

**The London School of Economics and Political Science**

**International Investment Protection and the National  
Rule of Law:**

*A Normative Framework for a New Approach*

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## **Declaration**

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## Abstract

The relationship of international investment law (IIL) with the rule of law is an increasingly important topic. There is a broad agreement that the rule of law is a guiding notion for IIL and investor-State dispute settlement (ISDS), both in terms of their own operation and regarding the obligations imposed on host States. One of these obligations – the FET standard – has been specifically interpreted as requiring respect for certain fundamental rule of law principles such as predictability, non-arbitrariness and transparency.

The principal argument of this thesis is that the FET standard should be seen, in addition to securing *international* rule of law for foreign investors, as a tool to strengthen the *national* rule of law in the host States. Progressive development of the FET sub-principles should be complemented with a systematic taking into account the existing national rule of law framework in a host State. This can both enhance *ex ante* predictability of FET decision-making, and allow for other broader benefits that come out of rule of law improvement.

The proposed approach would involve a systematic recourse to a holistic set of existing municipal and international obligations beyond the investment treaty so to help interpret and apply the FET standard. These obligations embody a specific national vision of the rule of law that should be given recognition and support, within limits and without jeopardizing the international character of the IIL norms. Furthermore, decision-making can be enhanced by having recourse to comparative benchmarks to provide persuasiveness of determinations and by limiting the role of good faith considerations. With a complementary focus on the national rule of law, investment awards can become a clearer source for suggesting needed reforms, bringing benefits to a wider circle of domestic stakeholders and more broadly supporting the host State development.

*To Petra and Iva.*

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## SELECTED ABBREVIATIONS

BIT	Bilateral Investment Treaty
CJEU	Court of Justice of the European Union
EBRD	European Bank for Reconstruction and Development
ECHR	European Convention on Human Rights
ECJ	European Court of Justice
ECT	European Charter Treaty
ECtHR	European Court of Human Rights
EU	European Union
FDI	Foreign Direct Investment
FET	Fair and equitable treatment
FPS	Full protection and security
GAL	Global Administrative Law
ICC	International Chamber of Commerce
ICJ	International Court of Justice
ICSID	International Centre for Settlement of Investment Disputes
ICSID Convention	Convention on the Settlement of Investment Disputes between States and Nationals of Other States 1965
IIA	International Investment Agreement
IIL	International Investment Law
ILA	International Law Association
IROL	International rule of law
ISDS	Investor-State Dispute Settlement
LCIA	London Court of International Arbitration

MAI	Multilateral Agreement on Investment
MFN	Most favoured nation
MIGA	Multilateral Investment Guarantee Agency
NAFTA	North American Free Trade Association
NGO	Non-governmental organisation
NIEO	New International Economic Order
NYC 1958	Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958
OECD	Organisation for Economic Co-Operation and Development
PIL	Public International Law
SCC	Stockholm Chamber of Commerce
UK	United Kingdom of Great Britain and Northern Ireland
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
US	United States of America
USAID	United States Agency for International Development
VCLT	Vienna Convention on the Law of Treaties 1969
WTO	World Trade Organization
WTO DSB	Dispute Settlement Body of the WTO

## INTRODUCTION

‘Indeed it is not too much to say that [...] the role of international law is to reinforce, and on occasions to institute, the rule of law internally.’<sup>1</sup>

James Crawford

‘Thus, as the Minister of Finance of Uruguay explained [...] when his country ratified its BIT with the United States, “We are not signing this treaty for them [i.e. the United States], we are signing it for *us*.”’<sup>2</sup>

Jeswald W. Salacuse

Promoting the *rule of law* is a goal of international investment law upon which different actors strongly agree.<sup>3</sup> This is unsurprising in light of the appeal that the notion of the rule of law enjoys in both legal and business quarters. A strong rule of law has consistently been considered a key condition for growth of commerce<sup>4</sup> and investment,<sup>5</sup> as well as economic development in general.<sup>6</sup> Both common and continental law jurisdictions have a long history of discussing and generally promoting the concept.<sup>7</sup> While the definition and content of the notion are unsettled, its broad

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<sup>1</sup> Crawford 2003, 8.

<sup>2</sup> Salacuse 2010, 444.

<sup>3</sup> Jowell 2015, 9; Salacuse 2000, 386-387 and 398; Fortier 2009a, 350; Schill 2015, 81; Ranjan 2016, 116; Guthrie 2013, 1160; McLachlan/Shore/Weiniger 2007, 128; Calamita 2015, 122; Rogers 2015, 71; for IIA negotiators espousing such views see Steffens 2009, 348 and Baldi 2013, 444. See for historical aspects Vandevelde 2016, 66.

<sup>4</sup> Hale 2016, 3.

<sup>5</sup> Guthrie 2013, 1159 and materials cited in fn 33.

<sup>6</sup> Carothers 2003, 6; Santos 2006, 253; Allen 2011, 15; Wang/Xu/Zhu 2012; see similarly in political science Fukuyama 2011.

<sup>7</sup> For an overview, see primarily Tamanaha 2004. See also Loughlin 2010, 314-324.

appeal is hardly in question – it has even been described as a ‘charmed concept, essentially without critics or dissenters.’<sup>8</sup>

The relationship of international investment law (hereinafter IIL) and the rule of law has been increasingly discussed over the past decade. The research has focused both on the investment protection regime in general, and more particularly on its adjudicative component - investor-State dispute settlement (hereinafter ISDS). Broadly speaking, authors focus on the rule of law characteristics and effects of substantive provisions in international investment agreements (hereinafter IIAs),<sup>9</sup> the rule of law features and flaws of the ISDS as a dispute-settlement mechanism,<sup>10</sup> and on the predominantly empirical examinations of the effect that IIL has on the rule of law in the host States.<sup>11</sup> The rule of law as a ‘guiding notion’<sup>12</sup> for IIL and ISDS thus makes the concept a promising ‘normative perspective’<sup>13</sup> for assessment and prescription in this field.

This thesis focuses on decision-making on the merits under the claims that the ‘fair and equitable treatment’ (FET) standard has been breached by the host State. The FET standard, mainly through ISDS jurisprudential developments, is now widely considered to embody the key rule of law requirements such as predictability, respect for legitimate expectations, due process and transparency.<sup>14</sup> Due to its ubiquitous application in ISDS, FET can be seen as a worthy development in imposing the rule of law disciplines on host States. However, this thesis argues that the currently dominant normative underpinning of the FET standard as securing the *international* rule of law (IROL paradigm), in the sense that its rule of law requirements should be detached from those of the host State and should specifically offer protection to foreign investors, should be complemented by a *national* rule of law (NROL) paradigm.

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<sup>8</sup> Hurd 2014, 39. See prominently the UN General Assembly resolution 64/116 on the rule of law at the national and international levels (A/RES/64/116) and the 2005 World Summit Outcome document (A/RES/60/1). For regional organisations, see Aust/Nolte 2014, 57. See similarly for the universal appeal Watts 1993, 15; Kumm 2003, 20-21; Chesterman 2009, 67; Kanetake 2016a, 19; Ranjan 2016, 117-118; McCorquodale 2016, 278.

<sup>9</sup> See generally Guthrie 2013; more specifically, for the ‘fair and equitable’ treatment standard as an embodiment of the rule of law see Schill 2010b; Vandevelde 2010; Angelet 2011; Diehl 2012, 335.

<sup>10</sup> See particularly Van Harten (2010b, 2010c, 2012) as well as Pauwelyn 2015 and Reinisch 2016; see more generally De Brabandere 2014 and Wälde 2010.

<sup>11</sup> See in that vein Ginsburg 2005; Franck 2007; Shultz 2015 and Sattorova 2015. See also Guthrie 2013, 1167-1175. For caution about empirically measuring the rule of law see Calamita 2015, 120.

<sup>12</sup> Schill 2015, 85 and 98. See similarly Reinisch 2016, 292.

<sup>13</sup> Smits 2012, 44.

<sup>14</sup> See generally Schill 2010b; Vandevelde 2010; and Diehl 2012.

Investment arbitrators should, when interpreting and applying the FET sub-principles, systematically and consistently take into account and examine the international and national legal commitments of the host State beyond the IIA. This should be a conscious effort to examine if the host State decision-makers obeyed their own State's vision of how legal processes should have unfolded in accordance with the rule of law, although the ultimate determination on the existence of a breach of the FET standard remains formally independent of the results of this examination.

To briefly elaborate at this point, the FET standard *should* require, e.g. 'transparency' of the host State behaviour – but the FET standard is surely not the first, or even the most elaborate instrument requiring transparent behaviour of the host State and its decision-makers. Not giving due weight to other instruments (domestic/international) which also mandate transparent behaviour in relevant legal situations fails to realise the full rule of law enhancement potential of the ISDS proceedings. It also risks unnecessarily isolating some 'IIL-specific' understandings of the FET sub-principles from the rich wider corpus of domestic and international sources. The increased 'mutualism'<sup>15</sup> between the FET standard and other sources binding the host State can help to strengthen the national rule of law and thus lead to other potential benefits, such as helping enhance the host State development and increase the legitimacy of the ISDS and IIL more generally.

The remainder of this Introduction focuses briefly on the notion of the 'rule of law' for the purposes of this thesis (section 1), before focusing on the reasons for the focus on the FET standard (section 2). With this background in mind, section 3 provides a more detailed overview of the arguments put forward. Section 4 deals with certain methodological considerations, further delineates the scope of inquiry and the relationship with the ongoing reform processes. Section 5 provides an outline of the chapters that follow.

### 1. Rule of law

The wealth of scholarship on the rule of law and its more specific facets simultaneously provides a valuable source of insights and invites caution. What is meant

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<sup>15</sup> See for 'complementarity' and 'mutualism' Kjos 2015, 301-302.

by the ‘rule of law’ in terms of content? To which ‘law’ and which plane of operation it refers to? To ensure precision and clarity when dealing with such a ubiquitous (yet ‘essentially contested’)<sup>16</sup> notion, it is warranted to briefly elucidate the different relevant understandings,<sup>17</sup> before making clear their import for this thesis. The two most important distinctions are between the ‘thin’/‘formal’ and ‘thick’/‘substantive’ understandings on one side, and between the ‘international rule of law’ and the ‘national rule of law’ on the other. These refer, respectively, to the content of the concept and to the level at which it operates.

### *Formal vs. substantive rule of law*

Existing definitions of the rule of law are almost always positioned somewhere between the formal (thin) and substantive (thick) poles.<sup>18</sup> The formal conceptions emphasise that legal rules should comply with certain system-internal requirements, without passing judgment on the *substance* of those rules. Substantive ones go beyond by linking the existence of the ‘proper’ rule of law with the protection of specific values and/or the existence of specific guaranteed rights. This essentially requires ‘good’ as opposed to just ‘general, prospective and consistent’ laws.<sup>19</sup>

Formal understandings of the rule of law thus focus more on the *procedural*<sup>20</sup> or *mechanical*<sup>21</sup> aspects of the law, in particular on clarity and predictability. Oft-cited definitions by Joseph Raz and Lon Fuller broadly illustrate this. According to Raz, law must be prospective, general, clear, public and relatively stable – as well as coupled with a number of other features such as the independent judiciary and the possibility of judicial review.<sup>22</sup> For Fuller, ‘inner morality of law’ requires 1) generality, 2) publicity, 3) prospective orientation, 4) clarity, 5) non-contradictory nature, 6) issuance of

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<sup>16</sup> Waldron 2011a, 316-317. See similarly Loughlin 2010, 312-313.

<sup>17</sup> See similarly Guthrie 2013, 1160-1164.

<sup>18</sup> See in that sense Tamanaha 2004, 91; Craig 1997, 468; Santos 2006, 258-259; Chesterman 2007, para. 12; Hsu 2015, 131.

<sup>19</sup> This delineation is admittedly somewhat artificial. Formal concepts are themselves necessarily based on at least *some* substantive considerations, such as moral autonomy (Craig 1997, 482; Tamanaha 2004, 92). In parallel, ‘the adoption of a fully substantive conception of the rule of law has the consequence of robbing the concept of any function which is independent of the theory of justice which imbues such an account of law’ (Craig 1997, 488; similarly Calamita 2015, 106).

<sup>20</sup> Wacks 2014, 15; Chimni 2012, 291.

<sup>21</sup> Santos 2006, 260.

<sup>22</sup> See generally Raz 1977 and also Tamanaha 2004, 93.

requirements that can be obeyed, 7) stability, and 8) congruence between declared rules and actual practice.<sup>23</sup>

Going beyond ‘just’ the formal requirements, substantive conceptions of the rule of law usually take them as a starting point - while adding the requirements for existence of particular rights or values. As argued, an underlying theory of (usually democratic) *justice* needs to infuse the formal requirements with meaning and supplement the formal qualities with a substantive account.<sup>24</sup> Different substantive values can, of course, be put forward as dominant. Apart from those definitions that focus on a singular substantive aspect,<sup>25</sup> more holistic visions usually revolve around the respect for the (broader or narrower) corpus of human rights.<sup>26</sup>

A recent influential account in that vein was offered by Tom Bingham, for whom ‘[t]he law *must* afford adequate protection of fundamental human rights’.<sup>27</sup> ‘Roundly’ rejecting Raz’s formalistic account, Bingham argues for a thick definition, as otherwise the rule of law loses much of its virtue.<sup>28</sup> While recognizing the problems of trying to universalise human rights,<sup>29</sup> Bingham argues that there is a sufficiently clear core of rights that a rule of law system worthy of its name should embody.<sup>30</sup>

#### *International vs. national rule of law*

The most straightforward way to distinguish between the international and national rule of law for the present purposes (leaving aside for the moment the level of

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<sup>23</sup> Fuller 1969, 33-94.

<sup>24</sup> Hutchinson 1999, 199; Krygier 2012, 239; see famously Dworkin 1986, 355-399.

<sup>25</sup> An example is Friedrich Hayek, whose otherwise strongly formal account of the rule of law is coupled with an imperative of realising a free market economy (Hayek 1946). For a briefer overview, see Tamanaha 2004, 65-71.

<sup>26</sup> See for example, Venice Commission Report on the Rule of Law, 2011, available at: [http://www.venice.coe.int/webforms/documents/?pdf=CDL-AD\(2011\)003rev-e](http://www.venice.coe.int/webforms/documents/?pdf=CDL-AD(2011)003rev-e), accessed 1 February 2017; see also Legg 2016, 249-250 and McCorquodale 2016, 280.

<sup>27</sup> Bingham 2011, 66 (emphasis added). See similarly McCorquodale 2016, 293-294.

<sup>28</sup> Bingham 2011, 67.

<sup>29</sup> Ibid, 67-68.

<sup>30</sup> This includes the right to life, prohibition of torture, prohibition of slavery and forced labour, right to liberty and security, right to a fair trial, principles of no punishment without law, respect for private and family life, freedom of thought, conscience and religion, freedom of expression, freedom of assembly and association, right to marry, non-discrimination, protection of property, and the right to education (ibid, 68-84).



‘thickness’/substantive content) is the plane on which these concepts operate.<sup>31</sup> The national rule of law operates at the level of domestic legal orders, essentially aiming to constrain the arbitrary exercise of governmental power towards those under its jurisdiction.<sup>32</sup> The international rule of law operates at the level of international law. It is a structurally more complex notion that can be further broken down into three components. It is possible to discuss the international rule of law as: 1) operating in State-State relationships; 2) operating to regulate the relationship of the State and individuals/non-State entities under its jurisdiction and 3) directly operating between the level of international institutions and the individual.<sup>33</sup>

It is the second (regulating State-individual relation) understanding of the international rule of law that is of special relevance for this thesis.<sup>34</sup> In terms of content and structure, IIL is a mixture of some 3000 predominantly bilateral treaties and (far less significantly) customary international law and domestic statutes.<sup>35</sup> While the widespread ‘treatification’ of IIL<sup>36</sup> would suggest a State-State relationship as a primary one, the predominant understanding is that the IIL aims to regulate the exercise of State authority towards individuals and companies (eligible foreign investors) under its jurisdiction.<sup>37</sup> As is often argued, the desire to remove this relationship from the perceived vagaries of both diplomatic protection and the domestic rule of law primarily inspired the creation and eventual burgeoning of IIL.<sup>38</sup>

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<sup>31</sup> Since the topic examined here is the international law regulation of the State-individual relationship, as will be elaborated shortly, there is no need to engage with arguments that State-State rule of law and State-individual rule of law are essentially different phenomena (see Watts 1993, 17-18 and Schill 2016, 441).

<sup>32</sup> See for a brief overview Loughlin 2010, 333-337 and authors cited therein. See also in this sense Chimni 2012, 290; Krygier 2012, 242; Kanetake 2016a, 15; and generally Jowell 2007. For caution about practically realising the ideal of non-arbitrariness see however Loughlin 2010, 337-341.

<sup>33</sup> See Chesterman 2009, 68-69 and particularly Kanetake 2016a, 16-17. See similarly McCorquodale 2016, 288.

<sup>34</sup> This is not to say that the other two understandings are not relevant. While the international law - individual relationship is perhaps primarily manifested in international criminal law (Corell 2001, 265-266 and 268; Cassese et al. 2013), investor as a *sui generis* subject of international law has aroused considerable doctrinal interest (see, for example, Paulsson 1995, Weil 2000 and Douglas 2004). The State-State relationship in IIL has been recently emphasised, for example, by Anthea Roberts (Roberts 2010 and Roberts 2015).

<sup>35</sup> See generally Dolzer/Schreuer 2012, 12-27. As noted by Schill, ‘present day IIL, for all practical purposes, is equivalent to the law of investment treaties as interpreted and applied by investment treaty tribunals’ (2017b, 5). See similarly Ciurtin 2017, 29 and 33.

<sup>36</sup> As termed by Salacuse (2007).

<sup>37</sup> See generally Douglas 2004; Dolzer/Schreuer 2012, 24; McLachlan/Shore/Weiniger 2007, para. 7.178; Van Harten 2010c, 632. See similarly Muchlinski 2011, 7; Alvarez 2005, 961 and Wälde 2008.

<sup>38</sup> Dolzer/Schreuer 2012, 235-236; Reinisch 2016, 291-292; Brower/Steven 2001, 196; Schwebel 2008, 6; Ranjan 2016, 128; Kanetake 2016b, 275; Kumm 2003, 26.

In terms of content, specifically in light of the formal/substantive distinction, the IIL rule of law principles seen as imposed on participating States - in particular those embodied in the FET standard - are generally in line with broader public international law. At the level of international law, rule of law principles are usually considered to be formal/thin.<sup>39</sup> The attempts to universally ‘thicken’ their content with more substantive notions – such as human rights – are still unsettled and controversial.<sup>40</sup> For example, a widely cited UN definition of the content of the rule of law includes, apart from a number of formal principles, consistency with human right standards.<sup>41</sup> It has, however, been described as ‘almost certainly go[ing] beyond what states would actually implement.’<sup>42</sup>

*‘Rule of law’ for the purposes of this thesis*

While there are multiple ways to relate both the formal/substantive and international/national rule of law understandings to different IIL standards, the focus on the FET standard narrows the relevant aspects. Firstly, and as will be revisited in the chapters that follow, the FET standard predominantly deals with the *formal* aspects of the rule of law.<sup>43</sup> In an oft-cited summary, Stephan Schill identified how jurisprudence disaggregated the FET standard into seven sub-clusters of requirements, all of which ‘also figure prominently as sub-elements or expressions of the broader concept of the rule of law in domestic legal systems’:

- (1) the requirement of stability, predictability, and consistency of the legal framework; (2) the principle of legality; (3) the protection of legitimate expectations; (4) procedural due process and denial of justice; (5) substantive due process and protection against discrimination and arbitrariness; (6) transparency; and (7) the principle of reasonableness and proportionality.<sup>44</sup>

To be sure, some of these requirements may require engaging with the

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<sup>39</sup> Chesterman 2009, 69; Kanetake 2016a, 20 and 23.

<sup>40</sup> Kanetake 2016a, 21; Ranjan 2016, 117-118. See also McCorquodale 2016, 282 and Nollkaemper 2011, 4-5.

<sup>41</sup> UN Secretary-General Report ‘The Rule of Law and Transitional Justice in Conflict and Post-conflict societies’ (S/2004/616), para. 6.

<sup>42</sup> Chesterman 2009, 68. See also Aust/Nolte 2014, 51.

<sup>43</sup> McLachlan 2009, 119.

<sup>44</sup> Schill 2010b, 159-160 and 171.

substantive, value choices made by the host State. But leaving that aside for the moment, the requirements set above are the coordinates which are relevant for examining IROL and NROL paradigms in this thesis. Each of these requirements can have meaning and content imbued to it by the IIAs and the FET standard jurisprudence, whilst being enforced by investment tribunals. In doing so, as Chapter 1 will elaborate, the agreement in doctrine and practice seems to be that the tribunals are enforcing *international* rule of law discipline on the host State, and should not as a matter of principle be obliged to relate to rule of law concepts and requirements existing in the host State (as these might well be deficient and thus require existence of IIAs in the first place). Such a normative understanding of the role of the FET standard and the investment tribunals themselves is herein dubbed the international rule of law/IROL paradigm.

At the same time, in a particular legal situation which involves the foreign investors, each of the FET standard requirements can have meaning and content imbued to it by the national legal provisions (such as constitutional norms, administrative codes, civil and criminal procedure statutes) and international commitments of the host State beyond the IIA in question (e.g. human rights treaties). This meaning and content, derived to the extent possible from the interplay of these instruments, present a case-specific legal framework in which the domestic decision-makers should have operated regardless of and looking beyond any obligation contained in the relevant IIA. Exploring to what extent the host State behaviour was in line with such a legal framework is here dubbed the national rule of law/NROL paradigm. Thus, the national or domestic rule of law here refers to how a specific host State in question would understand the meaning and compliance with each of these FET-imposed rule of law requirements, when all relevant sources binding it are taken into account. This does not encompass the entirety of domestic law, but particular parts that are of relevance for a particular requirement (e.g. ‘due process’, ‘transparency’) in a specific legal situation that involved a foreign investor. The summary of these relevant sources, constructed on a case-by-case basis, is termed *the ideal-type model of the domestic rule of law* and is the main topic of Chapter 4.

As the case may be, ‘due process’ (e.g) may end up meaning different things in the IROL context and in the NROL context. Crucially, the NROL meaning might eventually have minimal or no influence whatsoever on the ultimate determination of

the FET breach. The disconnect between the two can thus lead to the creation of ‘bubbles’ or ‘enclaves’ for foreign investors – something that is sometimes lauded as desirable or at least seen as inevitable.<sup>45</sup> However, while in some situations such isolation may indeed be necessary to protect the foreign investors from the vicissitudes of domestic law and practice (and the FET standard allows this) as a more general normative orientation it leaves much to be desired.<sup>46</sup> It is the principal argument of this thesis that conscious and thorough balancing between IROL and NROL paradigms and bridging the gap between them can have tangible benefits for all involved stakeholders.

## *2. The reasons for focusing on the FET standard*

IIIL (and in particular the FET standard) as well as ISDS can be and often are perceived as an international rule of law success story. While the efficiency of enforcement of international obligations is generally strongly debated and criticised,<sup>47</sup> the IIIL regime exhibits a massive acceptance of international arbitral jurisdiction (with claims lodged by non-State entities directly)<sup>48</sup> and a high rate of compliance with award.<sup>49</sup> Similarly, in light of the still globally unsettled list of rule of law principles, the widespread binding adoption of those contained in IIAs is an important development.<sup>50</sup>

Yet, IIIL and ISDS continue to face criticism from different quarters and have been witnessing an increasing number of reform proposals.<sup>51</sup> The contrast with the success narrative presented above is clearly noticeable, and understanding (at this point briefly) its causes is important for explaining the focus on the FET standard. While acknowledging the risk of oversimplification, it is possible to locate some of the most pertinent causes of discontent in the interplay of the specific rule of law principles (as exemplified by the FET standard) and the structural/adjudicative features of the

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<sup>45</sup> See, for example, Dolzer 2005, 955.

<sup>46</sup> See on this, for example, Hepburn 2017, 195.

<sup>47</sup> See, for example, Shaw 2014, 800-801; Corell 2001, 264; Llamzon 2007; Watts 1993, 36-37 and 43-44; Conforti 1993, 5; Fikfak 2016, 48-49; Nollkaemper 2011, 5-6 and in particular fn 29.

<sup>48</sup> Schwebel noted the emergence of ISDS as one of the ‘most progressive developments in the procedure of international law in the last fifty years’ (2008, 4).

<sup>49</sup> See primarily Mistelis/Baltag 2008; see also Alexandroff/Laird 2008, Reed/Martinez 2009, Gerlich 2015; Sepúlveda-Amor/Lawry-White 2016 and Carvalho 2016, 23; notably, instances of opposition to enforcement (see Bjorklund 2009 and Gerlich 2015) are those that often capture the attention of academics and the public, perhaps skewing the perception of compliance.

<sup>50</sup> Reinisch 2008, 111-114.

<sup>51</sup> For an overview see Schill 2015, 98-100.

regime.<sup>52</sup> Generally, IIL is characterised by a challenging combination of: 1) superficial accordance on the rule of law principles that actually masks a deeply seated lack of agreement on their content; 2) the almost unprecedented level of overlap with the domestic rule of law and vertical State-individual relations; 3) a powerful enforcement mechanism which often foregoes the need to exhaust domestic remedies and aims to shape domestic law and practice; and 4) the lack of an in-built mechanism for either ensuring the consistency of the ISDS output or for securing a level of subsidiarity/deference towards the national (rule of) law.<sup>53</sup>

The FET standard is at the forefront of these issues. It has emerged as both the preeminent standard invoked by foreign investors,<sup>54</sup> the one bringing most success to them,<sup>55</sup> and the one most often directly connected to rule of law considerations.<sup>56</sup> In that sense, the FET standard and its sub-principles are very likely to be found in almost all existing (and prospective) ISDS disputes.<sup>57</sup> If there can be a reasonable prediction about a standard that is likely to feature in any hypothetical future ISDS claim, the odds are certainly in favour of the FET standard. It has emerged as a core concept of IIL with a potential to reach deeper into the regulatory sphere of States than any other standard.<sup>58</sup> Without disregarding the importance of other standards and provisions (primarily the prohibition of expropriation without compensation), this consideration itself strongly warrants focusing one's lens on the FET standard to discuss the interplay with the national rule of law.

Two further remarks are in order. Firstly, for purposes of this thesis, the sometimes separate prohibition of 'arbitrary' and 'unreasonable' measures found in IIAs is discussed jointly with the FET as its part.<sup>59</sup> This prohibition in relevant respects largely overlaps with the FET standard, thereby justifying their joint discussion.<sup>60</sup> As

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<sup>52</sup> See similarly Kleinheisterkamp 2015, 793-795.

<sup>53</sup> See similarly Landau 2009, 194-196.

<sup>54</sup> Bonnitcha 2014, 144; Dolzer/Schreuer 2012, 130; Draguiiev 2014, 273-274.

<sup>55</sup> Dolzer/Schreuer 2012, 98, 101 and 130.

<sup>56</sup> See on this the discussion in the earlier parts of this Introduction, and specifically Schill 2010b.

<sup>57</sup> See generally Dolzer/Schreuer 2012, 133-134.

<sup>58</sup> Dolzer 2005, 964; Schill 2010b, 151.

<sup>59</sup> This does not ignore that the wording of these provisions differs in IIAs. However, as noted, there is a high level of convergence among tribunals in assuming that FET embodies a common set of legal elements regardless of the differences in drafting (see, among many, Tudor 2008, 154; Dolzer/Schreuer 2012, 145; Kläger 2011, 117-18; Schill 2010b, 152). The issue will thus not be further explored here.

<sup>60</sup> See on this Hepburn 2017, 31 and materials cited therein and also, for example, *Lemire v. Ukraine – Jurisdiction and Liability*, para. 284.

noted, tribunals do not attach much weight to the difference between arbitrary and unreasonable, and these concepts overlap with FET in the sense that arbitrary and unreasonable behaviour will also breach FET and vice versa.<sup>61</sup>

Secondly, the focus on FET means that the arguments made here are not claimed to be necessarily relevant for other substantive provisions in IIAs, most importantly the prohibition of expropriation and the requirement of providing full protection and security to foreign investors. At occasions when these other provisions (and their jurisprudence) are relevant for the present discussion, this is made clear in the text. Although the FET and full protection and security provisions are sometimes equated in practice,<sup>62</sup> and same sets of facts are often being put forward to support both the FET standard and expropriation claims,<sup>63</sup> the normative arguments made here would likely need to be adapted to the specificities of these provisions and their accompanying jurisprudence. Whilst the proposed complementarity of the NROL paradigm and the suggested elements of decision-making may potentially have a fruitful application in these different contexts, this is something that the author will at this point leave for future research.

### *3. A complementary normative paradigm – a summary of thesis arguments*

The main argument of this thesis is that pursuing the international rule of law discipline on host States through the FET standard in a manner which is detached from national legal systems (IROL paradigm) should be systematically complemented with a national rule of law paradigm (or NROL paradigm). The NROL paradigm would suggest that FET decision-making should be consistently used to help strengthen the domestic, national rule of law in addition to providing a case-by-case piecemeal protection of claimants. This would aim to benefit a wider range of stakeholders than just eligible foreign investors, pursue the goal of domestic economic development more holistically, and ultimately enhance the legitimacy of the IIL regime. The FET and its sub-components can be used more actively as tools to illuminate and sanction the national rule of law failings when these occur. This should, in addition to providing redress to an investor in a specific case, incentivise and support the host State efforts to

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<sup>61</sup> See for example Henckels 2015, 71 and materials cited therein.

<sup>62</sup> Dolzer/Schreuer 2012, 161.

<sup>63</sup> *ibid*, 133-134.

remedy these failings more systematically, ultimately helping provide different additional benefits.

As has been noted above, IIL and general and the FET standard in particular have become an important tool in promoting the rule of law principles as (internationally) binding on host States. Through the ubiquitous IIAs which contain the FET standard and the body of jurisprudence interpreting and applying it, there is a wide understanding that this standard requires the host State to respect critical rule of law requirements in their behaviour towards the foreign investor.<sup>64</sup>

While its sub-principles have cognates at the domestic level, the FET remains an autonomous, international standard, that is not to be formally equated or tied to the host State's or any other domestic understanding of the rule of law requirements.<sup>65</sup> In that way, it can guarantee a common international level of protection to foreign investors by serving as a detached benchmarking tool for assessing host State behaviour.<sup>66</sup> It is this understanding that is dubbed the IROL paradigm in this thesis, and (as Chapter 1 will elaborate in more detail) it is this understanding that can be considered as firmly entrenched in the current ISDS jurisprudence and literature.

ISDS as an international dispute settlement mechanism has proved potent in 'giving teeth' to the IROL paradigm. Application of the FET standard as an emanation of the rule of law requirements can be seen at the vanguard of putting into practice the broad commitment of States to promote the rule of law at both 'the international and domestic level'.<sup>67</sup> It is thus a worthy development that should be preserved in future jurisprudence. But this does not mean that, from a normative perspective, new qualitative leaps forward are not possible. Rather, this thesis argues that to utilise the power of IIL more fully and to lessen the impact of the problems arising out of the particular features of both the FET standard and ISDS more generally (as noted above in section 2) there should be a *conscious and systematic effort in decision-making to complement the IROL paradigm understanding with what is here dubbed the NROL paradigm*.

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<sup>64</sup> See in particular Schill 2010b and numerous materials cited therein; see also McLachlan 2009, 119.

<sup>65</sup> Schill 2010b, 163; Hepburn 2017, 16.

<sup>66</sup> Schill 2010b, 154; McLachlan 2009, 106 and 119.

<sup>67</sup> See generally UN General Assembly resolution 64/116 on the rule of law at the national and international levels (A/RES/64/116).

Whilst fully embracing their position as international dispute settlers applying international instruments (IIAs) and provisions (the FET standard), arbitrators should from a normative viewpoint be fully aware of the special and deep-reaching type of rule of law assessment that they are often performing upon domestic legislators, administrators and judicial organs. This requires that the rule of law requirements (rightly) refined from the FET standard are further interpreted and applied in a way that duly and systematically recognises and takes into account the multitude of national and international legal commitments binding upon the host State decision-makers. In further interpreting and applying the requirement that the host State acted e.g. in a ‘non-arbitrary’, ‘transparent’, ‘predictable’ manner, a conscious and thorough effort should be put to relate, to the extent possible, the understanding of these requirements to international obligations of the host State beyond the FET standard and the IIA in question (such as human rights obligations) and to national law provisions (broadly understood to encompass constitutional law and other relevant sources).

In all likelihood, and with the exceptions that can be remedied through residual discretion remaining in the hand of arbitrators applying the FET standard, the domestic legal framework of the host States and their existing international commitments already *formally* requires the host State to act in a way that respects rule of law principles – being therefore rather clearly potentially relevant for the interpretation and application of the FET standard. Certainly, the autonomous nature of the FET obligation does not allow simply equating the requirements of the standard with other national or international obligations. But normatively it makes little sense to isolate the FET sub-principles from their cognates in national and international law<sup>68</sup> – in particular if these cognates were already accepted and internalized by the host State, and foreign investor could have expected them to be respected regardless of any IIA commitment. In the end, the reality of investor-State disputes is that despite the attempts to ‘insulate’ them, they ‘nevertheless take place within a wider set of legal relationships between investor and host state’.<sup>69</sup>

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<sup>68</sup> McLachlan 2009, 119 and 122.

<sup>69</sup> *ibid*, 102-103; see similarly Igbokwe 2006, 298.



Therefore, to fully embrace this reality, help enhance the respect that host State decision-makers have for pre-existing national and international obligations, as well as to provide a rich source of *ex ante* discoverable reference points for interpretation and application, investment arbitrators should to the extent possible interpret and apply the FET and its sub-components with systematic reference to these international and national commitments. Such an approach should be in full accordance with the fact that, as Campbell McLachlan notes:

The function of the international law standards enshrined in investment treaties is *not to replace host state law*. Rather it is to provide the fundamental protections of international law, in cases *where the host state legal system has failed to secure such protections itself*.<sup>70</sup>

To reiterate, this does not extinguish separate normativity of FET – it is rather a way to partially shape and relate it to other relevant sources binding upon the host State and strive to strengthen the national rule of law. It certainly remains true that (as per VCLT Art. 27) national law cannot justify a breach of an international obligation by the host State,<sup>71</sup> as well as that the breach of national law cannot *per se* entail a breach of the FET standard.<sup>72</sup> Rather, the point is to be fully aware of the challenging mix of the open-textured nature of the FET standard and its rule of law-based sub-components with the institutional and legal framework of ISDS - which leaves much to be desired in terms of securing consistency of jurisprudence. Thus, one aspect of complementing the IROL paradigm with an NROL one is the attempt to lessen the impact of this mix and help provide more *ex ante* predictability. This is particularly important as discretion and lack of predictability could lead to FET being seen as ‘a malleable tool of ex post facto control of host states’ measures based on the arbitrators’ personal conviction and understanding about what is fair and equitable.’<sup>73</sup> Both investor and host State should be reasonably certain that the examination of the holistically understood domestic law will prominently feature in tribunals’ application of the FET sub-principles.

The second aspect is that the thorough and systematic examination of the national law and other international obligation, with a clear normative orientation to

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<sup>70</sup> McLachlan 2009, 107 (emphasis added).

<sup>71</sup> See in the ISDS context Igbokwe 2006, 299; McLachlan 2009, 114-115 and materials cited therein.

<sup>72</sup> Schill 2010b, 163 and 167; Hepburn 2017, 32-33 and materials cited therein.

<sup>73</sup> Schill 2010b, 157.

identify the rule of law failings, has considerable potential to strengthen the rule of law in the host State and enhance the legitimacy of IIL.<sup>74</sup> With their detached international status and powerful enforcement mechanisms at hand, investment tribunals have an almost unique position to realize the goal of strengthening the national rule of law.

It should be made clear that it is not argued that investment tribunals do not already engage with the host State domestic law or other international obligations. Leaving aside situations not examined in this thesis (such as jurisdictional issues of existence of a property right and illegality of an investment),<sup>75</sup> investment tribunals have to varying degrees examined and engaged with domestic and (non-IIL) international law in interpreting and applying the FET standard.<sup>76</sup> However, the extent of this engagement is (sometimes drastically) unequal among cases and there seems to be no clear normative agreement among the tribunals on the role of these extra-IIA sources.<sup>77</sup> This thesis thus proposes an outline of such an agreement – one suggesting that national and international sources of rules relating to the rule of law principles refined in FET should *systematically and consistently* be taken into account in decision-making, with a clearly recognised goal to complement the protection of an individual investor with elucidating the rule of law problems in the host State and providing potential guidelines for their elimination.<sup>78</sup>

The proposals laid out in this thesis are *normative* in the sense that they entail prescriptive choices in interpreting and applying the law, choices that are allowed, but not mandated by the legal framework. There is little disagreement that the open-textured nature of the FET standard allows for considerable and wide-ranging discretion of arbitrators, something that remains the case (although arguably less) even with the refinement of the standard into sub-clusters mentioned above. As will be discussed in Chapter 2, the legal framework of IIL and ISDS allows for considerably different choices to be made in the sense of how FET standard is interpreted, what role is given to non-investment obligations of the host State stemming from other

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<sup>74</sup> See on overcoming legitimacy issues through moving the focus away from just the investor protection Douglas 2006, 51 and Hepburn 2017, 197.

<sup>75</sup> See on these Igbokwe 2006, 286-287; Hanotiau 2009, 148.

<sup>76</sup> See, above all, the recent thorough treatment of this issue in Hepburn 2017, 13-40.

<sup>77</sup> *ibid*, 14-15 and 17 and materials cited there, in particular *International Thunderbird v. Mexico – Separate Opinion Wälde*, paras. 12 and 33 and *Quasar v. Russia*, paras. 21-23.

<sup>78</sup> See generally for a similar position regarding the relevance of national law Igbokwe 2006, in particular 286-287 and 298.

(international) sources, and how the role and importance of national law is perceived. These choices, at the same time, remain within the boundaries of rules on interpretation of treaties and of the IIA provisions on the law applicable to the merits of the dispute. It is therefore not argued that complementing ISDS decision-making with an NROL paradigm is the only, black-law mandated way of interpreting and applying the FET standard. Rather, a proposal is made for a normative *ought*, among a number of perhaps equally legitimate alternatives. The normative arguments why this particular path is preferable, already hinted at in the previous discussion, are specifically engaged with in more detail in Chapter 3.

To translate these normative considerations into more practical insights for the decision-making process, and recognising that there are certainly other ways in which strengthening the national rule of law can be pursued through ISDS, this thesis suggests three specific *elements* that should be a regular feature of investment tribunals' deliberations on the FET standard claims. Firstly, in Chapter 4, it is argued that tribunals should, when examining the existence of a breach of a particular element of the FET standard, construct and take into account an *ideal-type model of the domestic rule of law*, as an overview of pre-existing obligations relating to specific rule of law requirements contained in the FET standard. Put briefly, in examining what was the behaviour expected from a host State organs so to act (e.g.) 'transparently', 'with due process' or 'reasonably', the tribunals should identify all relevant (domestic and international) sources of rules that impinged on a particular legal situation and take them into account in assessing the existence of a breach.

Importantly, the ideal-type model should not only include the most obviously applicable domestic legal instruments (which is often meant by the requirement of *legality*) but also other international commitments, national constitutional provisions and hierarchically superordinate legislation.<sup>79</sup> Examination of these instruments, so to

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<sup>79</sup> This is also a recognition of the fact that the substantive interactions between the international and national level have 'rendered the formal dualistic perspective [...] increasingly mismatched with the reality of inter-order interfaces.' (Kanetake 2016a, 37; see similarly Kumm 2004, 913-915; Schill 2016, 419; De Wet 2012, 1211-1212; Nollkaemper 2011, 11) and that practically all States have *already* through different international instruments acknowledged their commitment to the domestic rule of law (Watts 1993, 19-21; Aust/Nolte 2014, 57).

achieve the necessary persuasiveness of arbitrators' reasoning,<sup>80</sup> should be supplemented by secondary sources such as relevant judicial practice and doctrine. Such an approach would strive to strengthen the national rule of law vision by examining if the broadly understood national 'law on the books' was, in a concrete case, reflected within the 'law in action'.<sup>81</sup> The cause of action remains undisputedly international, and the FET remains the basis of review of State actions,<sup>82</sup> but this should not prevent the systematic interaction with the multitude of pre- and parallel existing rule of law commitments in the host State.

The autonomy of the FET standard certainly allows the arbitrators to reach solutions based on 'justice and fairness'<sup>83</sup> in appropriate situations. One of these is certainly where the examination of the holistic national framework relating to the FET sub-principles shows that the existing non-IIL obligations, even if fully fulfilled, would still be unsatisfactory - and that 'something more' (secured by the FET standard and IIL more generally) is and was required. But a thorough engagement and persuasive explanation of how even these commitments were not fulfilled, or why the full compliance would still not have prevented a FET standard breach, are critical in helping the host State potentially reform and (among other benefits) avoid future ISDS claims in a similar context.

Providing persuasive accounts and making calls on whether the host State acted in accordance with the FET sub-standards, other international obligations and domestic law are often difficult and sensitive issues. Chapter 5 thus proposes and discusses two elements that could offer distinct benefits to the exercise of scrutiny by the tribunals. First element are the *comparative benchmarks*, consisting of comparative law, policy and practice. These – apart from their potential roles in ascertaining the general principles of law or their use within the comparative public law approach in IIL – can provide a further source of persuasive arguments for whether particular host State behaviour was

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<sup>80</sup> As noted, the process of *reasoning* is the core of legal activity and the *reason why* something was decided matters more than the outcome (Smits 2012, 62-64). As Paulsson notes, the reference to both international and domestic law enhances the persuasiveness and legitimacy of awards (2008a, 230).

<sup>81</sup> The congruence of 'books' and 'action' has been perceived as critical, yet challenging to achieve (Fuller 1969, 81-91). As Stephan Schill (2015, 93-94) argues, even well-developed legal systems can and do experience unfortunate omissions and flaws in the rule of law processes. See also Baetens 2015, 2-3 and earlier seminal work of Diver (1984).

<sup>82</sup> McLachlan 2009, 117.

<sup>83</sup> Douglas 2006, 27 and 51.

acceptable.<sup>84</sup> Briefly put, finding that a measure was (e.g.) reasonable or not can strongly benefit from a finding that other countries in sufficiently similar situations resorted to same or sufficiently similar measures. While there are some hints of such practice in existing jurisprudence, more reliance on comparative materials from sufficiently comparable States and regimes can considerably enhance the reasoning process and legitimacy of findings, and also provide clearer guideposts for potential rule of law-oriented reforms in the host State.

The final suggested element are the *corrective good faith factors*. These would represent the shift from a more rule-generative role of good faith in IIL towards a more corrective one. Instead of relying on the principle of good faith and its specific emanations as sometimes critical providers of meaning and content to FET and its sub-principles, good faith considerations should rather be circumscribed to specific factors so to allow the NROL paradigm and the domestic legal framework to assume a more important place. These factors would be fact patterns which, if sufficiently intense, could in some situations change a more tentative conclusion on host State liability arising out of the ideal-type model scrutiny. At the same time, a caveat for a more direct role of good faith can be left for situations of relatively obvious *mala fides* and also for good faith obligations which arise *within* the ideal-type model of a particular host State. Such an approach would arguably help *ex ante* predictability and legitimacy of the reasoning process overall by reducing the reliance on the inevitably discretion-laden good faith concepts.

One final general remark is in order. It is by no means claimed that the infusion of the NROL paradigm considerations and a systematic engagement with the holistically understood legal obligations of the host State would yield some form of panacea to issues arising from the indeterminacy of the FET standard and/or guarantee success in enhancing the national rule of law. Taking into account the multitude of instruments that existed and (should have) shaped the behaviour of host State decision-makers does not mean that these instruments necessarily provide clear, unambiguous, mutually harmonious answers. Eventually, the investment arbitrators need to preserve a

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<sup>84</sup> Persuasiveness is particularly needed in light of discretion that relevant instruments are likely to leave to domestic officials - discretion which is not itself *necessarily* problematic. As noted by Rubin (1989, 399-402), legislative vagueness and accompanying administrative discretion are not *per se* contrary to the (formal) rule of law. See similarly McCorquodale 2016, 281-282.

significant degree of discretion to finally make a (perhaps close) call on whether a behaviour was, e.g., arbitrary or not. This is arguably an inevitability of any dispute settlement process, and investment arbitration is no different in that sense. Nor is it certain that a host State, winning or losing, will necessarily take away the (hopefully) well-elaborated points on which it can improve its rule of law. Many factors outside the strict realm of ISDS can influence such developments. But this does not mean that the decision-making process should not strive to balance the IROL and NROL paradigms, the piecemeal protection and a more lasting rule of law impact. The normative reasons for it advocate it nevertheless. While results may not always follow, best efforts should still be exercised towards reaching them.

#### 4. *Methodological considerations, contribution to the existing literature and the scope of inquiry*

##### *Normative approach and methodological considerations*

A common delineation of methodological approaches to legal research, for the present purposes summarized by Jan Smits,<sup>85</sup> identifies four groups of questions that can be asked about law.<sup>86</sup> These questions are ‘how *does* the law read?’ (descriptive/dogmatic approach); ‘how *ought* the law to read? (normative approach); ‘what are the *consequences to society* of applying a certain legal rule?’ (empirical approach); and ‘*what is* law? *how does it develop* in light of historical/social/economic factors?’ (explanatory theoretical/legal philosophy approach).<sup>87</sup>

At the core of this thesis is the *normative* approach and the question of how the IIL *ought* to read, sometimes seen as the essence of legal research.<sup>88</sup> *Normative* is thus understood as the way something ought to be done according to a value position and/or policy justification. It is contrasted to a ‘merely’ objective, value-neutral and descriptive exposition of what the law is.<sup>89</sup> This also implies that IIL development so far

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<sup>85</sup> See generally Smits 2012.

<sup>86</sup> See also for an overview Siems 2008.

<sup>87</sup> Smits 2012, 9.

<sup>88</sup> As Edward Rubin noted, the legal discipline is ‘a practice whose discourse consists largely of prescriptions that scholars address to public decision-makers for the purpose of persuading those decision-makers to adopt specified courses of action’ (Rubin 1988, 1881).

<sup>89</sup> Of course, the link between descriptive and normative, *is* and *ought* is never completely severed (Greenwalt 2004, 270-271; Smits 2012, 9 and 43).

is not exclusively mandated and thus suitable only for dogmatic exposition and/or ‘internal coherence’ arguments.<sup>90</sup>

However, the normative discussion should not take place in an abstract vacuum. There are well-recognised benefits which come from drawing upon insights from other approaches.<sup>91</sup> This thesis thus also relies upon the wealth of materials provided by other fields of research.

The normative discussion is hardly imaginable without the immense amount of doctrinal work on the mass of IIAs, case law and other materials in the IIL sphere.<sup>92</sup> Importantly, as Jeremy Waldron suggests, the sphere of the rule of law is one where the back-and-forth between descriptive and normative is particularly desirable (if not outright necessary).<sup>93</sup> Similarly, theoretical explanations and particularly historical analysis of economic and social factors shaping the origins of foreign investment protection is of importance for providing both the context and normative arguments for the role of IIL.<sup>94</sup> Finally, empirical insights into the creation and operation of the IIL regime both problematize the often-held assumptions and provide further normative arguments, especially regarding the effect that IIL has on the expectations and behaviour of domestic decision-makers and investors.<sup>95</sup> In that sense, the proposals made in this thesis aim to engage and draw upon existing knowledge and avoid the risk of proposing ‘better law’ completely detached from the one that shapes the everyday reality of investor-State relations.

#### *Relationship to existing literature*

This thesis aims to contribute to existing debates regarding the IIL and the rule of law in a number of ways. It differs from the predominant part of existing doctrine in

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<sup>90</sup> For Jan Smits, if ‘pure’ doctrinal exposition ever actually existed, those days are largely over (2012, 29). As noted, there is hardly ever just one answer as to what legally ought to be (Rubin 1988, 1893; similarly Kraus 2004, 694-696 and Coleman 2004, 316-320).

<sup>91</sup> Some authors note that the ‘true realm and métier of legal scholarship [...] is the world of ideas’ (Collier 1991, 271), but this should not exclude the different (empirical and other) sources of influence on these ideas. See Smits 2012, 31, 34, 41 and 73 and materials cited therein.

<sup>92</sup> What exists is thus used as a foundation for a normative exercise, as explained by Waldron 2004, 370.

<sup>93</sup> *ibid.*, 372-373.

<sup>94</sup> Although the topic is too complex to be comprehensively addressed, the aspects of it feature in Chapter 1.

<sup>95</sup> Empirical research is especially relevant for normative arguments in Chapters 1 and 3.

that it aims to consistently problematize the often implicit idea that the FET standard and its rule of law (sub-) principles should *a priori* be interpreted, applied and developed in an autonomous manner that does not (have to) thoroughly take into account the legal framework of a particular host State at hand. It furthermore differs from the remaining part of the doctrine in that the proposals herein do not lead to some form of IIL deconstruction, but a different approach to the rule of law function and the related decision-making methodology.<sup>96</sup>

The discussions on the proper role of national law in ISDS decision-making are certainly present in doctrine and practice and deserve careful examination.<sup>97</sup> But the holistic interlinking of international and domestic host State obligations through the ideal-type model adds further perspectives on the relevance of national law. Perhaps going against the ‘*deformation professionnelle*’ of the international lawyer’ to constantly contribute to the development of international law,<sup>98</sup> the aim is to show that sometimes less can be more. A change of attitude from primarily aiming at prospective (international) law development to focusing on what *already* exists should by no means be an ‘inferior’ choice.<sup>99</sup> Opportunity to persuasively contribute to further ‘regime development’ and refinement of FET can and should be taken when warranted. But it should be balanced with the case-to-case national rule of law considerations, bearing again in mind the ‘exceptionally close connection’ of IIL to the domestic laws of host States.<sup>100</sup>

#### *Lex lata, lex ferenda and other reform processes in IIL*

In light of the different ongoing reform processes, it is warranted to note the relationship of arguments set out in this thesis to the potential future shifts in the substantive, procedural and institutional aspects of IIL. The thesis argues that the NROL paradigm can and should be systematically introduced in the decision-making process concerning the FET and its rule of law sub-principles *as they currently exist in ILAs*

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<sup>96</sup> As sometimes relevantly noted, the aim of all legal scholarship is to ‘challenge existing knowledge and offer new perspectives’ (Smits 2012, 103).

<sup>97</sup> For some examples see Reisman 2000; Igbokwe 2006 and recently Hepburn 2017.

<sup>98</sup> Kumm 2006, 260; similarly Kennedy 1994, 335.

<sup>99</sup> As noted by Sureta ‘[r]estraint would seem the wiser choice for ad hoc tribunals of limited jurisdiction. Avoidance of unnecessary pronouncements on contentious issues would help reduce the perception of a ruptured international investment legal regime and the resulting uncertainty.’ (2012, 19).

<sup>100</sup> Picker 2013, 55. See somewhat similarly in the expropriation context Dolzer/Schreuer 2012, 104.



*and accompanying jurisprudence* (with the cut-off date of 26 September 2017, when this thesis was submitted). Importantly, however, the proposed systematic introduction of an NROL paradigm should in no way be understood as an either/or alternative to the ongoing reform processes in IIL.

It is possible, although not explored further, that the approach and elements suggested in this thesis can also be a part of renegotiation/‘re-calibration’ efforts concerning existing and future IIAs. Likewise, as Chapter 4 will also touch upon, at least some of the current ‘new generation’ IIAs and their provisions do not by themselves seem to negate the need for supplementing the decision-making with an NROL paradigm as set out here. The need to continue thinking about the normative underpinning of FET decision-making is highlighted, however, by the fact that the success of some important reform efforts is in no way guaranteed. For example, the attempts to renegotiate/‘recalibrate’ existing IIAs through clarifying the open-textured standards such as FET<sup>101</sup> so far produce rather modest results. These results arguably leave the door open for suggesting rethinking of the reasoning process and the interrelationship with other sources of rules.<sup>102</sup> This, of course, if ‘new model’ IIAs become binding at all, something which is not always the case.<sup>103</sup> Notably, the predominant number of ISDS claims continues to be lodged under the ‘old generation’ IIAs of the 1990s and before.<sup>104</sup>

The rule of law aspects of the ISDS *as an adjudicative mechanism* - such as arbitrators’ impartiality, transparency of proceedings and attempts at structural/institutional changes – are not the topic of discussion in this thesis. The proposed structural reforms to the IIL regime, primarily in terms of introducing an appellate level of review,<sup>105</sup> or substituting the existing arbitration mechanisms with an

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<sup>101</sup> See generally Kurtz 2012 and Titi 2015, as well as Kleinheisterkamp/Poulsen 2014 and Schill 2017a for the specific context of ‘mega-regional’ agreements.

<sup>102</sup> See on this also Chapter 4, section 4.3. and Ortino 2013b, 158-160; Paparinskis 2015a, 668-670; Miles 2013, 305-307 and Kläger 2011, 87-88.

<sup>103</sup> See on the limited success of the Indian efforts at recalibrating their IIAs Ray 2016 and Patnaik 2016; Similarly, a new Norwegian model BIT, touted as progressive in many regards (Stern 2011, 190-191) has not yet even been adopted as a template. See on the earlier discontinued iteration Vis-Dunbar 2009, and for the more recent 2015 draft Usynin 2015. See for some other recalibration efforts Trakman/Sharma 2015.

<sup>104</sup> See <http://investmentpolicyhub.unctad.org/ISDS/FilterByApplicableIia>, accessed 10 February 2017.

<sup>105</sup> See on the unsuccessful attempts in mid-2000s Kalb 2005; Legum 2008 and Appleton 2013.

Investment Court System as advocated by the EU,<sup>106</sup> have certainly gained in prominence recently. It suffices to note, however, that regardless of the likelihood of their success (which is at this point arguably rather uncertain)<sup>107</sup> these reforms still leave open the question of *how* substantive decision-making should look like. The possible decision-making of the (e.g.) Investment Court System could and should be used to secure and enhance the national rule of law along the lines proposed here – especially as the claims for the breach of the FET treatment are very likely to often come before it.

Finally, this thesis does not engage with the equally complex area of jurisdictional issues in IIL – an area which itself can also have implications for the national rule of law. This is perhaps most obvious regarding the potential existence of corruption during the investment realisation/admission process. These situations, as confirmed in practice, critically affect the decision on whether an eligible protected investment exists.<sup>108</sup> Such matters cannot be addressed within the scope of this thesis, but certainly represent an intriguing field for further research into the role which ISDS can play as a national rule of law enhancer.

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<sup>106</sup> See for the details of the Investment Court System proposal [http://trade.ec.europa.eu/doclib/docs/2015/september/tradoc\\_153807.pdf](http://trade.ec.europa.eu/doclib/docs/2015/september/tradoc_153807.pdf), accessed 1 February 2017. On appellate mechanism see most recently Calamita 2017. See also generally Reinisch 2008, 119-122 on these and similar proposals.

<sup>107</sup> For a sceptical assessment see Schreuer 2013, 399-400; Bjorklund 2013, 196-197 and Baetens 2015, 10. For example, while the opposition to the Transatlantic Trade and Investment Partnership agreement has already been vocal in the EU, the uncertainty has been vastly amplified by the new US administration of President Trump. See generally, among many others, Schill 2017a, Novotna 2017 and Buonanno/Dudek 2015. Similarly, the conclusion process of the Transpacific Trade Partnership has been effectively terminated. See on this Solis 2016. The most recent advance in that sphere are the conclusions of the Canada-EU Trade Agreement (CETA) and the EU-Vietnam FTA, which both contain provisions on a new self-contained ISDS regime that includes an appeals mechanism. But even assuming the ratification of these instruments occurs without further problems, the envisioned dispute-settlement system is interrelated with ICSID in a novel way – which, at least for some authors, is also legally questionable (see Calamita 2017). See also on most recent challenges Chapter 1, section 1.4.1.

<sup>108</sup> See, for example, Cremades 2009 and decisions in *World Duty Free v. Kenya* and *Metal-Tech v. Uzbekistan*.

## 5. The outline of chapters

### **Chapter 1 - The IIL regime and the international rule of law paradigm**

Chapters 1 and 2 focus on the issue of complementing the IROL paradigm in the FET standard decision-making with an NROL one is *possible* and *needed*. In that context, Chapter 1 focuses on the foundations and Chapter 2 on the operation of the arguably currently dominant IROL paradigm. Taken together, these Chapters suggest that a normative approach that suggests the complementarity of IROL and NROL considerations is both *possible* and *warranted* within the existing framework.

Chapter 1 presents first the overview of the dominant understanding that IIL is a *regime* that is there to provide the *international* rule of law, with particular reference to the FET standard as its preeminent tool for that goal. International rule of law would here entail a supranational and substantively uniform understanding of the rule of law requirements contained in the FET standard and enforced against host States through ISDS. This is problematized by arguing firstly that the predominantly bilateral nature of the regime's building blocks brings into question the vision of multilateral substantive uniformity; and secondly, it is problematized by the peculiar process of IIA conclusion. In many instances, it is unclear if the participating States were aware of the possibility that an IROL paradigm would emerge - or even of the possibility that IIL was to coalesce into a regime. While these issues do not formally bar the *de facto* multilateralization that occurred after the rise of ISDS, they represent important normative factors that do not seem to have duly and sufficiently influenced the regime-building process or the interpretation and application of the FET standard.

The remainder of the chapter sketches the IIL regime-building process and illustrates how - mainly due to the specific features of the arbitration community and the widespread recourse to *de facto* precedents - the normatively problematic issues did not prevent the emergence and dominance of the IROL paradigm. The overall conclusion is that the foundations of the IIL regime did not make it inevitable that the IROL paradigm should be the only relevant one. From both formal and normative perspectives, the FET standard remains open to different understandings of the aims of decision-making, while still being broadly oriented towards the rule of law promotion.

## **Chapter 2 - The IROL paradigm challenges and the tools for tackling them**

The broader normative *possibility* of adding complementing paradigms to FET decision-making does not necessarily imply a *need* for them, nor does it guarantee formal feasibility. Chapter 2 therefore goes further to examine and problematize certain aspects of the IROL paradigm as operating in practice, as well as to illustrate that NROL paradigm complementation is a possibility under the formal legal framework. Thus, before further normative discussion (in Chapter 3) of why the FET sub-principles should be interpreted and applied with national rule of law in mind, this Chapter will set out three propositions as a relevant background.

Firstly, the FET jurisprudence does indicate an unequal and divergent approach to the interpretation and application of the FET sub-principles, both in terms of the autonomous understanding of what the FET standard specifically entails and in terms of the relationship towards national law and international obligations of the host State. Secondly, and relatedly, there *are* examples in jurisprudence that clearly demonstrate the readiness of tribunals to duly take into account the parallel obligations of the host State and incorporate them into the FET decision-making. This shows that the NROL paradigm as such is not a groundless proposal even when considering the existing jurisprudence. Furthermore, and thirdly, this Chapter argues that both in terms of rules of interpretation and through choice and weighing of relevant facts, investment tribunals do have at their disposal the necessary formal tools to make the suggested NROL paradigm a regular complementary feature of deciding the FET claims.

