give meaning to our public values*' O.M. Fiss 'The Forms of Justice' (1979-1980) 93 Harv. L. Rev. 1 at p.2.

<sup>18</sup> M. Sornarajah, *The International Law on Foreign Investment* (Cam. U. P) (2004) at p.211-217.

<sup>19</sup> J. Paulsson, *Denial of Justice in International Law* (Cam. U. P) (2005) at p.98



Freeman in his seminal work on Denial of Justice in the minimum standard context summarised six elements to the content of denial of justice:<sup>20</sup>

- (i) Every wrong that a state commits to an alien that is a breach of international law.
- (ii) Unlawful acts and omissions by judicial authorities.
- (iii) A procedural breach based on the refusal to recognise a wrong.
- (iv) Denial of justice as related to application of municipal standards of judicial conduct, and wrongful (in the sense of municipal law).
- (v) Failure to obtain redress by an alien for a wrongful act of private individual or Government.
- (vi) Failure of judicial organs to meet international standards.

As well as Freeman's synopsis, Paulsson makes a further distinction between procedural and substantive denial of justice.<sup>21</sup> A procedural denial of justice (a misleading term) is concerned with the overall fairness of the proceedings and the consequential outcome. A substantive denial of justice is concerned with the manner in which proceedings are carried out, such as the way the law is applied by the judge. The latter is where FET could feasibly develop denial of justice beyond its customary international law position.

### C. Illustrating the Customary International Law Position

As the decisions of international courts and tribunals are sources of international law, they will be incorporated into the FET standard through the minimum standard in international law.<sup>22</sup> As denial of justice was one of the most significant

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<sup>20</sup> A. Freeman *The International responsibility of states for denial of justice* (Kraus Reprint (1970) at p.67-168, and, specifically, at p.161.

<sup>21</sup> J. Paulsson, (n19 above) at ps.98 & 167.

<sup>22</sup> The minimum standard is the lowest level of protection feasibly afforded to the investor under FET. See, I. Tudor, *The Fair and Equitable Treatment Standard in The International law of Foreign Investment* (OUP) (2008) at p.56-60.

substantive doctrines under-which a range of complaints of foreign nationals were brought there are several cases on this.<sup>23</sup> Some of the examples given demonstrate that, some international tribunals, aided by a much more specific remit in their compromis have gone into reviewing the decision of municipal court in order to determine whether the breach of the rule has in fact occurred.

The *Neer* decision is the most important decision in this field, as it is formulaic of the customary international law level of treatment of foreign nationals. It also gives a high threshold for a denial of justice that is not easy for the claimant to satisfy: '*that the authorities... acted in an outrageous way, in bad faith, in wilful neglect of their duties or in a pronounced degree of improper action*'.<sup>24</sup> The claim itself is not directly related to the conduct of or outcome of judicial proceedings, but rather a broader issue of access to justice. The claimants were denied an investigation into the death of a relative in Mexico. Their claim for a denial of justice was rejected. This was on the basis that the efficacy and intricacies of a states' criminal justice system, including the decision as to whether to prosecute and investigate, was a matter of municipal law and policy outside the realm of international adjudication.<sup>25</sup>

A classic example of a denial of justice is a complete absence of legal remedies. Thus in the *Atocha* case it was unjust to expel without judicial proceedings an American citizen for a finding of complicity in a revolution.<sup>26</sup>

#### Construction of an 'objective or 'outcome' based approach to denial of justice

The 'objective' approach (or 'outcome approach'), termed here, is where denial of justice does not look into how a judge exercises his or discretion on law or facts,

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<sup>23</sup> See, Freeman (n20 above) at p.97-101.

<sup>24</sup> L.F.H. Neer & P. Neer (U.S.A) v. United Mexican States (1926) IV RIAA 60 (Award 05/10/1926) at p.62

<sup>25</sup> Neer (n.24) at p.61-66.

<sup>26</sup> J.B. Moore, *Digest of International law* (Washington) (1906) Vol. 4 at p.97, s.551.

but rather looks at the decision as a whole bearing in mind the alien's case and determines whether there should have been judgment in the alien's favour. This, however, allows the international tribunal to substitute its judgment for that of the national court.

Most approaches to the doctrine fall this way, and looking into the national judge's exercise of discretion is usually avoided. Thus the tribunal in *Martini* would not extend its review to the personal motivations of judges passing judgment. From a pragmatic view point these may be difficult to prove, as the tribunal stated:

*'The tribunal is not in a position to form an opinion upon motives that might have inspired the Venezuelan judges at the time of the Martini case. If the decision of the Venezuelan court is based upon law, the psychological motives play no part. On the other hand, the defects in the decision maybe such as to cause the inference of bad faith on the part of the judges, but, in this case it is also the objective character of the decision which is decisive'.<sup>27</sup>*

This 'objective' or reviewing the overall 'outcome' of the case based approach focuses the review of the international tribunal on the final decision, and whether in it there are elements that may breach the *Neer* threshold. This is an 'effect to cause' based reasoning that may not protect the alien from minor, yet significant biases, by domestic remedies that cannot be spotted in the final outcome. Fitzmaurice, for example, envisages an objective approach through analysis of the decision first, then as opening a door to investigate the process. The threshold suggested again is high:

*'The only thing which can establish a denial of justice so far as a judgment is concerned is an affirmative answer, duly supported by evidence to some such question as 'was the court guilty of bias, fraud, dishonesty lack of impartiality, or gross incompetence.'<sup>28</sup>*

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<sup>27</sup> *Martini Case (Italy v. Venezuela)* 3 May 1930, (II RIAA 975); 5 ILR 153 at p.156.

<sup>28</sup> G.G. Fitzmaurice, 'The meaning of the term denial of justice' (1932) 13 BYIL 93 at p.113-114.

However, 'objective' or 'outcome' assessment can however relate to one part of a dispute or claim. Thus the tribunal stated that for a claim of denial of justice that all reasoning upon which the judgment was decided did not have to be have been unjust in order to bring a denial of justice claim. The tribunal stated:

*'A decision may contain several independent findings and certain of them may be taken into consideration apart from the others'.<sup>29</sup>*

*Misapplication of National Law and unwanted interpretations of national law as a basis of the claim*

The doctrine does not extend to errors of law made by national courts. This is illustrated by the *Martini* case. The *Martini* case concerned a mining concession granted to Venezuela.<sup>30</sup> A claim was brought for a denial of justice and a breach of the 1861 Treaty between Venezuela and Italy. This claim was made in relation to a hearing in the Federal Court of Appeal in Venezuela.

The concession for mining was issued in 1898 for a period of 15 years. The company was to pay the Government rent under the concession. The company ceased exploitation work on the basis of a civil-strife. The municipal court rejected the claimant's plea that civil-strife allowed it to breach its obligation under the concession.<sup>31</sup> The Venezuelan Governmentt then brought an action in the Venezuelan Courts.

The tribunal drew a distinction as to which matters were for the jurisdiction of the international tribunal for the denial of justice claim, and which matters had to be left for a municipal court. Thus, if a Venezuelan court had erroneously stated that

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<sup>29</sup> Martini (n27 above) at p. 157.

<sup>30</sup> Martini (n27 above)

<sup>31</sup> Martini (n27 above) at p.154; The position in international law may be different today due to the concept of attributability in the international law of state responsibility – See, Crawford (n3 above).

the concession was not in breach of the treaty then the actions of the court would invoke the international liability of Venezuela. However the tribunal stated that the related question of monopolies to the concession was a matter only for the Venezuelan Court.<sup>32</sup> It would thus not pass judgment on this matter. The denial of justice doctrine did not extend so far as to cover errors of law as far as the tribunal was concerned.

The tribunal cited the basis of a discussion suggested by the Preparatory Committee for the Codification of International Law (the precursor to the International Law Commission) on the engagement of state responsibility to aliens. This is summarised below:

- (i) The foreigner refused access to courts to defend his rights.
- (ii) A judicial decision which is final and without appeal is incompatible.
- (iii) There has been an 'unconscionable delay' on by the court system.
- (iv) The substance of a judicial decision is prompted by ill-will towards foreigners.
- (v) Damaged suffered by the foreigner by judicial process- 'is so gross as to indicate that they did not offer the guarantees indispensable for the proper administration of justice'.<sup>33</sup>

As to non-interference with judicial discretion to interpret contracts, *Martini* tribunal stated that where the municipal court had a choice of interpretations as to a contract, a single choice of one over another could not amount to a denial of justice. There would have to be bad faith as to the choice of a particular interpretation over another. Thus any bad faith would have to be demonstrated by the claimant through the decision itself. The tribunal had noted that as regards the agreement to pay rent, this was subject to many interpretations, so that it could *not*

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<sup>32</sup> *Martini* (n27 above) at p. 155.

<sup>33</sup> The tribunal cited the basis of discussion No.5 suggested by the preparatory committee for the codification of international law (in the matter of state responsibility to foreign property or persons). *Martini* (n27 above) at p.155, fn 1.

as the facts before the tribunal, be said that the decision of the Venezuelan court was manifestly unjust.<sup>34</sup>

A classic example of the 'objective' or 'outcome' approach is deciding whether the national court has been affected by public pressure. There is also possibility of public pressure concerning proceedings that may influence a decision amounting to a denial of justice. This was argued unsuccessfully, in the *Soloman* case, where the tribunal found that there was no clear link between public pressure and the actual adverse judgment that was passed.<sup>35</sup> It may often be the case that foreign investors in proceedings will lead to public interest.<sup>36</sup>

*No basis of complaint on denial of justice for failure of alien to bring plaint*

The alien could not also blame the national court for errors in the way it had conducted its litigation. With regard to the civil-strife related defence of the claimant, the tribunal noted that this had not clearly been put before the court. Thus 'the court could not be reproached for not having entertained an exception which was not clearly presented to it'.<sup>37</sup>

*Decisions of municipal courts contrary to international court judgments where international obligations apply*

The tribunal also discussed the issue of whether judgments of municipal courts contrary international awards could amount to a denial of justice. The tribunal stated that where there was a finding of a municipal court contrary to a finding of an international tribunal the State was bound to follow the international award.

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<sup>34</sup> Martini (n27 above) at p.156.

<sup>35</sup> Abraham Solomon US v. Panama 29 June 1933, VI RIAA 370.

<sup>36</sup> See, D. Szablowski, *Transnational Law and Local Struggles: Mining Communities and the World Bank* (Hart) (2007) at p.1-23.

<sup>37</sup> Martini (n27 above) at p.156.

Further, this did not require a national court to review the decision before following it. Nor could a municipal court invalidate it. In the Ralston award, the tribunal stated that state responsibility is engaged if ‘*the attitude of a Venezuelan court is incompatible with an international arbitral award rendered in accordance with an international treaty to which Venezuela is one of the Contracting Parties*’.<sup>38</sup> The tribunal also noted the inherent obligation upon states to follow an international award:

*‘An international arbitral award is rather of the nature of an international treaty than a decision of a national court’.*

Freeman in his analysis also included the possibility of a denial of justice occurring when a national court breaches international law.<sup>39</sup>

The case of *El Triunfo* concerned a Presidential decree that closed a port. A state concession for the operation of the port was acquired by a corporation with foreign shareholders. The corporation was thus unable to enjoy the benefits of the concession agreement.<sup>40</sup> The tribunal analysed the possibility of breach of contract stated in its own terms and stated:

*‘it cannot be said, as now here claimed by the Government of El Salvador, that there was any such failure of its obligations in the circumstances of the case as would have justified or sustained a complaint, for a breach of contract in a court of justice’.*<sup>41</sup>

The tribunal is placing its own subjective view of contract law, and specifically, what amounts to a breach of contract. However, the arbitrators believed that the success of the company lead to it being seized from foreign control, this was said to be a denial of justice as on remedy was given to that claimant for this usurpation of its rights to corporate control. Thus though the contractual element failed, the case still succeeded on other grounds.

### Judicial Errors

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<sup>38</sup> Martini (n27 above) at p.157).

<sup>39</sup> Freeman (n20 above) at p.310.

<sup>40</sup> *El Triunfo* (US v. El Salvador) – 8 May 1902 XV RIAA 455 at p.467

<sup>41</sup> *El Triunfo* at p474

There is a view that the doctrine does not cover errors of judges with regard to law. Such errors of the judicial role would amount to a denial of justice. Fitzmaurice states that *‘if all that a judge does is to make a mistake, i.e. to arrive at a wrong conclusion of law or fact, even though it results in serious injustice, the state is not responsible’*.<sup>42</sup> This approach may be justified on the basis that it may not be fair to make the state responsible for a minor aberration of judicial process. Realistically speaking, errors of fact and law may be inherent in all judicial systems. Thus in the absence of bad-faith it may not be fair to invoke international responsibility.

#### *Lack of Judicial Competency engaging state responsibility*

This has some support for leading jurists, though it is difficult to see how this would work without a lesser threshold working with the ‘outcome’ approach. Thus the following proposition by Paulsson may be unworkable; Paulsson also does not agree that the international tribunal should not review a decision of a municipal court where an adverse competence is made: *‘what needs to be understood is that even if in extreme cases the substantive quality of a judgment may lead to a finding of denial of justice, the objective of the international adjudicator is **never to conduct a substantive review**’*<sup>43</sup> Paulsson believes that there must be a manifest injustice to impugn the competence of a municipal court.<sup>44</sup>

For Fitzmaurice state responsibility is engaged when it appoints judges.<sup>45</sup> De Visscher also wishes competency to be an international obligation. If competency is a part of the doctrine then it is a state’s duty to provide for proper recruitment

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<sup>42</sup> G. Fitzmaurice, ‘The Meaning of the Term ‘Denial of Justice’ (1932) 13 BYIL 93 at p.112-113; Note also, E. J de Archèchaga ‘International Responsibility of States for Acts of the judiciary’, in Friedman, W.G. Henkin, and O.J. Lissitzyn Eds *Transnational Law in a Changing Society- Essay’s in Honour of Philip C. Jessup* (Columbia. Uni Press) (1972) at p.171-188.

<sup>43</sup> Paulsson (n19 above) at p.84.

<sup>44</sup> Paulsson (n19 above) at p.84-85.

<sup>45</sup> Fitzmaurice (n28 above).



of judges. However, Paulsson also states that where the court is not competent there is a denial of justice.<sup>46</sup>

### **4.3 The Local Remedies Rule.**

In customary international law, prior to an alien seeking redress through diplomatic protection or another international remedy and thus engaging inter-state relations, he or she has to ensure that he had sought out and exhausted all local-remedies. This requirement is known as the 'local remedies rule'.<sup>47</sup>

There is not a clear consensus as to whether the local remedies rule applies in investment arbitration.<sup>48</sup> Some international dispute arrangement provisions expressly provide for it.<sup>49</sup> As far as the engagement of the rule through existing

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<sup>46</sup> See Paulsson (n19 above) at p.80-90.

<sup>47</sup> See C.F. Amerasinghe *Local Remedies in International Law* (2<sup>nd</sup> Ed, 2004) at p.11-29; see *Certain Norwegian Loans* ICJ 1957 ICJ Rep 9 at p.39; J.E.S. Fawcett 'The exhaustion of local remedies: substance or procedure' (1954) 31 BYIL 452; J.M. Pasqualucci *The Practice and Procedure of the Inter-American Court of Human Rights* (CUP) (2003) at p.132.; D.R. Mummery, 'The content of the duty to exhaust local remedies' (1965) 59 AJIL 398 at p.401; *El Triunfo* (n40 above) at p.477; In the *ELSI* case Judge Schwebel stated that he agreed with the US that '*all reasonable*' local remedies had been exhausted, prior to bringing the claim. See, *Electronica Sicula S.p.A (ELSI) Case* (1989) at ICJ Reports 15 at p. 94. The requirement is thus not to pursue avenues which are otiose. It is regarded as part of customary international law. See, *Interhandel Preliminary Objections*, I.C.J. Reports 1959, at p.27.

<sup>48</sup> See C. Schreuer 'Calvo's grandchildren: The Return of Local Remedies in Investment Arbitration' (2005) 4 Law & Prac. Int'l Cts. & Trib 1 at p.1-3; In *Loewen*, the tribunal rejected Sir Robert Jennings' proposition in his opinion that local remedies rule is essentially confined to cases of diplomatic protection (n2 above) at para 150. NAFTA tribunals have stated that Chapter 11 of NAFTA dispenses with the notion of satisfying local remedies. See, *Wastemanagement (No2) v. United Mexican States* ICSID Case No. ARB/99/4 (30/04/04) (116). It has been stated that a full imposition of the local remedies rule is compatible with the investment treaty arbitration system, C. McLachlan, L.Shore & M.Weiniger *Investment Treaty Arbitration Substantive Principles* (OUP) 2007 at p.231-232.

<sup>49</sup> See, for example, . The application of the rule also exists in other international dispute resolution forums, See, for example, N. Udombana 'So far, so fair: the local remedies rule in the jurisprudence of the African commission on human and peoples rights' (2003)

customary international law, the first thing an international tribunal has to do prior to determining whether there has been a denial of justice is to assess whether the local remedies rule applies. This will occur so long as there is no express exclusion by the treaty. Secondly, the international tribunal must ensure, by reviewing the processes, that the alien has satisfied the rule. To explain further, Paulsson states:

*‘The issue of exhaustion of local remedies relates to the admissibility of claims and must be distinguished from issues of jurisdiction’*<sup>50</sup>

Similarly, in *Loewen* the Court stated that ‘the local remedies rule deals with the admissibility of a claim in international law, not whether the claim arises from a violation or breach of international law’.<sup>51</sup> Thus prior to lodging a claim for denial of justice in international justice, municipal avenues for the compliant have to be attempted. Thus in the *Leighland* case the judge stated that ‘*The Umpire (judge) does not conceive that any Government can thus be made responsible for the conduct of a judicial officer where no attempt has been made [for redress] to a higher court.*’<sup>52</sup>

On a strict application of the rule a claimant will only be willing to pursue international remedies if the claimant has, what is termed, ‘*exhausted*’ all local remedies. Thus the local remedies rule is not concerned with the substantive question whether there is a violation of international law. It is concerned with the question of whether a prerequisite procedural hurdle to international dispute resolution has been met.

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97 AJIL 1 at p.9. The rule has also been applied for claims under the European Convention of Human Rights,

<sup>50</sup> Paulsson (n19 above) at p.130

<sup>51</sup> The tribunal was referring to the reference to the local remedies rule in the International Law Commission’s Draft Articles for State Responsibility, Article 44 states: ‘*The responsibility of a State may not be invoked if... (b) the claim is one to which the rule of exhaustion of local remedies applies and any effective local remedy has not been exhausted.*’ Crawford (n3 above) at p.264.

<sup>52</sup> *Leighland & Co v. Mexico* (Case No.374 3 Moore Int Arb), cited at *Loewen* (n2 above) at para 150-151.

### Rationales for the rule

One of the key rationales of the local remedies rule is to give the state opportunity to redress the error.<sup>53</sup> Freeman, on the other hand, finds that the fundamental rationale for the local remedies rule is 'territorial'.<sup>54</sup> That is that the state where the violation occurs must be the where the judicial avenue for remedies must be pursued. The requirement that local remedies be exhausted is also based in fairness. Prior to the host-state being liable to the state of the alien, the host-state has been given adequate opportunity to remedy its wrong. Further the remedy allows the alien to reconcile the differences between itself and the host-state through seeking national remedies, particularly where the alien wishes to carry on operating in the host-state on secure or good terms. Further, international adjudication may be more costly than domestic litigation.<sup>55</sup> Cost may be an issue for justifying the rule where feasible local remedies exist. This would certainly be the case with respect to investment treaty arbitration where lodging of complaints and costs are significant.<sup>56</sup>

### Exceptions to its application

When determining whether local remedies have been satisfied-the tribunal can look at the judicial system to see whether viable remedies exist. Where they do not, the requirement will be waived. In the case of *Robert E. Brown*, the Claimant had been promised prospective licences to use a public gold field.<sup>57</sup> There was a

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<sup>53</sup> Loewen (n2 above) at para 71.

<sup>54</sup> Freeman (n5 above) at p.416.

<sup>55</sup> Professor Reisman states that 'The domestic remedy rule is founded on principles of economy, localisation of delict, remedy, and good faith'. W. M. Reisman, *Nullity and Revision: The Review and Enforcement of International Judgments and Awards* (Yale Uni Press) (1971) at p.364.

<sup>56</sup> Paulsson does not firmly grasp this point, (n19 above) at p.99-101.

<sup>57</sup> *Robert E. Brown (US v. GB)* (23.11.1923) VI RIAA 120

refusal to grant the licences. There was an initial judgment in Brown's favour setting aside the decision not to grant compensation as unconstitutional. Whilst a claim for damages was lodged the Chief Justice was dismissed by the President. The judgment was then made impossible to enforce by the executive. The tribunal stated that it did not matter that Brown had not lodged the claims he could have done, as in this instance it was futile.<sup>58</sup>

Similarly, the tribunal in *El Triunfo* noted that the Government had enervated the concession prior to local remedies being pursued thus the pursuit of local remedies would have been in vain.<sup>59</sup> In that instance, there was a law annulling the investment and it is impossible that the municipal judiciary would quash it or review its appropriateness. It would be sensible however to do away with the local remedies rule where the perusal of local remedies is costly and futile. This would be for example where the foreign national has no hope of success.<sup>60</sup>

Overall it is likely that the local remedies have to be exhausted prior to engaging a denial of justice claim. This allows a state to remedy its breach of justice. Where a state cannot afford a functioning appellate process, it may not be able to use the local remedies rule as a defence to admissibility of a claim.

#### **4.4 Denial of justice in investment treaty arbitration.**

##### **A. General Expositions as to current approach.**

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<sup>58</sup> Brown (n57 above) at p.128-129.

<sup>59</sup> *El Triunfo* (n40 above) at p.477-478.

<sup>60</sup> Paulsson endorses the approach that it is not worth pursuing local remedies where they are not available: '*there can be hesitation [to remove the requirement of the local remedies rule] if the international tribunal is satisfied as a matter of fact that theoretically available local remedies are incapable of altering a decision*' (n19 above) at p.115. Reisman states that international tribunals should do away with the local remedies rule if there are legislative enactments precluding suit. See, (n55 above) at p.365.

Denial of Justice is included in FET, both through the minimum standard and exclusively of it. The key question is whether the tribunals have developed it further, particularly as regards to creating law for the court and reviewing domestic decisions. The basic concept is fundamentally the same. As stated in the *Loewen* the tribunal accepted that customary international law, through NAFTA Article 1105, imposed on states an obligation ‘*to maintain and make available to aliens, a fair and effective system of justice*’.<sup>61</sup>

Currently broad statements by investment tribunals intimate that they will look at both the ‘outcome’ and the conduct of courts. For example, in *Loewen* the tribunal elucidated a threshold for denial of justice based on the expert opinion of Sir Prof. Greenwood QC CMG. Thus for a breach there had to be one of the following resulting from the municipal proceedings:<sup>62</sup>

1. ‘Manifest unfairness, or gross unfairness’.
2. ‘[A] flagrant and unexcusable violation’.
3. ‘[A] palpable violation’ in which ‘bad-faith seems to be the heart of the matter, not a mere judicial error’.
4. ‘[T]he alien must sustain a heavy burden of proving that there was an undoubted mistake of substantive or procedural law operating to his prejudice’.

As far as judicial error is concerned there is something of high threshold for a breach. The third and fourth elements indicate that this could lead to a breach but only in extreme cases. The nature and purpose of these requirements is to set a high-threshold for denial of justice.<sup>63</sup>

The tribunal in *Mondev International Limited v United States of America*, also envisaged looking at the conduct of the court whether a breach had of the doctrine had occurred. The tribunal stated that by looking at all the facts and the conduct of

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<sup>61</sup> *Loewen* (n2 above) at para 129 & para 153.

<sup>62</sup> Greenwood (n2 above).

<sup>63</sup> Professor Greenwood explained his opinion in [Greenwood in *Sarooshi*].

the court whether there had been a breach of the fair and equitable treatment standard.<sup>64</sup> The tribunal in *Mondev*, reaffirmed the classification on denial of justice by the tribunal in *Azinian v Mexico*. This highlighted four elements to the doctrine-

- (i) The relevant courts refuse to entertain a suit.
- (ii) Courts subject a suit to undue delay.
- (iii) Courts administer justice in a seriously inadequate way.
- (iv) Courts take part in a clear and malicious application of the law.<sup>65</sup>

Refusal to entertain a suit is a key element of denial of justice. As far as (ii) and (iii) are concerned, standards as to how domestic justice is carried out could potentially be incorporated by the adjudicating panel. The latter two certainly would permit an international tribunal to review the municipal decision. The term 'inadequate' is broad and vague and leaves it open to the international tribunal to determine adequacy. This in turn may lead to a review in the manner in which the judge approached the trial, determined the admissibility of evidence and other procedural and evidential rulings of the judge. Where adequacy becomes a judicial construct it may not factor in the capacity of municipal courts to administer certain types of justice without an express requirement to observe this factor.

The third and fourth here also allow the investment treaty panel to review the municipal courts conduct but set a very high threshold for a breach. As far as overall threshold put down in these four criteria, it is very similar to the Neer test in that it requires serious failings of the municipal court to engage state responsibility under denial of justice.

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<sup>64</sup> *Mondev International Limited v United States of America*, (ICSID Case No. ARB(AF)/99/2) Award of October 11, 2002 (42 ILM 85 (2003)), at paragraphs 126-127. See *Amto v. Ukraine Arbitration Institute of Stockholm Chamber of Commerce (Stockholm, Sweden)*, 26 March 2008 (Arbitration No 080/2005) at para 76.

<sup>65</sup> *Azinian, Davitian and Baca v. United Mexican States* ARB (AF)/97/2 at para 102-103 cited in *Mondev* (n64 above) at para 126.

The tribunal in *Mondev* felt that the ICJ determination in ELSI in relation to the degree of arbitrary conduct by a state invoking state responsibility for mistreatment of aliens was useful in determining these tests for denial of justice. The ICJ in ELSI described it as ‘*a wilful disregard of due process of law, ... which shocks, or at least surprises, a sense of judicial propriety*’.<sup>66</sup> The tribunal stated that ‘*in the end the question is whether (at the international level and having regard to generally accepted standards of the administration of justice)...the impugned decision was clearly improper and discreditable*’.<sup>67</sup> This perhaps conflates a little the process of arriving at a bad decision. It is not clear from this statement whether one or the other will lead to a breach.

With respect to the administration of justice or legal system, the tribunal in AMTO also emphasised that the tribunal should have regard to the development of the host-state’s legal system.<sup>68</sup> In *AMTO* the tribunal said that there is also a burden on the investor to use available legal rights and avenue in the host-state:

*‘The investor that fails to exercise his rights within a legal system, or exercises its rights unwisely, cannot pass his own responsibility for the outcome to the administration of justice, and from there to the host State in international law’.*<sup>69</sup>

## B. An Overview of the Substantive Content:

Key tribunal decisions in investment treaty arbitration on denial of justice follow in detail below. Other decisions are cited where relevant to the discussion.

### *Azinian.*

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<sup>66</sup> *Mondev* (n64 above) at para 126.

<sup>67</sup> *Mondev* (n64 above) at para 127.

<sup>68</sup> Note the AMTO tribunal stated that the doctrine should factor in: ‘*...the available means within the host State’s legal system to address errors or injustices*’ (n64 above).

<sup>69</sup> AMTO (n64 above) at para 76.

One of the first substantive dispute relating to denial of justice under NAFTA was the case of *Azinian*.<sup>70</sup> Ultimately, the claims under the treaty failed as the international tribunal felt that the investor had grossly misrepresented its experience in the industry.<sup>71</sup> However, the tribunal did address the issue of denial of justice. The State decision to annul the concession contract, for waste-disposal services in Mexico, was contested in municipal courts by the investor. The claimant stated that the Mexican courts had not addressed the contractual breach issue properly and accordingly there was a denial of justice. It was a claim on how judges had used the applicable law. The tribunal rejected the claim. The tribunal noted that there had been ‘three levels of Mexican courts’ that had found against the investor.<sup>72</sup> For this reason the tribunal emphasised that its proceedings at the international level were not an appeal avenue from the municipal courts.<sup>73</sup> The claimant, thus, had adequately opportunity to have his concerns about the applicable law adjudicated.

The tribunal affirmed Aréchaga’s work that stated that there are three grounds on which an international court could intervene in domestic legal process:<sup>74</sup>

- (i) Decision of a municipal court that is clearly incompatible with a rule of international law.
- (ii) Denial of justice.<sup>75</sup>
- (iii) ‘in certain exceptional and well-defined circumstances, a State is responsible for a judicial decision contrary to municipal law’.

It is the citing Aréchaga’s third ground that places investment treaty arbitration in a position to overturn national judges application of domestic law. It could review

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<sup>70</sup> *Azinian* (n65 above).

<sup>71</sup> *Azinian* (n 65 above) at para 29.

<sup>72</sup> *Azinian v. UMS* (2000) 39 ILM 537 at p.549

<sup>73</sup> This indicates that a repeated adverse finding will assist the defendant states in facing a claim.

<sup>74</sup> Aréchaga: ‘International law in the past third of a century’. (Hague 1978) *Recueil des Cours* (159-I)

<sup>75</sup> *Mondev* (n64 above) para 126.



the municipal court decision vis-à-vis this standard. This approach, may have the possibility for an appellate regime for the municipal courts application of the law. The Tribunal stated that the Claimant had not met the above requirements.<sup>76</sup>

### *Loewen.*

In *Loewen v. US*, the foreign investor was sued by a domestic business for contractual interference.<sup>77</sup> The case went to trial by jury on a broad range of causes of action. The domestic business won the suite and was awarded damages of half a billion dollars. The plaintiffs as to denial of justice were based on two fronts. The first basis of its claim was a requirement that appeals to the Mississippi court of appeals would require an unobtainable deposit of 125% of the award against a party to appeal. This rule was enacted in the nineteenth century, where the likelihood of such high jury awards was remote, and remains unchanged. Secondly, the investor claimed that the judge failed to give the appropriate jury direction in the trial to curb the behaviour of opposing counsel.<sup>78</sup> The investor here was specifically asking the international tribunal to determine the appropriateness of the conduct of the municipal judge. The tribunal dismissed all the claims, declining to do the latter. It stated that there was no basis in international law for such an intervention, into judicial discretion nor could the claimant challenge the out of date appeal rule.

On reflection, it is also difficult to explain how the huge \$625 million dollar deposit required to appeal was not a procedural rule amounting to the detriment of the investor. The Loewen decision has been heavily criticised as a feasible injustice.<sup>79</sup>

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<sup>76</sup> Azininan (n65 above) para 97-99.

<sup>77</sup> Loewen at ( n2 above).

<sup>78</sup> The tribunal stated that denial of justice was incorporated through the fair and equitable treatment standard in Article 1105 NAFTA (n2 above).

<sup>79</sup> See Rubens (n2 above).

### *Mondev.*

In *Mondev v. US* the tribunal dismissed all claims, including a denial of justice claim.<sup>80</sup> In *Mondev*, the dispute arose in relation to real estate development contract concluded in between two state bodies. The investor filed a suit in the Massachusetts Superior Court against the City and another state contracting party. The trial resulted in a verdict in favour of the investor against both defendants. The trial judge upheld the jury's verdict for breach of the Agreement against the City. However the judge held that the other State body was immune from liability for interference with contractual relations by reasons of a Massachusetts statute. The investor appealed with respect to this immunity.

On an appeal the immunity was upheld and the judgment previously in favour of the investor was overturned. Further, the investor's appeal to the US Supreme Court was denied. The investor claimed the denial of appeal, and the resulting upholding of the immunity of liability was contrary to the FET standard. Rejecting the investor's claim the tribunal said that in the absence of customary international law requiring statutory bodies to be liable for torts, it could not be said that the immunity of the breached Art 1105(1).<sup>81</sup> Further, the tribunal noted that there was no international consensus between states on the tort liability of a public body's interference with contractual rights.<sup>82</sup> The tribunal said that the immunity in this case was not a breach of NAFTA.<sup>83</sup>

In this decision, the tribunal assessed the discretion available to the municipal court to apply precedent. The international tribunal took a close examination of the proceedings. The tribunal stated that the municipal court had not applied appropriately its common-law discretion available to it to apply and disregarded

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<sup>80</sup> *Mondev* (n64 above).

<sup>81</sup> *Mondev* (n64 above) at para 140.

<sup>82</sup> *Mondev* (n64 above) at para 149.

<sup>83</sup> *Mondev* (n64 above) at para 154.

precedents when adjudicating the investors' contract claims against the City.<sup>84</sup> This demonstrated the detailed extent to which the international tribunal was willing to review the municipal court's exercise of judicial discretion when applying municipal law.

In an analysis, not so dissimilar to an appeal court, the tribunal went as far as to comment on the appropriateness of the municipal tribunal's application of municipal tax law. The tribunal stated that the municipal court's application of the municipal tax law principle of the 'square corners rule' in a contract law case, may raise a 'delicate judicial eyebrow', i.e. it might take judges who might try the same case by surprise but this did not mean that a denial of justice had occurred.<sup>85</sup>

Overall, the tribunal leaves it open whether a large misapplication of precedent would amount to a denial of justice. Opening this aspect of denial of justice more would lead investment treaty arbitration to question the municipal courts discretion as to application of law.

### ***Wastemanagement II.***

In *Wastemanagement II*, the dispute related to a concession for the provision of waste disposal services in the Mexican City of Acapulco.<sup>86</sup> The concession agreement was made between the claimant's subsidiary Acaverde and the Acapulco city council. Under the concession agreement, the 'subsidiary' undertook to provide on an exclusive basis certain waste disposal and street cleaning services in an area of Acapulco. The claimant claimed that the city acted in default of the agreement, particularly by not arranging financial relief. The investor brought a claim for denial of justice based on the manner of arbitration

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<sup>84</sup> Mondev (n64 above) at para 133.

<sup>85</sup> Mondev (n64 above) at para. 135.

<sup>86</sup> *Wastemanagement Inc. (No.2) v. UMS* ICSID Case No. ARB(AF)/00/3 Award (30/04/2004)

of the concession dispute by the municipal Chamber of Commerce, and the national courts.

Further the investors claim for denial of justice based on discrimination failed due to a lack of evidence of discrimination.<sup>87</sup> Material to the denial of justice claim was evidence of discrimination that was absent.<sup>88</sup> Further, even if state responsibility was engaged there was no breach of international law regarding the municipal arbitration process, as the claimant discontinued the process due to financial difficulty.<sup>89</sup>

In the Federal Court proceedings, Mexican courts granted standing for the Claimant's subsidiary against the Federal Bank for non-payment under the line of credit agreement.<sup>90</sup> The case and the appeal were struck out on the basis that the Claimant's subsidiary had not complied with terms of the line of credit agreement.<sup>91</sup> The appeal was struck out on the further ground that there was a dispute between the city and the subsidiary as to a provision of services.<sup>92</sup> A constitutional action by the claimant failed due to the failure of the subsidiary to prove a debt under the Line of Credit agreement.<sup>93</sup> A second action was dismissed on the basis that the Federal Bank having been notified of the dispute between the subsidiary and the city was entitled to withdraw payment.<sup>94</sup> Subsequent applications and appeals on this basis have failed.<sup>95</sup> The rejection of the investor's claims were thus justified by the municipal courts according to the tribunal.<sup>96</sup>

Further, the tribunal also noted that the investor had brought the action against the wrong person in the municipal courts and that the substance of the dispute

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<sup>87</sup> Wastemanagement (n86 above) at para (122).

<sup>88</sup> Wastemanagement (n86 above) at para 123 and ftn 71 therein.

<sup>89</sup> Wastemanagement (n86 above) at para 123.

<sup>90</sup> Wastemanagement (n86 above) at para 124.

<sup>91</sup> Wastemanagement (n86 above) at para 125.

<sup>92</sup> Wastemanagement (n86 above) at para 125.

<sup>93</sup> Wastemanagement (n86 above) at para 125.

<sup>94</sup> Wastemanagement (n86 above) at para 126.

<sup>95</sup> Wastemanagement (n86 above) at para 126.

<sup>96</sup> Wastemanagement (n86 above) at para 126.

was erroneously brought.<sup>97</sup> This is a pure ‘outcome’ or ‘objective’ approach as seen in customary international law.

The tribunal further emphasised that a litigant, such as a state party, cannot commit a denial of justice in proceedings-there has to be collusion by the courts. It is not unusual for litigants to be obstructive.<sup>98</sup>

*‘A litigant cannot commit a denial of justice unless improper strategies are endorsed and acted on by the court, or unless the law gives it some extraordinary privilege which leads to a lack of due process’.*<sup>99</sup>

There was no evidence of this in the case, hence the denial of justice claim based on the actions of Federal courts failed.<sup>100</sup>

## **AMTO.**

In *Amto v. Ukraine*, the claim for denial of justice was dismissed.<sup>101</sup> The claimant was a corporation registered in Latvia that played a key role in investing in an energy company, EYUM-10. EYUM-10 supplied its services to Energoatom. There was an attempt by EYUM-10 to resist majority shareholder takeover by the claimant through the Ukrainian Courts. The Ukrainian judicial process also sought to determine whether the existing purchase of shares by the claimant in EYUM-10 was a valid purchase of shares. However, following a partial hearing in the investor’s favour the judgments were not executed due to the bankruptcy of Energoatom. The claimant claimed that the non-enforcement of judgments and partial conclusion of court proceedings amounted to a denial of justice.

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<sup>97</sup> Wastemanagement (n86 above) at para 128.

<sup>98</sup> Wastemanagement (n86 above) at para 131.

<sup>99</sup> Wastemanagement (n86 above) at para 131.

<sup>100</sup> Wastemanagement (n86 above) at para 132.

<sup>101</sup> AMTO (n64 above).

The denial of justice claims were rejected. The tribunal said that there was no evidence that the Ukrainian Commercial Court of Appeal or Supreme Court were influenced by Government measures. The tribunal stated that the delays in proceedings that were complained of could be explicable due to complex nature of the litigation.<sup>102</sup> This could not be a basis for denial of justice. Thus the tribunal refined the idea of delays amounting to a denial of justice in *Azinian*, namely, that the complexity of the litigation had to be borne into consideration when determining a finding on delays.