Conclusion to this chapter also offers an overview of certain common points arising from the first two chapters, points that should sketch a normative way forward towards a complementary NROL paradigm. The general normative desirability and potential benefits of introducing a focus on the national rule of law are then the main topic of Chapter 3.

### **Chapter 3 - A normative case for strengthening the national rule of law through FET decision-making**

Chapter 3 sets out the key arguments for added benefits accruing from a complementary focus on the national rule of law in FET decision-making. As it is possible to imagine different answers to IROL paradigm challenges discussed in Chapter 2, the case is made as to why the complementary NROL paradigm should be seen as a preferable path, in addition to being formally feasible.

To offer a foundation for the normative discussion, Chapter 3 first discusses certain aspects of *Genin v. Estonia* award as a suitable example from practice. The analysis and findings of the tribunal in that case are (perhaps necessarily) of limited value for establishing any system-wide international rule of law requirements for a specific State-investor situation. However, those same findings also show much promise as a tool to strengthen the rule of law in a specific host State – provided that this goal is embraced and the reasoning accordingly enhanced.

The Chapter primarily discusses four key reasons for the complementary focus on the national rule of law. Firstly, this focus is warranted as it recognises the far more elaborate nature of domestic rule of law frameworks in comparison with the still developing FET jurisprudence. Secondly, respect for the national visions of the rule of law finds support in the concepts of sovereignty, subsidiarity and plurality in international law. Thirdly, the emphasis on the domestic rule of law framework is also more in accordance with the *ex ante* expectations of foreign investors and domestic decision-makers – with the FET protections in that sense rather being *ultima ratio* considerations. Finally, the focus on the national rule of law is a way of more effectively pursuing the ultimate expectation that the host States have from the IIL regime more broadly – economic development. The strength of the domestic rule of law framework critically contributes to host State development. This should thus be given due weight by the tribunals.

Chapter 3 provides both the conclusion to the normative discussion on the complementation of the IROL paradigm with an NROL one, and a background to discussing further practical implications of such complementation. These implications

are topics of Chapters 4 and 5. Specifically, these chapters focus on three proposed elements that should feature in substantive decision-making.

#### **Chapter 4 - The ideal-type model of the domestic rule of law**

If the focus on the national rule of law is accepted as normatively preferable, and NROL paradigm complementation is desirable, it is important to deduce the practical implications for the FET decision-making process. Chapter 4 elaborates upon the *ideal-type model of the domestic rule of law* as an element of decision-making that concretizes the NROL paradigm. The ideal-type model would be an overview or a summary of existing international and municipal obligations of the host State relating to the specific legal situation that is being assessed. In interpreting and applying the relevant sub-principle of the FET standard, the investment tribunal should duly and meaningfully take into account this ideal-type model in its deliberations – while still retaining the power to take into account other facts and circumstances relating to the case at hand. After that step, the final determination on the existence of a breach also depends on the relevant standard and method of review employed, with the adoption of these remaining a distinct interpretive exercise from the use of the ideal-type model.

Chapter 4 focuses on the method of constructing the ideal-type model, its potential elements, and a number of associated concerns and challenges. It also provides a hypothetical example to illustrate how the NROL paradigm complementation could look in practice. Specifically regarding potential challenges, the chapter discusses the importance of new treaty-making in refining IIA content; the relationship with the standards and methods of review; and potential conceptual and practical obstacles to ascertaining the content of instruments comprising the model.

Finally, to translate this discussion into illustrations, the chapter offers a case study (*Dan Cake v. Hungary*) as a support to the plausibility of elaborating ideal-type models. This should demonstrate that, providing there is a will, there is nothing inherently problematic for the tribunals to make persuasive holistic assessments of the host State rule of law obligations beyond the FET standard.

## **Chapter 5 – Comparative benchmarks and corrective good faith factors**

The final chapter discusses two additional elements that should feature in decision-making processes that aim to combine the IROL and NROL paradigms - *comparative benchmarks* and *the corrective good faith factors*. Respectively, these suggest the roles for the comparative recourse and good faith considerations that potentially enhance the persuasiveness of the tribunal's reasoning, offer firmer guidelines for the future conduct of the host State and/or ultimately secure a fairness of outcome that perhaps cannot be achieved otherwise.

The first part of the chapter examines comparative benchmarks – law, policy and practice – which should primarily serve to add persuasiveness and gravitas to the tribunals deliberations of how the host State fared under the combination of the FET sub-principle requirements and the ideal-type model. This should help enhance the tribunal's assessment if (e.g.) a particular measure was necessary or suitable, or if a delay was 'undue'. The benchmarks, ideally derived from comparable States or other regimes, would thus both serve to limit the appearance of impressionistic determinations in issues with potentially very serious consequences, and to potentially provide the host State with (comparative) guidelines as to how to avoid similar problems in the future.

The second part of the chapter deals with the corrective good faith factors which have a different, but potentially very important role. These factors would represent specific circumstances or fact-patterns existing on either the host State's or the investor's side. Their existence and intensity could lead to a different conclusion about the existence of a breach of the FET standard than the one tentatively reached through the ideal-type model scrutiny. While reserving a special role for the clear instances of bad faith behaviour (*mala fides*) and the concretisations of good faith existing within the ideal-type model, this element should represent a shift of the role of the good faith in IIL from a rule-generative to a corrective one. Corrective good faith factors could thus be of the main manifestations of the residual power of arbitrators under the FET sub-principles to achieve the fairness of outcome and to potentially counter-balance the overemphasis on considerations relating to specific national law.

## **Conclusion**

The conclusion provides a summary of the arguments and discusses potential avenues of further research. These can particularly focus on examining the jurisdictional and/or procedural aspects of IIL and ISDS which bear relevance to securing and enhancing the rule of law at the domestic level. In areas such as uncovering corruption, effective efforts to promote the national rule of law may in many ways require imaginative use of the procedural, jurisdictional and substantive decision-making tools at the arbitrators' disposal. The shift towards the national rule of law can and should have a broader meaning for IIL. It is thus the author's hope that this PhD is but a first step in uncovering that meaning.



## Chapter 1 – The IIL regime and the international rule of law paradigm

### 1.1. Introduction

Should protecting foreign investments lead to completely autonomous substantive rules, a globally equal legal ‘playing field’? Can the requirements contained in the FET standard be meaningfully translated into uniform and sufficiently specific rules and exceptions, so as to provide unambiguous guidance and benchmarks for host State behaviour? *Can* and *should* the decision involving a US investor in Canada be indistinguishable from the one involving a South African investor in Lebanon - in terms of sufficiently specific substance of applied rules? As suggested in the Introduction, there are normative reasons for complementing the quest for supranational and substantively uniform rule of law requirements with a systematic and case-specific focus on the national rule of law and the way it operated regarding a foreign investor. This and the following chapter focus on the existence of the *possibility* and the *need* for such complementing. Chapter 1 focuses on the foundations and Chapter 2 on the operation of the arguably currently dominant decision-making paradigm concerning FET (and IIL more generally), here dubbed the international rule of law (IROL) paradigm. Taken together, these Chapters suggest that a normative approach that suggests the complementarity of IROL and NROL considerations is both *possible* and *warranted* within the existing legal and normative framework.

This chapter first presents (in section 1.2.) the overview of the dominant understanding that IIL is a *regime* that is there to provide the *international* rule of law, with particular reference to the FET standard as its preeminent tool for that goal. International rule of law would here entail a supranational and substantively uniform understanding of the rule of law requirements contained in the FET standard, which are then enforced through ISDS. Section 1.3. to an extent problematizes such an understanding by arguing firstly that the predominantly bilateral nature of the regime’s building blocks brings into question the vision of multilateral substantive uniformity (1.3.1.). Secondly, the IROL paradigm is further questioned (in section 1.3.2.) in light of the peculiar process of IIA conclusion. In many instances, this casts doubts if the participating States were aware of the possibility of the IROL paradigm becoming dominant - or even of the possibility that IIL was to coalesce into *a* regime. While these

issues do not formally bar *de facto* multilateralization that occurred after the rise of ISDS, they represent important normative factors that do not seem to have duly and sufficiently influenced the regime-building process or the interpretation and application of the FET standard.

Section 1.4. presents an overview of that regime-building process. It aims to illustrate how, mainly due to the specific features of the arbitration community and the widespread recourse to *de facto* precedents - the normatively problematic issues did not prevent the emergence and dominance of the IROL paradigm over other considerations. Section 1.5. concludes by noting that the foundations of the IIL regime did not make it inevitable that the IROL paradigm should be the only relevant one. From both formal and normative perspectives, the FET standard remains open to different understandings of the totality of aims in decision-making, while still being broadly oriented towards the rule of law promotion.

## **1.2. The IIL regime and the IROL paradigm**

Securing the rule of law for foreign investors through IIL more broadly, and FET more specifically, arguably presupposes two elements. One is that IIL is perceived as a ‘regime’ that is more than simply a sum of IIAs as its parts, each of which might be alternatively seen as completely independent in its function and purpose. The second element, if IIL is thus perceived as a sufficiently homogenous whole, is clarity as to what this regime-inherent vision of rule of law entails for both the host States and foreign investors. Sections below discuss these elements. Section 1.2.1. briefly deals with the widespread and relatively uncontroversial view of IIL as a regime, while section 1.2.2. elaborates on the predominant understanding that the IIL regime should provide what can be termed the *international* rule of law, largely detached from potentially specific or idiosyncratic national understandings of that term – thereby providing the foundation for interpreting the FET standard in the same way. It is warranted to note that the discussion below touches upon the IIL regime more broadly, and can thus be relevant for other IIA standards as well. However, the purpose here is to provide the broader background which led to the FET standard being seen as perhaps the most prominent IROL-promoting tool in the arsenal of international investment law.

### 1.2.1. International investment law as a regime

The characterisation of IIL as a ‘regime’ is common in literature.<sup>1</sup> Discussing the actual meaning of the term, on the other hand, is not as common.<sup>2</sup> It is possible, of course, to perceive ‘regime’ as a mere catch-all phrase for the whole undifferentiated mass of IIAs and the ever-growing ISDS case law. But that would hardly be the usually desired meaning. Without going further into ‘regime theory’,<sup>3</sup> for the present purposes it suffices to note that both practice and doctrine *do* consider IIL to be more than just a sum of its parts. As the ISDS jurisprudence will be discussed more in section 1.4.3., the focus here is on the common doctrinal views. These retain their distinct focuses, but largely agree on the IIL operating as a greater and sufficiently homogenous whole.<sup>4</sup>

IIL is sometimes portrayed in the sense of a system of IIAs,<sup>5</sup> with an emphasis on IIL’s sub-field status within international law as a ‘specialized area of the legal profession.’<sup>6</sup> McLachlan, Shore and Weiniger note the ‘patchwork quilt of interlocking but separate bilateral treaties’<sup>7</sup> which eventually lead to a ‘common law of investment protection, with a substantially shared understanding of its general tenets.’<sup>8</sup> David Schneiderman portrays IIL as a ‘transnational regime’ attempting to ‘fashion a global tapestry of economic policy, property rights, and constitutionalism.’<sup>9</sup> It is a form of ‘supraconstitution’ which supersedes, disciplines and reshapes constitutional laws of the

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<sup>1</sup> For a very brief selection of examples see Salacuse 2010, Reisman 2013, Sauvant 2014, Sornarajah 2013 and Alvarez 2005. It should be noted that the distinction between IIL and ISDS is not always clear cut, thus leading some authors to describe ISDS as a system or regime of its own (see remarks of Banifatemi in Secreto/Teitelbaum 2009, 323-324).

<sup>2</sup> Schill 2009, 17. The exception to this is, for example, Salacuse 2010.

<sup>3</sup> In this context, for example, see Reisman 2013, 139 fn 26 on the notion of ‘system’ in the works of Parsons, Habermas and Giddens. See more generally the seminal work of Krasner 1983, as well as Keohane 1984; Levy/Young/Zürn 1995; Hasenclever/Mayer/Rittberger 1997 and Breitmeier/Young/Zürn 2006.

<sup>4</sup> But see also Peter Muchlinski, suggesting that IIL is not a system of law, but ‘more a process of practitioner-led treaty interpretation that allows for a creative approach to investor and investment protection’ (2011, 3). ISDS would thus be ‘more accurately described as just a method of delocalised dispute settlement based on the specific rights of claim and procedures contained in each treaty’ (2011, 8). Yet, as is also argued in this context, fact that actors themselves might not fully agree on the regime’s contours, values, or ‘degree of coherency’ (see Simma/Pulkowski 2006, 500), does not necessarily detract from regime being such (Reisman 2013, 142 and 150).

<sup>5</sup> Newcombe/Paradell 2009, 1-3 and 57-61. See similarly Alvarez 2005, 94.

<sup>6</sup> Dolzer/Schreuer 2012, 19; see generally and similarly also De Brabandere 2014; Wälde/Kolo 2001; Schill 2009, 17. M. Sornarajah identifies IIL overall as ‘a branch of international law [...] in the process of development and [which] can be isolated for separate study’ (2010, 32).

<sup>7</sup> McLachlan/Shore/Weiniger 2007, para. 1.08.

<sup>8</sup> *ibid*, para. 1.50 and more generally 1.48-1.56 and 3.83-3.103. See also Newcombe/Paradell 2009, 59-61; Dolzer/Schreuer 2012, 33.

<sup>9</sup> Schneiderman 2008, 2.

states across the globe.<sup>10</sup> Stephan Schill notes the multilateralization process of IIL, in which (mostly through the operation of ISDS) myriad BITs become a ‘treaty-overarching framework with uniform standards of investment protection’<sup>11</sup> with ‘only limited room for insular deviation by individual states’.<sup>12</sup>

The investment regime is also sometimes described as a ‘structure of global governance’,<sup>13</sup> within the broader phenomenon of Global Administrative Law (GAL).<sup>14</sup> GAL is a part of the vision of global governance as administrative action, with rulemaking, administrative adjudication and other forms of regulatory and administrative decision-making.<sup>15</sup> Within that conceptual structure, IIL regime is seen as defining specific GAL principles and setting standards for State-internal administrative processes,<sup>16</sup> creating a new body of constitution-trumping laws,<sup>17</sup> and simply ‘filling’ the normative content of GAL as its most prominent example.<sup>18</sup>

Largely regardless of what exact understanding is adopted, the perception of IIL as a regime opens the issue of its general normative underpinning, or more simply the question of what is the regime there to do. As the following section will argue, there are widespread arguments in doctrine that IIL is a tool to secure the rule of law for foreign investors, through constraining the host States according to the particular *international* rule of law precepts largely shaped within the regime itself. In that context, the FET standard often acts as the spearhead.

### **1.2.2. The international rule of law (IROL) paradigm and the FET standard**

As noted in the Introduction, the IROL paradigm in this thesis presupposes that the FET standard contains uniform rule of law requirements detached from those at the level of the host State, that are then given practical effect through ISDS. This is in accordance with the understanding of the international rule of law as mandating specific

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<sup>10</sup> *ibid*, 3. See somewhat similarly Schill 2009, 373.

<sup>11</sup> Schill 2009, 367.

<sup>12</sup> *ibid*, 17.

<sup>13</sup> Kingsbury/Schill 2009a, 1. See also generally Stone Sweet/Grisel 2014, 46-47.

<sup>14</sup> Kingsbury/Krisch/Stewart 2005, 17.

<sup>15</sup> *ibid*.

<sup>16</sup> Kingsbury/Schill 2009a, 1.

<sup>17</sup> Montt 2012, 12.

<sup>18</sup> Loughlin/Van Harten 2006, 122; Montt 2012, 296; Kulick 2012, 83.

behaviour from a State towards entities *under its jurisdiction*.<sup>19</sup> The IROL paradigm would thus imply a globally level playing field – where IIA-protected investors operate in different States while receiving consistent treatment in accordance with the critical precepts such as ‘fair’, ‘equitable’, ‘non-arbitrary’, ‘transparent’.<sup>20</sup> These precepts thus presume their sufficiently consistent understanding in ISDS practice so to make this possible.<sup>21</sup> If nothing else, this should at least limit the role of inadequacy of the domestic legal framework as a cause of legal and political risk.<sup>22</sup>

The IROL paradigm regarding the FET standard (and other aspects) is arguably dominant in the IIL doctrine, and in different ways also manifests itself in practice of investment tribunals. There is a widespread agreement among authors that the IIL provisions, as given ‘teeth’ by ISDS, are there to secure the rule of law for foreign investors.<sup>23</sup> The key concepts such as the FET standard largely reflect the common formal precepts of the rule of law, however with the more specific content here retaining an international (sometimes also dubbed transnational) character. Critical feature is the avoidance of unnecessary interaction with the domestic understandings of what the rule of law means and how it is secured in the concrete host State,<sup>24</sup> therefore also preserving the apparent neutrality of the rule of law precepts.<sup>25</sup> An IIA containing at least an FET provision is ‘necessary’ as the pre-existing legal framework is mostly

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<sup>19</sup> As discussed in the Introduction, this understanding is distinct from international rule of law as *between States* and as *between international law and the individual directly* (as in case of international criminal law). See Chesterman 2009, 68-69 and particularly elaboration in Kanetake 2016a, 16-17.

<sup>20</sup> See in that sense Ortino 2013a, 444 and Paulsson 2008b, 251-252.

<sup>21</sup> As Yackee notes, ISDS is ‘often justified as functionally necessary to [...] ensure investors access to stable, predictable and favourable legal rules’ (2012, 421).

<sup>22</sup> It is, however, also noted that IIAs are *not* meant to completely replace the actual foreign investment insurance. See for an overview of arguments and empirical research in this sphere Poulsen 2010 and more generally also Rubins/Kinsella 2005.

<sup>23</sup> As Van Harten notes, ‘rule of law-based advocacy is widespread in academic, practitioner, policy, and popular literature on investment arbitration’ (2010c, 627 and materials cited therein). See also, among many others, Guthrie 2013, 1160 ([...] BIT’s are a method of ensuring that foreign investment is treated in accordance with the rule of law’); Ortino 2013a, 443 (‘the principle of the rule of law [provides] a normative justification for investment treaties’); McLachlan/Shore/Weiniger 2007, 128; Alvarez 2016, 227 (‘of course, the investment regime is intended to compel governments to respect the rule of law [...]’); Bonnitcha 2014, 31. See also generally Mitchell/Sheargold/Voon 2016.

<sup>24</sup> As Alvarez notes, a conflict between an IIL understanding of the rule of law and the national one ‘is not only likely but inevitable’ (2008, 974). IIL community this sees its norms as ‘higher law’, providing ‘objective criteria’ detached from domestic understandings (Schneiderman 2017, 1). See similarly Spiermann 2008, 95 and Carvalho 2016, 1.

<sup>25</sup> Hirsch 2015, 151. See also Simma 2011, 576.

seen as insufficient and securing the rule of law is thus a primary function of an investment treaty.<sup>26</sup>

For James Crawford, the role of IIL is on occasion not just to reinforce but actually *institute* the rule of law - absence of arbitrary conduct, judicial independence and non-retrospectivity are all ‘standards’ of the rule of law present in IIAs so to potentially discipline a host State.<sup>27</sup> If a State fails to respect the rule of law, financial liability will likely come its way.<sup>28</sup> As David Rivkin summarized with specific reference to the FET standard, ‘[a]rbitrators have developed a *supranational rule of law* that has helped to create *uniform standards for acceptable sovereign behavior*.’<sup>29</sup>

To reiterate, in the context of FET, Stephan Schill has argued that this standard should be seen as having a genuine and independent normative content, united under the concept of the rule of law.<sup>30</sup> Schill further identifies 7 specific recurring clusters of its sub-elements in ISDS practice: 1) stability, predictability and consistency; 2) principle of legality; 3) protection of legitimate expectations; 4) procedural due process and denial of justice; 5) substantive due process and protection against discrimination and arbitrariness; 6) transparency and 7) reasonableness and proportionality.<sup>31</sup> A number of authors argue along similar lines.<sup>32</sup>

What does this mean for the host State? More generally, it suggests that the host States should bring their practice and law in line with the expectations which are considered inherent to IIA provisions.<sup>33</sup> In the oft-cited separate opinion in *International*

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<sup>26</sup> Guthrie 2013, 1166. See similarly Calamita 2015, 122 (‘a frequently recited aspect [...] is that a principal purpose of international investment treaties is to serve as an internationalised substitute for the domestic legal systems of host states in which the place of the rule of law [...] may be unreliable or uncertain.’); and also Dolzer/Schreuer 2012, 25; Hsu 2015, 137; Yackee 2012, 421; Hepburn 2017, 15; Brower/Blanchard 2014, 756.

<sup>27</sup> Crawford 2003, 7-8. See similarly Dolzer 2005, 953-954 and Kotuby/Sobota 2013, 454 and 464.

<sup>28</sup> Alvarez 2016, 227 (‘Investor-state arbitrations impose financial liability for states that fail to respect the rule of law.’)

<sup>29</sup> Rivkin 2012, 2 (and similarly at 14) (emphasis added). See similarly Guthrie 2013, 1167 and authors cited in Shultz/Dupont 2014, 1164.

<sup>30</sup> Schill 2010b, 154. It is also further seen as a part of the emerging global regime, something developed in more detail by Kingsbury/Schill 2009a. See also Gallus 2005, 712 and Dolzer/Schreuer 2012, 133-134 (‘There is no doubt that the FET standard is meant as a rule of international law and is not determined by the laws of the host state.’)

<sup>31</sup> Schill 2010b, 159-60. Analysis of these sub-elements is provided at 160-170.

<sup>32</sup> See in particular Vandevelde 2010, as well as Behrens 2007, 175; Guthrie 2013, 1165; Montt 2012, 76 and Mitchell/Sheargold/Voon 2016, 19.

<sup>33</sup> As Mavluda Sattorova notes, ‘[t]he proliferation of references to good governance in arbitral jurisprudence and investment treaty texts has coincided with a new wave of scholarship where

*Thunderbird Gaming*, the late Thomas Wälde suggested, concerning in particular the requirement of legitimate expectations, that preventing the '[a]buse of governmental powers [...] is at the core of the *good-governance standards embodied in investment protection treaties*.'<sup>34</sup> An award concerning this FET sub-principle should thus have a 'good-governance signal' as its ultimate goal - essentially a guidance for Mexico to observe in the future.<sup>35</sup> Numerous investment awards make sometimes less explicit, but nevertheless clear suggestions of the embedded rule of law requirements. To stay with Schill's delineation, awards for example require the host States to provide stability and consistency,<sup>36</sup> respect domestic legality,<sup>37</sup> provide procedural due process<sup>38</sup> and behave transparently.<sup>39</sup> Taken together, these requirements – joined together within the FET standard - could form a *sui generis* rule-of-law rulebook, specifically for dealing with foreign investors.

Indeed, specifically on the topic of the (common) interplay between IIL and domestic administration, Rudolph Dolzer concludes that the effect of IIL is the (necessary and unavoidable) creation of 'bubbles' of separate administrative law for foreign investors. As he notes, the 'impact [...] on the domestic law of host states remains real; [...] *domestic rules applicable to foreign investors must be adjusted to accord with the obligations imposed by the international treaty*'<sup>40</sup> - with the FET standard being one of the provisions with the 'most severe impact on the domestic legal systems.'<sup>41</sup> The

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considerable emphasis is made on the importance of the investment treaty regime in transforming governance culture and practices in host States' (2015, 165).

<sup>34</sup> *International Thunderbird v. Mexico – Separate Opinion Wälde*, para. 13 (emphasis added). See also paras. 14-15. See similarly Muchlinski 2006, 535-536.

<sup>35</sup> *ibid*, para. 123. See also for example the *Parkerings v. Lithuania* conclusions on the rule of law aspects of the behaviour of the Lithuanian Prime minister (para. 358) and of Lithuanian courts (para. 360).

<sup>36</sup> Often cited examples are *CMS v. Argentina – Award* (para. 274: 'stable legal and business environment is an essential element' of FET, followed almost ad verbatim in *Occidental v. Ecuador*, para. 183 and *LG&E v. Argentina – Liability*, para. 124) and the *PSEG v. Turkey* award description of the unacceptable 'roller-coaster' of legislative changes (para. 250).

<sup>37</sup> An influential early case in that sense was *Gami v. Mexico*, para. 91 ('a government's failure to implement or abide by its own law in a manner adversely affecting a foreign investor may but will not necessarily lead to a violation'). Similarly, but more pointing towards potential bad faith *abus de droit* is *Tecmed v. Mexico*, para. 154 – host States must use 'the legal instruments that govern the actions of the investor or the investment in conformity with the function usually assigned to such instruments' and similarly *Noble Ventures v. Romania*, para. 178). See also *Lauder v. Czech Republic*, para 207; *Plama v. Bulgaria*, paras. 291 and 267; *Genin v. Estonia*, para 365; *MCI v. Ecuador*, para 154. See also for comment Bonnitcha 2014, 203-204.

<sup>38</sup> *Rumeli v. Kazakhstan – Award* concluded that 'a court procedure which does not comply with due process is in breach of the duty [to provide FET]' (para. 653).

<sup>39</sup> *Tecmed v. Mexico*, para. 154; *Saluka v. Czech Republic*, para. 309; *Metalclad v. Mexico*, para. 99.

<sup>40</sup> Dolzer 2005, 955 (emphasis added). Somewhat similarly, Kulick argues that the pressure is put on the executive and legislature to conform administrative practice and legislative acts to IIA provisions, which he compares to ECHR effect in member States (2012, 126-127).

<sup>41</sup> Dolzer 2005, 957-958.

adjustment of host State behaviour takes form in limiting, defining and narrowing administrative regulations to which foreign investors are to be subjected,<sup>42</sup> and is inherently indifferent to issues relating to the host State nationals.<sup>43</sup> Dolzer surmised that this is ‘normally perceived as a necessary consequence of an investment friendly climate rather than a negative aspect which should be avoided in principle. [...]’.<sup>44</sup>

In a similar vein, UNCTAD noted that the increased number of arbitrations, almost always involving the FET standard, may motivate host States to ‘improve domestic administrative practices and laws in order to avoid future disputes.’<sup>45</sup> For some authors, both IIL and administrative law have the same major concern – conduct of the State – and can benefit and reinforce each other,<sup>46</sup> while for others the provisions such as the FET standard aspire to establish a ‘system of international administrative law for foreign investment’<sup>47</sup> or a ‘body of international rules of administrative law’.<sup>48</sup> But the ‘shaping’ effect is not confined to administrative issues.<sup>49</sup> More generally, the States are required to ‘conform their behaviour to rule of law standards that *enable market forces to unfold*’<sup>50</sup> and should not be allowed to ‘misregulate’.<sup>51</sup> As the *ADC v. Hungary* tribunal emphasised ‘a sovereign State possesses the inherent right to regulate its domestic affairs, the exercise of such right is not unlimited and must have its boundaries. [...] the rule of law, which includes [IIA] obligations, provides such boundaries.’<sup>52</sup> The legitimate expectation of a ‘fair treatment’ plays a particularly important role in that sense.<sup>53</sup>

In summary, the host State and its decision-makers should ideally face a set of sufficiently clear, IROL-defined concepts within the FET standard. These should also preferably be internalised so to avoid the conflicts with foreign investors arising in the

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<sup>42</sup> *ibid* 2005, 953.

<sup>43</sup> *ibid*, 954.

<sup>44</sup> *ibid*, 955.

<sup>45</sup> UNCTAD 2007a, ix.

<sup>46</sup> Pérez Loose 2010, 404–405.

<sup>47</sup> Dolzer 2005, 970. See similarly Kalderimis 2012, 159.

<sup>48</sup> Dolzer/Schreuer 2012, 24. See in that sense also the discussion of the relationship with Global Administrative Law in Van Harten/Loughlin 2006.

<sup>49</sup> More generally, as Guthrie notes, domestic legal systems are generally shaped to conform to ‘international standards embodied in a BIT’ (2013, 1194).

<sup>50</sup> Schill 2009, 364 (emphasis added). See also Wälde 2007, 104 stating that ‘the role of investment treaties is to provide an *external anchor* for economic policies that are in the long term sensible for national economies and the global economy.’ (emphasis added).

<sup>51</sup> Carvalho 2016, 20.

<sup>52</sup> *ADC v. Hungary*, para. 423.

<sup>53</sup> *ibid*, para. 424.



first place. Conversely, foreign investors should have recourse to these IROL-defined concepts in calculating their risks before investing and during the life of their investment. They should be able to, for example, warn the host State about what they perceive as the behaviour falling below their requirements. Should the relationship still break down, the precepts provided should also serve to pre-judge the comparative strengths of each party's positions and potentially help reach a solution that does not involve arbitration. Finally, these IROL-defined concepts should provide the 'objective criteria' according to which neutral arbitrators - regardless of the connection with the domestic legal system - can nevertheless persuasively settle the dispute and hopefully provide future guidance for other investors and host States.<sup>54</sup>

### **1.3. The IROL paradigm as exclusive – some foundational problems**

The understanding of IIL as a uniform regime and the widespread presence of the IROL paradigm for substantive decision-making in the FET may be dominant without necessarily being inevitable or preclusive to thinking about other normative possibilities. Whether a global, multilateralised foreign investment protection regime exists, and what its normative orientation is, are more than academic issues. Briefly put, IROL-oriented multilateralism implies a number of assumptions that should not be taken for granted without a degree of scepticism. For example, as is noted, investment protection has a politically and ideologically turbulent past.<sup>55</sup> Proclaiming a substantively uniform regime and supranational rule of law standards would suggest that ideological and legal struggles over investment protection have been conclusively settled.<sup>56</sup>

This does not seem so straightforward. In the early 1990s, it might have seemed plausible that entering into IIAs was seen by (at least some) of those involved as a ticket to join the neo-liberal Washington Consensus.<sup>57</sup> But what happens if that (or any other)

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<sup>54</sup> '[S]tate may take notice when others are found to have violated BIT obligations, and act pre-emptively to avoid a similar fate' (Guthrie 2013, 1194). Otherwise, it may appear that ISDS would produce something akin to a 'legal casino' (Werner 2003, 782).

<sup>55</sup> Muchlinski 2008, 5.

<sup>56</sup> See for earlier work suggesting this Gunawardana/Alvarez 1992, and more recently Hindelang 2004; and Alvarez 2008, 962-963. See also for discussion Schneiderman 2008, 62 and more generally on the spread of neo-liberalism Simmons/Dobbin/Garrett 2006.

<sup>57</sup> Jandhyala/Henisz/Mansfield 2011, 1054; Ruiz Fabri 2012, 353. See also more generally Simmons/Dobbin/Garrett 2006. On the Washington Consensus, see Salacuse 2007, 160 and also Dolzer/Schreuer 2012, 25.

consensus stops being accepted as such?<sup>58</sup> How can, in other words, IIAs cope with the need to interpret the provisions such as the FET standard in an evolutionary manner?<sup>59</sup> Saying that IIAs are somehow excluded from evolving interpretation would not only be doctrinally questionable, but also begs the question when and how was the canon of their (more ideological) interpretation irrevocably entrenched.<sup>60</sup> As is sometimes noted, even the developed Western capitalist democracies which are rightfully seen as the progenitors of the IIL foundations for most of its history,<sup>61</sup> differ so significantly in their approaches to market economy that it would be difficult to believe that the IIAs concluded by them implied a single, uniform model of ‘free market capitalism’.<sup>62</sup> This brings into question to what extent the rule of law requirements in the FET can truly be autonomous and supranational.

The appealing appearance of the FET standard and its sub-principles makes them almost impossible to disagree with in general.<sup>63</sup> A State announcing beforehand that it will not treat investors fairly would indeed be hard to find. This does not, however, mean that a broad commitment to fair and equitable treatment of investments necessarily implies an agreement on the content and the exceptions to this treatment.<sup>64</sup> This is particularly so regarding the ‘older generation’ IIAs (characterised by cursory provisions) which still form an immense part of the existing network.<sup>65</sup>

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<sup>58</sup> As is argued, the policy shift away from the Washington Consensus puts the whole rationale of IIL into question. See in that sense Garcia-Bolivar 2009b, 469-470; Van Harten 2010a, 899 and Salacuse 2010, 470.

<sup>59</sup> Muchlinski 2013, 413-414.

<sup>60</sup> As Vid Prislan concludes, ‘there is nothing to suggest that the parties to an IIA shall have intended its terms always to have a fixed meaning’ (2013, 472).

<sup>61</sup> See in that sense Schneiderman 2008, 45.

<sup>62</sup> As Fritz Scharpf has noted in the EU context, a uniform model simply does not exist as economic and institutional heterogeneity of European states is ‘extreme’ – models of capitalism and the welfare state simply cannot be generalized (Scharpf 2015, 395).

<sup>63</sup> On how this helped secure an ‘easy passage into treaty practice’ see McLachlan/Shore/Weiniger 2007, para. 7.181. See also more generally Smits 2012, 91.

<sup>64</sup> As UNCTAD has noted in the property protection context, there exists ‘the ever increasing and changing conception of property rights and, in particular, of the social function of property’ (UNCTAD 2013, 111). For Jansen Calamita, ‘[IIAs] in the main did a poor job of creating or articulating a political settlement on the underlying debate with respect to the appropriate standard of treatment of foreign investors.’ (Calamita 2015, 110). See also in a similar vein Muchlinski 2008, 17 and Waibel et al. 2010, xlvii.

<sup>65</sup> As Vandevelde noted, these IIAs are almost universally silent on numerous important issues (1998, 640-641).

Proclaiming the existence of globally uniform and sufficiently clear rule of law requirements contained in the FET standard is thus certainly an appealing prospect, but is also a considerably tall order. Writing as early as 1960, Paul Proehl states:

[...] the capital-importing nations are unwilling to go along with an agreement which commits them to an 'open-end' investment system and puts ultimate control over any segment of national economic life beyond governmental reach by reason of treaty right. Our sound and stable way of doing business cannot simply be extended by fiat to the underdeveloped countries. It cannot be unilaterally imposed nor less than freely accepted.<sup>66</sup>

As argued in the sections below, there are at least two features connected to the foundations of the IIL regime – the network of IIAs – which bring into question the today dominant understandings of the regime as a form of Proehl's 'open-end' system. Firstly, as discussed in section 1.3.1. the predominantly bilateral nature of the IIAs should both formally and normatively cause considerable pause before proclaiming a substantively uniform and coherent – *multilateralised* – international regime of foreign investment protection that should avoid systematic engagement with other aspects of the legal framework binding the host State. Secondly (as discussed in section 1.3.2.), empirical work on the process of IIA conclusion casts further doubts whether at least a considerable number of participating States actually desired the IROL-oriented interpretation of the provisions such as the FET standard – or were in some cases even aware that *any* particular paradigm will or should form. These considerations should both indicate the still open field for different thinking about the operation of the FET standard, and also serve as a background for discussing the process through which dominance of the IROL paradigm was achieved (as elaborated in section 1.4.).

### **1.3.1. Problematic regime symmetry - multilateralism *via* bilateral treaties**

The dense network of IIAs that undergirds the IIL regime is bilateral to a vast extent.<sup>67</sup> The number of multilateral, or rather plurilateral agreements is statistically negligible when compared to the total number of IIAs. This, of course, does not undermine the importance of these agreements otherwise. Agreements such as NAFTA (Chapter 11) and Energy Charter Treaty (Part III) have, for example, played a very

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<sup>66</sup> Proehl 1960, 364 (footnotes omitted). See also generally Vandevelde 1998.

<sup>67</sup> Schill 2009, 364.

prominent role in the development of IIL in terms of generating ISDS jurisprudence on issues such as the FET standard.<sup>68</sup>

If IIL is compared, for example, to the intentionally multilateral edifice of WTO, can such a fundamental difference in basic building blocks be waived away in terms of legal consequences?<sup>69</sup> That is, can both regimes be seen as ‘equally multilateral’ regardless of their different treaty bases? For some authors, there is little doubt in this regard - IIL is seen as an even stronger regime than WTO law.<sup>70</sup> For Stephan Schill, a legal ‘glue’ for the whole regime can be found in the operation of the ‘most favoured nation’ (MFN) clauses. As Schill suggests:

MFN clauses not only multilateralize the level of substantive investment protection, but also have a multilateralizing impact on dispute settlement procedures available to foreign investors. [...] MFN clauses, therefore, create a uniform regime for the protection of foreign investors in any given host State independent of the investor’s nationality.<sup>71</sup>

Another common argument for overcoming bilateralism is the sufficient similarity of wording of substantive provisions, making differing interpretations unacceptable from the viewpoint of consistency and predictability. The wording which is so similar, the argument goes, points toward an implicit striving for multilateral interpretation and regime-building.<sup>72</sup>

Some of this issues, namely the similarity of wording, will be revisited also in section 1.4.3. below. At this point it suffices to note that both arguments certainly have merit, and provide reasonable grounds for a form of multilateralization to take place. The issue is rather that even those arguments already presuppose to an extent a form of an IROL paradigm understanding – as in that the substance of an IIA provision is deemed to be substantively autonomous from the individual BIT and the specific host States which concluded it. If these clauses should have or do have universal meaning, then both the operation of the MFN clauses (in substantive issues) and insistence on

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<sup>68</sup> See generally on this Schreuer/Weiniger 2008 and also Dolzer/Schreuer 2012, 28.

<sup>69</sup> See on this also Kurtz 2014, 271.

<sup>70</sup> Sauvart 2014, xxxv. See similarly Alvarez 2008, 960-965.

<sup>71</sup> Schill 2009, 366.

<sup>72</sup> See in this sense Schill 2009, 372 (‘the standards [...] in any of the more than 2,500 BITs have to be understood as referring to the identical principles that impose identical obligations on the State parties involved.’)

the similarity of wording display the multilateralization potential. But if the content of the IIA provisions would be seen as depending at least to an extent on the identity of IIA parties, that potential arguably diminishes.

Even assuming that all the FET provisions were absolutely identical, it would not be settled that their supranational and ‘multilateralized’ interpretation and application was the only available path. As is claimed, these treaties are *leges speciales* aimed at differing from the pre-existing and mostly customary ‘universal’ law on the topic - whatever its content and merits/demerits might be.<sup>73</sup> A reversal towards complete and exclusive universalism would have to be more than lightly justified. The ‘autonomous legal system’<sup>74</sup> of each IIA would be ignored to a significant extent by aiming to disregard the role of the legal systems and other obligations of the treaty parties.

Another point of note is the lack of potential analogies for such regime-building. The ‘*de jure* bilateral-turning- *de facto* multilateral’ dynamic of IIL does not seem to have clear counterparts elsewhere in public international law. A somewhat analogous situation might exist with the bilateral double taxation treaties – yet the lack of any de-localised dispute settlement seems to prevent the emergence of a transnational regime of ‘double taxation law’.<sup>75</sup> This adds weight to the *sui generis* character of IIL development, and further questions if its developmental path was inevitable and/or is irreversible.

The normative concerns with promoting an exclusively IROL-oriented understandings arguably further increase in light of the failure to formally multilateralise the IIL rules, despite such attempts. Most prominently, the Multilateral Agreement on Investment (MAI), an OECD-led attempt to formulate a multilateral agreement that would build upon the common denominators of existing IIAs ended without an agreement in 1996. This, as noted, was caused by the whirlpool of NGO protests, poor political management of the process, lukewarm business support and lack of definite will among participating States.<sup>76</sup> For some, it was ‘doomed’ as it was an effort to

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<sup>73</sup> See generally on this Kishoiyian 1993 and Gunawardana/Alvarez 1992, 548-550.

<sup>74</sup> Stone Sweet/Grisel 2014, 30.

<sup>75</sup> See generally Baistrocchi 2017 on the limited and necessarily court-led attempt to provide the uniform meaning of terms found in tax treaties.

<sup>76</sup> Geiger 2011, 159-160 and Schneiderman 2008, 174-175; Ruiz Fabri 2012, 367-368; See also generally Kurtz 2002 and Miles 2013, 116-119.

‘replace the regulatory sovereignty of governments with absolute standards of investor protection’.<sup>77</sup> Somewhat surprisingly, the resistance to MAI was coming even from key countries that would have been expected to push vigorously for it within OECD and beyond.<sup>78</sup>

It would be wrong to assume MAI efforts demonstrated a complete lack of agreement among the OECD countries involved. Many issues were successfully negotiated before the collapse.<sup>79</sup> But it seems implausible to suggest that a failure to fully agree even between the largely like-minded OECD countries, followed by a similar failure of WTO efforts,<sup>80</sup> plays no role in normatively assessing the practice of IIL regime-building. The failure to specifically agree *should* be accounted for as it is arguably more meaningful than if the attempt had never even occurred.<sup>81</sup> This is further accentuated by the doubtful prospects for new multilateralization efforts.<sup>82</sup>

The predominantly bilateral nature of IIAs and failed multilateralisation efforts both cast doubt on a completely IROL-oriented understanding of the provisions such as the FET standard. They also enhance the importance of deducing what the host States actually desired when concluding the IIAs. Determining what at least some States (could have) wanted and were aware of seems warranted when discussing the relevant normative underpinnings. Clear indication that the States, despite the problems mentioned above, *did* want an exclusive IROL-oriented approach to the FET standard would go a long way in eradicating the normative concerns. However, as the following section will illustrate, such indications do not seem forthcoming from the existing empirical research.

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<sup>77</sup> Geiger 2011, 160.

<sup>78</sup> On the situation in Canada, see Schneiderman 2008, 196-197.

<sup>79</sup> See Schneiderman 2008, 174-175 and generally Stumberg 1998.

<sup>80</sup> See generally Amarasingha/Kokott 2008 and also Mouyal 2016, 74-75.

<sup>81</sup> See in this sense, for example, Saulino/Kallmer 2014, 2.

<sup>82</sup> Bjorklund 2013, 189-190 and Schreuer 2013, 397.

### 1.3.2. Conclusion of IIAs – controversies and normatively problematic aspects

To add further light to the issue of whether complementing the IROL paradigm with an NROL one should be seen as normatively plausible, it would be helpful to ascertain what where the attitudes of States during the conclusion of investment treaties. Clear indication that the IIA conclusion was accompanied by acceptance and expectation of imposing a distinct supranational set of rule of law principles through (at least) the FET standard could make arguments about complementing these with NROL considerations rather misguided.

It is warranted to first distinguish between the States' expectations relating to the operation of IIA standards and the ISDS, from the expectations that IIAs will translate into increased FDI flows – something that remains empirically controversial.<sup>83</sup> The key question is if the developed and developing States concluding the IIAs, primarily during the pre-ISDS explosion era of 2000s, could have expected and thus rationally consented to the IROL paradigm as it stands today? Could a relatively homogenous, self-referencing, strongly enforced regime of foreign investment protection through the FET (and some other) standards have been legitimately expected by the participating States?

This matters as every regime institutionalises new priorities and new biases of those actors and experts (such as arbitrators) operating within it.<sup>84</sup> As long as bias is 'well established, widely known, and resonates in the community to which the institution speaks'<sup>85</sup> this is generally not an issue. If this is not the case, potential redeeming quality is a level of political control over the regime. This is, however, largely absent in public international law sub-regimes and tends to strengthen the role of functional experts.<sup>86</sup> As Buchanan and Keohane state, '[i]t is not enough that that the relevant actors agree that *some* institution is needed; they must agree that *this* is the institution that is worthy of support.'<sup>87</sup>

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<sup>83</sup> This will also be further addressed in Chapter 3, section 3.6.2.

<sup>84</sup> Koskeniemi 2007, 5-6. See also Shalakany 2000, 465-468.

<sup>85</sup> Koskeniemi 2007, 6.

<sup>86</sup> *ibid*, 9.

<sup>87</sup> Buchanan/Keohane 2008, 29.

It is, with a degree of simplification, possible to broadly identify two schools of thought about the process of IIA conclusion. One can be described as the ‘rational choice’ approach. It presents a narrative of a generally rational approach of States towards the IIAs, with a sufficiently clear understanding of aims, potential benefits *and* arising liabilities. A different view is the ‘bounded rationality’ narrative, which seriously problematizes such assumptions.

#### *‘Rational choice’*

Allowing for certain differences, the point of agreement of the authors within the ‘rational choice’ camp is that the IIA conclusion was a rational response to the unsatisfactory state of international law regulating investor-State relations before 1959. It was a response which aimed at ensuring clarity and consistency, which was put into place with a general awareness of States of the cost-benefit calculus.<sup>88</sup> Portraying the process of IIA conclusion as a response to uncertainty is certainly plausible. As noted by Jeswald Salacuse, it was an attempt to provide rules which were ‘complete, clear, specific, uncontestable, and enforceable’.<sup>89</sup> But it can also be legitimately seen as a political choice. According to Jansen Calamita, the added goal was ‘reducing the likelihood of renewed disagreement with respect to the content or existence of protections in customary international law’,<sup>90</sup> an important goal in the age of the New International Economic Order (NIEO) battles.<sup>91</sup>

The stated goal of clarity and specificity is not *necessarily* marred by the open-textured nature of the substantive provisions. Such provisions can be a rational choice in face of uncertainty about future developments, and they are relatively widespread in international treaty-making.<sup>92</sup> As is sometimes remarked, a treaty is a ‘disagreement reduced to writing’.<sup>93</sup> This potentially indicates that States were not necessarily any less rational about IIAs than about other treaties – further implying that they could perhaps

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<sup>88</sup> Influential works in this general vein are Guzman 1998, Guzman/Elkins/Simmons 2006, Salacuse 2010 and Vandevelde 2009.

<sup>89</sup> Salacuse 2010, 439.

<sup>90</sup> Calamita 2015, 111.

<sup>91</sup> See on this Newcombe/Paradell 2009, 18-19; Vagts 2010; and Miles 2013, 9-11.

<sup>92</sup> See on this in particular Lim/Elias 1997, 3-11.

<sup>93</sup> Allot 1999, 43. See also in similar vein Koskenniemi 2007, 11.



rationality expect the development of an IROL-dominated application of the FET standard.

The said rationality is arguably most emphasised in the work of Elkins, Guzman and Simmons.<sup>94</sup> According to them, the proliferation of BITs (as most representative examples of investment treaties) was propelled in good part by a competition among potential host countries for credible property rights protections that investments require.<sup>95</sup> BITs were therefore viewed by hosts and investors as devices that raise expected returns on investment by assuming that government is making a credible commitment to treat foreign investment ‘fairly’ – thereby providing a ‘competitive edge’ in attracting capital.<sup>96</sup> BITs raise *ex post* cost of renegeing on contracts by reducing the ambiguity of the host government obligations and making a clear statement with much greater reputational costs if later renegeing.<sup>97</sup>

Perhaps the most important assumption is that a decision to sign a BIT *always* involves a host State assessment whether the expected benefits of attracting FDI outweigh the *sovereignty costs*.<sup>98</sup> Simply put, this presupposes that sovereignty costs could be known in advance, and that the operation of the IIA enforcement mechanism in that sense could have been rationally foreseen.

While there are certainly other aspects of rational behaviour that can explain the IIA ‘explosion’,<sup>99</sup> the focus on rational and informed competitiveness with other capital-importing States is argued to provide best explanations concerning developing countries.<sup>100</sup> It can also explain, according to Guzman, the collective resistance portrayed by the NIEO activity and the parallel piecemeal acceptance of IIAs.<sup>101</sup> As for the position of the developed countries, the rationality seems clear enough – it was a

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<sup>94</sup> Elkins/Guzman/Simmons 2006. Salacuse 2007 158-161 and Salacuse 2010, 434-435 follow the same basic idea of rationality, although not necessarily with the similarly strong emphasis on the competitiveness aspect.

<sup>95</sup> Elkins/Guzman/Simmons 2006, 812.

<sup>96</sup> *ibid*, 822-823.

<sup>97</sup> *ibid*, 823.

<sup>98</sup> *ibid*, 825. Similar assumption of availability of full information for ‘hard-nosed’ negotiations seems to be present, for example, in Saulino/Kallmer 2014, 5.

<sup>99</sup> Elkins/Guzman/ Simmons 2006, 819.

<sup>100</sup> *ibid*, 841-842 suggests that such explanation has strong theoretical foundation and is most consistently supported by data. For a more nuanced, but important look on competitiveness and emulation, see also Jandiyala/Henisz/Mansfield 1049-1052 and 1065. See also Ranjan 2010, 68-70.

<sup>101</sup> See generally Guzman 1998 and more briefly the conclusion at 687-688.

response to the emerging and unpredictable behaviour of the newly independent developing countries. While the existing public international law rules were still unclear, in comparison to the newly proposed NIEO concepts, IIAs were likely to be a far more protection-friendly set of provisions.<sup>102</sup> In that sense, ‘rational choice’ theorists also suggest that the developing host States were ‘price-takers’ with respect to treaty terms – they realized that they must compete with others and therefore cannot demand changes to the core provisions of the treaties.<sup>103</sup> Whether or not the developed states could have from their side be more aware how the protection regime will operate does not seem to be specifically addressed. However, if the assumption of knowing sovereignty costs applies to developing states, the same assumption would presumably apply equally (if not more) to the developed ones.

### *Questioning the rationality of choices*

The ‘rational choice’ of States when concluding IIAs can be questioned at both the theoretical and the empirical level. This extends to both the expectations of increased FDI and to how IIL will function in practice. A closer scrutiny of several tenets of the ‘rational choice’ approach rather leads to a conclusion that a considerable number of States engaged in wishful thinking more than in some form of cost-benefit analysis where the anticipated ‘sovereignty costs’ were fully accounted for.<sup>104</sup>

The expectation of increased FDI coming from IIAs would arguably be rational in face of consistent and convincing evidence of causation, or at least some form of correlation between the two events. It has been already mentioned that such conclusive evidence is not present. But more importantly, one should not fall into a trap of anachronism. When the tidal waves of IIA conclusion were the strongest, those same studies were not actually available. Measuring of these correlations seems to be a relatively recent phenomenon, arguably inspired to a considerable extent by the backlash against IIL, and the need to set the record straight if IIAs are actually ‘doing anything’.<sup>105</sup>

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<sup>102</sup> Salacuse 2010, 438-440.

<sup>103</sup> Elkins/Guzman/Simmons 2006, 822. See similarly Allee/Peinhardt 2010, 22-24 and more generally Simmons/Dobbin/Garrett 2006.

<sup>104</sup> As UNCTAD recently observed, ISDS ‘exposes host States to additional legal and financial risks, often unforeseen at point of entering into the IIA’ (UNCTAD 2015, 128).

<sup>105</sup> See in this sense Salacuse/Sullivan 2005 and Aisbett 2009.

Two other factors seem to have been more relevant for at least a significant number of capital-importing countries. One is a form of confirmation bias, as in the readiness to believe in anecdotal evidence that IIAs will indeed increase FDI.<sup>106</sup> The second one is emulation – the strive to ‘compete’ with other capital-importing countries by concluding IIAs seems to have been more alike to herd-like emulation out of fear that they will somehow be left behind, regardless of whether or not IIAs indeed prove beneficial.<sup>107</sup> Whether selective belief, fear and peer pressure lead to ‘rational choice’ is indeed highly debatable.<sup>108</sup>

*Ex ante* rational understanding of legal and regime-building implications of IIAs is likewise theoretically problematic. When considering the wording of the IIAs themselves, the legal situation preceding and surrounding their conclusion, it is unclear if either developed or developing countries could have predicted their interpretation, application and practical effects.<sup>109</sup> For example, one could suggest that States would have *ex ante* relied on other (more general) rules of public international law to help in interpreting the IIAs. However, the ‘ephemeral’ nature of the law preceding IIAs,<sup>110</sup> and the (lack of) concurrent international law developments contravene such a suggestion. The ICJ noted in 1970 that regarding investor-State relations ‘no generally accepted rules [...] have crystallized on the international plane.’<sup>111</sup> Even 13 years later, (then) Judge Rosalyn Higgins commented that State liability in the context of the regulatory state is a newer theme.<sup>112</sup> Arguably, only after the US-Iran Tribunal output there were truly new developments within the international law sphere,<sup>113</sup> but these occurred roughly quarter of a century after the first IIAs.

Even if there were concurrent public international law developments, seeing their effect would require some form of ISDS test cases. IIAs did not start including

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<sup>106</sup> Poulsen 2014, 3-4.

<sup>107</sup> *ibid.*, 4. See also Chung 2007, 962.

<sup>108</sup> See in that sense also Weiler 2004, 554.

<sup>109</sup> See generally on this Van Harten/Loughlin 2006, 150 and Kahale III 2012, 20-21. See also Katselas 2015, 212-213.

<sup>110</sup> Salacuse/Sullivan 2005, 68. See also specifically on this Proehl 1960, 367-368.

<sup>111</sup> *Barcelona Traction*, 47.

<sup>112</sup> Higgins 1983, 269. See also Montt 2012, 8. This was not helped, as noted by Van Harten and Loughlin, by the fact that states were simply reluctant to refer investment disputes to the ICJ (2006, 128).

<sup>113</sup> Dolzer/Schreuer 2012, 244.

arbitration-based ISDS provisions until roughly 10 years after the first BIT,<sup>114</sup> and ICSID registered its first case (non-BIT based, to be clear) only in 1972.<sup>115</sup> As some authors suggest, up until the first BIT-based arbitration – *AAPL v Sri Lanka* (occurring in 1990, 31 year after the first investment treaty) it was questionable if these treaty-based tribunals were truly envisioned to be investor-state (as opposed to state-state) dispute settlers at all.<sup>116</sup> IIAs and ISDS languished in obscurity for many years, spatially and temporally dispersing the arrival of important information about the potential costs of investment agreements.<sup>117</sup>

### *'Bounded rationality'*

Both the more general research on treaty conclusion, and that aimed particularly at BITs, seem to point to conclusions of limited or 'bounded' rationality of governments when concluding IIAs. This can be argued at least (but certainly not exclusively) on the capital-importing States' side. Generally, it is empirically doubtful if States speak with one voice in concluding a treaty, and that rigorous cost-benefit analysis precedes such a conclusion.<sup>118</sup> As Marti Koskenniemi puts it succinctly, '[t]ry to find out the national position on a matter and you will hear different answer depending on whom you ask'.<sup>119</sup> The reality of treaty-making is a heterogeneous picture, with different ministries, conflicting motives and often spontaneous reactions to events.<sup>120</sup> In developing countries, the additional problem is the often-present lack of expertise in international (investment) law in general.<sup>121</sup> Furthermore, the turnover of bureaucratic staff is often excessively high, which obstructs learning and specialization.<sup>122</sup>

On top of these constraints, the various subtle and less subtle forms of pressure aimed at IIA conclusion hardly helped the (often hypothetical) rational cost-benefit

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<sup>114</sup> Parra 2012, 12-27.

<sup>115</sup> *Holiday Inns S.A. and others v. Morocco* (ICSID Case No. ARB/72/1), which was discontinued after a settlement.

<sup>116</sup> Pauwelyn 2014, 397. See for some problems of 'novel' topics and the 'youth' of ISDS in Alvarez 2016, 193-194.

<sup>117</sup> Chung 2007, 954 and Poulsen/Aisbett 2013, 274.

<sup>118</sup> See in that sense Alvarez 2013, 170 and Kurtz 2014, 260.

<sup>119</sup> Koskenniemi 2007, 28.

<sup>120</sup> Simma/Pulkowski 2006, 489 and Saulino/Kallmer 2014, 4.

<sup>121</sup> Poulsen 2014, 6.

<sup>122</sup> See generally Busch/Reinhardt/Shaffer 2009. One similar example in that regard is the lack of awareness of existing obligations among different departments, resulting in legislative drafting that directly contravenes even sufficiently clear IIA obligations. See Ranjan 2010, 71-73.

analysis by the capital-importing States.<sup>123</sup> The promotion of IIAs (especially during the 1990's boom) was a coordinated effort of international organizations, multilateral agencies, Western governments and the private arbitration industry.<sup>124</sup> Examples varied from 'speed-dating' IIA conclusion sessions organised by UNCTAD to different pressures on States with balance-of-payments problems in need of loans.<sup>125</sup> An example of an arguably unequal bargaining position regarding IIAs is the effective mirroring of developed countries templates, despite the availability of less stringent models.<sup>126</sup> The negotiation process was often reduced to a 'take it or leave it' type of deal – described sometimes as an 'intensive training seminar' for the representatives of the other party.<sup>127</sup> As Alvarez noted as early as 1992, these relationships reflect 'hardly a voluntary, uncoerced transaction'.<sup>128</sup>

Perhaps the most informative empirical look at IIA conclusion is offered by the research conducted by Lauge Poulsen, individually and in cooperation with Emma Aisbett. In short, Poulsen and Aisbett lay out the theoretical framework of the 'bounded rationality' hypothesis, where State actually conduct a cost-benefit analysis (or even merely become aware of IIAs they allegedly 'rationally' concluded) only after being subject to an investment claim.<sup>129</sup> The empirical testing of this proposition was conducted through 30 interviews with officials from 13 countries worldwide.<sup>130</sup> While taking into account the limits of such a study, and potentially different learning processes for certain developed countries,<sup>131</sup> what has been revealed is a clear lack of actual understanding on the side of key IIA negotiators regarding the potential effects of these agreements.

While the States had a genuine desire for economic improvement through FDI, this was coupled with overly optimistic views on IIAs which were not supported by

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<sup>123</sup> See generally about the questionable neutrality of international organisations Ruiz Fabri 2012, 353.

<sup>124</sup> Jandhyala/Henisz/Mansfield 2011, 1054-55; Poulsen 2014, 1.

<sup>125</sup> Elkins/Guzman/Simmons 2006, 833 and 840. See also generally Simmons/Dobbin/Garrett 2006.

<sup>126</sup> Poulsen 2014, 1-2.

<sup>127</sup> Chung 2007, 958.

<sup>128</sup> Gunawardana/Alvarez 1992, 552. See also Schneiderman 2008, 62. It is worth reiterating that the arguments in this chapter do not imply potential invalidity of IIAs on account of this 'coercion', although the doors for such arguments potentially remain open.

<sup>129</sup> See generally Poulsen 2014 and Poulsen/Aisbett 2013.

<sup>130</sup> Poulsen/Aisbett 2013, 281.

<sup>131</sup> *ibid*, 275.

corrective data of any sort.<sup>132</sup> Coupled with the system's dormancy, the effect was that potential risks of IIAs were largely ignored until the State experienced an ISDS claim.<sup>133</sup> The interviews with the negotiators confirmed a prevailing opinion that the IIA conclusion would not lead to practical implications, as these have been perceived as merely diplomatic gestures.<sup>134</sup> Importantly, the countries included were not from the least developed or even developing list – they included South Korea, Czech Republic and Chile.<sup>135</sup>

To illustrate with one example among a number of others, the Advocate-General of Pakistan, the country which signed the very first BIT, upon receiving the Swiss investor's BIT claim in 2001 (starting the *SGS v Pakistan* case) had to Google what a BIT was.<sup>136</sup> There was practically no trace of Pakistan-Switzerland BIT negotiations or of the ratification process, coupled with a fact that there was no copy of the BIT in Pakistan's possession - a copy had to be procured from the Swiss government.<sup>137</sup> The fact that by 2001 there have been a number of claims initiated globally, making Pakistan potentially aware about the potency of the treaties, made little difference for the appreciation of their importance. Another striking example of the dismal level of attention given to IIA conclusion is Mali. In the process of concluding a BIT with South Africa, Mali returned the signed template of the proposed BIT by email without even putting the name of the country in the required blank field.<sup>138</sup>

Similar points have been raised, for example, by Christoph Schreuer in his capacity as an expert witness in the *Wintershall* case. When asked about the level of awareness about the contents of BITs by the States concluding them, Professor Schreuer stated that:

[...] many times, in fact in the majority of times, BITs are among clauses of treaties that are not properly negotiated. BITs are very often pulled out of a drawer, often on the basis of some sort of a model, and are put forward on the occasion of state visits when the heads of states need something to sign [...]. In other words, they are very often not negotiated at all, they are just being put on the table, and I have heard several representatives who have actually been active in this Treaty-making

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<sup>132</sup> Poulsen 2014, 5 and Poulsen/Aisbett 2013, 296 and 301.

<sup>133</sup> *ibid.*

<sup>134</sup> Poulsen/Aisbett 2013, 282-283.

<sup>135</sup> Poulsen 2014, 8-10.

<sup>136</sup> *ibid.*

<sup>137</sup> *ibid.*

<sup>138</sup> *ibid.*, 10.

process, if you can call it that, say that, ‘We had no idea that this would have real consequences in the real world’<sup>139</sup>

The actual learning about what IIA provisions meant often came only after a State was subject to a claim. This is confirmed by South African,<sup>140</sup> Indian<sup>141</sup> and Pakistani<sup>142</sup> experiences – they generally resulted in moratoriums and halting of further IIA conclusion, at least before a systematic review and analysis was conducted. But even more generally, analysis of the behaviour of 138 countries shows strong support for the hypothesis that when a country is subject to at least one BIT claim it considerably reduces the BIT conclusion process, and that this effect is over and above any effect that might exist from observing claims against other countries.<sup>143</sup> These findings thus provide robust evidence of ‘highly narcissistic’ learning about the risk of treaty claims,<sup>144</sup> something that seems increasingly recognized in literature.<sup>145</sup> For some authors, no language seems off limits in explaining the full impact of bounded rationality:

[i]n far too many cases, those negotiating the treaties had little idea of the *monster* they were creating in the form of unclear provisions that could be molded by international arbitral tribunals set up pursuant to the treaties’ arbitration provisions into a set of state obligations far beyond what the negotiators intended.<sup>146</sup>

### 1.3.3. Foundational problems – some concluding remarks

Discussing the foundations of IIL necessarily implies important caveats. The sheer number of IIAs, the often fundamentally asymmetrical power of the parties involved, and the specific circumstances of each IIA conclusion prevent a ‘single cause’ explanation for the diffusion of treaties, wording, bilateral nature, or underlying economic ideology.<sup>147</sup> It would be hard to claim that factors influencing a conclusion of an IIA in 1959 and 2009 were identical.

Regardless, some general remarks seem pertinent. The largely bilateral foundations of the IIL edifice should provide a form of a cautionary restraint, an additional reason to justify and legitimize the approach that suggest the exclusivity or

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<sup>139</sup> *Wintershall v. Argentina*, para. 85. See also Kurtz 2014, 261.

<sup>140</sup> Poulsen 2014, 11.

<sup>141</sup> See generally Ranjan 2014.

<sup>142</sup> Poulsen/Aisbett 2013, 281.

<sup>143</sup> Poulsen/Aisbett 2013, 292.

<sup>144</sup> *ibid*, 296 and 301.

<sup>145</sup> Jandhyala/Henisz/Mansfield 2011, 1056; Katselas 2015, 212-213; Waibel et al. 2010, xlv.

<sup>146</sup> Kahale III 2012, 20 (footnotes omitted, emphasis added).

<sup>147</sup> See in similar vein Poulsen 2014, 2; Allee/Peinhardt 2010, 22-24; Shan 2007, 659-664.

over-reliance on the IROL-oriented interpretations of the FET standard. The lack of a multilateral framework, and a sound failure in agreeing one, should at both legal and normative levels provide an incentive for thorough and transparent reasoning by arbitrators as to what can and should be expected from an ‘treaty-overarching framework’<sup>148</sup> in terms of balancing international and national rule of law considerations.

Furthermore, regarding at least a considerable number of participating States, there is a questionable rationality of consent to IIAs and to IIL as a regime in general. This should arguably result in a further significant pause before proclaiming offered substantive interpretations and ways on application of the FET standard as self-evident or inevitable. Justifying these interpretations as expected by the States through the very fact of entering the regime should at least be seriously questioned.<sup>149</sup> To be sure, the argument is not that there are grounds for invalidity of international treaties such as fraud and duress (as contained in VCLT Arts. 46-53). No State has so far attempted to do either. Rather, the broader normative aspect of these issues gains in importance. For the IIL to retain and enhance its legitimacy, it would have been important for these considerations to be taken into account.

The specific foundations of the IIL regime opened the path for its dispute-settling element - ISDS - to provide (for better or worse) the key shaping force of its normative development. Before engaging with the operation of the IROL paradigm in more detail in the next chapter, the final section will offer a sketch of how ISDS forged the structure of IIL as is known today, and some indication to what extent the issues and concerns discussed in this section featured in that process. These should serve as a further background to examining the possibilities and the need for a normative rethinking of substantive decision-making regarding the FET standard.

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<sup>148</sup> Schill 2009, 367.

<sup>149</sup> See similarly Kurtz 2014, 262.



## 1.4. ISDS as the regime's engine and the role of normative concerns

### 1.4.1. ISDS in general

The dispute settlement provisions in IIAs are not uniform.<sup>150</sup> However, the vast majority of treaties concluded after 1970 contains at least one avenue for the investor to have the IIA dispute settled by investor-State arbitration.<sup>151</sup> The revolutionary character of 'arbitration without privity'<sup>152</sup> in the context of international law has been recognised for a considerable time now. A short overview should thus suffice to show why the choice of arbitration crucially helped transform ISDS into the IIL's engine of growth – and in turn of the IROL paradigm as well.

Leaving aside national courts,<sup>153</sup> most IIAs offer the prospective claimants a choice between initiating disputes through a number of arbitral institutions and/or through *ad hoc* arbitral proceedings. The choice of *ad hoc* arbitration rules is fairly uniform in IIAs, these usually being the UNCITRAL Arbitration Rules 1976.<sup>154</sup> On the institutional arbitration side, a widely present option is ICSID, although often coupled with other renowned arbitral institutions such as the International Court of Arbitration of the International Chamber of Commerce (ICC) or the Arbitration Institute of the Stockholm Chamber of Commerce.<sup>155</sup> In broad terms, investor-State arbitration is procedurally generally akin to international commercial arbitration, from which it drew heavily in many ways.<sup>156</sup> With the exception of ICSID Convention and ICSID Arbitration Rules discussed below, both *ad hoc* and institutional rules (with some recent and limited exceptions)<sup>157</sup> do not generally distinguish between commercial (B2B) and investor-State arbitrations.

The ICSID Convention is unique in the sense of a truly delocalised arbitration regime, one specifically geared towards investor-State dispute settlement.<sup>158</sup> The most

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<sup>150</sup> See generally Reinisch/Malintoppi 2008.

<sup>151</sup> Dolzer/Schreuer 2012, 235-245; see also Reinisch/Malintoppi 2008, 692-693.

<sup>152</sup> Paulsson 1995.

<sup>153</sup> See on this Reinisch/Malintoppi 2008, 694-698.

<sup>154</sup> Dolzer/Schreuer 2012, 243.

<sup>155</sup> *ibid*, 238-245.

<sup>156</sup> See generally Roberts 2013. See also Stone Sweet/Grisel 2014, 46-47 and Schneider 2015, 8.

<sup>157</sup> See in that sense certain ISDS-specific additions (pages 38-40) in the new SCC arbitration rules at [http://sccinstitute.com/media/169838/arbitration\\_rules\\_eng\\_17\\_web.pdf](http://sccinstitute.com/media/169838/arbitration_rules_eng_17_web.pdf), accessed 10 February 2017.

<sup>158</sup> Reinisch 2008, 111-114.

pertinent features for this delocalisation are the provisions on recognition and enforcement of ICSID awards and the rather limited possibilities of recourse against the awards within the ICSID framework.<sup>159</sup> The ICSID Convention dispenses with the possibility for national courts to review the ICSID awards.<sup>160</sup> The possibility of rejecting to comply with an award always remains, but by virtue of Article 27(1) of the ICSID Convention such rejection allows for the re-launch of diplomatic protection by the investor's home State. As the Argentinian experience shows, such non-compliance can be both costly and ultimately unsuccessful.<sup>161</sup>

The recourse against awards is thus possible only on the narrow grounds provided in the Convention itself.<sup>162</sup> Such limited possibilities for review have led authors not just to question the credibility of the system<sup>163</sup> but also to describe it as 'quick and dirty justice' which 'shocks the sense of rule of law or fairness' and is unsuitable when sovereignty and hundreds of millions of dollars are at stake.<sup>164</sup> Unsurprisingly, a lot of interest was raised by the 2004 proposal on the introduction of a fully-fledged appellate system within ICSID, an effort which failed to get traction at that point.<sup>165</sup> As suggested in the Introduction, a new wave of activity in a similar direction exists today, with the prospects still hanging in the balance.<sup>166</sup>

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<sup>159</sup> *ibid.*

<sup>160</sup> Article 54 (1) makes clear that '[e]ach Contracting State shall recognize an award rendered pursuant to this Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State.[...]'. See also Blackaby et al. 2015, paras. 11.125-11.130.

<sup>161</sup> See for an overview, for example, Allen & Overy Publication 'Argentina settles five investment treaty awards' (7 November 2013, available at: <http://www.allenoverly.com/publications/en-gb/Pages/Argentina-settles-five-investment-treaty-awards.aspx>, accessed 15 May 2015).

<sup>162</sup> These ground are provided in Article 52 (1) of the Convention, and relate to the improper constitution of the tribunal, manifest excess of power, corruption on the side of the arbitrator, serious departure from the fundamental rule of procedure, and failure to state reasons upon which the award is based. See for comments on the limited possibility of review, for example, Schreuer et al. 2009, 898-906; Landau 2009, 196; Chung 2007, 967.

<sup>163</sup> As Geiger notes, if annulment panels damningly criticise the legal reasoning of the award, and yet are powerless to take action, the credibility is seriously questioned (2011, 170).

<sup>164</sup> Chung 2007, 967-969.

<sup>165</sup> See generally Kalb 2005 and Appleton 2013.

<sup>166</sup> As of 6 September 2017, Belgium has submitted a request for opinion from the ECJ on the CETA agreement, in particular regarding the proposed Investment Court System that could in future be further multilateralised. See on this [https://diplomatie.belgium.be/en/newsroom/news/2017/minister\\_reynders\\_submits\\_request\\_opinion\\_ceta](https://diplomatie.belgium.be/en/newsroom/news/2017/minister_reynders_submits_request_opinion_ceta), accessed 20 September 2017.

The features of a strongly autonomous IIL regime persist even outside the ICSID framework.<sup>167</sup> Almost universally, the recognition, enforcement, and recourse against investment awards is governed by the New York Convention 1958 and the almost identically worded nationally adopted versions of the UNCITRAL Model Law 1985/2006.<sup>168</sup> In practice, the oversight conducted by the national courts is largely non-intrusive. As Van Harten and Loughlin note, the ‘piggybacking of investment treaties on the enforcement structure of international commercial arbitration both fragments and restricts judicial supervision of investment arbitration.’<sup>169</sup> The closer look at enforcement of awards under NYC 1958 shows that it is indeed a largely automatic process in most situations.<sup>170</sup> Whether under ICSID or otherwise, the recognition and enforcement has been described as practically compulsory.<sup>171</sup> In the words of Thomas Wälde:

[I]t is the ability to access a tribunal outside the sway of the host State which is the principle advantage of a modern investment treaty. This advantage is much more significant than the applicability to the dispute of substantive international law rules.<sup>172</sup>

The role of dispute settlement is critical for IIL as a whole.<sup>173</sup> While for some authors the IIAs on their own do enough to create a regime,<sup>174</sup> IIL as it stands today is unimaginable from just the text of the treaties. The fact that arbitration in general is ‘not in fact a system, but rather is a framework’ potentially presented great challenges for building any sort of ordering within ISDS.<sup>175</sup> And yet, the confluence of legal aspects of the employed framework and the sociological features of the arbitral community resulted in a perfect storm for creating a new regime.<sup>176</sup> Especially in the ICSID context (but essentially within other arbitral frameworks as well) this was made possible by the limited review avenues, a powerful enforcement regime, basically a commercial arbitration procedure and remarkable vagueness of the standards such as the FET.<sup>177</sup>

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<sup>167</sup> Ortino 2012, 35.

<sup>168</sup> Importantly, despite the grounds for recourse under these instrument being somewhat broader than in ICSID Convention Article 52 (1), the merits of the decision generally and usually remain beyond review. See for an overview Blackaby et al. 2015, paras. 11.40-11.124 and Moses 2012, 211-230.

<sup>169</sup> Van Harten/Loughlin 2006, 135.

<sup>170</sup> *ibid*, 135-137. See also Chung 2007, 968-969 and Ortino 2012, 35.

<sup>171</sup> Landau 2009, 196.

<sup>172</sup> Wälde 2005, 190. See also similarly Montt 2012, 370.

<sup>173</sup> See in that sense also Behrens 2007, 158.

<sup>174</sup> Salacuse 2007, 164.

<sup>175</sup> Caron 2009, 516.

<sup>176</sup> Yackee 2012, 401.

<sup>177</sup> See also on this the Introduction to this thesis, as well as Kleinheisterkamp 2015, 793-795.

Building on the legal features of the ISDS framework, the socio-legal aspects of the arbitration community are another critical factor in shaping the IROL-oriented interpretations. The synergy of the legal features and the sociological ones eventually played a major role in the understanding of the rule of law ‘mission’ of the FET and IIL more generally, and particularly so through the master tool of *de facto* precedent. The following section will thus focus on these two aspects.

#### **1.4.2. The ‘epistemic community’ of ISDS arbitration**

To lay out the key points of the discussion below, the characteristic sociological features of international arbitration scene fostered the IIL regime-building that leaned towards strong emphasis on their international rule of law role and detachment from the engagement with domestic legal systems. This was done through homogenising the legal and ideological background of arbitrators, a domination of a number of law firms as ubiquitous repeat players and capitalizing on the reality of governments being disparate bodies with intriguingly low capacity for institutional learning in the context of BITs (as also discussed in the IIA conclusion context in section 1.3.2. above). In such surroundings, some of the normative challenges to the IROL paradigm arising out of IIL foundations were effectively overcome in regime-building, although in a way that arguably still leaves both considerable legitimacy issues and normative alternatives open.

To be sure, the ‘arbitration community’ can encompass a large number of actors in a sociological sense.<sup>178</sup> Within the limited scope of this section, however, the aim is to focus on those actors who critically contributed to the IIL regime growth through investment arbitration – arbitrators and law firms, as well as (arguably much more side-lined) States.

The arbitral community in ISDS is in many ways an offshoot of the broader commercial arbitration community.<sup>179</sup> In particular, as ISDS emerged from its virtual multi-decade slumber in mid-1990’s, it seemed a logical choice to have (prestigious) commercial arbitrators filling the roles. As mentioned, ISDS heavily borrowed from

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<sup>178</sup> See in particular Gaillard 2015, 10-11 and caution against broad generalizations in Puig 2014, 420.

<sup>179</sup> See generally on this community and its culture Karton 2014b.

commercial arbitration in the procedural sense, and choosing those versed in that area is in that sense understandable.

The arbitrators are generally the category that attracts by far the most attention from a sociological standpoint, particularly in the light of the transformation of arbitrating from an occasional activity into a ticket for the social category of professional arbitrators.<sup>180</sup> And it is within that social category that arguably the most high-profile members get the opportunity to get involved with the ISDS cases. As recently supported by meticulous empirical research, temporal aspect of ISDS ‘explosion’ is of great importance. Sergio Puig concludes that ‘[...] the deluge of cases in the last 10 years has skewed the results towards specific arbitrators who were appointed early in this stage and whose careers had been consolidated by or ripened around the end of last century.’<sup>181</sup> Once ‘entrenched’, those arbitrators remain central, and can use their social and professional standing to receive further appointments, influence the doctrine and general political/ideological orientation of IIL.<sup>182</sup>

While the extent of the phenomena is sometimes overstated and is prone to gradual change, the world of ISDS arbitrators is still relatively small.<sup>183</sup> It is an own universe, in some ways detached from both commercial arbitration and public international law.<sup>184</sup> The arbitrators’ network is dominated by a dense and interconnected group of mostly male, European and Anglo-American professionals.<sup>185</sup> This leads to intertwining of professional affiliations, relationships and friendships and can in turn be a breeding ground for new legitimacy and credibility challenges.<sup>186</sup>

At the same time, the small world of investment arbitrators becomes an epistemic community as well.<sup>187</sup> As noted, the line between a scholar and a practitioner is blurred

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<sup>180</sup> Gaillard 2015, 4.

<sup>181</sup> Puig 2014, 420-421.

<sup>182</sup> *ibid*, 421-422. Another temporal aspect is that the ISDS explosion started before the big crises of the 2000’s, and before IIAs became more truly two-way ‘swords’. The early and immensely influential precedents were thus open to the understanding that a ‘deluge of state practice’ buried any ‘socialist alternative’ to liberal capitalism of the Thomas Friedman variety (Alvarez 2005, 94) or even just a rights-based (as opposed to market-based) approach to the organization of the economic system (Schill 2009, 377; Van Harten 2010c, 635; Ruiz Fabri 2012, 357).

<sup>183</sup> See generally Puig 2014. It can be said to resemble international commercial arbitration field of several decades ago (as presented by Gaillard 2015, 13-14, who does however also make an argument of the ISDS field increasingly growing and ‘polarizing’ into specific roles).

<sup>184</sup> Schneider 2015, 8. See however also discussion at Gaillard 2015, 15-16.

<sup>185</sup> Puig 2014, 418-419.

<sup>186</sup> See generally Miles 2013, 342-346 and Park 2010. See also Waibel et al. 2010, xli-xlii.

<sup>187</sup> See for example Miles 2013, 342-346 and Van Harten 2010c 649-650 and materials cited therein. It should be noted, however, that a number of authors emphasise the ISDS epistemic community as being

in investment arbitration, perhaps more than in any other field of law.<sup>188</sup> Those involved insist that the field requires specialist knowledge, provided and supported by an epistemic community - with its own networks, conferences, journals, newsletters and mailing lists. Such a development is sometimes taken as a mark of technical sophistication which signifies the progressive evolution of IIL.<sup>189</sup>

The relatively low number of involved arbitrators corresponds somewhat to the low number of involved law firms.<sup>190</sup> The repetition of involved law firms is also conducive to entrenching particular features of ISDS, such as the reliance on precedent.<sup>191</sup> This is furthered by the predominantly common law legal culture of the leading firms. In that regard, Picker notes that:

[r]eflecting these and other factors, a recent survey of the top hundred law firms of the world identified only two that were not from a common law country, and only seven that were not from the United States or Britain. This dominance by Anglo-American law firms has and will continue to have a long-term impact on the development of the legal culture of international investment law.<sup>192</sup>

The crystallization of leading law firms also leads to increased intertwining with the world of investment arbitrators.<sup>193</sup> Not only do law firms garner sufficient 'intelligence' about particular arbitrators so as to make their reappointment sensible from a strategic viewpoint,<sup>194</sup> but these two communities start to intertwine in membership terms. As the vocal debates about 'wearing two hats' show, the role of the counsel and the arbitrator is not kept distinct.<sup>195</sup> Therefore, it becomes the prerogative of international investment lawyers, arbitrators and scholars (categories often intermingled) to decide to a great extent on the substantive developments.<sup>196</sup>

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actually comprised of members of different epistemic communities, such as public international lawyers and more private law oriented individuals (see primarily Roberts 2013, but also Schill 2011, 903).

<sup>188</sup> Infantino 2014, 195 and materials cited therein; Ginsburg 2003, 1340-1341; Fauchald 2008, 352.

<sup>189</sup> Mills 2011, 486 and Gaillard 2015, 6-7 and 12-13. Quantity of these elements, however, as Schill warns, does not necessarily result in quality (2011, 904).

<sup>190</sup> See for statistical data, although not necessarily for normative conclusions based on it, Eberhardt/Olivet 2012, 20-22. On a more general note, as suggested by Gaillard, it is not the case that the number of strictly arbitration-oriented counsel is not increasing (Gaillard 2015, 5) – but so does the number of pending cases, leading to a roughly constant equilibrium of high-profile cases being handled by the 'usual suspects'.

<sup>191</sup> Laird 2009, 153.

<sup>192</sup> Picker 2013, 46 (footnotes omitted).

<sup>193</sup> Yackee 2012, 405.

<sup>194</sup> See in this sense Gaillard 2015, 15-16.

<sup>195</sup> Park 2010, 197-205; Van Harten 2010b, 436-446.

<sup>196</sup> Schneiderman 2011, 5. As Tamanaha notes, legal professionals in any field constitute an interpretive community which stabilises the interpretation and application of rules, deeming certain interpretations as unacceptable ones that will simply 'not write' (Tamanaha 2004, 89).

What is the role of States in all these processes? Legally, the routes to shaping the IIAs and their interpretation (including both procedural and substantive aspects) remain in their hands, but in practice the ‘epistemic community’ arguably plays a more dominant role for several reasons. The process of IIA modification or interpretation can be slow and uncertain,<sup>197</sup> and the deferral of States to law firms is of considerable importance. Predominantly, host States do not field their own legal teams that could potentially offer different visions of IIL in terms of substance or procedure.<sup>198</sup> States are often represented by the same law firms that generally dominate the field.<sup>199</sup> The lack of own resources sometimes makes this necessary, but it can also be seen as a logical choice if the primary aim is to defeat an investment claim. It makes sense to go to those who have the expertise, even (or especially so) if they are those defining what expertise *is* in the first place.<sup>200</sup> As Schneiderman notes, ‘we should not [...] overstate the capacity of states to depart from the expert advice given to them by international investment norm-entrepreneurs who have the ear of those having authority over this dossier.’<sup>201</sup> IIAs become treated as another ‘layer’ of regulation on which experts need to be consulted daily.<sup>202</sup>

The interaction of the relevant factors – small numbers and a characteristic culture in the first place - leads to repetitive appointments and, eventually, the perhaps unexpectedly high importance of the ‘human factor’ in ISDS decision-making.<sup>203</sup> This is, of course, nothing strictly limited to ISDS or to arbitration in general.<sup>204</sup> But the extent

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<sup>197</sup> See generally on this topic Van Aaken 2014.

<sup>198</sup> Schreuer 2016, 737.

<sup>199</sup> Eberhardt/Olivet 2012, 20-21.

<sup>200</sup> This also brings to mind the arguments of Dezalay that self-developing a normative system allows lawyers to extract and ensure a ‘situational rent’ (Dezalay 1993, 211). As also argued, international business lawyers, encompassing here the ISDS community for sure, are arguably engaged in the process of ‘double dealing, by guiding their clients through the regulatory maze they know all the better for having been, to a great extent, its designers.’ (ibid, 203). See in the same vein Tucker 2015, 143.

<sup>201</sup> Schneiderman 2011, 5.

<sup>202</sup> Montt 2012, 113-114.

<sup>203</sup> This is something that law firms are hardly secretive about in advising their clients – the composition of the tribunal and the careful appointment of arbitrators are seen as hugely important factors to consider in ISDS. See for example <http://www.steptoe.com/publications-10464.html>, accessed 12 June 2016.

<sup>204</sup> A related discussion, which is not the topic here, is the one of ‘pro-investor’ or ‘pro-state’ bias of the arbitral epistemic community. It suffices to note that some authors insist on the ‘pro-investor’ bias of awards (Sornarajah 2010, 5; Muchlinski 2013, 432; Van Harten 2007, 172-175; Kahale III 2012, 6) while for others (see in particular Schwebel 2009; Brower/Schill 2013, 492; Kapeliuk 2010, 81; Franck/Wylie 2015) the proof or rationale for such leaning would be missing. See on this also recent empirical research in Pauwelyn 2015. While the ‘pro-investor’ or ‘pro-state’ bias by arbitrators continues to be a hotly disputed topic, it is however somewhat tangential to the aims of this thesis. Whether investors or States fare better under the current IIL rules is a separate issue from the one if these rules can actually be

of the phenomenon should be noted. Experienced practitioners, it is claimed, can often predict the outcome of an investor-state arbitration based upon the composition of the tribunal, as opposed to just merits of the case.<sup>205</sup> The track record, outlook and experience become the key considerations, something that militates against the diversification of the arbitrators' pool.<sup>206</sup>

As Jeffery Commission noted in his seminal study, the tribunal members are simply not ever-changing – their backgrounds and regular interactions have contributed to an 'esprit de corps' among ICSID and other ISDS arbitrators.<sup>207</sup> Arbitrators are in a 'constant dialogue' that likely results in a form of peer pressure that serves to keep errant arbitrators in line to a certain extent.<sup>208</sup> With this general framework in mind, it is possible to take a closer look at the instrument of *de facto* precedent through which the mentioned arbitral dialogue primarily takes place.

#### 1.4.3. *De facto* precedent as a master tool of regime-building

While the issue of *de facto* precedents will also be examined in Chapter 2, it is useful to note here an interesting mismatch between the formally suggested cautious approach and the actual prodigious use of previous awards.<sup>209</sup> There is universal acknowledgment in practice and doctrine that there is no doctrine of *stare decisis* in investment arbitration, regardless of the institution under whose auspices the proceedings are taking place.<sup>210</sup> The rules of arbitral institutions dealing primarily with international commercial arbitration do not need to reiterate the lack of precedential value of arbitral awards,<sup>211</sup> while the ICSID Convention arguably deals with the issue in its Article 53(1) when mandating that the award is 'binding on the parties'.<sup>212</sup> This approach is not different from the public international law in general. At least formally,

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normatively justified in the light of the IIL development and contentious issues therein. The issue of how much each side wins in a game is not the same as the question if this is *the* game that should be played in the first place.

<sup>205</sup> Kahale III 2012, 3.

<sup>206</sup> Pauwelyn 2015, 787.

<sup>207</sup> Commission 2007, 136 and 141.

<sup>208</sup> Kalb 2005, 208-209 and Kapeliuk 2010, 68.

<sup>209</sup> August Reinisch picturesquely described this mismatch as 'almost schizophrenic' (2008, 123).

<sup>210</sup> See generally McLachlan/Shore/Weiniger 2017, 3.157-3.159; Dolzer/Schreuer 2012, 33-35; Grisel 2014, 224; Rubins 2016; De Brabandere 2012, 268-269; Schreuer/Weiniger 2008, 1189.

<sup>211</sup> See on international commercial arbitration and precedent Schultz 2014a, 177 and King/Moloo 2014, 876.

<sup>212</sup> Schreuer et al. 2009, 1102.



there is no *binding* precedent in international law dispute settlement.<sup>213</sup> As is sometimes argued specifically in the context of ISDS, the precedential force of awards is conceptually impossible.<sup>214</sup>

Yet, as suggested by empirical research, the recourse to previous decisions of investment tribunals is widespread.<sup>215</sup> In an oft-cited study by Fauchald, results show that out of 98 decisions analysed, 92 decisions (94%) used case law as an interpretive argument.<sup>216</sup> The importance of these precedents varied from being a purely supportive argument to being decisive for a conclusion, but it was in general quite common for tribunals to use case law as a means of establishing a presumption in favour of one result.<sup>217</sup> In general, the same importance was attached to *obiter dicta* as to *ratio decidendi*.<sup>218</sup> Authors generally recognize that a ‘system of precedent’,<sup>219</sup> ‘precedent-based discourse’,<sup>220</sup> *de facto stare decisis*,<sup>221</sup> ‘*jurisprudence constante*’<sup>222</sup> or a ‘tool of shorthand’<sup>223</sup> now exists in IIL and ISDS. Fuelled by the ready availability of published awards and susceptible IIA norms,<sup>224</sup> a system is put in place in which re-visiting the nominally used sources of law itself is abandoned and heavy reliance is placed on the arbitral decisions themselves.<sup>225</sup>

Tribunals do usually take special care to distinguish the practice of *persuasive* precedent from a potentially *contra legem* practice of *binding* precedent. The line between the two, however, is sometimes blurry indeed. An oft-cited passage of *Saipem v. Bangladesh* illustrates this:

[t]he Tribunal considers that it is not bound by previous decisions.<sup>(10)</sup> At the same time, it is of the opinion that it must pay due consideration to earlier decisions of international tribunals. It believes that, subject to compelling contrary grounds, it has a *duty* to adopt solutions established in a series of consistent cases. It also believes that, subject to the specifics of a given treaty and of the circumstances of

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<sup>213</sup> McLachlan/Shore/Weiniger 2017, 3.158 and 3.161-3.163; Grisel 2014, 224; Schreuer/Weiniger 2008, 1189.

<sup>214</sup> Orakhelashvili 2009, 168-169 and De Brabandere 2012, 254-255. For a skeptical, but no so necessarily negative assessment of precedent, see Douglas 2010.

<sup>215</sup> See generally Commission 2007 and Fauchald 2008, as well as Ortino 2012, 39.

<sup>216</sup> Fauchald 2008, 335.

<sup>217</sup> *ibid.*, 336-337.

<sup>218</sup> *ibid.*, 335.

<sup>219</sup> Commission 2007, 135-136.

<sup>220</sup> Stone Sweet/Grisel 2014, 44.

<sup>221</sup> D'Aspremont 2012, 43 and Reed 2010, 96.

<sup>222</sup> See generally Bjorklund 2008 and De Brabandere 2012, 268-269.

<sup>223</sup> Rubins 2016.

<sup>224</sup> Commission 2007, 135-136 and Stone Sweet/Grisel 2014, 44.

<sup>225</sup> Yackee 2012, 427; Rubins 2016 and Landau 2009, 199 and 203-204. See similarly Douglas 2010.

the actual case, it has *a duty* to seek to contribute to the harmonious development of investment law and thereby to meet the legitimate expectations of the community of States and investors towards certainty of the rule of law <sup>(11)</sup> 226.

The quoted paragraph is interesting for a number of reasons, not the least for its use of the arguably strong term of ‘duty’. Almost paradoxically, the first footnote in the passage - offered as a support for the position that the tribunal is not bound by previous decisions - itself refers to a previous decision, in *AES v. Argentina*. The second footnote offers support for the progressive development of IIL, and refers to an academic piece of writing by a fellow ISDS arbitrator, Gabrielle Kaufmann-Kohler, demonstrating in one swoop both the extent of the arbitrator/academic overlap and the strong bonds of the ISDS epistemic community.

It is not the argument here that a persuasive precedent is either unique to ISDS (it certainly is not) or that it is intrinsically unacceptable. For example, Valentina Vadi argues that persuasive precedent particularly fits with investment arbitration, offering the option of not following unconvincing decisions, promoting meritorious ones and gradually developing a coherent IIL.<sup>227</sup> Equally importantly, examples from ISDS practice include decisions which rather explicitly reject the mandate that the *Saipem* tribunal sees as imposed on arbitrators, including the reliance on previous decisions.<sup>228</sup>

What causes concern is the possibility that (over-)reliance on precedent is another ultimate expression of the socio-legal aspects of ISDS community, and not necessarily of careful appraisal of IIL foundations and related normative tenets. The dense citation of previous awards in submissions of the parties has a feedback effect which pressures arbitrators in seeing those awards as evolving law.<sup>229</sup> As D’Aspremont notes concerning dispute-settlement more generally ‘[...] there is a natural loyalty among judges who inevitably rely on one another [...] as a result of the constant and abiding quest [...] for the preservation of the authority of their pronouncements.’<sup>230</sup>

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<sup>226</sup> *Saipem v. Bangladesh*, para. 90. For a very similar understanding, see also *MCI v. Ecuador – Annulment*, para. 25 and *Duke v. Ecuador*, para. 117.

<sup>227</sup> Vadi 2008, 14.

<sup>228</sup> See particularly *Romak v. Uzbekistan*, para. 171, where the tribunal asserted it was not entrusted, ‘by the Parties or otherwise’, with a mission to ensure coherency and/or development of jurisprudence. Indicative in that regard is also the opinion of one of the most appointed ISDS arbitrators, Brigitte Stern, as expressed in *Burlington v. Ecuador – Jurisdiction*, para. 100.

<sup>229</sup> Stone Sweet/Grisel 2014, 44.

<sup>230</sup> D’Aspremont 2012, 45-46. See also Schultz 2014a, 121-122.

As has also been noted in the Introduction, the way in which the FET standard has been gradually solidified into rule of law requirements is a positive development, and in that sense the reliance on precedents has certainly proved beneficial. But seen against the background of normative issues regarding IIL foundations, and the features of the ISDS arbitral community, it is possible to mark as at least controversial the manner in which these normative issues were dealt with. The remainder of this section will examine how the specific issues were engaged with (if at all) and ultimately overcome in the process of creating IIL as it stands today. This process, importantly, led to the dominance of the IROL paradigm, but should *not* be seen as excluding the potential for complementing NROL considerations.

*Overcoming the bilateral 'hurdle'*

Duly apart from the pressure and/or desire to conform to the common understanding that precedents should be followed, there arguably still had to be a sufficiently cogent formal justification to go beyond the clearly bilateral, or at best plurilateral framework of IIAs. There needed to be an explanation why the arbitrators were effectively making the 'rules for every bilateral investment treaty relation, not only the one that governs the specific dispute at hand'<sup>231</sup> even if such practice runs counter to the foundational principles of essentially one-off investment arbitration.<sup>232</sup> Furthermore, there should arguably be a clear explanation why the bilateral character of the treaties does not by itself lead towards putting special emphasis on the national legal systems of the contracting States.

The critical lifeline was found in the undisputable fact that IIA provisions are a part of international law. Thus, as touched upon above in section 1.3.1., if a FET provision in an IIA between States A and B is an international law provision, and similarly worded provision in IIA between States X and Z is also of the same character, a mandate is given to arbitrators to aim at both consistent interpretation and, if necessary, further development of the actual international law norm that lies beneath the wording of 'fair and equitable treatment'. International law seemingly cannot be substantively pluralistic in the face of identical or basically identical wording. The dominant paradigm becomes the 'deeply-rooted perception of the unity of international

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<sup>231</sup> Schill 2009, 368.

<sup>232</sup> De Brabandere 2012, 287.

investment law and of the need for consistency’.<sup>233</sup>

Once such a premise is entrenched, numerous other developments become possible. Recourse to precedent is expected, as it is ‘natural that arbitrators will want to know what other in similar situations have done’.<sup>234</sup> The self-reinforcing effect takes hold – the need for consistency and certainty by recourse to precedent is seen as expected by the parties,<sup>235</sup> and the parties themselves have recourse to previous decisions as this becomes customary.<sup>236</sup> The ‘mountains’ of previous decisions are addressed and put forward ‘because they are there’.<sup>237</sup> Also, the strong attachment to public international law seemingly helps the awards to profit in legitimacy terms from the oft-proclaimed ‘neutrality’ of this law and its implied unbiased, apolitical determinations.<sup>238</sup>

A further consequence is a perceived licence for ‘progressive development’ of IIL that is granted to arbitrators.<sup>239</sup> National specificities might matter little if the goal is to further international law in general and break beyond the confines of just the treaty at hand. This is further incentivised if the field is seen as undeveloped and scarcely populated by norms<sup>240</sup> - helping international law to grow becomes not just a possibility, but the duty of a conscientious arbitrator.<sup>241</sup>

While the task of juggling correct decision-making in an individual case with the broader implications has been described as no less than ‘schizophrenic’,<sup>242</sup> this does not generally detract from the enthusiasm of many arbitrators and scholars in the field. The elastic legal concepts in IIAs, it is argued, ‘beg to be illuminated with reasoned findings

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<sup>233</sup> Schill 2011, 84.

<sup>234</sup> Weiniger/McClure 2013, 10.

<sup>235</sup> Reinisch 2013, 237.

<sup>236</sup> As summarised by the *El Paso* tribunal: ‘It is, nonetheless, a reasonable assumption that international arbitral tribunals, notably those established within the ICSID system, will generally take account of the precedents established by other arbitral organs, especially those set by other international tribunals. The present Tribunal will follow the same line, *especially since both parties, in their written pleadings and oral arguments, have heavily relied on precedent*’ (*El Paso v. Argentina – Jurisdiction*, para. 39, emphasis added).

<sup>237</sup> Reed 2010, 97.

<sup>238</sup> See generally on ‘depoliticisation’ of investor-State disputes Paparinskis 2012b and Cutler 2014. See also Dolzer/Schreuer 2012, 23-24 and Miles 2013, 334.

<sup>239</sup> Some authors, such as Mills, see this as the result of the attitude brought by PIL specialist arbitrating in the field (Mills 2011, 484). See also generally Roberts 2013.

<sup>240</sup> See for example Pellet 2013, 231 on objective scarcity of ICJ jurisprudence in this field. See also Weil 2000, 406-407.

<sup>241</sup> Schill 2011, 84; Kaufmann-Kohler 2007, 377; Fauchald 2008, 315. This is also exemplified in the *Saipem v. Bangladesh* passage quoted above.

<sup>242</sup> Caron 2009, 517. See similarly Reinisch 2013, 238.

by tribunals.<sup>243</sup> The belief that accumulation of jurisprudence will ‘cure’ the lack of rules runs deep. As Weil notes:

[a]s to the argument that international law incorporates only few rules on foreign investment, this is the case with most new branches of international law. It is a temporary deficiency which, like youth, vanishes with the passage of time.<sup>244</sup>

The bilateral nature of most IIAs is thus overcome by a particular understanding of the consequences arising from the international law character of their provisions. The once adopted (but by no means inevitable) understanding of the need for multilateral uniformity and substantive consistency becomes embedded more deeply with every passing decision that does not question the starting premise. The normative expectations of investors and States thus become increasingly formed on that premise, and potential criticism that earlier decisions have themselves perhaps been problematic<sup>245</sup> is simply swamped in the sheer volume of awards. In many ways, the uniform structure of substantive IIL thus lifts itself from the ground by pulling its own shoelaces. Yet, the consistent identification of the rule of law requirements in the FET standard still does not answer the question of how are these further interpreted and applied, and what is the overall normative orientation in that exercise.

#### *The side-lining of issues concerning the conclusion of IIAs*

The fact that States themselves seemingly had little to say on this orientation did not seem to overly impact the development of the IROL paradigm. The controversies surrounding the empirical aspect of IIA conclusion hardly featured as a relevant point for tribunals, and were sometimes actively dismissed in doctrine. That is to some extent not surprising – as previously mentioned, these controversies are unlikely to affect the validity of IIAs, even if such arguments were brought to the fore. A State arguing ignorance of what the IIA provisions meant would likely find little understanding from a tribunal. *Ignorantia legis nocet*.

Still, if the *leges* were not quite capable of being known in the first place, a formalistic approach would seem unduly harsh. In this regard, it is sometimes argued in doctrine (in addition to the discussion in section 1.3.2. above) that the normative issue

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<sup>243</sup> Reed 2010, 97.

<sup>244</sup> Weil 2000, 407.

<sup>245</sup> See for discussion in the FET context Schill 2012b, 159.

does not actually exist since the States *knew* or *could have known* how the IIA provisions such as the FET standard will affect them. Francisco Orrego-Vicuña has perhaps most vocally dismissed allegations of (particularly developing States') ignorance as nothing other than 'paternalistic'.<sup>246</sup>

Furthermore, as also touched upon above, it is claimed that the parties 'expect that tribunals [...] [embed] their interpretation into the discursive framework created by earlier investment treaty awards'.<sup>247</sup> According to King and Moloo, the parties to a treaty either signed up only to have their own disputes decided, without regard to prior (much less subsequent) jurisprudence; or the parties consented with an awareness and expectation of their dispute being decided within the context of, and with reference to, a system of prior awards.<sup>248</sup> According to them, most parties' expectations likely fall somewhere in the middle, with their dispute being the central focus of the tribunal's decision, but with *prior case law functioning as a guidepost* for the arbitrators where there is a large body of public decisions and 'common understanding' of the meaning.<sup>249</sup>

Yet, this simply begs the question of the 'zero hour' – what could have the States expected before the first decisions started appearing? The existence of the 'body' of public decisions, or of 'common understanding' of IIA provision meaning would be hard to demonstrate for the period when the IIAs were concluded *en masse* and even when the ISDS rise began. Their existence is uncertain even today. The *Romak* tribunal highlighted the difficulties:

Even presuming that relevant principles could be distilled from prior arbitral awards (which has proven difficult [...]), *they cannot be deemed to constitute the expression of a general consensus of the international community, and much less a formal source of international law*. Arbitral awards remain mere sources of inspiration, comfort or reference to arbitrators.<sup>250</sup>

The question of what each individual State could have expected from IIL and ISDS in terms of their operation is one that cannot be ultimately resolved without a truly unimaginable mountain of empirical research, if even then. But that does not mean that existing arguments should not be put to closer scrutiny when bearing in mind what is indeed available in terms of empirical research. The explanation that States agreeing

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<sup>246</sup> Orrego-Vicuña 2002, 30.

<sup>247</sup> Schill 2011, 81.

<sup>248</sup> King/Moloo 2014, 890.

<sup>249</sup> King/Moloo 2014, 890 and 899-900.

<sup>250</sup> *Romak v. Uzbekistan*, para. 170.

to IIAs (or staying bound by them) accept the whole of ISDS jurisprudence that came afterwards is, at worst, misleading as it arguably avoids a ‘chicken and egg’ problem or is, at best, overly simplistic. Remaining open to different normative visions of decision-making in areas such as the FET standard - that can also spring from the same IIA foundations - would seem a preferable way to proceed in both practice and doctrine.

## 1.5. Conclusion

The IIL regime is in many ways a strange, yet certainly powerful animal. It is based on a dense network of treaties that suggest the existence of substantial content – content that was, however, almost impossible to truly ascertain in advance. Further (and inevitably decentralized) ‘progressive development’ was necessary to establish the multilateral substantive edifice of the regime. Still, as Joost Pauwelyn suggests, the development of IIL was in many ways haphazard, fraught with accidents and akin to an organic evolution involving independent actors.<sup>251</sup> To take the analogy one step further - there was hardly an all-knowing, intelligent ‘watchmaker’ of IIL - the one existing would rather be, to use the famous title of Richard Dawkins’ 1986 book, of the ‘blind’ variety.

The features of the IIL regime development at the same time also imply that alternative normative visions of interpreting and applying its key standards, such as the FET, were and still are possible. The legal, empirical and ideological issues surrounding the IIA network conclusion also suggest that no ‘legitimate expectation’ existed on the side of at least a considerable number of States that this standard will necessarily be dominated by the IROL paradigm. The bilateral character of IIAs, broadness of the standard, the at least sometimes present *en passant* character of their conclusion and arguably the never completely settled ideological background for their interpretation do not seem to offer as strong a basis for the complete dominance of substantive international multilateralism as is the case with other regimes, such as the WTO.

It is not just that it is possible in abstract to imagine a more pluralistic and national rule of law-oriented idea of the FET standard. All these factors arguably also demanded more practical justification from arbitrators when engaging in the regime-

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<sup>251</sup> See generally Pauwelyn 2014.

building exercise. There was from a legitimacy viewpoint, if nothing else, a clear need for caution, circumspection and additional efforts in providing an explanation what the States - the nominal IIA 'masters' - could have reasonably expect from the FET standard and ISDS after decades of dormancy,<sup>252</sup> and how the awards corresponded to these expectations.

The case-law in general does not seem to indicate particular concern for these foundational normative issues. The ISDS mechanism, providing the main engine of growth for the quasi-legislative interpretations of the FET standard, was in many ways fuelled by the idiosyncratic legal and sociological features of international arbitration. The relatively low number of actors (arbitrators/counsel/law firms); the overlap of those deciding and those commenting the decisions; the strong protective 'cocoon' of the arbitration regime in terms of possibilities for review; strong proclivity for relying on precedent; perceived mandate for 'progressive development' of the law; and the relative homogeneity of the ideological outlook, all allowed for a vision of coherent, multilateral IIL regime and of its provisions that does not *a priori* leave room for national, case-specific legal variations. Still, those variations *can* - should the relevant normative orientation exist – be given effect within the broad wording of IIA provision, and are also arguably suggested by the predominantly bilateral nature of investment treaties.

The normative changes remain *possible* in the IIL regime as it exists now. The reliance on persuasive precedent, for example, indicates that dislodging a particular strand of reasoning in jurisprudence might not be easy or quick, but also shows that new awards can eventually launch broader trends. As Koskenniemi notes, '[a] regime is as indeterminate as the nation - its founding principles contradictory and amenable for conflicting interpretations and its boundaries constantly penetrated by adjoining rationales.'<sup>253</sup> The IIL regime is not closed to new influences, it is just that response to them might be seen as determined exclusively by its own principal players - arbitrators, lawyers and academics.<sup>254</sup>

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<sup>252</sup> As Ortino notes, 'investment treaty arbitration has literally been discovered in the last decade of the 20th century' (2012, 51).

<sup>253</sup> Koskenniemi 2007, 26.

<sup>254</sup> Schneiderman 2011, 9 and Schill 2011, 903.



If the normative change is still possible when bearing in mind the foundations of the IIL regime and the IROL paradigm, this would still not necessarily mean it is *needed*. The following chapter will thus focus on the operation of the IROL paradigm in practice, and suggest the reasons why a normative shift towards complementing the FET decision-making with the NROL paradigm is further warranted. The conclusions of this and the following Chapter should thus provide a more complete background for the discussion of the national rule of law orientation in Chapter 3.

## Chapter 2 – The IROL paradigm challenges and the tools for tackling them

### 2.1. Introduction

Chapter 1 presented the foundations of the IROL paradigm concerning the FET standard. This paradigm entails understanding the FET standard as embodying *international* rule of law precepts to guide the host State behaviour. These precepts or sub-standards should thus ideally be: a) of supranational character detached from the national specificities; b) with a *de facto* multilateralised and uniform substantive content; and c) embodying mostly a formal, de-politicized understanding of the rule of law. Chapter 1 also problematized the idea of the uniform regime of IIL as a precondition for the IROL paradigm. It is questionable if the idea of a multilateralised, uniform regime was an inevitable result or even an anticipated development by at least some of the participating States. The unsettled expectations and specific legal foundations thus still make different normative paradigms possible concerning both the FET standard and IIL more broadly.

However, the fact that the IROL paradigm understanding is not inevitable or that it is open to enhancements does not suggest its abandonment.<sup>1</sup> On the contrary, as the Introduction to this thesis emphasised, insistence on the rule of law requirements enforced through an international mechanism is a worthy development that accords well with general efforts to enhance the international rule of law. This Chapter rather seeks to point out that there should be no room for self-congratulatory narratives or complacency in practice just because the FET has come to be seen and applied as embodying the rule of law requirements. Even if the opaque ‘fair’ and ‘equitable’ is distilled into perhaps less opaque ‘predictable’, ‘non-arbitrary’, ‘transparent’, ‘with due process’ this should by no means indicate that tasks of further interpretation and application are made straightforward.

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<sup>1</sup> This is not to say that it cannot be criticised, as it sometimes strongly is. There is a body of doctrine criticising the ‘rule of law’ narrative in IIL from a different viewpoint - a combination of democratic legitimacy concerns, Third World Approaches to International Law and criticism of neo-liberalism. Some of the well-known arguments are put forward by Sornarajah (see for example Sornarajah 2009 and 2013). Schneiderman similarly notes that the ‘presence of a contemporary rule-of-law regime to protect and promote foreign investment [...] is intended to shield the market from intrusion of vulgar democratic politics.[...] It seems [...] perilous to embrace it.’ (2008, 222). For Kate Miles, the narrative of IIL as an ideal embodiment of the rule of law is a ‘particularly insidious’ manifestation of historical imperialistic patterns (2013, 347; see similarly *ibid*, 277-278 and 335).

The combination of the still considerably open-textured FET sub-principles and the decentralised nature of ISDS immediately poses challenges to predictability of decision-making and coherence of jurisprudence more generally. As this Chapter illustrates with some pertinent examples, these challenges have materialised into tangible issues in practice, issues that can jeopardize the valuable IROL mission of the FET standard. As will be shown, approaches to interpretation and application of requirements such as the respect for ‘legitimate expectations’ have been markedly different in practice, as has the issue of what should be the role of parallel non-investment obligations of the host State more generally. These issues impinging on legal certainty have their legitimacy costs, which should be taken seriously.

To be sure, clear and prospective rules and certainty in their application lie at the core of the formal understanding of the rule of law – and are also a foundation for all other (cumulatively more demanding/substantive) rule of law understandings properly so called.<sup>2</sup> If the ‘supranational rule of law [...] [and] [...] uniform standards for acceptable sovereign behaviour’<sup>3</sup> are to be realised, seeking paths towards enhancing certainty and predictability (in addition to structural reforms not here discussed) remains an ever-important task. This is even more so when potentially considerable practical effects of ISDS on the host States and their populations are taken into account.<sup>4</sup> Hachez and Wouters observe in the context of IIL predictability that ‘in view of the requirements of the rule of law and in light of the public interest, “working well most of the time” is not enough.’<sup>5</sup> What ‘working well’ means is certainly open to disagreement. Yet, sufficiently clear deficiencies related to certainty and predictability should in any case serve as a strong indicator that preserving the worthy developments might require constant adjustments based on the accumulated experience.

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<sup>2</sup> Tamanaha 2004, 91-92 and 102; see similarly Calamita 2013, 170 and Summers 1999, 1693-1695. An exception in that sense is what Tamanaha terms ‘Rule-by-Law’ – where everything that government does is consistent with the rule of law if given a legal form (ibid, 92). As he observes, ‘understood in this way, the rule of law has no real meaning’ and excludes any sort of potential for external review and assessment (ibid, 92; see similarly Reynolds 1989, 3 and Raz 1979, 212-213). Such an understanding would have little value for IIL if it is to constrain the host States at all.

<sup>3</sup> Rivkin 2012, 2. See similarly Carvalho’s contention that ISDS offers ‘legal predictability and equality among disputing parties who do not necessarily share the same domestic legal values and customs’ (2016, 15) and also Van Harten 2010c, 628-629.

<sup>4</sup> As noted by Tamanaha, any determination of moral legitimacy of the law must also consider the effect of the rules (2004, 94).

<sup>5</sup> Hachez/Wouters 2013, 434.

As indicated in the Introduction, and as will be further explored in particular in Chapters 3 and 4, this thesis argues that the introduction of the NROL paradigm as a regular complement to the IROL one is a normatively desirable development that can help tackle some of the critical challenges and bring about additional benefits. But before discussing further why the FET sub-principles should be interpreted and applied with systematic reference towards pre-existing international and domestic commitments of the host State, this Chapter will set out three propositions as a relevant background.

Firstly (as elaborated in section 2.2.) the FET jurisprudence does indicate a divergent approach to the interpretation and application of the FET sub-principles, both in terms of the autonomous understanding what the FET standard specifically entails and in terms of the relationship towards national law and international obligations of the host State.

Secondly, and relatedly (as also discussed in section 2.2.) there *are* examples in jurisprudence that clearly demonstrate the readiness of tribunals to duly take into account the parallel obligations of the host State and incorporate them into FET decision-making. This shows that the NROL paradigm as such is not a groundless proposal even when considering the existing jurisprudence.

Furthermore, and thirdly, this Chapter argues in section 2.3. that both in terms of rules of interpretation (primarily the Vienna Convention on the Law of Treaties, hereinafter VCLT) and through choice and weighing of relevant facts, investment tribunals *do* have at their disposal the necessary formal tools to make the suggested NROL paradigm a permanently-present complementary feature of deciding the FET claims.

Section 2.4. will offer concluding remarks and a proposal for certain common points arising from the first two chapters, points that should sketch a normative way forward towards a complementary NROL paradigm. The general normative desirability and potential benefits of introducing a focus on the national rule of law are then the main topic of Chapter 3.

## **2.2. The limits of the IROL paradigm - different approaches to the meaning and requirements of the FET standard**

The text of the FET standard whose breach is alleged is an uncontroversial starting point for assessing the liability of the host State.<sup>6</sup> Ideally, how the process of that assessment unfolds further should be sufficiently similar in all cases involving the FET standard. If the IROL paradigm is to (exclusively) play its rule of law securement role, the very broad ‘fair’ and ‘equitable’ language should be consistently distilled into more exact sub-principles, and these should then further be interpreted and applied in a sufficiently consistent manner. But challenges to such an ideal picture can be observed at almost every point. While the distilling of ‘fair’ and ‘equitable’ into the common rule of law requirements is the predominant trend, there are also cases in which ‘fair’ and ‘equitable’ requirements were not found to require further interpretation before being applied (section 2.2.1). Perhaps even more importantly, even in a much more common situation where the rule of law sub-principles are taken as a starting point for further assessment, the understanding of these sub-principles and the actual process of determining the relevant reference points for their further interpretation and application also exhibit divergences that cannot be ignored. This can be illustrated by the now ubiquitous doctrine of ‘legitimate expectations’ (section 2.2.2.) and the more general attitude towards the role and relevance of parallel host State obligations in interpreting and applying the FET standard (section 2.2.3).

### **2.2.1. The (un)tenability of ‘fair’ and ‘equitable’ as a beginning *and* an end**

There can certainly be an argument for the text of the FET standard being not just a start but also an end point in interpretation and application. Andreas Kulick, for example, asserts that ‘[...] a BIT sets out the investor rights in an express, clear and detailed manner [...] [and] is a more or less comprehensive body of rules, comparable to-or sometimes even more elaborate than-domestic law on investment.’<sup>7</sup> This could suggest that further interpretation might not be by itself necessary.

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<sup>6</sup> ‘The question of liability for a breach of the investment treaty must be resolved by the application of the legal standard encapsulated in the investment treaty obligation forming the basis of the claim. This [...] has never generated difficulties in practice.’ (Douglas 2009, 81). See similarly McLachlan 2005, 287; Spiermann 2008, 107; Schreuer et al. 2009, 578.

<sup>7</sup> Kulick 2012, 31. See also generally Schreuer et al. 2009, 605.

This understanding has occasionally surfaced in the awards. Sometimes the reasoning process consisted of the elaboration of facts, followed by a simple conclusion on whether (on the balance) host State behaviour was in breach of the FET.<sup>8</sup> As Toby Landau picturesquely noted, sometimes ‘the award suddenly peters out, and ends, not with a bang but a whimper.’<sup>9</sup>

One example is *Achmea v. Slovakia – Final Award*.<sup>10</sup> After summarizing the parties’ positions on the merits and the relevant IIA provisions,<sup>11</sup> the tribunal essentially dispensed with the critical issue of whether the FET breach existed within one paragraph:

[...] the imposition of the ban on profits and the ban on transfer of the portfolio were measures that *self-evidently and unequivocally* put Eureko’s investment into a situation that was incompatible with the most basic notions of what an investment is meant to be, and that the imposition of those measures upon the investment after it had been made *was incompatible with the obligation to accord the investment fair and equitable treatment* under the Treaty. [...]<sup>12</sup>

Several potentially important issues, such as Respondent’s arguments about the existence and importance of regulatory autonomy,<sup>13</sup> essentially went unaddressed. Regardless of the recourse to the preamble of the IIA and the VCLT when discussing jurisdictional issues,<sup>14</sup> there was no similar attempt in elucidating the content of the relevant substantive standards. In a somewhat similar vein, although focusing primarily on expropriation, the Tribunal in *ADC v. Hungary* found no difficulty in establishing a breach of host of other relevant standards in a single paragraph by concluding that:

the meaning of “*fair and equitable treatment*”, “*unreasonable or discriminatory measures*” and “*full security and protection*” are to be determined under the specific circumstances of each specific case. However, in the light of the facts established in this case [...],

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<sup>8</sup> As Landau notes, sometimes ‘conclusions are given, instead of any reasons at all’ (2009, 202). At least for early cases, this might be attributed to the presence of commercial arbitrators, as their ‘culture brings a strong focus on facts rather than the law’ (Laird 2009, 153).

<sup>9</sup> Landau 2009, 202.

<sup>10</sup> A somewhat similar example can be found in *Eureko v. Poland*, paras. 231-235 and also *RFCC v. Morocco* (for which see also Tudor 2008, 129).

<sup>11</sup> *Achmea v. Slovakia – Final Award*, paras. 220-277.

<sup>12</sup> *ibid*, para. 281.

<sup>13</sup> *ibid*, para. 269.

<sup>14</sup> *ibid*, paras. 169-170.

the Tribunal is satisfied to conclude that these requirements [...] have *all* been breached by the Respondent.<sup>15</sup>

Somewhat puzzlingly, the *ADC* tribunal indicated it was to turn to VCLT Article 31 and 32 for interpretative purposes,<sup>16</sup> yet after this single mention, these provisions were not later referred to in any way.<sup>17</sup>

Such a (perhaps deceptively) straightforward application of the FET standard is not, however, the predominant trend. The open-textured nature makes hard-and-fast decision-making problematic.<sup>18</sup> Whether welcomed or rued, there is wide acknowledgment in practice and doctrine that the FET and other IIA standards exhibit considerable broadness and even vagueness of language.<sup>19</sup> The FET standard has been described as intentionally vague, designed to give ‘quasi-legislative’ authority to arbitrators in order to articulate a variety of rules.<sup>20</sup> It has also been considered to be broad ‘as of its nature’ and ‘not to be cut down or over-refined.’<sup>21</sup> The appealing language of fairness and equity, as was touched upon in Chapter 1, certainly contributed greatly to its ‘easy passage into treaty practice’<sup>22</sup> but has also masked ‘an absence of any kind of settled agreement over [its] content.’<sup>23</sup>

The risks of over-reliance on the vagueness of the standards are sometimes specifically acknowledged, as they could suggest subjectivity and damage the legitimacy of decision-making.<sup>24</sup> Thus, unless a meaning of a given provision is clear, there is a need to go further so to concretise its meaning.<sup>25</sup> One of the primary topics of

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<sup>15</sup> *ADC v. Hungary*, para. 445 (emphases added)

<sup>16</sup> *ibid.*, para. 290.

<sup>17</sup> It is sometimes argued that ignoring VCLT is caused by the (commercial arbitration-oriented) counsel and arbitrators being unaware of the different nature of investment arbitration (Ascension 2016, 369).

<sup>18</sup> Grisel 2014, 218-219.

<sup>19</sup> *CMS v. Argentina - Award*, para 273; *Sempra v. Argentina - Award*, para 296; *Rumeli v. Kazakhstan - Award*, para. 610; *Suez v. Argentina - Liability*, paras 196 and 202; *Total v. Argentina - Liability*, paras 106–9. See more generally Vasciannie 1999, 145; Tudor 2008, 155; Dolzer/Schreuer 2012, 133-134; Trinh 2014, 17 and authors cited therein.

<sup>20</sup> Brower 2001, 56.