#### Summary on scope of review

The tribunal in *Mondev* formulated the doctrine as follows:

*‘in the end the question is whether, at an international level and having regard to generally accepted standards of the administration of justice...the impugned decision was clearly **improper** and **discreditable**, with the result that the investment has been subject to unfair and inequitable treatment’.*<sup>103</sup>

The difficulty here is whether there is such a thing as ‘*generally accepted standards of the administration of justice*’. Standards of justice will depend on states and available revenue, as discussed below. In absence of specific formulations for rules, the denial of justice doctrine remains, in investment treaty arbitration, at a position where it only provides protection for the most egregious breach. Further, taking the *Loewen* decision into consideration, even this is questionable. Lack of standards of how efficiently and methodically both a judicial system, and judges, ought to operate, closes the opportunity for investment arbitration to carefully review the behaviour of legal systems.

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<sup>102</sup> AMTO (n64 above) at para 83.

<sup>103</sup> *Mondev* (n64 above) at para 127.

Instead the approach to denial of justice is that investment treaty arbitration panels is that there is not likely to be a breach barring the kind of glaring injustice envisaged under the minimum standard. Further, Loewen suggests that a glaring injustice caused by a peculiar national law, here an old appeal bond requirement, will not result in a denial of justice as extant (as opposed to retrospective) national laws cannot form part of a successful plaintiff.

However, the high threshold approach coupled with a denial of review of municipal proceedings is not a consistent position. An assessment of the way the municipal court applied the tax law in *Mondev* is distinct, and feasibly incompatible from the strict boundary of not interfering with judicial directions to jury in *Loewen*. The difference between reviewing judicial discretion on law in the former and not reviewing jury direction on the latter is difficult to justify or rationalise. Both are interventions into judicial discretions, and it seemingly makes no sense to exclude one from the scope of a breach of state responsibility and not the other.

The lack of clarity as to what the scope of review of municipal decisions is for arbitrators is also created by lack of certainty in definitions of denial of justice. Thus, broad definitions of denial of justice, in some cases still leave open the possibility of a close review of the municipal system including judicial discretion. For example, the tribunal in *AMTO* stated:

*'It is, [denial of justice], a manifestation of a breach of the obligation of a State to provide fair and equitable treatment and the minimum standard of treatment required by international law. Denial of justice relates to the administration of justice, and some understandings of the concept include both judicial failure and also legislative failures relating to the administration of justice (for example denying access to the courts).'*<sup>104</sup>

The scope of review here depends on the threshold of what is and what is not 'failure'. On one reading, errors of judicial discretion could fall within this. In

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<sup>104</sup> *AMTO v. Ukraine* (n64 above) at para 75.

another decision, *Mondev*, the tribunal goes close to assessing this regarding the judicial application of municipal law. Thus the tribunal in *Mondev* looked at the application of the *Leigh v. Rule* of domestic law by the municipal court. Further, the tribunal looked at whether the judge departed significantly from this and stated that he had not done, as it falls within a range of applications that would have been applied by a common-law judge.<sup>105</sup> A significant departure would have indicated a judicial error that may have given a finding of denial of justice. This does not mean that the threshold of denial of justice would be changed by a closer review than the close door approach in *Loewen*. In fact, only the most arbitrary and aberrant exercise of judicial interpretation of law may still engage the doctrine. Thus *Loewen* could have been decided the same way despite carrying out the same review, but having a high threshold of breach. By contrast, in *Mondev* the tribunal's review of the judicial discretion was the 'appeal' process approach that the tribunal itself had sought to avoid.<sup>106</sup> As the tribunal in *Azinian* stated:

*'The possibility of holding a State internationally liable for judicial decisions does not, however, entitle a claimant to seek international review of the national court decisions as though the international jurisdiction seized as plenary appellate jurisdiction. This is not true, generally, and it not true for NAFTA.'*<sup>107</sup>

#### Possible Defences and Issues with Current position.

There are a few defences available for the host-state, including unacceptable review of the municipal judges' discretion as in *Loewen* (rather muddled by the review of the *Mondev* tribunal). Further, as well as saying that the high threshold for a denial of justice has not been met, or that the host-state's courts are not fully developed<sup>108</sup> or do not have full avenues for appeal and the investor has to take

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<sup>105</sup> AMTO v. Ukraine (n64 above) at para 133.

<sup>106</sup> *Mondev* (n64 above) at para 126.

<sup>107</sup> *Azinian* (n65 above) at para 99, cited in *Mondev* (n64 above) at para 126.

<sup>108</sup> AMTO (n64 above) at para 76.



these as it finds them there is also the slightly more controversial immunity defence.

At present there is an available escape door for states to avoid suit for denial of justice in investment treaty arbitration. This is state immunity. If public bodies are immune from actions in municipal law, then the preclusion by immunity is enough to prevent a claim for denial of justice.<sup>109</sup> The tribunal in *Mondev* did say that there could be circumstances where the general conferral of immunity for a municipal public authority could breach NAFTA, but did not elucidate how.<sup>110</sup> The international tribunal noted, however, that there would be reasons why a state may make a regulatory body immune from suits.<sup>111</sup> For example, it would affect the work of the body to meet negligence suits.

Thus, the tribunal in *Mondev* explained:

*‘...it can be well imagined why a legislature might decide to immunize a regulatory authority, mandated to deal with commercial redevelopment plans, from potential liability for tortuous interference. Such an authority will necessarily have both detailed knowledge of the relevant contractual relations and the power to interfere in those relations by granting or not granting permissions. If sued, it will be able to plead that it was acting in good faith and in the exercise of a legitimate mandate – but such a claim may well not justify summary dismissal and will thus be a triable issue, with consequent **distraction** to the work of the Authority.’<sup>112</sup>*

The preclusion of liability of public bodies by a host-state is an important policy choice regarding affordable cost of operating public bodies.<sup>113</sup> A state may

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<sup>109</sup> As per Azinian (n65 above) para 97

<sup>110</sup> *Mondev* (n64 above) at para 151.

<sup>111</sup> *Mondev* (n64 above) at para 153.

<sup>112</sup> *Mondev* (n64 above) at para 153.

<sup>113</sup> H.W. Kennedy & R. C. Lynch, ‘Some Problems of a Sovereign without Immunity’ (1962-1963) 36 S. Cal. L. Rev. 161 at p.162-163.

preclude liability not only due to paying out money for such costs, but also due to the loss of revenue possibly fettering the function of public bodies. For example, in the UK, public bodies can be sued with respect to their statutory functions only.<sup>114</sup> This is done not only to give justice to a victim for a breach, but also for the ulterior motive of getting them to comply with their statutory functions. Government actions taken under the Crown can be sued in tort, though the range of these acts in public administration is limited. This by virtue of a specific statutory enactment, the Crown Proceedings Act 1947.<sup>115</sup> States may also have reasons to put certain acts beyond judicial accountability and control. This can be rationalised from the basis that states will place immunity on public bodies due to the costs of suits and that compliance with civil liability laws may interfere with their function.

From this point of view, unfortunately for the investor, if a state contracts with an investment treaty and wishes to restrict the review of an international tribunal entertaining a suit for denial of justice, it may wish to pass municipal immunity laws prior to any investments being made under investment treaties. The tribunal in *Mondev* dealt has permitted immunity to preclude a possible finding for denial of justice, that does not sit tightly with the benefits of investment treaty arbitration as providing state responsibility without application of state immunity doctrines.<sup>116</sup>

#### **4.5 Conclusions.**

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<sup>114</sup> See Clerk & Lindsell *On Torts* 19<sup>th</sup> Ed. (Sweet and Maxwell) (2006) at p.519 et subseq; Buckley, 'Liability in Tort for Breach of Statutory Duty' (1984) 100 LQR 204 at p.204-212; K. Stanton 'New forms of the tort of breach of statutory duty' (2004) 120 LQR 324 at p.324-336.

<sup>115</sup> See Clerk & Lindsell *On Torts* (Sweet and Maxwell) (2006) at p.258-268; Trietel, 'Crown Proceedings: Some Recent Developments' [1957] PL 321 at p.321-330.

<sup>116</sup> Though this specific exclusion is exclusive to ICSID, as opposed to investment treaty dispute resolution under other rules. See, D.R. Sedlack, 'ICSID's resurgence in international investment arbitration' (2004) 23 Penn. S. Int'L. Rev. 147 at p.149.

The denial of justice claim under the fair and equitable treatment standard is an area of interpretation of FET, which, in contrast to legitimate expectations and transparency, has not resulted in significant positive outcomes for the investor.<sup>117</sup> This supervision of judicial conduct, the road taken by the *Mondev* tribunal, may require a response by states to prevent breaches of judicial errors in applying national law, in terms of accuracy of discretion in applying law. In host-states where such problems are persistent, appropriate training of judges to ensure that such discretion is exercised appropriately may be required.<sup>118</sup> However, investment arbitration is not at present littered with complaints by investors of this type. This may also be an unaffordable cost burden to many developing countries.

Further international review of domestic judges could result in states encouraging domestic courts to take care in investors disputes to avoid liability. This may lead to a preferential treatment of foreign investor's over municipal nationals who do not stand to benefit from the creation of such international obligations.<sup>119</sup> If the

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<sup>117</sup> None of the claims described in this chapter have been successful: *Amto Limited Liability Company v. Ukraine* Sc. Case No. 080/2005 (ECT) (26/03/2008); *Loewen Group Inc. and R.L. Loewen v. US* ICSID Case No. ARB(AF)/98/3 (NAFTA) (26/06/2008); *Wastemanagement Inc. (No.2)* ICSID Case No. ARB (AF) 100/3 (NAFTA) (30/04/2004); *Mondev Int Ltd. V. USA* ICSID Case No. ARB (AF)/99/2 (NAFTA) (11/10/02); *Amo Asia Corp., Pan American Development, Ltd and PT Amco Indonesia v. Indonesia (AMCO II, resubmission)* (1990) 1 ICSID Rep 569.

<sup>118</sup> For example, Judicial Studies Board, in the UK hard to train judges to deal with the impact of the European Convention of Human Rights on municipal proceedings; J. Farsedakis 'The European Union and its activities in Europe with regard to training of judges. Applying European and United Nations principles in Practice' in *The Application of the United Nations Standards and the Norms in Crime Prevention and Criminal Justice* (Ministry of Justice) (Vienna) (At: <http://www.abanet.org/intlaw/committees/disputes/criminal/standards%20&%20norms.pdf>). Here the incorporation of international norms was done through the assistance of international institutions. There maybe a need for complementary international training here to make domestic judges aware of the standards within the denial of justice norm.

<sup>119</sup> W.H. Landes & R. A. Posner 'The Independent Judiciary in an interest group perspective' (1975) 18 *Journal of Law and Economics* 875; cf. D. J. Boudreux & A.C. Pritchard 'Re-assessing the role of independent judiciary in enforcing interest group bargains' (1994) 5 *Constitutional Political Economy* 1. For the difficulty in creating an independent judiciary in a developing country, See J.A. Widner, *Building the rule of law*,

standards created under FET were to be greater than those provided to nationals, then this protection of the investor in municipal courts comes at a cost. Municipal proceedings are conducted at a financial cost to the state.<sup>120</sup> If specific standards for judicial discretion had been produced by investment treaty arbitration, then there would have been a further compliance cost as judges may need to be trained to accommodate international standards and to adhere to them.

There are also ramifications of the possible investor preference intimated earlier. Host-states, particularly developing ones seeking capital, in order to comply with international standards, may re-align their municipal legal systems to carefully consider investor complaints.<sup>121</sup> Civil justice systems are needed to facilitate and ensure harmony in social order and for legitimate allocation of social resources.<sup>122</sup> This is often due to revenue limitations that result in a state only being able to accommodate certain types and quantity of claims for justice.<sup>123</sup> These may be good reasons not develop more specific rules using FET for domestic proceedings, though, as a matter of consistency, these reservations have not been borne with respect to transparency and legitimate expectations under FET.

Specific rules, as with administrative burdens, have to be created in a way that states can comply with them. This will be an issue with developing states where there will be restricted revenue available to legal systems in contrast to the developed world.<sup>124</sup> In some developing countries legal systems are under

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*Francis Nyalali and the road to Judicial Independence in Africa* (W.W.Norton & Co) (2001) at p.214-232.

<sup>120</sup> See 'Resource Allocation & Compliance- the social cost of investment arbitration' in Chapter 1.

<sup>121</sup> See M. Clayton and A. Williams ed. *Social Justice* (OUP) (2004); They also function to complement and to ensure the efficacy of the rule of law- R. Pound *Social Control Through the Law* (Transaction Publishers) (1996) p.35 et subseq; Justice also has, historically, been useful in keeping social order: See, for example, A. Somerset *The Affair of Poisons: Murder, Infanticide & Satanism at the Court of Louis XIV* (Weidenfeld & Nicolson) (2003) at p.1 – regarding the feeling of satisfaction of the French people in the importantly regarded conviction of the poisoning murderer Marquis de Brinvilliers.

<sup>122</sup> P. Pleasance *Causes of Action: Civil Law and Social Justice* (Stationary Office) (2006) at p.1.

<sup>123</sup> See, for example, H. Brighouse *School Choice and Social Justice* (OUP) (2004) at p.2-16.

<sup>124</sup> The costs of modern legal systems in the developed world are significant. The UK allocated approximately over 60 Euros (over £40 p.a) per person per annum with respect

development and reform.<sup>125</sup> Judicial systems in the developing world have the following characteristics that could harm the investor in disputes:<sup>126</sup>

- (i) Lack of judicial independence from the judiciary
- (ii) Ineffective resource management
- (iii) Inadequate legal education
- (iv) Difficult access due to raised fees
- (v) Inaccessible procedure

Thus an investor used to judicial standards in a better resource allocated system may feel aggrieved as to the manner of proceedings or outcome.<sup>127</sup> However, if carefully tailored, potentially these are standards for host-states that could have

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to access to legal services. See Paper, 15 September 2006 by the European Commission for the Efficiency of Justice (CEPEJ), Report on European judicial systems - Edition 2006 (2004 data) (Council of Europe) (2006): at [http://www.coe.int/t/dghl/cooperation/cepej/evaluation/2006/Report2006resume\\_en.pdf](http://www.coe.int/t/dghl/cooperation/cepej/evaluation/2006/Report2006resume_en.pdf) at p.4. The annual income in Burundi is less than £100 (IBRD) (2008), demonstrating a disparity in resource allocation to justice systems. The problem of institutional inefficiency, including miscarriages of justice, in judicial proceedings is said to be not only resource based- See J.C.Botero, R. La Porta, F.López-de-Silanes, A. Shleifer & A. Volokh, 'Judicial Reform' (2003) 18(1) The World Bank Research Observer 61 at p.61-67 at [http://siteresources.worldbank.org/OPSMANUAL/Resources/July15OP310\\_annexD\\_FY09updatedDEC\\_FR\\_MJuly152008.pdf](http://siteresources.worldbank.org/OPSMANUAL/Resources/July15OP310_annexD_FY09updatedDEC_FR_MJuly152008.pdf) at p.2. In terms of ensuring access to legal systems, the Annual Figure for Legal Funding for litigants to have access to courts in the UK is £2.1Bn (<http://www.justice.gov.uk/news/newsrelease060508a.htm>) which is equivalent to the annual GDP of

<sup>125</sup> J. Casaus: 'Court Organisation Reform Experiences in Latin America' M. Rewet, W.H. Malik, M. Dakolias *Judicial Reform in Latin America and the Caribbean: proceedings of a World Bank Conference* (1995) (World Bank) (Technical Paper No. 280) at p.59; R.W. Page 'Governance and Administration of the Courts of Latin America' in M. Rewet, W.H. Malik, M. Dakolias *Judicial Reform in Latin America and the Caribbean: proceedings of a World Bank Conference* (1995) (World Bank) (Technical Paper No. 280) at p.55

<sup>126</sup> For a directory of African legal systems: A.N. Allot ed. *Judicial & Legal Systems in Africa* 2<sup>nd</sup> Ed (Butterworths) (1970); M. Rewet, W.H. Malik, M. Dakolias *Judicial Reform in Latin America and the Caribbean: proceedings of a World Bank Conference* (Technical Paper No. 280) (IBRD) (1995) at p.vii

<sup>127</sup> The institutional efficacy of legal systems in the developed world and their appreciation of the value of judicial independence is far greater than the developing- See a comparison between France and Germany, and Ecuador, Hungary and Peru in M.Dakolias, *Court Performance around the World: A comparative perspective* (Technical Working Paper a No.430) (IBRD) (1999) at p.33-45. Note particularly that an increase in budget in Germany increased the courts ability to handle and resolve cases, at p.37.

been brought in under FET, which could assist the investor. The FET standards could have been tailored with caveats as to development. Thus ‘undue delays’ could be reformulated as, ‘*taking into consideration the available resources in the state, the legal system has to be prompt in dealing with the investor’s complaint*’. It is also worth noting that not all countries will wish to develop to market-based economies where the rule of law is a vital part of societal structure.<sup>128</sup>

Such standards may not be able to be created through adjudication, where arbitrators may not have speed or resources to assess domestic legal systems. A legal criterion under FET of having expert evidence could provide some guidance. Alternatively, there could be an adequate system brought into determine whether these standards can be complied with domestically. There are also benefits for the host-state of incorporation. In transition economies where there is a developing rule of law, such standards- carefully construed to be cost viable- could assist economic development. This would support the purpose of many developing countries signing up to investment treaties: to receive capital for the end game of economic development.

#### *Current Issues with High Threshold and Scope of Review.*

There are benefits of the high threshold and restricted scope of review of municipal proceedings and legal systems. For one, they provide a level of coherence and clarity that other FET legal positions in transparency and legitimate expectations do not. However if certain caveats are observed, there is no reason to suggest that only the high threshold and restricted scope of review without standards could achieve this level of clarity and not a, different, more expansive normative position. Further clarity here with the minimum standard is not absolute, the current state of denial of justice in investment treaty arbitration

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<sup>128</sup> This disparity between states can be illustrated by the various difficulties faced by commercial agents in getting contracts enforced in transition economies-See J.Sekolec ‘The Rule of Law and the Transition to a Market Based Economy’ in M. Andenas & G.Sanders Eds. *Enforcing Contracts in Transition Economies, Contractual Rights and Obligations in Central Europe and the Commonwealth of Independent States* (BIICL) (2005) at p.11-19.

merely tells us that it is very difficult to bring such a claim, in the absence of the ‘outrageous’ conduct envisaged in the *Neer* decision.

The lack of development of denial of justice is arguably inconsistent with developments made by other law under FET for the improved conduct of domestic organs towards foreign investors. A case for caution has been mentioned by some commentators. There is a school of thought that advocates caution by international tribunals reviewing in detail municipal proceedings. For example, Paulsson also does not agree that the international tribunal should not review a decision of a municipal court where the court is of questionable competence:

*‘what needs to be understood is that even if in extreme cases the substantive quality of a judgment may lead to a finding of denial of justice, the objective of the international adjudicator is **never to conduct a substantive review**’*<sup>129</sup>

Paulsson’s concern of review of domestic courts decisions can be substantiated by the decision of *Yuille Shortridge & Co.*<sup>130</sup> Here, the tribunal stated that the acts of a municipal judge including the judgment and his or her conduct could not be relevant to a finding of denial of justice. Pertinently, the tribunal noted that in the Portuguese Constitution there was a marked distinction between the executive and the judiciary.<sup>131</sup> Rationalising the observation of this distinction it is possible that if a finding was made to the contrary, the executive arm of the state may have to monitor judicial conduct to prevent a denial of justice where a foreign national is involved in a dispute. This may affect judicial impartiality. In turn this may be unconstitutional in Portuguese law. Thus the tribunal stated that it would be

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<sup>129</sup> Paulsson (n19 above) at p.84.

<sup>130</sup> International courts would not develop state liability for judicial acts due to a possible compromise of the independence of the judiciary. See, *Yuille Shortridge & Co* (21 October 1861) in A. de Lapradelle and N. Politis, *Recueil des arbitrages internationaux* vol.I, 78, at p.103-106.

<sup>131</sup> Yuille (n131 above).

unjust to make the Portuguese government to be liable for the courts, as courts in the Portuguese constitution were independent of the government.<sup>132</sup>

It is still open to debate whether international tribunals can review the manner in which municipal tribunals have applied law. In doing so they may create an appellate regime for the investor. This is through providing another opportunity to debate points of law for a different outcome. This may be beneficial as it may create legal certainty in litigation involving the investor.<sup>133</sup> Concerns include criticisms of appellate regimes of law-makers or political institutions are accurate, then this may result in enervation of the autonomy legal systems.<sup>134</sup> As the Tribunal in *Idler* noted, the effect of executive ability to constantly invalidate judicial decisions: *‘otherwise the validity and strength given by law to the final decisions of the courts of justice of competent jurisdiction, upon full knowledge of the facts and the law of the case, and in faithful compliance with the precepts of law, would be weakened and destroyed’*.<sup>135</sup> Another possible concern of international review by municipal courts is already stated, investor preference.

Fitzmaurice envisages a higher level of obligation than Paulsson stating *‘if all that a judge does is to make a mistake, i.e. to arrive at a wrong conclusion of law or fact, even though it results in serious injustice, the state is responsible’*.<sup>136</sup> It is possible that in investment treaty arbitration a broader scope or review into municipal proceedings and legal system efficacy could have been done on these authorities, they would have covered the problem in *Loewen* regarding not exercising appropriate judicial directions to the jury.

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<sup>132</sup> Yuille (n131 above).

<sup>133</sup> B. Atkins, ‘Interventions and Power in Judicial Hierarchies: Appellate Courts in England and the US’ (1990) 24(1) Law and Society Review 71 at p.74-75; M. Shapiro, *Courts: A Comparative and Political Analysis*, (Chicago: University of Chicago Press) (1981) at p.37-64.

<sup>134</sup> B. Atkins (n135 above) at p.76.

<sup>135</sup> See, *Idler v. Venezuela* discussed in Paulsson (n19 above) at p.160

<sup>136</sup> Fitzmaurice (n28 above) at p.112-3



Further a lower threshold could be chosen for denial of justice. For example the following test: *‘an exercise, or omission, of judicial discretion which no reasonable judge could have made’* would increase the likelihood of a breach. It would allow the international tribunal to review the municipal court’s application of the law and decide whether an appropriate conclusion had been reached. Such a problem increases judicial flexibility, though ‘reasonableness’ is problematic still in terms of legal certainty.

Overall there are reasons for a more substantive review, as well as against it. A greater form of review, and a lower threshold for a breach would have prevented the glaring injustice in *Loewen*.<sup>137</sup>

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<sup>137</sup> See Rubens (n2 above).

**Chapter 5:**  
**Consent, rule-making and coherence.**

**5.1. Introduction**

**5.2. Coherence**

**5.3 The Nature of FET rules**

**A. Rationales of Public Law**

**B. A brief history of English public law and administrative state.**

**C. The role of deference**

**5.4 Rule-Making Issues regarding FET**

**A. Participation and consent in Rule-Making**

**B. A Law and Economics Perspective on Transplantation**

**5.5 Conclusion**

**Abstract**

*The importance of coherence in rules to legal certainty shall open the discussion in this chapter, to put a case for why the lack of coherence in transparency and legitimate expectations may be a problem*

*This chapter will then discuss the origins of administrative law, particularly with reference to the U.K., a developed nation. It will suggest that the creation of administrative law and the process of judicial review is a part of a particular set of historical circumstances in the development of the U.K., as with other developed nations. These pertain to the rise of the administrative and regulatory state in developed countries.*

*Thus the creation of rules under FET that pertain to administrative standards that apply to developing countries will be opened to a critique of problems associated with transferring these rules from developed states to developed states. This will be further elaborated in the subsequent chapter. With respect to this problem the importance of consenting to rules by states, particularly developing countries to, what is possibly, a novel legal framework of liability, shall be intimated.*

*Issues discussed here are an outline of the value of deference to the legislatures in using public law doctrines such as substantive legitimate expectations, particularly as investment treaty arbitration operates without constitutional constraints.*

### **5.1. Introduction**

This and the following chapter is an examination of issues relating to the jurisprudence outlined in the previous three, particularly in relation to legitimate expectations and transparency. As these are rules that affect public bodies and state action at the policy level, the underlying question is why they ought to be formulated clearly so that states and investors can identify their rights and obligations. This shall be done by starting with a discussion on the importance of coherence in rule-making.

This Chapter will then shift direction to develop a second set of critiques in relation to FET rule-making, mutually distinct from coherence. It shall begin with a discussion of what issues there may be in relation to public administrative liability, that has its origins as an idea in the developed world. This is because through FET rules are being transposed to the developing world due to the proliferation of the FET standard in investment treaties. It shall begin this discussion by outlining the origins of administrative law, giving a case study of England and demonstrate there were distinct historical reasons for its creation. This shall form the basis of further criticisms with its compatibility in investment treaty law, again regarding the existence of developing states who will take on such obligations through current decisions being a valid form of law under the sources of international law.

Further to this, the idea of choice to a new form of accountability envisaged in public law rules under FET for the developing world shall be opened, to be developed into discussions in the next chapter. Here it will be done in an initial phase, outlining why it is important for states to be able to consent to legal rules.

Critiques of FET rules which bring in administrative liability into ITA shall be discussed in the next chapter, and will then be used to strengthen a case for direct

consent of FET rules for developing countries that may struggle to appreciate what is involved in incorporating such rules domestically. Further to this, institutional changes for accommodating this value of consent will be brought to light in the final chapter.

These discussions, predominantly in the abstract here, will be coupled with a discussion of legal transplantation in the next chapter, to formulate a critique of whether it is appropriate to incorporate public law liability where so many potential defendant states, due to their capital-importing desire, are likely to be from the developing world.

## **5.2. Coherence**

The problems of coherence in relation to legitimate expectations and transparency have been outlined in the discussions in preceding chapters. Here is an explanation of why coherence is important so as to make a case for some institutional changes in the concluding chapter that may improve coherence with respect to the doctrine. Regarding this value, this chapter will also discuss ‘deference’, which will be later explored as a tool to increase coherence of FET rules created by arbitrators in the final chapter.

Coherence of construction and application of legal doctrine by adjudicators is needed for the acceptability of a system of adjudication.<sup>1</sup> On a fundamental level legal incoherency occurs when laws cannot be identified.<sup>2</sup> Of further significance

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<sup>1</sup> E.J. Weinrib, ‘Legal Formalism: On the Immanent Rationality of the law’ (1988) 97 Yale. L.J. 949 at p.952; T. Franck, *Fairness in International Law and Institutions* (OUP) (1995) at p.38-41 & p.121-130.

<sup>2</sup> For example, this problem is seen with native American Indian law which is predominantly derived from historical analysis: P.P. Frickey, ‘Adjudication and its discontents: coherence and conciliation in Federal Indian Law’ (1997) 110(8) Harv. Law. Rev. 1754 at p.1756-1578; Methodological problems with customary international law may also lead to incoherence- J.P. Kelly, ‘Twilight of Customary International law’ (2000) 40 Va. J. Int’l 449 at p.449-450. For a different position, See J. Pearce, ‘Customary International Law: not merely fiction or myth’ (2003) Aust. Int. Law. Jnl. 125 at p.125-126.

is what such lack of clear identification does to the rule of law, or the acceptability of judge made law.

A key component of coherency is predictability of the application of legal doctrine and its comprehensibility by subjects. Coherency renders judicial decision-making comprehensible where legal principles are being applied clearly<sup>3</sup>, and within the mandate given to adjudicators. Further, coherency allows subjects to whom rules apply to determine their obligations and rights, permitting acceptability of rules through their knowledge.<sup>4</sup> Legal coherency thus supports the rule of law, by supporting a key part of it: knowledge and accessibility of rules.<sup>5</sup> Coherence of legal doctrine is also vital to the functioning and management of adjudication<sup>6</sup>: courts and tribunals may not be able to control the type of claim before them but they must be able to exclude unmeritorious claims, provide justice and at the same time maintain legal doctrine.<sup>7</sup> These aspects go into judicial decision-making simultaneously and they do not necessarily sit together hand in hand. Balancing such factors may make coherence of legal outcome a challenge. Absolute coherence is not necessary,<sup>8</sup> but subjects of laws ought to be able to

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<sup>3</sup> K. Kress, 'Coherence and formalism' (1993) 16 Harv. J.L. & Pub. Pol. 639 at p.641.

<sup>4</sup> E.J. Weinrib, 'The jurisprudence of Legal Formalism' (1993) 16 Harv. J.L. & Pub. Pol'y 583 at p.590-p.596; E.J. Weinrib, 'Legal Formalism: On the Immanent Rationality of the law' (1988) 97 Yale. L.J. 949 at p.972.

<sup>5</sup> This idea goes to the heart of administrative law's aims of promoting the rule of law: D. Dyzenhaus, 'Rule of (Administrative) Law in International Law' (2004) 68 Law & Contemp. Prob. 127 at p.129.

<sup>6</sup> P.P. Frickey, 'Adjudication and its discontents: coherence and conciliation in Federal Indian Law' (1997) 110(8) Harv. Law. Rev. 1754 at p.1756-1578

<sup>7</sup> This is particularly so in precedent based system where judge's make and maintain legal doctrine: K.J. Kress, 'Legal Reasoning and Coherence Theories: Dworkin's Rights Thesis, Retroactivity and the Linear Order of Decisions' (1984) 72 Cal. L. Rev. 369 at p.354- p.390.

<sup>8</sup> Weinrib argues it is not possible: Weinrib, (n1 above) at p.966. This may be because obligations that are unclear, due to either: (i) Because the application of a given rule to a context is not clear or, (ii) that the drafting of the rule itself is unclear, will need resolution often by legal adjudication. Hence legal adjudication in some extent is a process of clarification of previous ambiguities in rules. Thus the efficacy of such a process itself can be determined by coherence of outcome, i.e. how a rule is formulated or reformulated through judicial dicta. Kress, for example, also states that borderline cases would not affect overall doctrinal coherence: K. Kress, 'Coherence and formalism' (1993) 16 Harv. J.L. & Pub. Pol. 639 at p.666. This is because they can be ignored by judges when applying legal doctrine. E.g. the permissiveness of abortion would not

approximately determine their rights and obligations from legal rules.<sup>9</sup> Further, it has been argued that only with legal certainty through coherent legal doctrine, can law-makers and judges ascertain whether rules have beneficial or harmful effects,<sup>10</sup> thus allowing rectification of bad laws where necessary to maintain the rule of law. Assessment of the quality of judicial adjudication is also done by looking at how legal coherence is maintained and sustained.<sup>11</sup>

The advantage of legal coherence is that it reduces conflicting propositions of law, and different outcomes on similar disputes.<sup>12</sup> A key component of coherence is linguistic clarity in drafting, of judgments and laws. Ambiguous language or articulation of doctrine may harm legal coherence.<sup>13</sup> Coherence may have to be weighed against other factors of ideal adjudication.<sup>14</sup> Hence rigidity of doctrine, though assisting its coherence may undermine judicial flexibility to do justice.<sup>15</sup> From this perspective its relationship to acceptability of rules may not be absolute, but only as one important component of an ideal process of adjudication. However it is also argued that coherence is key to maintaining formal law-making (law-making by mandated institutions as opposed to custom) in a modern rule of law based government.<sup>16</sup>

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dismantle the law of murder. See also, J. Pearce, 'Customary International Law: not merely fiction or myth' (2003) *Aust. Int. Law. Jnl.* 125 at p.125-126 on non-requirement of *absolute* coherence.

<sup>9</sup> J. Rawls, 'Outline of a decision procedure for ethics' (1951) 60 *Phil. Rev.* 177 at p.178-181.; Rawls' states in his *Theory of Justice* that coherence is co-dependent on the subjects ability to assimilate the rule- Rawls, *A Theory of Justice* (OUP) at p.19 ; See, Kress (n8 above) at p. 664.

<sup>10</sup> See, Kress (n8 above) at at p.645.

<sup>11</sup> Weinrib (n1 above) at p.971.

<sup>12</sup> A problem inherent in investment treaty arbitration due to its lack of supervisory judicial institution: See, Y. Shany, 'Contract Claims vs. treaty Claims: mapping conflicts between ICSID decisions on multisourced investment claims'. (2005) 99(4) *AJIL* 835 at p.835-840; See, Kress (n8 above) at p.657.

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R. Charnock, 'Clear Ambiguity', in A. Wagner & S. Cacciaguidi-Fahyat (Eds.) *Legal language and the search for clarity: practice and tools* (Peter Lang) (2006) at p.65.

<sup>14</sup> See, Kress (n8 above) at at p.647, who does not place coherence of legal doctrine as an absolute in maintaining legitimacy of doctrine.

<sup>15</sup> Similarly, legislative processes may have to be pragmatic in weighing the passage of a law over and above its absolute coherence: See, Kress (n8 above) at at p.679

<sup>16</sup> R. Dworkin, *Taking Rights Seriously* at p.150-171.

Fundamentally, coherence of the law is important as subjects of the law rely on rules to determine what appropriate conduct and burdens are. In a commercial context awareness of rules may change decisions to enter into obligations of a private nature.<sup>17</sup> Coherence also goes to the subject-matter of rules. Thus, though consistency of doctrinal application forms an important part of the fabric of coherence, mere consistency alone, without acceptable subject-matter of a given doctrine of law would not suffice for a workable doctrine. Such an approach would permit incomprehensible or unacceptable doctrine or its parts to exist without rectification. Coherence may mean something more than mere consistency and clarity; something more akin to actual relationships between ideologues behind a given doctrine, the application in a given case and its impact as a general rule.

Coherence also values comprehensiveness of legal doctrine, so that most circumstances the rule seeks to control are within its ambit.<sup>18</sup> This is so that effects of the rule and the aims of the rule are clear and comprehensible to subjects. However, detail or comprehensiveness of legal doctrine does not necessarily import coherence.<sup>19</sup> On a basic level varied and different forms of a single cause of can undermine its coherence,<sup>20</sup> though the benefits and losses of this may not be balanced.

Thus, a judge faced with a huge range of different actions as forming the law of negligence, may decline to exercise his inherent power of not granting jurisdiction on the possibility of his removing a genuine claim. This would leave defendants unable to grasp what conduct is acceptable and which is not,<sup>21</sup> thus leading to behaviour that is both risk averse and commercially detrimental. On the other

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<sup>17</sup> R.A. Posner, *Economic Analysis of Law* 7<sup>th</sup> Ed. (Aspen) (1998) at p.101-111.

<sup>18</sup> See, Kress (n8 above) at at p.650.

<sup>19</sup> See, Kress (n8 above).

<sup>20</sup> See, Kress (n8 above).

<sup>21</sup> R. Stammler, *Fundamental Tendencies in Modern Jurisprudence* (1922-23) 21 Mich. L. Rev. 862 at p.881-883.

hand, an excessively conservative restriction on doctrine, could preclude new areas of law developing through older ones, despite preventing any intervening incoherence in this development. Some common attributes to forms of liability within a given legal doctrine are important to maintain coherence, so that causes of action can maintain some degree of predictability in their existence.<sup>22</sup> Coherence of rules is more important than consistency, due to the need to change law to meet changing social circumstance, for example, a rule of murder that encompasses all forms of voluntary killing barring those done with a particular implement maybe incoherent, as well as irrational, for rational subjects to accept.<sup>23</sup>

Coherence is subject to varied definitions.<sup>24</sup> Coherence theory can be generally articulated as ‘monist’ or ‘dualist/ pluralist’, although there is significant similarity as to the goal of these approaches.<sup>25</sup> Monist theories consist of analysing coherence of legal doctrines from how different parts can fit together without the doctrine losing sense.<sup>26</sup> As an example of monism, Weinrib’s conception of coherence values legal certainty but is also concerned with the existence of an overriding theme. Thus coherent rules are those that have a unifying theme, and an absence of competing ideologues or values within the same laws or legal system.<sup>27</sup> From this perspective, the coherence of fair treatment would mean the existence of some common goals between interpretations, in order to make interpretations predictable as opposed to random.

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<sup>22</sup> See Franck (n1 above).

<sup>23</sup> R. Alexy & A. Peczenik, ‘The concept of coherence and its significance for discursive rationality’ (1990) 3 Ratio Juris. 130 at p.13

<sup>24</sup> Dworkin, for example, believes that legal coherence is made of constituent organs of the state that participate in legal norm making and the cohesiveness (or compatibility) of the values these organs produce- See, Dworkin, *Law’s Empire* (Hart) (1998) at p. 178-200.

<sup>25</sup> This follows a general distinction made by Kress. See, Kress (n8 above) at at p.662.

<sup>26</sup> The work of Weinrib, as described by Kress, is monist. See, Kress (n8 above) at at p.641; J. Stick, ‘Formalism as the Method of Maximally Coherent Classification’ (1992) Iowa. L. Rev. 773 at p.773-782.

<sup>27</sup> E.J. Weinrib, ‘Legal Formalism: On the Immanent Rationality of the law’ (1988) 97 Yale. L.J. 949 p.971.



Pluralist theories seek to focus on how different aspects of a given legal doctrine co-exist and their relationships.<sup>28</sup> Thus such analysis relates to the compatibility of different interpretations of the same legal doctrine, and whether the inclusion or exclusion of any specific part breaks or undermines a given taxonomy. For example, such an analysis would include a determination as to whether product liability, which may only arise through breaches of contract, is effective in its aims of deterrence as with other forms of strict liability in the law of negligence so as to be a part of that legal field. Appropriate plurality maintains relevant aspects of the law that make it coherent, and removes parts that render it incoherent. There thus exists a commonality of varying subject-matter, including effect of the rule, or the particular policy the rule conveys. Plural coherence is not concerned with a singular overriding guiding principle for an area of law, or cause of action as monist coherence might be. The monist and dualist distinction serves to demonstrate some important attributes of legal coherence that will create legitimate legal doctrine.