<sup>21</sup> McLachlan/Shore/Weiniger 2007, para. 7.181.

<sup>22</sup> *ibid.*, para. 7.03.

<sup>23</sup> *ibid.*, para. 7.08. See similarly Douglas 2009, 81. One of the rare universally acknowledged limits is that FET should not be conflated with decision-making *eq aequo et bono* (Dolzer/Schreuer 2012, 133-134; *ADF v. United States*, para. 184)

<sup>24</sup> *ibid.*, 7.14-7.15; See also D’Argent 2012, 1-3 and McLachlan/Shore/Weiniger 2017, paras. 1.86-1.91.

<sup>25</sup> See for such an understanding *Globex v. Ukraine*, para. 50 and *Murphy v. Ecuador*, para. 71. See also Weeramantry 2012, para. 3.142; Trinh 2014, 12; Vadi 2016, 111 and Ascensio 2016, 369-371.

contention concerning the FET standard and IIL more generally is how the tribunals are to perform this exercise.

It must be said that the state of jurisprudence (after some decades of development) does not necessarily entice optimism. Subsequent tribunals can engage in their own further refining of (often themselves relatively vague) doctrines espoused through a line of previous cases, which can sometimes lead to a situation in which a nominal reference to a same doctrine can actually mask different and incompatible understandings. Staying with the FET standard, although similar claims can also be made about expropriation,<sup>26</sup> Jason Bonnitcha relatively recently concluded that ‘a close examination of existing arbitral decisions reveals very different understandings of the legal content of the FET standard. These differences entail divergent patterns of legal reasoning and would lead to different decisions on an identical set of facts.’<sup>27</sup>

Such divergence risks creating an impression of the IROL paradigm goals being achieved (as in ‘all tribunals are using the same doctrines’ or ‘all tribunals recognize the role of VCLT’) while masking the actual heterogeneity. Bearing in mind the importance of this challenge for the existing IROL thinking, it is warranted to examine two prominent and somewhat interrelated examples. These relate to the doctrine of legitimate expectations (section 2.2.2.) and the role given to parallel treaty obligations (in particular human rights ones) in interpreting and applying the FET standard (section 2.2.3.).

### **2.2.2. The doctrine of legitimate expectations**

#### *The importance and origin*

The doctrine of legitimate expectations is described as having a central role in interpreting the FET standard.<sup>28</sup> Its origins, development and the current state,

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<sup>26</sup> This is particularly so regarding the differing interpretation whether intention of the host State (as opposed to just the effect on investment) is a relevant factor for establishing the existence of expropriation. For an overview of diverging practice and doctrine, see Dolzer/Schreuer 2012, 114-115. See also Cotula 2015b, 120 and in particular Calamita 2013, 172-174.

<sup>27</sup> Bonnitcha 2014, 166; See also similarly Kläger 2011, 317-320; Diehl 2012, 550-551; UNCTAD 2012a, 80-91; Stone 2012, 93-97 and 105-107; See also for an early indication in same vein Tudor 2008, 180-181.

<sup>28</sup> Dolzer/Schreuer 2012, 145; Potestà 2013, 88-89; Radi 2013, 9-10.



however, illustrate well the challenges in providing a set of clear, prospective and consistently interpreted rules. The origin of the doctrine is often said to be the *Tecmed v. Mexico* award. Faced with the interpretation of the FET provision in the Spain-Mexico BIT (as a part of the minimum standard of treatment)<sup>29</sup> the tribunal stated in an oft-quoted passage that:

[...] this provision [...], in light of the good faith principle established by international law, 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. 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 the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations. [...]<sup>30</sup>

This important concretisation of the FET standard was reached through a somewhat puzzling interpretive process. The tribunal clarified that the above understanding of the FET requirements:

[results] from an autonomous interpretation, taking into account the text of Article 4(1) of the Agreement according to its ordinary meaning (Article 31(1) of the Vienna Convention), *or* from international law and the good faith principle, on the basis of which the scope of the obligation assumed under the Agreement and the actions related to compliance therewith are to be assessed.<sup>31</sup>

The following paragraph of the award also relies on the preamble of the applicable BIT for supporting a proposition that FET is there to ‘strengthen and increase the security and trust of foreign investors’, suggesting (although not explicitly) the interpretation in light of the object and purpose of the applicable BIT as per VCLT Article 31(1).<sup>32</sup>

To begin with, it can be noted that this interpretive process leaves doubts about the origin of the legitimate expectations doctrine. The tribunals seem to suggest that it stems from both the ‘ordinary’ meaning and the principle of good faith in international

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<sup>29</sup> See Spain-Mexico BIT, article IV (1), available at: <https://www.italaw.com/sites/default/files/laws/italaw6182%282%29.pdf>, accessed 15 April 2015. The applicable law provision of the BIT (Article XV) also designates the provisions of the BIT and principles of international law as exclusively applicable.

<sup>30</sup> *Tecmed v. Mexico*, para. 154.

<sup>31</sup> *ibid*, para. 155 (emphasis added).

<sup>32</sup> *ibid*, para. 156.

law. The ‘ordinary’ meaning of IIA standards in general - and ‘fair’ and ‘equitable’ in particular – is quite opaque, as noted above. While the principle of good faith certainly can be invoked as an interpretive tool by the tribunal through VCLT Article 31(3)(c) (although this was not made explicit), it is doubtful if it can serve as a source of obligation in itself.<sup>33</sup> The doctrine was not further grounded in any other source of international law or authority,<sup>34</sup> as would be possible (although perhaps not successful) through the general principles of law and a consequential examination of national orders.<sup>35</sup>

But apart from the interpretive process, its outcome in terms of substance can also demonstrate the practical problems associated with the generally desirable creation of IROL requirements, which however remain disentangled from national practices. One significant risk is to set unrealistically ambitious thresholds of good administration. The *Tecmed* award suggests an exacting and unqualified test,<sup>36</sup> and one that objectively might be too strict to pass. As noted by Behrens, ‘[t]he award defined the principle of transparency in such an ambitious way that one must wonder whether any government anywhere in the world may be living up to this definition of the principle.’<sup>37</sup> Zachary Douglas similarly observed that this test or standard ‘is rather a description of perfect public regulation in a perfect world, to which all states should aspire but very few (if any) will ever attain.’<sup>38</sup>

#### *Further developments*

An equally important element for understanding the IROL paradigm challenges is the path which the doctrine took in jurisprudence. Arguably, the problematic interpretative process could have been enhanced in future awards, potentially leading to a different understanding which is more suited to the realities of everyday administration. The reliance on precedent is not in itself an unqualified good, as the

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<sup>33</sup> See the ICJ decision in *Nicaragua v. Honduras*, para. 94 and Potestà 2013, 92.

<sup>34</sup> See also Roberts 2010, 214-215.

<sup>35</sup> As is argued, the inspiration for the doctrine was found in national legal orders (see Potestà 2013, 93-98) although the exercise might not be particularly successful as it is not recognized in a significant number of them (Roberts 2010, 214-215).

<sup>36</sup> Bonnitcho 2014, 207.

<sup>37</sup> Behrens 2007, 177.

<sup>38</sup> Douglas 2006, 28. See also for similar criticism *White Industries v. India*, para. 10.3.5.

original decision can be ‘wrong’.<sup>39</sup> What initially occurred, however, was a ‘cascade effect’,<sup>40</sup> in which the subsequent tribunals were happy to embrace and apply the doctrine – sometimes *ad verbatim* – on the simple basis of it being previously decided and without revisiting the process of interpretation.<sup>41</sup> As more decisions referred to the doctrine, the more it became a useful interpretive short-cut for deducing a large part of the meaning of the FET standard.<sup>42</sup>

If indeed the process resulted only in *ad verbatim* translation of the doctrine (despite the problematic nature of that process VCLT-wise) an argument could be made that, for all the potential rigidity of requirements, there at least existed sufficient certainty. This would, regardless of the substance, comply with the basic formal rule of law expectations and potentially sufficiently orient the host States’ behaviour. *Dura lex, sed lex*. What followed, however, were further disparate attempts to refine the content of the doctrine, leading to a broader umbrella term of ‘legitimate expectations’ covering different understandings.

Generally, there is an agreement that the investor should be able to legitimately rely on expectations induced by host State behaviour (primarily through representations to the said investor), and that a breach of such expectations could entail the breach of the FET standard.<sup>43</sup> But eventual developments lead to different understandings of what sort of ‘representations’ justify the creation of legitimate – as opposed to unfounded – expectations.<sup>44</sup> It has been argued that there are at least four different approaches to the question of what expectations are legitimate.<sup>45</sup> As Bonnitcha sets out:

- i) Expectations can only rest on specific rights that the investor has acquired under domestic law.
- ii) In addition to i), expectations may rest on specific representations made to the investor by government officials.
- iii) In addition to ii) expectations may rest on the regulatory framework in force in the host state at the time the investor made the investment.

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<sup>39</sup> See in this sense above all Ten Cate 2013 and Schultz 2014b, as well as Newcombe/Paradell 2009, 104-105.

<sup>40</sup> Potestà 2013, 90.

<sup>41</sup> See in particular *MTD v. Chile – Award*, paras. 114-115 and *LG&E v. Argentina – Liability*, para. 131; see also *Saluka v. Czech Republic*, para. 302. See also Potestà 2013, 91.

<sup>42</sup> Although there are arguable exceptions, where the doctrine has been largely and explicitly ignored as not contributing much – see *TECO v. Guatemala – Award*, paras. 617-622.

<sup>43</sup> Dolzer/Schreuer, 145-149.

<sup>44</sup> Potestà 2013, 121-122; *Urbaser v. Argentina*, para. 615.

<sup>45</sup> See similarly Potestà 2013, 100-119.

iv) In addition to iii), expectations may rest on the business plans of the investor.<sup>46</sup>

Critically, the differences between these approaches are not easily reconcilable. Each of these views is a different, distinct and *per se* coherent interpretation of this specific facet of the FET standard - and could lead to different outcomes on a same set of facts.<sup>47</sup> Yet, the adoption of a particular understanding or a decision to break from even a long line of existing case law, is not a ground for annulling the award.<sup>48</sup>

To summarise, an increasingly accepted 'core' obligation under the FET standard can leave both the investors and host States in considerable uncertainty as to how to proceed in their mutual relations. The possibility that a same set of representations will be qualified differently – with a direct effect on the outcome – in many ways can question the ability of the host State to deduce the meaning of the rule of law as mandated by the FET standard.

An important further aspect of the uncertainty is also the extent to which parallel host State obligations in international and domestic law affect the legitimacy and frustration of investors' expectations and the interpretation process more generally. This is the topic of the next section.

### **2.2.3. The role of parallel host State obligations for the FET standard**

A related important issue is whether and to what extent the parallel, non-IIA, obligations of the host State should play a role in interpreting and applying specific sub-principles of the FET standard. This includes, but is certainly not limited to, the legitimate expectations and transparency issues mentioned above. This is directly relevant for the NROL paradigm as discussed in this thesis. Limiting the discussion largely at this point to international obligations, the responses that the investment tribunals have given to how these affect the assessment of host State behaviour can

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<sup>46</sup> Bonnitcha 2014, 169. For an example of i), see *LG&E v. Argentina – Liability*; for ii) see *Duke Energy v. Ecuador*; for iii) see *Frontier Petroleum v. Czech Republic* and for iv) see *MTD v. Chile - Award*. For a commentary, see generally Bonnitcha 2014, 167-194.

<sup>47</sup> Bonnitcha 2014, 194.

<sup>48</sup> Weeramantry 2012, 5.20; see also Ortino 2012, 38-41 and 51-52. However, for a proposal to incentivise *jurisprudence constante* by making the departure from consistent line of case-law a ground for annulment see in particular Wälde 2007, 105-106.

significantly clarify if the existing jurisprudence provides any support for advocating an NROL paradigm or if its introduction would require a largely unlikely U-turn in decision-making. Focusing on the particularly contentious issue of host State's human rights obligations, it is possible to demonstrate that there has, on the one hand, been a degree of reticence towards engaging with other international obligations too closely. Yet, on the other hand, there is also a number of recent examples where this has been done in a considerably thorough manner. Therefore, although the IROL paradigm would still in this sense be dominant, its exclusivity by no means monopolises the jurisprudence – and offers support for realistically thinking about complementing it with NROL considerations.

*Human rights obligations as the focal point*

The interplay between investment obligations and human rights obligations is one of the most contentious topics in IIL.<sup>49</sup> Relatively common invocations of human rights obligations by the host States in cases involving FET claims generally garnered limited success so far.<sup>50</sup> The existing jurisprudence, however, again demonstrates considerable heterogeneity. The arguments put forward by both the tribunals and parties sometimes do suggest the relevance of human rights obligations, while not necessarily elaborating on it within the context of interpretation instruments such as the VCLT.

In some situations, the consideration of human rights by the tribunals have been eschewed due to allegedly insufficient elaboration - such as in *Siemens v. Argentina*, where the argument was introduced through international human rights obligations internalised in the Argentinian constitution.<sup>51</sup> *Azurix v. Argentina* tribunal reached a similar conclusion, in a situation where the human rights treaties were specifically invoked, but not in an 'understandable' way.<sup>52</sup> A somewhat different approach was taken in *Suez v. Argentina – Liability*. The tribunal recognized that Argentina was subject to both investment protection *and* human rights obligations, which were 'not mutually

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<sup>49</sup> See generally Dupuy 2009; Simma 2011 as well as *Tulip Real Estate v. Turkey*, para. 86. Area is also contested as IIAs themselves only exceptionally point to relevance of human rights in their texts (Dumberry/Dumas-Aubin 2012, 359). See also Knoll-Tudor 2009, 339-340.

<sup>50</sup> Ascensio 2016, 381-382. See also Schreuer et al. 2009, 605. For an argument that these spheres should remain separate on determining the merits of the FET claim, see Knoll-Tudor 2009, 342.

<sup>51</sup> *Siemens v. Argentina*, paras. 74-75 and 79.

<sup>52</sup> *Azurix v. Argentina*, paras. 254 and 261.

exclusive’ and could be fulfilled simultaneously.<sup>53</sup> The human rights considerations ultimately were not relevant to the outcome, but more importantly, such an understanding supports the view that investment protections have an autonomous meaning that should not *per se* be influenced by human rights obligations.

An oft-discussed indication in that regard is also the *von Pezold v. Zimbabwe – Procedural Order 2*, which replied to an *amicus* submission requesting the consideration of human rights of indigenous peoples in a dispute at hand. The tribunal(s) noted, *inter alia*, that the reference to general international law ‘in the BITs does not incorporate the universe of international law into the BITs or into disputes arising under the BITs.’<sup>54</sup> Furthermore, no support was found that ‘any decision of these Arbitral Tribunals which did not consider the content of international human rights norms would be legally incomplete’<sup>55</sup> and furthermore was not persuaded that consideration of the invoked human rights was ‘part of their mandate under either the ICSID Convention or the applicable BITs.’<sup>56</sup>

To be sure, there are warnings in both case-law and doctrine that a wholesale incorporation of the international law universe, even if the formal requirements would be met, would hardly be justified.<sup>57</sup> Another concern is the risk of oversimplification between the differences in similar but not identical standards used in different areas of public international law.<sup>58</sup> Overall, it has been noted that the attitude of investment arbitrators towards interaction with other areas of international law is cautious, and the record is still not particularly abundant.<sup>59</sup>

#### *A more positive attitude towards parallel obligations*

It is of special importance, however, that case-law also exhibits a strand of cases increasingly recognising the relevance of human rights obligations for interpreting the

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<sup>53</sup> *Suez v. Argentina – Liability*, para. 262.

<sup>54</sup> *von Pezold v. Zimbabwe – Procedural Order 2*, para. 57.

<sup>55</sup> *ibid.*, para. 58.

<sup>56</sup> *ibid.*, para. 59.

<sup>57</sup> See, for example, Dupuy 2009, 59 and also *von Pezold v. Zimbabwe – Procedural Order 2*, para. 57.

<sup>58</sup> McLachlan 2005, 311; Kurtz 2014, 281; Ascensio 2016, 383.

<sup>59</sup> Hirsch 2008, 179; Schreuer et al. 2009, 605; Roberts 2013, 75; De Brabandere 2014, 136-137 and 147.

FET standard and some other IIA obligations.<sup>60</sup> While sometimes relying on human rights jurisprudence more incidentally,<sup>61</sup> and sometimes recognising human rights considerations rather implicitly,<sup>62</sup> newer awards such as *El Paso v. Argentina – Award* relied on the provisions and case-law under human rights treaties to add support to important interpretive findings.<sup>63</sup> An important recognition was the *Frontier Petroleum v. Czech Republic* tribunal finding that rights granted under the ECHR (specifically the right to expeditious proceedings) accrued to all persons under the jurisdiction of the Czech Republic (including the foreign investor), but declined to discuss the breach of ECHR standards *in concreto* as no party pleaded them specifically.<sup>64</sup>

Two recent decisions have particularly clearly set out the increasingly direct relevance of the obligations imposed by non-IIA conventional law for interpreting the FET requirements, with the extraneous rules having a direct impact on the outcome. In *Al Warraq v. Indonesia*, for the purposes of interpreting the FET standard (‘imported’ into the relevant IIA through an MFN clause) and in particular the requirements for the denial of justice, the tribunal extensively examined the provisions and case law on the right to a fair trial in international human rights instruments, in particular the International Covenant on Civil and Political Rights (ICCPR).<sup>65</sup> The tribunal unambiguously confirmed the universal binding character of ICCPR in treating all subjects under Indonesia’s jurisdiction,<sup>66</sup> as well as the obligation to obey its provisions in good faith.<sup>67</sup> In addition, the tribunal invoked a number of other treaties, and at relevant points found Respondent’s behaviour in breach of not only the ICCPR,<sup>68</sup> but also the UN Convention on Transnational Organised Crime,<sup>69</sup> UN Convention against

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<sup>60</sup> See for a brief overview *Tulip Real Estate – Annulment*, para. 91. Interestingly, this tribunal also used human rights treaties and case law in interpreting the ‘fundamental rule of procedure’ as a ground for annulment in Article 52(1)(d) of the ICSID Convention (paras. 86-92, 146 and 152). See however for a cautionary comment Ascensio 2016, 383.

<sup>61</sup> For example, *Mondev v. United States* relied on ECtHR jurisprudence for inspiration-providing ‘analogy’ (para. 144, and specifically in paras. 1381, 141 and 143. The 2001 *Lauder v. Czech Republic*, para. 200 relied on ECHR jurisprudence in delineating formal and de facto expropriation while the 2006 *ADC v. Hungary*, para. 497 did so for clarifying the issues relating to compensation due for the established breach. *IBM v. Ecuador – Jurisdiction*, para. 72 relied on Inter-American Court of Human Rights jurisprudence to add support to its finding of supremacy of international law over domestic provisions.

<sup>62</sup> *LG&E v. Argentina – Liability*, paras. 226 and 234; *Continental Casualty v. Argentina – Award*, para. 180.

<sup>63</sup> *El Paso v. Argentina – Award*, para. 598 which used relevant ECHR provisions and case law to add support to the finding of emergency clauses not being self-judging.

<sup>64</sup> *Frontier Petroleum v. Czech Republic*, para. 338.

<sup>65</sup> *Al Warraq v. Indonesia*, paras. 556-621. See for doctrinal support in that sense also McLachlan 2008, 376.

<sup>66</sup> *ibid*, para. 559.

<sup>67</sup> *ibid*, para. 560.

<sup>68</sup> *ibid*, paras. 588-589, 601, 604.

<sup>69</sup> *ibid*, para. 590.

Corruption,<sup>70</sup> and the 1963 Vienna Convention on Consular Relations.<sup>71</sup> Basing its conclusions *directly* on the breaches of these instruments, the tribunal found a breach of the FET standard, which to it was enshrined in the ICCPR.<sup>72</sup>

Another recent example is *Urbaser v. Argentina – Award*. The tribunal made several important general pronouncements before focusing on the right to water, in the context of deciding on the host State’s counterclaim. While staying broadly within the context of the doctrine of legitimate expectations within the FET standard, the tribunal stated that investor’s expectations ‘are placed in a legal framework embracing the rights and obligations of the host State and of its authorities, subject to the protections provided in the BIT.’<sup>73</sup> Importantly, ‘the host State is bound by obligations under international and constitutional laws [...] [and] is legitimately expected to act in furtherance of rules of law of a fundamental character.’<sup>74</sup> Measures conducted in such furtherance ‘*cannot hurt the fair and equitable treatment standard* because their occurrence *must have been deemed to be accepted* by the investor when entering into the investment.’<sup>75</sup> But the tribunal retains the right to assess whether the manner in which the measures were taken still comports with the FET standard, so not to exclude the standard’s relevance.<sup>76</sup>

In the context of the right to water, the *Urbaser* tribunal examined a number of relevant instruments, including the 1966 International Covenant on Economic, Social and Cultural Rights.<sup>77</sup> While the focus of the discussion was on whether *investors* also bear obligations under international human rights law (in the light of Argentina’s counterclaim), the tribunal reiterated that ‘[t]he BIT has to be construed in harmony with other rules of international law of which it forms part, including those relating to human rights.’<sup>78</sup> Likewise, the tribunal stated that ‘[t]he human right to water entails an obligation of compliance on the part of the State’<sup>79</sup> and that there is a ‘State’s obligation [...] to enforce the human right to water of all individuals under its jurisdiction.’<sup>80</sup> These

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<sup>70</sup> *ibid*, para. 591.

<sup>71</sup> *ibid*, para. 605.

<sup>72</sup> *ibid*, para. 621.

<sup>73</sup> *Urbaser v. Argentina – Award*, para. 619.

<sup>74</sup> *ibid*, para. 621. Similarly *ibid*, para. 624.

<sup>75</sup> *ibid*, para. 622 (emphasis added).

<sup>76</sup> *ibid*.

<sup>77</sup> *ibid*, paras. 1195-1198.

<sup>78</sup> *ibid*, para. 1200.

<sup>79</sup> *ibid*, para. 1208.

<sup>80</sup> *ibid*, para. 1210.



deliberations resulted in a conclusion with a direct impact on the output of the case – ‘[i]t was therefore the State’s primary responsibility to exercise its authority over the [Claimant] in such a way that the population’s basic right for water and sanitation was ensured and preserved.’<sup>81</sup> Respondent’s failure to exercise its authority in that way eventually, *inter alia*, led to the dismissal of the counterclaim.<sup>82</sup>

To conclude, extraneous treaty obligations can become a prominent part of the framework of rules used to assess host State compliance with the IIA standards. The potential benefits of their inclusion are considerable. One is the possibility to use the wealth of secondary materials to assist tribunals in clarifying the exact scope of commitments and behaviour expected from the host State. The legitimacy advantages lie in recognising the role for parallel non-investment concerns, and doing so in accordance with provisions that the host State *itself* adopted and could expect to be taken into account as relevant.

#### **2.2.4. Some concluding remarks on the limits and challenges of the IROL paradigm**

The above examples suggest that the autonomous, international nature of the rule of law requirements imposed by the FET standard should not hide the problems relating to predictability and certainty, which if unaddressed have the potential to adversely affect the generally worthy development of the IROL paradigm. Different tribunals applying the same sub-principles of the FET standard can and did sometimes pronounce mutually incompatible understandings of the further requirements and of the role that existing non-investment obligations of the host State (can) play in fulfilling them. Looking at that aspect, it should be relatively uncontroversial that enhancement of predictability is both possible and desirable.

Focusing specifically on the NROL paradigm as here discussed, it can be said that the enhancement of predictability can also be theoretically achieved by its complete *negation*. That is, tribunals might actively *disregard* other relevant sources of obligations in an effort to create a sufficiently precise, consistent and IIL-specific understanding of the

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<sup>81</sup> *ibid*, para. 1213.

<sup>82</sup> *ibid*, para. 1219.

FET rule of law sub-principles. But as both Chapter 1 and the discussion in Chapter 2 so far aimed to show, feasibility of such a path is severely undermined by the decentralised nature of ISDS. Likewise, opting instead for due account of other national and international sources of rules in deciding the FET standard claims is by no means an exotic occurrence. What the cases demonstrate (and doctrine often supports) is that obligations of the host State stemming from other treaties can be and have been taken into account, sometimes to the extent that was determinative.<sup>83</sup>

This is the path that this thesis, though the vehicle of the NROL paradigm, finds as normatively preferable for reasons relating to both predictability enhancement and achievement of additional benefits further discussed in the following Chapter. But before moving on to the more prescriptive discussion, it is warranted to delineate what are the formal tools that can allow (and have allowed) the tribunals to take due account of the international obligations beyond the IIA, as well as of the national legal framework. Elucidating the formal feasibility of such an endeavour is in many ways a necessary precondition for further discussing its normative desirability.

### **2.3. The tools for introducing the NROL paradigm – applicable law, interpretation, and the choice of relevant facts**

How non-investment international obligations of the host State, as well as national law, can systematically be taken into account is a question that first requires clarity on the applicable law. Depending on that law, the focus is then put on the ways in which the NROL paradigm can be legally feasible. Specifically, this part of the Chapter argues that (despite some potential complexities) the law applicable to State liability under the FET standard is international law (section 2.3.1.) Based on that, the ways in which other international legal obligations and national law can become relevant are twofold. Firstly, the process of *interpretation* of the FET standard and its-sub principles under international law can (relying primarily on systemic integration through VCLT Article 31) can make non-investment international obligations relevant for decision-making (section 2.3.2). Secondly, the importance of both these obligations and national law can be secured through the process of selecting the relevant *facts* which are to be taken into account in the process of applying the sub-principle that serves as a

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<sup>83</sup> Hirsch 2008, 174.

basis for review (section 2.3.3.) In combination, these two paths should allow the tribunals that are willing to do so to thoroughly consider the relevant spectrum of existing rule of law obligations of the host State and make that a regular feature of the FET decision-making.

### 2.3.1. International law as applicable law to FET claims

Generally, the IROL paradigm could be seen as almost necessarily entailing the primary or even exclusive role for international law in situating, interpreting and applying the FET standard. Unlike the patchwork of around 200 municipal laws, international law is (at least conceptually) a single entity – which is a strong precondition for substantive uniformity.<sup>84</sup> Secondly, international law can prevail over municipal laws in the case of conflict, at least when applied in international adjudication.<sup>85</sup> As Schill notes, '[t]hat conduct that is legal under domestic law, suddenly becomes illegal under international law is the most normal of consequences the acceptance of, and submission to, international law by states can have.'<sup>86</sup> In some ways, achieving the *international* rule of law while retaining a key role for *national* legal systems would seem almost an oxymoron.

There is broad agreement in practice and theory that in deciding on the host State compliance with the IIA standards, including the FET standard, the governing law *is* or even *has to be* international law. Zachary Douglas, in his rigorous systematisation of applicable laws, summarizes thus:

Rule 10: The law applicable to the issue of liability for a claim founded upon an investment treaty obligation is the investment treaty as supplemented by general international law.<sup>87</sup>

As Florian Grisel has noted, most authors tend to analyse investment arbitration decision-making exclusively through the prism of public international law.<sup>88</sup> This

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<sup>84</sup> 'The standards set for investor treatment in investment treaties exist on the plane of international law. Their content is therefore determined by international law, and not by the national legal systems of either the host State or any other State.' (McLachlan/Shore/Weiniger 2007, para. 7.172).

<sup>85</sup> In general terms both international and national law perceive themselves as autonomous and irreducible, leading to domestic judges admitting international rules through the lens of municipal law (Dupuy 2010, 174). See generally also Nollkaemper 2011 and von Bogdandy 2008b, 402-403.

<sup>86</sup> Schill 2016b, 332.

<sup>87</sup> Douglas 2009, 39. See in that sense *MTD v. Chile – Annulment*, para. 74 ('the *lex causae* [...] based on a breach of the BIT is international law') and also Spiermann 2008, 107 and De Brabandere 2014, 9.

<sup>88</sup> Grisel 2014, 215.

‘analytical bias’ tends to stem from the often-stressed quality of investment tribunals as public international law tribunals.<sup>89</sup> This is hardly contentious as a starting point. IIAs are indeed international, State-to-State instruments governed by international law even if the IIA is silent on the applicable law provisions.<sup>90</sup> For some authors, national law cannot ever truly apply on its own in this context. Even in cases of express invocation of national law, ‘domestic law does not apply *proprio motu*: it only applies because the treaty designates it.’<sup>91</sup>

To note, the applicable law clauses in IIAs and default choice of law provisions in the relevant arbitral rules might suggest that the matter is not so straightforward.<sup>92</sup> Formally, the law to be applied to any and all issues arising in the investment dispute – including liability under the IIA standards such as the FET – can generally either be chosen by the parties or determined using a default rule.<sup>93</sup> As for the law chosen by the parties, the variety of potentially applicable arbitral rules shows a remarkable uniformity in allowing party autonomy.<sup>94</sup> Article 42(1) of the ICSID Convention provides:

The Tribunal shall decide a dispute in accordance with such rules of law *as may be agreed by the parties*. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable. (emphasis added)

Other widely used arbitral rules for resolving investor-state disputes, as well as national laws relevant for non-ICSID arbitrations, are also largely in agreement on this point.<sup>95</sup>

As for realising this autonomy of choice, the content and even the presence of

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<sup>89</sup> *ibid*, 215 and 222. Some particular examples in that sense include Alvarez 2011 and De Brabandere 2014. See also Schreuer et al. 2009, 583.

<sup>90</sup> *ADC v. Hungary*, para. 290; *LG&E v. Argentina*, para. 85; Spiermann 2008, 107; Schreuer et al. 2009, 578; Gazzini 2012, 106.

<sup>91</sup> Reisman 2013, 135-136.

<sup>92</sup> See also similarly Igboke 2006.

<sup>93</sup> Kjos 2013, 296; See for ICSID Convention context Schreuer et al. 2009, 554. As noted by the authors, however, this has not been followed constantly by the tribunals, resulting in methodological blurring of the exercise (*ibid*).

<sup>94</sup> Kjos 2013, 295; Schreuer et al. 2009, 557. To be clear, in arbitrations based on IIAs the ‘parties’ are Contracting States and the investor is deemed to have accepted the choice of law made by them by initiating arbitration (Spiermann 2008, 107; Schreuer et al. 2009, 558).

<sup>95</sup> UNCITRAL Arbitration Rules in the first sentence of Article 35(1), ICC Rules in the first sentence of Article 21(1) and SCC Rules in the first sentence of Article 22(1) all provide the essentially same rules regarding party autonomy. See generally on this Capper 2014, 32-34.

choice of law clauses in IIAs varies very considerably.<sup>96</sup> Where choice of law clauses exist, they commonly include references to the law of the Contracting State in addition to the IIA itself, rules and principles of international law and sometimes rules of a particular contract.<sup>97</sup> A frequently used formula lists host State law, the IIA itself and other treaties, any contract and general international law.<sup>98</sup> Some notable exceptions include the multilateral IIAs, such as ECT and NAFTA Chapter 11, which refer to international law as the only applicable law.<sup>99</sup> However, while there are certainly a number of IIAs that exclude domestic law from consideration, there are also IIAs that also exclude international law as well.<sup>100</sup> UNCTAD has advised against the exclusive selection of international law, as that law can lack both clarity and technical detail.<sup>101</sup>

IIAs also frequently do not contain a clause on applicable law.<sup>102</sup> The default provisions contained in relevant arbitral rules therefore come into play. Focusing on perhaps the most discussed provision in ISDS practice and doctrine, the second sentence of the above cited ICSID Convention Article 42(1) makes it clear that domestic and international law both have a role to play – ‘In the absence of [...] agreement, the Tribunal shall apply the law of the Contracting State party to the dispute [...] and such rules of international law as may be applicable.’<sup>103</sup>

However, there seems to be little doubt that as the FET and other IIA standards are international standards, determining their breach requires application of international law. Article 42(1) provision grants *discretion* to arbitrators, rather than *mandating* the examination of both sources of law. Zachary Douglas summarizes this position by stating that

this provision does not provide any guidance as to the circumstances in which national law or international law should be applied by the tribunal. [...]. It simply recognises the competence of the tribunal to apply both national and international

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<sup>96</sup> Schreuer et al. 2009, 558.

<sup>97</sup> UNCTAD 2003b, 11. See similarly Schreuer et al. 2009, 562.

<sup>98</sup> Schreuer et al. 2009, 576; Dolzer/Schreuer 2012, 290; Gazzini 2012, 112.

<sup>99</sup> See ECT Articles 10(1) and 26(6); NAFTA Articles 1105 and 1131.

<sup>100</sup> See Gaillard/Banifatemi 2003, 377-378 and examples listed there.

<sup>101</sup> UNCTAD 2003b, 92.

<sup>102</sup> Gaillard/Banifatemi 2003, 379; Schreuer et al. 2009, 578; Gazzini 2012, 112.

<sup>103</sup> As for other arbitral institutions and rules, the predominant solution is the one which allows arbitrators considerable leeway in selection of applicable rules. See in that sense the second sentence of UNCITRAL Rules Article 35(1); second sentence of ICC Rules 21(1) and the second sentence of SCC Rules 22(1) all essentially allowing reaching the same result as in Article 42(1) second sentence.

law. It is for ICSID tribunals to adopt a coherent set of principles to guide the choice of either of these laws with respect to the particular issues [...].<sup>104</sup>

The arbitrators thus retain considerable discretion.<sup>105</sup> It has been (especially since the decision in *Wena v. Egypt – Annulment*)<sup>106</sup> generally held that the international law nature of claims and adjudication allowed, if not always necessarily mandated, the supremacy of international law in determining host State liability.<sup>107</sup> As put in strongest terms by Prosper Weil:

[...] no matter how domestic law and international law are combined [...] international law always gains the upper hand and ultimately prevails. [...] The reference to the domestic law of the host State, even if designed only to ascertain whether it is, or is not, compatible with international law, is indeed a pointless exercise, the sole *raison d'être* of which is to avoid offending the sensibilities of the host State.<sup>108</sup>

So while there may be situations in which broadly worded dispute settlement clauses in an IIA may lead to application of national law even to determine international liability,<sup>109</sup> for the purposes of the FET standard and this thesis the situation is rather straightforward. If a claim is put forward that a treaty standard was breached, the claim is of an international nature and requires the application of international law.<sup>110</sup>

### **2.3.2. Interpretation as a path towards other international rule of law obligations of the host State**

To make non-investment international obligations of the host State relevant for ascertaining the meaning of the FET standard and its requirements, one potential path is through interpreting them in a way that takes these obligations into account in accordance with the VCLT Article 31(3)(c). As has been suggested in Chapter 1 and will be revisited below, tribunals have so far heavily relied on previous decisions to ascertain the meaning and sub-principles of the FET standard – something that is arguably not in

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<sup>104</sup> Douglas 2009, 129 and similarly 133; see also similarly Schreuer et al. 2009, 630; Dolzer and Schreuer 2012, 293. See in that sense also *MTD v. Chile – Annulment*, paras. 59 and 74-75.

<sup>105</sup> See also in that sense Kjos 2013, 296 and 301-302; Kurtz 2014, 258.

<sup>106</sup> *Wena v. Egypt – Annulment*, paras. 40-41.

<sup>107</sup> See primarily *Santa Elena v. Costa Rica*, para. 64 and also *Wena v. Egypt – Award*, para. 79; *Wena v. Egypt – Annulment*, paras. 39-40; *Siemens v. Argentina*, paras. 76-78; *CME v. Czech Republic – Final Award*, paras. 398-413; *CMS v. Argentina – Award*, para. 116; *Vivendi v. Argentina – Annulment 1*, paras. 60 and 102. See also on this topic Gaillard/Banifatemi 2003 and more recently Kjos 2013, 224-235.

<sup>108</sup> Weil 2000, 409.

<sup>109</sup> See on this Schreuer 2014b, 7-10.

<sup>110</sup> See, above all, Kjos 2013, 128.

itself contrary to VCLT, and that has allowed for IROL paradigm to take hold. But VCLT offers much more possibilities, which should be consistently and systematically used. Through interpretation, a host of international obligations that have a bearing on a particular legal situation involving a foreign investor can be given a proper role in ascertaining if particular rule of law requirements were complied with.

*The formal importance of VCLT for interpretation*

Formally, the ‘embeddedness’ of IIAs in public international law<sup>111</sup> makes the relevant provisions of the VCLT a starting point in infusing the content and meaning through interpretation.<sup>112</sup> For the purposes of this discussion, it is warranted to focus on the VCLT Article 31, and specifically on sections (1) and (3)(c) which often feature (at least nominally) in jurisprudence and doctrinal discussions.<sup>113</sup> The relevant portions of VCLT Article 31 read:

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.  
[...]
3. There shall be taken into account, together with the context:  
[...]
- (c) Any relevant rules of international law applicable in the relations between the parties.

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<sup>111</sup> ‘As a general class, investment treaties are deeply and often explicitly embedded in the fabric of public international law’ (Kurtz 2014, 280). See similarly Douglas 2009, 85; Grisel 2014, 217; Cordero-Moss 2009, 785; See more generally McLachlan 2005, 287.

<sup>112</sup> Gazzini 2012, 119 and materials cited therein; Saldarriaga 2013, 166-167; Ascensio 2016, 369. These provisions are also considered to restate the customary law on the topic, as confirmed by *Canadian Cattlemen v. US*, para. 46 and *Noble Ventures v. Romania*, para. 50. See also Trinh 2014, 36-39 and Weeramantry 2012, 7.04.

<sup>113</sup> Article 31(2) also contains additional interpretative tools, which are strongly case-specific – any agreements made/accepted as made in connection to the conclusion of the treaty. These are, of course, very important in situations where they exist, but in light of their scarce availability regarding by far the most IIAs, they do not require further discussion in this context. As Douglas notes, 31(2) elements are ‘seldom relevant in the [IIA] context for the simple reason that such agreements and instruments are not a feature of state practice in relation to the conclusion of investment treaties’ (2009, 82; similarly Ascensio 2016, 371 and Weeramantry 2012, 7.04). The situation with Article 32 is somewhat similar in that sense (McLachlan 2008, 372; Trinh 2014, 67 and 106; Ascensio 2016, 368; Calamita 2013, 176 and materials cited therein). Similarly to Article 31(2) mentioned above, 31(3) also contains additional potential interpretive tools, namely subsequent agreement of the parties on its interpretation/application or subsequent practice in application which establishes an agreement regarding interpretation. Again similarly to 31(2), where existing, these are very important factors (most famously in the case of the NAFTA FTC interpretation of the NAFTA Article 1105), but as they are also more generally rare (see Trinh 2014, 54-55) they also do not require further discussion for the purposes of this chapter.

These two sections, at least in theory, offer considerable possibilities to investment tribunals in interpreting the meaning of the FET standard. It is commonly noted that the ‘ordinary’ meanings of concepts such as ‘fair’ and ‘equitable’, derived from dictionary definitions, are unlikely to provide much assistance.<sup>114</sup> Therefore, the determination of context can (and in practice sometimes did) provide a considerable number of reference points.<sup>115</sup> Similarly, the recourse to the ‘object and purpose’ of investment treaties can both provide guidance and limit the overly impressionistic arbitrators’ conclusions on what IIA provisions are meant to achieve.<sup>116</sup>

VCLT Article 31(3)(c) can also provide a large number of other reference points for interpretation through putting the FET standard into a harmonious relationship with the broader corpus of international law.<sup>117</sup> As the International Law Commission concluded, ‘[n]o rule, treaty, or custom, however special its subject-matter or limited the number of the States concerned by it, applies in a vacuum.’<sup>118</sup> As noted by Zachary Douglas, ‘the tribunal must inevitably have recourse to general international law and conventional international law for otherwise it would be interpreting the legal standards in a void.’<sup>119</sup> VCLT Article 31(3)(c) allows recourse to the sources listed in Article 38 of the ICJ Statute<sup>120</sup> – customary international law, conventional international law, and general principles of law as primary sources, as well as to jurisprudence and doctrine as subsidiary means in determining the law.<sup>121</sup>

It is important to note that customary international law and general principles of law (generally unlike conventional law extraneous to an IIA) can also be directly applicable in an investment dispute.<sup>122</sup> While customary law and general principles can

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<sup>114</sup> Douglas 2009, 82; Weeramantry 2012, 3.41-3.43; Roberts 2013, 50; Vadi 2016, 113; Trinh 2014, 47-50.

<sup>115</sup> See generally Weeramantry 2012, 3.52-3.69.

<sup>116</sup> See also *ibid.*, 3.70-3.82.

<sup>117</sup> See for discussion generally McLachlan 2005, Simma/Kill 2009; Simma 2011; Ascensio 2016; Vadi 2016, 110-119.

<sup>118</sup> ILC 2006, para. 120; see also similarly McLachlan 2005, 311;

<sup>119</sup> Douglas 2009, 81; Dupuy 2009, 53. See also Schreuer et al. 2009, 578 and materials cited therein and in the VCLT context Sinclair 1984, 139. A similar statement in ISDS jurisprudence can be found in *Phoenix v. Czech Republic*, para. 78.

<sup>120</sup> McLachlan 2005, 290; Douglas 2009, 86 and public international law cases cited therein; Trinh 2014, 55.

<sup>121</sup> See also recently *Tulip Real Estate v. Turkey – Annulment*, para. 87; see also Gaillard/Banifatemi 2003, 397; De Brabandere 2012, 246; Tams 2012, 319; Cole 2012, 311-312; Vadi 2016, 86; Schreuer et al. 2009, 604 and in particular materials in fn 266; Ascensio 2016, 375.

<sup>122</sup> There is also the rather undisputed possibility to directly apply *ius cogens* norms of international law, which always prevails in any case (Article 53 VCLT; see also Schreuer et al. 2009, 638; Donovan 2007, 208-209; Kjos 2013, 101; see also recently *Urbaser v. Argentina*, para. 203). While certain undisputed



and have been used explicitly so as to help with interpretation of IIA provisions, they can also be directly applied in questions so deserving.<sup>123</sup> Customary international law is in general seen as ‘offering important guidance’ to investment tribunals, and has found its place in numerous awards, where the line between direct application and interpretation was not always clear.<sup>124</sup> In some situations, the tribunals expressly stated that customary law will be directly applied as the IIA was ‘silent’ on a particular issue.<sup>125</sup> General principles of law have also been considered to be directly applicable in international adjudication,<sup>126</sup> such as in situations where gaps are left by treaty and customary law, and have been applied in a number of investment awards.<sup>127</sup>

Going back to interpretation, there is no dearth of sources to which the tribunals can - or as is also argued - are mandated to turn to for interpretation in every case.<sup>128</sup> As a matter of practice, references to the VCLT rules, and Article 31 in particular, are certainly not lacking in jurisprudence, although they are not universal.<sup>129</sup> But a closer look at jurisprudence also reveals a recurring pattern in which a selective and even somewhat superficial application of certain elements of Article 31 in certain early awards leads to concretising obligations stemming from the FET standard. As touched upon in the previous Chapter, these understandings then become entrenched through reliance on previous decisions (and academic commentary) to such an extent that *de facto* precedent often becomes the predominant interpretive device.

#### *The practical importance of de facto precedent for interpretation*

The investment tribunals commonly used nominal (if any)<sup>130</sup> reference to VCLT Article 31 to fashion new doctrines on what the IIA standards including the FET

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prohibitions under *ius cogens* (such as genocide and piracy) are unlikely to become relevant in investment disputes, some relatively plausible scenarios in which these norms are relevant can exist (see Donovan 2007, 209).

<sup>123</sup> See, for example, McLachlan 2005, 282-283; Schreuer et al. 2009, 587; Trinh 2014, 57.

<sup>124</sup> See primarily Schreuer et al. 2009, 606-607 and materials cited therein.

<sup>125</sup> See for example *Accession Mezzanin v. Hungary – Decision on Objection*, paras. 67-68, 72 and 77. See also D’Aspremont 2012, 29. It is important to distinguish this issue from the one of whether the accumulation of similar IIA provisions leads to creation of new customary law for all States, on which see more generally Dumberry 2010 and D’Aspremont 2012. For direct application of customary law in practice of other court and tribunals in international law see also McLachlan 2005, 312 and ICJ *Oil Platforms* decision, as well as WTO decisions in *Shrimp-Turtle* and *Korea – Measures Affecting Government Procurement*.

<sup>126</sup> McLachlan 2005, 313.

<sup>127</sup> Schreuer et al. 2009, 608-609 and materials cited therein; Vadi 2016, 120.

<sup>128</sup> McLachlan 2005, 290; Ascensio 2016, 369. See also generally Arsanjani/Reisman 2010.

<sup>129</sup> See for an overview Trinh 2014, 8-31.

<sup>130</sup> See in that sense also Saldarriaga 2013, 172-175 and Fauchald 2008, 358-359.

standard would require, and have also been to an extent helped in that free-flowing exercise by the requirement to interpret treaty provisions ‘in good faith’.<sup>131</sup> These new doctrines could then be relied upon by subsequent tribunals, sometimes being recognized as potentially supplementary means of ascertaining law under VCLT Article 32, but sometimes without any clear justification in terms of the VCLT at all.<sup>132</sup> Importantly, a failure to apply VCLT Article 31 correctly or at all has not emerged as an effective ground for annulment of investment awards.<sup>133</sup> As Anthea Roberts noted, this resembles ‘a house of cards built largely by reference to other tribunal awards and academic opinions, with little consideration of the view and practices of states in general or the treaty parties in particular.’<sup>134</sup>

The specific dynamic of rule-generation in ISDS puts emphasis on previous decisions far more than would be expected from the usually espoused theory of sources in international law.<sup>135</sup> While some authors are cautious regarding the relationship of such practice with the VCLT rules,<sup>136</sup> there are also sterner objections in doctrine.<sup>137</sup> As Trinh concludes:

Overreliance on judicial decision in investment treaty arbitrations demonstrates an oversimplified approach to treaty interpretation, which jeopardizes international legislation process by rules created among private adjudicators without states’ consent.<sup>138</sup>

This could, on the other hand, also be seen as a normatively acceptable if it was to actually provide the desirable clarity of and *ex ante* predictability.<sup>139</sup> The potentially problematic application of the VCLT could be (normatively at least) offset by the actual achievement of the IROL paradigm goals.<sup>140</sup> The best-argued solutions would form the basis of future practice<sup>141</sup> as ‘perplexing outliers’ are isolated,<sup>142</sup> and this would provide sufficient guidance to States so as to make the standards of investment protection an

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<sup>131</sup> See on this Weeramantry 2012, 3.22-3.31.

<sup>132</sup> Orakhelashvili 2009, 167-169; Weeramantry 2012, para. 5.25-5.29.

<sup>133</sup> See generally Saldarriaga 2013 and also Ascensio 2016, 369. For an example in practice see *MCI v. Ecuador – Annulment*, para. 54.

<sup>134</sup> Roberts 2010, 179.

<sup>135</sup> See generally Weeramantry 2012, paras. 5.04-5.31; Trinh 2014, 83-91.

<sup>136</sup> Weeramantry, paras. 5.29-5.31.

<sup>137</sup> See, for example, Orakhelashvili 2009, 168-169.

<sup>138</sup> Trinh 2014, 91.

<sup>139</sup> So to respect the ‘expectations investors and states develop regarding the future application of the standard principles’ (Schill 2010b, 156-157).

<sup>140</sup> See in that sense Weeramantry, para. 5.30-5.31. and materials cited therein. See also Potestà 2013, 91.

<sup>141</sup> See generally for the idea of jurisprudence constante in ISDS Bjorklund 2008.

<sup>142</sup> Paulsson 2008b, 253.

example of the international rule of law.<sup>143</sup> Simply, if somewhat in a social Darwinist fashion, the ‘fittest’ decisions would survive.<sup>144</sup>

While this, as noted in the Introduction, has allowed the crystallization of the FET standard as a tool for imposing rule of law requirements, the challenges are obvious and have been discussed in part 2.2. There is no institutional mechanism in place to oversee the use of VCLT, nor do such mechanisms exist to secure adherence to previous decisions even if such (sometimes doctrinally questioned) practice is indeed seen as beneficial.<sup>145</sup> Thus, in many ways, the realization of the IROL paradigm remains critically dependent on the homogenous views of arbitrators, and their desire to promote the *jurisprudence constante* along the lines most prominently advocated in the *Saipem v. Bangladesh* award.<sup>146</sup> Yet, even allowing for their relatively small numbers and an arguably shared adherence to the IROL paradigm, the pool of ISDS arbitrators is in many ways not homogenous to start with.<sup>147</sup> The consistent growth in the number of new claims, as well as the introduction of new arbitrators to the pool, do not seem to increase the chances of consistent interpretations and the homogeneous decision-making process.<sup>148</sup>

Furthermore, there are sometimes reasons to be cautious about embracing substantive consistency within the IROL paradigm - as when the ‘substance’ is itself problematic. As exemplified by *Tecmed*, there are considerable objections to formulating obligations in a manner detached from the realities of actual host State operation and their legal framework. This ties in with the broader point that taking into account non-investment concerns and parallel existing obligations might be necessary to recognise these realities and preserve the legitimacy of the ISDS regime.<sup>149</sup> But the increasing recognition of the need to do so does not equal certainty of how this will materialise in an individual case. As Hachez and Wouters conclude:

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<sup>143</sup> Crawford makes a point that national systems founded on the rule of law cannot in the long run ‘tolerate review by international systems not so founded’ (Crawford 2003, 9).

<sup>144</sup> See for example discussion in Rivkin 2012, 16; Kaufmann-Kohler 2007, 376-378; Stern 2011, 186-187; Paulsson 2008b, 247-248.

<sup>145</sup> See similarly Calamita 2013, 167.

<sup>146</sup> To reiterate from Chapter 1, the tribunal stated that ‘subject to compelling contrary grounds, [tribunal] has a duty to adopt solutions established in a series of consistent cases’ (para. 90, emphasis added).

<sup>147</sup> See primarily Roberts 2013; see also Hirsch 2015, 143-146 and Radi 2013, 21.

<sup>148</sup> Hirsch 2015, 154-155.

<sup>149</sup> See, for example, Calamita 2013, 171 on the need to find a ‘politically legitimised normative value set’.

[r]egardless of how many awards are well balanced, apply the law sensibly and take the public interest into account, the arbitral system cannot hide the fact that real chances also exist for an award that contradicts other awards and that is supported by odd legal reasoning, with dire consequences for the host state's budget.<sup>150</sup>

As indicated above, customary international law and general principles of law (as found in Article 38(1) of the ICJ Statute) can be directly applicable in an investment dispute, in addition to their interpretive role.<sup>151</sup> In that sense, it is certainly possible to make the host State obligations stemming from these two sources of international law relevant. However, the practical significance of these sources is more debatable. Both display a 'very great level of generality' and an 'inchoate' character.<sup>152</sup> This makes them of limited use in, for example, playing a corrective role upon host State's law or providing certain minimum standards to comply with.<sup>153</sup>

As Florian Grisel argues, customary international law provides 'weak guidance' to investment arbitrators, and its lack of clarity and precision might even deprive it of its status as a formal source of IIL.<sup>154</sup> Similar conclusions can be drawn about general principles of law, as indicated by both their wording and the relative infrequency of use in international adjudication.<sup>155</sup> This of course relates to general principles in their current form. A different conclusion might be reached if a more dedicated comparative approach to general principles of (public) law is taken, as suggested by the increasingly discussed comparative public law approach.<sup>156</sup>

#### *The feasibility and prospects of relying on extraneous treaty law*

Leaving aside at this point the potential for future development, the limited practical guidance currently provided by these sources suggests an enhanced role for

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<sup>150</sup> Hachez/Wouters 2013, 434. See also similarly Yackee 2008a, 809 and 812 and Calamita 2015, 112.

<sup>151</sup> This is also generally supported by the International Law Commission conclusions, themselves based on long-standing ICJ decisions, that all questions not resolved expressly in a treaty should be governed by general public international law and the parties 'entering into treaty obligations' do not intend to 'act inconsistently with generally recognized principles of international law' (ILC 2006, 204). See also Ascensio 2016, 384.

<sup>152</sup> McLachlan 2005, 282-283 and 313.

<sup>153</sup> Schreuer et al. 2009, 620; similarly Mendelson 2009, 490.

<sup>154</sup> Grisel 2014, 221-222. See also D'Aspremont 2012, 30-31 and materials cited therein.

<sup>155</sup> See for limited helpfulness and use of general principles Cassese 2005, 190-194 and in the ISDS context Fauchald 2008, 312 and Gazzini 2009, 104.

<sup>156</sup> See primarily Schill 2010a, Kingbury/Schill 2010 and also support in Douglas 2009, 89-90 ([t]he comparative method for extracting general principles of law would replace the impressionistic assessment of the relative equities of the parties' positions'). See also Chapter 5, section 5.2.1.

*conventional* law. As treaties have a pervasive reach in international law,<sup>157</sup> and with a wealth of generated secondary materials, a recourse to relevant conventional law can prove beneficial. Yet, it is well recognized that (with rare exceptions)<sup>158</sup> direct applicability of extraneous treaty norms is not generally permissible in the decision-making of investment tribunals.<sup>159</sup> Even if the legal process is couched in terms of VCLT Article 31(3)(c), applying a legal source for which there is no jurisdictional basis can lead to possible annulment,<sup>160</sup> not to mention the potential effects on the legitimacy of ISDS.<sup>161</sup> Therefore the main path through which extraneous treaty obligations of the host States can be taken into account is through their role in potentially concretising the FET standard requirements in the interpretive process. This is particularly so in light of the increasing agreement that interpreting the IIA provisions generally requires a balance between the interests and concerns of investors and host States – the latter’s interests often being related to implementing parallel existing obligations.<sup>162</sup>

Still, the formulation of VCLT Article 31(3)(c) has often been described as lacking sufficient guidance for adjudicators, especially in the field of overlapping treaty obligations.<sup>163</sup> As Rosalyn Higgins noted, this ‘entails harder work in identifying sources and applying norms, as nothing is mechanistic and context is always important.’<sup>164</sup> The difficulties with having recourse to other treaties in investment arbitration via VCLT Article 31(3)(c) are twofold, as there is a need for rules contained in an extraneous treaty to be both *applicable* and *relevant* between the parties.

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<sup>157</sup> McLachlan 2005, 283.

<sup>158</sup> This would include situations where IIAs directly indicate another treaty as applicable, which is uncommon (Salacuse 2015, 165-167).

<sup>159</sup> See in particular *Channel Tunnel – Partial Award*, paras. 151-153 and also McLachlan 2005, 301; Gazzini 2012, 122; Kurtz 2014, 280-281; Mendelson 2009, 492.

<sup>160</sup> Knoll-Tudor 2009, 336; Mendelson 2009, 492; Hirsch 2008, 174.

<sup>161</sup> See also more generally McLachlan 2005, 288 and 2008, 370; Dupuy 2009, 57.

<sup>162</sup> Certain early awards, including to some extent the *Tecmed v. Mexico* (see para. 156, mentioned above) insisted on interpreting uncertainties in IIAs in investors’ favour (see primarily *SGS v. Philippines*, para. 116, and approval in *Kardassopoulos v. Georgia*, para. 181; *Continental Casualty v. Argentina – Jurisdiction*, para. 80; see also in that vein Weiler 2013, 324 and fn 951). Such an approach has also been seen as expressing a strongly commercial arbitration outlook (Hirsch 2009a, 108-109; Roberts 2013, 76; Van Harten 2010c, 634-635). It has been, however, largely replaced by the view that suggests the need to balance the competing interests of the investor and the host State and recognise the right to regulate domestic matters in the public interest (see *Total v. Argentina – Liability*, paras. 124, 162, 309, 333 and 429. See similarly *Lemire v. Ukraine – Jurisdiction and Liability*, para. 500; *Feldman v. Mexico*, para. 103; *Plama v. Bulgaria – Award*, para 177; *EDF v. Romania*, para 299; *El Paso v. Argentina – Award*, para 358.) See also Kingsbury/Schill 2010, 103; Kläger 2011, 151. Bonnitcha 2014, 46-47; McLachlan/Shore/Weiniger 2007, paras. 1.62. and 7.188.

<sup>163</sup> McLachlan 2005, 281; Mendelson 2009, 490; Ascensio 2016, 371.

<sup>164</sup> Higgins 1994, 8.

As for applicability, the VCLT is silent on the criteria for applicability of a rule, specifically in terms of establishing the identity of the parties and the actual need for a treaty to be in force between them.<sup>165</sup> An often controversial issue of the identity of the parties in dispute, does not seem to be a critical problem regarding IIAs, and in particular BITs.<sup>166</sup> As Tarcisio Gazzini noted, this question ‘does not arise in the context of BITs due to the bilateral character of these treaties.’<sup>167</sup> Thereby, conventional law applicable between the parties to the applicable IIA *can* be used for interpretive purposes.<sup>168</sup> Likewise, while it would generally be necessary for relevant conventional law to be in force between the parties, there is also a possibility to use treaties not fulfilling that condition as an ‘evidence of the common understanding of the parties as to the meaning of the term used.’<sup>169</sup>

As for the *relevance* requirement, there is certainly a case to be made for the relevance of extraneous treaties, such as those on human rights in investment disputes. The examples in practice discussed above show that ultimately the decision on relevancy might largely rest on the normative viewpoints of arbitrators. This also suggests that the apparent ‘neutral’ formality of the FET rule of law precepts might not be completely sustainable in the light of substantive considerations that the tribunals can perceive as integral to investment relationships.<sup>170</sup>

As Martins Paparinskis has suggested, public international law practice exhibits both narrow and broad readings of what is ‘relevant’ for interpreting particular international norms.<sup>171</sup> Importantly, the ‘factual reality for most states [...] is that they hold various different international obligations in parallel which they are to be understood as seeking to respect simultaneously, in good faith.’<sup>172</sup> The willingness to recognize this particular overlap from the perspective of the host State is thus crucial.<sup>173</sup>

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<sup>165</sup> McLachlan 2005, 291 and 313.

<sup>166</sup> See in this sense the refusal of *Wintershall v. Argentina* tribunal to consider treaties concluded between the Respondent and third states for interpreting the IIA at hand (para. 128).

<sup>167</sup> Gazzini 2012, 122. See also McLachlan 2005, 315.

<sup>168</sup> The situation is less straightforward in the context of plurilateral/regional agreements, although in those situations a widespread acceptance of many potentially relevant treaties (such as those on human rights) would still leave the option open (see in that sense Simma 2011, 579).

<sup>169</sup> See in that sense arguments of Gavin Griffith in his *Mox Plant* dissent, as discussed and supported by Campbell McLachlan (McLachlan 2005, 301 and 315).

<sup>170</sup> See in that sense also Calamita 2013, 168 and Simma 2011, 586.

<sup>171</sup> Paparinskis 2012a, 71.

<sup>172</sup> Krommendijk and Morijn 2009, 424. See similarly Freeman 2004, 214.

<sup>173</sup> Simma 2011, 578.