Determination of plural coherence may be important to overall acceptance of the law. To a degree legal coherence is affected by conflicting ideologues within legal doctrine or their parts. Plural cohesion understands that approaches to an area of law may affect its form.<sup>29</sup> For example, whether one sees the aims of tort law to provide distributive or punitive justice will affect the law of damages that attach to the substantive law, and to a degree, the formation of doctrines of liability. A given elucidation of legal doctrine by a court should also be coherent in its content; it ought to contain import factors that play into a correct and fair adjudication of a cause of action based on it.<sup>30</sup> Analysing from the same proposition, the opposite may also hold a truth: namely that irrelevant considerations may render the application of a doctrine incoherent to parties to the adjudication. Weinrib, for example, sees it as important that the policy behind

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<sup>28</sup> For example, Dworkin sees institutional coherence as been filled by multiple facets of institutional behaviour. Dworkin (n24 above) at p.178-220.

<sup>29</sup> Kress, (n8 above).

<sup>30</sup> D. Kennedy, 'Form and Substance in Private law Adjudication' (1976) 89 Harv. L. Rev. 1685 at p.1721-1725.

the rule is clearly ascertainable from its judicial application.<sup>31</sup> This will protect judge made law from arbitrariness that can harm the rule of law by affecting the predictability of rules.<sup>32</sup>

Overall the following two key characteristics of coherence will be important to rule-making, or elucidation of legal doctrine. These are: (i) linguistic clarity of elucidated rules and (ii) predictability and consistency of rules. These attributes are not fully satisfied with FET in relation to the scope of review being different between denial of justice and legitimate expectations, and the lack of clarity within transparency and the legitimate expectations doctrine.

If the standard wishes to increase legal certainty and move to a more concrete doctrinal position, ensuring these two factors are met will increase legal predictability and enhance the rule of law in investment arbitration. As the FET standard is linguistically ambiguous, perhaps even with customary international law as an aid to its interpretation,<sup>33</sup> there is a challenge for arbitrators is to reduce clarity through the creation of coherent interpretations. Interpretations that improve legal clarity of obligations will make it easier for states to follow the rules and ensure investors know of what their rights are.<sup>34</sup>

Systemic problems such as different arbitrators being able to apply different interpretations of FET law with different aims of what the doctrine that may create legal incoherence, will be discussed in the concluding chapter.<sup>35</sup> Suffice to

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<sup>31</sup> E.J. Weinrib, 'The Jurisprudence of Legal Formalism' (1993) 16 Harv. J.L. & Pub. Poly 583 at p.585-589; For Kress this has to be manageable rather than absolute: See, Kress (n8 above) at p.677

<sup>32</sup> E.J. Weinrib, 'Legal Formalism: On the Immanent Rationality of the law' (1988) 97 Yale. L.J. 949 at p.971.

<sup>33</sup> See chapter 1; J.P. Kelly, 'Twilight of Customary International law' (2000) 40 Va. J. Int'l 449 at p.449-450

<sup>34</sup> E.g. An exercise of police discretion is found to be more lawful where the rules are clear. See, C.E. Smith, 'Bright-Line Rules and the Supreme Court: The tension between clarity in legal doctrine and justice's policy perspectives' (1989) 16 Ohio. N.U. L. Rev. 119 at p.120-121.

<sup>35</sup> A similar problem is faced with theory: See, Kress (n8 above) at p.668; D. Kennedy, 'Distributive and Paternalist motives in contract and tort law; with special reference to

say at this stage, in common-law systems this problem is to a degree off-set by controlling appellate jurisdiction and giving that jurisdiction power to reformulate rules.

### **5.3. The Nature of the FET rules.**

The fair and equitable treatment standard has been interpreted to ensure government process acts in accordance with certain standards, as outlined in Chapter 1. What follows is a discussion of the nature of administrative liability and its rationales in order to explore what difficulties states, particularly those in the developing world, may face with these forms of liability.

#### **A. Rationales of Public Law**

The existence of rules to govern administrative organs and avenues of legal accountability of state action is based on specific ideals of governance.<sup>36</sup> This ideal of governance evolved to avoid the dangers of the unlimited and arbitrary exercise of power.<sup>37</sup> This is because such power was not always exercised in the public or national interest, nor did it result in circumstances favourable to either.<sup>38</sup>

The development of the ability of courts to adjudicate matters of state that affect private individuals is a reflection of this historiography towards transparent democracy. Where legitimate government is only government by consent, the availability of state accountability to the individual will be a fundamental prerequisite in making government action acceptable. This is a key rationale

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compulsory terms and unequal bargaining power' (1982) 41(4) *Maryl. Law. Rev.* 563 at p.563-564.

<sup>36</sup> M. Loughlin, *The Idea of Public Law* (OUP) (2003) at p.1-27.

<sup>37</sup> *Ibid.*

<sup>38</sup> W.M. Sloane, 'History and Democracy' (1895) 1(1) *Am. Historical. Rev.* 1 at p.5-6

towards the development of public law.<sup>39</sup> A legal avenue to redress wrongs of state action was thus seen as an important step in not only constraining the power of the state but also ensuring that affected individuals could obtain redress, thus maintaining acceptability of the machinery of government as a whole.<sup>40</sup>

Administrative law also aims to play an important role in strengthening the rule of law by ensuring the framework of state action is bound by rules that can be subject to adjudication.<sup>41</sup> Its theoretical foundations and development are based in the Western concept of the state and Government.<sup>42</sup> It is particularly a response to the growth of the administrative state.<sup>43</sup> This form of governance, rooted in individual accountability is one that has been accepted globally with reservation,<sup>44</sup> as well as currently being short of full institutional implementation.<sup>45</sup> Thus in a global legal system that would prefer political plurality, the formation of uniform rules of public law may not sit happily with that preference.<sup>46</sup>

At the heart of public law is the idea of state function as opposed to private function. This distinction of private and public, is based on a liberal conception of the state that seeks to protect the realm of private action for the individual. This liberal reading of public law has at its heart legal avenues that seek to maintain

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<sup>39</sup> R.C. Moe & R.S. Gilmour, 'Rediscovering Principles of Public Administration: The Neglected Foundations of Public Law' (1995) 55(2) Pub. Admin. Rev. 135 at p.135-138; M. Loughlin, *Public Law and Political Theory* (OUP) (1992) at p.29-36.

<sup>40</sup> See T.R.S. Allan, *Law, Liberty, Justice: Legal Foundations of British Constitutionalism* (OUP) (2001)

<sup>41</sup> (n36 above).

<sup>42</sup> See Loughlin (n39 above).

<sup>43</sup> A.W. Bradley & K.D. Ewing, *Constitutional and Administrative Law* (Pearson: Longman) (2007) at p.661-663.

<sup>44</sup> K.L. Remmer, 'New theoretical perspectives on democratisation' (1995) 28(1) Comp. Pol. 103 at p.103-105.

<sup>45</sup> G.A. O'Donnell, 'Delegative Democracy' (1994) 5(1) Jnl of Democ. 55 at p.55-58 For a discussion of how international governance models need domestic implementation capacity see, A. Dimitrova, A. "Enlargement, Institution-Building and the EU's Administrative Capacity Requirement". (2002). 25 (4), *West European politics* 171. at p.173

<sup>46</sup> Pluralism would look at more than one source of law, See P.S. Berman, 'A pluralist approach in international law' (2007) Yale. Int'l L. 301 at p.310, 312-313. (c.f. Moravcsik does not feel that pluralism is possible due to inherent tendencies towards hegemony in polity-See, A. Moravcsik, 'Taking preferences seriously: a liberal theory of international politics' (1997) 51(4) Int. Org. 513 at p.518).

individual liberty through ensuring public participation in administrative decision-making.<sup>47</sup> From this perspective, public law is actively involved in ensuring the legitimacy of the individual and the state. Thus legislation to control administrative action became popular where state administrators could not be relied upon to use unlimited discretion granted to them appropriately. As Loughlin argues, this developed from ideas of natural rights conceived during the enlightenment, including the idea that the end game of governance is to exercise power for individual interest. Thus public lawyers now ascribe administrative law as constraining unlimited power so as to corroborate the rule of law.<sup>48</sup>

To assess the appropriateness of placing constraint on investment tribunals, rationales for constraints in English law are useful. English Public law is concerned with both the substantive law that governs administrative institutions and the judicial process of reviewing administrative action. This latter process is termed ‘judicial review’.

Judicial review in English law has developed certain key rules for individuals to challenge acts of administrative organs.<sup>49</sup> A key theme within judicial review in English law is that whilst it grants substantive remedies to annul or override administrative acts, it cannot do so with respect to legislative acts.<sup>50</sup> For political expediency and to maintain judicial integrity,<sup>51</sup> the English constitution has been arranged so that direct decision of matters of policy and law are out of reach of

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<sup>47</sup> The liberal basis being a fundamental part of democracy. Doyle defines democracies as having four major characteristics: (1) protection of private property; (2) a market economy; (3) equality under the law and respect for human rights; and (4) a representative government individuals. *See* M. W. Doyle, *Kant, Liberal Legacies, and Foreign Affairs*, 12 *Phil. & Pub. Af.* 205, at p. 206-09.

<sup>48</sup> J.L. Jowell, *Law and Bureaucracy: Administrative Discretion and the Limits of Legal-Action* (Dunellen: New York) (1975) at p.12.

<sup>49</sup> The rules of (a) irrationality; (b) illegality; and (c) procedural impropriety has highlighted by Lord Diplock in the seminal English case of *Council of Civil Service Unions v. Minister for the Civil Service* [1985] A.C. 374 at p.410; H.F. Rawlings, ‘Judicial Review and the ‘control’ of Government’ (1986) 64(2) *Pub. Admin.* 135 at p.135-144.

<sup>50</sup> S. Susan, ‘Judicial Review in Britain’ (1994) 26(4) *Comp. Pol. Stud.* 421 at p.425-p.426.

<sup>51</sup> Judicial integrity is said to be important to maintain judicial legitimacy over disputes so that parties comply with judgments. It is also important to the rule of law: as institutions that assess the abuse of power by individuals and the state ought not to themselves act in excess or without restraint- *See*, T. Persson, G. Roland, G. Tabellini, ‘Separation of powers and political accountability’ 113(2) *Qrt. Jnl. Econ.* 1163 at p.1163.

courts.<sup>52</sup> This approach of ‘deference’ to the legislature is at the heart of the English constitutional arrangement between law-makers and adjudicators.<sup>53</sup> This means that courts can review the decision of administrative organs and quash inappropriate decisions, but not any law, delegated law, or regulation.<sup>54</sup> Though the process of review may include issues of law, the remedy available in the process is not used to annul it.<sup>55</sup> The process also avoids an impact that has a similar effect.

A further reason for this is to preserve democracy in rule making. Thus whilst legislative processes are done by consent of the citizens that those rules affect, there is no consent *prima facie* granted to courts to annul law by the public. Citizens at large cannot participate in a judicial analysis that results in the production of a rule. Denying a legislative effect or altering it judicial through interpretation may impact upon the policy that the rule is promoting.<sup>56</sup> The judicial position, a fortiori, becomes a policy choice itself. There is also a general concern that judicial law-making is inefficient in making general rules due to it

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<sup>52</sup> This unwritten rule of the English constitution is primarily the result of historical development of a constitutional convention. For a broader discussion: See, D. Jenkins, ‘From unwritten to written: Transformation in the British common-law tradition’ (2003) 36 Vand. J. Trans. 863 at p.864-867.

<sup>53</sup> Though this has been no means absolutely accepted. Judges continue to argue of the role of judicial law-making when there is a conflict between fundamental rights and legislative enactments, See P. Mullender, ‘Parliamentary Sovereignty, the Constitution and the Judiciary’ (1998) 49 (1) N.I.L.Q. 138 at p.138-139. In the U.S. there have been calls for a ‘political question’ doctrine whereby the Supreme Court can evade dealing with political questions related to constitutional disputes, to preserve the constitutional separation between legislature and judiciary: See, L. Henkin, ‘Is there a ‘political question’ doctrine?’ (1976) 85(5) Yale. L.J. 597 at p.597-599

<sup>54</sup> J. Jowell, ‘Beyond Wednesbury: Substantive Principles of administrative law’ (1998) 14. Commw. Law. Bull. 858, at p.858-859

<sup>55</sup> Determinations of the legality of administrative acts vis-à-vis the statutory powers granted to them through the use of the *ultra-vires* norm are a classic example of this, See P. Craig, ‘Ultra-vires and the Foundations of Judicial Review’ (1998) Cam. Law. Jn. 57 at p.57-63.

<sup>56</sup> Federal control of insurance regulation that was espoused in the U.S. McCarran-Ferguson Act 1945 was said to be ‘emasculated’ through judicial interpretations of the Act over decades. See: S.L. Kimball & B.P. Heaney, ‘Emasculation of the McCarran-Ferguson Act: A study in judicial activism’ (1985) Utah. Law. Rev. 1 at p.2

being a result of particular disputes.<sup>57</sup> A particular dispute is not necessarily a basis on which to determine general law or policy. Thus judicial law-making can only have a specific scope restricted to the case before it, rather than be of general application. Alternatively judges may have to balance creating a general rule with dealing with the dispute before them, at the cost of efficacy of the former. This is said to restrict judicial constraints

A *deferential* approach by courts has on occasion affected fundamental rights that were sought to be vindicated by the judicial review process. Thus, criticism has been thrown at English courts for their strict adherence to doctrines such as ‘irrationality’ which set a high threshold for review, and thus restrict the scope of the courts interference with administrative decision-making until that threshold is met.<sup>58</sup>

Judicial review in English law was subject to concern in its early days by those who supported the Diceyan orthodoxy. A common justification and response for the process of judicial review is that it would improve the efficiency of law. Sunkin criticises this emphasis on efficiency as it is not the key concern of democratic rights in public processes with which public law is concerned. Rather it is concerned with participation in decision-making to increase consent of outcome, often at the cost of efficiency.

## **B. A brief history of English Public Law and the Administrative State**

In some states judicial review is a relatively recent phenomenon.<sup>59</sup> This is so even amongst developed or capital importing states, as a brief history of English public

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<sup>57</sup> A. Scalia, ‘The rule of law as a law of rules’ (1989) 56 (4) *Uni. Chicago. Law. Rev.* 1175 at p.1176-1177.

<sup>58</sup> See Jowell (n54 above) at p.861.

<sup>59</sup> The World Bank is advocating judicial review of legislative acts in the third world on the basis of filling the gap in generally weak democratic accountability mechanisms- See, R.E. Messick, ‘Judicial Reform and Economic Development: A survey of the issues’ (1999) 14(1) *World Bank Research Observer* 117 at p.123; Problems of developing judicial accountability of acts of state is not restricted to developing states, and have been

law can demonstrate. Judicial review is a dispute-settlement response to the rise of the administrative state or public administration and the need to regulate new forms of economic activities.<sup>60</sup> This form of state construct started to form at the end of the nineteenth century and through the twentieth century.<sup>61</sup> It was both a part of a shift of ideological approach to the nature of the state, such as the rise in welfarism from liberal laissez-faire approaches,<sup>62</sup> and a functional one. The latter includes the need of the state to respond to the development for the general safety of its citizens as well as maintain its power through economic hegemony. The growth of public administration is a product of a particular historical paradigm. Arguably administrative frameworks using the law were built to minimize the discretion of state officials and organs to prevent the abuse of power. The reduction of the powers and discretion of the police to carry out legal determination in the nineteenth century has been cited as an example of this.<sup>63</sup> It has been argued that it is the specific political discourse and economic factors of the western post-industrial state that has given rise to the growth of administrative institutions to execute an increasing range of state activity.<sup>64</sup> In simple terms, this has the growth of the industrialised state at the heart of it and, subsequently, the rise of welfarism in the developed world.<sup>65</sup> This has had a significant impact on developing governing processes as distinct from central government to meet multifarious administrative, and also, regulatory institutions. The latter was

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seen in the transition to democracy in prior communist states, H. Schwartz, 'The Struggle for Constitutional Justice in Post Communist Europe' (Uni Chicago Press) (2000) at pages, ix-xii, p.1-4.

<sup>60</sup> For a brief historical account See, P.P. Craig, *Administrative Law* (1999) (4<sup>th</sup> Ed) (Sweet and Maxwell) at p. 54-67 where Craig highlights the increased use of the administrative state in the 19<sup>th</sup> and 20<sup>th</sup> C.

<sup>61</sup> G. Majone, 'The rise of the regulatory state in Europe' (1994) 17(3) West. European. Pol. 77 at p.78

<sup>62</sup> A.J. Taylor, *Laissez-Faire and state intervention in the 19<sup>th</sup> Century*, (Macmillan) (1972) at p.14-452.

<sup>63</sup> G.H. Williams, *The Law and Politics of Police Discretion* (Greenwood Press) (1984) at p.16

<sup>64</sup> O.P Dwivedi & K.M. Henderson, 'State of the art public administration & development administration' in *Public Administration in a World Perspective* (IOWA Uni Press) (1990) at p.13-15.

<sup>65</sup> For example there was a significant rise in public administration as a result of the U.S. New Deal in the 1930s, See, G. Lawson, 'The Rise and rise of the administrative state' (1994) 107 Harv. L. Rev. 1231 at p.1232-1233



primarily a state response to economic theory developing beyond mere laissez-faire to advocating the benefits of state intervention in the market.<sup>66</sup>

With the growth of administrative institutions came the need to develop particular working cultures and practices amongst their employees.<sup>67</sup> The rise of the administrative state raised concerns about maintaining democratic controls over administrative acts.<sup>68</sup> At its heart, this was the development of safety-regulation and related administrative frameworks in the industrial period. As a contrast, today, many African and South American states with a different historiography, including a lack of economic and industrial development, have a weak administrative infrastructure along with a tendency for centralized government.<sup>69</sup> Where initiatives of developing an administrative state come from economic and social development,<sup>70</sup> they are absent from many developing states.<sup>71</sup> Further administrative infrastructure and reform requires key resources such as an

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<sup>66</sup> See, Majone, (n61 above) at p.78. Here Majone cites the need to regulate new economic activities such as railways as giving rise to state administration.

<sup>67</sup> D. Nachmias & D.H. Rosenbloom, *Bureaucratic Culture* (London: Croom Helm) (1978) at p.4-31.

<sup>68</sup> C.D. Burns, 'Ideals of Democracy in England' (1971) 27(4) Int. Jnl. Ethics. 432 at p.433-434. Similar concerns are voiced in the U.S.A: D. Waldo, *The administrative state: a study of the political theory of American Public Administration* (Transaction) (2007) at p. x. These concerns are also raised with respect to the administrative roles played by international institutions: J. Delbrück, 'Exercising public authority beyond the state: Transnational democracy and/or alternative legitimation strategies' (2003) 10 Ind. J. Glob. Leg. Stud 29 at p.31. In the European Union norm making by administrative civil servants are said to threaten the democratic mandate of law-making in the EU: P. Lindseth, 'Democratic Legitimacy and the administrative character of supra-nationalism: the example of the European Commission' (1999) 99(3) Colum. Law. Rev. 628 at p.645-p.650. Solutions advanced include appropriate training of civil servants to protect and express democratic values- J.P. Burke, 'Reconciling public administration and democracy: the role of the responsible administrator' (1994) 20(4) Int. Jnl. Pub. Admin. 1017 at p.1017-1020.

<sup>69</sup> R.H. Jackson & C.G. Rosberg, 'Why Africa's weak states persist: The Empirical and the Judicial Statehood' (1982) 35(1) World Pol. 1 at p.7

<sup>70</sup> D.A. Rondinelli, *Development projects as policy experiments: An adaptive approach to development administration* 2<sup>nd</sup> Ed (Routledge) (1993) at p.viii; Dwivedi and Henderson argue the social and economic factors were not present in the developing world to bring about an effective modern administrative state- O.P Dwivedi & K.M. Henderson, 'State of the art: Comparative Public Administration & Development administration' in O.P Dwivedi & K.M. Henderson (Eds.), *Public Administration in a World Perspective* (Iowa Uni Press) (1990) p.13-14.

<sup>71</sup> Dwivedi & Henderson (n70 above).

effective revenue base and professional civil servants to function.<sup>72</sup> The restricted availability of these fundamental resources in the developed world has often thwarted administrative development. This places states with weak or non-existent administrative institutions at a greater risk of violation of administrative standards created at the international level. This is due to the absence of appropriate administrative infrastructure that can meet the ideal needs of foreign investor. In essence this means that administrative efficiency is less, and thus more likely to violate administrative law under the fair treatment standard, particularly as those rules are created without reflection of administrative structure of the state.

Judicial review of administrative acts in English law did not materialize as a cohesive process until the 1970s.<sup>73</sup> Until then English law operated under a stricter doctrine of Parliamentary Sovereignty, whereby the courts were not to adjudicate on legislative acts. In England, there was for a considerable period from the end of the nineteenth century to the mid-twentieth century significant judicial opposition to officially recognizing public law. This opposition was based on the idea that the state should be subject to the common-law, or private law, and to grant the state a distinct system of law was to lead to special privilege. This would not be compatible with a liberal democracy.<sup>74</sup> As stated, English Public law is concerned with the substantive law of administrative frameworks and the judicial process of reviewing administrative action.

Thus, in broad terms, Public law can be seen historically as the legal response to the development of civil rights and the modern state. The latter incorporates administrative and regulatory apparatus, that were developed primarily as a result of the industrial revolution in the nineteenth century.<sup>75</sup> These rights originated in political discourse reflecting upon and, in turn, inspiring revolutionary movements

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<sup>72</sup> Dwivedi & Henderson (n70 above).at p.13-14.

<sup>73</sup> A. Tomkins, *Public Law* (OUP) (2003) at p.21

<sup>74</sup> M. Shapiro, *Who guards the guardians? Judicial control of administration* (Georgia Uni Press) (1988) at p.36-37

<sup>75</sup> See, E. Hobswan, *The Age of Capital, 1848-1875* (Vintage) (1996) at p.29-47.

away from monarchical Government to democratic ones.<sup>76</sup> As such they focus around a particular conception of the state and its relationship with the individual that historically pertains to specific states in the world.<sup>77</sup> This democratic political theory placed primary emphasis on the role and rights of the individual vis-à-vis those that governed him. It included notions of liberty that minimized state interference in the individual's life and ensure that the Government apparatus functioned as far as possible with the consent of the individual.<sup>78</sup> For this reason administrative legislation in England was regarded with some suspicion as it seemed to remove power away from a democratically elected body that legislated. When rights against administrative institutions were developed by English courts, it was with strict reverence to law that was formed through the democratic process of Parliament. This preservation of law that is made through electoral consent in actions in English public law has been highlighted by public lawyers through the term 'deference'. 'Deference' then can be an important method of preserving consent in adjudicatory action.

### **C. The Role of Deference**

The orthodox position of not granting remedies that affect substantive law and regulation in Judicial Review is termed 'deference' to the legislature. Deference is justified from the perspective that a court overruling a law passed in a democracy is impinging on the consent of people to govern themselves. The U.S. judge Kenneth Starr states that courts are deferential due to the lack of explicit power to supervise administrative action, in the way that courts can supervise policy vis-à-vis a constitution.<sup>79</sup> Where no such power exists constitutionally, there may be no consent from citizens given to courts to make decisions that affect law. Deference to legislature is also said to maintain judicial integrity. This stems from realising

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<sup>76</sup> For historical analysis, See: A.E. Howard, 'For the common-benefit: Constitutional History in Virginia as a case book for the modern constitution-maker' (1968) 54 Virg. Law. Rev. at p.816 & p.902.

<sup>77</sup> For a history of the concept of the modern constitution, See

<sup>78</sup> Stolleis, *A history of public law in Germany 1914-1945* (OUP) (2004) at p.17

<sup>79</sup> Starr, 'Judicial Review in the post-Chevron era' (1986) 3 Yale J. Reg 283 at p.300

that judges are not best equipped to deal with issues of policy,<sup>80</sup> and thus rulings that affect legislative enactments can be indirect policy decisions. Limitations on judicial capacity on legal review are based on the reality that the inherent policy within rules can involve fields as diverse as economics, science, and revenue requirements of the state.

Deference also maintains public integrity in the judicial institution, in that key policy decisions are left to the realm of politics where the public may have a greater opportunity for participation. In the US, where judicial review of policy has occurred through the application of the constitution, the legitimacy of the judiciary has been called into question.<sup>81</sup>

Deference is also indicative of acceptable limitations of adjudication in certain forms of disputes.<sup>82</sup> Controversies relevant to legislative deference are faced by the national courts when determining obligations in international law.<sup>83</sup> Such issues become more pertinent when one is considering the limits to judicial interpretation where interpretations are tantamount to law-making. Law-making may transcend the implied authority of a court in the separation of powers, and when it determines obligations between states, as the creation of rules under FET has done, it may become an usurpation of executive function.

Whether the creation of law under FET makes assumptions about the relationship between states, or where the boundaries lie,<sup>84</sup> is not easy to delineate. For

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<sup>80</sup> D.N. Kmiec, 'Judicial deference to executive agencies and the decline of the non-delegation doctrine' (1988) 2 Admin L.J. 269 at p.269

<sup>81</sup> M.R. Levin, *Men in Black: How the Supreme Court is destroying America* (New York: Regnery Publishing) (2005) at p.10

<sup>82</sup> Brilmayer, *International Law on American Courts: A modest proposal* (1999) 100 Yale L.J. 2277

<sup>83</sup> Charney, 'Judicial Deference in Foreign Relations' (1989) 83 AJIL 805 at p.

<sup>84</sup> Benevisiti discusses two critical judicial avoidance techniques that national courts use to avoid elucidating international obligations: (i) the use of doctrines of deference, such as act of state; (ii) refusing standing or justiciability of claims through narrowing the

example, Koh does not advocate an unrestricted role for the national court in such a matter, neither is a position propounded that is *absolutely* deferential to the legislature. Koh's own value judgment is that courts in such instances have to value three critical factors: (a) comity of nations; (b) separation of powers; (c) judicial competence to deal with international issues.<sup>85</sup> However, exact methodology as to how to characterize this is lacking and it seems that the degree to which each of these may be applied may have to be determined on a case-by-case basis.<sup>86</sup>

As has been seen with the interpretation of a fair treatment standard in relation to substantive FET, the arbitral system has not followed any strict doctrine of deference.

The issue of deference becomes important in relation to substantive legitimate expectations outlined in Chapter 2. This is because these can potentially force states to keep policies the same if they wish to avoid liability to the investor. This aspect of deference will be discussed further in Chapter 7, particularly with respect to its incorporation in future decisions.

#### **5.4. Rule-Making issues regarding FET.**

For FET rules to be accepted as law domestically by states they have to be able to comply with them.<sup>87</sup> This means that they have to be able to understand and relate to the rules, and also be able to afford the institutional changes needed to comply with them. As seen earlier the *Westerncentric* provenance of public law liability may make this difficult for developing states in terms of knowing and understanding what such liability involves and how to institutionally adjust to it. They have not directly consented to this. The importance of consent is discussed below. Then

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criterion for these. E. Benevisiti, 'Judicial Misgivings Regarding the Application of International Law: An analysis of the attitude of national courts' (1993) 4 EJIL 159 at p.161

<sup>85</sup> H. Koh, 'International law as a part of our law' (2004) 98 AJIL 43 at p.43-57.

<sup>86</sup> Benevisiti (n84 above).

<sup>87</sup> Franck at p.711

begins a discussion of why developing states may wish to directly consent to FET rules. This discussion is continued into the next chapter which postulates that this consent may be important due to FET being used to turn investment treaty arbitration into a system of governance that operates by transplanting forms of administrative law into the system.

### **A. Participation and Consent in Rule-Making.**

Consent to rules is important, as it can affect its subjects complying with the laws it produces.<sup>88</sup> Here the acceptance of FET rules will be related to participation of states in the rule-making process of arbitrators.<sup>89</sup> Participation will be based on the inability of states, as representative of people to effectively participate in the law-making process of investment tribunals. Whilst states can prepare defences to argue against a proposal of a new law by the claimant, the process of formulating law is ultimately left to arbitrators, not states.<sup>90</sup> The questioning of legal content can only occur after damages have been awarded on the challenge of the award. Prior to adjudication there is also an issue of adequate representation of public interest when states enter into treaty obligations.<sup>91</sup>

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<sup>88</sup> Contrast, D.B. Hollis, 'Why state consent still matters: non-state actors, treaties and changing sources of international law' (2005) 23 Berk. J. Int'l 137 at p. 165-174.

<sup>89</sup> Democratic accountability is seen as a key facet of institutional legitimacy in international political economy. Thus defence of the EU's legitimacy has been made in democratic terms, See A. Moravcsik, 'Reassessing legitimacy of the European Union' (2002) 40(4) Jnl. Com. Mkt. Stud. 603. Similar concerns are raised with respect to the WTO and the IMF and the World Bank: M. Krajewski, 'Democratic Legitimacy and Constitutional Perspectives of WTO law' (2001) 35(1) Jnl. of World. Trade at p.167 at p.167-170. (Krajewski narrates the exclusion of developing states from WTO negotiations); V. Collingwood, 'Non-governmental organisations, power and legitimacy in international security' (2006) 32 Rev. Int. Stud. 439 -Collingwood expresses legitimacy deficit in a formulation that suggests it is greater where the power of the institutions over domestic governance is high at p.446.

<sup>90</sup> See, A. Scalia, 'The Rule of Law as Law of Rules' (1989) 56(4) U. Chic. Law. Rev. 1175 at p.1175-1176.

<sup>91</sup> B. Roth, *Governmental Illegitimacy in International Law*. (OUP) at p.1-37; M.W. Gobbi, 'Enhancing Public Participation in the treaty making process: A reassessment of New Zealand's Constitutional Response' (1998) 6 Tul. J. Int'l & Comp. L. 57 at p.57 & p.100-103.

Governments may be manipulated by private interests when entering into treaties to prefer their needs over other important public interest.<sup>92</sup>

Thus participation may still have will also include public interest being diluted by special interest groups, such as investor claimants,<sup>93</sup> who may wish investment treaties to be drafted in an open textured way or adjudication set-up that will not take a restrictive approach to investor rights. The investment arbitration system has not at present adequately accommodated NGO and third party interest groups in the formation of laws so that protection of public interest is ensured.<sup>94</sup>

State consent to legal frameworks, can be formulated, amongst others methods, along two relevant lines considering the narrow provenance of the public administration liability brought in by FET.<sup>95</sup> This is as follows: (i) lack of direct state control over what rules are and (ii) the implicit concern within this that the peoples of that state have not consented to such rules created by a private, usually close-door, international adjudication process.<sup>96</sup> Such concerns have been raised in the human rights field with law-making through interpretation.<sup>97</sup> It is thought that lack of direct consent by Governments that manifests through open-textured interpretation may undermine the will to comply with the laws in the long-term. Similar, concerns have been raised about *universalist* approaches to customary international law. Thus Kelly states that placing a creation of an (assumed) customary rule without state consent creates concerns due to the '*lack of democratic*

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<sup>92</sup> P.B. Stephan, 'Accountability and International Lawmaking: Rules, Rents and Legitimacy' (1996-97) 17 Nw. J. Int'l & Bus. 681 at p.697.

<sup>93</sup> For the manner in which investors formulate their FET claims using public law concepts, See I. Tudor, *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment* (OUP) (2008) at p.140-142.

<sup>94</sup> See, T. Ishikawa, 'Third Party participation in investment treaty arbitration' [2010] 59(2) ICLQ 373 at p.373-382.

<sup>95</sup> R.B. Hall & T.J. Biersteker, (Eds.) *Emergence of Private Authority in Global Governance* (CUP) (2002) at p.5.

<sup>96</sup> Van Harten, *Investment Treaty Arbitration and Public Law* (OUP) (2007) at p.159

<sup>97</sup> C.A. Bradley & J.L. Goldsmith, 'The Current illegitimacy of international human rights litigation' (1997) 66 Ford. Law. Rev. 327 at p.327-341.

*Governance*'.<sup>98</sup> The views against this suggest a pragmatic view of how international relations work.<sup>99</sup> However, in the field of foreign investment consent may still matter due to historical concerns regarding enervation of sovereignty of developing countries, particularly those relating to their right to expropriate.

To illustrate: the classic example of where consent and compliance were inter-related in the field of foreign investment protection was the tension surrounding the general acceptance of the Hull Formula, where many states did not wish to accept the giving of compensation of where expropriation occurred.<sup>100</sup> In relation to the US, it has been questioned whether derivations of universal customary international law by international institutions and their application to the state sits in firmly with domestic democratic law-making procedure.<sup>101</sup>

Bradley and Goldsmith state that it is important to have a fail-safe mechanism, where rejection of international law created without direct domestic ratification is possible in order to preserve the invaluable tenet of consent.<sup>102</sup> This may allow the state to reject laws that are created through teleological processes by institutions or judicial exposition. However it is not altogether clear why consent itself should be a basis for the rejection of a useful and efficient rule, or one of high moral standing.<sup>103</sup> Michelman approaches the question of acceptability of rules as being one dependant on their moral standing and whether on this basis rules are worth

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<sup>98</sup> J.P. Kelly, 'The Twilight of Customary International Law' (2000) 40 Virg. Jnl. Int. L. 449 at p. 453

<sup>99</sup> However, according to Franck consent may not necessarily be so important for compliance for realists in international relations, as there are a range of coercive factors that may induce compliance. Though this may not be fair: T.M. Franck, *The Power of Legitimacy amongst nations* (OUP) (1990) at p.204-206.

<sup>100</sup> R. Rafat, 'Compensation for expropriated property in recent international law' (1969) 14(2) Villanova. L. Rev. 199 at p. ; R. Dolzer, 'New Foundations of the Law of Expropriation of Alien Property' (1981) 75 Am. J. Int'l 553, 554-556.

<sup>101</sup> L. Henkin, 'Constitution and the United States Sovereignty: A century of Chinese exclusion and its progeny' (1987) 100(4) Harv. Law. Rev. 853 at p.876-878; J. I. Charney, 'Universal International Law' (1993) 87(4) AJIL 529, at p.537-538 & p.546.

<sup>102</sup> C.A. Bradley & J.L. Goldsmith, 'Customary International law as Federal Common law: A critique of the modern position' (1997) 110 Harv. L. Rev. 815 at p.870-873.

<sup>103</sup> E.g. Jus Cogens rules. See, G.A. Christenson, 'Jus Cogens: Guarding Interests Fundamental to International Society' (1987) 28 Virg. Jnl. Int. law. 585 at p.585-593.



following, rather than one based on direct state consent provided through some procedural process of approval.<sup>104</sup> This approach is subject to the immediate shortcomings with respect to objectivity.

Consent based understandings of acceptability of law-making is criticized from the perspective that it is Eurocentric, based on democratic political theory.<sup>105</sup> This critique is further based on a particular conception of the state that is not universal.<sup>106</sup> Fallon, on the other hand, makes a more subtle point about acceptability of law-making in reference to the US constitution. He states, implicitly, that the inherent gulf in behavioural practices between law-makers and their objects, and the shortcomings of law-making processes in reflecting the desires of those whom they govern make absolute legitimacy dubious as a pure goal of a governing legal system.<sup>107</sup> From this perspective it may be unfair to ask arbitrators to determine what states want from FET, despite the obscurity of the standard giving some mandate to determine laws for themselves, as states may not know themselves what exactly should be done with FET.

A consent based analysis of acceptability of international law maybe limited due to it being shaped by conceptions of domestic politics and the role of people in Government processes, which may not be applicable in parallel with international institutions.<sup>108</sup> Many states may not be concerned with their ability to consent to rules made outside domestic legislatures, as done by arbitrators using FET. For

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<sup>104</sup> F.I. Michelman, 'Ida's way: Constructing the Respect Worthy Governmental-System' (2003) *Ford. Law. Rev* 345 at p.345-356.

<sup>105</sup> J. T. Gathii, 'Neoliberalism, colonialism and international governance: Decentring the international law of Governmental legitimacy' (1996) 98 *Mich. L. Rev.* 1996 at p. 1997-2000; For response to Gathii, See B.R. Roth, 'Governmental illegitimacy and neocolonialism: response to review by James Thuo Gathii' (1996) 98 *Mich. L. Rev.* 2056 at p.2056-2058; Roth has however, criticized the one-sided political values in democratic legitimacy analysis- See, also, B. Roth, 'Democratic Intolerance: Observations on Fox and Nolte' (1996) 37 *Harv. Int. L.J.* 235 at p.235-247.

<sup>106</sup> N.Rose & P.Miller, 'Political Power beyond the State: Problematics of Government' (1992) 43 (2) *Brit. Jnl. of Soc.* 173 at p.173-175.

<sup>107</sup> R.H. Fallon, JR. , 'Legitimacy and the Constitution' (2005) 118 *Harv. Law. Rev.* 1787, at p.1787-1788.

<sup>108</sup> D.Kennedy, 'The Disciplines of International Law and Policy' (1999) 12 *Leiden. J. Int'l* 9 at p.17

some the lack of consent over certain actions of international institutions is not a matter of concern or problematic. Developing states may be deliberately passive in participating in international law-making process.<sup>109</sup>

This may be partly due to their political history, where issues of political rights to question authority are not as deep rooted, thus their demand for accountability is not pressing.<sup>110</sup> Consent based critiques of international institutions are important as they provide a check on the abuse of power and ensure that action of international institutions serves appropriate state interests.<sup>111</sup> Held has stated the eurocentricity of consent as an ideal should not weaken the important role that the concept can play in validating the action of international institutions.<sup>112</sup>

In international law acceptability of transnational institutional action can also be seen as protecting the state from unmandated impositions of law.<sup>113</sup> Further, the acceptability of institutions in international relations questions the political dogma of international institutions and whether states have consented to the political ideologies behind their actions, particularly these come into effect after the institution has been created and takes on a conceptual framework of its own.

From this perspective realistic control is only retrospective, and maintaining consent is about maintaining effective access to the law-making process. As only a defendant in an investment treaty claim, developing states have some input, however the problem arises when other states could be subject to the arbitrators reasoning in that case due to that decision being a source of law to assist in treaty

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<sup>109</sup> J. Stiglitz, *Making Globalisation Work* (Penguin) (2007) at p.128.

<sup>110</sup> A. Leftwich, 'Governance, democracy and development in the third world' (1993) 14(3) Third. World. Quarterly. 605 at p.606.

<sup>111</sup> D. Held, *Democracy and the Global Order: From the Modern State to Cosmopolitan Governance* (Cambridge: Polity Press) (1995) at p. 282; L.W. Pauly, 'Capital Mobility, State Autonomy and Political Legitimacy' (1995) 48(2) Jnl. Int Affairs. 369 at p.317-374

<sup>112</sup> Held, (n111 above).

<sup>113</sup> Gathii (n105 above) at p.1998.

interpretation.<sup>114</sup> Thus true consent for an FET law such as transparency may only be possible if all states that are likely to be bound by it have an input into it.

A pertinent critique on this front is the lack of political accountability of institutions following the pro-capital or commercial agenda, investment treaty arbitration being one of these institutions.<sup>115</sup> International law-making is inherently restrictive on state sovereignty in relation to law-making competence. If the effects of non-participation result in particular ideologues such as market liberalism dominating interpretations, they may potentially override, as some decisions under substantive legitimate expectations show, important social reasons to regulate and have other commercial costs for the public benefit. This is through re-prioritisation of policy to fit the commercial agency of the investor.<sup>116</sup> It is this diminishment of public good that makes concerns as to effective participation in law-making that has a commercial agenda important.

These concerns are made real when one sees that there only a few capital exporting developed states that have been able to control agendas of international institutional processes, such as the bilateral investment treaty program, to this end.<sup>117</sup> Foreign investment is also under scrutiny and suspicion from domestic nationals in the developing world.<sup>118</sup> Foreign investors' use of resources, particularly those that are scarce such as land, can cause social discontentment and political pressure.<sup>119</sup> For this reason states may have to ensure that FET law-

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<sup>114</sup> See Article 31 of the Vienna Convention on the Law of Treaties 1969, as discussed in A. Aust, *Modern Treaty Law and Practice* (Cam. U. P) (2000) at p.186-p.201.

<sup>115</sup> These are the Bretton woods institutions, See Gathii (1996) at p. 1999; J.T. Gathii, 'Representations of Africa in Good Governance Discourse: Policing and Containing Dissidence to Neo-Liberalism' (1998-99) *Third. Wrld. Legal Stud* 65 at p.65-74.

<sup>116</sup> A. Smith, A. Stenning & K. Willis, Eds., *Social Justice and Neoliberalism: Global Perspectives* (Zed Books) (2008) at p.1-5.

<sup>117</sup> On Gill's realist analysis of this, See S. Gill, 'Economic Globalization and the Internationalization of Authority: Limits and Contradictions', (1992) 23(3) *Geoforum* 269 at p. 269-80.

S. Gill, 'New Constitutionalisation, democratization, and global political economy' (1998) 10(1) *Global Change, Peace & Sec.* 23 at p.23-32.

<sup>118</sup> D. Szablowski, *Transnational Law and local struggles: Mining Communities and the World Bank* (Hart) (2007) at p.1-24.

<sup>119</sup> N.J. Jacobs, *Environment, Power and Injustice: A South African History* (CUP) (2003) at p.211

making balances rights of foreign investors against the importance of public views and other social needs. This balance may wish to be left to arbitrators for risk of an adverse outcome. Possibility of a remedy here is intimated in relation to a case for constitutional 'deference' in the final chapter.

Within this discourse highlighting possible inherent partisanship of transnational commercial agency through institutions such as investment treaty arbitration, there are issues of consent of greater concern. This is where international agreements delegate out public interest decisions, such as the creation of laws or policies, to international institutions.<sup>120</sup> This can be seen to be done in investment treaty arbitration, a predominantly private dispute resolution process that has created working law such as substantive legitimate expectations doctrine.

For some the lack of state consent in the creation of law in this private way has been extremely described as a method of international 'authoritarianism'.<sup>121</sup> The private nature of formulating substantive legitimate expectations under FET, has a particular public interest conflict potential and gives some merit to these criticisms- albeit their rather coloured expression.

The key issue in investment arbitration of concern here is the gap of consent and accountability of all states of the liberal democratic assumptions in formulating public law form of liability.<sup>122</sup> If peoples are to delegate further public interest issues under interpretative powers to investment tribunals, it is at least questionable whether further public participation in that law-making process is necessary. This is particularly so where for many developing states the end game of investment treaties is economic development that would increase human capital, social choices, and economic opportunities for their own nationals. Thus

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<sup>120</sup> For example, the European Commission: See, S. Weatherill & P. Beaumont, *EU Law* (Penguin) (1999) at p.45-49.

<sup>121</sup> H. Giroux, *The terror of neo-liberalism: Authoritarianism and the Edge of Democracy* (2004) (Boulder Co: Paradigm) at p.1-11.

<sup>122</sup> This has been approached by Van Harten, though distinctly and *not* from the premise of provenance of public law or legal transplantation. See. Van Harten (n96 above) at p.48-49.

they have a real concern over the success of the system's function, in a way that is distinct from the capital-exporting country that may only wish to see its investments protected and profits brought home.

### **B. A Law and Economics Perspective on Transplantation.**

Further problems of adequacy of FET law-making will be highlighted here, by looking at what the current law-making process has not done: by assessing whether these rules, if complied with, can bring about the desired effect of improving administration and regulatory conduct in the host-state. This may be important for future investors from other states (which the host-state may wish to benefit from) and also the on-going investment of claimants in cases (particularly where an expropriation has not occurred).

Law and development does not always have the desired positive economic benefits.<sup>123</sup> Two aspects of the vast field of law and economics will be applied here to illustrate the difficulties of transplants. The first is the discussions in relation to how effectively rules influence the behaviour of objects they are aimed at.<sup>124</sup> The second is how the objects influence the formulation of the rules, and how effective rules are in carrying out their needs or aims. The latter analysis pertains to an argument concerning the viability of law to carry the social process that forms them across jurisdiction. It is not here concerned with the efficiency of legal systems or legislative processes as such. How both these aspects may relate to one another is also important. If rules are very much part of specific social processes and their compliance co-dependent upon them, then transplants may be less viable where significant differences in society are present. The study of law and

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<sup>123</sup> It is unclear whether law and development could have prevented market instability in the developing world in the 1970s and 1980s, See, A.O. Krueger, 'Government Failures in Development' (1990) 4(3) *Journal of Economic Perspectives* 9 at p.9-12

<sup>124</sup> See Posner (n17 above).

economics also reveals that law itself has a limited impact on altering the behaviour of its objects.<sup>125</sup>

Thus, the field of law and economics identifies shortcomings between the intended behaviour a law seeks to bring about and the reality of conduct that a given law induces.<sup>126</sup> From this perspective it is important to analyze the limitations of law's impact and appreciate that liability is limited form of coercion towards compliance.<sup>127</sup> This is important in the field of legal transplantation, particularly where transplants are assumed to have the same social impact in the state of designation as the state of origin. This is not necessarily the case, particularly due to the sociological differences between states and their cultural make up.<sup>128</sup> Mattei argues that transplants themselves have different impacts in similar legal systems, thus questioning their ability to operate in an investment treaty system across several dozen states.<sup>129</sup> Thus an economic analysis of transplants needs to be taken, so that it can be determined whether their intended impact is viable at all. Where this is not the case, an alternative method of obtaining the goal of the rule may need to be used distinctly or in tandem with the rule. This may be done as an alternative to jettisoning the transplant or letting it evolve into a different rule.<sup>130</sup> However, this may not sit with investment arbitration's claim that the fair and equitable rules protect and promote cross-border investment. Mattei also intimates that economically inefficient law, that is law where there is a gulf between social practice and conduct envisaged within it,

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<sup>125</sup> J. Griffith, 'Is law important?' (1979) 54 NYU L.Rev. 339 at p.341-348; B.G. Garth & Y.Dezalay, *Global Prescriptions: The Production, Exportation and Importation of a New Legal Orthodoxy* (Ann Arbor: University of Michigan Press) (2002) at p.

<sup>126</sup> Samuels, 'Interrelations between legal and economic processes' (1971) 14 J. Law & Econ. 435 at p.

<sup>127</sup> From one perspective international law liability relating to investments has only been historically enforceable by some threat of physical force; D. F. Vagts, 'Coercion and Foreign Investment Rearrangements' (1978) 72 AJIL 17 at p.26-30 at p.435-447.

<sup>128</sup> A. Watson, *Legal Transplantation. An approach to Comparative Law*. (1974) at p.1-26.

<sup>129</sup> U. Mattei, 'Efficiency in Legal Transplants: An Essay in Comparative Law and Economics' (1994) 14 Int. Rev. of Law and Econ. 3 at p.3

<sup>130</sup> On one theory of law and economics, laws evolve naturally to reach a balance between the ideals of the rule and the capacity of the society to comply. See Epstein, 'The Static Conception of the Common Law' (1980) 9 Jnl. Leg. Stud. 253 at p.253-258.

might increase the cost of compliance, perhaps making compliance unviable.<sup>131</sup> Thus, for example, the investment rules of transparency may be far easier to comply with in some states than others, and the cost of meeting the same level of conduct as between different states may be too great for some states to bear. On one view, the framing of legal rules is an outcome of a competitive process, where various interested parties compete to materialize their views in the rule.<sup>132</sup> Different social processes will give rise to the different tenders, and in an ideal process the most effective and important formulation of a law will result.<sup>133</sup> From this perspective, legal rules are inherently state specific and the social processes that give rise to the rules may also have to be mirrored if transplants are effective. Otherwise transplantation itself may be mere guesswork as to parallels of social processes between legal systems or states. Where there is a relationship between social processes of law creation and compliance, then transplantation is at risk of being undermined due to alien sociology inherent in transplanted rules. Mattei also states that transplants assume that they are the most efficient rules for dealing with their intended aims, however as the competitive construct alludes to, this is not always the case.<sup>134</sup> The implication for transplantation of law by arbitrators is that they may need to be aware of the sociological and political disparities between states that impact upon rule compliance.

## **5.5. Conclusion.**

Overall, a fair process of creation and implementation of rules that appreciates the short-comings of consent to transplants may be important to make arbitral

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<sup>131</sup> Mattei (n29 above). at p.7

<sup>132</sup> Mattei (n29 above)( at p.8.

<sup>133</sup> Ibid.

<sup>134</sup> Cross border application of principles of tortious liability is a clear example of this- Priest, 'The invention of Enterprise Liability, A critical history of the intellectual foundations of modern tort law' (1985) 14 J. Leg. Stud 461 at p.461-474.

interpretations more acceptable.<sup>135</sup> The differences in origins of rules, particularly their political nature will have an impact on legitimacy of transplants. The products of such a process ought to be coherent to subjects in their form and in the substance of rights and obligations they seek to obey.

Further, issues such as the feasible alien nature of transplants to states in the developing world with a developing a transitional rule of law system, can be overcome by giving those states a greater say in whether they wish to be bound by such rules, including within this an opportunity to determine whether they can comply with them considering current institutional practices.

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<sup>135</sup> Ecuador pulling out of the investment dispute resolution system ICSID to protect its sovereignty as a classic example of this concern amongst developing states. For further analysis see: E. Gillman, 'Article: The End of Investor-State arbitration in Ecuador? An analysis of Article 422 of the Constitution of 2008' (2008) 19 Am. Rev. Int'l Arb 269 at p.269-274.



**Chapter 6:**  
**Transplants and Governance**

- 6.1. Introduction**
- 6.2. Governance via the Fair Treatment Standard**
  - A. Administrative and Regulatory Governance**
  - B. International Governance and Concerns**
- 6.3. Administrative Rules and Transplantation**
- 6.4. Capacity of states to respond to FET Governance**
- 6.5. The Nature of International Governance under Fair Treatment**
- 6.6. Reforms of FET Governance**

**6.1. Introduction**

This chapter will assess whether FET rule-making is a system of governance of domestic administrative and regulatory institutions. Further, it shall be determined whether its use of administrative law is suitable considering that many Contracting Parties to investment treaties are from the developing world. This shall be done through critiques of legal transplantation. If FET is described to be a system of governance over domestic institutions, critique of the law and development movement shall be used to suggest improvement to the governance role. This will lead the discussion into the final chapter on further reforms.

**6.2. Governance via the Fair Treatment Standard**

The analysis here shall be related to the effects of rules created by interpretation of the FET standard. It will be argued that current interpretations have turned FET into a system of governance of state administration and regulatory activity. This forms state institutions with control, something which contracting parties

may not wish to delegate, neither the foreign states seeking capital nor the investor, as it is not expressly provided for in model investment treaties.<sup>1</sup>

The term governance is frequently used in international relations as a metaphor to describe the acts of international institutions that share the characteristics of domestic legislatures.<sup>2</sup> The plurality of the use of the word 'Governance' at the international level creates ambiguity.<sup>3</sup> Without strict definition and application, the use of the term can suffer from a tendency to become intangible and excessively abstract.<sup>4</sup>

This can undermine its effectiveness both as a descriptive and an analytical tool to ascertain the legitimacy of institutional action. Governance here, in the general sense, will be used to mean processes that provide order to domestic administrative and regulatory institutions.<sup>5</sup> Governance, of this form, is a *Western-centric* idea dependent upon the formation of institutions (or institutional based activities), e.g. corporations, hospitals, government bodies.<sup>6</sup> Hence FET interpretations of legitimate expectations and transparency are not just neutral values but they also incorporate a particular idea of what investment treaty arbitration as an institution should be requiring, as an institution, from states.

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<sup>1</sup> See, for example, the U.S. model: G. Gagne, 'The Evolving Foreign Policy on Investment Protection: Evidence from Recent FTA's and the 2004 Model BIT' (2006) 9(2) Jnl. Int. Econ. L. 357 at p.369-p.379; J.W. Salacuse, 'Do BITs really work: An evaluation of bilateral investment treaties and their grand bargain' (2005) 46 Harv. Int. L.J. 67 at p.82-85.

<sup>2</sup> Finkelstein says that governance 'mirrors the breadth of Government activity', See, Finkelstein 'What is global governance?' (1995) 1 Global Governance 367 at p.369

<sup>3</sup> Finkelstein (n2 above) at p.371.

<sup>4</sup> See, for example, the following vague postulation given by Ruggie: 'an indivisibly related complex of processes and problems with the increasing scale of human activity viewed within the context of planetary life-support systems' in J. G. Ruggie, 'On the Problem of the 'Global Problematique' What Roles for International Organisations?' (1979-1980) 5 (4) Alternatives. Social Transf. Humane. Gov. 520 at p.520

<sup>5</sup> See statement by Council of Rome in A.King & B.Schneider, *The First Global Revolution: A Report of the Council of Rome* (New York: Pantheon Books) at p.181-182, cited in J.N.Rosenau, 'Governance in the Twenty-first Century' (1995) 1 Global Governance 13 at p. 14

<sup>6</sup> M.L. Djelic & K. Sahlin-Andersson, *Institutional Dynamics of Regulation* (Cam. Uni. P) (2006) at p.13-14.

Governance as a conceptual tool can be used to describe a variety of factors related to the roles that domestic governments play.<sup>7</sup> Standard setting (or the creation of a system of rules) to bring order to a field of activities is a key part of government action that is common to the use of governance as a descriptive tool.<sup>8</sup>

Governance has also been described as *restructuring* or *reordering*.<sup>9</sup> Thus the phrase 'Governance' can be used to describe various processes and analytical processes that reorder institutions, institutional conduct, and varied subjects of the law from corporations to individuals.<sup>10</sup> Rule-making is a part of Governance but not the only role that Governance plays.<sup>11</sup>

Based on this broader conceptualization, another understanding of governance is a range of acts of government that can extend beyond the creation of law.<sup>12</sup> From this governance can also conceptually encapsulate processes of determining appropriate norms and their effectiveness in pushing their subjects towards desired conduct.<sup>13</sup> Effectiveness includes institutional design and overcoming institutional shortcoming. Thus Governance is also concerned with ensuring the appropriate impact of institutional decision-making.<sup>14</sup> This is why the critique of legal transplantation discussed earlier is relevant to administrative liability formed under FET. The appropriateness of this role for arbitrators, as opposed to national governments, has to be questioned in relation to their ability to factor in and overcome the transplantation problems discussed earlier.

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<sup>7</sup> (n2 above).

<sup>8</sup> See, for example, the role played by 'Transmission Control Protocol' in the field of internet law in P.J. Weiser, 'Internet Governance Standard Setting and Self-Regulation' (2001) Nth. Ky. Law. Rev. 822 at p.825-826. Similar standard-setting occurs in other fields, See D.O. Rourke, 'Outsourcing Regulation: Analyzing non-Governmental System of Labour Standards and Monitoring' (2003) 31(1) Pol. Stud. Jnl. 1 at p.1-8.

<sup>9</sup> D. Held, *Democracy and the global order: from the modern state to cosmopolitan governance*. (Cambridge : Polity Press) (1995) at p.16-23.

<sup>10</sup> (n2 above).

<sup>11</sup> Ibid.

<sup>12</sup> Caron has described it as a fundamentally a legislative process undertaken by international institutions: See, D.D. Caron, 'The Legitimacy of the Collective Authority of the Security Council' (1993) 87 AJIL 552 at p.552-553

<sup>13</sup> See Finklestein (n2 above) at p.370.

<sup>14</sup> (n2 above).

Governance outside the paradigm of domestic legislative activity is not confined to international institutions. Governance is also a municipal phenomenon, a classic example of governance being regulatory systems in some states. Governance processes also provide useable legal frameworks for state administration and regulation to follow. Regulatory models and institutions, including formal contractual guidelines and standards, and commercial monitoring institutions, are taking over and are increasingly being used by states too.<sup>15</sup> Further, outside of institution-based governance, governance has not just been understood as an external process controlling or directing an agent. It can also be understood as a system of self-ordering or control, like a laissez-faire market.<sup>16</sup> Therefore subjects of governance may also be its agents, particularly where it may be useful to have fields of self-ordering activity. Thus ‘Self-Governance’ is also a form of Governance.

Overall, key attributes of governance for the purposes of this discussion are:

- (i) Providing ‘order and coherence’ to a given system and
- (ii) Generating rules and standards that seek to fulfill a given ‘order and coherence’ of a given system.

These two elements have occurred through FET, due to its ‘ordering’ how state institutions should conduct themselves. This ordering includes not only transparency, and legitimate expectations as described in Chapters 2 and 3 respectively. It also includes a requirement that state institutions should not discriminate against the investor;<sup>17</sup> should not treat investors in an arbitrary way;<sup>18</sup>

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<sup>15</sup> C. Hood, R. Henry & R. Baldwin, *The Government of Risk: Understanding Risk Regimes* (2001) at p.11-16.

<sup>16</sup> D. Coen & M. Thatcher, ‘The new governance of markets and non-majoritarian regulators’ (2005) 18 (3) *Governance* 329 at p.329-340.

<sup>17</sup> *SD Myers Inc v. Government of Canada* (2000) 8 ICSID Rep at para 259.

<sup>18</sup> *Lauder v. Czech Republic* (2001) 9 ICSID Rep 62, at para 219.

behave with bad faith;<sup>19</sup> misuse their powers;<sup>20</sup> and that they should refraining from harassing investors.<sup>21</sup>

Thus on this conceptualization, FET is performing a governance role on state institutions.<sup>22</sup>

### **A. Administrative and Regulatory Governance**

‘Administrative governance’ is the process of ordering state administrative organs and administrative processes by rule-making through interpretations of the fair treatment standard. Administrative governance ensures that the organs of the state are receptive to the needs of the foreign investor through norms determined by arbitrators. This process of ordering is possible due to the enforcement mechanism of classical international arbitration being available to investment treaty arbitration.<sup>23</sup>

The fair and equitable treatment standard has been used to order both the domestic administrative and regulatory frameworks so that they can accommodate the needs of the investor, as arbitrators perceive them to be.<sup>24</sup> Administrative governance through interpretations creates burdens of transparency for public bodies. They also require that the investor be allowed to participate in administrative decision-making,<sup>25</sup> and envisage specific good conduct for

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<sup>19</sup> *Wastemanagement II v. United Mexican States* (2004) 43 ILM 967 at para 994.

<sup>20</sup> *Metalclad v. United Mexican States* (2000) 5 ICSID Rep 209, at para. 228

<sup>21</sup> *Pope & Talbot v. Government of Canada* (2002) 7 ICSID Rep 43 at para 163-163.

<sup>22</sup> B. Kingsbury & S. Schill, ‘Investor-state arbitration as governance: Fair and Equitable Treatment and proportionality’ (2009) *New. Yrk. Uni. Pub. L. & Legal. Theory. W. Paper* No. 146 at p.1-8; K. J. Vandevelde, ‘A unified theory of fair and equitable treatment’ (2010) *NYUJ Int’L & Pol.* 44 at p.49-63.

<sup>23</sup> Z. Douglas, ‘The hybrid foundations of investment treaty arbitration’ (2003) 74 *BYIL* 151 at p.226-236.

<sup>24</sup> Y. Dezalay & B.G. Garth, *Dealing in Virtue: International Commercial Arbitration and the transnational world order* (Uni Chicago P) (1996) at p.27-39.

<sup>25</sup> *S.D. Myers Inc v. Government of Canada (NAFTA: UNCITRAL)* (2000) 8 ICSID Rep 3 at p.115.

administrators.<sup>26</sup> Thus in cases such as *Metalclad* and *Wastemanagement*, the Tribunal placed a burden upon public officials to ensure that they would not make promises to investors that could not be kept, or they would breach the fair and equitable treatment standard. The cases of *Tecmed* and *Wastemanagement* imposed a standard of transparency on public administration.<sup>27</sup>

A mere framework of rules, may not, however, be enough to create an effective system of administrative governance through FET. Standards of administrative law may require a change in the behaviour of public institutions that they apply to.<sup>28</sup> This may result in the re-configuring of administrative bodies to incorporate rules such as transparency which require the investor to participate in decision-making processes,<sup>29</sup> or ensure that the notification of decisions is possible.<sup>30</sup> Staff may have to be retrained or reallocated to meet these burdens.<sup>31</sup> Though this may be an immediately unaffordable cost for some contracting parties, an administrative law framework for investment treaty arbitration may also have the incidental, and important effect, of improving public administration through

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<sup>26</sup> See *Tecnicas Medioambientales Tecmed S.A. v. The United Mexican States* (Award) ICSID CASE No. ARB (AF)/00/2 (29/05/03) at para 154.

<sup>27</sup> See, Choudhary's analysis on transparency in B. Choudhary, 'Caveat Investor?' *The Relevance of the conduct of the investor under the fair and equitable treatment standard* (2005) 6 JWIT 297 at p.302; *Tecmed* (n 26 above) at para 154; *Waste Management Inc. v. United Mexican States* (Merits) (30 April 2004), 43 I.L.M. 967, 16(4) *World Trade and Arb. Mat.* 3. at para 98.

<sup>28</sup> Standards of judicial review provide standards for administrative decision-making, such as *Wednesbury* reasonableness in English law: See J. Jowell & A. Lester, 'Beyond *Wednesbury*: Substantive Principles of Administrative Law' (1987) PL 368 at p.368-370.

<sup>29</sup> See Chapter 3.

<sup>30</sup> Administrative conduct includes the speed of processing applications for permits, storing information, allowing accessible information, correctness of decision-making.

<sup>31</sup> There is a systemic problem of administrative standards in the developing world, namely the absence of frameworks in place to professionally train public administrators: J.E. Jreisat, 'Administrative Reform in developing countries: A comparative perspective' (1988) 8 *Pub. Admin & Devlp.* 85 at p.93-94 Alternative strategies, due to lack of appropriate public administration training for administrators, include delegating these functions out to the private sector: J.S. Wunsch, 'Institutional Analysis and decentralisation: developing an analytical framework for effective third world administrative reform' (1991) 11 *Pub. Admin & Devlp.* 431 at p.445. The feasibility of this in turn depends on market availability of such services.

liability.<sup>32</sup> Though whether public law does in fact have the effect of improving administrative performance is questionable;<sup>33</sup> and whether it can have such an impact in the developing world, as will be illustrated by the discussion on legal transplantation later in this chapter, is also questionable.

In addition to administrative governance, there is also a regulatory governance role that is played by the fair treatment standard. In this role the standard is used by arbitrators to review the manner in which states pass regulations and the appropriateness of passing regulations.<sup>34</sup> The obligation on the host-state, often a developing country, is outlined by the tribunal in the *GAMI* in the NAFTA context:

*‘The duty of NAFTA tribunals is rather to appraise whether and how preexisting laws and regulations are applied to the foreign Investor. It is no excuse that regulation is costly. Nor does a dearth of able administrators or a deficient culture of compliance provide a defence. Such is the challenge of governance that confronts every country’.*<sup>35</sup>

The burden is thus on states to improve both their legislative and administrative frameworks of law, and institutions to standards set by arbitrators. Further states

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<sup>32</sup> As stated in Chapter 1, Legal liability is an incentive to train public servants to cut-costs of litigation associated losses, as far as empirical data is concerned it does not have an impact on public servant behaviour directly, as for example argued in Y.S. Lee & D.H. Rosenbloom, *A Reasonable Public Servant: Constitutional Foundations of Administrative Conduct in the U.S.* (M.E. Sharpe) (2005) at p.1-12.; Thus civil servants are trained to follow administrative norm protocol, E.g. training in Romania at: [http://www.kas.de/proj/home/events/103/1/year-2010/month-2/veranstaltung\\_id-39723/index.html](http://www.kas.de/proj/home/events/103/1/year-2010/month-2/veranstaltung_id-39723/index.html)

<sup>33</sup> For an example of no relationship between the review and improved performance, See M. Sunkin, ‘Does judicial review influence the quality of local authority services’ (2008) (Jan) ESCRC Working Paper No. 47 at p.1-17. ; In the U.S. empirical studies are limited. One suggests that there is a relationship between the administrative review and improved performance, though it is subject to qualification: P.H. Schuck & E.D. Elliot, ‘To the Chevron station: An empirical study of federal administrative law’ (1990) *Duke. L.J.* 984 at p.985-987 & p.1059-1061.

<sup>34</sup> G. Van Harten & M. Loughlin, ‘Investment Treaty Arbitration as a species of global administrative law’ (2006) 17(1) *EJIL* 121 at p.122 & p.124.

<sup>35</sup> *GAMI v. UMS (UNCITRAL)* (Final Award) (15<sup>th</sup> November 2004) at para 94.

must comply with rules set for regulatory bodies by arbitrators under the standard.<sup>36</sup> As the dicta in *Gami* indicates, there is no regard given to the capacity of developing states to comply. The state must simply overcome existing shortcoming in regulatory, legislative and administrative infrastructure.<sup>37</sup>

An example of regulatory impact of the fair treatment standard is given by the *Lauder* case. There the arbitrators had interpreted fair treatment to include a requirement of consistency of regulatory practice. Thus in *Lauder* in reference to domestic media regulation the tribunal stated: *‘The state bound by the Treaty must indeed pursue the stated goal of achieving a stable [regulatory] framework for investment. The minimum requirement is that the State does not engage in **inconsistent** conduct, e.g. by reversing, to the detriment of the investor, prior approvals on which he justifiably relied’.*<sup>38</sup>

In the case of *CME* the tribunal reasoned to prevent the state from regulating broadcasting that would have harmed the profits of an investment in a broadcasting company.<sup>39</sup> Preserving an important public interest in proscribing broadcasting was not a factor that the tribunal took into consideration.

Occasionally, fair treatment has used a ‘regulatory governance’ role to determine the appropriateness of regulation in terms of its effects on the investor. However it has not always considered national or public interest in such a role,<sup>40</sup> questioning its legitimacy from the concern of public interest deficit in this approach.

Broadly speaking, regulation is passed to improve the working of the economy, particularly the market, for all commercial agents and to ensure that negative

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<sup>36</sup> CME Republic B.V. v. Czech Republic (SVEA Judgment) (15 May 2003) (C.A. Sweden), 15(5) World Trade and Arb. Mat. 171

<sup>37</sup> Ronald S. Lauder v. Czech Republic (Final Award) (3 September 2001), (2002) 4 World Trade and Arb. Materials 35 at para 290.

<sup>38</sup> *Ibid.*

<sup>39</sup> See CME (n 35 above).

<sup>40</sup> See *Azurix v. Argentine Republic*, ICSID Case No. ARB/01/1 (Award 14/07/06) at para 372-378.



effects (termed ‘externalities’) of market activity on the public are contained.<sup>41</sup> Approaches, such as the Lauder one requiring consistency of regulatory frameworks, are unrealistic: as the short outline of the nature of regulation below will show, regulation can only be consistent, unchanging or static if the agency it is intending to control is so. However, this would defeat the very purpose of regulation itself, to react to changes, often adverse, in human and economic agency. This is why regulation serves as an important tool of protecting public interest in the role of modern states.

Commonly accepted characteristics of regulation are: (i) gathering information on a field of commercial agency, (ii) behavioural modification of the economy, & (iii) standard setting for the economy or a given sector of it.<sup>42</sup> Definitions of regulation tend to stem from the general encompassing all forms of control of economic activities by organs of the state, to the more specific such as encouraging conduct beneficial to the economy.<sup>43</sup> Regulatory organs in this sense promote behaviour that they perceive boosts the market economy and preclude harmful acts.<sup>44</sup> Regulation in this sense operates subsidiary to legislation in achieving policy objectives by more direct forms of control, by being closer in an abstract spatial sense, to the agents needed to be controlled.<sup>45</sup> Regulatory governance thus concerns itself with the appropriateness of regulatory decision-making. It does not solely concern itself with decisions to regulate, but also deregulation or re-alignment of regulatory practices between states.<sup>46</sup> The latter point has been seen in the *CMS Gas Transmission* case, where the tribunal found

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<sup>41</sup> A. Ogus, ‘Regulation: Legal, Form and Economic Theory’ (Hart) (2004) at p.21-22; C. Sunstein, *After the rights revolution: reconceiving the regulatory state*, (Cambridge: Harvard Uni Press.) (1990) at p.3-14.

<sup>42</sup> C. Hood, H. Rothstein, & R. Baldwin, *The Governance of Risk* (OUP) (2001) at p.23

<sup>43</sup> Morgan & Yeung, *Introduction to Regulatory Theory* (Cam Uni. P) (2001) at p.3-4.

<sup>44</sup> J. Francis, *The politics of regulation* (OUP) (1993) at p.5-17.

<sup>45</sup> For example, regulation of industry: G. J. Stigler, ‘The theory of economic regulation’ (1971) 2(1) *Bell. Jnl. Econ. & Mngmt. Sc.* 3 at p.3-5.

<sup>46</sup> J. Braithwaite & P. Drahos, *Global Business Regulation* (Cam. Uni. P) (2000) at p.3-11; D. Levi-Faur, ‘The Global Diffusion of Regulatory Capitalism’ (2005) (598) (1) *Ann. Am. Acad. Pol. Sc.* 12 at p.12-17; The EU is an organ vested with powers of regulatory harmonization: See, G. R. D. Underhill, ‘Keeping governments out of politics: transnational securities markets, regulatory cooperation, and political legitimacy’ (1995) 21(3) *Rev. Int. Stud.* 251, at p.251-255.

that the removal of a regulatory system of which controlled the valuation of currency by the state breached the fair treatment standard.<sup>47</sup>

With this in mind, the inherent danger of a regulatory governance role of fair treatment is the risk of inadvertently determining what are the appropriate boundaries of regulation are without an adequate appreciation of the political, economic and social, consequences of doing so.<sup>48</sup> Determining when to regulate is a decision that can be of political nature and of significant economic consequence.<sup>49</sup> Further, regulatory decisions can involve complex economic calculation that tribunals are unable to perform.<sup>50</sup> This can occur without the arbitrators knowing that they have done this. For example: by being blind to the needs of regulating the activity in question, then determining that the regulation is harmful to the investor, and subsequently determining that the investor has a right not to be affected by the regulation. This approach is exemplified by the case of *Azurix*. This case epitomizes the difficulties of determining the need to regulate, broader economic considerations, and determining the appropriate economic freedom of the investor.<sup>51</sup> Here the tribunal overruled price-freezing regulation in favour of consumers, which was a promised policy at a national election, as it reduced investor profits. As consumer needs are an important part of maintaining a fair price of supply in the water economy, the tribunal's preference of one over

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<sup>47</sup> CMS Gas Transmission v. The Argentine Republic (ICSID Case No. ARB/01/8) (Award May 2005) at para. 273 – 275 (Here the regulatory system concerned a currency valuation method which was removed by the state).

<sup>48</sup> The general function of commercial regulatory institutions is to restrict or encourage behaviour of market agents: See R. Baldwin & M. Cave, 'Understanding Regulation: Theory, Strategy and Practice' (OUP) (2002) at p.2; P. Selznik, 'Focusing organisational research on regulation in R. Noll, Regulation Policy and the Social Sciences (Uni Cal: Berkley) (1985) at p.363-369.

<sup>49</sup> CMS was a decision by the Argentine Government to link the peso to the dollar, repeal of which harmed the foreign investment (n46 above); See B. Morgan & K. Yeung, An Introduction to Law and Regulation, Text and Materials (CUP) at p. 1-2; L.N. Cutler & D.R. Johnson, 'Regulation and the Political Process' (1975) 84(7) Yale. Law. Jnl. 1395 at p.1395-1400.

<sup>50</sup> R. Baldwin & M. Cave, 'Understanding Regulation: Theory, Strategy and Practice' (OUP) (2002) at p.11. See also discussion of public utility regulation. Thus Baldwin and Cave discuss how regulation can incentive commerce and yet reduce cost is not empirically clear (p.203-205).

<sup>51</sup> See (n39 above).

another was an economic choice usually with the domain of a national government's economic policy.<sup>52</sup>

Some governments prefer social economic policies resulting in an aggressive style of market regulation that restricts economic activity to prevent most harm.<sup>53</sup> On the other hand laissez-faire theorists can prefer larger degree of error and harm in the market in order to realize greater capital, and see regulatory interference as commercially harmful.<sup>54</sup> The former framework of national policy, that was a part of democratic choice at an Argentine election, was implicitly usurped by the tribunal in *Azurix*.<sup>55</sup> Once arbitrators assume a regulatory role, and usurp the related democratic mandate through their construction of a mandate to protect investments, there is nothing to restrict their value judgments shaping the regulatory system, or consequentially a part of the economy, one way or another.<sup>56</sup> As regulatory activity is a political risk investors account for in deciding whether to invest,<sup>57</sup> it may be incorrect for arbitrators to use their mandate to promote investments through deciding the inappropriateness of regulation.<sup>58</sup> As regulation

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<sup>52</sup> For an example of need for pricing policy for water supply, See C. Varela-Ortega-J.M. Sumpsi, A. Garrido, M. Blanco & E. Iglesias, 'Water pricing policies, public decision making and farmers' response: implications for water policy' (1998) 19 (1-2) *Agricult. Econ.* 193, at p.193-197.

<sup>53</sup> S. Issacharoff, C. Camerer, G. Loewenstein & T.O. Donoghue, 'Regulation for Conservatives: Behavioral Economics and the Case for "Asymmetric Paternalism"' (2003) 151(3) *Uni. Penn. Law. Rev.* 1211 at p. 1211-1212 (Though Issacharoff et al argue for a less aggressive moderate regulatory control of markets, at p.1212-1213).

<sup>54</sup> A. Ogus, 'Rethinking self-regulation' (1991) 15 *OJLS* 97 at p.97-99

<sup>55</sup> (n39 above).

<sup>56</sup> Regulation of economic risk often requires a balancing of the freedom of commercial agency with reducing risk to public interests, such as the environment or the overall well-being of the economy. An increase in the latter may reduce the former. Broadly, see United States Supreme Court Justice Stephen Breyer in S. Breyer, *Breaking the Vicious Circle: Toward effective risk regulation* (Harv. Uni. Press) (1993) at pps. ix-x, 1, 10-12; The economic complexities of determining appropriate boundaries of regulation are shown, for example, in the field of banking capital adequacy regulation, See M. Koehn & A.M. Santomero, 'Regulation of bank capital and portfolio risk' (1980) 35(5) *Jnl Finance*. 1235 at p.1235-1239.

<sup>57</sup> This is a position stated by the investment tribunal in *Maffezini*

<sup>58</sup> Political risk is the risk of state action adversely affecting the investment, as opposed to an error in commercial feasibility of the investment (a commercial risk)- See, N. Rubins & N. S. Kinsella, *International Investment, Political Risk and Dispute Resolution: A practitioner's guide* (OCEANA) (2005) at p.11-17, describing regulation as political risk. It has been argued that investment treaty arbitration should not place the burden of commercial risk on the host-state. This is stated by the tribunal in *Maffezini v. Spain*

is also passed to prevent harmful economic activity, an increase in the use of fair treatment to restrict regulation may make the cost of investments with respect to harmful economic activity too high to allow some states to afford investment treaties.<sup>59</sup>

Overall, the case law demonstrates that there are two ways in which the fair and equitable treatment standard has operated to be regulatory governance system:

- (i) Where Government regulation is involved in the subject matter of the dispute, and the investor complains that the *manner* of the passage of the regulation is unfair.<sup>60</sup>
- (ii) Where the legitimate expectations doctrine is used as a policy estoppel that affects matters to be regulated in order to prevent the state from regulating in its desired way once a foreign investment is made.<sup>61</sup>

There is also a third way. This is where the tribunal decides whether the regulation in question is appropriate by determining whether it pursues the aims the state intended. This analysis would include looking at the intended economic consequences of the regulation and noting whether the overall public interest in regulation justifies harm to the investor.<sup>62</sup> This third way is representative of a national regulatory body. The fair treatment standard has not, so far, been used for this purpose. However if the constraint of regulation is important to investor

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Case No. ARB/97/7 (9/11/00) at para 64. Note also, P. Muchlinski, 'Caveat Emptor?: The relevance of conduct of the investor under the fair and equitable treatment standard' (2006) 53(3) ICLQ 527 at p.527-538.

<sup>59</sup> For example, developing economies may need to regulate markets more intensively than developed states to counter economic cycles: J.A. Ocampo, Capital Account and Counter-Cyclical Prudential Regulations in Developing Countries (United Nat) (2002) at p.29. This differs from broad and generic liberal economic assumptions about the benefits of removing regulation for general economic development, See: J.L. Guasch & R.W. Hahn, 'The costs and benefits of regulation: implications for developing countries' (1999) 14(1) World Bank. Res. Obs. 137 at p.154-157.