The norms bearing on a single issue should be, to the greatest extent possible, interpreted as to give rise to a single set of compatible obligations,<sup>174</sup> as is sometimes also manifested by giving extraneous treaties an arguably central role in cases not involving human rights.<sup>175</sup> A particularly pointed argument regarding the relevancy of human rights treaties has been put forward by Bruno Simma and Theodore Kill, who extensively examined and argued for these treaties as proper interpretive reference points for tribunals in cases involving parallel human rights obligations.<sup>176</sup>

To conclude, and as the examples of *Al Warraq* and *Urbaser* show, the obligations imposed by treaties extraneous to the IIA can be taken into account in interpreting what the FET standard or its sub-principles (such as denial of justice) require. In that way, through the vehicle of these sub-principles, pre-existing international obligations of the host State stemming from treaties common between the IIA parties and that relate to the rule of law *can* be given ‘bite’ in the FET decision-making process. In addition to the added benefit of supporting systemic integration and tackling fragmentation of international law, in this specific context this opens one path towards the ‘international’ element of the plethora of rule of law obligations that usually bind the host State. But as the next section will aim to show, it is not the only path – and also it is not the path that can necessarily lead to due recognition and influence of ‘purely’ domestic law. To open a different path for relevance of international obligations and also of the ‘domestic’ element of rule of law framework, investment tribunals can rely on their choice and assessment of facts they deem relevant.

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<sup>174</sup> Hirsch 2008, 178-179; McLachlan 2008, 396-397; D’Aspremont 2012, 42 (who also notes that VLCT offers a ‘sweeping’ power to arbitrators to harmonize); Kurtz 2014, 281; Dupuy 2009, 55; Dumberry/Dumas-Aubin 2012, 360. Writing in the context of international trade law, Joost Pauwelyn has argued that different branches of international law *necessarily* overlap, making it impossible to resolve trade questions without taking into account human rights or environmental issues (Pauwelyn 2004, 904 and 913). For a more cautious, but still approving comment in the ISDS context see Mendelson 2009, 492-494.

<sup>175</sup> See in that sense in particular *Micula v. Romania – Award*, paras. 326-328 and commentary in Ascensio 2016, 382.

<sup>176</sup> Simma/Kill 2009 (also referred to approvingly by the tribunal in *Tulip Real Estate v. Turkey – Annulment*, para. 90). See similarly Dumberry/Dumas-Aubin 2012, 359-360. See also Ascensio 2016, 382, arguing that international human rights law can be relevant for investors to expect certain evolution of domestic legislation or adaptation to treaties under ratification. Another path for recognising human rights considerations is through their acceptance as part of customary law (Dupuy 2009, 50) or general principles of law (McLachlan/Shore/Weiniger 2017, 7.19), although the exact scope and content of rights recognized as being part of these sources arguably leaves treaties as the preferable route (leaving also aside the issue of rather non-controversial *ius cogens* norms embodying certain basic human rights, on which see also Dupuy 2009, 57).

### 2.3.3. The choice and assessment of facts as a path towards both international and domestic rule of law obligations of the host State

The combination of the international nature of the FET standard and the applicability of international law to assessing liability under this standard can also move the search for ways to secure due regard to other sources of rules towards other points in the decision-making process. More specifically, the relevance of these sources and rule of law obligations contained therein can also be secured by their systematic and thorough inclusion as relevant facts for assessment under the FET sub-principles in question. The still open-textured nature of these sub-principles should allow for the tribunals to take these sources as relevant indicators to what extent particular behaviour was e.g. ‘non-arbitrary’, in accordance with ‘due process’, ‘transparent’ etc.

To be sure, this is a possible alternative or complementary path for taking due account of international obligations. Interpretation in accordance with VCLT Article 31(3)(c) might, for example, exclude international obligations stemming from a treaty to which both BIT parties are not a party. In those situations, a particular international obligation that binds only the host State in question (and not the BIT partner) can be taken into account as a relevant fact. Likewise, even for tribunals not wishing to engage in the interpretation process but instead being satisfied with relying on the existing jurisprudence to distil FET sub-principles, the phase of application of these sub-principles can offer the gateway towards other international obligations.

As also held in *Wena v. Egypt – Annulment*, resort to rules of international law is particularly justified when ‘the rules in question have been expressly accepted by the host State.’<sup>177</sup> This, the tribunal noted, ‘amounts to a kind of *renvoi* to international law by the very law of the host State’<sup>178</sup> - ‘when a tribunal applies the law embodied in a treaty to which Egypt is a party it is not applying rules alien to the domestic legal system of this country.’<sup>179</sup> The fact, for example, that the Argentine Constitution gives supremacy to the incorporated international commitments has also been noted in many

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<sup>177</sup> *Wena v. Egypt – Annulment*, paras. 41-42.

<sup>178</sup> *ibid*, para. 42.

<sup>179</sup> *ibid*, para. 44. See also similarly *LETCO v. Liberia*, paras. 64 and 215.



decisions arising from the 2001-2002 Argentine crisis.<sup>180</sup> While this path towards international instruments may be unpredictable due to the different approaches of domestic systems towards the incorporation of international commitments,<sup>181</sup> it is certainly an important possibility.

Without negating the importance of this path for international obligations, it is worthy in particular to elaborate further on how national legal obligations can become part of the decision-making process. The interpretation path discussed in the previous section is generally not available for reaching national law, and therefore it is important to approach to dedicate due space to the sometimes thorny relationship of IIL (and international law more generally) and the national, municipal law in host States.

*The subordinate role of national law more generally*

A qualitatively different – fact-like – character of municipal law provisions builds on a considerable pedigree in international law.<sup>182</sup> The PCIJ in *Certain German Interests in Polish Upper Silesia* famously held that ‘[...] municipal laws are merely facts which express the will and constitute the activities of States, in the same manner as do legal decisions or administrative measures.’<sup>183</sup> The national (il)legality of a behaviour does not determine the outcome at the international level. As Dupuy notes, this is also ‘one of the most solidly-anchored rules of customary international law.’<sup>184</sup> As such, it has also found its place in Article 3 of the influential 2001 ILC Articles on Responsibility of States for Internationally Wrongful Acts.<sup>185</sup> Numerous ISDS cases confirm such an understanding.<sup>186</sup>

To clarify, there *is* also a trend of parallel application of national law *as law* within

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<sup>180</sup> For example, *CMS v. Argentina – Award*, paras. 119-120; *LG&E v. Argentina – Liability*, paras. 90-91; *Enron v. Argentina – Award*, para. 208; *Sempra v. Argentina – Award*, paras. 237-238. The argument that

<sup>181</sup> Schreuer et al. 2009, 582.

<sup>182</sup> Grisel 2014, 222.

<sup>183</sup> *Certain German Interests in Polish Upper Silesia*, 19.

<sup>184</sup> Dupuy 2010, 173.

<sup>185</sup> ‘The characterization of an act of a State as internationally wrongful is governed by international law. Such characterization is not affected by the characterization of the same act as lawful by internal law.’ See on this in the context of expropriation claims also Douglas 2009, 70.

<sup>186</sup> See, for example, *MTD v. Chile – Award*, para. 204; *Lucchetti v. Peru – Annulment*, para. 88; *Inceysa v. El Salvador*, paras 214– 17; *Soufraki v. UAE – Annulment*, para 59; *Kardassopoulos v. Georgia*, para 182. See also generally Spiermann 2008, 114-115.

international investment arbitration.<sup>187</sup> But this is not usually considered to determinatively affect the host State compliance with IIA provisions, including the rule of law precepts of the FET standard. The formal role of the national law remains largely confined to other issues. Most prominently, these are the nationality of the investor,<sup>188</sup> the existence of actual property rights necessary to create an investment or a precondition to expropriation<sup>189</sup> and the attribution of acts to the host State.<sup>190</sup> Domestic law can thus play a key *formal* role in deciding if there is an eligible investor and/or investment, or if the actor whose behaviour is examined is part of the State apparatus - but the behaviour itself would remain subject to examination under international law.<sup>191</sup> As is sometimes put, '[w]hen the issue becomes the international validity of certain acts of the host state that have prejudiced the investor's legal entitlements under municipal law, then international law applies exclusively.'<sup>192</sup>

### *Applicable law in IIL and national law*

Interestingly enough, the plain reading of the numerous IIA clauses on applicable law and default choice of law provisions would not necessarily and *per se* support the limited or fact-like nature of municipal law. In many situations, a legitimate conclusion can be drawn that international and national law have an equal status even regarding the breach of the relevant IIA standards.

Section 2.2 above already touched upon the relevant provisions on applicable law. As mentioned, many IIAs have provisions that call for the simultaneous application of international and national law. Where the relevant IIA provisions are lacking, the default provisions in arbitral rules do lead or can lead to the same result. Particularly regarding Article 42(1) of the ICSID Convention, the currently predominant trend has been to

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<sup>187</sup> Kjos 20013, 298; Some of the scenarios include *renvoi* of a BIT to domestic law, implicit *renvoi* of international law to domestic law and the use of default rules on applicable law such as the Article 42(1) second sentence of the ICSID Convention. See in that sense Dolzer/Schreuer 2012, 291-293; Pérez Loose 2010, 381-382; Grisel 2014, 217 and 223.

<sup>188</sup> See for example *Aznian v. Mexico*, para. 96; *EnCana v. Ecuador*, paras. 184-188; *Saluka v. Czech Republic*, para. 204. See also for discussion Douglas 2009, 52-69.

<sup>189</sup> See generally Staker 1987, 163-169; McLachlan/Shore/Weiniger 2007, paras. 3.79 and 6.67-6.70; Douglas 2009, 44-45; Spiermann 111-112.

<sup>190</sup> Dupuy 2010, 179-183.

<sup>191</sup> See in that sense *Vivendi v. Argentina – Annulment 1*, paras. 96 and 101; *EnCana v. Ecuador*, para. 184; *MTD v. Chile – Annulment*, para. 74-75. See also Spiermann 2008, 108; Douglas 2009, 41 and 48-49 and McLachlan/Shore/Weiniger 2007, 8.65.

<sup>192</sup> Douglas 2009, 70.

interpret it as granting discretion to arbitrators as to what issues will be governed by which law. The resulting discretion largely resulted in the supremacy of international law for determining the breach of the IIA standards, sometimes to the extent that the municipal law was not examined at all.<sup>193</sup>

To problematize this, Article 42(1) can be used as a proxy for the situations of explicitly possible parallel application of international and domestic law. The interpretation of this provision has been called ‘central to ICSID arbitration’,<sup>194</sup> and its drafting history, while largely outside the scope of this discussion, provides some interesting indications. To briefly summarize, the ICSID Convention’s *travaux* indicates a compromise that granted a *primary* role to domestic law, while reserving a role for international law as a concession to developed countries worried about nationalizations.<sup>195</sup> As Ibrahim Shihata noted in 1986, the ICSID Convention ‘takes into account specific concerns which, in an earlier era, prompted the formulation of the Calvo Doctrine’ in particular by proper recognition of the role of the domestic law.<sup>196</sup>

However, there is also a common argument that the primary role of national law is the result of the *contract*-based investor-State arbitrations dominating the scene at the time of the ICSID Convention’s conclusion and up to the 1990’s.<sup>197</sup> Ole Spiermann argues that, ‘as Article 42 of the ICSID Convention has been designed for purposes of contract claims, applying the provision directly and unreservedly to treaty claims involves a strong element of absurdity.’<sup>198</sup> The jurisprudential developments are broadly in line with such a position. The tribunals largely ascribed the primary role to domestic law in early ISDS cases stemming from investment contracts, and international law was largely given a supplementary and corrective function.<sup>199</sup> The rise of treaty-based investment arbitrations during the 1990’s changed this position considerably. The oft-cited *Wena v. Egypt – Annulment* decision was critical in abandoning the sequential national/corrective international law application. It affirmed the autonomous scope of

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<sup>193</sup> See section 2.2. above and in particular *Santa Elena v. Costa Rica*, para. 64.

<sup>194</sup> Gaillard and Banifatemi 2003, 379.

<sup>195</sup> See generally Kjos 2013, 167-168; Kulick 2012, 11-17; Reisman 2000, 363-379; Igbokwe 2006, 279. For similar early views see also Lauterpacht 1968.

<sup>196</sup> Shihata 1986, 10-11.

<sup>197</sup> Spiermann 2008, 98 and 107. See also Igbokwe 2006, 279.

<sup>198</sup> *ibid*, 107. See similarly, for example *Azurix v. Argentina*, para. 67, reserving for the Argentinian law merely the role of a helpful element in assessing compliance with the IIA.

<sup>199</sup> See generally Kulick 2012, 19-33.

application for international law in situations so deserving, and largely confirmed the right of arbitrators to apply it independently from national law.<sup>200</sup> While even previously there was a degree of reluctance to abandon international law in favour of municipal law,<sup>201</sup> subsequent awards instituted a strong ‘internationalisation’ in the sphere of determining liability.<sup>202</sup> The resulting attention given to national law has been described as ‘scarce’, and caused by the widespread belief in the ultimate primacy of international law due to the international origin of ISDS.<sup>203</sup>

Be that as it may, and without arguing that national law should formally apply,<sup>204</sup> the relevance of national law should remain obvious and lend support to its special position even in the sphere of facts. Discussing the choice of law in investment *contracts*, Schreuer et al. note that:

[t]he investor’s activities will be so closely linked to the administrative law, labour law, tax law, foreign exchange regulations, real property legislation and many other areas of the host State’s legal system that it would be impractical to choose the law of another country.<sup>205</sup>

But the very same considerations are present in treaty-based claims as well. The switch to treaty-based as opposed to contractual claims does not automatically lead to downplaying the importance of national law. The investor’s activities remain closely linked to the domestic laws mentioned above.<sup>206</sup> It should not come as a surprise that the host State’s law is of relevance for the dispute – it should actually be considered a given.<sup>207</sup> As Viñuales argues:

[...] if foreign investment regulation relies heavily on a variety of domestic laws, the analysis of its sources cannot be limited to mere treaties, customary law and, subsidiarily, general principles of law. A conceptual understanding of the sources of international investment law limited to such ‘formal sources’ would be too narrow or simply inaccurate, as it would not account for an important part of the phenomenon it is expected to illuminate.<sup>208</sup>

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<sup>200</sup> *Wena v. Egypt – Annulment*, paras. 40-41. See also for a critical commentary Igbokwe 2006, 279.

<sup>201</sup> Schreuer et al. 2009, 585-586; Spiermann 2008, 100; Higgins 1994, 141.

<sup>202</sup> See generally Kulick 2012, 33-50.

<sup>203</sup> Perez Loose 2010, 404-405; for an early suggestion in that sense see also Schreuer 1996, 99.

<sup>204</sup> See for some arguments Igbokwe 2006, 279 and 285-286.

<sup>205</sup> Schreuer et al. 2009, 559 and similarly 595.

<sup>206</sup> See recognition of this fact also by Spiermann 2008, 113. As Arghyrios Fatouros noted, ‘interaction of national laws and international rules is at the center of the legal regulation of FDI’ and these two sources are ‘in a continuous dialectical relationship’ (Fatouros 1995, 192).

<sup>207</sup> Kjos 2013, 262.

<sup>208</sup> Viñuales 2016, 4.

Perhaps more symbolically, Santiago Montt has noted that the ‘regrettable tendency’ of ignoring domestic constitutional and administrative law cannot be done without compromising the legitimacy of IIL.<sup>209</sup> Preserving such legitimacy would arguably mandate the tribunals to regularly engage with the domestic law and the obligations it imposes on the host State, and provide sufficiently thorough and persuasive reasoning for establishing its potential conflict with relevant international norms.<sup>210</sup>

*National law as a ‘qualitatively different’ fact*

Would it be justified to treat national law as any other fact even in situations where international law was exclusively applicable? The reasons mentioned in the previous section suggest a negative answer and a recognition of the qualitatively different status of national law.<sup>211</sup> Bearing in mind the importance of the national law framework for the host State decision-makers, it is arguable that its examination should form an unavoidable (and sometimes determinative) part of assessing the compliance with the obligations stemming from the FET standard.

A useful starting point in further elaborating this position can be the provision on applicable law found in the recently adopted CETA agreement, as commented upon by Jarrod Hepburn.<sup>212</sup> Article 8.31 (2) of CETA, after paragraph (1) affirmed the exclusive applicability of international law to investor-state disputes, states that:

[t]he Tribunal shall not have jurisdiction to determine the legality of a measure, alleged to constitute a breach of this Agreement, under the domestic law of the disputing Party. For greater certainty, in determining the consistency of a measure with this Agreement, the Tribunal may consider, as appropriate, the domestic law of the disputing Party as a matter of fact. [...].<sup>213</sup>

As noted, this provision is actually aligned with the public international law position going back as far as the above mentioned PCIJ decision in *Certain German*

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<sup>209</sup> Montt 2012, 153.

<sup>210</sup> See similarly Igbokwe 2006, 294.

<sup>211</sup> See also *ibid*, 285.

<sup>212</sup> See generally Hepburn 2016 and also Hepburn 2017, 104-105.

<sup>213</sup> Similar provisions have also been featured in the EU-Vietnam FTA, EU’s 2015 TTIP proposals and a series of BITs (starting in 2006) concluded between Colombia and Japan, the UK, India, Belgium, China, Peru and Switzerland.

*Interests in Polish Upper Silesia*.<sup>214</sup> But, as stated as early as 1938 by Wilfred Jenks, it is a ‘mistake to attach undue importance’ to the ‘factual’ character of municipal law.<sup>215</sup> As noted, ‘[i]nvestment tribunals [...] have often interpreted and applied domestic law when necessary, and it is not clear that treating this domestic law as fact *has made or would make much difference* to the tribunal’s reasoning process.’<sup>216</sup> As ISDS often practically demands examining domestic law when determining the merits of a dispute,<sup>217</sup> ‘it is not entirely natural to treat this process instead as an instance of applying *facts to facts*.’<sup>218</sup>

Jurisprudence shows that even when international law was established as exclusively applicable, tribunals took positions that vary from treating domestic law as essentially irrelevant to it being a very important factor. As Hepburn, dealing specifically with FET, concludes:

[...] cases such as *Cargill, Semptra*, and *Enron* have explicitly denied the relevance of domestic law at all in FET or arbitrariness analyses. Moreover, many cases involving claims of FET breach have not even addressed the question of the host state’s compliance with domestic law, thus implying that domestic legality is not relevant. However, [...] tribunals in fact do often examine the domestic legality of the respondent state’s conduct. Certainly, domestic legality has not become an outcome-determinative feature in FET analyses [...] [but] consideration of domestic law plays an important contributory role for tribunals attempting to give content to the often nebulous FET standard. [...].<sup>219</sup>

The above-mentioned *Al Warraq v. Indonesia* award can also provide an example in that sense. Despite the relevant IIA being silent on applicable law, and the tribunal making no explicit statement itself, its deliberations clearly suggest that it saw international law as applicable in this case.<sup>220</sup> However, this did not prevent the tribunal from determining that the violation of domestic law caused a breach of the FET standard (as interpreted in line with extraneous treaties), specifically the Indonesian Code of Criminal Procedure by the host State.<sup>221</sup> For all intents and purposes, the domestic law (arguably a fact in this context) was of determinative impact. While the specific context of the case – denial of proper criminal procedure – makes the

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<sup>214</sup> *Certain German Interests in Polish Upper Silesia*, 19.

<sup>215</sup> Hepburn 2016; See Jenks 1938, 68 and similarly Douglas 2009, 69.

<sup>216</sup> Hepburn 2016 (emphasis added).

<sup>217</sup> See in this sense also Stephan 2014, 365-368.

<sup>218</sup> Hepburn 2016 (emphasis added).

<sup>219</sup> Hepburn 2017, 39-40 (references omitted). See somewhat similarly regarding expropriation *ibid*, 58 and 67-68.

<sup>220</sup> *Al Warraq v. Indonesia*, para. 188, 203 and 243.

<sup>221</sup> *ibid*, paras. 584-588.

circumstances somewhat unique, it can still serve as an indicator of the artificiality of perceiving domestic law as just another fact.

#### **2.3.4. Concluding remarks on the tools for introducing the NROL paradigm**

There is little doubt that international law is applicable to claims that an FET standard provision contained in an IIA has been breached. But that does not rigidly limit the scope of both international and national legal sources and rules that can and should be relevant. By using the rules of interpretation – for these purposes codified in the VCLT – the investment tribunals can interpret the FET provision and the sub-principles refined through *de facto* precedent in a way that incorporates other non-investment, rule of law related obligations of the host State. The situation in this scenario can actually make these obligations for all intents and purposes equal to applicable law through the vehicle of the FET standard.

There is also another path for taking due account of both international and national legal obligations, in the latter case being often the only available one. These obligations can also be taken account as facts, and (as suggested above) of qualitatively higher character that warrants their regular, systematic and thorough examination and enhanced importance for the assessment of host State behaviour. As is sometimes noted in doctrine, ‘the question of whether a state has acted in a manner inconsistent with the obligations it assumed under a treaty cannot be decided without an investigation into the national law of that state.’<sup>222</sup> The realities of the foreign investment processes in many ways make a formal ‘wall’ between IIA and other obligations both normatively undesirable and practically unachievable.

#### **2.4. Conclusion**

##### *The challenges of the IROL paradigm*

Chapter 1 problematized the perception of IIL as inevitably leading to a *de facto* multilateral regime that imposes substantively uniform international rule of law standards on host States. The IIL was in many ways both formally and normatively a

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<sup>222</sup> Igbokwe 2006, 286.

*tabula rasa*, subsequently written upon by ISDS jurisprudence and (perhaps equally importantly) doctrine. This largely allowed for the emergence of a dominant IROL paradigm in the FET standard interpretation and application.

This chapter moved away from the foundations of the IIL regime and focused on the operation and limits of the IROL paradigm. It first examined how well the requirement of consistent interpretation and application of the FET sub-principles works in practice. As examples sought to illustrate, there are rather obvious challenges to such consistency. In several important areas, the jurisprudence shows worrying heterogeneity. Awards exhibit a spectrum from the straightforward application of the top-level ‘fair’ and ‘equitable’ requirement to concrete facts toward the examination and even determinative role of the parallel existing international obligations of the host State in making the determination if a breach existed.

Jurisprudence certainly exhibits widespread attempts to pursue consistency by relying on previous awards, as already touched upon in Chapter 1. This could be normatively (if not strictly formally) defensible if it practically led to a high degree of *ex ante* predictability and reasonable certainty that a similar set of facts would result in a similar outcome of a case. Yet, concretising the obligations stemming from the FET standards through (over-) reliance on previous decisions can also exhibit considerable deficiencies.<sup>223</sup> Even in situations of a clear agreement on a sub-principle, such as legitimate expectations, there are persisting differences in concretisation. Furthermore, these concretisations themselves sometimes remain open to questioning. The attempt to fashion a purely IROL understanding of a concept such as transparency can lead to it becoming unrealistically demanding, further invoking legitimacy concerns.

Inconsistent and/or unrealistic concretisations of IIA standards can be tackled by the regular complementing with an NROL paradigm – practically manifested by due account of the spectrum of existing and *ex ante* discoverable provisions related to securing the rule of law that already bind the host States. VCLT Article 31(3)(c) in that sense allows taking into account the rules of international law existing between the State

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<sup>223</sup> For example, the principles/canons of interpreting IIAs established by tribunals are contradictory and ‘unhelpful as a guide for future tribunals’ (McLachlan/Shore/Weiniger 2017, para. 3.146.) It is not possible to ‘discount the effect of arbitrators’ personal perspectives in formulating the canons of construction they have individually developed’ (ibid, para. 3.149).



parties for the purpose of interpreting and concretising the meaning of IIA standards. Likewise, for both international and national legal obligations, the choice and examination of relevant facts by the tribunals can secure a similar NROL-oriented outcome. In particular, the applicability and supremacy of international law should not lead to ignoring the important role of national law, which in many cases can and should have a determinative influence. National law should not, from a normative perspective, be equated to others fact. As Jarrod Hepburn has recently argued, national law has (and should have) a different *qualitative* status, regardless of the potential formal supremacy of international law.<sup>224</sup>

More generally, the IIL's problems and possibilities – well exemplified in the FET context - are summarized by Susan Franck:

The challenge, however, is that the investment treaty arbitration *may not be an appropriate example of a rule of law*, particularly where tribunals articulate vague and contradictory decisions on basic points of law. [...] Nevertheless, to the extent that arbitrators and commentators develop a reliable, consistent, and reasoned doctrine, this model *could encourage* adherence to the rule of law by domestic [institutions].<sup>225</sup>

The generally narrow possibilities for the review of investment awards allow for the differing approaches on various issues to persist.<sup>226</sup> The currently still predominant atomized structure of ISDS lowers the possibility to institutionally tackle some of these challenges, and grants the critical role of doing so to arbitrators. With the generally increasing number of ISDS cases and the potentially expanding pool of arbitrators, the likelihood of divergent jurisprudence hardly decreases. As the Introduction to this thesis touched upon, a common theme in reform-minded scholarship are thus the proposals for different system-internal and system-external ways of achieving consistent rulings and increasing legal predictability.<sup>227</sup> For many international lawyers, the lack of consistency simply seems 'perverse or pathological'.<sup>228</sup> However, as recently argued, the promise of the rule of law instead of the rule of lawyers still has a long way to go in

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<sup>224</sup> Hepburn 2018, 195-197.

<sup>225</sup> Franck 2007, 367 fn 147 (emphasis added). See similarly Crivellaro 2014, 128.

<sup>226</sup> As Kurtz observes, 'there is a distinct and peculiar "moving target" quality to the hermeneutics of investment arbitration with arbitral tribunals often paying simple lip service to the customary rules on treaty interpretation' (2014, 275).

<sup>227</sup> See, apart from the discussion in the previous Chapter, also Fortier 2009b, 12-17; Franck 2005; Dolzer 2013; Kaufmann-Kohler 2005a and 2007.

<sup>228</sup> Alvarez 2016, 178. European Commissioner Malstrom, for example, made it clear in this context that '[w]e want the rule of law, not the rule of lawyers' (Pauwelyn 2015, 763).

ISDS.<sup>229</sup> As Jansen Calamita noted on the clarity of rules, ‘the content of the standards of protection afforded under [IIAs] remains almost as uncertain and as controversial as it ever was under customary international law.’<sup>230</sup> Whilst one can certainly disagree with such propositions, the possibility and desirability of enhancement would seem to be largely beyond doubt.

#### *A normative path forward*

To borrow a question from a (then) aspiring political theorist - ‘what is to be done?’ This and the previous chapter indicate both the need and the possibility to suggest a complementing NROL paradigm when assessing the host State compliance with the FET requirements. The critical features in that sense would be to retain the orientation towards the rule of law and the IROL paradigm as a starting point, whilst fully accepting the reality of parallel obligations and concerns of the host States. At the same time, there is a need to further the efforts to overcome the practical institutional limits imposed by the decentralized dispute settlement.

To reiterate, the appealing normative features of the IROL paradigm are hardly in dispute. There is little to object to in envisioning the mission of the FET standard and of IIL more generally as one striving to enhance the rule of law. The FET standard as interpreted in jurisprudence largely embodies the precepts that the vast majority of States would surely find as reflecting the critical rule of law requirements, and would likely see as desirable within their own municipal legal framework.<sup>231</sup> The question is rather how to react to the challenges of the IROL paradigm in the face of concrete formal and practical obstacles – and also to enhance the potential benefits. There is likewise certainly little to be said against the reform attempts aimed at centralization of decision-making and re-calibration of IIAs. These can therefore be supported to the extent that they reflect the now (hopefully) more informed desires of States as ultimate masters of the IIL regime. Yet, these processes are still ongoing, and their future outcomes are objectively uncertain to a considerable degree.<sup>232</sup> With all the ‘re-calibration’ efforts, the IIL regime will, for the foreseeable future, likely continue to be

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<sup>229</sup> See generally Pauwelyn 2015.

<sup>230</sup> Calamita 2013, 167.

<sup>231</sup> As also suggested by the wide adherence to rule of law instruments, touched upon in the Introduction to this thesis.

<sup>232</sup> See Kurtz 2014, 272.

dominated by IIA treaties containing relatively broad standards such as the FET. In such circumstances, and with the legitimacy of IIL and potential consequences for host States in mind, the system-internal, ‘from within’<sup>233</sup> paths of reform through decision-making remain worthy of exploration.

By pulling together the various threads explored in the previous discussion it is possible to construct certain common points:

Firstly, the ‘rule of law mission’ of the FET standard retains its appeal and offers a strong legitimacy enhancement factor. As the Introduction to this thesis touched upon, the almost undisputed commitment of practically all States towards the realisation of this ideal makes it a valuable focal point for decision-making.

Secondly, the strong enforcement, limited review possibilities, and potentially costly awards, for all their risks, also offer the possibility to powerfully influence the rule of law in host States. This is an influence in some aspects unmatched by other regimes in international law. Normatively, the possibility to address rule of law deficiencies in the host State that (for various reasons) may be out of reach of domestic or other international actors should be utilised.

Thirdly, the resulting discretion of arbitrators in shaping many aspects of the regime, apart from risks,<sup>234</sup> offers the potential to incorporate new paradigms without the potentially lengthy and unpredictable formal reform processes. The open-textured nature of the FET standard can therefore in this way be an advantage for the rule of law promotion.

Fourthly, the existing legal framework, as also evidenced in practice, offers the possibility to have recourse to a large number of sources from both international law and municipal law. This allows securing the realisation of the rule of law without necessarily engaging in the, e.g., formulation of new doctrines – this potentially being formally and legitimacy-wise problematic.

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<sup>233</sup> See in that sense Schill 2014.

<sup>234</sup> See discussion, for example, in Roberts 2013, 76-77. See in the same vein Van Harten 2010c, 628-629 and Landau 2009, 194-195.

Fifthly, both the predominantly open-textured nature of the FET standard and institutional deficiencies suggest the need to enhance *ex ante* predictability. There is a possibility to suggest decision-making paradigms that at least limit the problems arising out of the fact that a subsequent tribunal is not bound to agree with or follow a decision of a previous one.

Sixthly, and finally, there is also a need to fully embrace the nature of investment decision-making as often involving substantive choices and the interplay of many non-investment considerations. How are the substantive choices to be made and who should be ultimately making them? As Calamita notes, with reference to Dworkin, '[t]he reference to core normative values in the interpretation and application of standards is essential in order to give such standards a principled juridical meaning.'<sup>235</sup> In the absence of normative underpinning, the process of interpretation faces serious danger of being arbitrary and illegitimate.<sup>236</sup>

The following chapters will make a normative case and more practical suggestions for introducing the NROL paradigm as a complement to the IROL one, in accordance with these common positions. It will argue for substantive decision-making that combines formulating the substantively uniform *international* rule of law with a focus on strengthening the *national* rule of law. This should be done in a way that respects, to the extent possible, the existing framework of international and domestic legal commitments of the host State. It should aim to hold the host State also to account in accordance with the holistic set of norms that it adopted and could have (alongside the investor) *ex ante* expect to be relevant. At the same time, the systematic focus on the constellation of *existing* legal commitments should limit the problems arising from the inability to secure consistent jurisprudence in an atomized ISDS system. It is therefore a vision, further elaborated in the coming chapter, where the FET claims can help *enhance the rule of law case by case, State by State*.

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<sup>235</sup> Calamita 2013, 170.

<sup>236</sup> *ibid*, 170-171.

## Chapter 3 – A normative case for strengthening the national rule of law through FET decision-making

### 3.1. Introductory remarks

Chapters 1 and 2 focused on the foundations and the operation of the IROL paradigm. As noted, the idea of a consistently enforced ‘global’ set of rule of law precepts is a worthy development, but one which holds specific challenges and is open to further normative enhancements. The de-centralised dispute settlement structure without a formal doctrine of binding precedent, persistently enduring open-textured provisions, and the objectively limited scope for their further ISDS-led refinement are still the dominant features of IIL.<sup>1</sup> There is thus room for continuing contemplation on the IROL paradigm and its potential improvements. Some of the critical questions are if and how ISDS can provide the ‘real currency’ of IIL<sup>2</sup> – legal certainty, but at the same time further utilize its power towards the desirable goals of rule of law enhancement in the host States.

To focus on the first aspect, legal certainty is admittedly a matter of degree. The very nature of law as an ‘argumentative discipline’<sup>3</sup> seems to negate the possibility of absolute certainty. In the FET context, however, there is a lot to be gained by shifting the more abstract discussions of ‘certainty’ and ‘predictability’ of the rules to a somewhat more pragmatic perspective. It can be beneficial in that sense to adopt the viewpoints of the ‘users’ of the system which in practical terms might have the most at stake. Symmetry, coherence and consistent repetition of rules and principles in case law are desirable from a more abstract viewpoint of a ‘system’. Yet, this is ultimately of limited importance if it does not lead to a host State or an investor being able to predict, with sufficiently high degree of probability, whether a *particular* host State act is a (potentially very costly) breach of an IIA. In the end, it is the behaviour of ‘*subjects*’ that the law should be capable of guiding if the rule of law is to be a reality.<sup>4</sup> Orienting the

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<sup>1</sup> Bearing in mind, of course, the recent reform efforts that have been touched upon in the Introduction to this thesis and the previous chapters.

<sup>2</sup> Kleinheisterkamp 2015, 825.

<sup>3</sup> MacCormick 1999, 163-165.

<sup>4</sup> Raz 1979, 214.

normative perspective towards these subjects can thus offer important insights as to how to better achieve both certainty and other goals.

*The certainty of investment protection and the everyday realities of investment processes*

A government official facing an investor's representative who is threatening an FET claim over a refusal to issue a permit might be pleased that the relevant sub-principles are becoming more certain over decades.<sup>5</sup> She might, however, be far more interested if (e.g.) the fact that the domestic regulations have been followed honestly and to the letter will be sufficient to avert a multi-million dollar encumbrance on the State budget. The investor's representative would also likely be interested to know if the metaphorical gun of the ISDS claim is actually loaded.

The challenges of pursuing only the IROL paradigm become clear in the context of these everyday encounters. Fruitful *ex ante* decision-making and the assessment of legal prospects arguably calls for a clear indication of sufficiently precise *rules* (as opposed to principles) that can be applied to the existing facts. To the detriment of the hapless government official and her litigious visitor, it is sometimes asserted that 'as a practical matter, it is currently almost impossible to provide useful advice to disputing parties since, ultimately, so much will depend upon the identity and tastes of the particular arbitrators appointed.'<sup>6</sup> As the previous chapter has to an extent sought to elaborate, the jurisprudence on the FET standard exhibits a double problem in that sense.

Firstly, beyond a general agreement on rule of law principles as sub-elements, there is a limited possibility to ascertain for which further specific refinements the hypothetical tribunal would opt for. Which of the (at least) four different understandings of what 'legitimate expectations' entail will be at play?<sup>7</sup> Certainly, the efforts that tribunals put in refining (e.g.) the FET standard are laudable and add new layers of certainty – to the extent that this is not potentially undermined by the very choice that a future tribunal will now have in adopting a 'conservative' or a 'progressive'

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<sup>5</sup> Sometimes expressed as 'we know much better what fair and equitable treatment, expropriation, or full protection and security mean than we did ten or fifteen years ago' (Reinisch 2008, 125).

<sup>6</sup> Landau 2009, 199.

<sup>7</sup> See Chapter 2, section 2.2.2.

understanding. A possibility exists that the said future tribunal will also perhaps decide that both of these seem unsatisfactory and that interpretive innovation is in order.

Secondly, and relatedly, even a complete agreement on the ‘sub-principles’ of the FET standard (and on further interpretive refinements) arguably still leaves the matters half-way as far as the government official and investor are concerned.<sup>8</sup> Understandably, even the refined, ‘2.0’ version of the FET aims to leave enough flexibility for the myriad potential facts to be assessed under them. It is questionable if much can be different if the standard is expected to deal with immensely diverse legal areas.<sup>9</sup> As Joseph Raz argues, flexibility is not in itself contrary to the rule of law - it is both inescapable and beneficial if reasonably used.<sup>10</sup> As in (e.g.) domestic systems of judicial review, there needs to be sufficient discretion so as to accommodate the specificities of individual cases.<sup>11</sup>

In doctrine, the discussion of FET and ISDS as rule of law providers often ends here. Simply put, international rule of law *à la* IIL will have to be discretionary to a considerable degree and this is likely to stay so.<sup>12</sup> Limiting the degree of discretion and tackling the most troubling instances of divergence regarding relevant principles are to an extent addressed through various reform initiatives touched upon in the Introduction to this thesis. If a State is unhappy, the argument often goes, there is always the prospect of ‘re-calibrating’ the IIAs, offering binding interpretations and, ultimately, exiting the regime.<sup>13</sup> But the prospect of ‘condensing’ IIL into an exhaustive, detailed and annotated code of behaviour for the host States and investors alike remains dubious.<sup>14</sup> As Richardson points out, a parenthesis in a statute can translate into thousands of pages of detailed rules for administrative procedure.<sup>15</sup> How many

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<sup>8</sup> As Michael Ewing-Chow notes, the satisfaction with the emergence of ISDS *jurisprudence constante* largely depends on the level of scrutiny – ‘macro level’ seems promising, but the divergence at the ‘micro level’ persists (2013, 232).

<sup>9</sup> See on this diversity Dolzer/Schreuer 2012, 288; Schill 2011b, 1085; Maupin 2014b.

<sup>10</sup> Raz 1979, 222. See also generally Jowell 2015, 5; Bradley/Ewing 2006, 726; McCorquodale 2016, 281-282 and similarly Richardson 1999, 318. It is also argued that purposive-oriented discretion is inevitably gaining in prominence and intensity in the contemporary context (Craig 1997, 476 and Shklar 1987, 9-10).

<sup>11</sup> See in particular Cane 2004, 185 and Goldsworthy 2012, 693 as well as Bell 2006, 1263, 1272, 1281-1282; Van Harten 2010c, 630-631 and 633; Brewer-Carías 1989, 110; Southey/Weston/Bunting 2012, v.

<sup>12</sup> See for example Crivellaro 2014, 138, and discussion in Chapter 2 of this thesis.

<sup>13</sup> See generally Brower/Blanchard 2013 and also Crivellaro 2014, 138.

<sup>14</sup> See for caution on codification efforts Bjorklund/Reinisch 2012 and Bjorklund 2012, as well as the ultimate abandonment of the codification effort by the International Law Association at <http://www.ila-hq.org/download.cfm/docid/058DBA5E-310B-44F9-AF9A0F0CBDB887CF>, accessed 1 February 2017.

<sup>15</sup> Richardson 1999, 314.

thousands of pages would be required for a three-word phrase such as ‘fair and equitable’ is open to imagination.

*The inevitable discretion and the reasoning process*

In normative terms, however, this perhaps inevitable acceptance of considerable decision-making discretion should result in the renewed and rigorous focus on how this discretion is exercised. The more an agreement is reached on the existence and extensive scope of arbitrators’ discretion, the more critical their *legal reasoning process* becomes.<sup>16</sup> As famously observed by Wendell Holmes, ‘general principles do not decide concrete cases’ – much of the key work must be done through case-by-case judgments to specify the abstraction at the point of application.<sup>17</sup>

If the prospect for a hard-and-fast codification of what FET means remains unclear, a sufficiently consistent, systematic and persuasiveness-oriented reasoning process should allow to at least ‘reverse engineer’ something akin to it.<sup>18</sup> If the government official can reasonably know in advance that the hypothetical factors A, B and C *shall* be taken into account by the arbitrators, and some indication of the weight to be given to them, that is arguably already a considerable improvement. As discussed previously, the existing ISDS jurisprudence unfortunately sometimes leaves much to be desired regarding the reasoning process, not the least in relation to the approach to interpretation, recourse to non-IIA international obligations, and the role of domestic law.<sup>19</sup> Bearing in mind the context and the potential consequences of ISDS awards, this is certainly unfortunate.

As Toby Landau notes on this topic, the ‘reason for reasons’ in ISDS goes well beyond that in commercial arbitration and must take into account the unique position of investment tribunals.<sup>20</sup> Especially in the light of the ‘unprecedented responsibility’

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<sup>16</sup> See in that sense Smits 2012, 64 (‘[i]n law, it is not only (or even primarily) the result that counts, but it is the reason why this result was chosen that matters’).

<sup>17</sup> Sunstein 2007, 11.

<sup>18</sup> See in this sense also Alvarez/Reisman 2008, 1.

<sup>19</sup> See Chapter 2, sections 2.2. and 2.3.; sometimes even ‘the most careful reading of the award failed to reveal key factual findings, major or minor syllogistic premises, or normative judgments that were necessary to reach a conclusion’ (Alvarez/Reisman 2008, 1).

<sup>20</sup> See generally Landau 2009 and similarly Grigera Naón 2014, 105; Kotuby/Sobota 2013, 455-456 and Alvarez/Reisman 2008, 2 and 29. On recent trends regarding the reasoning requirement see Infantino 2014 and Ortino 2012, 34-35.



that is on the shoulders of ISDS arbitrators, it is the nature and quality of an award itself (as opposed to mere outcome) that will frequently decide the success of the arbitration as a whole.<sup>21</sup> What should be expected is persuasiveness that goes beyond the rudimentary or formal fulfilment of the requirement for a decision to be ‘reasoned’.<sup>22</sup> A broad range of interested entities, including both the host State population and those governing them, have a legitimate interest in a decision rendered with sufficiently detailed reasoning.<sup>23</sup> For some authors, facilitating the acceptance of the award by the broader audience also becomes the key function of the tribunals’ decision-making.<sup>24</sup>

### *Towards the complementing paradigms*

To pull the threads together – how can substantive decision-making in FET claims reconcile the parallel existence of the large degree of discretion available to arbitrators, the expectations of firm(er) guidance by host States and investors, and the rule of law ‘mission’ of ISDS? The previous Chapter has sought to elaborate some starting points in devising a possible answer.<sup>25</sup> This and the following chapters will argue that, normatively, the substantive decision-making process in FET claims and its accompanying legal reasoning *ought* to be an exercise in complementing the *international* rule of law paradigm with a *national* rule of law one. To the extent possible, in interpreting and applying the FET sub-principles, due account needs to be taken of the vision of the rule of law that a host State has chosen for itself through its domestic and international commitments beyond the IIA. It is this vision that is arguably primarily anticipated by both States and investors as likely to govern the life of an investment. Substitution of the domestic dispute settlement institutions and/or assessment of their

<sup>21</sup> *ibid*, 187-188. See similarly Lalive 2010, 57 and 64-65; Giovannini 2011, 79 and 90; Kotuby/Sobota 2013, 455. See for a somewhat different distinction between clarity for ‘internal functioning’ of ISDS and external legitimacy Ortino 2012, 33-34..

<sup>22</sup> As required, for example, in ICSID Convention, Art. 48 (3); UNCITRAL Arbitration Rules 2010, Art. 34 (3); SCC Rules 2010, Art. 36 (1) and ICC Rules 2012, Art. 31 (2). See also on the formal obligation on reasons Alvarez/Reisman 2008, 2-27 and Ortino 2012, 35-38. For importance of reasoning regarding jurisdictional issues, see the dissenting opinion of Sir Franklin Berman in *Luchetti v. Peru – Annulment* (also discussed by Lalive 2010, 59-61).

<sup>23</sup> Landau 2009, 193-194 and 197. Similarly Kingsbury/Schill 2009a, 43-44; Schill 2010d, 413; Ortino 2012, 32 and Infantino 2014, 183. Another potential benefit, not discussed here, is the possibility that a clear and detailed award on liability enhances the prospect of (cost/time-saving) settlement (see Infantino 2014, 188). Likewise, there is an important concern in avoiding a potential annulment (see on this Lalive 2010, 57-61; Ortino 2012, 36-38 and Kotuby/Sobota 2013, 458-460).

<sup>24</sup> Infantino 2014, 185; see similarly Kingsbury/Schill 2009b, 52-53; Alvarez/Reisman 2008, 29 and Ortino 2012, 32-33.

<sup>25</sup> See Chapter 2, section 2.4.

operation in a specific case should not automatically mean a wholesale displacement of the substantive legal framework of the host State.

To offer a very preliminary sketch, that will be elaborated in the following chapters, the arbitrators should, *to the extent that the FET standard as so far refined in jurisprudence does not provide sufficiently clear guidance*, focus on what else, in substantive terms, is already there. Instead of a simple exercise of discretion and/or attempting ‘progressive development’ they should turn their attention to the constellation of domestic instruments and international obligations of the host State (*the ideal-type model of the domestic rule of law*) as either relevant interpretive reference points (in accordance with VCLT) or qualitatively crucial facts so to help ‘fill’ the considerable substantive hollowness of IIL principles.<sup>26</sup> By using these instruments and obligations, as well as comparative insights, a tribunal should (if necessary) point to what it perceived as deficient in the provision of the rule of law to the foreign investor, and offer potential reform guidelines.<sup>27</sup> Finally, to preserve the need for case-specific equity, good faith considerations can be (carefully) used as a form of a corrective. This is to the extent that the analysis through the lens of the domestic rule of law vision and comparative indicators still fails to produce what the tribunal would consider a just outcome. Overall, the most normatively satisfying achievement for the ISDS in the FET context should be to prevent the need for its own recurrence, and to do so in a more engaging way than by relying on damages as a sufficient ‘incentive’.<sup>28</sup>

The remainder of this chapter focuses on answering further the questions why the *complementary* focus on *national*, country-specific rule of law is warranted. Four key interconnected reasons are examined. Firstly (as addressed in section 3.3.) the focus on the national rule of law framework is warranted as it recognizes its far more elaborate nature in comparison with the still developing FET jurisprudence. Secondly, section 3.4. will argue that the desirability of taking due cognisance of the domestic framework finds support in the concepts of sovereignty, subsidiarity and plurality in international law. Thirdly, it will be argued in section 3.5. that the importance of the national rule of law

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<sup>26</sup> This also accords with the understanding that host States are more likely to follow the rules which they ‘internalized’ themselves and thus perceive as legitimate (Hirsch 2009b, 873 and materials cited therein).

<sup>27</sup> As Infantino remarks, ‘it is not rare that international investment arbitrators appear to be acutely conscious of the *pedagogical* elements involved in the arbitration process.’ (2014, 195, emphasis added; similarly Lalive 2010, 56 and Draguiiev 2014, 302).

<sup>28</sup> Schill 2015, 96.

framework is also more in accordance with the *ex ante* expectations of foreign investors and domestic decision-makers. The FET standard and IIL more generally should in that sense be seen as remaining an *ultima ratio* consideration. Finally, as section 3.6 will argue, the focus on the domestic rule of law is a way of more effectively pursuing the ultimate expectation that the host States have from the IIL regime – economic development. The domestic rule of law framework whose strength, regardless of and beyond the IIAs, critically contributes to host State development, and this should be given due weight.

To offer a better foundation for discussing these reasons, the following section will present an example from existing ISDS practice - *Genin v. Estonia* award. Focusing on just a few aspects of this case should sufficiently illustrate the potentials and pitfalls of the reasoning process in FET claims, and its interrelationship with the rule of law. To note, *Genin* award is not chosen as a landmark case, but rather as containing a set of elements that serve well for illustrative purposes. As addressed in the previous Chapter and in the following ones, there are other awards which contain similar elements and could serve as equally useful case studies (such as *MTD v. Chile - Award*, *Toto v. Lebanon - Award*, *Bogdanov v. Moldova*, *Al Warraq v. Indonesia*, *Maffezini v. Spain - Award*, *Dan Cake v. Hungary*, *Saluka v. Czech Republic*, *Funnekotter v. Zimbabwe*). In that sense, *Genin v. Estonia* is representative of a broader group of cases which gave domestic rule of law considerations significant weight, and provide a good basis for elaborating on NROL paradigm more generally. While not representative of the whole FET jurisprudence (it would indeed be hard to find one single case to fulfil such role), it offers a good window into a large part of existing ISDS decision-making.

### 3.2. Illustrating the issues – *Genin v. Estonia*

#### *The facts*

The relevant facts of the case can be briefly summarized for present purposes.<sup>29</sup> They revolve around a revocation of a banking license of a foreign-owned Estonian Innovation Bank (EIB) by the Central Bank of Estonia. This was a culmination of increasingly hostile relations between the two entities, and encompassed several events

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<sup>29</sup> *Genin v. Estonia*, paras. 30-61.

which are not of central concern here. The two critical aspects of the case relate to two (out of 8) Claimants' claims.<sup>30</sup>

The first is the formal act of revocation of the EIB's license by the Central Bank. A series of inspections and audits, according to the Central Bank, revealed a large number of breaches of relevant laws by the EIB. After a meeting of the Council of the Central Bank, the EIB's license was revoked on 9 September 1997 with immediate effect.<sup>31</sup> For the Claimant, the revocation was conducted in breach of due process, without any prior notice and on grounds that were a pretext for actual motives.<sup>32</sup> This, as claimed, resulted in a breach of a number of provisions of the applicable 1994 US-Estonia BIT.<sup>33</sup> The Claimants made a rather broad sweep as to which standards were actually breached, resulting in a claim for a simultaneous breach of the FET standard, full protection and security standard, prohibition of arbitrary and discriminatory measures, as well as expropriation.<sup>34</sup>

Two days after the revocation, EIB challenged it on various grounds before a competent administrative court.<sup>35</sup> While these proceedings were pending, a non-related shareholder in the EIB initiated separate proceedings on 18 November 1998 to have the EIB liquidated on account of its license revocation.<sup>36</sup> On 12 January 1999, an application to stay the liquidation proceedings pending the outcome of the licence revocation challenge was rejected, and this rejection was subsequently confirmed on appeal.<sup>37</sup> On 6 October 1999, EIB's challenge to the revocation was dismissed on the grounds that the bank was by then *already* in liquidation.<sup>38</sup> According to Claimant, such sequence of events which ultimately led to EIB's liquidation, amounted to no less than a 'travesty of justice' and breached a number of BIT provisions, including again the FET standard and prohibition of unlawful expropriation, but also adding the requirement to provide effective domestic means for pursuing investment claims.<sup>39</sup>

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<sup>30</sup> See summary in *ibid*, paras. 66-97.

<sup>31</sup> *ibid*, para. 57.

<sup>32</sup> *ibid*, paras. 90-91.

<sup>33</sup> *ibid*, para. 91.

<sup>34</sup> See *ibid*, in conjunction with paras. 13-18 reiterating the relevant provisions of the US-Estonia BIT.

<sup>35</sup> *ibid*, para. 58.

<sup>36</sup> *ibid*, para. 59.

<sup>37</sup> *ibid*, para. 60.

<sup>38</sup> *ibid*, para. 61.

<sup>39</sup> *ibid*, para. 94 in conjunction with paras. 13-18.

The legal reasoning for deciding these claims offers several interesting points. The Tribunal eventually decided to frame all of its investigations under the interrelated standards of FET and non-discriminatory and non-arbitrary treatment.<sup>40</sup> What the decision illustrates, however, is that in determining the breach of these standards the critical role of domestic law is quite possible even if the applied standards are unquestionably international and the BIT itself at relevant points only mentions international law as applicable.<sup>41</sup> Basing its decision on ICSID Article 42(1), the Tribunal decided to apply Estonian law in assessing the merits of the claims.<sup>42</sup> Added to this decision was a cursory statement that there is no basis to believe that the application of international law would lead to a different outcome.<sup>43</sup>

As for the act of license revocation, the Tribunal noted that the Central Bank reasoning on the revocation decision was ‘superficial’, yet it lead to a correct outcome.<sup>44</sup> On the key question of whether the denial of justice occurred during the revocation process, the tribunal answered negatively, yet ‘not without some hesitation’.<sup>45</sup> The main concerns of the tribunal were, in essence, that:

[...] [n]o notice was ever transmitted to EIB to warn that its license was in danger of revocation unless certain corrective measures were taken, and no opportunity was provided to EIB to make representations in that regard. When the Council of the Bank of Estonia was convened on 9 September 1997 to discuss the revocation of EIB’s license, no representative of EIB was invited to respond to the submission made [...] as to why revocation of EIB’s license was necessary or appropriate in the circumstances.<sup>46</sup>

Despite the Tribunal’s demonstrated readiness to meaningfully engage with the various provisions of Estonian law,<sup>47</sup> at this critical point the tribunal did not provide an analysis of the question if there was a legally mandated requirement for either the said notice, possibility of making representations, or the possibility for an EIB representative

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<sup>40</sup> *ibid.*, para. 316.

<sup>41</sup> See 1994 US-Estonia BIT, Article II (3) (a) and III (2).

<sup>42</sup> *Genin v. Estonia*, para. 350.

<sup>43</sup> *ibid.*

<sup>44</sup> *ibid.*, para. 352.

<sup>45</sup> *ibid.*, para. 357.

<sup>46</sup> *ibid.*, para. 358.

<sup>47</sup> See, for example, *ibid.*, para. 62 and paras. 352-356.

to attend the Council meeting. The tribunal also did not ascertain the previous and/or subsequent practice of the Central Bank in these situations.<sup>48</sup> Paragraphs that follow in the award are focused on the *substantive* correctness of the Central Bank's decision,<sup>49</sup> and end with a positive assessment that (indicatively) concludes: '[t]he decision, as it turns out, was further justified by *subsequent* revelations and appears even more understandable with *hindsight*.'<sup>50</sup>

Despite not engaging with the *procedural* provisions of the potentially relevant Estonian laws, the Tribunal reached a following conclusion:

The Tribunal considers, however, that certain procedures followed by the Estonian authorities in the present instance, *while they do conform to Estonian law* and do *not amount to a denial of due process*, can be *characterized as being contrary to generally accepted banking and regulatory practice*. They include the following:

- (1) No formal notice was given to EIB that its license would be revoked unless it complied with the Bank of Estonia's demands within a reasonable time;
- (2) no representative of EIB was invited to the session of the Bank of Estonia's Council that dealt with the revocation to respond to the charges brought by the Governor;
- (3) the revocation of the license was made immediately effective, giving EIB no opportunity to challenge it in court before it was publicly announced.<sup>51</sup>

Eventually concluding on this matter, the Tribunal's stated that '[i]t is to be hoped, however, that Bank of Estonia will exercise its regulatory and supervisory functions with greater caution regarding procedure in the future.'<sup>52</sup>

The fate of the second claim, regarding the behaviour of Estonian courts, is quite puzzling. The Tribunal did not in the end substantively address the matter. Rather, the Tribunal implicitly reached a (rather peculiar) conclusion that the Claimant, as proceedings developed, essentially stopped pursuing this claim. While the Tribunal announces that it will deal with all the issues regarding license revocation (thus including behaviour of Estonian courts)<sup>53</sup>, the question that Tribunal eventually puts before itself as determinative makes no mention of the judicial proceedings - '[d]id Respondent, in

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<sup>48</sup> Despite a later claim that there is no indication of discrimination regarding the treatment that Estonian investors received – para. 369.

<sup>49</sup> *ibid*, paras. 359-363.

<sup>50</sup> *ibid*, para. 363 (emphasis added).

<sup>51</sup> *ibid*, para. 364 (emphasis added).

<sup>52</sup> *ibid*, para. 372.

<sup>53</sup> *ibid*, para. 313.

the person of its agency, the Bank of Estonia, violate the BIT or Estonian law by revoking EIB's license (and if so, what damages are owed as a result)?<sup>54</sup> By analysing the preceding discussion, and admittedly adding some unstated assumptions in the mix, it could be argued that the Tribunal implied the renouncing of the claim from Claimant's reiteration that Bank of Estonia board license revocation was the 'core' of its claim.<sup>55</sup> The alleged and at least *prima facie* controversial 'travesty of justice' thus remained unexplored.

*Commentary – international or national rule of law?*

Reasoning of the tribunal allows for some preliminary comments on *international* vs *national* rule of law realization, and their complementation. Can the FET jurisprudence be considered a sufficiently reliable exclusive provider of uniform rule of law principles for foreign investors engaged in the banking sector? Will the investor contemplating an IIA-protected investment in a bank in (e.g.) Finland or Israel be able to fully ascertain how it will be treated in case of licence revocation? Equally importantly, will the central banks of these countries be able to prospectively adjust their behaviour so to stay on the 'safe side' of a potential FET claim?

Unambiguously positive answers to these questions are hardly possible, and this sheds light on the limits of the IROL paradigm. The Tribunal impliedly suggested that neither IIL nor the broader corpus of international law have much to offer on the issue of banking licences. But the FET standard's role in protecting the rule of law, in the vein of IROL exclusivity, would arguably require *something* (preferably clear and persuasive) to exist. The tribunal's brief assertion that the application of international law would likely lead to a 'similar outcome' arguably seems more like a veiled admission of the substantive hollowness of international law than as an actual conclusion on the content of some (hypothetical) provisions.

The previously discussed availability of discretion could have led the tribunal to either a more impressionistic 'facts and then a conclusion' reasoning process or towards suggesting a more elaborate set of rules<sup>56</sup> that could be then prospectively used as

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<sup>54</sup> *ibid*, para. 315.

<sup>55</sup> *ibid*, paras. 242, 319, 348.

<sup>56</sup> Sometimes described as 'inevitable interpretative "law-making"' (Crivellaro 2014, 137).

international/transnational benchmarks on the banking licence revocation procedures.<sup>57</sup> Both paths would however suggest the weaknesses of the IROL paradigm. The first option would do little to enhance legal certainty, as it would largely negate the possibility of *ex ante* predictability. But the latter option, with its ‘refinement’ orientation, would still face at least two normative and practical problems. Firstly, the tribunal would face a challenge not to *appear* to be engaged in overly vibrant arbitral activism, as its related potential legitimacy costs are considerable.<sup>58</sup> Secondly, the structural ‘handicap’ of the decentralized ISDS makes uncertain the prospects for adopting these hypothetical new benchmarks in future cases.

Perhaps considering this, the tribunal eventually made a choice to primarily focus on the already existing and sufficiently elaborate domestic legal framework. This shows that the assessment of the Central bank of Estonia’s behaviour might not mean much in *substantive* terms for (e.g.) the Israeli Central bank. What it rather *could* mean is that the legal reasoning process in further applying relatively uncontroversial rule of law principles such as transparency and denial of justice will put a strong focus on taking due account of the pre-existing legal framework, and thereby that the respect for that framework should be an important, if not primary, *ex ante* concern for any Central bank. As Hepburn notes, domestic law might be significant for individual disputes, but is not necessarily significant for the ‘system’ of investment arbitration.<sup>59</sup>

From the perspective of NROL paradigm complementation, the reasoning process in *Genin* exhibits both the considerable potential for national rule of law strengthening and the risks of not realizing that potential in full. On one side, the tribunal did engage rather thoroughly with certain aspects of Estonian law. In light of the facts, the ultimate outcome (no host State liability) is also arguably correct. At the same time, the Tribunal hinted at the significant deficiencies of the host State rule of law, but gave rather vague and questionable suggestions for improvement. Also, the tribunal failed to address the behaviour of Estonian courts, a highly relevant issue in the national rule of law context.

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<sup>57</sup> See, for example, Kleinheisterkamp 2015, 818 on arbitrators’ not infrequently feeling overwhelmed and resorting to ‘simplistic’ transnational solutions. See also similarly Kotuby/Sobota 2013, 455 and Hepburn 2017, 62.

<sup>58</sup> ‘A single incidence of an adventurist arbitrator going beyond the proper scope of his jurisdiction in a sensitive case may be sufficient to generate a [political] backlash.’ (Paulsson 1995, 257).

<sup>59</sup> Hepburn 2017, 4.