<sup>60</sup> See, *Pope & Talbot Inc. v. Government of Canada* (Merits, Phase 2) (10 April 2001), 13(4) World Trade and Arb. Mat. 61.

<sup>61</sup> E.g, *Azurix* (n39 above).

<sup>62</sup> This approach is similar to the application of the doctrine of proportionality in some legal regimes, See M. Andenas & S. Zleptnig, 'Proportionality: WTO law: In comparative perspective' (2006-07) 42 Tex. Int'l L.J. 371 at p.382-388.

protection, the arbitration process may have to equip itself with the means to determine regulatory policy by having details of the economic impact of its actions at hand. This is certainly beyond the textual mandate offered in investment treaties, however it may reduce the risk of adverse impact of an incorrect regulatory decision. At the moment there is an usurpation of national regulatory action by arbitrators that is without consent from Contracting Parties.<sup>63</sup>

## **B. International Governance and Concerns.**

Administrative and regulatory governance reflects general concerns of lack of legitimacy of international or global governance. One use of the phrase ‘Global Governance’ is an encapsulation in social science literature as a phenomenon known as globalization. Global governance is the use of international institutions to order inter-state and cross-border interactions caused both by state agents and private parties.<sup>64</sup> Investment arbitration is an *a priori* institution of global governance, seeking cross-border capital through a legal adjudicatory structure that has been developed by arbitrators into a system of administrative and regulatory governance.

Global governance has been described as more than just ordering of human or economic agency across borders, <sup>65</sup> as it also provides guidance for municipal governance.<sup>66</sup> Global governance encapsulates supra-national ordering of domestic policy and institutions, which occurs with a set paradigm over several

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<sup>63</sup> Note, that due to reciprocal nature of bilateral investment treaties a restriction of regulatory action in the defendant state, would also mean the same activity would be implicitly curtailed for relevant foreign investors in the investor’s state. See, A. Lenhoff, ‘Reciprocity: The Legal Aspect of a Perennial Idea’ (1954-55) 49 Nw. U. L. Rev. 752 at p.753-759. All investment treaty decisions on fair treatment thus far have omitted this fundamental point.

<sup>64</sup> The U.N. is a classic example, See. P. Williams & G. Baudin O’ Hayon, ‘Global governance, Transnational Organised Crime and Money Laundering’ in D. Held & McGrew Ed. *Governing Globalisation: Power Authority and Global Governance* (2002) (Wiley Blackwell) at p.127-145; I. Ayres & J. Braithwaite, *Responsive Regulation, Transcending the Deregulation debate* (OUP) (1992) at p.3-6.

<sup>65</sup> (n2 above).

<sup>66</sup> See, S.K. Sell ‘Intellectual Property Rights’ in D. Held (n.63 above) at p.171-183.

states.<sup>67</sup> In this context foreign investment relationships are by their very nature supra-national. This is due to their being created by international treaties.<sup>68</sup> The regulatory and administrative governance has a broad reach as the FET standard occurs in several thousand bilateral investment treaties with varied and numerous state contracting parties.<sup>69</sup> It is also present in multilateral treaties such as NAFTA and the ECT.<sup>70</sup>

Global governance occurs through a variety of institutions, and their processes of rule creation.<sup>71</sup> Global Governance is partly a response to the need of sovereign states to direct and order cross-border agency of varied entities.<sup>72</sup> On this basis, the creation of investment arbitration has been done to bypass weaknesses in domestic governance to protect commercial interests of foreign investors.<sup>73</sup>

The proliferation of supra-national institutions playing a governance role over

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<sup>67</sup> A.C. Robles Jnr, 'Global Governance: and Political Economy: German and French Perspectives' (1995) 1 *Global Governance* 99 at p.100.

<sup>68</sup> K.W. Abbott & D. Snidal, 'Hard and Soft Law in International Governance' (2000) 54(3) *Int. Org.* 421 at p.421-424; T. Ginsberg, 'International Substitutes for Domestic Institutions: Bilateral Investment Treaties and Governance' (2005) 25(1) *Int. Rev. Law. Econ.* 107, at p.107-112.

<sup>69</sup> See Douglas, (n23 above) at p.6.

<sup>70</sup> J.E. Alvarez, 'Critical Theory and the North American Free Trade Agreement's Chapter Eleven' (1997) 28 *Inter-Am. L.R.* 303 at p.303-314; A.E.L. Tucker, 'The Energy Charter Treaty and 'Compulsory' International State/ Investor Arbitration' (1998) 11 *Leiden J. Int'l L.* 513 at p.513-516.

<sup>71</sup> A similar and relevant example of global governance to concerns of legitimacy is transnational regulation which has been described as: 'Transnational regulation is a mode of governance in the sense that it structures, guides and controls human and social activities and interactions beyond, across and within national territories'. Djelic & Sahlin-Andersson (n6 above) at p.6

<sup>72</sup> Though a range of foreign policy, power-play between states and other factors are also of important. Thus in investment treaty arbitration, there is a view that the system is imposed on the developing worlds through a zero-sum game where those states do not fully appreciate burdens of the treaties, A.T. Guzman, 'Why LDCs sign treaties that hurt them: Explaining the popularities of BITs' (1997-98) 38 *Va. J. Int'l* 639 at p.666-682.

<sup>73</sup> This has been an approach advocated to deal with the failures of the developing world to deal with financial liberalization, See K.Rogoff, 'International Institutions for Reducing Global Capital Instability' (1999) 13(4) *Jnl. Econ. Persp* 21 at p.21-24.

national institutions has raised questions of the accountability of those institutions to states. The impact is firstly on the reduced power of territorial control of domestic governments, which may weaken their acceptability to their citizens. This concern particularly arises from the perspective of a master-citizen theory of democratic governance, which sees the role of governance as one primarily concerned with fulfilling public interest.<sup>74</sup> It also limits protection that domestic democratic processes usually afford citizens when dealing with governance, seen in terms of democratic theory as 'the exercise of power'.<sup>75</sup> It also reduces the ability of democratic processes to control the harm of international activity by creating external spheres of order and conduct outside the peripheries of political control by citizens.<sup>76</sup>

The benefit of political control is that it can increase public acceptance of international transactions that are beneficial to the states. In investment arbitration this is important where the foreign economic agent is likely to be viewed with suspicion by the local populace.<sup>77</sup> Public concerns over global governance include increasing complexity and lack of transparency in those realms where it existed before in simpler forms. Concern also related to global governance is the extension of control to new realms of social and human life without expectation but due to domestic governments leaving those sectors uncontrolled.<sup>78</sup>

Global governance differs significantly from municipal governments in key ways relevant to its legitimation from the point of view of public consent. As far as direct accountability is concerned in democratic states global governance is usually accountable to the executive; whereas domestic governance to the

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<sup>74</sup> In modern democratic theory, the citizen is the principal or master and his or government is the servant, See P. Pettit, *Republicanism: A theory of freedom and government* (OUP) (2007) at p.8; P. Manent, *Tocqueville and the Nature of Democracy* (Rowman & Littlefield) (1996) at p.xiii-ix.

<sup>75</sup> J.A. Scholte, 'Civil Society and Democratically Accountable Global Governance' (2004) 39(2) Govt & Opp 211 at p.211-212.

<sup>76</sup> *Ibid.*

<sup>77</sup> See, for example, Peruvian attitudes in Swabrowski, *Transnational Law and Local Struggles: Mining, Communities, and the World Bank* (Hart) (2007) at p.41-42.

<sup>78</sup> See Djelic & Sahn-Andersson (n6 above) at p.12

populous.<sup>79</sup> Thus accountability to public interest depends upon the ability of citizens to hold the executive function accountable. This is more difficult than legislative accountability in democratic states, as executive function is generally not transparent or directly controlled by the legislature, but operated through governmental discretion.<sup>80</sup> Thus, global governance does not often involve direct participation by the citizens of nation states. Further, this is heightened by the fact that global governance has the capacity to adapt its governing mandate and self-determine its roles beyond the original conception of its mandate.<sup>81</sup> It is this aspect that gives rise to concerns about its ability to fulfill public interest, due to the omission of direct representation of all affected parties. Thus the omission of public representation in the exercise of arbitrators' interpretative powers is of particular concern where that exercise creates novel rule-making, rather than being merely an exercise of executive discretion of national governments in international relations.<sup>82</sup>

Where there are genuine public interest concerns raised by states that are being complained above, the issue of whether public interest is maintained in governance under FET is of importance.<sup>83</sup>

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<sup>79</sup> See B. Roth, *Governmental Illegitimacy in International Law* (OUP) (1999) at p.6-23.

<sup>80</sup> In the U.S. the concern over international norm-making altering rights and obligations of domestic private parties resulted in a period of exclusive legislative control of such off-shoots of legislative action. See debates regarding the Bricker Amendment: G.A. Finch, 'The need to restrain the Treaty-Making power of the United States within Constitutional Limits' (1954) 48 AJIL 57 at p.54-64.

<sup>81</sup> E.g., The European Court of Justice has expanded the realm of powers of the European Community through expansive readings of the Treaty text. For example in European Law provisions: L. Hinnekens, 'Recent trends in the case-law of the ECJ in matters of direct taxation' (2006) 7(2) ERA Forum 281 at p.281-282.

<sup>82</sup> P.B. Stephan, 'The New International law-Legitimacy, Accountability, Authority and Freedom in the new Global Order' (1999) 70 Uni. Col. Law. Rev. 1555 at p.1579; Lack of control of executive function is a classic approach to determining the legitimacy of EU policy-making is based on this, See, for example, J. Tallberg, 'Executive Politics' in Eds., K.E. Jørgensen, M.A. Pollack & B. Rosamond, *Handbook of European Union Politics* (SAGE) (2007) at p.201-202

<sup>83</sup> \*Nanz and Steffek argue that this will only be possible through the creation of a 'transnational public-sphere' where public scrutiny and input occurs into fully transparent international institutions, See P. Nanz & J. Steffek, 'Global Governance, Participation and the Public Sphere' (2004) 39(2) Gov & Opp. 314 at p. 314-321.



However, as public interest has not been factored into fair treatment interpretations,<sup>84</sup> both regulatory and administrative governance by the fair treatment standard give rise to issues in relation to both state and direct public participation.<sup>85</sup> These concerns are also heightened by a spatial conception of proximity of governance to its subjects. This can exacerbate the lack of democratic consensus of law-making by the international institution.<sup>86</sup> This spatial gap between subjects and international governance can restrict the ability of international institutions to act as effective coordinators of domestic regulatory activities.<sup>87</sup> These issues are of concern due to some of the restrictions of regulatory activity that some interpretations of FET have done. These give cause for a greater input from public interest bodies and agencies which can represent public interest that may not be reflected by governments in their orthodox paradigm of foreign relations role that comprises negotiation and execution of treaties, contrary to the general perceptions of government activity in the international sphere.<sup>88</sup> Alternatively states can respond by constricting the powers of arbitrators or increase executive control over arbitral decisions by subjecting them to greater control.<sup>89</sup>

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<sup>84</sup> Note Chapter 2 on legitimate expectations.

<sup>85</sup> See, Roth (n.78 supra).

<sup>86</sup> This issue has permeated governance discourse regarding the EU. See, A. Follesdal & S. Hix, 'Why there is a democratic deficit in the EU: A response to Majone and Moravcsik' (2006) 44(3) JCMS 533 at p.534-537.

<sup>87</sup> See, J.O. McGinnis & M.L. Mousesian, 'Against Global Governance' (2004) 45 Harv. Int. L.J. 353 at p.355-356, countering Guzman's call for expanding the WTO's mandate beyond direct trade matters: A.T. Guzman, 'Global Governance & The WTO' (2004) 45 Harv. Int. L.J. 303 at p.307. This implies a degree of locality is important to effective governance, i.e. institutions of governance or government are to be present at the local level- See, H. Blair, 'Participation and Accountability at the Periphery: Democratic Local Governance in Six Countries' (2000) 28(1) World. Dev. 21 at p.21, p.23-25.

<sup>88</sup> Models of direct input of public interest have been discussed with the WTO, See E-U. Petersmann, 'Challenges to the Legitimacy and Efficiency of the World Trading System: Democratic Governance and Competition Culture in the WTO: Introduction and Summary' (2004) 7 (3): Jnl. Int Econ. Law 585 at p.590-593. These include controls on negotiators of international agreements that force them to consider democratic consequences of treaties, and level of control that national legislatures can have over international governance. The latter can be modified so that it has a greater input in international governance when norms are being created (*discussed ibid*).

<sup>89</sup> See Chapter 7.

### **6.3. Administrative Rules and Transplantation.**

Investment treaty arbitration is a quasi-universal system of jurisprudence; judicial reasoning being applicable to disputes concerning several thousand investment treaties.<sup>90</sup> It can be seen from the legitimate expectations and transparency chapter that this system applies notions of administrative law and controls domestic regulation through the fair and equitable treatment standard. This is through the operation of judicial decisions as a source of international law.<sup>91</sup> Thus these rules are potentially applicable to all states party to investment treaties irrespective of their stage of economic development, and without regard to how developed their administrative infrastructure or systems of regulation are.

The application of administrative law and regulatory standards in the interpretation of FET can be termed 'legal transplantation'. 'Legal transplantation' is the transfer of rules or laws from one legal system to another.

In this context, legal transplantation places Western domestic administrative law on defendant States in investment treaty arbitration proceedings.<sup>92</sup> The investment arbitration system pre-supposes that certain administrative conduct is appropriate for states to accommodate administrative interaction with the investor and beneficial for the long-term development of state infrastructure.<sup>93</sup> However, not

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<sup>90</sup> Z. Douglas, *The international law of Investment Claims* (Cam Uni. P) (2009) at p.2-3.

<sup>91</sup> The potential of investment treaty arbitration decisions to be used as the subsidiary method to interpret and render unambiguous the fair and equitable treatment standard is significant: See Article 38(1)(d) of the Statute of the International Court of Justice as an accepted method of determining international rules. Shaw, *International law* 5<sup>th</sup> Ed (Cam Uni, Press) (2003) at p. 66; W.W. Burke-White, 'International Legal Pluralism' (2003-04) 25 Mich. J. Int'l 963 at p.970-971 (Investment treaty arbitration jurisprudence can also be used by other international courts, at p.972-94).

<sup>92</sup> A. Watson, *Legal Transplants: an approach to comparative law* (Scottish Academic Press) (1974) at p.1-26; T. Waelde & J.L. Gunderson, 'Legislative Reform in Transition Economies: Western Transplants- A short-cut to social market economy status?' (1994) 43(2) ICLQ 347 at p.366-370. See also Chapter 5 discussions on administrative law origins. D. Krueger, 'The Combat Zone: *Mondev International Ltd v. United States* and the Backlash against Chapter 11' (2003) 21 Bostn. U. Int. L.J. 399 at p.420.

<sup>93</sup> See, S. Montt, *State Liability in Investment Treaty Arbitration: Global Constitutional Law in the BIT Generation* (Hart) (2009) p.146-155.

all states that are a part of this system may be familiar with notions of liability through administrative law.<sup>94</sup> The law and development movement sheds lights on the problems that 'legal transplantation' of administrative law may create for the practicability interpretations of FET. The movement fundamentally concerns itself with problems that 'legal transplantation' may face when transferring law from developed to developing states.

Transplantation was advocated in the 'law and development' movement. This sought to create economic growth through the transplantation of legal norms and institutions from developed states.<sup>95</sup> This was thought to assist in the creation of a viable legal system in developing states that was based on the rule of law. Initially, focus of legal development had been primarily to directly use law to assist economic development, rather than integrate legal development with other forms of development such as social and political development that may indirectly assist economic development.<sup>96</sup> Law was seen as a fundamental servant to economic growth. There was little evaluation of the relationship between the two during the early application of legal transplantation.<sup>97</sup>

Problems of 'legal transplantation' were realized in the critiques that were applied to the field of 'law and development' in the 1970s and are relevant to problems that might be faced by current legal constructions under FET.<sup>98</sup> A key facet of a

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<sup>94</sup> For example, problems for harmonization of rules within the European Union can occur due plural legal systems. See in the field of accountancy rules: A.G. Hopwood, 'Some reflections on the harmonization of accountancy in the EU' (2001) 94(3) Eur. Acc. Rev. 241 & p.250-251.

<sup>95</sup> Nyhart, 'The Role of Law in Economic Development' (1962) 1 Sudan. L.J. & Rpts. at p.394; Friedman, 'On Legal Development', (1969) 24 Rutg. L. Rev 11 at p.53

<sup>96</sup> E.M. Burg, 'Law and Development: A Review of the Literature & a Critique of 'Scholars in Self-Estrangement' (1977) 22 Am J. Comp. L. 492 at p.502.

<sup>97</sup> Nyhart, (n6 above) at p.398.

<sup>98</sup> T. Geraghty, 'People, practice, attitudes and problems in lower courts of Ethiopia' (1969) 6 Journal of Ethiopian Law 427 at p.429-435. ; N. Singer, 'Modernisation of law in Ethiopia: a Study in process and personal values' (1970) 11 Harvard Int. Law Journal. 73; at p.73-79. B.O. Bryde, 'The reception of European Law and Autonomous Legal Development in Africa' (1978) 18 Law and State 21 at p.21-30; B. de Sousa Santos, 'Law: a map of misreading, towards a post-modern conception of law' (1987) 14(3) Jnl of Law & Soc. 279 at p.279-283 & p.288-292.

critical approach to that field was the work of *Trubeck*. Trubeck's fundamental concern with 'legal transplantation' was that it did not sufficiently appreciate: (i) distinctions between cultures;<sup>99</sup> (ii) the limitations of law's impact on social development; (iii) the complexity of modern legal-systems and (iv) ambiguity over the exact effect transplanted rules were supposed to have.<sup>100</sup> The latter affects the efficacy of 'transplanted rules' through the ambiguity of what precise role transplants are supposed to play.

Trubeck noted that cultural practices in the developing world, including forms and methods of governance, would make it difficult for rule of law-based ideals to be transplanted. Where this transplantation would occur, without democratization, it would be at risk of increasing the control power of autocratic government.<sup>101</sup> On one reading, transplanting rules from a state with a functioning rule of law and institutional accountability to one without them, might undermine the development of the economy of the new host state of the transplant, by reducing the autonomy of market agents through increased central control.

Two immediate concerns for 'legal interpretation' in FET may arise from this. The first here is that it is assumed, by way of justification for interpretations, rather than proven that administrative law and regulatory standards in interpretations will have desired benefits to the host-state. Secondly, that the lack of clarity and specificity to what those benefits are, and where exactly beneficial impact is to occur, may affect the ability of transplants to be successful on a general level, as well as the specific. At this initial stage of critique, such ambiguity may militate against the construction of any consent to the process of

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<sup>99</sup> D.M. Trubeck & M. Galanter, 'Scholars in estrangement: some reflections on the crisis in law and development studies in the U.S.' (1972) 4 *Wis. L. Rev* 1062 at p.1070.

<sup>100</sup> D.M. Trubeck, 'Towards a social theory of law: An essay on the study of law and development' (1972) 82(1) *Yale L.J.* 1 at p.10-11 & p.34-40; G. Maydea, 'Appreciate the difference: The role of different domestic norms in law and development reform: Lessons from China and Japan' (2006) 51 *McGill L.J.* 547 at p.550-551.

<sup>101</sup> D.M. Trubeck, 'Towards a social theory of law: An essay on the study of law and development' (1972) 82(1) *Yale L.J.* 1 at p.28-29

transplantation itself, particularly due to the aforementioned unpredictability for developing states.

Further, there is an inherent problem with the idea that mere transplantation of administrative law and regulatory standards can benefit the host-state economy. Transplanted rules and ideas were geared towards a singular aim of development that would create market-based economies that would become key drivers of growth.<sup>102</sup> These would assist in the creation of fixed institutions and their accountability under a working rule of law.<sup>103</sup> The process failed because it presumed certain reactions of development on institutional reform. These were perhaps far too multi-variant in practice to be done by transplantation alone, without the re-calibration of other relevant factors in states, whether sociological, political or economic, to be effective.<sup>104</sup> This is what arbitrators creating standards such as transparency may need to appreciate.

As a response, since the initial phase in the late 1960s and 1970s, law and development through transplantation has made a recovery through shifting its discourse to allow for the broader aspects of development structure, such as those which relate to economics, cultural differences and social structure. It is this *meta-legal* re-focus that has allowed it to become, comparatively, a more effective tool for international development. From this, creation of administrative law using FET may need to take into consideration other factors related to providing the institutional development needed for an investor friendly environment, through broader input into FET interpretations that create rules.

Further criticisms of transplantation related to its legal coherency. These were elaborated along the lines that there was no clear consensus over what is

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<sup>102</sup> All of these ideologies have issues of legitimacy relating to non-plural approaches to domestic polity- namely not recognizing existing development status of states as indigenous cultures and ways of life, See: F. von Benda-Beckmann, 'Legal Pluralism & Social Justice in Economic and Political Development' (2001) 32(1) IDS Bulletin 46 at p.46-49.

<sup>103</sup> H.W. Arndt, *Economic Development, The history of an idea* (Chicago Uni) (1987) at p.115-165. See also, J. Hatchard & A. Perry-Kessaris, *Law and Development: Facing Complexity in the 21<sup>st</sup> Century* (Cavendish) (2003) at p.vii-viii.

<sup>104</sup> (n99 above).

developed law, or what form the appropriate rules would take.<sup>105</sup> Significant disparities regarding the role of law with respect to its impact on the market exist between the developed and developing world.<sup>106</sup> On a fundamental level developing countries may not wish to create institutions accountable to public law. Further, they may have genuine concerns such as the problems accountability may pose to the flexibility of administrative organs carrying out key development policies. The problem of coming to a generally acceptable definition of what law is itself makes transplantation difficult.<sup>107</sup>

The transplantation of administrative law also includes the presumption of the existence of effective legal institutions to adjudicate public law disputes.<sup>108</sup> The existence of formal adjudication in the developed world, such as that found in the adversarial system or the process of inquiry, may depend on the legal culture and practices of developing states.<sup>109</sup>

Even within developed states there are considerable differences in public law dispute resolution amongst developed states. Thus, to take an example, specific frameworks of administrative law in French and English law are very different in their approach to legal content and adjudicatory process.<sup>110</sup> Some states may have almost non-functioning systems of law and no framework of accountability for public institutions.

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<sup>105</sup> There is tendency for the critics of law and development to succumb to instrumentalism, forgetting their own skepticism. See Burg (n97 above) at p.523.

<sup>106</sup> J.W. Salacuse, 'From Developing Countries to Emerging Markets: A Changing Role for law in the third world' (1999) 33 Int'l 875 at p.875-878 & p.889-890.

<sup>107</sup> (n97 above)

<sup>108</sup> See, Salacuse, (n106) at p.888-889.

<sup>109</sup> S.E. Merry, 'Legal Pluralism' (1998) Law & Soc. Rev. 869 at p.869-871.

<sup>110</sup> The detail and structure of French administrative law is still significantly more detailed than the common-law; B. Schwartz, *French Administrative Law and the Common Law World* (Law Book Exchange) (2006) at p.2-p.5; J.H. Merryman, 'How others do it: The French and German Judiciaries' (1987-88) 61 S. Cal. L. Rev 1865 at p.1866 & p.1870; J.H. Merryman, 'Public Law – private law distinction in European and American Law' (1968) J. Pub. L. 3 at p.3-12; J.H. Merryman, 'The French Deviation' (1996) 44 Am. J. Comp. L. 109 at p.110-p.113, p.117-118.

It is feasible that states that have developed administrative law, or special administrative tribunals, will be able to adjudicate public law claims better than others due to an understanding of what the limits of administrative rights of individuals are and how to procedurally manage claims. This difference in capacity to utilize administrative law works against the attempts of arbitrators to create a generic and universal system of administrative rules under the fair treatment standard for all states.<sup>111</sup>

Transplanted rules may have to be in line with the customs, institutional practices and cultures of states to be effective.<sup>112</sup> In law and development, the weakness of compliance with foreign transplanted rules by developing states had been attributed to a lack of this alignment.<sup>113</sup> Public administrative law is a particular type of system of accountability that is based on the creation of formal administration, usually emanating from a centralized Government structure, and formal written (non-customary) rules.<sup>114</sup> This is not present in many developing states, where administration away from central Government tends to be weak and underdeveloped. De Soto states that greater enforcement mechanisms are required where there is a mismatch between the transplanted law and domestic custom, the result of this is to drive up the cost of the legal process for the host-

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<sup>111</sup> T. Heng Cheng, 'Precedent and Control in Investment Treaty Arbitration' (2006-07) 30(1) *Ford. Int. Law. J.* 1014 at p.1016 & p.1036-1037; S.D. Franck, 'The Nature and Enforcement of Investor Rights Under Investment Treaties: Do Investment Treaties have a bright future?' (2005) 12 *U.C. Davis. J. Int'L L & Pol'y* 47 at p. 73-75.

<sup>112</sup> See, E. Buscaglia & W. Ratliff, *Law and Economics in Developing Countries* (Stanford) (2000) at p.4; Further, where a transplanted norm requires a centralized enforcement mechanism, it may be less likely to result in behavioural change that is compliance with the norm if the enforcement is not done locally, or at the place where the impact of the norm is required. (ibid p.4-5) This may result in a need for on-site or in house monitoring of normative obligations in public institutions.

<sup>113</sup> See, R.D. Cooter, 'The Rule of State Law and the rule of law State: economic analysis of the legal foundations of development' in *Annual World Bank Conference on Development* 1996 (IBRD) (1997) at p.191-192.

<sup>114</sup> See, Buscaglia & Ratliff, (n 112 above) p.11-12. Note that customary law, as opposed to formal written code is the practice in many developing states. Some are undergoing reform to formalize customary rules as written law passes through a formal process of enactment, See, D. Berkowitz, J. Pistor & J-F. Richard, 'Economic development, legality and the transplant effect' (2003) 47 *Eu. Econ. Rev.* 165 at p.165-174.

state to comply with the norm.<sup>115</sup> There may be a degree to which states have to take the burden of implementing new rules imposed upon them by processes that use transplantation, whether domestic or international. This will depend on available resources of both monetary and non-monetary nature (see below). However, investment arbitration may have to be sensitive to difficulties of compliance with its FET administrative law transplants, if they are to be a fair burden of responsibility upon states.

Arbitrators applying the process of 'legal transplantation' may have to factor in some sensitivity to national particularities such as cost compatibility of rules and the cost of their enforcement to make compliance with administrative law frameworks more feasible. This may mean that the interpretive method may have to be customized to reflect national approaches to administrative liability and law.<sup>116</sup> Greater recourse to domestic law and custom in interpreting fair and equitable treatment may be useful for arbitrators, if not as a source of law then for a context in which to determine appropriate rules.<sup>117</sup> Domestic law, if part of an effective system of national legal accountability, may reflect compliance ability of states.

This approach of domestic referencing may be useful despite concerns in investment treaty arbitration of the lacunae of legal protection available to investors in many states and the resulting use of general international law in

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<sup>115</sup> H. de Soto, *The Other Path: The invisible revolution in the third world* (I.B. Tauris & Co. Ltd) (1989) at p.55-57.

<sup>116</sup> An appreciation of domestic normative positions on potential international rules can be fundamental to their acceptance: See, Gotlieb and Dalfen's work on contrasting international rules on the law of the sea and concomitant Canadian positions: A. Gotlieb & C. Dalfen, 'National Jurisdiction and International Responsibility: New Canadian Approaches to International law' (1973) 67(2) AJIL 229 at p.233-p.235.

<sup>117</sup> There is a jurisprudentially underdeveloped provision in this regard in Article 42(1) ICSID, See: C.H. Schreuer, *The ICSID Convention: A commentary* (Cam U. P) (2001) at p.565-567 See I. F.I Shihata, 'Towards a greater depoliticisation of investment disputes: the roles of ICSID and MIGA' in K.W. Lu, g. Verheyen & S. Perera, Eds., *Investing with confidence, Understanding Political Risk Management in the 21<sup>st</sup> Century* (IBRD) (2009) at p.10.



arbitration as a buffer against these.<sup>118</sup> Ensuring that rules brought in through transplantation are not significantly too onerous for states would reduce the cost of implementation of the norm and would make the imposition of liability on the host-state fairer considering the unpredictability created by the textual ambiguity of the fair treatment standard.<sup>119</sup> In some instances the issue of cost may be determinative of the unworkability of administrative law transplants due to developing countries lack of resources. Where there is a significant short-coming it may require an increase in cost sharing by the investor's own state if it feels that administrative law application by arbitrators is intrinsic to gathering foreign investment for development, and it benefits from having many investors working in the territory of the developing state.

Thus investment treaty arbitration as a system may have to be re-designed in order to address possible long-term compliance abilities of developing states to meet its legal espousal. To reduce cost, in turn, legal harmonization may be an option. This is balancing the ideal administrative framework of the investor against the capacity to comply with the host-state.<sup>120</sup> Depending on interpretations, one might even choose to water-down existing investment arbitration rules in order to increase compliance, if adequate mechanisms for compliance are not built in into the arbitration system or developing states.

Transplantation does often require behaviour change of institutional practices and individuals.<sup>121</sup> This can have an unwanted impact on local culture.<sup>122</sup>

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<sup>118</sup> C.N. Brower & L.A. Steven, 'Who then should judge?: Developing the international rule of law under NAFTA Chapter 11' (2001) 2 Chi. J. Int'l 193 at p.196. The advantage of a contextual approach with respect to domestic law, rather than a mere restriction of protection to domestic law as in the Calvo doctrine, is that it will allow greater flexibility and development in investment protection and, perhaps, be a lesser contributor to investor flight, See *ibid* at p.194.

<sup>119</sup> See Chapter 1, for textual ambiguity.

<sup>120</sup> See, Waelde & Gunderson (n 92 above) at p.368-371.

<sup>121</sup> E.g. In the Eastern block countries following the cold-war the bureaucracy has taken reform and time to change habits under centralized power to alter to a free-market state, See, A. Kotchegura, 'A decade of transition is over: What is on the Reform Agenda' in T. Verheijen (Ed.), *Civil Service Systems in Central and Eastern Europe* (Edward Elgar) (1999) at p.9-15.

<sup>122</sup> This issue has been debated with the transplantation of human rights and civil liberties norms into developing world. E.g A case made to protect incompatible national culture,

Transplanted rules do not always have their desired effects. This means that the factors that affect the impact of rules have to be factored in by arbitrators in order to make the rule more effective in achieving its desired ends. Depending on the complexity of these factors, arbitrators may need input from litigating parties where this is possible, or development institutions that are able to study factors relating to compliance of rules.

*Co-Dependency on the rule of law culture of administrative law transplants*

Law and development also states that effective change on the ground for transplants requires both an analysis of the rules being transplanted, and the practices of institutions or individuals that they seek to affect. Complex rules of administrative law may encounter difficulties of compliance due to a lack of appropriately trained domestic administrators. There may be a gulf of technical knowledge that will need to be overcome in the developing world to understand the rules and to design a method of implementation at the national level.<sup>123</sup>

Further, transplantation without effective training and education of what compliance entails may render the process nugatory.<sup>124</sup> Specific training may need to be harmonized with general legal education about the importance of compliance with transplants, such as administrative law, to maintain the rule of law domestically and international obligations towards foreign investors.<sup>125</sup> In some states it may need to be a part of a broader institutional development process of transplanting general Western rule of law notions such as accountability of governmental action.<sup>126</sup> Investment arbitration may need a

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see: I. Bonny, 'Between culture and constitution: Evaluating the cultural legitimacy of human rights in the African state' (2000) 22(3) Hum Rts. Qrt. 838 at p.839-841.

<sup>123</sup> M.S. Tanner, *The Politics of Law-Making in China: Institutions, Processes and Democratic Prospects* (OUP) (1999) at p.1-17.

<sup>124</sup> Otto, Stoter, & Arnscheidt, *Law Making for Development* (Leiden) (2008) at p.56.

<sup>125</sup> (n. 124 supra).

<sup>126</sup> J.A. Widner, *Building the rule of law: Francis Nyalali and the road to judicial independence in Africa* (Norton) (2001) at p.178-179.

system of oversight that both reviews and also builds the correct institutional frameworks for compliance with administrative law transplants to be possible.<sup>127</sup>

General education in developing states about the rule of law is a difficult and costly process that investment treaty arbitral panels need to be aware of.<sup>128</sup> Rule of law implementation also depends on the availability of domestic legal processes to challenge incorrect implementation and oversight by an international institution.<sup>129</sup> None of these are yet available in investment treaty arbitration. Implementation of foreign rules in developing countries often has to be protected from political process and political interference. There may be an increased risk of this in developing states due to the weakness of the rule of law and the concomitant increase in arbitrary interference with private property interests.<sup>130</sup> These factors are critical to a legitimate, from a workability point of view, framework of administrative law rules created through interpretations of FET.

To some extent the investment arbitration system may provide such an oversight through its enforcement process. The enforcement of a given particular arbitration award, however, does not monitor post adjudication compliance with rules.<sup>131</sup> If the system wishes to move beyond punitive liability to create rules that effectively protect and promote foreign investment then it may have to do this. Effective transplantation may well require a system of monitoring.<sup>132</sup> Of all the benefits of transplants, it must be recalled that in some states they are a substitute for omissions in the organic domestic legislative process.

### *Domestic Political Context.*

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<sup>127</sup> T. Eggerston, *Imperfect Institutions, Possibilities & Limits of Reform* (Uni of Michigan) (2005) p.176-185

<sup>128</sup> Otto, Stoter, & Arnscheidt, (n124 above) at p.55.

<sup>129</sup> See, R.J. Daniels, 'Political Economy of the Rule of Law in Developing Countries' (2004) 26 Mich. Jnl. Int. L. 9 at p.128-134.

<sup>130</sup> (n115 above).

<sup>131</sup> (n112 above).

<sup>132</sup> (n112 above).

As stated, a compatible political context may be necessary for administrative law transplants. For their long-term enforcement, accountability of administrative institutions to legislatures and the courts will be necessary. This form of accountability of institutions depends upon values of democratic governance in the host-state.<sup>133</sup> The law and development movement, for example, found that certain transplants did not work in ex-Soviet states due to different political values held by states in the cold-war. Once socialist based political reforms occurred in the developing world, rules that were based on free-market liberalism and the rule of law like administrative law were transposed, with huge difficulty.<sup>134</sup>

In some states where the nature of the government is autocratic similar problems may persist. Hungary in the cold war, for example, did not allow judicial adjudication of contractual disputes. Instead a Government body itself would intervene on the basis of national interest over private interest.<sup>135</sup> This form of centralized government would affect the accountability of administrative acts by independent means. These issues are still being dealt with by political reform strategy in the Western block.<sup>136</sup>

Thus arbitrators in FET administrative law transplantation may wish to note the distinctions of political context between various states to be taken into consideration when applying public law rules into the investment treaty system. This is particularly where there is a claimant from a significantly more developed state, who seeks public law liability.<sup>137</sup> Further transplantation of rules that were

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<sup>133</sup> See, P.P. Craig, *Public Law and Democracy in the United Kingdom and the United States of America* (OUP) (1990) at p.47-50.

<sup>134</sup> See, Waelde & Gunderson (n 92 above).

<sup>135</sup> See Trubeck, (n 100 above) at p.34

<sup>136</sup> R. Dñino, 'The importance of the rule of law and respect for contractual rights in transition countries' in M. Andenas & G. Sanders, Eds., *Enforcing Contracts in Transition Economies: Contractual rights and Obligations in Central Europe and the Commonwealth of Independent States (BIICL)* (2005) at p.1-7

<sup>137</sup> CMS in Argentina is an example of this. See, CMS (n 47 above).

reliant on the rule of law to function was not wholly successful due to the lack of local enforcement mechanisms and culture in the developing world.<sup>138</sup>

It can thus be seen, that administrative law transplants face political<sup>139</sup> and institutional hurdles to become effective in the developing world. Further, public law can fetter the operation of government processes to the detriment of the developing world. For example, transplantation of rules associated with open public processes, a key public law rule in England, does not always sit harmoniously with a government's need to prioritize efficient close-door decision-making to protect policy priorities and reduce cost in public decision-making.<sup>140</sup> Further cost and viability of appropriate institutional training in institutional practice transplantation was underestimated.

Long term compliance with FET administrative law by state institutions may be limited by a lack of willingness and institutional capacity to change institutional practices and culture on the ground.<sup>141</sup> Transplants can be affected by local educational limitations such as language and literacy requirements generally and in public administration.<sup>142</sup> Further ethical training may be requisite for fair public administration practices, which has to have the right educational background and framework to be effectively absorbed. For example, Seidman states that it is vital to study existing behavioural conduct on the ground before transplantation to create rules that will be acceptable.<sup>143</sup> Further, transplants themselves may need to be modified, by watering down onerous obligations such as transparency, in order to assist compliance, and following an assessment of whether absolute compliance

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<sup>138</sup> (n 47 above)

<sup>139</sup> Political desires to limit judicial review in England, E.g.

<sup>140</sup> In some jurisdictions concerns over public interest being defeated in adjudication have led to a public interest exception developing. See, M. Forde, 'The "Ordre Public" exception and the adjudicative jurisdiction conventions' (1980) 29 ICLQ 259 at p.259-260.

<sup>141</sup> See, Waelde & Gunderson (n 92).

<sup>142</sup> J.H. Beckstrom, 'Handicaps of Legal Social Engineering in a developing nation' (1974) 22. Am.J. Comp.L. 697 at p.703

<sup>143</sup> A. Seidman & R.B. Seidman, 'Law in aid of development "Hasty Legal Transplants" and the fatal race' (2006) 2(1) Journal of Comparative Law 282 at p.282-291.

is possible. This, perhaps, realist position on transplantation may leave many of rules under the fair and equitable treatment standard unreal ideals as opposed to workable goals.