First point is thus the Tribunal's finding that the Bank of Estonia's procedures did not amount to denial of justice, but were still not beyond significant reproach. The Tribunal's reference to the 'generally accepted banking and regulatory practice' as a benchmark in that sense might suggest comparative insights as guidelines for the host State, something that will be discussed more in Chapter 5. Leaving aside the mentioned lack of engagement with Estonian law on these points, could the tribunal's suggestions in general be utilized for reforming the relevant procedural aspects? Bearing in mind the tribunal's marked hesitation to immediately confirm the full respect of due process – something that could be interpreted more strictly by a hypothetical future tribunal – there are strong reasons for a heightened effort to provide guidance in that sense.

This is also desirable because the actions of the Central Bank were not without their own merits. For example, secrecy and expeditiousness can be justified by the need to prevent the EIB's shareholders and directors (a rather suspect group, as the tribunal determined) from detrimentally influencing the EIB's assets in the light of an impending revocation decision. Similar justification can be found in the need to prevent a sudden 'rush to the bank' by the bank's depositors. In this light, there is certainly a case to be made for a more persuasive and systematic elaboration of the 'generally accepted' standards that the tribunal had in mind. The eventual finding in favour of the State arguably does not detract from this need – the Tribunal should see its role above and beyond the 'correct' ultimate outcome.

Even more questionable is the lack of engagement with at least *prima facie* problematic behaviour of Estonian courts. The Tribunal's relatively muted conclusion that this claim was dropped is rather dubious, not the least when contrasted to the 'travesty of justice' rhetoric employed by the Claimant. But even if the Claimant did put more emphasis elsewhere, this should not be determinative when an apparently glaring rule of law issue is at stake.<sup>60</sup> The matter of what is 'relevant' in dispensing with an ISDS claim must not be overly narrow – and should include concern about the interests of the wider group of stakeholders in resolving a particular issue.<sup>61</sup>

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<sup>60</sup> See also on properly addressing all claims of the losing side Giovannini 2011.

<sup>61</sup> Landau 2009, 203. This might confront with a narrower 'dispute-settling' focus, as explained for example by Alvarez 2013, 161.

Was the Tribunal influenced by the rather strong case that the Bank of Estonia decision was correct,<sup>62</sup> and that the courts would presumably confirm license revocation and liquidation anyway, even without the problems with parallel and pending proceedings?<sup>63</sup> Perhaps, even if this is nowhere explicitly put forward. But this still results in a missed opportunity to provide a thorough assessment regarding a situation (revocation/liquidation/parallel pending proceedings) which is certainly not uncommon and which is likely to be encountered by both the foreign and domestic investors in Estonia.

It is with these (certainly non-exhaustive) considerations in mind that it is now possible to explore in more detail the reasons for the proposed complementing of the IROL paradigm with an NROL one. The focus will first (3.3.) be on the richness of national law as a source of case-specific rules, as well as on the broader reasons why this source should be given special attention (3.4.). The discussion will then proceed to reasons specifically concerning the expectations of investors and States in terms of the legal framework (3.5) and the broader relevance of the approach for the economic development as the *telos* of IIL (3.6.).

### **3.3. Substantive richness of the national (rule of) law**

A key aspect of the tribunal's reasoning in *Genin* was focusing on the national law in assessing the Central Bank's actions. Leaving aside the thoroughness of the tribunal's assessment, this should be seen as a normatively justified choice as national laws generally contain a more elaborate set of legal rules with important mechanisms for self-correction. Systematically taking due account of these rules and mechanisms as (usually) facts in applying the FET standard is normatively justified as it can insert a considerable dose of predictability, certainty and associated legitimacy to the decision-making process – even if the ultimate finding of a breach remains formally distinct from this exercise.

Oft-discussed arguments concerning the richness of national laws have been put forward by Jan Paulsson.<sup>64</sup> Paulsson mainly discusses the full extent of the arbitrator's

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<sup>62</sup> See again *Genin v. Estonia* para. 363 on the decision's correctness 'in hindsight'.

<sup>63</sup> See in that sense a comment in Hepburn 2017, 34-35.

<sup>64</sup> See primarily Paulsson 2008a, and similarly Paulsson 2013, 231-255. For similar earlier arguments, see Gaillard/Banifatemi 2003, 394. See also for objections to Paulsson's arguments Mayer 2011.

duty to apply national law in both commercial and investment arbitration.<sup>65</sup> He argues that this duty includes the possibility to ignore ‘unlawful’ laws, i.e. those enacted in conflict with the foundational and constitutional norms of the domestic legal system, as they are simply ‘not law’.<sup>66</sup> Leaving for the moment certain differences to the broader normative approach discussed above, it is useful to focus on several Paulsson’s ideas that resonate well with it.

Summing much of the discussion to come, Paulsson states that:

[n]ational laws themselves contain corrective norms, and they may be formidable. An international court or tribunal charged with applying a national law has both the duty and the authority to apply it as a whole. If it does so, there may be no need to determine whether international law trumps national law. In this way a confrontation of legal orders is avoided.<sup>67</sup>

The focus on law ‘as a whole’ means that individual laws (and Paulsson remains focused on laws in the meaning of statutes, or *les lois*) must be seen as dominated by the broader legal system, or ‘law’ (*le droit*).<sup>68</sup> In practice, the legal system ‘in the books’ and the written constitution at its summit may be largely unrelated to the everyday exercise of power, as exemplified by what Paulsson calls the ‘lofty eloquence of the constitutions of banana republics of yore’.<sup>69</sup> This, however, should not be a critical hampering point. As Paulsson further notes:

[a] purported mandatory law—like any law—is not necessarily effective even on the national level. In all legal systems worthy of the name, courts may annul or disregard laws which violate the rule of law—often by their constitutional irregularity. *International courts and tribunals must have at least equally great authority if their duty to apply the national law is to have its full meaning.*<sup>70</sup>

The points about the (at least nominal) richness of corrective national norms aimed at the preservation of the rule of law can be supported more generally. Where a more predictable and grounded domestic law exists, there is little reason for tribunals to ignore it in favour of more abstract FET principles.<sup>71</sup> The FET provisions are certainly not the most developed set of commitments that oblige the host States to respect the

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<sup>65</sup> Paulsson 2008a, 218.

<sup>66</sup> *ibid*, 221-225.

<sup>67</sup> *ibid*, 215.

<sup>68</sup> *ibid*, 217.

<sup>69</sup> *ibid*, 219-220.

<sup>70</sup> *ibid*, 224 (emphasis in the original). See also in this context Grigera Naón 2014, 99.

<sup>71</sup> Hepburn 2017, 56.

rule of law.<sup>72</sup> Combined obligations existing beyond the IIAs are almost in every case more developed and detailed in terms of obligations imposed upon the host State decision-makers, arguably even with all of the FET jurisprudence considered.<sup>73</sup> An additional matter in that sense are also the ‘hierarchical’ considerations, where (for example) the position of the ICJ expressed in the *Barcelona Traction* judgment is that human rights considerations embody a *higher value* than investment disciplines.<sup>74</sup>

It is thus normatively questionable if the decision-making process should avoid ‘juxtaposing’ the FET sub-principles with at least some of the crucial commitments that bind the host State decision-makers in parallel.<sup>75</sup> This also allows to temper the considerable normative and analytical problems associated with the investment tribunals saying what the ‘good’ law should be.<sup>76</sup> As Paul Stephan notes:

[s]uperficially, investment treaties [...] [specify] legal duties that host states have with regard to foreign investors. [...] But all of them refer to the content of municipal law. Each invites a reviewing body [...] to compare the host state’s behaviour to the legitimate expectations that its municipal law created. The enforcement of the international legal duty thus requires a review of municipal law.<sup>77</sup>

To reiterate, the promulgated form of domestic commitments is not usually problematic – as far as ‘law in books’ is concerned, it is hard to globally find a

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<sup>72</sup> As Echandi notes, ‘IIAs rarely include standards of treatment and protection that are not already provided by the host countries’ domestic laws and regulations at the time of the negotiation’ (2011, 14). See similarly for FET sub-components as common core principles of domestic administrative law McLachlan/Shore/Weiniger 2007, 7.99-7.100; on the ‘elusive’ character of due process obligations in international law see Hepburn 2017, 56.

<sup>73</sup> See in that sense Watts 1993, 16 (arguing that the domestic rule of law notions and mechanisms are far more developed than international ones in any case) and somewhat similarly Waldron 2011b, 390 and Hepburn 2012 as well as Hepburn 2017, 16 fn 21. For the discussion of ISDS jurisprudence, see generally Chapter 2.

<sup>74</sup> *Barcelona Traction*, para. 33. See also similarly Human rights, trade and investment - Report of the High Commissioner for Human Rights, E/CN.4/Sub.2/2003/9, 3-4; Viñuales 2014, 323-324 and Maupin 2014b, 491-492. For a view that investors cannot legitimately ignore host State human rights obligations see *Suez v. Argentina – Separate Opinion Nikken*.

<sup>75</sup> Recognising thus again, as Tamanaha notes, that all general ideals are contestable in meaning and reach (Tamanaha 103-104). See also Vandevelde 2010, 53 on high level of generality of the identified requirements. For similar ‘juxtaposing’ exercises of the US Supreme Court see Chang/Yeh 2012, 1181 and materials cited therein; for some other jurisdictions see Shelton 2011a, 17-18. For similar considerations in constitutional law context more generally see Stone Sweet 2010a, 203. These bear particular relevance if ISDS is indeed ‘the closest we have come to an international constitutional or administrative court’ (Van Harten 2010c, 632).

<sup>76</sup> See on this Calamita 2015, 106 and more generally McCorquodale 2016, 282.

<sup>77</sup> Stephan 2014, 358. See somewhat similarly Kotuby/Sobota 2013, 464.

jurisdiction that does not seem to be strongly committed to the rule of law.<sup>78</sup> It is the rule of law operation at the ‘most granular level of human affairs’ that is the crucial challenge, not the formal proclamation of the concept’s often supreme status.<sup>79</sup>

To return to Paulsson’s arguments, the utilization of the domestic self-correcting rule of law mechanisms for ‘unlawful laws’ would thus: remain distinct from international law intervention;<sup>80</sup> would not be conditional upon waiting for domestic judiciary to act regarding the same issue;<sup>81</sup> nor limited by the fact that there are perhaps no practical avenues for remedies in domestic law.<sup>82</sup> While the opportunities for international arbitrators to pronounce domestic laws unlawful/unconstitutional are unlikely to come often, ignoring them when they come would present ‘*une forfaiture*—a dereliction of duty on the part of the international decision-maker’.<sup>83</sup>

Some of Paulsson’s concluding remarks also strongly resonate with the *ratio* of the NROL paradigm. Paulsson argues that, in the end, the value of his approach lies in that ‘the outcome is shown not to be an international imposition on national law, but a vibrant affirmation of that same law.’<sup>84</sup> In the long run, in cases of governmental abuses, ‘even citizens of the country whose law is in question may come to see the international tribunal as a defender of enduring national values’.<sup>85</sup> Directly referencing the FET standard, Paulsson concludes that:

[...] one should have faith that a fully and judiciously motivated decision, reached after a painstaking ascertainment of the sources of national law, will be accepted by thoughtful nationals as wholly legitimate. If that is not so, why should one have higher hopes for perceptions of the way an international tribunal applies international norms, like “fair and equitable treatment,” which, in the view of detractors, are nebulous and therefore ultimately arbitrary?<sup>86</sup>

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<sup>78</sup> The need for clear laws that are fairly implemented on a consistent and predictable basis is almost universally present (Stephens 2015, 31). As Carvalho notes, ‘there is nothing in ISDS material protection that is nor covered – or should not be covered – by a civilised society respectful of the rule of law’ (2016, 22). See for global human rights commitments McCorquodale 2016, 293-294 and also Duan 2008, 509-510; for the global trend of enhancement of the rule of law in administrative affairs Pérez Loose 2010, 405; and for general investment-friendly legal reforms primarily Wälde/Gunderson 1994 and Salacuse 2000, 387-388 and 396-398.

<sup>79</sup> Stephens 2015, 31. See also Barber 2003, 452 and Salacuse 2000, 391-392 and 395-396.

<sup>80</sup> Paulsson 2008a, 222 and 225.

<sup>81</sup> *ibid*, 224.

<sup>82</sup> *ibid*, 226. See similarly to this and the previous point Grigera Naón 2014, 100-101.

<sup>83</sup> Paulsson 2008a, 229.

<sup>84</sup> *ibid*, 230.

<sup>85</sup> *ibid*, 232.

<sup>86</sup> *ibid*. See in similar vein Grigera Naón 2014, 103-104.

While Paulsson's arguments bear clear relevance to the approach discussed here, it is important to note some differences.<sup>87</sup> Firstly, his discussion largely focuses on a hierarchical conflict between the State's constitution (broadly understood) and a statute that is to be applied in a dispute.<sup>88</sup> This, while certainly important, leaves out a host of other potentially relevant conflicts.<sup>89</sup> Examining an individual statute is but one of many scenarios. As *Genin* award shows, the constitutionality of the relevant Estonian statutes was not an issue – the issue was rather the exercise of discretion under them.

Secondly, Paulsson's insistence on operation *within* national law and *without* international law<sup>90</sup> can potentially leave out the possibilities for rule of law strengthening stemming from both the IROL paradigm in the FET standard and other international commitments of the host State more generally. For example, there is nothing to guarantee that careful examination of the 'purely' domestic legal framework will either yield a conclusive result in terms of unlawfulness nor that that result, even if conclusive, would still not be open for discussion from a rule of law viewpoint. Keeping open the possibility for some form of an international law 'intervention' arguably remains crucial if the IIA provisions are to keep their role in limiting unbridled host State sovereignty.

This is also in line with a normative understanding that not 'anything goes' – a principled right for autonomous shaping of the domestic legal order cannot be an excuse for an unhindered *fiat* of the host State.<sup>91</sup> As has been noted, the interpretation, at least in some cases, cannot both begin and end with just the domestic law

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<sup>87</sup> One point not addressed here is whether the approach in commercial arbitration should normatively be the same as in ISDS (see generally Infantino 2014, 186-196). For some examples supporting that see Grigera Naón 2014, but see also caution in Mayer 2011.

<sup>88</sup> See similarly Grigera Naón 2014.

<sup>89</sup> For example those listed by Mayer 2011, 364 ('entre un traité et une loi, entre une loi et un règlement administratif, entre une disposition d'origine communautaire (règlement ou directive) et une loi ou un règlement administratif, ou encore (sous réserve de discussion) entre une loi et une règle jurisprudentielle...')

<sup>90</sup> See also for distinction in this regard Grigera Naón 2014, 105.

<sup>91</sup> As noted by Jowell, '[a]cknowledgment that there may be different ways of achieving the rule of law does not, however, lead to the conclusion that the rule of law is an entirely relative and shifting concept and therefore may be readily excused by the standard of national convenience.' (2015, 8; see also Bell 2006, 1278 and Schill 2017a). See similarly *ADC v. Hungary*, paras. 423-424.

considerations.<sup>92</sup> There is, however, a strong case for any sort of intervention to be exercised with caution, rigorousness and judicial ‘modesty’.<sup>93</sup> If for nothing else, there will almost inevitably exist (however tempered) a distinct *ex post facto* character of imposing requirements in matters that can rip into the ‘social fabric’<sup>94</sup> of the host State or cause economic damages that might be ‘impossible to bear’.<sup>95</sup> The focus should thus be on trying to shape the ‘international’ intervention in a more predictable way (e.g. through using the already existing international commitments) rather than forsaking it altogether.

Thirdly, Paulsson (and several other authors on this topic)<sup>96</sup> for the purposes of their discussion assume the legally mandated application of national law.<sup>97</sup> Although this can also sometimes (although rarely) occur in the FET context, depending on an individual IIA, the focus of arguments here is on the more prevalent situation where national law is a *fact* for the purposes of decision-making.<sup>98</sup>

To briefly summarise, the substantive ‘richness’ of domestic law as a source of (more) predictable *ex ante* rules certainly holds considerable practical appeal for investors, host State officials and investment arbitrators. The focus on domestic law can offer a legitimacy-enhancing way out of the difficulties caused by the open-textured nature of the FET sub-principles. However, further support for focusing on the national rule of law framework, particularly in a more holistic sense, can also be found in international law itself. The following section will argue that the concepts of sovereignty, subsidiarity and pluralism in international law can also support the complementation of international rule of law considerations with national ones.

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<sup>92</sup> Van Harten 2010c, 632-633.

<sup>93</sup> See for an appeal for more ‘modesty’ in ISDS decision making also Montt 2012, 22.

<sup>94</sup> Schill 2010a, 16.

<sup>95</sup> Fabri 2012, 361. See similarly to this and the previous point Ortino 2012, 32.

<sup>96</sup> See similarly Mayer 2011 and Grigera Naón 2014.

<sup>97</sup> Paulsson remarks that his discussion refers to the applicability of national law resulting from any scenario, including both the ICSID Convention Article 42 and the ‘garden-variety applicable-law clause found in a commercial contract.’ (2008, 218).

<sup>98</sup> See Chapter 2, section 2.3.3.

### 3.4. Sovereignty, subsidiarity and plurality

The concepts of sovereignty, subsidiarity and the respect for plurality in international law certainly entail complexities that go beyond this chapter. But it is possible to link these concepts in a way which shows normative insights for both the FET standard and IIL more broadly. Put briefly, the persisting relevance of sovereignty correlates with the respect for plurality in international law. Both concepts are further interrelated with subsidiarity in decision-making, which aims to limit the extent of substantive choices made *for* States at *non*-State levels.

#### *The relevance of sovereignty*

Raising sovereignty as a normative argument can appear problematic. The concept has been increasingly criticized as either unclear (and therefore unhelpful)<sup>99</sup> and/or obsolete in the modern globalizing world.<sup>100</sup> It might also seem misplaced to attach normative importance to arguments of State sovereignty in the FET standard context. IIAs were, as is often repeated, envisioned as *limitations* of sovereignty as a part of the investment-attracting ‘grand bargain’.<sup>101</sup> Re-importing sovereignty concerns might be construed as an (unjustifiable) desire of States to have the sovereignty cake and eat it too.

Duly taking this into account, it still does not seem normatively defensible to interpret the limitations imposed by (among others) the FET standard without seriously considering the starting position upon which these limitations are imposed.<sup>102</sup> As James Crawford noted, ‘[d]espite repeated suggestions of the obsolescence or death of sovereignty as an idea, its normative basis remains’<sup>103</sup> and it is still a ‘standard operating assumption’<sup>104</sup> in international law.<sup>105</sup> There is little doubt that the shape and relevance of the concept is changing.<sup>106</sup> But this rather indicates that ‘sovereignty’ might not be

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<sup>99</sup> See, for example, Henkin 1994 and an overview in Kalmo/Skinner 2010.

<sup>100</sup> See above all Kingsbury 1998 and Crawford 2012, 127-129.

<sup>101</sup> See Kleinheisterkamp 2015, 795 and 804-805. The idea of the ‘grand bargain’ comes from Salacuse/Sullivan 2005.

<sup>102</sup> See particularly Chung 2007 and Sornarajah 2013.

<sup>103</sup> Crawford 2012, 129.

<sup>104</sup> *ibid*, 132.

<sup>105</sup> See also in that sense Alvarez 2012.

<sup>106</sup> For a selection of discussions on the topic in the ISDS-related context, see Stumberg 1998, Viñuales 2014, Kleinheisterkamp 2015 and Sasson 2011. See also for a briefer overview Bonnitcha 2014, 31-32.



overly helpful as a grand proclamation or an undifferentiated conceptual ‘mass’. A look at its more specific aspects can prove more beneficial.

As is sometimes argued, sovereignty should be seen not as a brooding presence in international law, but rather as a ‘bundle’ of particular specific rights and obligations.<sup>107</sup> One particularly relevant aspect is the right of States to make their own choices in dealing with economic, social and political affairs within their jurisdiction.<sup>108</sup> This principled allowance comes clearly through several international instruments as well as international jurisprudence,<sup>109</sup> and is summarized by Michael Reisman:

[a] basic postulate of public international law is that every territorial community may organize itself as a State and, within certain basic limits prescribed by international law, organize its social and economic affairs in ways consistent with its own national values.<sup>110</sup>

Legislative expressions of variations in the law of different states that result from value differences are thus internationally lawful and entitled to respect.<sup>111</sup> The idea that States have the inherent legal authority to regulate has also been a constant feature in international jurisprudence.<sup>112</sup> As Viñuales remarks, the essentially exceptional nature of the IIL/ISDS inroad into national sovereignty should thus not be mistaken to ‘be the rule, or even the entire picture’.<sup>113</sup>

But the inroad does exist. It is clear that the scope of obligations of the host State cannot remain the same as before the IIA conclusion.<sup>114</sup> However, a less clear-cut

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<sup>107</sup> See generally Viñuales 2014.

<sup>108</sup> As Kjos notes, this can provide support for the arguments on the need to apply national law in ISDS cases (2013, 163).

<sup>109</sup> Such as the Article 1 of the Charter of Economic Rights and Duties of States (G.A. Res. 3281 (XXIX), U.N. Doc. A/RES/3281 (1974) and the UN General Assembly Declaration on Principles of International Law Concerning Friendly relations and Co-operation Among States (G.A. Res. 2625, U.N. Doc. A/8028 (1970). For a well-known ICJ pronouncement, see *Nicaragua v. United States*, para. 258. See also Shaw 2014, 32 and 153-156; Lowe 2015a, 8.

<sup>110</sup> Reisman 2000, 366. Similarly in the WTO context, see Howse 2002, 519. For member States’ entitlement to regulate their respective economies in the ECHR context, see Emberland 2006, 19. On how this right to regulate manifested itself in widely varying ways during the EU financial crisis, see Kilpatrick 2015.

<sup>111</sup> Reisman 2000, 367. See also Mann 2016, 290-291 and Picker 2013, 50-51.

<sup>112</sup> The examples from ICJ jurisprudence range from those as early as 1926 *Certain German Interests in Polish Upper Silesia (Merits)*, p. 22 to more recent 2012 *Territorial and maritime dispute (Nicaragua v Colombia)*, para. 80. See also Viñuales 2014, 327 and 337.

<sup>113</sup> Viñuales 2014, 360. See similarly Muchlinski 2008.

<sup>114</sup> Bonnitcha 2014, 32. This is further supported by VCLT Articles 31(1) and 32(b) VCLT which militate against treaty interpretations that render provisions redundant or meaningless. See particularly for the VCLT context Linderfalk 2007, 110 and materials cited therein.

question is how the fact that the IIA conclusion is also an *expression* of sovereignty (therefore including the right to autonomously shape the domestic economic and other affairs) should influence the interpretation of these sovereignty limitations.<sup>115</sup> Should there be, to put matters differently, a ‘nationally-flavoured’ interpretation of IIA provisions such as the FET standard?

*The interplay with plurality and subsidiarity in global governance*

A positive answer is suggested by the combined calls for plurality in international law and subsidiarity in global governance more generally. Their joint impact, combined with the rule of law ‘mission’ of IIL, supports the NROL paradigm importance for the FET standard. It invites the ISDS tribunals to recognize their subsidiary role in securing the investors’ rights, while according a more profound recognition to the existing social, political, economic, and cultural plurality of host States. It is also a recognition of a legitimate and desirable degree of plurality in understanding the rule of law notions.<sup>116</sup> The goal should thus be to offer international protection to investors and also sanction the domestic rule of law deficiencies in a persuasive way – but not to constrain pluralistic ‘innovation, experimentation, and the capacity to imagine alternative futures for managing the relationship between politics and markets’.<sup>117</sup>

The concepts of subsidiarity and plurality are themselves recognized as interrelated in important ways. Within the scope of this chapter it is certainly not possible to give the fully deserved space to the importance of the concept of subsidiarity,<sup>118</sup> so the discussion must be limited to the most important points in this normative context. While not uniform in meaning,<sup>119</sup> the principle of subsidiarity is in essence a (rebuttable) presumption for decision-making to be made at a lower level, closer to the affairs/citizens in question.<sup>120</sup> One of the critical reasons for subsidiarity is the recognition that the social and economic plurality is better respected by subsidiary

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<sup>115</sup> As Crawford notes, ‘sovereignty does not mean freedom from law but freedom *within* the law’ (2012, 122; emphasis added).

<sup>116</sup> See in that sense Kläger 2011, 125-127; Ranjan 2016, 121 and 142; Kanetake/Nollkaemper 2016, 458; Chesterman 2009, 69. For the ECHR context see generally Dothan 2014 and Legg 2016, 262-264.

<sup>117</sup> Schneiderman 2008, 8.

<sup>118</sup> Subsidiarity, for example, is a general principle of EU law and one of the primary notions for organising the functioning of the EU. See particularly Article 5(3) of the Treaty on European Union and discussion in Chalmers/Davies/Monti 2014, 204-214 and 393-405.

<sup>119</sup> See Jachtenfuchs/Krisch 2016, 5 and particularly fn 17 and 18.

<sup>120</sup> Jachtenfuchs/Krisch 2016, 6-7 and 9; Kumm 2004, 921-922.

decision-making, as lower level organs are presumed to be more ‘in touch’ with relevant considerations.<sup>121</sup> In the issues of judicial review (or similar processes) beyond the state, the sensitivity to the question of what level within multilevel governance is most suitable for making a particular decision assumes critical importance.<sup>122</sup>

As Jachtenfuchs and Krisch note, there is a plausible case for strong subsidiarity in global governance, as reasons that stem from culturalism and value pluralism converge with the democratic legitimacy concerns.<sup>123</sup> Shifting the decision-making to ‘higher’ (ISDS) levels requires ‘good reasons’<sup>124</sup> and implies the importance of reasonable deference, modesty and well-argued persuasion in decision-making for those to whom the decision-making power is granted.<sup>125</sup> In particular, the ‘demand for subsidiarity [...] rises when acts are highly intrusive and concern specific cases’.<sup>126</sup> In the same vein, Urueña argues that the more public nature of ISDS decision-making implies a higher need for subsidiarity.<sup>127</sup> As is also argued, the need for national authorities to generally have a ‘first say’, and for due respect towards them, are critical for ISDS operation.<sup>128</sup> While subsidiarity cannot be used to justify State behaviour that goes against the best interests of individuals, it can still play a useful role in guarding against overly centralistic visions of global governance.<sup>129</sup>

Going back to the IROL paradigm, the calls for plurality and subsidiarity in international law also indicate the limits of how much an ‘internationalized’ vision of

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<sup>121</sup> Kumm 2004, 921-922. Practical reasons are also important, on which see Warbrick 2000, 449-450.

<sup>122</sup> Von Staden 2012, 1034. For a discussion of the issue in the WTO context, see Lang 2011, 316 and 343-346, as well as Montt 2012, 22 and 347. See also support in Shany 2005, 909-910 and Mahmood 2013, 103.

<sup>123</sup> Jachtenfuchs/Krisch 2016, 22-23.

<sup>124</sup> Kumm 2004, 921; Jachtenfuchs/Krisch 2016, 6-7.

<sup>125</sup> For a similar argument regarding the subsidiarity of ICJ decision-making, see Nollkaemper 2006, 318. In the EU context, there is an increasing reliance on ‘process review’ aimed at assessing if *existing* procedures were followed, as opposed to suggesting new ones. See Chalmers/Davies/Monti 2014, 922-925 as well as Lenaerts 2012, 3-4. See particularly *Unibet* as a good example of how extensively the Court is ready to accommodate existing national procedures as compliant with the Treaties. Concerning the ECtHR, the 2012 Brighton declaration of all member States strongly reiterated the use of ECHR as a last resort, that should come after a careful analysis of national laws and procedures. See also Warbrick 2000, 449-450.

<sup>126</sup> Jachtenfuchs/Krisch 2016, 15.

<sup>127</sup> Urueña 2016, 100-102. See also Jachtenfuchs/Krisch 2016, 16 and 20. See in, a somewhat different context, the support for ‘asymmetrical’ ISDS decision making in Maupin 2014b, 495.

<sup>128</sup> Von Staden 2012 and Burke-White/von Staden 2010a and 2010b; see also Urueña 2016, 116.

<sup>129</sup> Follesdal 2013, 60-62.

the rule of law can achieve.<sup>130</sup> The ‘depth and scope of reasonable disagreement’<sup>131</sup> about approaches to the rule of law issues militates against too ambitious attempts to proclaim State autonomy a thing of the past.<sup>132</sup> A warning is also often put against the overly Westernized understandings of the rule of law. As Chimni notes, ‘to ignore the enormous diversity of human experience is to have an unwarranted epistemological confidence that has its roots in hegemonic aspirations.’<sup>133</sup> There are indeed ‘multiple worlds of international law’ and ‘[t]he legitimacy of an international rule of law is a function of its journey towards becoming a more plural construct, taking cognisance of cognate narratives in other cultures and civilisations.’<sup>134</sup>

In some ways, a throwback can also be made to the early days of IIL. As Ibrahim Shihata argued in 1986, apart from very key formal characteristics, rule of law principles will ‘of course’ be based on own choices and convictions of States.<sup>135</sup> Elements of the rule of law can be ‘satisfied in different ways in different systems’.<sup>136</sup> IIAs, as argued more recently by Alvarez, ‘do not assume that their treaty parties share the Western rule of law tradition, nor do they seek to re-make states to conform to that tradition’.<sup>137</sup>

In summary, there is support in some of the basic concepts of international law and their doctrinal interpretations for a careful and thorough balancing of the ‘substitution’ and ‘subsidiarity’ imperatives in FET decision-making. A normatively desirable path should be combining the detached dispute settlement role (‘substitution’ of the domestic institutions) with a principled respect for substantive domestic legal choices. If the ‘vast’<sup>138</sup> discretion remains at the disposal of arbitrators, it should not

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<sup>130</sup> See, for example, Watts 1993, 21; Kumm 2003, 27; Chimni 2012, 306-307; Nollkaemper 2016, 4-6; Kanetake 2016a, 38-39. For the ECtHR context see Spano 2014.

<sup>131</sup> Kumm 2004, 927. See also Sunstein, for whom the incompletely theorized agreements are well suited to the (legal) world containing social disagreement on large scale issues (2007, 13).

<sup>132</sup> See in that sense Besson 2011, 380. See similarly in the private law codification context Smits 2012, 99; and for administrative law Bell 2006, 1261 and 1266-1267.

<sup>133</sup> Chimni 2012, 291. See similarly in the ISDS context Picker 2013, 41; and more generally Trubek 2006, 87.

<sup>134</sup> Chimni 2012, 306-307.

<sup>135</sup> See elaboration in Santos 2006, 271.

<sup>136</sup> Crawford 2003, 5. Similarly, for Petersmann, ‘[t]he rule of law, therefore, may legitimately differ in domestic and international jurisdictions depending on their often diverse constitutional and international legal obligations and the democratic and judicial conceptions of the rule of law prevailing in that jurisdiction’ (Petersmann 2009b, 518.)

<sup>137</sup> Alvarez 2016, 220. See relatedly Tamanaha 2004, 4-5. Likewise, ISDS tribunals are not particularly well positioned to pass value judgments and draw legal inferences from issues such as (non-)democratic domestic political set-up (see Schill 2012a, 23 and materials cited therein).

<sup>138</sup> Landau 2009, 195 and similarly Ortino 2012, 35.

result in dispute-settlement substitution transforming into wholesale substantive rules substitution. In other words, procedure should not profoundly dominate the substance. The future of IIL might be in question without a careful engagement with the domestic law as the expression of state sovereignty.<sup>139</sup>

The following two sections will deal more specifically with additional support for such a position that can be gauged from the *expectations* of host States and investors that should be accorded respect. The following section will first argue that the thorough cognisance of the domestic legal framework is also normatively desirable as it accords with the expectations of host States and investors. Section 3.6. will then examine an expectation of a different type – that participating in IIL and subjecting to, *inter alia*, the FET standard will allow for the economic development of the host State.

### 3.5. Expectations of investors and States

#### *Introductory remarks*

There is little debatable in requiring that the parties involved in an investment endeavour know the law that will be applied to them, in accordance with the age-old maxim of *ignorantia legis nocet*. However, a question arising in the foreign investment context is *what law* is expected to be known. Will an investor coming into the host State primarily consult the IIA on what to expect in legal terms, or host State laws? Will the domestic official primarily have a look at the FET provision when confronted with a procedure involving a foreign investor, or the otherwise applicable domestic law? Could the EIB investors in *Genin* initially expect anything else but that relevant Estonian laws will be applied fully and correctly?

There are strong reasons to believe that host States and investors *primarily* expect that in their mutual relationship they will have to comply with the domestic law *beyond* the IIA, and that the IIAs – with the FET standard being here particularly prominent – are *not* expected to be the key instruments to secure the rule of law throughout the life of an investment. While duly accounting for potential overgeneralization, these

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<sup>139</sup> Hepburn 2017, 7-8.

expectations should still be given proper weight by investment tribunals.<sup>140</sup> The tribunals should avoid deciding as if the host States and investors used (or should have used) the FET standard as a primary guidepost for their behaviour, as it is questionable if that corresponds with reality. In many ways, a normative preference for respecting the realistic perspective of these key actors – State and investors – should complement the fact that the mandate of the tribunal stems from an IIA and that the applicable standard is international.<sup>141</sup> The source of the mandate should still not result in some peculiar ‘IIA/FET worldview’ that ignores the realities of business and administrative operations.

The expectation of domestic law *applicability* is certainly not the same as the expectation of its *importance* for tribunal’s deliberations. From a formal viewpoint, at least the host State is expected to be aware of the existence of the FET standard obligation and its content as an international standard. In many situations it is certainly practically aware of these as well, as are many foreign investors.<sup>142</sup> But this awareness alone detracts little from a normative position that even in those situations the parties will likely first and foremost strive to comply with domestic law – if for nothing else because the FET sub-principles are often simply too open-textured (and sometimes unequally interpreted) so as to provide guidance.

Expectations discussed here, to be clear, are not the same issue as just the operation of the doctrine of legitimate expectations, although they certainly affect this issue.<sup>143</sup> What is at play here is a broader question of the initial approach to the relevant legal framework in light of the actual or at least presumed expectations of the involved parties. This is also independent of the existence of a specific investment contract with the host State. The existence of such a contract certainly has a large (or sometimes determinative) influence on the resolution of a dispute. However, it does not in itself answer the question if for matters not regulated by the contract, an investor and

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<sup>140</sup> See also Grigera Naón 2014, 105 for the importance of parties’ expectations for the decision-making process.

<sup>141</sup> As Alvarez notes, there is a viewpoint in doctrine in international adjudication suggesting that investment dispute settlers should keep to their regime-specific law that they are ‘licensed’ to apply (2013, 161).

<sup>142</sup> See in that sense remarks of Mark Kantor in Orr 2007, 2.

<sup>143</sup> See also Chapter 2, section 2.2.2.

domestic decision-makers are to look to IIL as a primary guidepost or to the national legal system, with the IIA being just one (and admittedly, rather small) part of it.<sup>144</sup>

The aim here is to make a more abstract normative point - one that deals with an arguably more common scenario where the FET standard protection becomes relevant *ex post facto* only.<sup>145</sup> To show the reasons why it is warranted to ascribe an important complementing role to the domestic rule of law framework, the following sections will examine some existing empirical research on the actual expectations of investors and host States before engaging in a more general normative discussion.

### *The expectations of investors*

Empirical research aimed at determining specifically investors' attitudes towards the IIAs and standards contained therein is still relatively scarce. However, the existing empirical research, as well as anecdotal experience, shows that at least for a large number of foreign investors the knowledge of rules, jurisprudence and even existence of IIL is not *a priori* a given.<sup>146</sup> With the immense variety of foreign investors today,<sup>147</sup> it would be rather optimistic to presume that all will have specialised legal assistance in this area, let alone to such a degree that investment protection becomes a predominant factor in assessing legal and/or political risks.<sup>148</sup> But perhaps more importantly, even when the knowledge about this protection exists (as will be shortly addressed), the belief in its ability to secure the rule of law is far from entrenched.

For example, a 2007 survey of 602 MNCs operating worldwide,<sup>149</sup> showed that about a quarter were not influenced by IIAs at all, nearly half saw their importance as

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<sup>144</sup> This is also not a question that can be resolved by simple examination the applicable law clause of the investment contract. As extensively discussed in doctrine, the relationship between contracts and IIAs is far more complex (see for example Dumbery 2012).

<sup>145</sup> See remarks of Krishan in Orr 2007, 6 and also Wälde 2007, 64.

<sup>146</sup> See Yackee 2011, 427 and particularly fn 125. See generally also Wälde 2008 ('Investment protection perhaps should be high on the priority of the negotiators and drafters, both in government and with the investor, but it is often not the chief concern').

<sup>147</sup> See on the rising importance of small and medium enterprises as foreign investors OECD 2004 and Pu/Zheng 2015.

<sup>148</sup> To note, this section is not mainly focused on expertise that the major law firms in this field might have, as they are, as Picker notes, crucial players in forming the legal culture of IIL in general (Picker 2013, 45-47). Socio-legal research in any case tends to indicate that the influence of law on business behaviour is far from unambiguous, and that the attenuated link is even more present regarding international law (Yackee 2008a, 807; Yackee 2011, 431-433).

<sup>149</sup> See generally Kekic/Sauvant 2007 and in particular Shinkman 2007.

limited and only 19% considered that IIAs influence their investment decision to a great extent.<sup>150</sup> A more recent British Institute of International and Comparative Law/Hogan Lovells survey of 301 senior executives of multinational corporations focused on their investment decisions, and in particular the role of the rule of law in the process.<sup>151</sup> It showed that 95% of respondents felt national laws were ‘essential’ (66% of respondents) or ‘very important’ (29% respondents) in securing rights, property and security. The BITs were still ranked high, as expected, at 76% respondents considering them ‘essential’ or ‘very important’ but, as the survey notes, the ‘intensity of feeling is lower’.<sup>152</sup> Only 9% of respondents saw BITs as ‘essential’.

As concluded, ‘the treatment of investments by a host country’s *national legal system* remain a *key factor* influencing FDI decisions.’<sup>153</sup> Many companies invested in relevant markets even without IIAs in force (despite claiming they were ‘essential’)<sup>154</sup> and actual research into IIA existence was far from a regular occurrence with determinative results.<sup>155</sup> Likewise, despite a generally cautious view on the rule of law levels in the region, answers on Sub-Saharan Africa demonstrate that significant number of respondents indicated that the existence of IIAs was not of particular importance for investment, with only 20% of respondents feeling that BITs would be effective in securing the rule of law.<sup>156</sup>

Somewhat relatedly, Jason Yackee investigated the attitude towards the IIAs of for-profit business consultants, political risk insurance providers and general counsel of large US corporations.<sup>157</sup> Briefly, Yackee concluded that evidence suggest that ‘BITs do not meaningfully influence FDI decisions.’<sup>158</sup> The impact of IIAs on political risk ratings

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<sup>150</sup> Shinkman 2007, 96.

<sup>151</sup> However, for caution on using multinational corporations as proxies for foreign investors generally see remarks of Schill in Orr 2007, 2 and 6-7 and Baetens 2015, 3.

<sup>152</sup> *ibid*, 7. See relatedly UNCTAD 2009, 7-9.

<sup>153</sup> BIICL 2015, 10 (emphasis added). The concerns about the domestic legal system are, if possible, addressed by investment contracts and not left to the IIAs (see generally Dumbery 2012 and also Yackee 2008a, 811-812). Somewhat similar conclusions can also be derived from the survey of 96 CEOs of affiliate firms seated in South Eastern Europe and CIS, where the predominant number confirmed that the enhanced legal environment, and domestic rule of law more broadly, were critical factors for their operation (see UNCTAD 2009, 13-14 for the summary).

<sup>154</sup> BIICL 2015, 10.

<sup>155</sup> *ibid*.

<sup>156</sup> *ibid*, 10-11.

<sup>157</sup> See Yackee 2011, 399-400.

<sup>158</sup> *ibid*, 400.



was not statistically significant or was, at best, minuscule.<sup>159</sup> Concerning political risk insurers, the data indicated largely non-existent or at best slight influence of the BIT existence on the insurance cover or premium.<sup>160</sup> Finally, responses from 75 general counsel respondents from US Fortune 500 companies indicated a ‘low level of familiarity with BITs, a pessimistic view of their ability to protect against adverse host state actions, and a low level of influence over FDI decisions.’<sup>161</sup> Summarizing the existing research in 2009, UNCTAD concluded that within their ‘limited role’ as foreign investment determinants IIAs *can* influence a company’s decision where to invest (although less than broader free trade and investment agreements).<sup>162</sup>

More anecdotal evidence provides some interesting insights as well.<sup>163</sup> Experienced practitioners expressed a view that the existence of a BIT played a negligible, if any, role in a decision to commit capital – being rather a ‘footnote’ in a report for the Board.<sup>164</sup> At the same time, however, Thomas Wälde expressed a view that not taking investment treaty protection/arbitration into account when planning investments would be no less than ‘a sign of negligent management and counsel’.<sup>165</sup>

The above should suggest a cautious approach to considering the ubiquitously present FET standard as some sort of primary rule of law securer in the eyes of foreign investors.<sup>166</sup> This coincides with the caution about the idea that host States themselves create (or are aware they should create) some forms of IIA-based ‘enclaves of justice’<sup>167</sup> for foreign investors in their everyday operation.

### *The expectations of host States*

If the host States are expected to respond to obligations such as the FET standard by adjusting their legal order and ensuring *ex ante* compliance, then

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<sup>159</sup> *ibid*, 421.

<sup>160</sup> *ibid*, 425-426.

<sup>161</sup> *ibid*, 429.

<sup>162</sup> UNCTAD 2009, xii and xiv. See also Joubin-Bret/Rey/Weber 2011, 22-23.

<sup>163</sup> See generally Orr 2007.

<sup>164</sup> See contributions of Krishan and Dundas in Orr 2007, 2 and 6.

<sup>165</sup> Wälde in Orr 2007, 10.

<sup>166</sup> See also UNCTAD 2009, xi-xii; Garcia-Bolivar 2009b, 474 and Baetens 2015, 2 for views that IIAs might be one of relevant factors, but not *the* factor in that sense. See also Orr 2007, 1-2.

<sup>167</sup> Paulsson 2007.

governments ought to *understand* the scope and meaning of required guarantees.<sup>168</sup> Very relevant empirical research recently conducted by Mavluda Sattorova, which includes several case-studies in countries already exposed to ISDS claims, does not seem to indicate that this understanding occurred. Government officials at central, regional and local level all seem to be equally ‘rarely if at all aware of the fact that their behaviour may lead to host State liability’.<sup>169</sup> While it is certainly hard to generalize these conclusions, and much more empirical work is required in this field, there is reason for caution in considering IIL as being able to clearly steer host States towards what the ‘international rule of law’ would require from them. This can also cast doubt as to its potential to transform domestic governance,<sup>170</sup> and further indicate the need to have recourse to the domestic rule of law framework.<sup>171</sup>

The reaction of host States to ISDS would rather seem to encompass either a cessation in IIA conclusion,<sup>172</sup> or the switch towards (over-)cautious behaviour due to uncertainty. The uncertainty that the operation of ISDS brings to the domestic decision-making is not just an abstract concern.<sup>173</sup> While admittedly still limited, there is empirical evidence of the doctrinally espoused decision-makers’ ‘fear’ of review that results in ‘defensive’ practices aimed at minimizing risk instead of improving quality of decisions made.<sup>174</sup> It should be noted that in general obtaining empirical evidence on events that *did not* occur (e.g. the non-adoption of a measure due to ISDS claim fears) is difficult.<sup>175</sup> With that in mind, and the caution about overgeneralizations,<sup>176</sup> it is indeed possible to identify situations in which the ‘mere risk of liability under an investment treaty has been sufficient to dissuade states from maintaining measures that may well have been investment treaty compliant.’<sup>177</sup>

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<sup>168</sup> UNCTAD 2012a, 12; Sattorova 2015, 175; Mitchell/Sheargold/Voon 2016, 31.

<sup>169</sup> Sattorova 2015, 175-176.

<sup>170</sup> *ibid*, 176.

<sup>171</sup> See Guthrie 2013, 1176-1179 for the rule of law enhancement projects hampered by the lack of recognition and respect for the domestic legal and administrative context.

<sup>172</sup> See Chapter 1, section 1.3.2.

<sup>173</sup> The topic has also been picked up by UNCTAD in its World Investment Report series. See for example UNCTAD 2003c, 111-113 and 145; UNCTAD 2007c, 18-19; UNCTAD 2010b, 83-90, 136-138, 157-158.

<sup>174</sup> On this interplay between decision-makers and review see Cane 2004, 436; Stone Sweet 2010a, 202-203; in the ISDS context also Miles 2013, 181-182.

<sup>175</sup> See generally Bonnitcha 2014, 115-116 and specifically for environmental measures Neumayer 2001, 78 and Tienhaara 2009, 263.

<sup>176</sup> Bonnitcha 2014, 120.

<sup>177</sup> *ibid*, 121-122 and 126-127 and references therein. See also Tienhaara 2012, 615 and for some specific examples Miles 2013, 182-187 and Poulsen/Bonnitcha/Yackee 2015, 28.

To the extent that empirical record exists, it thus does not indicate that there is a clear picture as to what the FET and other standards do or are meant to do for the content and quality of the rule of law that is to be provided to the foreign investor. Rather, there seems to exist a varying level of awareness about the existence of obligations, definite uncertainty about the actual requirements that their content entails, and a relatively sceptical assessment of their ability to secure the rule of law in some 'internationalized' form. It is thus not much of a surprise that IIL does not seem to be 'the' factor host State decision makers and foreign investors turn to, despite potentially costly consequences.<sup>178</sup>

### *Normative considerations*

The empirical insights above suggest the strong importance of the domestic (rule of) law considerations for expectations and behaviour of both host State organs and foreign investors. This should suggest the tribunals to put themselves, to the extent possible and leaving aside here the issues of deference, in the position of the domestic decision-makers facing the (holistically understood) national legal framework.<sup>179</sup> The actions of these actors are likely to be guided by the FET standard obligations only to a limited (if any) extent – making it normatively questionable to use such a provision as an exclusive *ex post facto* examination prism. As Salacuse notes, the principal issue in investment protection is mostly whether domestic decision-makers 'really function in accordance with the [domestic] legislative scheme [...] efficiently, effectively, and fairly?'<sup>180</sup>

It is admittedly not a given that domestic decision-makers should be shown leniency regarding the extent to which they should account for the FET and other obligations in addition to just the domestic 'legislative scheme'. Having a two-track model of requirements imposed on a domestic actor by international and national law is

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<sup>178</sup> See in that sense also Wälde 2008.

<sup>179</sup> This can in a way also be compared to the constitutional adjudication as described by Alex Stone Sweet – 'constitutional judges will evaluate the decision-making processes of that legislature or that judge. They will put themselves in the latter's shoes, and walk through these processes, step-by-step basis. The judges will, in effect, expect those whose decision-making is being controlled to have reasoned through the constitutional norms as the constitutional court has, and to have acted in accordance with the dictates of the law' (2010a, 204).

<sup>180</sup> Salacuse 2000, 395-396.

certainly nothing unusual. However, the specificities discussed in this and previous chapters warrant caution. Here is how the process of obeying international law is sometimes described in a more classical model of two-track obligations:

[...] all around the world [...] public officials routinely conduct their business within the framework of international law, and corporate officers and individuals, to the fast-increasing extent that they engage with international law, also do so. [...] the rules of international law largely *spell out the normal way* in which international transactions are conducted—the rules and principles that are tacitly accepted as the grammar of international bureaucracies, both public and private—so that in most cases *it would require a conscious effort to act contrary* to international law.<sup>181</sup>

Furthermore, when international law rules are to be applied within a State, in many (or even most) cases they are translated into ‘purely’ domestic law.<sup>182</sup> Thereby most international rules cannot work without the constant help and support of national legal systems,<sup>183</sup> and the national implementation of international rules is of crucial importance.<sup>184</sup>

However, neither the ‘effortless’ compliance with the international rules nor the reliance on domestic transposition are a given in the case of the FET standard. As for the transposition, there are scarcely any attempts in comparative practice to institute specific codes of (e.g.) administrative behaviour to deal with foreign investors.<sup>185</sup> What Lowe calls above an ‘account of international law as it is applicable within [a] State’ for the purposes of the public administration<sup>186</sup> would seem to be a very daunting prospect concerning the FET standard, let alone IIL more generally. The conclusion that host States need to ensure that their national laws do in fact secure the rights granted under IIAs<sup>187</sup> is without a doubt correct in principle, just very elusive in practice.

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<sup>181</sup> Lowe 2015a, 19 (emphasis added).

<sup>182</sup> Cassese 2005, 29.

<sup>183</sup> *ibid.*

<sup>184</sup> *ibid.*, 217. There are also claims in doctrine of a general duty to bring national law into conformity with international law, but this is questionable. See *ibid.*, 218 and Nollkaemper 2011, 11.

<sup>185</sup> Leaving aside national laws on protection of foreign investors which largely follow the wording of IIAs (see generally [https://www.law.cornell.edu/wex/foreign\\_direct\\_investment](https://www.law.cornell.edu/wex/foreign_direct_investment), accessed 1 February 2017), the only developments in that regard have been attempts to institute internal processes of sharing information about IIA obligations between government branches and agencies. However, this is limited to only a handful of examples and there is little empirical information on the effect of such mechanisms (see UNCTAD 2010a, 66-74 and Bonnitcha 2014, 71).

<sup>186</sup> Lowe 2015a, 37. It is similar to ‘judge over your shoulder’ guidance documents as existing for example in the UK (see <https://www.gov.uk/government/publications/judge-over-your-shoulder>, accessed 1 February 2017).

<sup>187</sup> Lowe 2015a, 54. See similarly Echandi 2011, 19 and 21-22.

Could perhaps a way out be found if a decision-maker, well informed of State's obligations, attempts to directly 'conform' to ISDS jurisprudence regarding the FET standard? As Chapter 2 sought to illustrate, while this would be desirable, the task would still be a somewhat unenviable one. Especially bearing in mind the often-emphasised need for 'administrative workability',<sup>188</sup> the existing jurisprudence often leaves much to be desired. As the *Genin* award indicates, there might be little in terms of 'international' to try and comply with in the first place.<sup>189</sup>

This is hardly beneficial for foreign investors either, regardless of how their position might be seen as enhanced by having the ISDS option as a form of leverage.<sup>190</sup> This leverage might indeed be a sub-par replacement for achieving more *ex ante* certainty in dealing with domestic administration. As Bonnitcha notes:

[r]espect for the rule of law requires that discretionary power should only be exercised to the extent that it is conferred by law and that it be constrained by open, stable and general rules governing its exercise. The fact that a foreign investor does not know how a future discretion will be exercised is entirely consistent with the rule of law, so long as the investor is capable of knowing the rules and procedures that will govern its exercise.<sup>191</sup>

Thinking of the FET standard as a reliance-worthy provision illuminated with sufficiently detailed rules is not only an empirically dubious proposition, but to a certain extent turns on its head the regular process of reasoning in risk assessment.<sup>192</sup> Both the investor and the host State decision-makers would seemingly be expected to base their assessments of legal risks on the (considerably vague) principles and rules that would be applied in case that: a) there is a dispute; that b) escalates to the costly level of investment arbitration.<sup>193</sup> It is not only problematic that in practice parties to any

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<sup>188</sup> See for the administrative workability Breyer 2000, 140-142, noting that constitutional judges 'recognize that their decisions will have to be understood and applied by thousands of judges and lawyers and public officials to hundreds of different laws.' (142). See also for a call for improved reasoning of ISDS awards so to better guide the behaviour of States and investors Ortino 2012, 34.

<sup>189</sup> It is relevant to note that empirical research (see generally Halliday 2004) and doctrine affirm that clearer and more consistent law has proportionally greater impact on the behaviour of public functionaries (Cane 2004, 452).

<sup>190</sup> See for example Poulsen/Bonnitcha/Yackee 2015, 23-24 and Koskenniemi 2017, 351. See also Schreuer et al. 2009, para. 30. For a cautious assessment, see Wälde 2007, 62.

<sup>191</sup> Bonnitcha 2014, 297.

<sup>192</sup> See for more on legal risks and IIL Stephan 2014, 357-358 and on the inconsistent ISDS jurisprudence as a threat to risk assessment by investors Schill 2011c, 66.

<sup>193</sup> See in that sense remarks by several contributors in Orr 2007, 2 and similarly Muchlinski 2013, 438.

venture rarely anticipate that a dispute will arise.<sup>194</sup> It is also doubtful that more *ex ante* interest and research will be put by an investor into a potentially applicable IIA and accompanying ISDS jurisprudence than into numerous other issues such as the expediency of administration, simplicity of procedures and general effectiveness of courts.<sup>195</sup> As Mairal observed, ‘between a government and private parties, respect for the expectations that arise from [IIAs] is but the “last step”. In international investment cases this “last step” has been taken with great emphasis’.<sup>196</sup>

The *complementarity* of the FET and other provisions of the domestic rule of law processes<sup>197</sup> thus needs to be taken seriously in normative and practical terms. As recognized in the ICSID Convention preamble, investment disputes ‘would usually be subject to national legal processes’ – and ISDS is to be seen as appropriate only in some cases.<sup>198</sup> Properly understood complementarity is what ought to feature in the legal reasoning process of the tribunals. As Paul Stephen argues, States committed to ISDS ‘should be presumed to *expect* and *desire* an objective and informed review of *municipal* law’.<sup>199</sup> This expectation should be followed through, with a caveat that municipal law can and should be understood in a holistic manner.

There is however another, broader, expectation which underlies the IIL regime and should thus guide the FET standard interpretation and application as well. As the following section argues, the host State expectation of *economic development* lies at the core of the IIL regime. This expectation should be given fuller effect through the emphasis on strengthening the national rule of law in the FET standard decision-making.

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<sup>194</sup> Similarly Schneider 2015, 4 noting that if the investors knew of the likely dispute they would most likely not invest at all. See also similarly Garcia-Bolivar 2012, 465 and the remark of Metalclad owner, Mr Heller, that he would not have gone to law if he had known the meagre outcome (Orr 2007, 12). See also Yackee 2011, 435 and particularly highly illustrative text in fn 150.

<sup>195</sup> See in that sense Salacuse 2000, 386-387 and also Orr 2007, 2 and 10.

<sup>196</sup> Mairal 2010, 450.

<sup>197</sup> See in that sense UNCTAD 2012b, 133-136; UNCTAD 2015, 125-126.

<sup>198</sup> See also Schreuer et al. 2009, para. 17.

<sup>199</sup> Stephen 2014, 371.

### 3.6. Economic development as the goal of investment protection

The final normative reason for according due consideration to the NROL paradigm is that it more profoundly realizes the underlying IIL goal of economic development.<sup>200</sup> There is a strong argument that the ultimate goal of States when entering into IIAs is to achieve economic development, and to realize this goal the focus on the *national* rule of law is at least as important as the *international* version.<sup>201</sup> In that context, focus will first be on the economic development as the arguable *telos* of the IIL regime, and then on why the concurrent emphasis on national rule of law strengthening is a normatively desirable path to achieve it.

Some preliminary remarks are in order. This section looks at the broader normative underpinnings of the IIL regime, and its effect on the FET decision-making. However, even from a more formal perspective that is focused on the object and purpose of IIAs, it is at least plausible to insist on the goal of economic development. Furthermore, for the present purposes *economic development* is defined as a process by which a nation improves the economic, political, and social *well-being* of its people. While the definition of economic development is certainly open to differing interpretations,<sup>202</sup> the crucial point (following Amartya Sen) is that economic *development* is different from economic *activity* or *growth* and encompasses efforts to improve the general well-being as opposed to strictly business interests.<sup>203</sup>

#### 3.6.1. Economic development as the ultimate goal of IIL

The relationship between IIL, FDI and economic development can be approached from different legal, empirical and policy angles.<sup>204</sup> Looking specifically at the economic development as the overall *telos* of IIL, however, relevant normative and

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<sup>200</sup> For a similar argument concerning the FET and the rule of law, see Schill 2010b, 176-181.

<sup>201</sup> As Kurtz (2014, 269) notes, the type of authority delegated to arbitral tribunals - 'constrained agent function' - supports the view that states expect arbitrators to exercise authority closely in line with state preferences and objectives, which would arguably in this case be the economic development objective.

<sup>202</sup> See for example Garcia-Bolivar 2012, 602-605.

<sup>203</sup> For a relatively brief overview, see above all Sen 1983. For a longer discussion, see Sen 2001. See similarly Garcia-Bolivar 2012, 588 and 604.

<sup>204</sup> See, for example, contributions in Cordonier Segger/Gehring/Newcombe 2011.

legal points have been put forward relatively recently by Garcia-Bolivar, Ortino, and Kleinheisterkamp.<sup>205</sup>

In many ways, the *quid pro quo* question lies at the core – why should the host States accept potentially considerable sovereignty limitations in favour of foreign investors?<sup>206</sup> Answering this question reaches critical importance in the light of the open-textured provisions such as those in the FET standard and the need to have recourse to teleological considerations of ‘object and purpose’.<sup>207</sup> While these have been touched upon in the context of interpretation in the previous Chapter, they will here be revisited also in the context of the broader normative orientation of the IIL regime. To briefly reiterate, as per VCLT Article 31 (1), the object and purpose of an international treaty is one of the primary guides for interpreting its provisions – and that object and purpose is usually sought within the preambles of IIAs.<sup>208</sup>

However, the preambles do not necessarily provide a clear answer for the IIL regime overall. Generalizing over roughly 3000 IIAs is not a simple task.<sup>209</sup> Still, the texts of the preambles do tend to exhibit broad similarities that make at least some general conclusions possible.<sup>210</sup> A recurring feature is the *simultaneous* emphasis on a) protection of foreign investors; b) enhancement of FDI flows and c) broader economic development and prosperity. A typical modern IIA preamble includes both the reference to ‘*favourable conditions* for greater investment’ and a recognition that ‘reciprocal *protection* [...] of such investments will be conducive to the *stimulation of individual business initiative and will increase prosperity* in both States.’<sup>211</sup> The treaties thus generally refer to both the desire to encourage economic cooperation and the role that protecting investments has in that regard, with some newer model BITs also including a specific aim to improve living standards.<sup>212</sup>

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<sup>205</sup> See also similarly Radi 2013, 7.

<sup>206</sup> Kleinheisterkamp 2015, 807; Ortino 2013a, 439-440; Garcia-Bolivar 2012, 587.

<sup>207</sup> Kleinheisterkamp 2015, 803-804. See also Garcia-Bolivar 2009b, 482.

<sup>208</sup> Dolzer/Schreuer 2012, 29-30; Bonnitcha 2014, 40; Ortino 2013a, 439-440. For some examples in the ISDS jurisprudence see *Noble Ventures v Romania*, para 52; *Saluka v Czech Republic*, para. 299; *Kardassopoulos v Georgia*, paras 178–81; *Austrian Airlines v Slovakia*, paras. 101-104.

<sup>209</sup> See in that sense Ortino 2013a, 440.

<sup>210</sup> See generally Dolzer/Schreuer 2012, 30 and McLachlan/Shore/Weiniger 2007, 2.10-2.13.