There is also the view that administrative law cannot be transplanted into the developing world at all because for many states compliance with administrative law liability under FET would be unfeasible. Friedman, for example, questioned whether transplantation of formal Western rule of law based rules could work at all, considering the history of the development of the rule of law, which was part of a slow historical evolution of society and linked to other cultural variables such as progress in political philosophy and science.<sup>144</sup>

Further, the fundamental premise of administrative law transplants using the FET is questionable. Arbitrators have justified legal interpretation on the basis that they are within the purposes of what Contracting Parties to investment treaties had in mind with respect to the aims of treaties being to encourage capital across borders. However, it is not clear that transplants from states with a functioning rule of law, such as FET interpretations of transparency, can assist economic development through creating a preferential environment for investments.<sup>145</sup>

Trubeck, the predominant proponent of this critique, re-iterates Weber's position that the economic development of Western states occurred through the series of particularly historical conditions that may themselves have to be transplanted for law and development to occur.<sup>146</sup>

It is also unclear whether administrative law catalyzed economic development, or whether it was the other way around. To make this latter point one can see, as discussed in the previous chapter, that the rise of the bureaucratic apparatus that

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<sup>144</sup> Friedman, 'On legal development' (1969) 24 Rutg. L. Rev. 11 at p.12

<sup>145</sup> Trubeck basing his analysis on Weber: D.M. Trubeck, 'Max Weber on the rise of capitalism' (1972) (3) Wisc. Law. Rev. 720 at p.720-728

<sup>146</sup> Max Weber, *The Protestant Ethic and the Spirit of Capitalism* (UNWIN) (1974) at p.155-185.

was needed to administer the industrial state required the development of legal rules to ensure that this apparatus was fulfilling the role it had to play.<sup>147</sup> This analysis challenges the fundamental rationale behind administrative law transplants. Arbitrators under FET have, perhaps, on one feasible explanation assumed transplantation would work automatically due to acceptability of new rules being automatic considering the developing states' needs for reform.<sup>148</sup> Alternatively, they have sought to find liability in the abstract, not engaging upon the idea of liability at all. Though there has been some sensitivity to this by the *AMTO* tribunal regarding the state of the host-state's courts.<sup>149</sup> This approach however has not extending to constructing legitimate expectations or transparency.

These weaknesses of viability are of fundamental importance when determining the legitimacy and appropriateness of public law in investment treaty arbitration.<sup>150</sup>

Transplantation itself may require political change to be effective, hence for administrative law values to be transplanted into institutional practice political involvement in institutional reform may also be necessary.<sup>151</sup> The problems encountered by transplantation in law and development occurred partially through not understanding the theoretical basis of the rules. This included the political values that were imbued in the rules and the apposition of those political values with the culture of the state in question.<sup>152</sup> Transplantation often failed as it had

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<sup>147</sup> This historical pattern has been noted by other law and development commentators, . Note also the rise of ultra-vires doctrine in public law to ensure that administrative organs fulfill the tasks delegated to them:

<sup>148</sup> See, Waelde & Gunderson (n 92).

<sup>149</sup> *Amto v. Ukraine* Arbitration Institute of Stockholm Chamber of Commerce (Stockholm, Sweden). 26 March 2008 (Arbitration No 080/2005) at para. 76.

<sup>150</sup> This form of analysis is omitted from Franck's work on legitimacy, See S.D. Franck, 'The Legitimacy Crisis in Investment Treaty Arbitration: Privatising Public International law through inconsistent decisions' (2005) 73 *Ford. Law. Rev.* 1521 at p.1584-1588.

<sup>151</sup> See Trubeck, (n 145 above).

<sup>152</sup> *Ibid.*

no system of monitoring whether transplantation had been absorbed into practice through compliance.<sup>153</sup>

There are also conservative views to transplantation that arbitrators may wish to consider. For example, Steiner warns of law interfering with natural social change to the point of inhibition.<sup>154</sup> Thus public law forms of liability may inhibit nascent developing political movements of accountability thus inhibit policy concerning reforms of institutions.<sup>155</sup>

### *Overall*

Transplantation as a part of law and development was justified on the basis of ‘spill-over’ of economic development from transplanted rules associated with a functioning rule of law, and often the incorporation of the rule of law itself. This is not so distinct from the presumption of transplantation in investment treaty arbitration.

Thus the tribunal in *Tecmed* to justify a series of legal standards for public administration through interpreting the fair and equitable treatment standard states:

*If the above were not its intended scope, [Fair and Equitable Treatment] would be deprived of any semantic content or practical utility of its own... the parties intended to strengthen and increase the security and trust of foreign investors that invest in the member States, thus maximizing the use of the economic resources of each Contracting Party by facilitating the economic contributions of their economic operators.’<sup>156</sup>*

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<sup>153</sup> *Ibid.*

<sup>154</sup> Steiner, ‘Legal education and socio-economic change: Brazilian Perspectives’ (1971) 19 Am.J. Comp. L. 39 at p.87-88.

<sup>155</sup> M.R. Somers, ‘Citizenship and the place of the public sphere: law, community, and political culture in the transition to democracy’ (1993) 58(5) Am. Socg. Rev. 587 at p.588-p.589.

<sup>156</sup> *Tecmed* (n 26 above) at para 156.



The tribunal here both assumes the intention of contracting parties and, heuristically, the economic benefits to the host-state of its own interpretations.<sup>157</sup>

What processes of transplantation, like the *Tecmed* elucidation, may fail to appreciate is that the creation of administrative standards and may need at least partial habit of institutional practice on the ground. Further, to bring this about effectively it may have to emanate from domestic political will,<sup>158</sup> and mere exposure to liability from investment arbitration may not be enough of an incentive.

The transplantation of the rule of law is seen as key to development projects.<sup>159</sup> Public law transplantation, based on the rule of law, has an inherent set of assumptions about the relationship of the state and law towards people.<sup>160</sup> Different states with different approaches to the rule of law will have different inherent assumptions regarding its role. Thus there may be an immediate incompatibility between the value of the transplanted norm and the existing or non-existing legal framework on the ground that will hinder its functionality.

According to Trubeck's latest retrospective analysis, the rule of law transplantation has not yet overcome the short-comings of differences in governance models between States that hinder transplantation.<sup>161</sup> Rule of law based accountability also involves a particular relationship between the courts and the State, whereby the courts have jurisdiction to bring Government actions to account in legal process.<sup>162</sup>

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<sup>157</sup> *Ibid.*

<sup>158</sup> See B.R. Weingast, 'The Political Foundations of Democracy and the Rule of Law' (1997) 91(2) Am. Pol. Sc. Rev. 245 at p.245-247 & p.254.

<sup>159</sup> J.M. Otto, W.S.R. Stoter, & J.Arnscheidt, 'Using legislative theory to improve law and development projects' in J.J.M. Otto, B. Van Rooij, J. Arnscheidt Eds. Lawmaking for development, Explorations into the theory and practice of International Legislative Projects (Leiden) (2008) at p.54

<sup>160</sup> See, Trubeck and Galanter (n99 above).

<sup>161</sup> (n 99 above).

<sup>162</sup> See, Trubeck and Galanter, (n99 above) p.1071-1072

Thus without the support of independent, effective, functioning of courts transplantation of conceptions of the rule of law may fail. Administrative law transplantation may overestimate the ability of law to alter the conduct of public institutions.<sup>163</sup> Galanter and Trubeck stated that there are social harms associated with excessive legislation associated with rule of law-based transplants.<sup>164</sup> For example excessive legalization through a particular concept of the rule of law (that for consistent conduct to occur legal proscription is required) may undermine comprehensibility of the legal system to nationals in developing states.<sup>165</sup>

These may weaken commercial development and institution building. Although rules may be clear in drafting, their proliferation may decrease accessibility of public process without effective communication channels. Other social harms highlighted by Trubeck and Gallanter is that formal law from the developed world may actually increase elitism and undermine social equality through lack of knowledge of legalistic procedure, it will also increase the prevalence of social hierarchy due to limited availability of education, particularly literacy.<sup>166</sup>

Overall, the process of legal transplantation under FET could be improved by a greater appreciation of limitations of compliance from the ground in the developing world, as the above critiques highlight.

#### **6.4. Capacity of states to respond to FET Governance.**

It is of importance in formulating fair burdens of liability whether all contracting parties can comply with the legal framework created by arbitrators using the

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<sup>163</sup> (n 162 above).

<sup>164</sup> See, Trubeck and Galanter, (n 99 above) p.1073-1076.

<sup>165</sup> A. Nollkaemper, 'On the effectiveness of international rules' (1992) *Acta. Politica* 49 at p.51-52; \*For a general narrative on the relationship between comprehension of laws and compliance, See: J.L. Tapp & L. Kohlberg, 'Developing senses of law and legal justice' (1971) 27(2) *Jnl. Soc. Sci.* 65 at p.65-67.

<sup>166</sup> (n 162 above).

FET.<sup>167</sup> Differences of institutional development between states question the legitimacy of arbitrators' elucidations of the FET that construe standards for administrative process and regulatory institutions.<sup>168</sup>

The ulterior aims of cross border investment include the raising of capital for development and to increase the size of domestic markets through previously unavailable resources and consumers.<sup>169</sup> Institutional development is of particular concern to capital importers.<sup>170</sup> Commercial agents need support from administrative institutions of the state to function effectively.<sup>171</sup> From this perspective, perhaps, there is an implicit licence, if not a temptation, for arbitrators to choose the administrative law framework to meet the needs of investors. This may be acceptable to some states, though it is not ascertainable through investment treaties whether this is so. Bearing in mind certain assumptions regarding the impact of administrative law on public institutions, administrative liability might improve institutional practice towards foreign and

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<sup>167</sup> The Gami tribunal has pointed out that the failure of the state administration to meet national standards will be a breach of FET: 'Breaches of NAFTA are assuredly not to be excused on grounds that the Government's compliance with its own law is difficult' in *GAMI Investments, Inc. v. Government of the United Mexican States (Merits)* (15 November 2004), 17(2) *World Trade and Arb. Mat.* 127 at para 94.

<sup>168</sup> T. Frank, 'The New Development: Can American Law and Legal Institutions Help Developing Countries' (1972) *Wisc. L. Rev.* 767 at p.788; E.g., For a historical explanation for some of the differences in the development of institutions in the developing world, see this colonial analysis in relation to South America- See, S.L. Engerman & K.L. Sokoloff, 'Factor Endowments, Inequality and paths of development among new world economies' (2002) 3(1) *Economía* 41 at p.44-45, p.52-58, who argue that differentials in benefits and disadvantages from colonial heritage impact on different rates of institutional development in the developing world.

<sup>169</sup> The relationship is espoused in the work of Williamson; O.E. Williamson, *The Economic Institutions of Capitalism: Firms, Markets, and Relational Contracting* (Collier) (1985) at p.52-56; Z.Elkins & A.T. Guzman, & B.A. Simmons, 'Competing for Capital: The Diffusion of Bilateral Investment Treaties, 1960-2000' (2006) 60 *Intl Org* 811 at p.822-824.

<sup>170</sup> Interactions between foreign businesses and local institutions has been a recognizable factor of political risk for investors- See, S.J. Kobrin, 'Political Risk: A review and reconsideration' (1979) 10(1) *Jnl. Int. Bus. Stud.* 67 at p.67-68; p.72-77. Predictable institutional practices serve to improve general economic performance creating certainty for commercial entities: D.C. North, *Institutions, Institutional Change and Economic Performance* (Cam. Uni. Press) (1990) at p.3-5.

<sup>171</sup> See, D.C. North (n170 above)

national investors.<sup>172</sup> The acceptability of this is entirely an assumption of arbitrators when they are constructing laws that affect states institutions and regulation.

No doubt for certain states administrative institution building is a key part of international development, and useful for economic stimulus.<sup>173</sup> Hence there is some legitimization of arbitrators' assumptions to create laws that may assist this. However, what arbitrators have failed to appreciate is that different states have different capacities, frameworks and training of administrative bodies.<sup>174</sup> Some standard setting by arbitrators may be useful, if it bears in mind domestic institutional practices, their state of development and availability of resources for reform. This is not done in the present method of standard-setting by tribunals. Investment treaty arbitration's incorporation of administrative law, through transplantation, is alien to many states in the world, or still subject to development reform processes to be fully functional.<sup>175</sup>

A fundamental issue relating to capacity of states to comply with arbitrators' standards is the novelty of the idea of effective administrative institutions. On a general level the problems with law and development suggest that, institutions, and other affected subjects and relationships,<sup>176</sup> generally require time to adapt to alien legal systems.<sup>177</sup> The administration of private-property rights, that investment treaties protect, requires effective state institutions.<sup>178</sup> This may be problematic as the protection of private property rights is a relatively recent idea

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<sup>172</sup> See Montt (n93 above) at p.154.

<sup>173</sup> See, Enhancing Capabilities for Administrative Reform in Developing Countries, ST/ESA/SER.E/31, United Nations, New York, 1983 at p.4-17. G.E. Caiden, *Administrative Reform Comes of Age* (de Gruyter) (1991) at p.73-95 & p.243-271; Dolzer & Schereuer, *Principles of International Investment Law* (OUP) (2008) at p.9; D.C. North, (n 170) above.

<sup>174</sup> The developing world is said to be characterized by weak infrastructure: See, J. Dunning, 'The advent of alliance capitalism' in J.H. Dunning & K.A. Hamdani, *The New Global Capitalism and Developing Countries* (United Nations) (1997) at p.37.

<sup>175</sup> Waelde & Gunderson (n 92 above) at p.355-370

<sup>176</sup> *Ibid.*

<sup>177</sup> *Ibid.*

<sup>178</sup> Q. Li & A. Resnick, 'Reversal of Fortunes: Democratic Institutions and Foreign Direct Investment inflows to developing countries' (2003) 57 Int. Org. 175 at p.177

in some developing states and institutional development for its protection is still in a nascent phase.<sup>179</sup> The novelty of protection of private property, in the developing world, comes from the fact that it is an idea that originates in the political ideal of negative liberty, developed within the Enlightenment discourse in the West.<sup>180</sup> The spirit of private property protection is to preclude state interference with private property rights.<sup>181</sup> The idea of protecting property rights and restricting state action from the sphere of private contractual relations is still undergoing acceptance in the developing world.<sup>182</sup> Institutions in the developing world are often not equipped to work effectively to administer private-property rights: this includes processing permits for contracts and effective enforcement institutions for breaches of agreements.<sup>183</sup> Further, in the developing world there may be a greater need to interfere with private property rights to sustain the economy and protect economic growth.<sup>184</sup>

Capacity of administrations and regulatory systems in the developing world to fulfill standards of FET such as,<sup>185</sup> consistency, non-arbitrariness and transparency, is questionable. Compliance with administrative law may not be possible due to lack of ability of administrative institutions to comply with formal

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<sup>179</sup> M.S. Khan & C.M. Reinhart, 'Private Investment and Economic Growth in Developing Countries' (1990) 18(1) World. Devpmnt. 19 at p.25

<sup>180</sup> I. Berlin, *Liberty, Incorporating Four Essays on Liberty* (OUP) (2002) at p.170-171. Essays on Freedom at p. where Berlin defines negative liberty as leaving things alone by preventing action that interferes. This concept of negative liberty was first espoused in Western Enlightenment thought by J.S. Mill, and is a reaction to the increasing size of state bureaucracy and law-making; (at p.218 et subseq); J.N. Gray, 'On Negative and Positive Liberty' 28(4) Political Stud. 507 at p.507-514.

<sup>181</sup> M.J. Radin, 'The Liberal Conception of Property: Cross Currents in the jurisprudence of takings' 88 Colum. L. Rev 1667 at p.1668-70 & p.1678-1680.

<sup>182</sup> Third world behaviour towards private-property has been partly characterized as state-based taking without compensation: A. Akinsanya, *The Expropriation of multi-national property in the Third World* (NY: Praegar) (1980) at p.1-12; J.W. Salacuse, 'From developing countries to emerging markets: A changing role for law in the third world' (1999) 33 Int'l Lyr. 875 at p.879-880.

<sup>183</sup> E.g. M. Fafchamps, 'The Enforcement of Commercial contracts in Ghana' (1996) 24(3) World. Devp. 427 at p.445-446.

<sup>184</sup> C.F. Runge, 'Common Property and Collective Action in Economic Development' (1986) 14(5) World. Devp. 623 at p.623-625.

<sup>185</sup> E.g. Tecmed (n25 above) at para 154.

rules of administrative law. This can occur due to lack of training of administrative staff due to cost of that training.<sup>186</sup> Administrative law requires trained professional civil servants who have a high degree of numerical and verbal literacy. In Less Developing Countries where formal education is not widespread, it will impact on the efficiency and effectiveness of state administrative organs through available highly literate administrative bureaucrats.<sup>187</sup> Difficulties of compliance can also occur due to inability of the state administration to formalize administrative conduct into a code or a set of rules, either through lack of knowledge of formal administrative management techniques or financial resources. Good administrative governance it requires a certain level of communication within governmental apparatus. Thus, central government must be able to effectively communicate international rules to local administration.

Where a state does not historically have a solid rule of law, developed administrative organs of a state and a strong judicial system it is likely that administrative law is an alien obligation. As stated earlier, it must be understood that in some states judicial review is a relatively recent phenomenon. This includes the idea of legal accountability to standards within judicial process.<sup>188</sup> Thus the idea of international courts reviewing administrative organs and setting standards for institutions of states will be a concept alien to many states. Further, states may not be able to comply with administrative law due to the constraints standards can place upon the creation and execution of policy by organs of the state by slowing down administrative processes for compliance.<sup>189</sup>

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<sup>186</sup> There is a general cost of institutional alignment to benefit from FDI for developing states, See J. Dunning, 'The advent of alliance capitalism' in J.H. Dunning & K.A. Hamdani, *The New Global Capitalism and Developing Countries* (United Nations) (1997) at p.17

<sup>187</sup> A. Leftwich, 'Governance, democracy and development in the third world' (1993) 14(3) *Third World Quarterly* 605 at p.612; S. Lall, *Building Industrial Competitiveness in Developing Countries: Vol 1*, (OECD) (Paris) (1990) at p.9; See, Widner, (n 187) at p.95-p.100

<sup>188</sup> Widner, (n 126 above).

<sup>189</sup> U.S. administrative law has been careful not undermine the execution of policy by administrative organs, but at the same time ensuring judicial accountability of general administrative process, See A. Scalia, 'Judicial deference to administrative interpretation of the law' (1989) 3 *Duke L.J.* 511 at p.512-517. Some argue that courts do this through

Overall, for developing countries, many of which do not have organized public institutions, compliance will come at significant cost.<sup>190</sup> It will on occasion involve creation and monitoring of institutions that may not be feasible. In formulating the administrative and governance role arbitrators have not noted that not all states will be able to comply with the administrative law developed under the fair treatment standard. Nor have arbitrators paid regard to the development status of a state's administration. Some interpretations demonstrate the opposite.<sup>191</sup> There is also no assessment taken of the revenue required for state administration to comply with the FET laws created, and this in turn may undermine administrative and regulatory governance role for investor protection.<sup>192</sup> The omission of an assessment for the capacity of states to comply with laws created under FET interpretations renders the current practice of interpretations of questionable legitimacy.

### **6.5. The Nature of International Governance under Fair Treatment**

As alluded to earlier, some interpretations of the fair and equitable treatment standard can be characterized as being similar to the concept of 'negative liberty'.

<sup>193</sup> This is freedom from state action for private agency, and placing as a priority

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disguising policy as administrative discretion and hence making it subject to review: M. Shapiro, 'Administrative Discretion: The next stage' (1983) 92(8) Yale L.J. 1487 at p.1489.

<sup>190</sup> The concept of creating standards to be followed was systemic only in a few legal systems at the turn of the century according to Al Sanhoury, *Les Restrictions contractuelles à la liberté individuelle de travail dans la jurisprudence anglaise, Contribution à l'étude comparative de la règle de droit et du standard juridique* (Marcel Giard) (1925) cited in Tudor, *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment* (OUP) (2008) at p.112

<sup>191</sup> Note significant burdens elucidated by the tribunal in *Tecmed*. *Tecmed* (n25) at para 154.

<sup>192</sup> For example, Jackson and Rosberg argue that in many African states the tendency to exercise power in a centralized form means that very little administrative infrastructure of the state is developed, R.H. Jackson & C.G. Rosberg, 'Why Africa's weak States Persist: The Empirical and the Juridical Statehood' (1982) 35(1) *World Pol.* 1 at p.7

<sup>193</sup> A. Director, 'The Parity of the Economic Market Place' (1964) 7 *Jnl. Law & Econ.* 1, at p.2-3; See, J.N. Gray (n180 above).

of the autonomy of the individual or commercial entity over general public interest in state action. In the economic context,<sup>194</sup> this approach results in a tendency to preclude state interference with private property rights.<sup>195</sup> The protection of private property is an ideology that many developing states are not familiar with, or are still engendering.<sup>196</sup> It is unclear from negotiations of investment treaties that such an ideology is to be imposed upon developing countries through the interpretation of investment treaties.<sup>197</sup> Further, as Montt intimates, private property rights are generally interfered, at the domestic level, with an overriding public interest in mind. Arbitrators have, in instances such as rejecting the doctrine of state necessity as a justification for interference with investors, rejected public interest or omitted it from the FET governance role they have constructed. They have implicitly, in some cases dealing with regulation, created a state-free zone for foreign investments that is characteristic of negative liberty and carries a significant public interest deficit. This is a key legitimacy issue of current usage of FET.

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<sup>194</sup> Formulated on the political ideas of the enlightenment philosopher John Locke, the predominant advocate of private property rights-C.B. Macpherson, *The political theory of possessive individualism: Hobbes to Locke* (Clarendon Press) (1962) at p. ; Other, comparatively modern, liberal economic philosophers have influenced modern law of contract and property- P.S. Atiyah, *The Rise and Fall of Freedom of Contract* (OUP) (1979) at p.1-23. Atiya states that the development of the modern law of contract in England was a result of post-reformation economic developments: P.S. Atiyah, *An Introduction to the Law of Contract* 5<sup>th</sup> Ed (OUP) (2004) at p. 2; A.W.B. Simpson, *A history of the Common Law of Contract: The Rise of the Action of Assumpsit* (OUP) (1996) at p.199. \*One can contrast developed contract law to the, often weak, protection of agreements of in the developing world: R. Dănilo, 'The importance of the rule of law and respect for contractual rights in transition countries' in M. Andenas & G. Sanders, Eds., *Enforcing Contracts in Transition Economies: Contractual rights and Obligations in Central Europe and the Commonwealth of Independent States (BIICL)* (2005) at p.1-7.

<sup>195</sup> E.g. Using the fair treatment standard to create a doctrine of legitimate expectations that prevents a state from adversely affecting contractual relationships in *Alpha Projektholding GmbH (Claimant) v. Ukraine (Respondent)* ICSID Case No. ARB/07/16 at para 422. M.J. Radin, 'The Liberal Conception of Property: Cross Currents in the jurisprudence of takings' 88 *Colum. L. Rev* 1667 at p.1668-70 & p.1678-1680.

<sup>196</sup> R. Dănilo, 'The importance of the rule of law and respect for contractual rights in transition countries' in M. Andenas & G. Sanders, Eds., *Enforcing Contracts in Transition Economies: Contractual rights and Obligations in Central Europe and the Commonwealth of Independent States (BIICL)* (2005) at p.1-7.

<sup>197</sup> Though for Vandevelde this is predictable based on current liberal macro-economic policy permeating international economic institutions: Vandevelde, 'Political Economy of Bilateral Investment treaties' (1998) 92 *AJIL* 621 at p.627-628.



One of the aims of cross border investment is to raise capital for development and increase size of markets through previously unavailable resources and consumers.<sup>198</sup> From this perspective perhaps there is an implicit licence for arbitrators to choose an administrative law and regulatory law framework, constraining both activities at will.<sup>199</sup> There are also certain assumptions regarding the impact of administrative law on public institutions, such as improving institutional efficacy that can legitimize its creation through ‘legal interpretation’. For certain states administrative institution building is a key part of international development.<sup>200</sup> However, as discussed above, different states have different capacities, frameworks and training of administrative bodies. Investment treaty arbitration’s Eurocentric conception of administrative law is alien to many states in the world, or still subject to development reform processes to be fully functional. Thus, some states may find it difficult to meet some FET administrative law.

FET governance can be seen as a part of the global liberal economic movement. Liberalism is the movement towards deregulation, privatization and encouraging capital based growth towards a free-market economy.<sup>201</sup> This process has been sold to developing countries, many of whom are capital importers, under the guise of sustainable economic development. Investment treaties were signed by many

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<sup>198</sup> See, the ‘beneficial relationship’ described in chapter 1. As discussed, the relationship is espoused in the work of Williamson; O.E. Williamson, *The Economic Institutions of Capitalism: Firms, Markets, and Relational Contracting* (Collier) (1985) at p.52-56; Z.Elkins & A.T. Guzman, & B.A. Simmons, ‘Competing for Capital: The Diffusion of Bilateral Investment Treaties, 1960-2000’ (2006) 60 Intl Org 811 at p.822-824.

<sup>199</sup> Administrative governance can be constrictive where it uses legitimate expectations to penalize changes regulation and law. A state would then have to avoid changes in order to avoid liability, which may be important to developing states short of revenue. See Chapter 2.

<sup>200</sup> See, Enhancing Capabilities for Administrative Reform in Developing Countries, ST/ESA/SER.E/31, United Nations, New York, 1983 at p.4-11.; G.E. Caiden, Administrative Reform Comes of Age (de Gruyter) (1991) at p.73-95 & p.243-271; Dolzer & Schereuer, *Principles of International Investment Law* (OUP) (2008) at p.9

<sup>201</sup> Liberal marketization is seen as a global phenomenon, including the movement of cross-border capital to this end, See J. Peck, ‘Remaking laissez-faire’ (2008) 32 Progress in Human Geography 3 at p.3-11.

for assisting this very purpose.<sup>202</sup> It is also relevant that the adverse problems in relation to liberalism's impact on states which would give them cause to question some of the role of administrative and regulatory governance under the FET, have not been addressed by arbitrators. For example the key concern relating to liberalism is of distribution of state resources for private investors, through regulatory and administrative re-alignment, away from the public sphere has not been factored into decisions, including *GAMI*, *CME*, *Lauder and CMS*.

States can be seen to enter investment treaties to bargain for foreign corporations that act as domestic privatization catalysts.<sup>203</sup> However, privatization allows market forces to determine resource allocation over the state.<sup>204</sup> Privatization of key public utilities, such as water and energy, has a significant impact on public life, including health and well-being. The availability and access to these key resources would be subject to huge public interest, and an implicit question of legitimacy can be formulated on the basis of fair Government distribution of them.<sup>205</sup> A key concern of the impact of liberalism is that it affects social

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<sup>202</sup> (n 72 above).

<sup>203</sup> G. Hunya, 'Large Privatisation, Restructuring, and FDI' in S. Zecchini Ed., *Lessons from the Economic Transition: Central and Eastern Europe* (Kluwer) (1997) at p. 286-288; R.E. Horkisson, L. Eden, C. Ming Lau & M. Wright, 'Strategy in Emerging Economies' (2000) 43(3) *Acad. Mngmt. Jnl.* 249 at p.249-251; P.P. Kuczynski & J. Williamson (eds), *After the Washington Consensus* (Washington, DC, Institute for International Economics) (2003) at p.16 Investor state relationships that often form litigation under investment treaties are a product of a de-nationalisation process or privatization process, mostly done in developing economies M. Watts, 'Development II: The privatization of everything' (1994) 18 *Progress of Human Geography* 371 at p.372-378. It is odd then they then face claims of public law, based on values derived from functioning rule of law economies whilst still in a transitional development stage. For examples of case law on this paradigm see, Ioannis Kardassopoulos & Ron Fuchs v. The Republic of Georgia ICSID Case No. ARB/05/18 and ARB/07/15 (Award of 26/02/2010) at para 69. Note also similar paradigms in the following decisions- See, CMS (n47 above); *Gas Natural SDG, S.A. v. The Argentine Republic*, ICSID Case No. ARB/03/10 (Spain/Argentina BIT) (17/06/05); *Sempra Energy International v. The Argentine Republic*, ICSID Case No. ARB/02/16 (US/Argentina BIT) (Award 28/09.10); *Alpha Projektholding GmbH v. Ukraine*, ICSID Case No. ARB/07/16 (Austria/Ukraine BIT) (Award 8.10.10); *CME v. Czech Republic* (n 36 above).

<sup>204</sup> See, Watts (n 203).

<sup>205</sup> N. Laurie, S. Radcliffe, & R. Andolina, 'The new excluded "indigenous"? The implications of multi-ethnic politics for water-reform in Bolivia' in R. Seider (ed.), *Multiculturalism in Latin America: Indigenous Rights, Diversity and Democracy*, (Palgrave Macmillan) p.252-76.

equity.<sup>206</sup> Concerns about employment availability and fairness to access opportunities that new capital creates have led to protests.<sup>207</sup>

Free-market liberalism also has an impact on social structures and indigenous culture in the developing world. This is seen clearly in the impact of imported technology on municipal culture.<sup>208</sup> This impact is not often foreseen by Governments that sign up to neo-liberal instruments.<sup>209</sup> It should be noted that investment treaties are not just bargains for capital but also for technology and skill. Foreign businesses will also not necessarily abide by fair employment practices including gender equality.<sup>210</sup> The state may need to act in order to redress fairness in opportunity.

Overall, the FET standard has been interpreted so as to affect the internal order of the state and restrict its regulatory powers to the benefit of the investor. From this perspective, it *liberalises* the investor from state interference. Thus the system usurps the critical power of the state to determine the space allocated to the public function and private function in the domestic market, by taking it upon itself to determine where and where not the state can appropriately act vis-à-vis foreign investment. The mandate for such action, perhaps, is found in a teleological reading of investment treaties, specifically that minimizing the public sphere of state action, by restricting regulation, the investment arbitration system can reduce political risk. Thus such an approach can have an implied mandate within investment treaties and the ICSID Treaty.

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<sup>206</sup> A. Smith, A. Stenning & K. Willis Eds., *Social Justice and Neo-liberalism: Global Perspectives* (Zed Books) (2008) at p.3.

<sup>207</sup> H. Leitner, E.S. Sheppard, K. Sziarto & A. Maringanti, 'Contesting urban futures: De-centering neo-liberalism' in H. Leitner, J. Peck & E. Sheppard Eds., *Contesting Neo-liberalism: The Urban Frontier* (New York: Guildford Press) (2007) at p.19; W. Fisher & T. Ponniah (eds); *Another World Possible: Popular Alternatives to Globalisation and the World Social Forum* (Zed Books) (2003) at p.14-41.

<sup>208</sup> A. Ong, 'Neo-liberalism as mobile technology' (2007) 32 *Transaction of the Insitute of British Geographers* 3 at p.3- 8

<sup>209</sup> *Ibid.*

<sup>210</sup> D. Elson, 'Male bias in the development process' in D. Elson, *Male Bias in the development process* (1995) 2<sup>nd</sup> Ed. (Man. Uni Press) at p. 14-35.

## **6.6. Reforms of FET Governance.**

On the analysis thus far some reforms to investment arbitration will be useful to alleviate current short-comings in the governance role of the fair treatment standard. The governance usage of the fair and equitable treatment standard, highlighted above, requires institutional responses to be improved if it is to function effectively and not ignore key criticisms of legal transplants. This is not just changes to investment arbitration as an institution, there may also need to be some alterations to the methods in which treaties are formulated in order to make state intent clear as to the scope of FET. These systemic changes will be fully discussed in Chapter 7.

The limits of general legal coercion at least bring forward the question of different approaches to long-term effective compliance with FET administrative law and FET's requirements for regulatory consistency.<sup>211</sup> At the moment, for example, there is no monitoring of post award compliance by states of FET laws. Further, a significant institutional short-coming in the FET governance role is the inability to ensure that the legal framework of administrative governance is capable of being complied with by all states to investment treaties.

To improve current usage, perhaps, there needs to be within investment treaties and ICSID some restriction of FET to reflect limitations of state capacity for compliance with FET administrative law. In the absence of this, arbitrators need to develop a defence for states along these lines. These defences need to reflect explanations for limitations, such as current institutional frameworks of the state

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<sup>211</sup> Limits to coercion are discussed with respect to domestic and international law: M.S. McDougal & F.P. Feliciano, 'International Coercion and World Public Order: The General Principles of the law of war' (1957-58) 67 Yale. L.J. 771 at p.772; Compliance often depends on the will of the objects of law to comply and the complexity of the rules, See R. Pound, 'The Limits of Effective Legal Action' (1917) 27(2) Int. Jnl. Ethics 150 at p.151-153. For a specific example of the negligible effects of law through coercion in the field of criminality, See, T.K. Gregoire & A.C. Burke, 'The relationship of legal coercion to readiness to change among adults with alcohol and other drug problems' (2004) 26(1) Journal of Substance Abuse Treatment 35 at p.35-41.

that the investor ought to have researched, and limitations of revenue.<sup>212</sup> This may allow for more effective FET governance in encouraging institutional development by giving states a realistic opportunity to comply, and a fairer construction of liability for some developing states. The resulting requirement of investor knowledge of comparative development of institutions may create an incentive for states to develop institutions to compete more effectively for FDI.<sup>213</sup>

Transplantation of administrative law is not enough to create the institutional improvements that will assist investors. To deal with the lack of institutional development in the third world, institutional development needs strategies over and above liability. These will include understanding the limitations of domestic institutional practices, including availability of adequate human resources.<sup>214</sup> Where there are ingrained cultural practices transplants will need gradual implementation methods that can change practices.<sup>215</sup> These include appropriate changes to conduct through training and changes in procedures in institutional practices. If FET laws wish to apply burdens to national administrations, investment arbitration may need to assist by providing the means to meet those burdens.

To build the capability of institutions to learn models of governance for states that breach FET administrative law may need to appreciate the lack of the best schools of public administration training in developing states to build behavioural changes within institutional practice to meet high maintenance obligations under FET, such as transparency.

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<sup>212</sup> A shift of burdens to investors to research conditions in states has been intimated by Muchlinski, See P. Muchlinski, 'Caveat Emptor?' The relevance of the conduct of the investor and the fair and equitable treatment standard' (2006) 53(3) ICLQ 527 at p.527-529.

<sup>213</sup> For a positive correlation between institutional development and FDI see, A. Bevan, S. Estrin & K. Meyer 'Foreign Investment Location and Institutional Development in transition economies' (2004) 13 Int. Bus. Rev. 43 at p.43-45.

<sup>214</sup> D.C. North, (n170 above).

<sup>215</sup> See, Burg (n96 above) at p.522.

At the moment there is no system of monitoring between arbitrators creating law under FET and reviewing whether national governments ensure that public bodies carry out their functions effectively.<sup>216</sup> The investment arbitration law-making process needs to be given the appropriate equipment to carry out regulatory and public policy decisions, such as specialist input that can highlight broader policy impacts of FET administrative and regulatory governance, through FET's law-making role.<sup>217</sup> Further, a legal system of governance needs to appreciate limitations of its subjects to comply with laws that it produces.

From a developing state's perspective, the risk of adverse outcomes in dispute resolution should not outweigh the benefits of cross-border capital gained from the investment treaty agreement.<sup>218</sup> The excessive damages currently awarded in the investment arbitration system could be mitigated by a complementary institutional development programme to assist states in compliance.<sup>219</sup> This would create a fairer liability for future breaches, as states would be able to strategize,<sup>220</sup> through institutional development, to prevent FET administrative law breaches and ensure a more consistent national regulatory framework to meet requirements of 'consistency' under FET.

Critiques of legal transplantation can also be used to improve the governance of FET over domestic public administration.<sup>221</sup> For transplants to be effective, institutional awareness and political awareness for the rule of law needs to be

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<sup>216</sup> For example of how this is done at the national level, See: C.C. Hooton, *Executive Governance, Presidential Administrations and Policy Change in the Federal Bureaucracy* (M.E. Sharpe) (1997) at p.12-34.

<sup>217</sup> For example, new governance models in the EU have included input from civil society groups in EU law making to determine public interest: See, J. Scott & D.M. Trubeck, 'Mind the gap: Law and New approaches to Governance in the EU' (2002) 8(1) *Eu. Law. Jnl* 1 at p.3

<sup>218</sup> See, A.T. Guzman (n 72 above).

<sup>219</sup> See, *Sempra v. Argentina*, where after four rounds of hearings an award of \$75,000,000 was inflicted on Argentina.

<sup>220</sup> c.f. E.g, Corporate liability has been seen as a risk assessment and management exercise: W.S. Laufer, 'Corporate Liability, Risk Shifting, and the Paradox of Compliance' (1999) 52 *Vand. L. Rev* 1341 at p.1341-1343.

<sup>221</sup> Such institutional changes are not easily successful and may just be a mouth-piece for making the system more acceptable. See, Swabowski, (n 77 above) at p.19

brought about.<sup>222</sup>Bringing about the rule of law is co-dependent on other public reforms that have be identified, such as increasing transparency and removing corruption in the form of dominant private interests.<sup>223</sup> Transplants will also only be effective with local institutions that can protect the rule of law.<sup>224</sup> Further, the rule of law is not a static concept, it is subject to varied interpretations, and hence the governance model must communicate clearly the burdens and reforms necessary for states to increase its function.<sup>225</sup> Thus, continuous monitoring of institutional development, particularly preparing institutions to respond to legally accountable rules, is needed as a part of an effective Governance process.<sup>226</sup>

Good administrative and regulatory governance may include working out best solutions and executing them for development.<sup>227</sup> Comparisons between existing legal frameworks, such as the comparatively conservative approach to FET seen with legitimate expectations in English law, may benefit improvements to schemes of governance by providing increased legal coherence.<sup>228</sup> Further, the regulatory and administrative governance role of FET may find it useful to work with other international institutions. Another aspect of ensuring compliance with FET administrative law and regulatory governance would be investment arbitration providing technical legal assistance to developing states, following an adverse

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<sup>222</sup> See, R. Dañino, 'The Rule of Law and Contractual Rights in Transition Countries' in M. Andenas & G. Sanders (Eds.), *Enforcing Contracts in Transition Economies: Contractual Rights and Obligations in Central Europe and the Commonwealth of Independent States* (BIICL) (2005) at p.5-6

<sup>223</sup> T. Carothers, 'The rule of law revival' (1998) 77(2) *For. Aff.* 95 at p.95-96. ; For example, corruption fettered the commercial arrangement in the WDF case: *WDF v. Kenya* ICSID ARB/00/7 (Award) (04/10/06) , p.5-p.9

<sup>224</sup> R. Dañino, (n222 above) at p.6-p.7.