<sup>211</sup> Dolzer/Schreuer 2012, 29 (emphasis added). See similarly Behrens 2007, 171; Van Harten 2007, 140; Garcia-Bolivar 2012, 594-595.

<sup>212</sup> McLachlan/Shore/Weiniger 2007, 2.10 and 2.13.



Summarizing broadly the IIA landscape, Federico Ortino argues that:

the object and purpose of a standard bilateral investment treaty [...] is to ensure the protection of foreign investments (object of the BIT) in order to intensify economic cooperation, encourage/promote international capital flows and increase the prosperity of both contracting parties (purpose of the BIT).<sup>213</sup>

The simultaneous existence (or lack) of different imperatives in the preambles thus limits their usefulness for decisively ascertaining the *telos* of IIL and applying it in interpretation. As Kleinheisterkamp notes, ‘the basic principles of how to determine the “object and purpose” are far from clear, and even more so what the actual *telos* eventually is’.<sup>214</sup> Critically, the application of the IIA provisions requires a ‘much clearer picture of the normative foundations for developing investment treaty law’.<sup>215</sup>

The consequences of the lack of clarity in this area are visible in case law.<sup>216</sup> A number of awards (not necessarily in the FET context, but instructive nevertheless) focused primarily on the investment protection objective.<sup>217</sup> These share a view that foreign investments’ protection is such a dominant object of IIAs that it requires interpreting their provisions (and ambiguities) in a way most favourable to the investor.<sup>218</sup> However, a number of awards suggest restraint for practical and legitimacy reasons as overly pro-investor interpretations can fuel the ‘backlash’ against IIL.<sup>219</sup> Going further, there are also calls for putting more emphasis in decision-making on encouraging the foreign investments in general.<sup>220</sup> Finally, a number of cases exhibit the purpose-oriented view where foreign investment promotion is not ‘an end in itself’, but rather an instrument for economic growth and development.<sup>221</sup>

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<sup>213</sup> Ortino 2013a, 441-442. See similarly Paparinskis 2015a, 667.

<sup>214</sup> Kleinheisterkamp 2015, 810. As is also noted, the blame for this is sometimes put on the governments and their inability to make preambles more instructive (*ibid.*) Yet, this is indeed hard to square with the empirically suggested lack of awareness as to how IIAs will actually perform in practice (*ibid.*), an issue that has been discussed in Chapter 1.

<sup>215</sup> Kleinheisterkamp 2015, 802. Similarly Garcia-Bolivar 2012, 587 and 595.

<sup>216</sup> See also for a short overview Hepburn 2017, 64-65.

<sup>217</sup> For a particularly poignant argument in favour of such an approach, see Alvarez/Khamsi 2009.

<sup>218</sup> See Kleinheisterkamp 2015, 803-804; van Aaken 2009a, 528-529; Garcia-Bolivar 2012, 601. Some prominent examples in jurisprudence include *SGS v. Philippines*, para. 116; *Azurix v. Argentina*, para. 307 and *Tokios Tokelés v. Ukraine – Jurisdiction*, para. 85.

<sup>219</sup> See generally in this sense Waibel/Kaushal/Chung 2010, Vagts 2010 and Van Harten 2010b. See also Dolzer/Schreuer 2012, 30.

<sup>220</sup> See in that sense *SGS v. Philippines* para. 116 and in doctrine Salacuse 2015, 215-217 and Claussen 2009, 1554.

<sup>221</sup> See for a summary Bonnitich 2014, 40 and in particular *Saluka v. Czech Republic*, para. 300; *Plama v. Bulgaria – Award*, para. 167. For an early award in that sense see *Amco v. Indonesia*, para 249.

The often vague nature of both the preambles and the substantive provisions of IIAs such as the FET standard largely allow the broader normative arguments to ultimately determine where the focus of the arbitrators should be. Arguably, the primary focus on the investor protection or just the FDI attraction (without further developmental goals) becomes less appealing when all the normative considerations are weighed in. As Kleinheisterkamp notes, ‘teleological interpretation cannot follow a simplistic “more [in favour of the protected party] is better” logic, as the much more comprehensive understanding of the *telos* is required by the broader context of IIL.’<sup>222</sup>

This more comprehensive understanding leads toward the goal of economic development. As is sometimes noted, ‘[s]tates seek to attract foreign investments because they are a means to promote, foster and finance the welfare of their people and their development’.<sup>223</sup> Even if sometimes unarticulated, economic development remains the central rationale behind participating in the IIL regime, and is as such indispensable for a fair solution of investor-State disputes.<sup>224</sup>

The importance of development also becomes clearer in light of the broader context in which IIAs came into being. The crucial role of the World Bank – institution dedicated to fostering global development – provides indications in that sense.<sup>225</sup> The goal of development has been ‘essential for the efforts to justify the creation of the modern system of investment protection through arbitral tribunals’.<sup>226</sup> For example, the ICSID Convention preamble opens with the Contracting States ‘[c]onsidering the need for international cooperation for *economic development*, and *the role* of private international investment therein’.<sup>227</sup> The leading ICSID Convention commentary makes it clear in no uncertain terms that ‘[t]he Convention’s primary aim is the promotion of economic development.’<sup>228</sup> A link to economic growth and development can also be found in the

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<sup>222</sup> Kleinheisterkamp 2015, 805 and 807.

<sup>223</sup> Garcia-Bolivar 2009b, 473. See similarly Hepburn 2017, 64 for whom the objectives of IIL extend to ‘encouraging the development of the host state, promoting respect for the rule of law, and increasing general welfare’. See also Mitchell/Sheargold/Voon 2016, 27-28.

<sup>224</sup> Garcia-Bolivar 2012, 587.

<sup>225</sup> Kleinheisterkamp 2015, 808; Garcia-Bolivar 2012, 591-592. See on the World Bank development and rule of law objectives Krever 2011.

<sup>226</sup> Kleinheisterkamp 2015, 809. See also similarly Landau 2009, 200-201; Kingsbury/Schill 2009a, 20-21 and Wälde 2007, 72-73.

<sup>227</sup> See also the Kleinheisterkamp 2015, 809-810 for the words of Aron Broches, a key figure in the Convention adoption, on the crucial importance of international investment for economic development and the role of World Bank in impartially removing the obstacles to these investments.

<sup>228</sup> Schreuer et al. 2009, para. 11. See similarly Garcia-Bolivar 2012, 590-591.

Energy Charter Treaty preamble and Article 2.<sup>229</sup> Similar conclusions can also be drawn from the preamble of NAFTA.<sup>230</sup>

The emphasis on the *role* of FDI found in the ICSID Convention preamble indicates its instrumental nature. This also suggests that, normatively, it is also not the FDI *per se* that should be the ultimate goal. As noted above, economic activity itself (here manifesting itself in foreign investment) does not necessarily equal development or prosperity – it needs to be regulated and channelled to improve welfare.<sup>231</sup> This regulation, as is sometimes claimed, is the very *raison d'être* of the existence of the State – and cannot be ignored in the ISDS context either.<sup>232</sup> That FDI does not equal development is suggested also by the voluminous literature on how to translate foreign investments into measurable improvements of different developmental aspects.<sup>233</sup>

Concluding on these issues, Kleinheisterkamp states that:

[i]t is therefore arguable that international investment law derives its normative legitimacy from the logic that investment should be protected, not for the sake of individual economic interests but for the purpose of contributing to enhancing social welfare. Translated into normative terms, this would mean that the ideal aimed at by the relevant telos is that of an investment protection system that grants privileges (restrictions to the exercise of state sovereignty) to the degree necessary to obtain that goal – but not more. [...] investment treaty law must serve an objective beyond the optimisation of investment flows and profits [...]<sup>234</sup>

Along similar lines, Federico Ortino notes that:

the fundamental point here is that the purpose of the treaty is the contracting parties' prosperity rather than the protection of foreign investors. This approach is in principle neutral with regard to the pro-investor or pro-State outcome of the interpretative exercise carried out by investment tribunals.<sup>235</sup>

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<sup>229</sup> See for a comment also Garcia-Bolivar 2012, 592.

<sup>230</sup> *ibid*, 592-593.

<sup>231</sup> See Kleinheisterkamp 2015, 810 and in particular fn 82. See also Halle/Peterson 2005, 17-18.

<sup>232</sup> Garcia-Bolivar 2012, 588. See also Kurtz 2014, 263-264.

<sup>233</sup> See in the IIL context above all De Schutter/Swinnen/Wouters 2013; Colen/Maertens/Swinnen 2013; Joubin-Bret/Rey/Weber 2011, 16 and materials cited therein. See more generally, for example, OECD 1999; Javorcik 2013 and Sutton et al. 2016.

<sup>234</sup> Kleinheisterkamp 2015, 811 (references omitted). See also Landau 2009, 201.

<sup>235</sup> Ortino 2013a, 443. Likewise, seeing the object of IIAs as 'establishment of a framework for the control of the lawfulness of public decision-making' is in line with this understanding of prosperity as central (*ibid*, 445).

To the extent that the economic development is indeed the *telos* of IIL, this can suggest manifold potential insights for ISDS decision-making that go beyond just substantive deliberations and the FET standard.<sup>236</sup> But for the purposes of this chapter the important question is what does it mean in terms of the rule of law sub-principles of the FET standard? Or more specifically, is it warranted to put an equally strong focus on the *national* rule of law paradigm so to achieve economic development?

### 3.6.2. The national rule of law as a preferable path to economic development

#### *Preliminary remarks*

Few further remarks are in order. Firstly, it is not within the scope of this thesis to examine whether FDI itself is conducive to economic development.<sup>237</sup> The assumption adopted is that the host States, by signing IIAs, do see FDI as desirable and do consider it significant for their economic development, however that development is understood.<sup>238</sup>

Secondly, it is widely held that the rule of law generally benefits economic development, and that is the assumption adopted here. While there are certainly important caveats to be borne in mind,<sup>239</sup> the importance of the rule of law for economic development more generally is almost axiomatic in most economic circles, followed closely by the legal ones.<sup>240</sup> Theoretical and empirical economic studies tend to support similar conclusions.<sup>241</sup>

Thirdly, however, it is important to note that literature discussing the rule of law

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<sup>236</sup> See, for example, the effect on defining a protected investment Garcia-Bolivar 2009b, 482-483.

<sup>237</sup> On the causality relations between foreign investment and growth see Hansen/Rand 2006; Chowdhury/Mavrotas 2006; Prasad et al. 2003; Carkovic/Levine 2002.

<sup>238</sup> As Bonnitcha explains, that is also the predominant view in social scientific literature. See in detail Bonnitcha 2014, 17-18 and materials cited therein. See also in this sense Paulsson 2008b, 243; Echandi 2011, 15; Kleinheisterkamp 2015, 810; Joubin-Bret/Rey/Weber 2011, 15.

<sup>239</sup> See on caution regarding the measurement problems and actual effects of the rule of law Haggard/Tiede 2011; Fukuyama 2011, 247 and Calamita 2015, 120-121; Santos 2006, 283-285; Trubek 2006, 86.

<sup>240</sup> Santos 2006, 253. See also Dolzer/Schreuer 2012, 25; Reisman/Sloane 2004, 117 and Tamanaha 2004, 2. For Jowell, 'investment will shirk countries which do not honour contracts or property rights, or which tax retrospectively or discriminate or intimidate selected firms or individuals without any hope of recourse' (2015, 9). See similarly Salacuse 2000, 386-387 and 398 and Fortier 2009b, 11, and for a historical support of the idea Vandeveld 2016, 66.

<sup>241</sup> See, for example, Rodrik/Subramanian/Trebbi 2004; Glaeser et al. 2004; Acemoglu/Johnson/Robinson 2005; Bénassy-Quéré/Coupet/Mayer 2007; see also generally Schill 2009, 4-5; Guthrie 2013, 1159 and in particular authors cited in fn 33.

and FDI attraction/economic development does not generally differentiate between the international or national concepts of the rule of law, but rather considers the rule of law *in a particular State*, regardless of how it is ‘provided’ to business entities. What matters for most authors are the particular rule of law elements that need to be present. Whether or not these elements are achieved through more ‘international’ or ‘purely domestic’ institutions does not seem to be a key distinction. Simply put, whether the host State (e.g.) fully respects and efficiently enforces contractual rights due to a special regime for foreign investors and out of fear of ISDS, or because it is simply due to their domestic tradition is ultimately of secondary importance. It is the outcome that matters in the end.

But for the ISDS decision-makers this is not a secondary consideration. Arbitrators can put their efforts into examining if and how the domestic rule of law mechanisms failed a foreign investor. They can alternatively apply/further develop an international ‘set’ of rule of law precepts not in the least because the domestic ones are *a priori* perceived as insufficient or simply legally irrelevant. These are substantively different processes, and a general choice needs to be made - whether exclusive or complementary paths are to be taken. There are at least three normative reasons why in the ‘rule of law for economic development’ context the NROL paradigm should be pursued in complementarity with the IROL one.

#### *The national rule of law, FET and economic development*

The first reason overlaps to an extent with the discussion in section 3.5. Namely, to provide the elements of the rule of law that foreign investors tend to expect, focusing on the national rule of law is a strongly desirable option. What do the foreign investors expect in that sense? In addition to the findings already discussed, the BIICL/Hogan Lovells report indicates that the rule of law was found to be ‘essential’ or ‘very important’ for investing for 88% of participants, topped only by ‘ease of doing business’ (a factor potentially also related to the rule of law) and ‘stable political environment’.<sup>242</sup> Summarizing these and many other findings, the survey offers an important lesson to host States:

For states seeking to attract FDI, one of the key messages that emerges from the survey is that the Rule of Law matters, acting not only to pull investment in, but also to push it away when Rule of Law conditions are not satisfactory. [...] There

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<sup>242</sup> BIICL 2015, 6.

is a clear need for states to take steps to improve their *domestic* Rule of Law institutions, not only by establishing clear rules and policies, but also by improving the efficacy with which state officials enforce them.<sup>243</sup>

As Salacuse has noted in a somewhat Weberian vein, it is the predictability and stability that is primarily sought by the foreign investors when it comes to the rule of law – ‘[i]nvestors who know the law can plan’.<sup>244</sup> As has been elaborated in both this and the previous chapter, if ‘knowing the law’ is sought, focusing on the national (rule of) law is a normatively important path.

Secondly, focusing too much on only building the substantive content of IIA provisions such as the FET standard should be tempered by the fact that IIAs themselves have not been empirically proven to actually increase FDI (and consequently economic development). Decades of empirical research on the specific link between the IIAs and the FDI increase have simply failed to provide a consensus.<sup>245</sup> The existing research cannot sufficiently persuasively prove the correlation between IIAs and increased FDI flows.<sup>246</sup> Studies finding such correlation,<sup>247</sup> are countered by those that find no<sup>248</sup> or weak correlation,<sup>249</sup> those that indicate that IIAs simply form one part of the overall environment<sup>250</sup> or that specificities of a particular economic sector actually play a more important role in FDI attraction.<sup>251</sup> Increase in the ‘strength’ of IIA provisions also does not seem to be associated with increased investment.<sup>252</sup> Anecdotal evidence, at least the one from an early stage of the ISDS rise, hardly provides clearer results.<sup>253</sup>

In other words, there is a risk to focus too much on an unproven method – and too little on the national rule of law. IIAs and their standards are *on their own* at best just

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<sup>243</sup> *ibid*, 11 (emphasis added).

<sup>244</sup> Salacuse 2000, 398-399.

<sup>245</sup> Guthrie 2013, 1156-1157; UNCTAD 2009, xiii.

<sup>246</sup> For a good overview of numerous positions, see generally Sauvart/Sachs 2009. See also Van Harten 2010d, 30-32; Muchlinski 2011, 14; Baetens 2015, 2.

<sup>247</sup> Büthe/Milner 2009; Neumayer/Spess 2005; Salacuse/Sullivan 2005. It is worth noting, however, that in normative terms Büthe and Milner do not support IIAs as a policy measure due to sovereignty costs (2009, 213-214).

<sup>248</sup> Hallward-Driemeier 2003.

<sup>249</sup> Tobin/Rose-Ackerman 2003. Similarly Yackee 2008b.

<sup>250</sup> UNCTAD 2009, xi-xii; Rose-Ackerman/Tobin 2009.

<sup>251</sup> Aisbett 2009; Colen/Persyn/Guariso 2014.

<sup>252</sup> Yackee 2008a, 807.

<sup>253</sup> Franck 2007, 347-348. Some empirical research from 1970’s and 80’s tends to confirm a degree of ignorance about IIL in general, but its age might urge caution in drawing broader conclusions. See Yackee 2008a, 810.

one part of the FDI/economic development equation and, at worst, even a potentially rather irrelevant one.<sup>254</sup> The more recent UNCTAD publications on the topic display a similar view, where the IIAs are seen as the complements to general rule of law improvement. In summary, '[w]ith or without TNC participation, countries need to develop strong legal and regulatory systems [...] The creation of participatory, transparent and accountable governance systems that promote and enforce the rule of law is critical [...]'.<sup>255</sup>

Third and final reason is that the focus on the *national* rule of law allows to strengthen it for the benefit of *all* the relevant actors in the host State, domestic and foreign, and therefore to create preconditions for economic development in a more holistic and wider-reaching way.<sup>256</sup> The examination, application and potential criticism of domestic law can be relevant for all those subject to it. This issue, also termed the 'spill-over' effect, warrants a closer look as it is sometimes questioned in the doctrine.<sup>257</sup>

#### *The 'spill-over' effect*

Put briefly, if the ISDS awards finding the FET breach would incentivize the domestic officials to also fully follow the domestic rule of law framework, this reflects upon all the entities in the host State and should help promote development. A legitimate concern might be that the host State officials, primarily interested in avoiding costly liability, exhibit heightened levels of care and diligence *only* in dealing with the foreign investors. After all, it is not uncommon to see references to IIL and ISDS as isolated 'enclaves of justice',<sup>258</sup> and opinions that '[t]he treaties address the treatment of foreign investors alone and are *inherently indifferent* to issues of the legal system that relate to the nationals of the host state.'<sup>259</sup> As noted, the primary concern for IIL advocates was not the improvement of the host State governance – but the spill-over effects are now increasingly put forward as justifying its continued existence.<sup>260</sup>

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<sup>254</sup> See similarly Halle/Peterson 2005, 15-17 and Garcia-Bolivar 2009b, 474.

<sup>255</sup> UNCTAD 2008, 150. An early study in that sense is UNCTAD 1998; See similarly UNCTAD 2001, 5-6 and 131-132; UNCTAD 2003c, 86. As UNCTAD 2009, xv makes clear - 'IIAs alone cannot do the job'.

<sup>256</sup> Guthrie 2013, 1159-1160.

<sup>257</sup> *ibid*, 1180. See also recently for a somewhat cautious outlook Schneiderman 2017, 20.

<sup>258</sup> See in particular Paulsson 2007.

<sup>259</sup> Dolzer 2005, 954 (emphasis added). See similarly Carvalho 2016, 15. See also Schultz/Dupont 2015, 1161.

<sup>260</sup> Sattorova 2015, 167-168. See Guthrie 2013, 1159-1160 and authors cited therein, in particular in fn 34; as well as Echandi 2011, 14-15 and Carvalho 2016, 15.

In addition to the discussion in section 3.5., it is warranted to make at least two remarks specifically on the ‘spill-over’ concerns. These would suggest that it is unlikely that potential rule of law benefits can be somehow isolated for foreign investors only, even if the host State would for any reason specifically aim for that scenario.<sup>261</sup>

Firstly, as also exemplified by *Genin*, the factual matrix of the FET cases usually involves a legally *domestic* entity (even if foreign-owned) that is subject to *domestic* legal framework which is the same as for other domestic entities.<sup>262</sup> While the host States might enact foreign investment protection laws, these laws are hardly in themselves autonomous ‘legal systems’ for the foreign investors – in substance they usually replicate IIA provisions, and are primarily relevant for the ISDS options they provide.<sup>263</sup> It seems that there yet needs to arise a case where a tribunal was to deal with, e.g., separate insolvency,<sup>264</sup> or banking<sup>265</sup> regulation for foreign investors – with the resulting hypothetical ruling being relevant *just* for this class of entities. While the decisions might be for the foreign investors’ ‘immediate benefit’<sup>266</sup>, there seems to be a recognition that ‘clinical’ isolation of ISDS decision from domestic rule of law issues is hardly possible,<sup>267</sup> and that the reform and modernization incentives coming out of these decisions relate to the domestic legal system in general.<sup>268</sup>

Secondly, there is also a more jurisdiction-oriented consideration. Simply put, at a given point in time, a domestic decision-maker might not actually know if it is dealing with an IIA-protected foreign investor or not. Particularly in the more liberal investment regimes, ownership of domestic entities can change hands relatively easily.<sup>269</sup> It might be unrealistic to expect that a government official is always aware of the domestic/foreign status of a specific entity, and furthermore if that foreign status also grants specific protection. The intricacies of forum-shopping and the nationality requirements in ISDS jurisprudence reinforce this point further.<sup>270</sup> It seems thus that

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<sup>261</sup> See similarly Schill 2015, 88-89.

<sup>262</sup> See in that sense Viñuales 2016, 4.

<sup>263</sup> See on this more in the Introduction to this thesis.

<sup>264</sup> As in *Dan Cake v. Hungary*, discussed in Chapter 4, section 4.7.2.

<sup>265</sup> As in *Genin v. Estonia*, discussed above.

<sup>266</sup> Ortino 2013a, 439.

<sup>267</sup> Schneiderman 2016, 151.

<sup>268</sup> Dolzer 2005, 971; Muchlinski/Ortino/Schreuer 2008, vi-vii.

<sup>269</sup> See on this Van Harten 2010d, 28-29.

<sup>270</sup> *ibid*; see also on these issues generally Schlemmer 2008; Schreuer 2009 and Thorn/Douclevff 2010.



the most prudent course would be to fully and diligently fulfil the national rule of law requirements in each case.

### 3.7. Conclusion

The goal of providing the rule of law to foreign investors opens multiple paths to investment arbitrators, paths left open by the open-textured wording of the FET provisions and by the features of ISDS that have been discussed in previous chapters. A normatively appealing and so far largely followed path has been to pursue developing and applying a uniform set of substantive international rule of law sub-principles. These should, ideally, create a common ‘playing field’ for foreign investors across the globe. This, however, almost inevitably leads to keeping the principles considerably open-textured and results in consequent extensive discretion of arbitrators. The concerns of vagueness and discretion have not so far seriously undermined the IROL paradigm in both practice or doctrine. They have rather led to multifarious reform proposals on how to keep the discretion and unpredictability within manageable limits, and/or how to effectuate further substantive development for the FET and other standards.

Building upon the discussion in previous chapters, this Chapter has offered a normative case for further benefits that arise from complementation of the IROL paradigm with an NROL one. Whilst recognizing that the extensive discretion of arbitrators will likely remain present in the future, the legal reasoning process in exercising this discretion should be complemented with national rule of law concerns. While retaining the international rule of law and substantive system-building considerations, efforts of arbitrators should in parallel be aimed at *strengthening the national rule of law in the host State*.

Four main reasons have been put forward for this complementation. First is the substantive richness of domestic law in comparison to open-textured and often still fledgling sphere of the FET standard. This developed nature can help a desirable *ex ante* discoverability of *rules* (as opposed to standards/principles) for both foreign investors and host State officials. Second reason is that giving due weight to a substantively rich constellation of national choices on how the rule of law should look like is further supported by the considerations of sovereignty, plurality and subsidiarity in

international law. It is a demonstration of respect for the right of the State to (within limits) opt for a particular vision of social and economic life on its territory. It is also a check on the too Western-centric understandings of what the rule of law should be.

The third reason is that the primary importance of the domestic legal framework for regulating the normal (i.e. dispute-free) life of an investment should be seen as reasonably expected by both foreign investors and host State officials. This makes this framework a normatively justified reference point for examining the behaviour of the parties and limits the appearance of applying *ex post facto* derived standards. The final reason goes to the underlying *telos* of IIL and the expectations of host States in this sense. If, as it is strongly arguable, the ultimate goal of IIL should be effectuating the economic development in the participating States, then the focus on strengthening the national rule of law is a recommended path. Enhancing the national rule of law, among other advantages, helps achieve the goal of economic development more profoundly by making its benefits available to both foreign and domestic actors.

This Chapter has thus sought to answer *why* the normative focus on the national rule of law is desirable. The chapters that follow will focus further on the more practical implications of translating these normative arguments into the FET standard decision-making. Chapter 4 will focus on the creation and elaboration of the *ideal-type model of the domestic rule of law* as a basis for the NROL paradigm inclusion. Chapter 5 focuses on further elements of relevance for the legal reasoning process, namely the *comparative benchmarks* and the *corrective good faith factors*. Overall, the goal is therefore to elaborate the path that the complementary strengthening of the national rule of law can take in practice.

## Chapter 4 – The ideal-type model of the domestic rule of law

### 4.1. Introduction

The previous chapter has laid out some of the key normative arguments for providing due emphasis on strengthening the national rule of law in decision-making under FET claims. This and the following chapter further explore the implications and the potential translation of this normative position into the practicalities of the legal reasoning process, building at the same time on the legal feasibility of such endeavour that was also discussed in Chapter 2.

There is certainly a multitude of paths through which the investment tribunals can focus on strengthening the national rule of law, no less so in jurisdictional matters than on the merits.<sup>1</sup> Even on substance, a comprehensive discussion would hardly be achievable within the scope of this thesis.<sup>2</sup> With these caveats in mind, and without attempting to provide an exhaustive account of application to individual cases, this and the following Chapter will argue for three elements that should be present in the legal reasoning process of the tribunals deciding the FET claims through complementary IROL and NROL paradigms. These elements should help reaching persuasive decisions aimed at both protecting the foreign investor under international law, strengthening the national rule of law, and preserving an amount of flexibility necessary to provide fair outcomes in individual cases. Likewise, they should, depending to an extent on the specific factual matrix, be present regardless of the standard or method of review used by the tribunal in assessing the claim.

The three elements proposed are a) the relating of the FET sub-principles to the *ideal-type model of host State's domestic rule of law*; b) the use of *comparative benchmarks* to enhance persuasiveness and potentially provide additional guidelines for reform; c) the use of *corrective good faith factors* to secure the fairness of outcome in situations so

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<sup>1</sup> A prominent example in that sense would be the issues of corruption arising at the stage of establishing the investment. See for an overview primarily Llamzon 2014, as well as *World Duty Free v. Kenya* and *Metal-Tech v. Uzbekistan*.

<sup>2</sup> Particular rule of law transgressions can also feature as relevant at the stage of compensation and costs determination. See *Metal-Tech v. Uzbekistan*, para. 422.

requiring. The first element is the main topic of the present chapter, while the latter two will be discussed in Chapter 5.

Relating the FET sub-principles to the ideal-type model recognises their open-textured substance and puts emphasis on the assessment whether host State decision-makers respected their *own pre-existing international and municipal law obligations*. Section 4.1. lays out the foundation for such an approach as an implication of the normative arguments set out in the previous chapter. Section 4.2. deals with the method of constructing the ideal-type model and its potential elements, while the sections that follow examine different potential concerns, namely the relationship with the refinement of IIA standards through new treaty-making (4.3.), relationship with the applicable law in ISDS (4.4.), and with the standards and methods of review (4.5.). Section 4.6. will examine certain challenges in ascertaining the content of the ideal-type model, while section 4.7. will offer a case study (*Dan Cake v. Hungary*) as a support to the plausibility of the creation and elaboration of ideal-type models. Section 4.8. will offer some concluding remarks.

## **4.2. The ideal-type model of the domestic rule of law – a foundation**

To reiterate, the jurisprudence-developed sub-principles of FET that see it as an embodiment of the international rule of law present the worthy starting point in assessing host State behaviour. In many ways, the IROL paradigm is necessary because its wholesale replacement with mere assessment under national law would likely be an unwise trade-off. While national law rules might be more predictable, it would still be normatively questionable to sacrifice the quality of the rule of law provided to foreign investors in order to realise the advantages of predictability. If the host State in question adopts (e.g.) the least demanding understanding of the rule of law – everything a State does is acceptable so long as it has a legal form<sup>3</sup> – the possibility of constraining that State through IIAs would be severely limited, if not completely excluded.<sup>4</sup> However, as the previous Chapter has touched upon, the national laws at least nominally exhibit rich

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<sup>3</sup> As sometimes termed the ‘Rule-by-Law’ – where everything that government does is consistent with the rule of law if given a legal form (Tamanaha 2004, 92).

<sup>4</sup> As Tamanaha observes, ‘understood in this way, the rule of law has no real meaning’ and excludes any sort of potential for external review and assessment (2004, 92; see similarly Reynolds 1989, 3 and Raz 1979, 212-213).

substance and mechanisms to protect the rule of law.<sup>5</sup> This is even more so if national legal frameworks are understood as encompassing the international obligations of the host State. Systematically relating to these frameworks and mechanism can limit the actual of apparent *ex post* imposition of rules, and allow the host State and investors firmer guidance for their mutual relations. Such a focus also limits the IROL paradigm challenge of generating consistent substantive rules in an unfavourable (decentralised) setting.

The host States usually already have extensive international commitments to secure the rule of law domestically.<sup>6</sup> IIAs, and FET in particular, essentially and substantially overlap with these protections.<sup>7</sup> For example, they ‘overlap substantially with the rights protected in human rights treaties’,<sup>8</sup> have cognates in other international commitments of the State,<sup>9</sup> as well as in constitutional obligations.<sup>10</sup> In practical terms, the chances are that a host State in dispute will be democratic,<sup>11</sup> and will likely have a sufficiently advanced legal system where true *lacunae* rarely occur.<sup>12</sup> There is arguably little that can be *a priori* put against juxtaposing, examining and utilizing the existing host State commitments in substantive decision-making.<sup>13</sup>

These commitments would remain of little relevance if the host State’s behaviour was examined exclusively through the self-sufficient prism of FET sub-principles.

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<sup>5</sup> See Chapter 3, section 3.3. Also, in some cases, the deficiencies of the legal framework predating the IIAs are rectified through subsequent pinpointed reform (Guthrie 2013, 1192-1193). For the example of Algeria, see Mohammedi 2010, 401-405.

<sup>6</sup> Apart from the previous chapters, see also Guthrie 2013, 1165; Kingsbury/Schill 2009a, 10; Krommendijk/Morijn 2009, 423 and 447.

<sup>7</sup> Brower/Schill 2009, 489.

<sup>8</sup> Brower/Blanchard 2014, 758.

<sup>9</sup> Kingsbury/Schill 2009a, 10 and 18.

<sup>10</sup> See in particular Boisson de Chazournes and McGarry 2014, who note that the recourse to national constitutions ‘may be particularly helpful in, for example, determining whether the fair and equitable treatment standard has been breached by the denial of constitutional due process’ (865). For potential importance of constitutional provisions, see also Schill 2015b, 5; Schill 2016b, 314; Pérez Loose 2010, 384; Mahmood 2013, 106 and Krommendijk/Morijn 2009, 423.

<sup>11</sup> Yackee 2012, 420 and materials cited therein (‘In most investment disputes, at least one directly interested state will be a full-fledged democracy, while the other state is likely to be at least partially democratic.’)

<sup>12</sup> Kjos 2013, 193-195.

<sup>13</sup> As Petersmann has noted, international adjudicative bodies facing competing private and public interests need to show respect for the ‘reality of constitutional pluralism’ that manifests itself in competing sources of commitments for the host State (2009b, 532). Kleinheisterkamp and Poulsen somewhat similarly advocate (in the TTIP context) a ‘fundamental principle’ that the ‘treaty will not include greater substantive investor rights than those enshrined in domestic laws’ so to prevent the arbitrators from re-striking the nationally determined balance between the private and public interests (Kleinheisterkamp/Poulsen 2014, 1-3). See also Kingsbury/Schill 2009a, 14-15.

There are sometimes suggestions that the establishment of a protected investment creates an ‘enclave’ of law just for the foreign investor.<sup>14</sup> This could either imply a freeze of the host State law or require that the application of existing/promulgation of new laws comply with the requirements set by this ‘enclave’ – requirements which would not necessarily need to relate to the general rule of law commitments mentioned above. An unqualified realisation of either of these understandings would normatively not be in line with the expectations of investors and host States about the applicability of national law more broadly, as discussed in the previous Chapter.<sup>15</sup> However, as also touched upon before, such an unqualified position is also not prevailing in the existing jurisprudence either.

There is a strong consensus that the investor is generally bound to accept the host State law as existing at the moment of investment,<sup>16</sup> meaning that the focus of examination (with some exceptions)<sup>17</sup> is on how that law is applied rather than on its substance.<sup>18</sup> Leaving aside the explicit stabilization clauses, there is also a consensus that the State generally retains the right to amend its legal framework through new regulation and thereby affect (usually among others) foreign investors.<sup>19</sup> Combined, these positions generally provide that the investor should accept the law as it stood when it entered the host State, and should also not expect that law to never change.<sup>20</sup>

The focus then shifts to the *manner* of application and/or change of the domestic legal framework. As illustratively summarized by the *Parkerings* tribunal:

A State has the right to enact, modify or cancel a law at its own discretion. Save for the existence of an agreement, in the form of a stabilisation clause or otherwise, there is nothing objectionable about the amendment brought to the regulatory framework existing at the time an investor made its investment. As a matter of fact, any businessman or investor knows that laws will evolve over time. What is

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<sup>14</sup> In this vein see Dolzer 2005, 953-955.

<sup>15</sup> See Chapter 3, section 3.5.

<sup>16</sup> See for example Dolzer/Schreuer 2012, 115-116; Behrens 2007, 159; *AES v. Hungary – Award*, para. 9.3.34; *White Industries v. India*, para. 10.3.15.

<sup>17</sup> Such as the situation where a specific legislative act would *per se* be below the international law minimum standard of treatment. See on this Montt 2012, 316-317.

<sup>18</sup> See in that sense *TECO v. Guatemala – Award*, paras. 617 and 621.

<sup>19</sup> See Kingsbury/Schill 2009a, 11 and Brower/Schill 2009, 484. Especially regarding the amendment situation, this accords with the position put forward in particular by Jeremy Waldron, that the changes of legislation affecting property rights are not *in themselves* against the rule of law (Waldron 2012). Likewise, it helps avoid the conflict with the basic democratic principle that choices of a previous government cannot fundamentally restrict the policy options of the subsequent one (Van Harten 2010d, 56; Kurtz 2014, 263).

<sup>20</sup> See also in that sense Draguiev 2014, 283; Kriebaum 2011, 404.

prohibited however is for a State to act *unfairly, unreasonably or inequitably* in the exercise of its legislative power.<sup>21</sup>

Therefore, the ‘normal’,<sup>22</sup> non-‘drastic’<sup>23</sup> changes in the overall regulatory framework remain possible.<sup>24</sup>

The critical question thus boils down to what will determine ‘normality’, ‘fairness’ and ‘reasonableness’? The IROL paradigm discussed in Chapters 1 and 2 seeks to provide, as much as possible, the substantively uniform answers across the board. These answers, perhaps inevitably, remain at a considerable level of generality – as illustrated by the FET sub-principles. The normative focus on complementary strengthening of the national rule of law would suggest the due recognition to pre-existing rule of law commitments in the host State as a way to tackle that generality. What is often at stake in ISDS are ‘[...] intricate questions that can go to the *heart of a state's public policymaking*. [...] the way host states *govern, legislate, and adjudicate* and [...] a *profound impact on local populations*.’<sup>25</sup> In many ways, as much as war is too important to be left to generals, these issues are far too important to be simply and unquestioningly left to the open-textured and still forming IROL precepts.

The answer to the critical question of ‘what determines normality?’ should at least in part thus combine the two key aspects set out above – the nominal acceptability of the host State (rule of) law framework beyond the IIA and its FET obligation and the general requirement for the investor to accept the application and potential change of domestic law. This should create at least a working presumption that the holistically examined host State law *could* itself provide an adequate determination of ‘normality’ and ‘fairness’ – determination justified in the context of the host State where the investor is operating.<sup>26</sup>

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<sup>21</sup> *Parkerings v. Lithuania*, para. 332. See very similarly *Electrabel v. Hungary – Liability*, para. 7.77.

<sup>22</sup> *EDF v. Romania*, para. 217.

<sup>23</sup> *Toto v. Lebanon*, para. 244.

<sup>24</sup> See also Brower/Schill 2009, 484 and 489.

<sup>25</sup> *ibid*, 497.

<sup>26</sup> As Hepburn notes, rule of law concerns about domestic law are more likely to materialize in *ex post* actions than regarding *ex ante* legislation (Hepburn 2017, 152). See also Stephan, noting that ‘to determine whether a host sovereign behaved in an arbitrary or discriminatory fashion, one must know how it normally behaves. If its conduct [...] corresponds to its well-established past practice [...] the case for finding a violation [...] diminishes’ (2014, 359).

Therefore, in interpreting and applying the concepts such as ‘fair’, ‘equitable’, ‘non-arbitrary’, ‘transparent’, a regular and thoroughly conducted exercise should be assessing the State behaviour under what can be termed the *ideal-type model of the domestic rule of law* – an overview of the constellation of obligations stemming from the international (non-IIA) and municipal law sources, that relate to these specific rule of law requirements in the FET standard and in combination provide the parameters which the host State decision-makers *should have* had in mind when acting, and which the investor *could have* expected the host State to obey. In examining if the host State acted arbitrarily concerning a specific legal matter, it would then be necessary to carefully examine and take into account the constellation of legal obligations (beyond the FET obligation) that the State had concerning that specific legal matter, and State’s compliance with these obligations. While this would not be determinative in itself – as the autonomous international character of the FET provision provides them with residual discretion for the final assessment– it *should* form a strong indicator of the (non-) existence of a breach.

Ideal-type does not at the same time imply the need for perfection of the host State behaviour.<sup>27</sup> As discussed in section 4.5. below, the required level to which the host State should have lived up to this model would effectively be determined by the standard of review. Regardless, the very act of creation of such a model by investment tribunals can alter the decision-making paradigm and *ex ante* orient the behaviour and expectations of host State officials and foreign investors.

#### 4.3. The ideal-type model – method and elements

The FET standard and its sub-principles remain the starting point of examination, as they provide ‘the [...] norm that forms the basis of the review carried out by a [...] tribunal.’<sup>28</sup> Instead of somehow ‘replacing’ the FET and its developed sub-principles, the ideal-type model would be an overview or a summary of existing international and municipal obligations of the host State relating to the specific legal situation that is

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<sup>27</sup> The term ideal-type is rather inspired by Max Webber’s *Idealtypus*, or an abstract construction from elements of the given phenomena, but not meaning to correspond to all the characteristics of any one particular case. The word ‘ideal’ refers to the world of ideas (German: *Gedankenbilder*, ‘mental images’) and not to perfection. On the ideal type see, for example, Cahnman 1965.

<sup>28</sup> Ortino 2013a, 459.



being assessed. Therefore, in interpreting and applying the relevant sub-principle, the investment tribunal should refer to this ideal-type model to justify its deliberations – while still retaining the power to take into account other facts and circumstances relating to the case at hand. The strong emphasis on the ideal-type model, however, would be a desirable normative recognition of the limited substantive content inherently provided the standards such as FET.<sup>29</sup> As Yannick Radi has noted specifically regarding the relationship with human rights obligations:

on the face of the drafting of most of the provisions [...] and the vagueness they mirror, it proves to be impossible to demonstrate that these norms provide for conducts that clash with the conducts required from host states by the norms of international human rights law they are bound by. Indeed, what is the normative substance of the reference to ‘fairness’ and ‘equity’ that would allow one to argue *a priori* that it is in conflict with international human rights norms [...]?<sup>30</sup>

The limited guidance offered by these standards makes problematic the suggestions that other host State obligations are to be balanced completely independently from them. For example, as noted in Chapter 2, the *Suez v. Argentina – Liability* tribunal suggested that investment and human rights protections are ‘not mutually exclusive’ and could be fulfilled *simultaneously*.<sup>31</sup> This presupposes a sufficiently defined core meaning of investment obligations that would allow attempting a balanced, simultaneous attainment of both. If the open-ended nature of IIA standards such as the FET standard is truly recognized, this would seem to be a very uncertain *ex ante* endeavour.

Thus, in those and other situations, instead of necessarily attempting to imbue a distinct ‘global’ meaning, the tribunals should also see the FET and its sub-principles as being gateways towards other existing sources.<sup>32</sup> This also recognises and gives

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<sup>29</sup> On the scarcity of substantive IIA content see also, for example, Kalderimis - ‘[p]ublic international law is inherently [...] not about the rights of individuals against States. The investment treaty framework [...] is [...] a new development which requires new thinking.’ (2012, 154) and Viñuales 2016, 4 and 17 ([‘there is] a debatable assumption according to which investment treaties are self-contained or self-sufficient [...]). See also similarly Schill 2011c, 73-74; Douglas 2003, 204 and Wälde 2007, 49-50 and 118; Alvarez 2016, 174; for an example in practice, see *Perenco v. Ecuador - Liability*, para. 522.

<sup>30</sup> Radi 2013, 4 (references omitted).

<sup>31</sup> *Suez v. Argentina – Liability*, para. 262.

<sup>32</sup> For a somewhat analogous example (in the EU context) of ‘filling’ of a broad supranational norm with national law content, see Von Bogdandy/Schill 2011, 1429. A contrasting position is expressed, for example, in *Alpha Projektholding v. Ukraine*, para 233: ‘[t]he Tribunal finds that the question of whether the [BIT] has been breached can only be answered by reference to the [BIT]’s own terms.’

normative weight to the usual position of the host State officials faced with making decisions which can affect the foreign investors. As Neil McCormick has noted:

[...] argument-makers and decision-makers do not approach problems of decision and justification in a vacuum, but rather in the context of a *plethora of materials that serves to guide and justify decisions*, and to *restrict the range* within which the decisions of public agencies can *legitimately* be made.<sup>33</sup>

A guiding notion should thus be to present a persuasive account<sup>34</sup> of these materials so to construct the ideal-type model as an important element in examining the host State behaviour. The relevant sources for this model can, depending on the individual legal and factual matrixes, encompass both primary and secondary sources of international and municipal law.<sup>35</sup> Such an effort also presents a recognition of the interdependence and complementarity of national and international law and is aimed at the enforcement of rights and obligations regardless of their national or international origin.<sup>36</sup> This interdependence, as is sometimes noted, has critical importance for the national rule of law more generally.<sup>37</sup>

#### *A hypothetical example*

In broad terms, and leaving some possible illustrations from practice for section 4.7, the decision-making process could thus unfold as follows. A hypothetical tax has been imposed on all large (non-SME) enterprises in the host State. The proceeds are to be used for ameliorating the labour conditions in the country in various ways such as training programmes, awareness campaigns and donations for improvement of work safety. The affected foreign investor could (as is often the case) attack this measure

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<sup>33</sup> MacCormick 1999, 172 (emphasis added).

<sup>34</sup> As is sometimes noted, the legitimacy of ISDS depends at least in part on ‘the technical quality and persuasiveness of the reasons tribunals give’ (Kingsbury/Schill 2009a, 41). See also Hepburn 2017, 125.

<sup>35</sup> Regarding domestic law more specifically, Michael Reisman argued that ‘[t]he law of the State [...] must be understood broadly to include its statutory as well as judicially illuminated law.[...] If the host State’s law provides a general analytical framework, it is up to the Tribunal to apply that framework to the statutes, judicial precedents, and general principles of that system [...]’ (2000, 371).

<sup>36</sup> Kjos 2013, 302. See along similar lines Nollkaemper 2011, 3 and 13; Alvarez 2016, 181; and Schreuer 2016, 731 (‘Under wide jurisdictional treaty clauses that refer to all disputes concerning investments [...] the claimant may pursue claims based on sources of international law beyond the treaty that provides for jurisdiction.’). See also in this general sense *Enron v. Argentina – Award*, para. 207.

<sup>37</sup> Bingham 2011, 110 and 119 and similarly Nollkaemper 2011, 302.

through claiming a simultaneous breach of various IIA provisions, most likely including the FET standard.<sup>38</sup>

For the purposes of this example, it can be assumed that the claimant investor, a large multinational company operating in the host State, is claiming that this particular measure was in breach of the FET standard by being 1) arbitrary; 2) discriminatory; 3) non-transparently enacted; 4) against legitimate expectations of the investor.

From the IROL perspective only, the tribunal could make its assessment of these claims without necessarily engaging intensively (or at all) with extraneous sources of rules. Assessment of arbitrariness can be based on the tribunal's understanding if the measure was so divested from any legal ground and/or the purported goal as to be, in the words of *ELSI* judgment, 'opposed to *the* rule of law'.<sup>39</sup> Likewise, the assessment of the discriminatory nature of the measure can also rest on a completely autonomous judgment if there existed a discriminatory intent and regardless of any violation of domestic law.<sup>40</sup> Assessment of how transparently the host State acted in relation to enacting the measure could, as mentioned in Chapter 2, focus on an autonomous *Tecmed*-style determination if host State acted 'free from ambiguity and totally transparently'.<sup>41</sup> Finally, as also discussed in Chapter 2, the ascertainment of the legitimate expectations of the investor can be based on any of the number of espoused understandings of this doctrine in FET jurisprudence – both including and excluding the relevance of relying on the domestic legal framework which was in force when the investment was made.<sup>42</sup>

While using the said rule of law sub-principles as starting points, what could a complementary inclusion of an NROL paradigm mean for the decision-making process? Broadly put, in making their assessment, the investment tribunal should systematically and thoroughly take into account the international and domestic

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<sup>38</sup> The claimants' arguments for the breach of different standards and the existence of expropriation are often essentially the same, suggesting a strong overlap (Dolzer/Schreuer 2012, 101 and 132-134).

<sup>39</sup> *ELSI*, para. 128; this definition of arbitrariness has been supported and applied, *inter alia*, by *Azurix v. Argentina* (para. 392-393); *Duke v. Ecuador* (para. 378); and *El Paso v. Argentina – Award* (para. 319).

<sup>40</sup> Dolzer/Schreuer 2012, 196-197.

<sup>41</sup> *Tecmed v. Mexico*, para. 154.

<sup>42</sup> See Chapter 2, section 2.2.2.

obligations of the host State relating to labour rights, taxation and administrative law.<sup>43</sup> IROL paradigm can provide the initial starting point that a decision manifestly without legal ground will be considered arbitrary – but the *scope* of the examined legal grounds can be determined in line with the NROL paradigm and its focus on the more holistic assessment of the domestic rule of law framework.

Staying with the issue of arbitrary behaviour and legal grounds, this would mean that the tribunal should take into account (either through interpretation or fact assessment) the full scope of sources which impacted on this specific situation. Recognising the specificities of each individual framework,<sup>44</sup> and keeping for the purposes of brevity the focus on labour protection instruments, a holistic framework could include the relevant provisions of the ICESCR,<sup>45</sup> the International Labour Organisation (ILO) conventions,<sup>46</sup> or in some cases the ECHR.<sup>47</sup> Equally importantly, such an approach allows recourse to a plethora of secondary materials clarifying the obligations arising under these instruments. This arguably considerably surpasses the guidance that can be obtained from the IIL-related sources. In this specific scenario, Commentaries on ICESCR,<sup>48</sup> ILO Recommendations,<sup>49</sup> and the ECHR Guides (including summaries of relevant ECtHR jurisprudence)<sup>50</sup> can all serve to further clarify

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<sup>43</sup> To note, some tribunals have mentioned the implementation of international obligations as relevant in assessing host State behaviour, but these arguments were generally of ancillary and supportive nature, instead of being a main focus of investigation. See for example *SD Myers v. Canada – First Partial Award*, para. 255 (Basel Convention); *Parkerings v. Lithuania*, para. 385 (Convention Concerning the Protection of the World Cultural and Natural Heritage); *UPS v. Canada*, para. 118 (Universal Postal Convention and International Convention on the Simplification and Harmonization of Customs Procedures); see also Henckels 2015, 134-135.

<sup>44</sup> As Ian Hurd has observed '[...] one cannot ask what international law is on a given topic and expect an answer that is generalizable across states. Instead, one must ask what the law is for a given state [...]' (2015, 380). See also Glashauser 2005, 30 and 34.

<sup>45</sup> In particular Article 2 (1) which requires 'achieving progressively the full realization of the rights' 'to the maximum of its available resources'; Article 6 recognising the right to work and requiring steps such as training programmes; and especially Article 7 recognising the right to just and favourable employment conditions including safe and healthy working conditions.

<sup>46</sup> For example, the 1981 Occupational Safety and Health Convention or one of the branch-specific conventions such as the 1995 Safety and Health in Mines Convention.

<sup>47</sup> For example, Article 4 prohibition of slavery and forced labour can be relevant in the context of programmes aimed at tackling exploitation of forced labour or at raising awareness about these issues.

<sup>48</sup> For example, a recent General Comment No. 24 on State Obligations under the International Covenant on Economic, Social and Cultural Rights in the Context of Business Activities, suggesting, *inter alia*, the need for progressive taxation schemes to fulfil ICESCR obligations and business cooperation and support (para. 23) (available at: <http://www.ohchr.org/en/hrbodies/cescr/pages/cescrindex.aspx>).

<sup>49</sup> For example the recommendations supplementing the conventions mentioned above, such as the 1981 Occupational Safety and Health Recommendation.

<sup>50</sup> See, for example, the Guide on Article 4 of the European Convention on Human Rights (2<sup>nd</sup> edition, 2014), available at: [http://www.echr.coe.int/Documents/Guide\\_Art\\_4\\_ENG.pdf](http://www.echr.coe.int/Documents/Guide_Art_4_ENG.pdf), accessed 18 May 2017.

the range of legitimate decisions that *could* have been taken. The ideal-type model would be completed by similar recourse to municipal sources, such as constitutional rights, statutory obligations and the relevant domestic jurisprudence.<sup>51</sup>

The ascertained ideal-type model relating to arbitrariness could also help with assessing the existence of discrimination. Again, the IROL paradigm can provide for starting premises – but the primary provisions of and secondary materials on the sources mentioned above can play a very important, if not critical role, in illuminating to what extent a particular measure would be considered discriminatory under them or outside the IIL context more generally. Similarly, the determination on the breach of investor's legitimate expectations (as will also be touched upon in Chapter 5) can largely benefit from identifying if, for example, the domestic administrative law framework itself has a same or similar doctrine and if the facts of the case would lead to its application in the domestic context. Arguably, this could lead to an enhanced expectation from the host State decision-makers to make sure that in enacting the said measure they were not breaching *their own* administrative law – with a potential consequence of international liability under the FET.

Related to this last point, and to reiterate, the ultimate decision on the breach of the FET standard remains separate from the outcome of the ideal-type model assessment. Ultimately, the fact that the host State did everything in accordance with its domestic law might simply not be enough, because the domestic legal framework itself does not provide (in the eyes of the tribunal) the requisite level of rule of law guarantee – although such a conclusion would have to presumably be well-elaborated upon. Likewise, the identified breaches of international and domestic obligations might simply not be of sufficient gravity to establish an FET breach. A lot will, of course, depend on the standard and method of review employed by the tribunal (as further discussed in section 4.6.) and potentially will be enhanced by the recourse to comparative

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<sup>51</sup> In this context, the suggestion in *Continental Casualty v. Argentina - Award*, para. 281 seems pertinent:

[...] breaches of a treaty standard and breach of similar protection in domestic law are not necessarily interconnected. [...] On the other hand, if some of the Measures at issue here had been found finally unconstitutional by the highest judicial authority of Argentina [...] it would appear awkward that the same measure would not be in breach of the BIT standards.

benchmarks and corrective good faith factors discussed in the next chapter. Ultimately, the IROL paradigm remains supreme.

But the decision-making process that incorporates the NROL paradigm in the way suggested above is no less valuable because of that. The creation of the ideal-type model should be an effort to incentivise a ‘positivistic essence’ of the rule of law - whether State institutions abided by the positive (and sufficiently broadly understood) law in force.<sup>52</sup> It should be an attempt to realize the requirement that ‘public power derive its authority from a legal basis and be exercised along the lines of pre-established procedural and substantive rules’.<sup>53</sup> Not only could the tribunals benefit from anchoring their deliberations in often rich available materials dealing with specific sub-fields, but they would be sending a clear and important message to domestic decision-makers when it comes to rule of law.

That message would be that the existing obligations *truly and effectively matter* for domestic decision-making through the FET prism. There might be no absolute certainty that there will be no finding of liability even if sincere best efforts are made to be compliant with these obligations. However, the knowledge that examining this compliance will be a regular feature of decision-making would make such compliance perhaps the best available *ex ante* path to avoiding liability. The corresponding enhancement of the national rule of law, as the previous Chapter also focused upon, would then in itself lead to important further benefits.

It is, of course, possible that the actual host State decision-maker might not be aware of all the obligations under the ideal-type model. Likewise, it might not be in a position to take them into account when applying a directly relevant instrument (e.g. a statute) that might not be in accordance with hierarchically superior elements of the model. This, however, is not a flaw but rather the opportunity to use the considerable power of investment tribunals which are unconstrained by the domestic institutional considerations. The insistence on the holistic approach to the legal framework has the potential to strongly incentivise the host States to take care *ex ante* of the whole gamut

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<sup>52</sup> See for ‘positivistic essence’ of the rule of law Nollkaemper 2009, 77.

<sup>53</sup> Kingsbury/Schill 2009a, 14. Interestingly, for a (very) early suggestion in this sense in an ISDS award see *AGIP v. Congo*, para. 78: ‘If it wished to protect its interests as a shareholder, the Government should have respected the legal procedures available to it [...]’.

of their legal obligations, and to justify their measures in accordance with them. The inability or lack of awareness of the decision-maker to act in accordance with the ideal-type model can ultimately lead to liability. But this can pay off with dividends in the avoidance of future claims, and in particular by the rule of law spill-over effects for all entities under the host State jurisdiction.

#### 4.4. Refinement of the FET standard in IIAs

As noted above, the FET standard certainly remains the starting point for assessing host State actions. The IIAs are the basis of the tribunals' jurisdiction and the claims in ISDS necessarily have to be framed as claiming a breach of a particular provision. This also implies that increasing the specificity of the FET provisions can improve the clarity of the rule of law requirements and make the IROL paradigm exclusivity more feasible. It would certainly not be formally or normatively justified to go *against the sufficiently explicit wording* of these provisions by having recourse to the other elements of the host State legal framework. In that sense the efforts to re-calibrate the content of IIAs and in particular of the FET provisions continue to be an important avenue of reform.

However, the extent of such refinement is, as it stands, still relatively modest. Generally, the innovations in 'new generation' IIAs do not negate the possibility or a need for NROL paradigm complementation more generally, and the ideal-type model more specifically. The new wording in some of these treaties arguably encourages it.

The recent IIA practice seems rather disappointing if increasing levels of clarity and predictability is used as a benchmark.<sup>54</sup> The efforts to clarify the content of the FET standard are often in effect codifications of the still broad sub-principles arising out of ISDS jurisprudence, and the provisions aimed at protecting the regulatory sphere of the host State can arguably both allow and invite the use of the ideal-type model. For example, a recent 2017 Argentina-Qatar BIT (AQBIT),<sup>55</sup> provides relatively briefly that

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<sup>54</sup> See generally Alschner 2016 and Ortino 2013b, 158-160, and some examples in fn 48. See also Paparinskis 2015a, 668-670; Miles 2013, 305-307 and Kläger 2011, 87-88. Some of the new model IIAs are still just drafts (Stern 2011, 190-191; Usynin 2015) or have not attracted any signatories (Ray 2016; Patnaik 2016).

<sup>55</sup> Available at: <http://investmentpolicyhub.unctad.org/Download/TreatyFile/5383> (accessed 18 May 2017).

‘[i]nvestments [...] shall at all times be accorded fair and equitable treatment and shall enjoy full protection and security in the territory of the other Contracting Party’<sup>56</sup> as well as that FET ‘is to be interpreted and applied as the treatment provided to aliens in accordance with the principles of customary international law’.<sup>57</sup> Importantly, Article 10 affirms that none of the provisions affects ‘measures necessary to achieve legitimate policy objectives, such as the protection of public health, safety, the environment, public morals, social and consumer protection.’

Such FET provisions hardly make the content of the standard any more definite than in what are usually considered the ‘old generation’ BITs. The provisions in Article 10 on protecting the State’s regulatory sphere, on the other hand, open the possibilities for an ideal-type model approach. In particular, this invites arguments to what extent a particular measure has grounding in the existing holistically understood legal framework of the host State. At the same time, the still open-ended language of ‘legitimate policy objectives’ would arguably also leave room for the IROL paradigm attempts to create a more uniform IIL understanding of ‘legitimate’. For reasons discussed in the previous chapters this should be complemented by the ideal-type model framework for assessing the legitimacy of these measures. The fact that the same measure might potentially be regarded differently if occurring in Argentina than in Qatar is the expression of the realities of the (still?) pluralistic global arena, realities that should not be ignored in the decision-making process.

#### **4.5. Applicable law and the NROL paradigm – a short reiteration**

It is useful at this point to reiterate that the non-IIA international obligations of the host State and its domestic legal framework can be taken into account whilst fully accepting the autonomous international law nature of the FET standard as the cause of action. As has been elaborated in Chapter 2 there are two main ways through which the relevant sources can be given due weight while staying within the limits of provisions on applicable law.<sup>58</sup> The international commitments of the host State can be given due role through further interpretation of the FET standard and its sub-principles in line

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<sup>56</sup> AQBIT, Article 3(3).

<sup>57</sup> AQBIT, Article 3(4). See similarly Article 4 of the 2017 Japan-Israel BIT (available at: <http://investmentpolicyhub.unctad.org/Download/TreatyFile/5575>, accessed 18 May 2017).

<sup>58</sup> See generally Chapter 2, section 2.3.



with VCLT Article 31(3)(c).<sup>59</sup> Additionally, opting for another path, international commitments can also be taken into account as a part of ‘factual background’ of the case, as was done for example in *Micula v. Romania*.<sup>60</sup>

This second path is also the primary one for taking domestic legal framework into account, excluding perhaps the relatively rare situations where domestic law is explicitly chosen as applicable even for a clearly international cause of action.<sup>61</sup> As has been noted in Chapter 2,<sup>62</sup> the explicit exclusive applicability of international law does not limit the importance of municipal law for the proper resolution of a dispute. The qualitatively different character of municipal law in comparison to other facts is both supported in doctrine<sup>63</sup> and exemplified in practice.<sup>64</sup> As is argued, the traditional moulds of national/international cease to play a crucial role in investor-state disputes,<sup>65</sup> and the ‘mélange’<sup>66</sup> of existing national/international commitments of the host State becomes fully relevant. The choice of applicable law can thus be of less impact than it initially appears.<sup>67</sup>

The different sources of international law, national legislation, sub-legislative instruments, constitutions, jurisprudence and commentaries have, in various forms and with varying degrees of relevance, already found their place in the reasoning process of investment tribunals.<sup>68</sup> Rather than the formal constraints of the provisions on

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<sup>59</sup> Chapter 2, section 2.3.2. See also generally Van Aaken 2009b.

<sup>60</sup> Chapter 2, 2.4.2. and specifically *Micula v. Romania – Award*, paras. 326-328 and commentary in Ascensio 2016, 382.