<sup>225</sup> For an example of variances in meaning in the development context, See: A. N. Licht, C. Goldschmidt & S.H. Schwartz, 'Culture rules: The foundation of the rule of law and other norms of governance' (2007) 35(4) *Jnl Comp. Econ.* 659 at p.650-655.

<sup>226</sup> F. Dahan, 'Law Reforms in Central and Eastern Europe: the "transplantation" of secured transaction laws' (2000) 2(3) *European Journal of Law Reform* ? at p.

<sup>227</sup> J J.M. Otto, B. Van Rooij, J. Arnscheidt Eds. *Lawmaking for development, Explorations into the theory and practice of International Legislative Projects* (Leiden) (2008) at p.48-54

<sup>228</sup> See Finklestein, (n2 above) at p.369.

finding.<sup>229</sup> This includes highlighting fundamental flaws of implementing legal transplants. This may use private law implementation strategies (such as the way commerce responds to new rules) to alter practices in public administration.<sup>230</sup>

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In the first part of Chapter 5 it was noted that administrative law as a concept is tied into a particular form of political theory as outlined.<sup>231</sup> Many of its legal positions used in investment treaty arbitration are predicated on a rule of law basis. Its theoretical foundations and development are based in the Western concept of the state and Government. It is particularly a response to the growth of the administrative state.<sup>232</sup> Shifting public law from one country to another may cause difficulty for the state to which the obligations are new and unfamiliar.

The function of law is seen often to reflect the desired direction that a particular society wishes to go into.<sup>233</sup> Legal frameworks created by arbitrators may, to a degree, be able to direct state institutions to create amenable institutions to investors. Though investment treaties have been contracted into for the benefits of foreign investment, the choice of public law laws espoused by the system is value laden. Public law, as outlined, carries with it a particular conception of the rule of law and particular values which are tied into a form of democratic Governance. It is not necessarily clear that states have agreed to this in investment treaties just in order to attract capital.

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<sup>229</sup> Legal technical assistance has not always effectively worked due to short-comings in dialogue and financing, See S. Newton, 'Law and Development, law and economics and the fate of legal technical assistance' in J.M. Otto, B. Van Rooij, J. Arnscheidt Eds. *Lawmaking for development, Explorations into the theory and practice of International Legislative Projects* (Leiden) (2008) at p.31

<sup>230</sup> See Newton (n229 above) at p.31, criticizing the World Bank's approach under Ibrahim Shihata to legal transplantation.

<sup>231</sup> See M. Loughlin, *Public Law and Political Theory* (OUP) 1992 at p.16.

<sup>232</sup> Brown & Bell, *French Administrative Law* (OUP) (2007) at p.3-12.

<sup>233</sup> Sedler, 'Law Reform in the Emerging Nations of Sub-Saharan Africa: Social Change and the Development of the Modern Legal System' (1968) 13 St. Louis U.L.J. 195 at p.245



The critical discourse of both law and development and law and economics is useful to creating an effective Governance mechanism in investment treaty arbitration.

Law and Development techniques, particularly those of 'legal technical assistance'; 'institution building' and 'legal education' may assist investment arbitration towards realizing its public administration standard setting. In transition economies there is a general lack of appreciating private commercial interests and upholding contracts. This is both due to lack of institutional components to motivate and effectuate compliance and the related want of rule of law culture<sup>234</sup> This can filter into the Government sphere and influence attitudes in public administration. Hence investment arbitration may develop a system of effective Governance to counter this. This will assist in public administration of treating investors fairly.<sup>235</sup>

As outlined, also relevant to this discourse are arguments put forward by the law and economics school of jurisprudence. This highlights short-comings in the ability of law to bring about desired affects. It also questions the feasibility of arbitrators to bring about the desired effects on the ground through a purely legal framework, without support from non-legal/legal techniques that engender change of institutional conduct. Thus it questions any absolute presumption that administrative law can change or improve administrative conduct to the benefit of the foreign investor.<sup>236</sup>

The aforementioned transplantation discourse also demonstrates compliance difficulties to be faced by states in the developing world. These include the inability of rules to fully shift institutional practice in the developing world due to

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<sup>234</sup> K. Pistor, 'Supply and demand for contract Enforcement in Russia: Courts, Arbitration, and Private Enforcement' (1996) 22(1) Review of Central and Eastern European Law 55 at p. 57-58.

<sup>235</sup> World Bank, *Building Institutions for Markets* (IBRD) (2002) at p.2-17.

<sup>236</sup> N.Mercuro, Ed. 'Law and Economics Critical Concepts in Law' Vol. 1 (Routledge) (2007) at p.3

inherent different cultural practices, and lack of adequate planning and revenue for institutional reform. For FET rules to succeed in changing environments in the developing world, where most states are capital-investors, the critiques of the law and development movement will be relevant to both support and adapt the law-making framework for arbitrators. Further, the viability of creating public administrative reform through legal transplantation that relates to the inability of states to meet certain obligations is important to the issue of legitimacy.

**Chapter 7:**  
**Conclusion and Proposed Reforms.**

**7.1 Introduction.**

**7.2 Coherence and Remedies.**

**A. Coherence**

**B. The Minimum Standard as a tool for coherence.**

**C. The Case for Deference.**

**D. Possibly Expanding the Legal Framework.**

**7.3 Adjudicatory System Changes and Treaty Alterations.**

**A. Institutional Transparency.**

**B. Investment Court.**

**C. Treaty Alterations.**

**7.4 Concluding Remarks.**

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**7.1. Introduction.**

This chapter intends to tie up some proposals regarding problems seen in the discussed substantive jurisprudence, and with respect to the effects that such jurisprudence has on the ITA system as discussed in the previous two chapters.

From the point of an overview, the coherence of FET is questionable considering issues of competing decisions and unclear thresholds as to what constitutes a breach of a given standard. Further, arbitrators have not assessed the ability of states to comply with their interpretations. The system also lacks the ability to monitor long-term compliance by states. However, as will be discussed, these problems can be overcome with some institutional changes to the system, including altering treaties and possibly creating an investment court that is directly accountable to Contracting Parties.

Further, it shall be argued that, the lack of coherence with respect to the rules is not just an issue relating to the lack of having a court, or a system of precedent through an appellate regime, whereby rules can be improved, but also due to lack of judicial diligence in applying the rules themselves. This makes a case for appointed judges who can be dismissed by contracting parties when they do not create or apply rules diligently, and when they ignore important state announcements relating to the scope of treaty provisions.

This chapter at least opens the question that there needs to be a system whereby states can directly participate in rule-making of the type done under FET, and raise their concerns about rules, such as their ability to comply with them, to create a workable international investment protection policy.

Montt argues that the FET rules have legitimacy because they aid the institutional development of states.<sup>1</sup> However, his argument has omitted how exactly this would be possible and not appreciated the fundamental difficulties that have to be overcome, such as available revenue in the developing world, for it occur. Further difficulties in relation to capacity have been highlighted by the earlier discussion on legal transplantation. There may be a case for norm-making assistance by another process for arbitrators, considering the complexities of developing states capacity to comply with foreign investment strategy as highlighted by FET rules such as legitimate expectations.<sup>2</sup>

The suggestions in this Chapter here may improve current rules made under FET. They aim to meet the following goals for improvement:

(i) Create systemic changes for a more coherent jurisprudential output and respect host-state's policy-making competences; (ii) Ensure rules are more effective by being capable of being complied with; (iii) Ensure created rules are monitored for compliance to prevent future breaches; (iv) Grant technical institutional development support to developing states to increase their ability to lure foreign investment; (v) Allow scope for states to make important regulatory contingencies; (vi) Provide for an opportunity of public interest and civil society

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<sup>1</sup> S. Montt, *State Liability in investment Treaty Arbitration* (Hart) (2009) at p.154-155

<sup>2</sup> Thus increase in transport infrastructure and low taxes can encourage foreign direct investment, C.C. Coughlin, V. Arromdee, J.V. Terza, 'State characteristics and the location of foreign direct investment within the U.S.' (1991) 73(4) Rev. Econ. Stat. 675 at p.678.

representation to participate in FET rule-making; (vii) Make arbitrators more accountable for their decisions.

## **7.2. Coherence and Remedies**

### **A. Coherence.**

Currently there is doctrinal incoherence in FET. Thus, as discussed, the legitimate expectations doctrine is far from clear in relation to: (i) whether there is a requirement of a direct representation by the state; (ii) whether it applies to expectations arising from prior to the BIT being in force;<sup>3</sup> (iii) whether it is substantive to the extent that it acts as an estoppel on states changing their policy. As a corollary, it is difficult to comply with the doctrine in terms of scope of review. There are also different thresholds for the transparency norm for arbitrators to choose from.

There is also lack of consistency between FET rules and denial of justice. The former are used to review administrative and regulatory organs, yet so far the scope of domestic courts to similar review is not available. This is despite the fact the latter is also an institution that will impact upon investor treatment and reform of improvements of it will assist economic development.

### *Language of Elucidations.*

Further, current language of rules is unclear and imprecise. This can be seen from the different elucidations of ‘Transparency’. It is not that arbitrators cannot do this. Ambiguity is also inherent in the phrasing of the rules themselves. This is illustrated by the broad phraseology used to construct the Transparency norm, discussed in Chapter 3. Thus, contrastingly, the elucidation of the ‘*freedom from arbitrary interference*’ rule<sup>4</sup> is useful despite ‘arbitrariness’ being a vague and difficult concept to define. Under the FET this has been expressed in the following terms: *‘the minimum standard of treatment of fair and equitable treatment is*

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<sup>3</sup> Fuchs. v. The Republic of Georgia ICSID Corp Nos. ABR/05/18 & ARB/07/15

<sup>4</sup> See, *Lauder v. Czech Republic* (2001) 9 ICSID Rep 62 at para 219.

*infringed by conduct attributable to the state and harmful to the claimant if the conduct is arbitrary...*<sup>5</sup> What arbitrary has been subject to the following definition: ‘*Depending on individual discretion...founded on prejudice or preference rather than on reason or fact*’.<sup>6</sup> This difference may be explained by a lack of arbitrator’s diligence in formulating the transparency norm. States may wish thus to have control over appointment of all arbitrators, and not just one at present. Thus two other arbitrators in ICSID proceedings one of which is provided for by the investor, and the other by mutual agreement would also then be provided for by the state.<sup>7</sup> This may be particularly worth doing for developing states where future compliance with FET standards is expensive and costs of awards are high.<sup>8</sup>

Further the FET rules require a certain degree of due diligence on the part of domestic administrators, and regulators, to be complied with. Limitations of the ability of arbitrators to create these rules, as to technical development bodies, may make a case against a legal role for FET that solely involves arbitrators. It may be left to non-legal methods of institutional development at the domestic framework. The limitations of legal impact on its subjects illustrated by aspects of law and economics demonstrates this.<sup>9</sup> This demonstrates a requirement for a broader institutional political economy approach to norm making and enforcement, which engages varied development techniques of institution building.<sup>10</sup>

## **B. Minimum Standard as a tool for coherence.**

The minimum standard may be useful to add coherence to the system, as illustrated by the denial of justice discussion. There a clear bar on reviewing

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<sup>5</sup> *Waste Management Inc. v. United Mexican States* (2004) 43 ILM 967 at para 98.

<sup>6</sup> *Lander* (n4 above) at para 221

<sup>7</sup> See L. Reed, N. Blackaby & J. Paulsson, *Guide to ICSID Arbitration* (Kluwer Law) (2004) at p.77-79.; G. Van Harten, *Investment Treaty Arbitration and Public Law* (OUP) (2007) at p.169-171.

<sup>8</sup> G. Van Harten (n7 above) at p.2

<sup>9</sup> See Chapter 6.

<sup>10</sup> See below.

domestic institutions, namely courts, gave some clarity as to the scope of protection afforded by the doctrine. In other areas of FET this would preclude FET rules relating to domestic institutions, such as transparency and legitimate expectations. However disadvantages are that the system will not longer be able to use liability to force improvements in administrative and regulatory standards on the ground, due to breaches only being possible when there is an outrageous conduct of state institutions.

Clarifying interpretations as to scope of protection they offer by reference to the minimum standard may be useful. Thus, for example, legitimate expectations and transparency could only be breached if conduct was 'outrageous' as stated in the minimum standard. The denial of justice norm is a good example of consistency in jurisprudential output by using the minimum standard.

Had this limitation not been made in *Loewen*, it would have been possible to develop a series of rules (or standard) to govern domestic courts when dealing with litigation by foreign investors. Nevertheless the minimum standard may not be entirely ineffective as it may not sufficiently meet the aims of investment treaties to promote and protect investments.

### **C. The Case for Deference.**

In certain instances the result of transplantation is that the fair and equitable treatment standard is used to override national regulatory policy and to prevent a state from abrogating existing legislation. But when this is likely to occur is difficult to decipher as this approach of FET is not a consistent one.

The current use of the legitimate expectations doctrine leaves it open for several areas of public interest to be adversely affected by FET rules.<sup>11</sup> This creates public policy uncertainty in the host-state for fear of being overridden. Further, the detrimental rejection of the defence of necessity by a strict literal application of it, as seen in cases concerning the economic collapse of Argentina,

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<sup>11</sup> B. Choudhary, 'Recapturing Public Power: Is Investment Arbitration's Engagement of the Public Interest contributing to the Democratic Deficit' (2008) 41 Vanderbilt Jnl. Trans. Law. 775 at p.785-810.

demonstrates a need for a broader scope for policy deference needed to be tied into FET norm-making.

This can be done by incorporating a deferential approach to public interest, whereby the investment law commission does not create rules that affect the competences of states to regulate and also legislate without express consent from states. This can also be done by expressly providing for public interest deference in future investment treaties.<sup>12</sup> Further direct state input into the law commission will allow states to control key aspects of public policy rather than leaving it to the discretion of arbitrators.

Thus some states may wish, due to their pressing need for foreign capital, for a lack of deference to legislative and regulatory competence.<sup>13</sup> Where this can be bargained for by states, rather than by arbitrators creating rules such as substantive legitimate expectations, it may be that foreign investors may go to states that expressly provide for protection at the cost of public interest, and states can then weigh the need for foreign investment against general public interest curtailment through restrictions of law, policy and regulatory action.<sup>14</sup> Through the competition of foreign capital that this approach may generate, states may improve the quality of their institutions and attempt to have regulatory and legislative stability to entice foreign capital. However, this approach will allow them to weigh the costs of these developments against other public policy, which at the present the system of FET norm making by arbitrators does not.

In the absence of the law commission that has exclusive competence with investment protection and promotion norm making, deference may constrain tribunals from granting rights to investors that might conflict with public policy. Thus the *Azurix* decision, would have gone against the investor had the tribunal deferred to the state legislature.<sup>15</sup> This form of treaty interpretation of FET to

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<sup>12</sup> This is currently not provided for by the International Law Commission's Draft Articles of State Responsibility, See J. Crawford, *The International Law Commission's Articles on State Responsibility: Introduction, text, commentaries* (Cam. U. P) (2002) at p.178-186.

<sup>13</sup> A.T. Guzman, 'Why LDCs sign treaties that hurt them: Explaining the popularities of BITs' (1997-98) 38 Va. J. Int'l 639 at p.666-678.

<sup>14</sup> Thus altering the bargain inherent in investment treaties, See Guzman (n12 above).

<sup>15</sup> See, *Azurix v. Argentine Republic* ICSID Case No. ARB/01/1 (Award 14/07/06) at <http://ita.uvic.ca>



prevent conflict with legislation is entirely distinct from a judge elaborating on a constitutional right from the perspective of mandate.<sup>16</sup> This is because such a judge does not create the right itself, it comes from the constitution which is not true for the arbitrator who creates it.<sup>17</sup>

### *Deference and Coherence*

Deference also assists coherence. By having the constitutional boundaries between the courts and the legislature in mind it will be easier to define the rights of investors and how far those rights extend. The example is given by the comparative approach in English law to legitimate expectations demonstrates that deference can provide clarity. In English law it is much clearer how the right is engaged and its scope of not adjudicating on the legislature is clear. This latter issue is unclear with the transparency, legitimate expectations, and freedom from arbitrary action rules developed under the FET.

To explain further, while the minimum standard controls the threshold of the breach by setting it high, deference prevents courts from adjudicating on legislative enactments and regulation, thus protecting the democratic sphere, and where there is no democracy, general legislative competence. Deference thus corroborates the general rights of states to expropriate in accordance with international law, and a vital right contested in the NIEO period. It would increase the legitimacy of FET rules from the preservation of a state's right to control internal matters through the acts of its own national legislatures.

On the down side, the problem with of deference are is that it may place too much political risk for investors to account for as it would allow legislative promises by states to be broken.

*Deference preventing public interest conflict with substantive legitimate expectations.*

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<sup>16</sup> See Chapter 1.

<sup>17</sup> H.L.A. Hart, 'American Jurisprudence through English eyes: The Nightmare and The Noble Dream' at p.970-971, where Hart touches upon the mandate for interpretation that American judges exercised in comparison to British one's due to the role assigned to them in the American Constitution (Article III (1)).

A substantive approach in legitimate expectations can be explained to a degree from the fact that the fair and equitable treatment standard was included as part of aims of investment treaties to 'protect and promote investments'.<sup>18</sup> This may be justified from the view that investment treaties play a role of foreign capital protection, means that foreign capital loss must be protected from government conduct. The scope of this approach however may be difficult to justify considering that the question of whether investment treaties can actually promote and protect investments is questionable.<sup>19</sup> of law that makes a licence invalid implicitly contrary to international obligations.

The difference between English law and ITA as to legitimate expectations can probably be explained by the fact that investment treaty arbitration is not a precedential system of law. Overall the doctrine of legitimate expectations is a powerful tool in investment treaty arbitration to hold not only the actions of Government bodies, but also Government law and policy accountable to investors.

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<sup>18</sup> Professor Walde states that this is the predication for the expectations doctrine in investment treaty arbitration, see separate opinion in *International Thunderbird Gaming Corporation v. Mexico*, UNCITRAL (NAFTA) 26/01/06. at paras 35-37. See also, Tudor, *The Fair and Equitable Treatment Standard in International Law of Foreign Investment* (OUP) (2007) at p.1-2.

<sup>19</sup> There is certainly disagreement between empirical studies on the point. Thus, E. Neumayer & L. Spess 'Do bilateral investment treaties increase foreign direct investment to developing countries?' (2005) 33 *World Development* p.1567, which states that there is an increase in investment from investment treaties. This has also been a working presumption by lawyers, see K. J. Vandewelde 'The Economics of Bilateral Investment Treaties' (2000) 41 *Harv. Int'l L.J.* 469; J. C. Beauvais 'Regulatory Expropriations Under NAFTA: Emerging Principles & Lingerin Doubts' (2002) 10 *N.Y.U. Envtl. L.J.* 242 at p.253; S.D. Franck 'The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions' (2004-5) 73 *Fordham. L. Rev.* 1521 at p.1524-1525 (& ftn 8 therein). Conversely, Tobin and Rose-Ackerman state that there is no discernible benefit, and in some instances a decrease in investment following ratification. See, J.Tobin, & S. Rose-Ackerman in 'Foreign direct investment and the business environment in developing countries: The impact of bilateral investment treaties' (2005) Yale Law School Center for Law, Economics and Public Policy Research Paper No. 293 at p.1-16. In certain circumstances there may also be difficulties with the demonstration of any benefits of foreign investment: 'Impossibility of demonstrating net benefits' in D.W. Carr, *Foreign Investment and Development in the Southwest Pacific with special reference to Australia and Indonesia* (Praeger) (1978) at p.12-32.

Outside of Van Harten's public law thesis, a possible explanation, for a broader scope in investment treaty arbitration for legitimate expectations is that it has been elided with 'legitimate interest' of performance in contract law that applies between private parties, where contractual agreements where both sides have undertaken performance obligations.<sup>20</sup> A commercial arbitration influence on investment treaty interpretation, that draws parallels with contractual rights, may be responsible for this.<sup>21</sup> Thus the investment arbitration hybrid paradigm of bringing commercial disputes against state bodies, have resulted in a novel form of public law doctrines with greater forms of review to reflect commercial necessity of the investor. This view to protect investments a priority when creating legal doctrine that come into play may justify an investment tribunal to grant, contrary to positions of deference argued in cases such as *Maffezini* and *Gami*. may have a great claim for review and protection from the arbitral court.

By contrast, as explored below, it may be that a more cautious approach would involve policy deference that could be brought into the legitimate expectations doctrine.

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*Issues with Broad Review Under Substantive Legitimate Expectations and the case for deference.*

It will be seen below that factors that go into policy-making are multifarious and complex, further they are not constant. This means that there is

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<sup>20</sup> See, for example see the 'Clea Shipping Case' concerning obligations undertaken by both the owners of a ship and a charter-party for the performance of a rental agreement. See, *Clea Shipping Corpn v. Bulk Oil International Ltd, The Alaskan Trader* [1984] 1 All ER 129

<sup>21</sup> E.g., Douglas who says that the system is a hybrid construct: Z. Douglas, 'The Hybrid Foundations of Investment Treaty Arbitration' (2003) 74 BYIL 151 at p.151-153. This does not sit comfortably with a positivist construction of international law that says that the system has to be moderated in the public sphere of state action, rather than through control of private arbitrators or a single national court reviewing decisions. Cf. See, E.g, J. Klabers, 'On rationalism in politics: Interpretation of Treaties and the World Trade Organisation' (2005) 74 Nord. Jnl. Int. law. 405 at p.406-408 & p.411.

some case for municipal courts to give the policy maker or law-maker a wide measure of discretion in policy-making areas.<sup>22</sup>

One key reason for ‘deference’ is that many Contracting Parties to investment treaties will be developing countries, as well as some from the first world. In either instance complexities of policies, as highlighted below, may suggest why it would be important to defer to national governments as to whether policy changes that affect the investor are appropriate.<sup>23</sup> This discussion also provides some guidance as to when there may be appropriate justifications to change policy, to defeat a claim for substantive legitimate expectations. There will be different social needs and political exigencies that may come into play. For example, the theory that prisons is a method of effectively dealing with crime, may be subject to change as it is based on certain assumptions that may be proven to be false.<sup>24</sup> This may result in a state changing its policy to build a prison that will have an impact on an investor involved in its construction not being granted a permit. It is clear that expropriation should follow. However to say that the investor has a legitimate expectation that the prison is to be built and the licence granted appears a dubious usurpation of social policy making powers by the arbitral tribunal. The tribunals also need to appreciate the need for a change of environmental policy. States may not have realised the importance of legislating for the private sector to control environmental pollutions and may later need to legislate for such exigencies<sup>25</sup>. The investor ought to be wary, as in *Methanex* that the state may take such measures<sup>26</sup>. Professor Craig has characterised the

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<sup>22</sup> The European Court of Human Rights does this through the doctrine of ‘margin of appreciation’. See Y. Shany ‘Towards a general margin of appreciation in international law’ (2005) 16 EJIL 907 at p.907-912.

<sup>23</sup> This is explained in chapter 5 which deals with the concomitant rise of administrative law and the modern regulatory state.

<sup>24</sup> S. Karstedt & K. Bussmann, *Social dynamics of crime control-New Theories for a world in transition* (Hart) (2000) at p.148-152.

<sup>25</sup> Thus in the Eastern block this only started to occur in the early 1990s- See R. Bluffstone & B.A. Larson *Controlling Pollution in Transition Economies* (Edward Elgar) (1997) at p.1-3.

<sup>26</sup> There may be merit in this approach, though it is not the impact of narrowing Article 1105 as thought by C. C. Kirkman ‘Fair and Equitable Treatment: *Methanex v. United States* and the narrowing scope of Article 1105’ (2002-03) 34 Law & Pol Int’l Bus 364 at p.364-367.

legitimate expectations doctrine's choice between procedural and substantive rights as a '*dilemma as between legality and justice*'.<sup>27</sup> However, as intimated using the doctrine to adjudicate in the policy sphere to find justice is a high-risk game such that legal adjudication is best suited to defer legality.

*Explaining the case for deference further: Implicit policy deference in English law to protect public interest.*

Another case for deference is provided by the English law on legitimate expectations described in this thesis. The English case law demonstrates deference in varied areas by municipal courts applying the doctrine. The decisions intimate that Government policy is too intricate for courts to adjudicate by virtue of the judicial reluctance to apply the doctrine to grant substantive rights. In the municipal law the courts have not interfered with Government employment contracts, criminal justice policy, tax policy, planning policy, immigration policy and national security policy.

A similar approach is seen from the ECJ by virtue of the adherence to the principle of legality. Investment treaty arbitration has gone further in that its application of substantive legitimate expectations is not restricted by the doctrine of legality in cases such as *Durbeck*. There the legitimate expectations doctrine is used as a powerful check against government policy change almost like an estoppel.

There are good reasons why a cautious and more deferential approach following the principle of legality over the detrimental reliance approach may be suited. As stated in the first chapter courts are not designed to adjudicate in the policy-sphere. State policy is complex and subject, in its formation and maintenance, to a varied range of factors beyond judicial appreciation. This is why municipal public law follows legality (the law and policy of the state) and does not go against it. As a basic valid proposition all State policy is subject to change as it

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<sup>27</sup> P. Craig, *Administrative Law* (OUP) (2006) at p.621.

is subject to limitations of expenditure, changes of social need, and changes in social consent<sup>28</sup>. A judicial process is not suited both in terms of legitimacy<sup>29</sup> or capacity to deal with these processes.

Entrenching one field of policy play to grant justice to one individual may work against the public interest in the policy itself and may have implication in the disposition of other policies, as the French case of *Credit Arvole* shows. Looking at the complex nature of policy highlights a want in judicial potential to appreciate what the public interest is. As to capacity, this fact can be ascertained from analysing the basic nature-tax and fiscal policy itself. Public policy is carried out due to social policy programmes of the state, for example ensuring a basic level of water supply or housing for individuals.<sup>30</sup>

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<sup>28</sup> Social consent may be vital to policy considerations. For example, lack of funding may lead to close a mental-health hospital that may result in the opening of a community care programme for the patients. This may be due to consent of the community to such a policy through the desire to have more patient participation in the community and a different approach to mental-health care- See B. Whaf, *Community and social policy in Canada* (McClelland & Stewart) (1992) at p.37. Thus, it would not be feasible that an investor who ran the hospital would have a legitimate expectation that it would remain open. On a different note, a state's concerns over employment may lead to non-grant of permits as it may need to promote some businesses over others. This may result in forcing a change of location of the investment due to this social concern, See: K. Banting, 'Social Policy challenges in global society' in Morales-Gomez & Torres Eds., *Social Policy in a global society, parallels and lessons from the Canada-Latin American experience* (IDRC Canada) (1995) at p.27-55. Only a careful review, that appreciates the state's social policy framework, by the arbitral panel will such conduct not be found to be a breach of fair and equitable treatment and discrimination provisions in the investment treaty. C.f. A Similar point could be made in relation to environmental concerns in *Metalclad*, See, *Metalclad Corp v. United Mexican States* (2005) 5 ICSID Rep 209 at p.227-230.

<sup>29</sup> Modern democratic regimes rely on legislative legitimacy on the basis of electoral consent. Hardin states: 'democracy grounds political order in the consent of the Governed' in R. Hardin, *Liberalism, Constitutionalism, and Democracy* (OUP) (2003) at p.141, & p.142-145. For limitations of theory see p.152 et subsq.

<sup>30</sup> For example of a discussion of a policy of creating available of social housing in the UK to deal with situations where landlords are insolvent or facing commercial difficulty and thus increasing rents see J. Driscoll 'What is the future for social housing: reflections on the public sector provisions of the Housing Act 1996' (1997) 60 MLR 823 at p.827. In this instance the state will provide public funds for landlords that provide social housing, this will have implications for revenue and land-use.

Public policy will involve public spending and its scope will be based on revenue and its availability.<sup>31</sup> Revenue policy is part of the greater economic policy of states, which differs between states.<sup>32</sup> Policy is subject to change due to change due to social needs and available revenue<sup>33</sup>. Democratic needs, social change and the continuous differing needs of the populace are all reasons for the state to change its law and policy in all areas. It is no doubt feasible that these will have a range of affects on the investor (some even being the level of indirect expropriation under obligations in investment treaties). However to entrench policy by applying the legitimate expectation doctrine is questionable, due to the effects it will have on other policy areas of the state. This is because such an estoppel may act as a revenue constraint and also, where there is a limit to policy-making capacity, hinder policy-making capacity in other fields. It would be difficult, for example, to entrench tax-policy as the decision in *Occidental v. Ecuador* has sought to do. Tax policy depends on revenue and is one area could mean an increase in revenue in another. It is quite feasible that tax policy will impact upon the investment and result in a loss<sup>34</sup>. If an arbitral tribunal entrenches an area of tax policy it is applying the doctrine of public law against the public interest by saying the individual investor's damage has a greater claim in the policy sphere than the host-state national. The arbitral tribunal would thus be claiming legitimacy for host-state policy making. For states to avoid liability the result would be for states to either (i) compensate the investor for the revenue increase (if the obligation exists in the investment treaty<sup>35</sup>, or avoid (ii) taxation in areas

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<sup>31</sup> The availability of revenue is subject to complex economic calculation. See S. James & C. Nobes, *The Economics of Taxation* (3<sup>rd</sup> Ed Philip Allan, Publishers Ltd (1998)) at p.22-54. This beyond the sphere of competence of arbitral panels that are drawn from commercial lawyers and legal academics: See, Van Harten, (n8 above) at p.168-170

<sup>32</sup> The complexity of revenue prioritization for policies in the developing world is illustrated by Afrentiou in P.C. Afrentiou, *Fiscal Policy and Economic Development* (1976) 14(2) *The Develop. Econ.* 164-178.

<sup>33</sup> All policy making is subject to revenue-based limitations. For example in relation to education, See H.F. Ladd, *Making Money Matter: Financing America's Schools* (Nat. Res. Cncl. U.S.A) (1999) at p.1519.

<sup>34</sup> *Feldman v. Mexico*, ICSID Case No. ARB(AF)/99/1. (NAFTA) (16/12/02) at para 100-101.

<sup>35</sup> Note that in some ways the developing doctrine of indirect expropriation has played feasibly into the tax area, See at *Tecnias Medioambientales Tecmed SA v. United*

where there is a feasible interaction with the investment. Alternatively, investment tribunals can take a more cautious approach and avoid a possibility of deleterious affects by rejecting such claims in altogether.

Another are of policy that will be subject to multifarious factors in design and implementation is land-use policy. Thus an investor that appears to use the land, such as the claimant in the case of *Metalclad*, for a particular purpose may find that licence for that use revoked or not granted as the state may need to have a different policy of land-use for that particular piece of land. The decision of a state for the use of land for a commercial related activity has to be carefully considered. For example, the grant of a permit to use land to build an airport may involve the following considerations: (i) saving of public money, (ii) the need for farm land, (iii) the preservation of existing rural areas, (iii) noise pollution, (iv) environmental pollution, (v) adverse affect on tourist-trade, (vi) adverse affects on business and trade<sup>36</sup>. These factors may cross-apply into other areas of land-use.<sup>37</sup> Environmental policy is also subject to complicated mechanisms of creation, such as assimilation of scientific data on the impact of certain substances and, further, input of social groups.<sup>38</sup>

The latter is particularly important if any regulation passes as a policy is created is adhered to. In some ways the investor does not have an input on this process, barring the executive stage where a procedural legitimate expectation gives him some participation. However it is difficult to see why this participation should or would equate to social participation. On the other hand an investor may claim that his treaty right entitle him to the same level of participation in the determination of such policy as those locally socially concerned. His financial interest is thus equate to the social interest of the public in realising or not a

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Mexican States (2004) 43 ILM 133, at paras 113-116 and application in Feldman (n33 above) at paras, 100-101.

<sup>36</sup> C. Buchanan, *The Standstead Controversy, no way to the airport* (Longman) (1981) at p.2-14.

<sup>37</sup> See B. Cullingworth & V. Nadin, *Town and Country Planning in Britain* 13th Ed (Routledge) (2002) at p.1-12.

<sup>38</sup> S. Aguilar 'Corporatist and Statist Designs in Environmental Policy: The Contrasting Roles of Germany and Spain in the European Community Scenario' (1993) 2 Environ. Pol. 233 at p.234, referring to environmental policy creation purposes in Germany and Spain.



particular environmental policy. Often domestic processes of policy making give affected corporate entities an input into environmental policy.<sup>39</sup> It is not clear if investment treaties should play a role of giving the investor rights at the policy making stage. This may be a feasible alternative to the harsher impact of an estoppel approach that leads to damages.

Similar examples can be demonstrated from educational policy. This will have an impact on a hypothetical investor coming investing in a policy of state privatisation of teacher training.<sup>40</sup> The State then realises that it no longer has the quanta of need of so many teachers as it there is a labour shortage and the State decided to pass a law to change the school leaving age from 18 to 16. The investor then suffers loss a legitimate expectation that would grant substantive rights would fix the state's policy.

Education policy is also a complex area of policy-making. The shift in education policy is highly feasible considering the various factors that go into making state education policy. Thus an investor that comes in to build schools for a state or run a private educational establishment may suffer loss from a change of policy on the type or amount of school being built. The state education policy may depend on the affordability of suitable teachers.<sup>41</sup> There may be a change of public choice in the type of school being built.<sup>42</sup> There will also be revenue-linked limitations. This latter restriction applies, as stated, to different areas of

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<sup>39</sup> Ibid.

<sup>40</sup> The search for increased education in developing countries is encouraged by the UN Millenium Goals that may lead to a foreign investment to assist in obtaining this aim- See, M. Kremer 'Increasing School Participation' in 'The Contribution of recent innovations in data collection to development economics, randomized evaluations of educational programs in developing countries: Some Lessons' (2003) 93 The American Economic Review 102 at p.102-107.

<sup>41</sup> J. Currie, 'Employment determination in a unionized public sector Labor-Market: The Case of Ontario's School Teachers' (1999) 9(1) Jnl. Lab. Econ. 45 at p.63.

<sup>42</sup> For a discussion between the link between national educational curricula and public choice, See M. Holmes, *Education policy for the pluralist democracy: the common school choice and diversity*. (London. Falmer Press) (1992) at p.68-84. A foreign investment in schools may still be subject to government interference through national laws on curriculum changing. A right under substantive legitimate expectations may not be appropriate here.

Government policy may have to be altered due to short-coming in State financing due to change in the performance of the economy and thus taxation.<sup>43</sup>

Thus policy-making is done on a public need and public utility basis and is based on available revenue. All areas of policy-making are complex and involve multi-tiered research and analysis.<sup>44</sup> This may be a good reason to have ‘deference’ to the law-maker when applying FET.

*Deference to state intent in treaties.*

Deference to state consent may also operate to preclude a norm creation role for arbitration (if states do not wish a legislature) on the basis that there is no authority to do so without express state consent. Thus under an absence of express state consent to create rules or the inclusion of FET rules in treaties arbitrators may wish to defer to the literal language of the treaty as being the limit of state consent. From this point of view FET would mean ‘Fairness’, and where relevant, ‘equity’ as traditionally understood in international law.<sup>45</sup>

#### **D. Possibly Expanding the Legal Framework.**

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<sup>43</sup> For a basic account of the relationship between revenue and taxation, See, calculations for the UK Treasury’s official income and expenditure audit for central and local Government for 1996/7 in the UK Government’s annual spending proposal. For each year the public sector spending is based on revenue: N. Barr *The Economics of the Welfare State* 3<sup>rd</sup> (OUP) (1999) at p.170-171.

<sup>44</sup> Policy-making theorists often propose different factors that go into public policy-making. Thus the following key factors in public policy-making: historical and geographical conditions, social and economic composition, mass political behavioural tendencies. See, W. Parsons, *Public Policy-An introduction to the theory and practice of policy analysis* (Edward Elgar Publishing) (1995) at p.17-32.

<sup>45</sup> Equity is usually applied to dealing with territories and other quantitative calculations in international law. See, M.N. Shaw, *International Law* 6<sup>th</sup> Ed. (Cam. Uni. Press) (2006) at p.590 & p.1087.

In the developing world, there are preconceptions about the harm that foreign investors represent to local communities and resources.<sup>46</sup> The open-texture of FET could be used by arbitrators to alleviate these concerns of local people in the developing world regarding foreign direct investment. A part of this could be to incorporate an investor's burden of a social impact assessment through FET.<sup>47</sup>

This would assist in detecting harmful local impact of FDI on society, and can increase the potential of legal adherence by subjects of transplants.<sup>48</sup> A part of this would be broadly framed CSR obligations, that will also allow the investor and the rights it claims on domestic institutions to be more acceptable to locals. There could also be CSR encouraging a positive local involvement for the investor.<sup>49</sup> This could water down any public perception issues with public interest conflict that arises from having a substantive legitimate expectations doctrine.

#### **7.4. Adjudicatory System Alterations.**

On a literal reading of the FET standard there is no mandate for the construction of administrative law or a governance role to improve state institutions. Legal frameworks construed for this role are, of questionable of legitimacy as they are without direct state consent.<sup>50</sup> A key to alleviating the lack of direct state may be to afford state parties affected by the rule to be able to participate in the decision-making process of the legal framework under FET.

The creation of rules under FET is also partially a result of the lack of clarity over whether there is power granted to arbitrators to make rules, as well as open-texture drafting of FET. An investment court would go some way towards

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<sup>46</sup> For impact on indigenous culture of FDI, See: D. Estelle Long, 'The Impact of Foreign Investment on Indigenous culture: An intellectual property perspective' (1997-98) 23 N.C. J. Int'l & Comp. Reg. 229 at p.229-234.

<sup>47</sup> H.A. Becker, 'Social Impact Assessment' (2001) 128 Eu. Jnl. Op. R. 311 at p.312.

<sup>48</sup> H. Rittick, 'The Future of Law and Development: Second Generation Reforms and the incorporation of social rights' (2004-05) 26 Mich. Jnl. Int'l 199 at p.213-221. For similar methods of legal ordering in international governance, See: R. Wai, 'Transnational Private law and Private Ordering of a Contested Global Society' (2005) 46(2) Harv. Int'l L.J. 471 at p.483-484.

<sup>49</sup> R. Jenkins, 'Globalisation, Corporate Social Responsibility and Poverty' (2005) 81(3) Int. Aff. 525 at p.534-540.

<sup>50</sup> See Chapter 5 discussion on consent.

creating the legal certainty that currently affects the ICSID dispute system annulment process.<sup>51</sup> As substantive application of the legitimate expectations doctrine shows this has allowed an ad-hoc commercial dispute-resolution process to conflict with important national policy, and conduct of institutions of national states. Hence, as well as altering treaty provisions, any discretion given to arbitrators may need to be accountable to states.<sup>52</sup> This requirement of control could be provided by both a court suitably equipped to create obligations that take into consideration state's abilities to adhere to rules.

With selected input a court could create workable norms that provide guidance to states as to what investors will need to be protected and that they can afford to comply with these rules. Further, as an example of the cost benefit analysis<sup>53</sup> that arbitrators can be carried out is given one by looking at a case of nuisance where private property interests are running up against commercial interests. In *Sturges v. Bridgman* a confectioner who makes sweets in his shop, is met with a claim for an injunction from his next-door neighbour doctor.<sup>54</sup> The doctor carrying out his practice is hindered by noise from the confectioner's shop.

Here the judge decides to favour the doctor. What is not taken into account in such a decision is the commercial tax that might be raised from the now precluded practice of the confectioner, as opposed to a limited tax from the doctor, and the public benefit of such tax that could be used in welfare policy. Nor is it weighed against the availability of the particular health provision in

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<sup>51</sup> See: K.S. Jacob, 'Reinvigorating ICSID with a New mission with a renewed respect for Party Autonomy' (1992-93) 33 Va. J. Int'l 123 at p.125-126. Note that Van Harten's case for a court is distinct, it is not based on coherence but on the fact the ITA effects public policy through privately appointed arbitrators. See Van Harten, *Investment Treaty Arbitration and Public Law* at p.180-181.

<sup>52</sup> A description of the relevant failures of accountability of the present system as being inadequate, though done with respect to coherence, are discussed in detail by Franck. This includes a weak control annulment mechanism for ICSID, the only way to review ICSID decisions. See S.D. Franck, 'Legitimacy crisis in Investment Treaty Arbitration: Privatising Public International Law through Inconsistent Decisions' (2005) 72 Ford. Law. Rev. 1521 at p.1551-1559.

<sup>53</sup> R.H. Coase, 'The Problem of Social Cost' (1960) 3 Journal of Law and Economics 1 at p.10-14, discussing the Chancery cases of *Bryant v. Lefever* (1878-1879) 4 C.P.D 172 and *Sturges v. Bridgman* (1890) 25 Q.B.D. 481; This piece has been criticized-S.G. Medema, 'Legal Fiction: The place of the Coase theorem in law and economics' (1999) 15 Econ. and Phil. 209 at p.209-210.

<sup>54</sup> (1879) 11 Ch. D. 852

question. Thus the broader issues associated with the outcome are not taken into consideration by adjudication. The problems of adjudication to create rules is it is difficult to extrapolate general policy from specific disputes brought before courts. Hence it is better that policy should be left to legislatures that can be equipped to create and define it.

This guidance would include cost-benefit analysis of the implications of the application of investment protection rules such as legitimate expectations cases such as *Azurix*, where general public interest for cheap water conflicted with the investors profits. The benefit to both state parties, if a bilateral treaty, in terms of the benefits of profits taken to the investor' state through its national, would be weighted against the gain in foreign investment and the public interest cost to the host-state. As FET leaves it open to arbitrators to make such decisions with substantive legitimate expectations the system could be altered to assist them in the making of such determinations.

The procedural process of dispute resolution could be altered so that investors from party states, as future claimants, could pro-offer rules that they wish to be subject to a cost-benefit analysis to adjudicators. This is similar to the NAFTA Article 1121 procedure available to states that allows statements of interpretations to be made via the FTC.<sup>55</sup> They could also offer new standards of treatment that their investment would have assisted from had that being provided by the state.

Thus, prior to adopting specific legal positions, such as transparency, the state would be able to make submissions on legal positions as to why these would not be appropriate. Though this may make the system more expensive and longer it would be fairer to all contracting parties of investment treaties that the investor had been fairly treated bearing in mind what *the state could afford both monetarily and in terms of its current institutional development and existing policy priorities*. Bearing in mind the current cost of adverse decisions in investment treaty arbitration, this may be preferred by contracting parties, at least those who are in the developing world.

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<sup>55</sup> T Free Trade Commission, 'Notes of Interpretations of Certain Chapter 11 Provisions' (31/07/01) 13(6) Wld. Trd. & Arb. Mat. 139, art B(1).

## A. Institutional Transparency

Ensuring that investment treaty arbitration is a transparent institutions are is important to legitimise the interpretations of the fair and equitable treatment standard.<sup>56</sup> This is particularly so for transparency as this is demanded from states by the system, it is important that the system is not open to abuse of double standards.<sup>57</sup> At present hearings are closed and not all awards are published. Hearings ought to be made public so that citizens affected by concerns over investors could see the dispute. Although the advantages of the present system of arbitration is close-door hearings to preserve commercial confidences, there is no reason why this could not be offered with a court, in exceptional circumstances.

For example, closed door evidential hearings relating to admissibility in common-law criminal systems, termed *voire-dire*, could be used where there is confidential matters to be discussed and the public are asked to leave the court room.<sup>58</sup> In this way public participation and commercial confidentiality could be balanced in a way that is absent at present.

Further improvements to transparency could include models of direct input of public interest that are currently discussed as a part of WTO reforms.<sup>59</sup> There ought to be considered an automatic right to participation for NGOs or special public interest representatives in proceedings.<sup>60</sup> This is at the very least where particularly where substantive legitimate expectations of investors are

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<sup>56</sup> D.E. Skegg, 'How can Parliamentary Participation in WTO Rule-Making and Democratic Control be made more effective in the WTO' A United States Congressional Perspective' (2004) 7(3) EJIL 655 p.655-658.

<sup>57</sup> See Van Harten (n8 above) at p.159-160.

<sup>58</sup> B. A. Babcock, 'Voir dire: preserving its wonderful process' (1974-75) 27 Stan. Law. Rev. 545 at p.545-547.

<sup>59</sup> See E-U. Petersmann, 'Challenges to the Legitimacy and Efficiency of the World Trading System: Democratic Governance and Competition Culture in the WTO: Introduction and Summary' (2004) 7 (3): *Jnl. Int Econ. Law* 585 at p.590-593

<sup>60</sup> T. Ishikawa, 'Third Party participation in investment treaty arbitration' (2010) 59(2) ICLQ 373 at p.373-381.

claimed that conflict with public interest so that conflicting policy implications can be assessed.

At present this is left to the consent of parties. It may be important that some groups, who have an interest in the claim or wish to demonstrate harmful social impacts of investor conduct, get an opportunity to discuss the problems of associated with certain legal positions under FET.<sup>61</sup> NGO participation has significantly improved the distributive benefits of international governance.<sup>62</sup> This is through ensuring that adverse impacts of trans-national commercial activity, such as environmental consequences are considered in norm-making. Although not all public interest issues can be represented through the NGO medium, and NGOs on occasion represent politicised groups.

## **B. An investment court.**

There is a degree of uncertainty caused by lack of exact formulations of legitimate expectations and transparency causes jurisprudential incoherence. This is partly caused by the choice available to claimants, states and arbitrators as to which decisions to apply due to the sources of international law allowing assistance from previous arbitrations to interpret FET. This undermines the creation of a rule of law-based system that will fairly outline investor's rights and host-state's obligations. The incoherence impacts on the overall legitimacy of the system.

A permanent investment court with accountable judges and an appellate regime would be a useful suggestion to increase coherence.<sup>63</sup> Judges would be appointed by states to ensure that the court is accountable to states, thus assisting the law commission's norm creation role by ensuring that aberrant acts can be

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<sup>61</sup> K. Raustiala, 'States, NGOs and International Environmental Institutions' (1997) 41 Int Stud. Qrt. 719

<sup>62</sup> S. Charnovitz, 'Two Centuries of Participation: NGOs and International Governance' (1996-97) 18 Mich. J. Int'l 183 at p. 274-276. Though, as Charnovitz notes, a proliferation of NGOs may cause difficulty in assessing technical expertise of each one when determining which should have input due to procedural costs forcing a selection (*ibid*).

<sup>63</sup> For a different view See also, Van Harten (n49 above) at p.180-181.

made accountable. With compulsory input from state parties prior to norm creation as to their views and likelihood of logistical compliance with such obligations, the system would be much closer to the intentions of state parties.

Arguments against this could be that the advantages of commercial arbitration, namely flexibility and speed, would be lost. But it is no means clear that investment treaty arbitration operates in its correct form in a manner similar to classic commercial arbitration between two private parties. The cost of lodging ITA claims, for example, are significant and the timing of the process is not short.<sup>64</sup>

Self-rectification of arbitral elucidation may be possible under a system of binding precedent. This would close the choice of arbitrations approach through using previous decisions to assist in interpreting FET, as allowed by the law of treaties. However limitations on binding precedent also need to be appreciated in such a proposal. These include the possibility that precedent can make adjudication less flexible leading to injustice. Engaging precedent with a law-must not decrease flexibility of deciding disputes on a case by case basis. This may be remedied by having a flexible court, and a rectifying appeal court where boundaries of applying rules, or creating them with respect to state consent are overreached. Direct state input during the creation of an FET interpretation by the court of first instance could ensure that rules are realistically complied with by states, and are empirically likely to benefit both investors and the state when complied with.

There has been some support for the view that introducing an appellate or similar controlling regime for arbitrators using FET will not assist in settling 'legal interpretation'.<sup>65</sup> One argument is that it will simply make it less likely to control jurisprudence developing in one direction, once there is a consensus in the appellate regime as to a particular legal framework. Thus such a regime of

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<sup>64</sup> See for example, costs of \$4 Million awarded in *Europe Cement Investment & Trade S.A. v. Republic of Turkey* ICSID No. ARB (AF)/07/2 at p.33. Note also that the *Metalclad* dispute took over 4 years from launching proceedings to the final domestic court resolution. (For launch: *Metalclad Corp. v. UMS* Case No./ARB/AF/97(1) at para 11. For resolution See *UMS v. Metalclad* (2001) BCSC 1529).

<sup>65</sup> S. Montt, (n1 above) at p.155-159



appointed judges in a precedent style appellate system would not be able to then rectify legal errors, and would on the other hand entrench them.<sup>66</sup> Montt's advocacy of this is based on the lack of control over such issues legislatures have on constitutional courts rectifying lower court rules.<sup>67</sup>

However, this problem could be avoided by precluding all judicial norm-making activity without express state consent. As stated the law commission would allow state input as to appropriate rules, either by interpretative declarations or by clearly defined restrictions in treaties.<sup>68</sup> This will assist the appellate investment court in ensuring that the investment court acts within the legal framework. An appellate body will, however, deal with developing country concerns as to the misapplication of rules by investment judges.<sup>69</sup>

### **C. Treaty Alterations.**

The implicit mandate for current FET interpretations that contain administrative law and restrict regulatory action is that they may encourage cross-border investment by creating commercially favourable circumstances within states.<sup>70</sup> This choice of economic growth through administrative and regulatory liability to foreign investors was not however a choice presented to Contracting Parties of investment treaties at the time negotiation.<sup>71</sup> It is a value imposed by arbitrators.

As suggested earlier, they have not been able to weigh it against other costs and benefits that such liability may create. Further, these rules may bring about excessive cultures of litigation through arbitration amongst investors that may be

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<sup>66</sup> On a simple level this concern may not be so convincing as the system, on one reading, does this anyway.

<sup>67</sup> Montt (n1 above) at p.156.

<sup>68</sup> Montt has appreciated this point, (n1 above) at p.156

<sup>69</sup> A.H. Quereshi & S. G. Khan, 'Implications of an appellate body for investment disputes from a developing country point of view' in K. Sauvant (ed) *Appeal Mechanisms in International investment law* (OUP) 2008 at p.277

<sup>70</sup> D. Trubeck, 'Max Weber on law and the rise of capitalism' [1972] *Wis. L. Rev.* 720 at p.720-723.

<sup>71</sup> R. Dolzer & M. Stevens, *Bilateral Investment Treaties* (Martinus Nijhoff Publishers) (1995) at p.1-29.

harmful to the economic growth of developing states by the sheer quanta of damages that these awards grant.<sup>72</sup> Further when implemented, they may increase cost of administration as states try to ensure compliance with standards. For this reason states may wish to have express provisions in the treaty to be able to directly choose such liability.<sup>73</sup>

Further, the administrative and regulatory governance role is beyond the express consent of Contracting Parties, and only feasibly legitimate through implication. The phenomenon of how individual agents, such as commercial entities, can utilise international treaties and institutions for beneficial legalised governance is not new international law.<sup>74</sup> Considering that the problems with this governance role is the lack of knowledge of desired impact of rules of FET on domestic institutions lacks empirical support, the creation of FET rules is also of questionable validity based on implicit state consent that they further the aims of investment treaties of capital protection and promotion. It is not clear how

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<sup>72</sup> Van Harten (n7 above) at p.1-3.

<sup>73</sup> B. Choudhary & P. Kulkarni, 'Re-crafting bilateral investment treaties in a development framework: A comparative regional perspective' in A. Deshpande Ed., *Capital without borders: Challenges to development* (Anthem) (2010) at p.209-218.

<sup>74</sup> K.W. Abbott & D. Snidal; 'Hard and Soft law in International Governance' (2000) 54(3) *International Organisation* 421 at p.421-433. This may give rise to the perception that the investment institutional set-up is biased towards one agency (the investor) and may undermine its legitimacy. This may be due to its lack of ability to represent or appreciate public interest within a given investor claim. Cf. D. Bodansky; 'The Legitimacy of International Governance: A Coming Challenge for International Environmental Law?' (1993) 93 *AJIL* 596 at p.597-p.600, Note particularly the possible requirement of 'independence' of international institutions as a basis for legitimacy, at p.599. S.D. Franck, (n 18 above) at p.1529-1536. Policy orientation by international organs, such as 'trade' can often be used to incorporate soft-norm Governance-See, P.R.Trimble 'Globalisation, International Institutions and the Erosion of National Sovereignty and Democracy' (1997) 95 *Mich. L. Rev.*1944, at p.1947-1948. Investment arbitral panels can undertake a similar role. This is through pursuance of the policy of 'facilitation of the import and export of capital'-See A.T. Guzman, 'Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties' (1998) 38 *Virg. Jn'l of Int Law* 639 at p.639-647. Public protests may form justification through the lack of participation or lack of clear manifestation of public interest-See P.Nanz & J.Steffek 'Global Governance, participation and the public sphere' (2003) *ECPR Joint Session Workshop* 11, (<http://www.essex.ac.uk/ECPR/events/jointsessions/paperarchive/edinburgh/ws11/NanzSteffek.pdf>) at p.7-12; J. Steffek, C. Kissling & P. Nanz *Civil Society Participation in European and Global Governance: A cure for democratic deficit* (Palgrave: Macmillan) (2008) at p. 5-12. This risk may be evident in investment arbitration as the investor is permitted to claim against Government regulatory or administrative activity carried out in the public interest (See chapter 6). Appreciation of this by the investment arbitral panel may be particularly important, where it seeks a balanced construction of standards incorporated under the fair and equitable treatment standard.

some developing states would have taken on such costly burdens even if they did reap the benefits of foreign investment, or if they have weighed the costs of such rules against the benefits that foreign investment would bring.<sup>75</sup>

To respond to this the next generation of bilateral investment treaties could expressly allow statements from states in relation to proceedings. This is similar to NAFTA's FTC.<sup>76</sup>

This latter aspect would reduce coherence and lack of accountability by giving states an opportunity to directly sign-up rules and reject unfavourable ones. Alternatively, on the present system, incorporating FET rules directly into draft treaties for states to ratify is the only way of maintaining clear consent for FET rules. The ambiguity surrounding the text of the FET standard and the incoherence of the current jurisprudence, both issues could be solved by specific incorporation of FET rules, including, how they are engaged and their scope in investment treaties.

Further the restrictions on their scope, thus making it absolutely clear whether domestic laws and regulations could be overridden by the dispute resolution system. As highlighted by the coherence analysis, a problem of review without deference is that will cause domestic legislative and regulatory uncertainty where some decisions grant substantive review and others do not. This harms the cohesiveness of FET jurisprudence and makes it more difficult for subjects to prepare for the burdens of obligations. Further review without deference could end up rendering domestic legislative processes unpredictable. To deal with this it is important that states can expressly bargain for standards to have such a scope and treaties state clearly that they do so.

*Legal Transplantation of Administrative Law and a case for direct consent by states.*

Issues in relation to legal transplantation also suggests a case for direct consent through express treaty provisions, due to the problems of FET rules

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<sup>75</sup> A.T. Guzman, at p.639-41.

<sup>76</sup> (n54 above).

administrative accountability being expensive, and difficult to comply with states which are reforming their legal systems towards a functioning rule of law. Like FET norm creation, rules in legal transplantation were based on a legal framework operating in a Western model of government and economic development.<sup>77</sup> The initial application of transplantation failed to appreciate that the transplanted law cannot of its own bring about economic and governance improvements.<sup>78</sup> Thus transplanted rules did not create the desired institutional development and economic benefits that their proponents thought. Failure on this front is not a result of the rules themselves, but rather the lack of appreciation of the differences in economic capacity and social culture between the state of origin and the new host.<sup>79</sup>

Problems brought about by transferring models of law across jurisdictions have been associated partially due to the desire, of both states and theorists, for rapid economic growth.<sup>80</sup> This, as Trubeck suggests, is related to the lack of compatibility of legal rules to their new host-state. This is particularly the case where there is a disparate historical development to the states from where the norm originates to the new state where it is found.<sup>81</sup> If administrative law rules, incorporated through fair treatment, are said to be legitimate because there is a presumption that they assist in economic development, then the problems of compatibility and cost faced by legal transplantation question such a presumption. Whether they do this needs to be put on an empirical footing and analysed by states so that they are aware of what changes in domestic legal culture, and institutional behaviour need to be undertaken to adhere to them. Further, states in the developing world need to be given an opportunity to look at the rules and

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<sup>77</sup> Galanter, 'The Modernisation of Law' in M. Weiner, *Modernization* (Basic Books) (1966) at p.153-160 & p.164-165.

<sup>78</sup> This is a fundamental part of law and economics, and has been picked up in the law and development field. See Massell, 'Law as an Instrument of Revolutionary Change in a Traditional Milieu: The Case of Soviet Central Asia' (1968) 2 Law & Soc'y Rev. 179 at p.227-228.

<sup>79</sup> See Chapter 3.

<sup>80</sup> See E.M. Burg, 'Law and Development: A Review of the Literature & a Critique of 'Scholars in Self-Estrangement' (1977) 22 Am J. Comp. L. 492 at p.506.

<sup>81</sup> D.M. Trubeck, 'Max Weber on the rise of capitalism' (1972) 3 Wisc. Law. Rev. 720 at p.720-728.

determine whether they wish to be bound by them, by doing a cost-benefit analysis regarding the benefits of reform and costs undertaking it.

A basic analysis a state could do prior to consenting to such rules is shown by two illustrations of law and development failures of transplantation. These claim that some of the areas that transplants need to factor in to be effective are: (i) Domestic acceptability and costs of Transplants; (ii) Strategising for the difference between the intended conduct a norm brings about and the actual conduct in the host-state.<sup>82</sup> To be an effective system of legal transplantation, the norm transferring institution needs to ascertain the level of behavioural change on the ground required to comply with new laws.<sup>83</sup> At present FET transplantation is an inherently a legislative process that operates without the consultation or consent of national democratic legislatures that will affect their ability to prepare for and implement FET type rules. How to bring about those changes in the host-state will be a critical part of the implementation of transplants undertaken by the investment law commission.

Further, the use of administrative law in transplants, due to its roots in theories of democratic accountability is itself subject to criticism as being Western in origin, or from alien cultures.<sup>84</sup> There is no express provision in investment treaties that requires rule of law based accountability of the state to investors, yet arbitrators have created burdens under FET that do exactly this without state consent.<sup>85</sup>

Another problem of legal transplantation is that it often assumes that there is a relationship between the conduct of institutions and formal law.<sup>86</sup> Transplantation, assumed is that formal law would have its designed impact on assisting bringing about the rule of law in transition economies. It did not appreciate that with some rules, that social conditions themselves had formulated

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<sup>82</sup> J.M. Otto, W.S.R. Stoter, & J. Arnscheidt, 'Using legislative theory to improve law and development projects' in J. J.M. Otto, B. Van Rooij, J. Arnscheidt Eds. *Lawmaking for development, Explorations into the theory and practice of International Legislative Projects* (Leiden) (2008) at p.54-55.

<sup>83</sup> *Ibid.*

<sup>84</sup> See B. Rajagopal, *International Law from Below: Development, Social Movements and Third World Resistance* (CUP) (2003) at p.155-161.

<sup>85</sup> (n80 above).

<sup>86</sup> E.M. Burg, (n80 above) at p.516

the norm. Thus a lack of appreciating the *reciprocal* relationship of formation between law and society, and the limitations of each of these things to affect the other, lead to misconceived presumptions as to the success of rules altering conduct of their intended subjects.<sup>87</sup> These are crucial hurdles for compliance of FET rules in the developing world.

Burg, like Trubeck highlights that law is most successful in achieving compliance when it reflects existing customs. If this is so then if a particular FET norm is novel to the host-state, it will affect the ability of the state to comply.<sup>88</sup> This is likely for administrative law rules used for liability for transition economies where the rule of law is not fully functioning. Investment treaty arbitration as a system may need to focus, as well as liability, on the culture of conduct in public administrations and change that using non-legal techniques (those not associated with liability) before expecting long-term compliance with its created rules for investor protection.

Where there are ingrained institutional practices transplants will need gradual implementation methods that can change practices.<sup>89</sup> These include appropriate changes to conduct through training and changes in procedures in institutional practices. Rules such as transparency will need training of administrators in the developing world to adapt.<sup>90</sup> Thus it may be better for states to directly agree to these in treaties, so that they can do so when they can comply with them. Where the proposed court is left to create such rules, some method of input when creating such rules, such as a compulsory technical body (or evidence) to assist on likelihood of compliance being possible may be useful.

Such technical input could use of law and development techniques such as those of 'legal technical assistance'; 'institution building' and 'legal education' may assist investment arbitration towards realizing its public

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<sup>87</sup> See, L. Pospisil, 'Structural Change and Primitive Law: Consequences of a Papuan Legal Case' in L. Nader, Ed., *Law and Culture in Society* (Uni. Calif. Press) (1987) at p.208-230.

<sup>88</sup> Burg (n86 above) at p.517. See also, F.W. Riggs, 'Economic Development and Local Administration: A study in circular causation' (1959) 3 Phil. J. Pub. Ad. 86

<sup>89</sup> Burg at p.522

<sup>90</sup> *Metalclad Corp v. United Mexican States* (NAFTA: ICSID AF) (Award) 5 ICSID Rep 209 at p.228

administration standard setting. Further input could look at the real attitudes on the ground and resources available. It would realise that in certain transition economies there are a general difficulties upholding private commercial interests.<sup>91</sup> This is both due to lack of institutional components to effectuate compliance and a want of rule of law culture<sup>92</sup> This can filter into the Government sphere and influence attitudes in public administration towards private-property and commercial interest.<sup>93</sup>

## **7.6 Concluding Remarks.**

The approach of coherence is value lade. It is based on a rule of law approach to jurisprudence, there are other systems in other states that may not have legal clarity. There is a need to move away from the ability of arbitrators and parties to pick decisions and have unlimited discretion to reformulated FET rules for the sake of legal consistency. This could be done by a court with a rectifying appeal chamber and a system of precedent.

Further, the system has to take into consideration what rules states are likely to accept and be able to comply with. Thus legal positions such as subjective legitimate expectations may not be viable despite such claims being mounted by investors.<sup>94</sup> Often expectations of investors, and states, maybe unrealistic. As Franck states,

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<sup>91</sup> R.Dañino, 'The Rule of Law and Contractual Rights in Transition Economies' in M. Andenas & G. Sanders, *Enforcing Contracts in Transition Economies: Contractual Rihts and Obligations in Central Europe and the Commonwealth of Independent States* (BIICL) (2005) at p.5-6.

<sup>92</sup> K. Pistor, 'Supply and demand for contract Enforcement in Russia: Courts, Arbitration, and Private Enforcement' (1996) 22(1) *Review of Central and Eastern European Law* 55 at p.55-64.

<sup>93</sup> P. Keefer, *A review of political economy of governance: from property rights to voice* (IBRD) (2004) at p.22-23. S. Tenev, C. Zhang & L. Brefort, 'Corporate Governance and Enterprise Reform in China: Building the Institution of Modern Markets (IBRD & IFC) (2002) at p.5-28.

<sup>94</sup> See *CMS Gas Transmission v. The Argentine Republic* (ICSID Case No. ARB/01/8) (Award May 2005) at para. 317-331.

*‘Both the exporter and importer of capital may harbour false or exaggerated expectation. The former may believe that the mere act of investing in an undeveloped country should make it an object of gratitude and protect it from all risk of state intervention in its high risk venture. The latter may see the investor as little more than a thinly disguised emissary of an exploitative colonialist regime, unconcerned with the social problems of a society to which it has no real loyalty’.*<sup>95</sup>

A fundamental issue that arises, albeit incidentally, from this analysis is that contracting parties to investment treaties have not given express consent to arbitrators to use FET to create rules. These are created through a vague implication to further the aims of investment treaties of capital promotion and protection. A legal role assumed by a judicial body without a direct mandate, but through a construed mandate, can be stated to be illegitimate.<sup>96</sup> Here there is no empirical basis to show that such rules have desired beneficial effects on cross-border capital,<sup>97</sup> nor was such an analysis done prior to their creation through arbitration.

Another basis for an indirect mandate for FET rules is that they assist the end game that investment treaties are trying to pursue, namely economic development and growth. However, if investment arbitration’s mandate for applying administrative law to a myriad number of states is economic development then it undertakes a range of suppositions.

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<sup>95</sup> T.M. Franck, *Fairness in International Institutions* (OUP) (2002) at p.438.

<sup>96</sup> J.W. Nolin, ‘The Constitutional Illegitimacy of Expansive Judicial Power’ (2000/2001) 89 *Kentucky L.J.* 387 at p.387-p.445. Implied power is not the only factor in expanding judicial power. Other factors include disguising the obvious political impact of judicial decisions, See, K.J. Alter, ‘Who are the “Masters of the Treaty”: European Governments and the European Court of Justice’ (1998) 52(1) *Int. Org.* 121 at p. 129-133. An explanation for this is provided for by Gibson and Caldiera, who state that uncritical deference by developed countries towards the rule of law allow international courts and international institutions to get away with expanding their mandate and exacerbate lack of political control- See, J.L. Gibson & G.A. Caldiera, ‘The Legitimacy of Transnational Legal Institutions: Compliance, Support, and the European Court of Justice’ (1995) 39(2) *Am. Jnl. Pol. Sc.* 459 at p.482-p.484.

<sup>97</sup> The dubiousness of BITs attracting FDI has been asserted: See, UNCTAD, *Bilateral Investment Treaties in the 1990s* (1998) 177 *U.N. Sales & No.E.98 II. D.8* at p.8 ;J.W. Salacuse and N. P. Sullivan, ‘Do BITs really work? An Evaluation of Bilateral Investment Treaties and their Grand Bargain’ (2005) 46 *Harv. Int’l L.J.* 67 at p.111;



It presumes that there is a relationship between administrative law, institutional performance and economic growth.<sup>98</sup> It is here that it comes within the zone of a range of critiques related to development economics. Fundamental of these is that the development of institutions and the rule of law does not necessarily result in economic development.<sup>99</sup> This highlights the need to put the benefits of such rules to economic development on a stronger empirical footing, and this may require states to assess carefully whether FET rules can improve institutions and increase FDI, bearing in mind domestic legal culture and available revenue.

Implicit authorization for the regulatory restriction interpretation can be found from the common perception that political risk is an impediment to foreign capital.<sup>100</sup> However there is nothing in investment treaties to suggest that they are designed to curb, or create standards for regulatory activity as FET has done. Nor do they that this was a specific bargain that states gave-up between themselves in order to encourage foreign capital. Neither is it possible to deduce that the appropriateness of regulation should be left to arbitrators. Regulatory needs of states will differ according to needs to manage economic agency, thus whereas the same restrictive practice of regulation will be of little impact in one state, in another state it will be of enormous significance.<sup>101</sup>

Arbitrators have not wholly appreciated this and took it upon themselves to review state regulation in a generic way without this analysis. This makes a strong case for express treaty provisions to mandate such a role for arbitrators, or the proposed court.

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<sup>98</sup> L. Frischtak, 'Governance capacity and economic reform in developing countries' (World Bank Technical Paper No. 254;) (Washington D.C: World Bank) at p. ; A. Escobar, *Encountering Development: The Making and Unmaking of the Third World* (Princeton) (1995) at p.55-58.

<sup>99</sup>For example see South Korea in the 1960s: Steinberg, 'Law, Development and Korean Society' (1971) 3(2) J. Comp. 215 at p.216-241.

<sup>100</sup> W. Smith, 'Covering Political and Regulatory Risks: Issues and Options for Private Infrastructure Arrangements' in T. Irwin, M. Klein, G.E. Perry, M. Thobani Eds., *Dealing with public risk in private infrastructure* (IBRD) (1997) at p.45-p.53.

<sup>101</sup> M. Goodwin & J. Painter, 'Local Governance, the Crises of Fordism and the Changing Geographies of Regulation' (1996) 21(4) *Transactions of the Institute of British Geographers* 635 at p.635-p.637.

Further, there is no consent by many developing states of being bound by rules that have their conceptual origins in Western public law that desire of accountability of state organs in order to protect the rule of law.<sup>102</sup>

There is also a historical case for having direct state input into norm-making and express state consent to FET rules in treaties. Direct state input into norm making would douse historical concerns with foreign investment in the developing world. These were shown by the General Assembly resolutions that were reactions to a fear of losing control of sovereignty over resources by developing states.<sup>103</sup> The lack of consensus over the Hull formula as too onerous on national sovereignty represented these concerns of developing states in practice.<sup>104</sup>

Norm making under FET may need to be sensitive to the institutional reform may be necessary to bring about compliance with administrative law developed by arbitrators. As Frank argues that a particular intended outcome of law very much depends on the capacity of agents with respect to the norm to act in relation to it.<sup>105</sup> It would need to be sensitive to the fact that particular legal positions may have to reflect existing conduct, in terms of output and working

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<sup>102</sup>See, S.W. Schill, 'International Investment Law and Comparative Public Law- an introduction' in S.W. Schill Ed., *International Investment Law and Comparative Public Law* (OUP) (2010) at p.10-p.16.

<sup>103</sup> S.M. Schwebel, 'The Story of the UN.'s Declaration on Permanent Sovereignty over Natural Resources' (1963) 49 A.B.A. J. 463 at p.463-467. For Integrated Economic Development and Commercial Agreements See, UN GA. Res. 523 (VI),? Right to Exploit Freely Natural Wealth and Resources G.A. Res. 626 (VII) GA Res. 1314 UN GAOR, 7<sup>th</sup> Sess., UN Doc. A/2332 (XIII); Resolution on Permanent Sovereignty Over Natural Resources, United Nations G.A. Res. 1803 (XVII), UN GAOR, 17<sup>th</sup> 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, 6<sup>th</sup> 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, 29<sup>th</sup> Sess., Supp. No. 31, UN Doc. A/9631 (1974) 50, 14 I.L.M. 251

<sup>104</sup> O. Schacter, 'Compensation for Expropriation' (1984) 78(1) AJIL 121 at p.121-124; P.J. Kelly, 'Twilight of Customary International Law' (2000) 40(2) Virg. Jnl. Int'l L 449 at p.502

<sup>105</sup> T. Frank, 'The New Development: Can American Law and Legal Institutions Help Developing Countries?' (1972) Wisc. L. Rev 767 at p.788

practices of institutions, to be accepted.<sup>106</sup> This needs to be engaged by the system if it is to have an effective legal function. This, in turn, may assist transitional economies to avoid the excessive damages currently awarded in the investment arbitration system.<sup>107</sup> The technical body suggested here to be considered may help with this, as it would provide useful evidence on conditions on the ground in the developing world and make FET interpretations less formulated in the abstract based on *Western-centric* ideas of public law.

The act of ratifying investment treaties itself provides some legitimacy of arbitrators actions. On this reading the open-texture of investment treaties has given a licence to arbitrators to interpret standards as they see fit.<sup>108</sup> On this approach 'legal interpretation' has automatic validity and legitimacy.<sup>109</sup> This thus leaves the whole sphere of investment policy into the hands of arbitrators away from the control of national governments.

In contrast, the idea of substantive consent is that states would only agree with rules that are currently created through FET interpretations and its products with direct express validity and where the state is fully aware of the rules and its consequences prior to taking on the burden.<sup>110</sup> This may be particularly necessary due to public policy conflicts with substantive legitimate expectations that also make a case for deference to policy to protect it. ITA is subject to greater concern

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<sup>106</sup> See for example, formal commercial rules were introduced in post Soviet Russia by aligning them with existing business practices, J.R. Hay, A. Shleifer & R.W. Vishny, 'Towards a theory of legal reform' (1996) 40 (3/5) Eu. Econ. Rev. 559 at p.559-561.

<sup>107</sup> See, *Sempra v. Argentina*, where an award of \$128,250,000 was inflicted on Argentina at p.139.

<sup>108</sup> R. Wai, 'Transnational Private law and Private Ordering of a Contested Global Society' (2005) 46(2) Harv. Int'l L.J. 471 at p.483-484.

<sup>109</sup> A contrasting approach to this literal approach is the contextual, as broadly advocated by proponents in the field of hermeneutics' T.G. Phelps & J.A. Pitts, 'Questioning the text: The significance of Phenomenological hermeneutics for legal interpretation' (1984-85) 29 St. Louis U. L.J. 353 at p.355-356. On this approach arbitrators may be compelled to look at broader factors, such as feasibility and capacity to adhere to rules, in the construction of interpretations.

<sup>110</sup> For a discussion of validation of rules through formal decree, See T. Franck, *Fairness in International Law and Institutions* (OUP) (2002) at p.34-38.

and criticism due to it currently being an international institution with structurally very little direct public control.<sup>111</sup>

Overall, as suggested here appropriate changes to adjudication from ad-hoc arbitration, to a permanent court with controlled jurisdiction by state parties and technical input will maintain consent and create a consistent jurisprudence that is clear and which can be complied with.

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#### Postscript:

#### Overview of Propositions discussed in this chapter.

*Option 1: Continue rule-making under FET to include more forms of administrative law liability.*

*Benefits: Allows continuously expanding administrative law framework to built using FET with no restrictions.*

*Drawbacks: Law-making under FET using current methodology lacks coherence. There are no technical draftsmen, nor is there appropriate expert input of the difficulties of applying administrative law standards to the developing world. Further it has not taken into consideration the capacity of states to adhere to the rules or been able to fine tune obligations to meet states needs and the diversity of legal systems, which a formal law-making institution with policy input could do. Compliance with administrative rules created may be an ongoing issue.*

*Option 2: (Preferred Option) Continue rule-making under FET to include more forms of administrative law liability, but take special evidence as to the capacity of states, to comply with*

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<sup>111</sup> It is fundamentally a private arbitration mechanism deciding disputes in the public sphere. Cf. Van Harten, (n8 above) at p.70-71.

*rules and other broader input from NGOs. Further increase coherence via using a transparent investment court, with a rectification appeal mechanism, and a system of legal precedent.*

*Benefits:* *Investors protected and will know the extent to which a state has a burden that it ought to be able to meet. States are imposed on fairer burdens of obligations under FET. All parties who are subject to rights and obligations will be better placed to identify more clear and coherent obligations. Adverse impact of foreign investment may become known in the rule making process through NGO participation.*

*Drawbacks:* *It places investors at risks in developing states without investment treaty arbitration being an effective insurance. As many investors are from capital exporting states, they may expect some standards of good administrative conduct, failing which may not have a remedy. It may lead to less foreign investment in some states, particularly if judgments with respect to discussions on capacity are made public.*

*Option 3:* *Express Provisions for administrative law protection in investment treaties, with no power of tribunals to create rules using FET/*

*Benefits:* *Developing, and developed, states can directly bargain for burdens under investment treaties rather than leaving them to arbitrators. Obligations are known to all parties prior a foreign investment starting operations in the host-state. It will increase competition for capital in the investment treaty system by having plural competing treaties.*

*Decreases:* *Possible increased difficulties of negotiating treaties due to bargaining for more or less protection. Restricts arbitrators learning about investor complaints as they arise and developing appropriate rules to protect them against adverse host-state administrative practices. Significantly poor states that need foreign capital the most may not be able to bargain for investors and may lose out on foreign investment if they are seen as comparatively more risky places to invest.*

The second option has the benefits of flexibility of FET by maintaining the current system but allows realistic burdens to be imposed on developing states.

Table of breaches commences at the bottom of this page:

Case Name	FET Breached(x)
ADF	
AMT	X
Azinian	
Azurix	X
Bogdanov	X
CME	X

Continental	
CMS	X
CSOB	X
EDF	
Eureko	
Gami	
Genin	
Lauder	
Loewen	
LG&E Energy	X
Maffezini	X
Metalclad	X
Methanex	
Middle East C	X
Mondev	
MTD	X
Nobel	
OEPC	X
Olguin	
Petrobart	X
Pope & T	X
PSEG	X
RFCC	
Saluka	X
Sempra	X
SD Myers	X
Siemens	X
Tecmed	X
Thunderbird	
Vivendi II	X
Waste M II	
Wena Hotels	X

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