<sup>61</sup> See Chapter 2, section 2.4.1.

<sup>62</sup> Chapter 2, section 2.4.2.

<sup>63</sup> To reiterate, ‘treating domestic law as fact seems particularly inapt in relation to contemporary investment treaty arbitration.’ (Hepburn 2017, 105). Regardless of explicit recognition as applicable law, ‘tribunals usually inescapably have to apply domestic law anyway’ (ibid, 106 and materials cited therein).

<sup>64</sup> See for example Chapter 2, section 2.4.2. and in particular *Al Warraq v. Indonesia*, paras. 584-588.

<sup>65</sup> See also Kulick 2012, 49; Sureda 2012, 36 and Hepburn 2017, 105 (commenting on a similar approach by ICJ in *ELSI*). As Kjos has noted, in light of the concurrent relevance of the national and international law for investor-State relationship, any vetoing of the possibility to have recourse to both would be ‘under-inclusive’ (2013, 296).

<sup>66</sup> See for the ‘mélange’ or ‘integrated legal process’ of national and international law Kulick 2012, 48 and Alvik 2010, 91.

<sup>67</sup> See Guzman/Dalhuisen 2013, 14-15, as well as *Fraport v. Philippines – Fraport II*, para. 298, with the tribunal deciding to apply domestic law regardless of the lack of BIT reference to it.

<sup>68</sup> Examples are too numerous to list comprehensively, but in addition to the discussion in Chapters 2 and 3 see illustratively *CMS v. Argentina – Award*, *Sempra v. Argentina – Award* and *Continental Casualty v. Argentina – Award* (on discussing constitution, domestic civil and administrative law); *Grand River v. United States* and *Glamis Gold v. United States* (on interplay with constitutionally recognized rights); *Nykomb v. Latvia* and *Funnekotter v. Zimbabwe* (on, among others, relationship with national jurisprudence); *Saluka v. Czech Republic* (on customary international law).

applicable law, the crucial aspect would rather be the readiness to bring all these sources together so to strengthen the national rule of law.

#### 4.6. Relationship with standards and methods of review

##### *The importance of standards and methods of review*

As has been noted in previous chapters, as well as in section 4.3. above, regardless of the desirable inclusion of the ideal-type model, the ultimate determination on the existence of a breach of the FET standard will ultimately also depend on the standard and method of review chosen by the tribunal. In addition to providing a basis for review of State actions, the FET standard should also indicate the intensity of that review. This is the level of scrutiny that the reviewing body will employ, and can involve the concepts such as ‘full review, de novo review, anxious scrutiny, intermediate scrutiny, light touch review, minimum review, and total deference’.<sup>69</sup> The intensity of review determines, in this context, the deference or leeway that tribunals are ready to grant to the host State decision-makers in fulfilling their obligations stemming from the FET standard.

‘Deference’ is a term that is understood differently, but in the IIL context is perhaps best described as ‘margin of appreciation, a space for maneuver, within which host state conduct is exempt from fully fledged review by an international court or tribunal’.<sup>70</sup> As is also argued in doctrine, the *standard* of review should also be kept distinct from the *method* of review. As Henckels notes ‘[m]ethods of review are techniques used to determine the permissibility of interference with the primary norm, whereas standards of review refer to the intensity with which the method of review is applied.’<sup>71</sup>

The standards and methods of review employed by tribunals are one of the critical questions in investment arbitration.<sup>72</sup> In the context of legitimacy concerns, and

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<sup>69</sup> Ortino 2013a, 459.

<sup>70</sup> Schill 2012d, 582. See similarly and more generally Shany 2005.

<sup>71</sup> Henckels 2013, 199 fn 8.

<sup>72</sup> See for example, as part of the voluminous literature, Henckels 2015; Kjos 2016; Shirlow 2014; Schill 2012d; Stone Sweet 2010b; Kingsbury/Schill 2010; Krommendijk/Morijn 2009.

serious potential consequences to the host States, the level of deference is an issue of considerable importance.<sup>73</sup> Put in the context of the ideal-type model, the importance of assessing how the host-State decision maker navigated the holistic legal framework, and the level of deference shown to a decision with which the tribunal would disagree,<sup>74</sup> cannot be overestimated.

This is especially so as the obligations of the host State arising out of international and domestic instruments are often not clear-cut. While ‘a national system of law will, in principle, be a known and existing system, capable of reasonably accurate interpretation by experienced practitioners’<sup>75</sup> the challenges in this respect are still considerable. As also briefly mentioned in Chapter 2,<sup>76</sup> the sources of international law – including custom,<sup>77</sup> general principles<sup>78</sup> and treaty law<sup>79</sup> – often exhibit a considerable level of indeterminacy.<sup>80</sup> The same situation often occurs in municipal law. Both constitutional<sup>81</sup> and hierarchically lower sources<sup>82</sup> often leave considerable vagueness and discretion regarding the fulfilment of their provisions.<sup>83</sup> This indeterminacy in both international and domestic aspects can and should be tackled through secondary sources (including jurisprudence of courts and tribunals,<sup>84</sup> institutional<sup>85</sup> and academic<sup>86</sup> commentaries, and

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<sup>73</sup> Henckels 2013, 200.

<sup>74</sup> As Stephan Schill notes, deference would here mean that ‘the adjudicator respects the reasons for a state’s decision or conduct even if its own assessment was different’ (2012d, 582). See for a similar understanding *SD Myers v. Canada – First Partial Award*, para. 261.

<sup>75</sup> Redfern/Hunter/Blackaby/Partasides 2015, para 3.111. See similarly Hepburn 2017, 135.

<sup>76</sup> See Chapter 2, section 2.3.2.

<sup>77</sup> D’Aspremont 2012, 16.

<sup>78</sup> Fauchald 2008, 312; Gazzini 2009, 104.

<sup>79</sup> Allot 1999, 43. See generally contributions to Liivoja/Petman 2014 (in particular Pauwelyn/Wessel/Wouters 2014 and Creutz 2014). See also in that sense Calamita 2013, 182 and materials cited therein. See in particular Dupuy 2009, 54-55 in the context of human rights and investor protection.

<sup>80</sup> See also Kalderimis 2012, 149-153.

<sup>81</sup> Sunstein 2007, 1-2. See also Goldsworthy 2012, 691 and in the IIL context Boisson de Chazournes/McGarry 2014, 876-877 who note that, on the topic of emergency powers, ‘domestic constitutions vary widely [...] and may not provide substantive clarity to the tribunal concerning a government’s conformity or non-conformity with its own laws defining states of emergency’.

<sup>82</sup> Hepburn 2017, 133-134.

<sup>83</sup> It may be beneficial or simply necessary to leave a considerable sphere of discretion to decision-makers in complying with/achieving the goals of relevant instruments (Jowell 2015, 5; Bradley/Ewing 2006, 726 and similarly Richardson 1999, 318). This purposive-oriented discretion seems to be ‘inevitably’ gaining in prominence (Craig 1997, 476 and Shklar 1987, 9-10). See also seminal work of Diver 1984, as well as Braithwaite 2002 and Pérez Loose 2010.

<sup>84</sup> For the importance of case law in the international law context see generally Guillaume 2011. For the ISDS context see Montt 2012, 371-372; Vadi 2016, 76 as well as some examples in Fauchald 2008, 341-342. As for municipal law relevance see Hepburn 2017, 109-110; Dupuy 2009, 60-61; Boisson de Chazournes/McGarry 2014, 869 and Montt 2012, 336, and materials cited therein.

<sup>85</sup> See Dupuy 2009, 55; Simma 2011, 587-591.

<sup>86</sup> See Cole 2013, 42-43 and Fauchald 2008, 311, 315, 351-353.

potentially soft law<sup>87</sup>) as has already been suggested above.<sup>88</sup> Even with these efforts, the arbitrators will often be faced with situations where the decision-makers themselves had considerable room for discretion. In many areas of relevance to foreign investment, the considerable discretion of decision-makers is an almost necessary feature of the modern State.<sup>89</sup> This requires special efforts to persuasively justify why or why not a certain measure represented a (sufficiently severe)<sup>90</sup> departure from the ideal-type model, so as to also potentially warrant a finding of an FET breach.

*The distinct nature of the ideal-type model and the standards and methods of review*

While acknowledging their importance, the choice of the specific standard and method of review is *not* the topic of this or the following chapter. It is well-recognized that IIA provisions, including the FET standard, themselves offer limited guidance as to the level of scrutiny to be employed.<sup>91</sup> This allows for various viewpoints,<sup>92</sup> and essentially leaves the ultimate decision on the appropriate level of deference to the international tribunal.<sup>93</sup> The factors influencing this level of scrutiny can *inter alia* involve the ‘perennial’<sup>94</sup> question if the FET standard uses as a nature of review basis is connected to the international minimum standard,<sup>95</sup> as well as if the text of the IIA might provide other insights.<sup>96</sup>

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<sup>87</sup> On soft law instruments and their potential importance for IIL see Jacob/Schill 2014, Schill 2017b, 16-18 and (extensively) Miles 2013, 212-287.

<sup>88</sup> See also similarly Hepburn 2017, 118-119 and 183-184 and Radi 2013, 4 fn 8. On the efforts of tribunals in this context see Sureta 2012, 123.

<sup>89</sup> See for example Orrego Vicuña 2003, 192 and McLachlan/Shore/Weiniger 2007, para. 7.171. This is broadly in accordance with the position, expressed for example by Rubin (1989, 399-402), that legislative vagueness and accompanying administrative discretion are not *per se* contrary to the (formal) rule of law. See similarly McCorquodale 2016, 281-282.

<sup>90</sup> See for example *Urbaser v. Argentina*, para. 629 (‘The threshold for a treatment not being fair and equal also results from its intensity or gravity [...]).

<sup>91</sup> Urueña 2016, 104; Ortino 2013a, 462-463; Schill 2012a, 9; Henckels 2013, 197-198 and 200.

<sup>92</sup> See for a brief overview Urueña 2016, 118 and also 113-114; see also Alvarez 2016, 203.

Alvarez/Khamsi 2009, 446 suggest that the ISDS tribunals *must* second-guess the domestic courts in order to preserve the investment ‘bargain’.

<sup>93</sup> Ortino 2013a, 463-463. See also for the WTO context Bockhanes/Lockhart 2009, 386 and more generally Shany 2005, 910-911 and 919.

<sup>94</sup> Schill 2017b, 5. See also for an overview of approaches Henckels 2013, 201-203.

<sup>95</sup> See for discussion of relevant issues primarily Paparinskis 2013a, as well as classic writings of Root 1910, 21; See also Calamita 2015, 109; Paulsson/Petrochilos 2007; Tudor 2008, 158; Schill 2010b, 153; Vandervelde 2010, 46-47; Aust/Nolte 2014, 60-61.

<sup>96</sup> See for example *S.D. Myers v. Canada – First Partial Award*, para. 263. For a somewhat opaque suggestion towards the importance of deference see *Sempra v. Argentina - Award*, para. 301 and commentary in Schneiderman 2011, 13.

The ideal-type model is a decision-making element which is independent from the eventual standard and method of review adopted by the tribunal. As Stephan Schill notes, '[d]eference [...] concerns the institutional relationship between the decision-making body and the reviewing body and has to be distinguished from the *normative flexibility, or content, given to the substantive obligations at stake*.'<sup>97</sup> While there is an inevitable intertwinement between the obligations and the standard of review – with both stemming from the same provision<sup>98</sup> – the level of scrutiny or the intensity of review is analytically a question 'apart from the question of how substantive investment law should be interpreted and concretized'.<sup>99</sup> As Jansen Calamita noted specifically in the context of proportionality: '[p]roportionality by its terms therefore requires a balancing. But [...] this balancing requires *ab initio* an identification and qualification of *that which is to be balanced*, that is, the rights and interests at stake.'<sup>100</sup> Similarly, 'absent an infusion of normative content from external sources, proportionality simply functions as a *scale without weights*'.<sup>101</sup>

In a way, the ideal-type model as a manifestation of the NROL paradigm is thus there to help provide the 'weights' to the tribunal, regardless of the eventual choice of the scale. Whether there are specific standards or methods of review which are more conducive to strengthening the national rule of law,<sup>102</sup> or if there exists a case for deriving them from the ideal-type model,<sup>103</sup> are questions that can be answered that invite further research. In that sense, this thesis will be limited to arguing (in Chapter 5) for further elements that should be present in every exercise of scrutiny by the tribunals so to give further relevance to the NROL paradigm, as arguably complementary to the standards and methods already present.

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<sup>97</sup> Schill 2012d, 582 (references omitted, emphasis added). See similarly Henckels 2013, 199.

<sup>98</sup> See generally Ortino 2013a, 457-464.

<sup>99</sup> Schill 2012d, 579.

<sup>100</sup> Calamita 2013, 175 (emphasis added).

<sup>101</sup> Calamita 2013, 180 (emphasis added); see also similarly Spiermann 2007, 802.

<sup>102</sup> For example, as mentioned above, complete deference to decisions of host State decision-makers might render the rule of law mission meaningless. Still, completely non-deferential standards would, as Schill notes, certainly be problematic due to the intense second-guessing of decision-making choices (2016b, 332). See also generally Kjos 2016 and Henckels 2013, 200 and 209.

<sup>103</sup> See in this sense Montt 2012, 336.

#### 4.7. Reaching the elements of the ideal-type model

The readiness of an investment tribunal to construct an ideal-type model might be potentially hampered by two additional sets of considerations. The first is the extent to which the tribunal is dependent on the parties' submissions in incorporating the relevant sources in its analysis. The second, and somewhat related, is the practical possibility of sufficiently ascertaining the content of the potentially relevant sources. While important to bear in mind, neither of these considerations necessarily hamper the construction of ideal-type models as important elements of the tribunal's scrutiny.

##### *The (lack of) dependence on the parties' submissions*

Can the tribunal holistically examine the legal framework if this is not advocated by at least one of the parties? If the parties do not engage, e.g., in the discussion of the intricacies of domestic law, is the tribunal in a position to do so?<sup>104</sup> The general answer would be a (qualified) yes. As De Brabandere explains in his examination of the procedural aspects of ISDS:

[...] international investment tribunals operating under the ICSID Convention are not bound by the sole legal arguments presented by the parties, in the sense that they are not under an obligation to base their award on the arguments presented by the parties. This principle, however, does not permit a deviation from the applicable law as defined by the parties to the dispute.<sup>105</sup>

In international arbitration more generally, including arbitrations under national laws and arbitral rules of direct relevance for ISDS, there is also a wide consensus that arbitrators are in principle allowed to pursue the examination of arguments not suggested by the parties.<sup>106</sup> This is sometimes seen in line with the *iura novit curia* presumption in international arbitration,<sup>107</sup> as also recognised in international dispute settlement more generally.<sup>108</sup> This would indicate that the party submissions are not a crucial obstacle for a more proactive course by a tribunal.<sup>109</sup> As Hepburn notes in this

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<sup>104</sup> For a cautious treatment of this issue regarding the legitimacy of decision-making by international courts, see Von Bogdandy/Venzke 2012, 25-26.

<sup>105</sup> De Brabandere 2014, 106. See also *ibid*, 110 and similarly *Enron v. Argentina – Annulment*, paras. 72 and 110.

<sup>106</sup> Capper 2014, 39-54.

<sup>107</sup> Redfern/Hunter/Blackaby/Partasides 2015, para 5.73; also generally Jemielniak/Pfisterer 2015 and Alberti/Bigge 2015. For investment arbitrations, see Hepburn 2017, 120-125.

<sup>108</sup> Brown 2007, 54 and 89.

<sup>109</sup> See also in that sense Landolt 2012, 192.

context, '[i]t is largely agreed that an investment tribunal has at least a *power* to take [...] proactive steps.'<sup>110</sup>

This proactivity certainly has its limits.<sup>111</sup> It should not result in confronting the parties with a legal assessment they were completely unable to foresee – which calls for disclosing the reasoning to the parties and allowing their comments.<sup>112</sup> As Brigitte Stern summed up in assessing whether arbitrators were restricted to a 'tunnel' constructed by the lawyers:<sup>113</sup>

Of course, the research and legal expertise that lawyers bring to the table are invaluable to arbitrators. However, I have seen numerous cases in which arbitrators devised ideas that none of the parties presented, and then, of course, the tribunal asked the parties to further comment on these ideas to protect procedural due process.<sup>114</sup>

Initial pleadings of the parties aimed towards elaborating an ideal-type model would certainly considerably facilitate the tribunal's efforts.<sup>115</sup> Parties' counsels are certainly capable of producing very elaborate submissions on relevant issues.<sup>116</sup> Channelling these efforts towards a narrative of the national rule of law could go a long way in addressing the potential practical complexities.

#### *Ascertaining the content of the ideal-type model elements*

Can the arbitrators be expected to know the holistic legal framework sufficiently so as to produce persuasive accounts, or would a sometimes-required deep interaction be too Herculean a task? Andreas Kulick, for example, argues that it might:

[...] require the arbitrators to be experts in the domestic law of the host State, for without thorough knowledge of the domestic legal system and all its specific instruments - general principles, case law methodology and interpretative tools -

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<sup>110</sup> Hepburn 2017, 120 (emphasis in the original).

<sup>111</sup> One suggestion is that *iura novit curia* principle should be limited to individual legal research within *international* law sources, and that independent fact-finding powers should be limited to more exceptional cases (Schill 2010d, 422-424).

<sup>112</sup> *ibid*, 423. See for similar arguments also Cordero-Moss 2008, 1241-1242; Jemielniak/Pfisterer 2015, 79-80; Alberti/Bigge 2015, 20.

<sup>113</sup> As argued, for example, in Wälde 2007, 52-53.

<sup>114</sup> Stern 2011, 186. See on this also Friedman 2010 and Halle/Peterson 2005, 22-23.

<sup>115</sup> As Kingsbury and Schill note, tribunals are inevitably constrained at least to a degree by the quality of legal submissions, as well as costs (2009a, 48). See similarly Laird 2009, 153 and Landolt 2012, 185.

Kaufmann-Kohler (2005b, 637) suggests that the (encouraged) parties' submissions are the best way to obtain information on the domestic legal framework.

<sup>116</sup> Wälde 2007, 47; Kotuby/Sobota 2013, 455-457.

they would never be able to discern whether there is a lacuna or whether the law provides for a solution.<sup>117</sup>

A warning about the complexity of the task is justified, as systematic engagement with, for example, municipal law can indeed be demanding.<sup>118</sup> One aspect of the problem is coming to grips with the potential indeterminacy and conflicting demands put by the legal framework, as addressed in the previous section. But a more mundane (yet no less important) aspect is the possibility of obtaining information about a particular legal system.<sup>119</sup> The potentially crucial role of the parties' submissions has been mentioned,<sup>120</sup> but even in the case of tribunal's own efforts there are certainly various routes in gathering the relevant information.<sup>121</sup>

There are certainly significant discrepancies in the availability of information on over 180 potentially relevant legal systems. Language and accessibility barriers can hamper tribunals' independent examination. While this is sometimes a genuine obstacle,<sup>122</sup> it should not, however, be overestimated. Discriminating among the host State legal systems should not be acceptable in principle.<sup>123</sup> Avoiding interaction or simplifying analysis of the domestic legal system should not be generally justified by practical concerns.<sup>124</sup> Nor is the ISDS jurisprudence lacking examples of tribunals obtaining sufficient information about the legal systems which are certainly not usually in the spotlight.<sup>125</sup> Whether the relevant information is deemed to be a fact or law, the investment tribunals can appoint experts,<sup>126</sup> request information from the parties,

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<sup>117</sup> Kulick 2012, 28-29. See for similar concerns Hepburn 2017, 108-109 and generally Kaufmann-Kohler 2005b.

<sup>118</sup> For some examples, see Igbokwe 2006, 293-295 and Hepburn 2017, 113.

<sup>119</sup> See also in particular Hepburn 2017, 112-119.

<sup>120</sup> As noted by Zachary Douglas concerning the *CME v. Czech Republic* tribunal's lack of engagement with Czech law – '[a]ny criticism of this omission must be tempered by the observation that the Czech Republic, inexplicably, did not tender any expert evidence on Czech law during the liability phase of the arbitration proceedings.' (2004, 203).

<sup>121</sup> See for the similar dichotomy between the parties' submissions and independent research *Brazilian Loans*, 124. For international commercial arbitration, see similarly de Ly/Friedman/Radicati di Brozolo 2010.

<sup>122</sup> See for an argument in that sense Lew 2010, 11.

<sup>123</sup> For a similar criticism of over-reliance on English-language materials in comparative law, see Siems 2007, 137.

<sup>124</sup> See similarly Hepburn 2017, 167-169.

<sup>125</sup> For example, information about Congolese (*AGIP v. Congo*, para. 45-47 and 72-73), Liberian (*LETCO v. Liberia*, p. 33-37) and Yemeni law (*Desert Line v. Yemen*, paras. 197-198, 202 and 205-207) were all obtained by the tribunals. Some of these cases, such as *AGIP*, date back to the 1970s, with a reasonable assumption of less information availability than today.

<sup>126</sup> See in this sense Hepburn 2017, 105 and materials cited therein. For some potential problems, see also *ibid.*, 135-137.



examine witnesses without parties' request, and (as is increasingly common) use the potential of *amicus* briefs.<sup>127</sup> With these tools, and a generally increasing wealth of materials publicly available, one can fittingly conclude with Michael Reisman's crisp wording:

Since [...] exploration of the law may involve substantial investigation into a legal system with which the arbitrators have no training, first-hand experience, or even basic language facility, the burden may be great. *But the difficulty of the task is no excuse for avoiding it.*<sup>128</sup>

#### 4.8. Feasibility of the ideal-type model in practice – a case study

The previous sections have discussed several relevant issues connected to the construction and use of the ideal-type model. In addition to the hypothetical example in section 4.3., this section will present a case study from the existing ISDS jurisprudence – *Dan Cake v. Hungary* - that demonstrates a number of features in line with the idea of the ideal-type model. Considering the challenges discussed in the previous sections, this example can also serve as an indicator of the practical feasibility of the proposals made above.

To the best of the author's knowledge, no tribunal has so far explicitly constructed an ideal-type model in the holistic manner argued here. The case discussed below, demonstrates however the possible ideal-type model construction, thoroughness of engagement with the national legal framework, and the potential for enhancing the national rule of law. Similarly to some cases discussed previously, such as *Genin* in the previous Chapter, *Dan Cake* is not representative of ISDS jurisprudence as a whole, but it is a useful illustration of a strand of jurisprudence in which engagement with the national legal framework, along the NROL paradigm complementation lines, has been approached thoroughly and in a normatively desirable fashion. To this strand, it is certainly possible to add the examples of *Urbaser v. Argentina – Award* and *Al Warraq v. Indonesia* as discussed in Chapter 2, section 2.2.3. as well as *Maffezini v. Spain – Award*, which demonstrates a strong engagement with both international and domestic commitments of Spain in the sphere of environmental protection. *Maffezini* award,

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<sup>127</sup> Schill 2010d, 424. See also Hepburn 2017, 119 and 167 (the latter point criticizing the *Grand River v. United States* tribunal for failing to utilize these instruments).

<sup>128</sup> Reisman 2000, 369 (emphasis added). See similarly Igbokwe 2006, 279.

however, does not specifically relate to the FET standard and will as such not be examined in detail here. In any case, the *Dan Cake* award below should be seen as a representative of a strand of jurisprudence that demonstrates the *potential* of investment tribunals and their FET decision-making – and that should be one of the indicators of how it should unfold in the future. Certain different and contrasting examples certainly exist, such as a far more cursory assessment of the national rule of law issues in a similar denial of justice context in *Jetoil v. Albania*.<sup>129</sup> This indicates that opting for an NROL paradigm complementation ultimately remains a normative choice.

*Dan Cake v. Hungary* exhibits a focus on the procedural, denial of justice claim, and thus a relatively narrower ideal-type model that focuses on domestic sources. At the same time, it demonstrates a thorough and persuasive elaboration which is, as just noted, not always present in the FET jurisprudence. Regardless of the lenient standard of review used, the examination incorporating this elaborate overview of the domestic legal framework resulted both in the host State liability *and* arguably very palpable guidelines for potential rule of law enhancement.

#### 4.8.1. *Dan Cake v. Hungary*

##### *The facts*

The case arose out of the insolvency proceedings instituted against Danesita, a Hungarian confectionery manufacturer predominantly owned by a Portuguese company Dan Cake since 1996.<sup>130</sup> Danesita experienced fluctuating business fortunes, eventually resulting in a request for liquidation by its creditors on 7 August 2006.<sup>131</sup> After Danesita failed to respond to the request in 8 days, its insolvency was presumed in accordance with the Hungarian insolvency law, and liquidation proceedings (including appointment of a liquidator) were put into motion.<sup>132</sup> An appeal process against this initial decision (itself with some potential procedural misgivings) was unsuccessful on formal grounds.<sup>133</sup>

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<sup>129</sup> *Jetoil v. Albania*, paras. 764-771.

<sup>130</sup> *Dan Cake v. Hungary*, para. 2.

<sup>131</sup> *ibid*, paras. 38-39.

<sup>132</sup> *ibid*, paras. 40-41.

<sup>133</sup> *ibid*, paras. 42-44.

The key events occurred when Danesita attempted to exercise its right to convene a composition meeting of creditors in order to approve an agreement with the debtor.<sup>134</sup> Despite the apparent inclusion of all the necessary documents, the Metropolitan Court of Budapest preliminarily denied Danesita's request as 'in its current form' it was not suitable for distribution to the creditors and the convening of the meeting.<sup>135</sup> Danesita was ordered to make several supplementary filings and the liquidator was encouraged to continue with the liquidation process.<sup>136</sup> No appeal against this decision was possible.<sup>137</sup> For a number of reasons, Danesita found it impossible to comply with the ordered filings and its assets were eventually sold, thus ending the existence of Dan Cake's investment protected under the 1992 Portugal-Hungary BIT.<sup>138</sup>

### *Tribunal's analysis*

While the Dan Cake's claims – based on protection against expropriation, provision of full protection and security, FET and prohibition of unjust and discriminatory measures - were lodged against both the Court's and liquidator's behaviour, the latter's actions were declared as not attributable to Hungary.<sup>139</sup> This put the focus on the decision of the Metropolitan Court to order additional filings. In brief, Dan Cake argued that the court's decision was without legal basis in Hungarian law, as Danesita provided the required documents and the meeting should have thus been convened.<sup>140</sup> The eventual finding of liability resulted from the breach of the FET standard (through denial of justice) and due to a finding of unjust and discriminatory measures.<sup>141</sup> The key interest here is the manner in which the Tribunal reached its conclusion, in particular the extensive engagement with the Metropolitan Court decision, Hungarian statutes, jurisprudence and academic commentary. Unlike the Argentina-Spain BIT, the Portugal-Hungary BIT has no specific provisions on applicable law for the investor-State disputes, and simply provides for arbitration under the Washington Convention (thus implicating Article 42 of the said Convention).<sup>142</sup>

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<sup>134</sup> *ibid*, paras. 46-49.

<sup>135</sup> *ibid*, para. 54.

<sup>136</sup> *ibid*.

<sup>137</sup> *ibid*, para. 55.

<sup>138</sup> *ibid*, paras. 59-62. The text of the BIT can be found at:

<http://investmentpolicyhub.unctad.org/Download/TreatyFile/1542>, accessed 12 April 2017.

<sup>139</sup> *ibid*, paras. 158-160.

<sup>140</sup> *ibid*, paras. 82-84.

<sup>141</sup> *ibid*, paras. 146 and 161-162.

<sup>142</sup> See Article 8 of the Portugal-Hungary BIT.

As the Tribunal observed, the prompt convening of the composition meeting, provided all the statutory conditions were met, was of essence for Danesita.<sup>143</sup> In order to ascertain the relevant sources in the domestic legal framework, the Tribunal examined the provisions of the Bankruptcy Act, its commentary and an opinion expressed in the Hungarian case law.<sup>144</sup> In particular, while the tribunal explicitly refused to pass judgment on the quality of the Hungarian insolvency law *per se*,<sup>145</sup> it did (unlike the *Genin* tribunal) discuss the potential justifications and implications of a particular Court practice.<sup>146</sup>

The most important aspect from the rule of law viewpoint is the 'Tribunals' systematic and rigorous examination of the decision of the Metropolitan court. The Tribunal reiterated the oft-repeated position of ISDS tribunals that they are not to be seen as appellate tribunals, even in situations where the appeal to a particular decision was not possible.<sup>147</sup> It then opted to examine if the decision was unfair or unequitable by establishing if 'some of the requirements were *obviously unnecessary* or *impossible to satisfy*, or in *breach of a fundamental right*'<sup>148</sup> and especially bearing in mind the complexity and urgency of the situation which involves the ongoing liquidation proceedings. This decision illustrates the preservation of the right to deduce the required intensity of review from the IIA provision itself (as discussed above). The paragraphs of the award that follow, however, also show that the selection of a particular standard of review is not incompatible with a thorough reasoning process that can strengthen the national rule of law.

The tribunal started by quoting the decision of the Metropolitan court in its entirety,<sup>149</sup> before again engaging with the Hungarian legislation (including the Civil Procedure Act) jurisprudence and doctrine to establish what sort of discretion the Court might have in ordering the additional documents.<sup>150</sup> After recognizing that the Court might have a power to order additional, non-statutory mandated documents which are

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<sup>143</sup> *ibid*, paras. 92-93.

<sup>144</sup> *ibid*, paras. 94-98.

<sup>145</sup> *ibid*, para. 82.

<sup>146</sup> *ibid*, para. 97.

<sup>147</sup> *ibid*, para. 117.

<sup>148</sup> *ibid* (emphasis in the original).

<sup>149</sup> *ibid*, para. 99.

<sup>150</sup> *ibid*, paras. 108-116.

truly ‘necessary’;<sup>151</sup> the heart of the award then dissects in considerable detail *each* of the 7 requests for filing that have been ordered in the light of their necessity. This is done with references to the legal framework, reasonableness and actual commercial and business reality – and with a conclusion that *all* these requests were unnecessary.<sup>152</sup>

While it is not warranted within the scope of this chapter to examine every paragraph, it is illustrative to quote a part of the Tribunal’s reasoning:

If the legislator had meant to grant the Court the power to refuse to convene the composition hearing on the basis of its assessment of the likelihood that the required percentages of favourable votes will be met, it would certainly have said so. On the contrary, it stated that upon the debtor’s request, the Court *shall* convene a composition hearing within 60 days. The *Explanation on insolvency law* makes it clear that “the settlement petition cannot be refused with a view to foreseeable/predictable shortcomings on the merit even if the experienced judge is well aware that the submitted material will not surely be suitable for concluding a composition agreement.” In addition, first, the time between the convening and the hearing may be used to convince some creditors to accept a proposal and second, a composition agreement is not the mere gathering of consents previously given: it involves a process of negotiations during the hearing and a vote at the end of it (see Section 41(5) of the Bankruptcy Act). The Court’s opinion as to the likelihood of success would therefore, at the stage of convening the hearing, be premature.<sup>153</sup>

Many similar paragraphs form a persuasive and thorough build-up to a conclusion that ‘the Court simply did not *want*, for whatever reason, to do what was *mandatory*’.<sup>154</sup> Such a conclusion led to host State liability for breaching the FET standard and the prohibition of unjust and discriminatory measures, with the damages to be determined subsequently.<sup>155</sup>

*The relevant aspects in the ideal-type model context*

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<sup>151</sup> *ibid*, paras. 113 and 116.

<sup>152</sup> *ibid*, paras. 118-142.

<sup>153</sup> *ibid*, para. 127 (emphasis in the original, references omitted).

<sup>154</sup> *ibid*, para. 142 (emphasis in the original). See similarly in the *Sempra v. Argentina* award, para. 268:

[...]the obligations and commitments which the Argentine Republic owed [...] were not observed. *Whether the question is examined from the point of view of the Constitution, the Civil Code or Argentine administrative law, the conclusion is no different.* Liability is the consequence of such a breach, and there is no legal excuse under the legislation that could justify the Government’s non-compliance since *the very conditions set out by the legislation and the decisions of courts have not been met.* (emphasis added)

<sup>155</sup> *Dan Cake v. Hungary*, paras. 160-161. As of 20 September 2017, no decision on damages is publicly available.

The decision makes very clear the perceived deficiencies of the Metropolitan Court's actions, with thorough support by references to numerous domestic sources.<sup>156</sup> The decision did not engage with the international commitments or constitutional norms in Hungary, as some awards did.<sup>157</sup> However, it is questionable if there was a need to do so – illustrating how the shape of an ideal-type model can be adjusted to the specific facts. The key aspect in this sense is the openness towards examining the relevant sources, rather than the checklist-style clearance through all of them. Arguably, an even more rule of law engaged tribunal could have (very likely *obiter dicta*) suggest other potential deficiencies in the Hungarian framework – for example the fact that the decision of the Metropolitan Court could not be appealed. Criticizing this aspect could, hypothetically, find its support in international commitments of Hungary regarding access to justice and due process. There is certainly much that can be said about the plausibility and potential persuasiveness of such an effort, but at this point it should just be noted as a possibility.

Be that as it may, the thorough reasoning can already provide the guidelines on how to reform the relevant aspects of the legislation and/or practice so to avoid further claims. In the context of the rule of law spill-over effects,<sup>158</sup> a potential reform is unlikely to be limited just to foreign investors – a modification of the relevant aspects of insolvency law and practice is likely to be applied across the board and to benefit domestic actors as well. Bearing in mind the importance and frequency of insolvency proceedings generally, this potential enhancement would not be a niche improvement.

#### 4.9. Conclusion

Constructing the ideal-type model of the domestic rule of law as a regular feature of examining if particular FET sub-principles were breached would be a critical element in complementing the IROL paradigm with an NROL one. A persuasive elaboration of this model through taking into account international and municipal commitments of the host State recognises and respects both the rule of law mission of the FET standard and the realities of State-investor relationships. The insistence on examining the whole

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<sup>156</sup> A similarly thorough engagement with the domestic legal framework has been praised in the context of the *Yukos* decision by Stephan 2014, 361-365.

<sup>157</sup> Notably *Maffezini v. Spain – Award*, mentioned above.

<sup>158</sup> See Chapter 3, section 3.6.2.

spectrum of host State obligations can send a strong *ex ante* signal to domestic officials about the need to take cognisance of the State's rule of law commitments more broadly. It can also guide foreign investors by suggesting that the basic and primary rule of law expectation they should have lies in the holistically understood domestic legal framework.

Understanding the FET standard sub-principles also as gateways of sorts toward other existing sources does not go necessarily against further clarification of the content of these sub-principles, nor is it in conflict with the provisions on applicable law. As argued in Chapter 2, there are sufficient possibilities for the tribunal to have recourse to a multitude of sources. Likewise, as the case study in this Chapter has sought to demonstrate, the in-depth engagement with various primary and secondary sources is certainly not beyond the reach of tribunals. What remains crucial is rather the readiness to perceive the tribunal's role as the one aimed at enhancing the national rule of law.

The construction of the ideal-type framework should be an important, but not determinative, step in the actual examination of host State liability. The task of scrutinising the actual behaviour is further shaped by the employed standards and methods of review. These are in themselves distinct from concretising the normative content of relevant standards such as the FET, and the IIL jurisprudence and doctrine manifests different understandings of the appropriate level and method of scrutiny. The attempt to answer what the most appropriate standard or method might be for strengthening the national rule of law is not undertaken here.

Rather, it is important to recognise that regardless of the constructed ideal-type model the element of subjectivity or arbitrators' own imprint on a dispute cannot and should not be eliminated from ISDS, as it can hardly be eliminated from other forms of dispute settlement.<sup>159</sup> Retaining a degree of flexibility in dealing with the potential breaches of the ideal-type model recognises also what has been termed the 'aspirational nature of the rule of law ideal'<sup>160</sup> and the fact that the perfect adherence to the rule of

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<sup>159</sup> See, for example, Hutchinson 1999, 211-215; Goldsworthy 2012, 691; Bingham 2011, 51-54; Maupin 2014a, 497 fn 130.

<sup>160</sup> Fuller 1969, 43.

law remains practically hardly achievable.<sup>161</sup> In the ISDS today, the arbitrators can ultimately determine how much this ‘aspirational nature’ can translate into reality. In doing so, they can also be assisted by the additional elements of the reasoning process – comparative benchmarks and the corrective good faith factors – which form the topic of the following chapter.

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<sup>161</sup> See generally Loughlin 2010, 312-341. See also McCorquodale 2016, 291; Krygier 2012, 234; Schill 2015, 93-94 and Carvalho 2016, 23. For a recognition that investor cannot expect perfection from the host State, see the very first BIT arbitration *AAPL v. Sri Lanka*, para 77, and similarly, for example, *Gami v. Mexico*, para. 97. See more generally Wälde 2007, 106; Newcombe 2005, 19; Montt 2012, 321; Behrens 2007, 178.



## Chapter 5 – Comparative benchmarks and corrective good faith factors

### 5.1. Introduction

The previous Chapter has set out the proposal for the *ideal-type model of the domestic rule of law* as a way to concretise the requirements of the national rule of law framework, which is in itself a critical aspect of the NROL paradigm complementation. The ideal-type model should thus feature as a regularly occurring and thoroughly elaborated element of the tribunal's scrutiny of the host State behaviour under the FET standard. However, as was also discussed,<sup>1</sup> determining the standard and method of that scrutiny, including the level of deference to be granted to the host State, remains a separate issue. The elaboration of the ideal-type model remains both distinct from and compatible with the standards and methods of review currently employed in FET decision-making, but the model itself is not (necessarily) determinative for their selection.

However, the parallel focus on the national rule of law can suggest additional decision-making elements as a part of the NROL paradigm complementation. This chapter addresses two such elements - *comparative benchmarks* and *the corrective good faith factors*. Respectively, these suggest the roles for the comparative recourse and good faith considerations that potentially enhance the persuasiveness of the tribunal's reasoning, offer firmer guidelines for the future conduct of the host State and/or ultimately secure a fairness of outcome that perhaps cannot be achieved otherwise.

The recourse to comparative benchmarks – law, policy and practice – would primarily serve to add persuasiveness and gravitas to the tribunals deliberations of how the host State fared under the combination of the FET sub-principle requirements and the ideal-type model. This should help enhance the tribunal's assessment if (e.g.) a particular measure was necessary or suitable, or if a delay was 'undue'. The benchmarks, ideally derived from comparable States or other regimes, would thus both serve to limit the appearance of impressionistic determinations in issues with serious consequences at

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<sup>1</sup> See Chapter 4, section 4.5.

stake, and to potentially provide the host State with (comparative) guidelines as to how to avoid similar problems in the future.<sup>2</sup>

The discussion in section 5.2. first distinguishes the comparative benchmarks from certain other potential uses of the comparative exercise, such as the determination of general principles of law (5.2.1). The discussion then turns to jurisprudence, so to highlight examples where the use of the comparative benchmarks would have benefitted the persuasiveness of findings, as well as some examples where the attempt to provide comparative support was not fully followed through (5.2.2.). Finally, section 5.2.3 deals with some of the potential conceptual and practical challenges of using comparative benchmarks.

Section 5.3. deals with the corrective good faith factors which have a different, but potentially important role. These factors would represent specific circumstances or fact-patterns existing on either the host State's or the investor's side. Their existence and intensity could lead to a different conclusion about the existence of a breach of the FET standard than the one tentatively reached through the scrutiny which involved the combination of the FET sub-principles and the ideal-type model scrutiny.<sup>3</sup> While reserving a special role for the clear instances of bad faith behaviour (*mala fides*) and the concretisations of good faith existing within the ideal-type model, this element should represent a shift of the role of good faith in IIL from a rule-generative to a corrective one. Corrective good faith factors could thus be one of the main manifestations of the residual power of arbitrators under the FET sub-principles to achieve the fairness of outcome and to potentially counter-balance overemphasis on considerations relating to specific national law.

Section 5.3.1. deals more generally with the role of good faith in international law and IIL, before suggesting the above-mentioned shift of its role in the FET context. Section 5.3.2. examines the situations in which good faith would retain a more directly determinative role, such as the existence of clear *mala fides*, before turning in section 5.3.3. to the specific corrective good faith factors. Section 5.4. will offer some concluding thoughts on the role of both elements proposed in this Chapter.

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<sup>2</sup> See also for importance of policy and practice in comparative examinations Bell 2006, 1274-1275.

<sup>3</sup> Of course, they could equally further support the tribunal's findings reached at that stage.

## 5.2. Comparative benchmarks

### 5.2.1. Comparative benchmarks and the other uses of the comparative exercise

In combination with the ideal-type model, comparative benchmarks - law, policy and practice - should primarily serve as a corollary support to the tribunal's reasoning. They should help avoid the (impression of) 'I know it when I see it' decision-making. As has been observed, '[w]hile the 'I know it when I see it' standard has obvious practical advantages, it has an equally obvious Kafkaesque undertone'.<sup>4</sup> In general, many issues on which the tribunals might be called upon to decide are hardly truly novel. The comparative national and, to an increasing extent, supranational/international law and practice offer a remarkable 'reservoir of human experience that had accumulated over many decades'<sup>5</sup> in different fields of State activity. The decision of the tribunal is more likely to be understood and accepted if it appeals for support to a broad range of conduct by States, than simply to the reasoning of its constituent members who were appointed in an adversarial context.<sup>6</sup> As observed more generally by Tom Bingham, when it comes to the rule of law issues, comparative, 'world-wide perspective' can add 'immeasurable strength' to the reasoning of dispute-settlers.<sup>7</sup> Potentially, comparative benchmarks can also go beyond the case-specific assistance to arbitrators. They can provide guidance and inspiration to the host State so as to enhance the relevant aspects of its legal framework and/or decision-making - hopefully helping avoid future ISDS claims in the same subject matter. This can result in legislative changes, increases in the administrative capacity in targeted areas and in developing international cooperation so to facilitate reform.<sup>8</sup>

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<sup>4</sup> King 2008, 411. See similarly for the need to avoid heavy-handed 'legal chauvinism' Picker 2013, 42.

<sup>5</sup> Montt 2012, xi-xii.

<sup>6</sup> Cole 2013, 51. See also similarly Boisson de Chazournes/McGarry 2014, 883; Smits 2012, 77-79. As Henckels notes, '[i]t is arguable that the greater the degree of international harmonization or consensus with respect to the subject matter of the measure, the lesser the degree of normative or empirical uncertainty in relation to the appropriateness of the measure itself' (2015, 145).

<sup>7</sup> Bingham 2010, 10. See for the similar understanding of the Canadian Supreme Court Hardin 2003, 459 and materials cited therein. See similarly in the ICJ context Ford 1994, 78-80 and in the EU context Chalmers/Davies/Monti 2014, 266.

<sup>8</sup> See in that sense Vadi 2016, 23.

Generally, comparative law has been finding its place in many different dispute settlement contexts.<sup>9</sup> To be clear, the use of the comparative benchmarks here advocated is distinct from the efforts to ascertain new general principles of law as a source of international law or from calls to use comparative law to fashion an autonomous meaning of the IIL concepts. In recent years, these proposals have been perhaps the main area of doctrinal interaction between comparative law and IIL.<sup>10</sup> Most prominently, the scholars in the comparative public law approach suggest that using comparative constitutional and administrative law can provide the inspiration to arbitrators in interpreting and concretising the autonomous meaning of IIA concepts.<sup>11</sup> This includes the recourse to other international regimes such as human rights courts jurisprudence, while keeping in mind the relevant differences between the regimes.<sup>12</sup>

Apart from using comparative public law to determine suitable standards and methods of review, using comparative law to concretise the meaning of IIA standards such as FET can, but does not necessarily coincide with the NROL paradigm approach advocated here. However, the comparative examination of (e.g.) practice of other international regimes in which the host State participates would be an integral part of delineating the contours of the ideal-type model, as also suggested by Chapter 4.<sup>13</sup>

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<sup>9</sup> Comparative exercises are common in ECtHR decision-making, so to relativise ‘universal’ standards by showing their contingent nature (Carozza 1998, 1221 and 1236). Many national legal systems display increased reliance on comparative law for interpretation and reform. The Swiss Federal Tribunal has a long-standing practice in that regard (Kulick 2012, 23), and the US Supreme Court, while stopping short of formal deference, is increasingly sprinkling its opinions with citations to foreign law (Glasshauser 2005, 83-84). As for English law, Otto Kahn-Freund and Tom Bingham suggest the unprecedented foreign influence on both legislation and precedent-developed case law (Kahn-Freund 1974, 2 and Bingham 2010, 5-7). See also in the constitutional law context generally Halmai 2012 and Chang/Yeh 2012.

<sup>10</sup> See above all the contributions to Schill 2010f, and for an overview Schill 2010a and Bonnitcha 2014, 22-24. See also generally Montt 2012, and in particular 241, 298, 344; Vadi 2010 and 2016; Kalderimis 2012; Schill 2012d.

<sup>11</sup> As Schill has observed, ‘[a] comparative public law approach consists in conceptualizing and applying standard concepts of investment law [...] by drawing parallels with public law concepts used in domestic law and other international regimes’ (2010a, 26). For Santiago Montt, ‘[a]rbitral tribunals always must bear in mind that international investment law lacks a fully mature set of rules of global constitutional and administrative law that would permit them to resolve investment disputes without any reference to domestic law or comparative law.’ (2012, 366). See also *Total. v. Argentina - Liability*, para. 111: ‘a comparative analysis of what is considered *generally fair and unfair conduct by domestic public authorities* in respect to private investors and firms in domestic law may also be relevant to identify the legal standards under BITs.’ (emphasis added).

<sup>12</sup> Schill 2014, 19. See also Kalderimis 2012, 159.

<sup>13</sup> Similarly, many segments of the recent analysis of comparative exercises in ISDS offered by Valentina Vadi (Vadi 2016) would here be more fitting for elaborating the requirements of the ideal-type model or to the proper standard/method of review. See in this sense references to judicial borrowing (Vadi 2016, 88-126; 144-163) or to comparative standards of review (ibid, 188-218).

Another possibility is for the comparative exercise to lead to determination of new general principles of law as a source of international law.<sup>14</sup> The topic has been touched upon in Chapter 2, so it is warranted to only briefly return to it at this point.<sup>15</sup> For some authors, the dangers of arbitrators' subjectivity can be tackled by rigorous comparative analysis that yields a general principle of law.<sup>16</sup> In particular, the argument is that there is a great potential of general principles of public law to provide well-balanced solutions for relations between the States and investors.<sup>17</sup>

Establishing these new general principles of (public) law within international law would potentially lead to considerable enhancement of the FET sub-principles. If a tribunal can indeed convincingly establish a new principle with a required level of common presence in legal systems, this is to be welcomed.<sup>18</sup> With due caution about formal obstacles,<sup>19</sup> the extensive doctrinal work and jurisprudential developments might have charted new paths towards making general principles of law a more pronounced source of rules in this sphere.<sup>20</sup>

With these efforts duly in mind, the possibilities remain open for different uses of the comparative exercise as well,<sup>21</sup> among others in the sense of the comparative benchmarks here discussed. The benefits of a comparative recourse remain even if that exercise cannot yield a binding, formally applicable rule. If the goal is not to establish a general principle of law, tribunal's efforts can focus on those legal systems which are the

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<sup>14</sup> Schill 2010a, 27-34.

<sup>15</sup> See Chapter 2, section 2.3.2.

<sup>16</sup> Gazzini 2012, 139.

<sup>17</sup> *ibid.* See also Schill 2010a, 32.

<sup>18</sup> While the uniform presence in all legal systems is not required (Shaw 2008, 100; Schill 2012b, 148), the principle needs to be broadly grounded so to avoid brazen or unrealistic law making (*Barcelona Traction*, p. 3., paras. 39-43 and 50; Shaw 2008, 99). The international courts and tribunals have on occasion proclaimed general principles without proper comparative analysis (Gazzini 2012, 141; Sornarajah 2010, 418; see generally also Hanessian 1989). This analysis should at least encompass the principal domestic legal orders or international regimes (Schill 2012b, 148; Shaw 2008, 100; Gazzini 2009, 107 and 111 and examples referenced there), with a risk that frequently it will simply not be possible to identify a true general principle of law (Kleinheisterkamp 2015, 817-818).

<sup>19</sup> Also, insufficiently careful pronouncement of general principles can lead to an annulment of the award in the ICSID context – early *Klückner v. Cameroon – Ad Hoc* is a prominent example. See also for caution Alvarez 2016, 218, fn 175.

<sup>20</sup> General principles of law have been described as '[t]he most fertile, but underutilised' source for developing IIL (Douglas 2009, 89; see also in this context Snodgrass 2006; for a warning about avoiding selectivity in this exercise, see Sornarajah 2009, 418). More generally, the jurisprudence of PCIJ and ICJ generally exhibits a fairly limited importance of general principles (Shaw 2008, 99; Cassese 2005, 188-193). Situation in ISDS is somewhat similar (Fauchald 2008, 312).

<sup>21</sup> See also in this sense Roberts 2013, 52.

most instructive for providing persuasiveness in the specific legal and factual matrix.<sup>22</sup> At the same time, this focus can also increase the level of specificity and determinacy of benchmarks, thereby providing more tangible guideposts for all the actors involved.

### 5.2.2. Comparative benchmarks - potential and actual use in jurisprudence

Without delving into the specific standards and methods of review,<sup>23</sup> it is possible to say that the tribunals are (in the context of FET decision-making) relatively often put in an unenviable position to make sensitive pronouncements with potentially far-reaching consequences. The degree of deference given to the host State then also assumes an important role, but the problem can be illustrated by the *Metalpar v. Argentina* tribunal statement that ‘to try to abstractly determine whether the actions carried out by Argentina during the crisis were optimal is a difficult or impossible task’, which can have considerable consequences if host State liability is found.<sup>24</sup>

The tribunals, depending on the adopted standard and method of review,<sup>25</sup> often have to pronounce if a host State measure was e.g. suitable,<sup>26</sup> necessary,<sup>27</sup> least-onerous,<sup>28</sup> or simply reasonable;<sup>29</sup> as well as if a particular delay was ‘undue’ or not.<sup>30</sup> The need for strong persuasive support to reasoning seems particularly pertinent in those situations. As noted more generally by Bingham, comparative law is particularly apt to help prevent an inappropriate or unjust resolution of a dispute, or where no clear answer seems straightforward.<sup>31</sup> Recourse to other *comparable* States and/or regimes<sup>32</sup> can indeed prove beneficial for the persuasiveness of reasoning in many ways.<sup>33</sup>

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<sup>22</sup> See also for supporting a smaller scale comparative exercises in the administrative law context Bell 2006, 1266.

<sup>23</sup> For recent studies of these issues see generally Henckels 2015 and Bücheler 2015.

<sup>24</sup> *Metalpar v. Argentina*, paras. 198-199. See also Henckels 2015, 139.

<sup>25</sup> See also on these questions Calamita 2013, 175 suggesting that the tribunals invoking proportionality are ought to address suitability, necessity and proportionality *stricto sensu*; at least the first two questions are arguably amenable to comparative insights.

<sup>26</sup> *LG&E v. Argentina – Liability*, paras. 239–242 and 257; *Electrabel v. Hungary – Liability*, para. 8.34.

<sup>27</sup> *Pope & Talbot v. Canada – Merits*, para. 155; *SD Myers v. Canada – First Partial Award*, para. 195; *Glamis Gold v. US*, paras. 133, 138, and 140.

<sup>28</sup> *SD Myers v. Canada – First Partial Award*, paras. 195, 215, 221 and 255.

<sup>29</sup> *BG v. Argentina*, paras. 342-344. See also *CME v. Czech Republic – Partial Award*, para. 158 and Bonnitich 2014, 224.

<sup>30</sup> For example, *Chevron v. Ecuador – Partial Award*, para. 250.

<sup>31</sup> Bingham 2010, 8.

<sup>32</sup> For suggestions to go beyond States in comparative law, see Reimann 2001.

<sup>33</sup> See Vadi 2010, 98 for a similar understanding of the non-authoritative use of comparative insights.

A strong degree of commonality between the suitably compared legal systems can provide support for finding the host State's regulation or practice either outlying or acceptable, and influence the potential level of justification that would be necessary for it. Generally, ascertaining that States B, C and D do things the same/differently than the host State A can lend legitimacy that goes beyond just the tribunal's own reasoning.<sup>34</sup>

The current jurisprudence broadly exhibits two situations in this regard. One is a *lack* of comparative recourse in situations where it would arguably help the persuasiveness of the tribunal's findings. The second is a recognition of the benefits that comparative arguments can bring, but with a rather cavalier approach to the comparative exercise, manifested sometimes in broad assertions with little actual comparison.

*Situations where comparative benchmarks could have enhanced the persuasiveness of reasoning*

Perhaps a prime example of tribunals having to make sensitive pronouncements on host State measures are cases relating to the 2001-2002 Argentine crisis. The cases manifest different approaches to the scrutiny of the host State actions, including in terms of the standard and method of review, the level of deference granted, as well as the perception of the same underlying facts,<sup>35</sup> but a common point is their lack of comparative insights to support critical findings.

For example, the *InterAgua v. Argentina* and *Suez v. Argentina - Liability* tribunals (composed of the same arbitrators) found Argentina liable for the breach of FET due to the frustration of foreign investor's legitimate expectations.<sup>36</sup> A crucial finding was the 'rigidity' of behaviour the provincial government, and in particular the assertion that the government could have enacted measures other than the tariff freezing in order to secure access to services for the broader population.<sup>37</sup> Specifically, the tribunal suggested social tariffs or subsidies to the poor, noting that this was possible under the legal framework.<sup>38</sup> As noted by Henckels, it is at least arguable that the tribunal did not take into account if this alternative was reasonably available to the government in the

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<sup>34</sup> See also in this context Henckels 2014, 144-145.

<sup>35</sup> See also on this Maupin 2014b, 471-472.

<sup>36</sup> *InterAgua v. Argentina - Liability*, paras. 218, 228 and 248; *Suez v. Argentina - Liability*, paras. 238, 247-248 and 276.

<sup>37</sup> *InterAgua v. Argentina - Liability*, paras. 213-218; *Suez v. Argentina - Liability*, paras. 232-238.

<sup>38</sup> *InterAgua v. Argentina - Liability*, para. 215; *Suez v. Argentina - Liability*, para. 235.

crisis context, whether in terms the capacity to design and implement the alternative, or in terms of financing it.<sup>39</sup>

Additionally, however, it is also arguable that the persuasiveness of the findings would have benefitted through comparative examples of policies suggested by the tribunal as a feasible answer. After all, the Argentine crisis, despite certainly being formidable in terms of severity, is not an isolated example.<sup>40</sup> Providing relevantly comparable examples would lend additional legitimacy to a finding that eventually resulted in holding the host State liable. Perhaps equally importantly, potential failure to find such comparative examples could also have suggested to the tribunal that its tentative findings may be problematic.

Within that same context, it is possible to take a different look at the decisions in *CMS v. Argentina - Award*, *Enron v. Argentina – Award* and *Sempra v. Argentina – Award*. In all three awards, the tribunals determined that other measures with less impact on the investors were theoretically available to Argentina,<sup>41</sup> a key finding in rejecting the necessity defence for precluding the wrongfulness of Argentina's behaviour.<sup>42</sup> The measures thus asserted as available by the tribunals were not analysed to determine their feasibility or likely efficacy in the circumstances.<sup>43</sup> However, in both *Enron* and *Sempra* the parties' experts and even the tribunal suggested the importance of comparative experiences, but the tribunal's analysis went no further than stating that different measures were taken by other countries in crisis situations.<sup>44</sup> No actual attempt to relate the experience of these other countries to the case at hand was conducted. A mention of Uruguay as an example suggested by the Claimant's expert went no further than mere name-dropping in the tribunal's analysis.<sup>45</sup>

While the issues here also go to the proper interpretation of the necessity defence in international law, it suffices to mention that it is questionable if a mere assertion of

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<sup>39</sup> Henckels 2015, 106; see also Henckels 2013, 213.

<sup>40</sup> As suggested, *inter alia*, by *Sempra v. Argentina - Award*, para. 350 and *Enron v. Argentina – Award*, para. 308.

<sup>41</sup> *CMS v. Argentina - Award*, para. 323; *Sempra v. Argentina - Award*, paras. 350-351; *Enron v. Argentina - Award*, paras. 308-309.

<sup>42</sup> *CMS v. Argentina - Award*, para. 331; *Sempra v. Argentina - Award*, para. 354; *Enron v. Argentina - Award*, para. 313.

<sup>43</sup> *CMS v. Argentina - Award*, para. 323; *Sempra v. Argentina - Award*, para. 351; *Enron v. Argentina - Award*, para. 309.

<sup>44</sup> *Sempra v. Argentina - Award*, para. 339 and 350; *Enron v. Argentina - Award*, para. 300 and 308.

<sup>45</sup> *Sempra v. Argentina - Award*, para. 339; *Enron v. Argentina - Award*, para. 300.



other measures being theoretically possible should suffice to deprive the host State of the necessity defence. If indeed there needs to be at least *some* consideration of feasibility of the alternative suggested measures, thoroughly reasoned comparative recourse would seem to provide significant assistance for the persuasiveness and credibility of reasoning.

Recourse to comparative practice can also be beneficial in situations of assessing the practice of host State courts, or more specifically in qualifying the delays in proceedings before them. An example can be found in *White Industries v. India*, where the Tribunal was to assess whether a delay before the Indian courts in recognising and enforcing the foreign investors' arbitral award qualified as either a breach of legitimate expectations,<sup>46</sup> a denial of justice<sup>47</sup> or a breach of the obligation to provide investors with the domestic 'effective means' to assert their rights.<sup>48</sup> The tribunal found no legitimate expectations could have existed as the claimant 'either knew or ought to have known at the time in entered into the [investment] Contract that the domestic court structure in India was overburdened'<sup>49</sup> and received no specific assurances about award enforcement.<sup>50</sup> The tribunal also offered a Law Commission of India report on the Supreme Court from 1988 (around the time the Claimant's project started) which suggested that Supreme Court cases were not disposed for over a decade.<sup>51</sup>

As for the denial of justice, the tribunal noted that public international law does not provide for fixed time limits that should indicate whether a denial of justice exists,<sup>52</sup> and noted that this 'fact-sensitive' assessment included factors such as complexity of the proceedings, the need for swiftness, behaviour of litigants, the significance of interests at stake and the behaviour of the courts.<sup>53</sup> To this, importantly, the tribunal also added that it is relevant 'to bear in mind that India is a developing country with a population of over 1.2 billion people with a seriously overstretched judiciary.'<sup>54</sup> With all these factors examined, the tribunal concluded that while the overall and Supreme Court

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<sup>46</sup> *White Industries v. India*, section 10.3.

<sup>47</sup> *ibid*, section 10.4.

<sup>48</sup> *ibid*, section 11. The provision on 'effective means' was imported from the Kuwait-India BIT through the MFN clause, as discussed in section 11.2 of the award.

<sup>49</sup> *White Industries v. India*, para. 10.3.14.

<sup>50</sup> *ibid*. para. 10.3.15.

<sup>51</sup> *ibid*.

<sup>52</sup> *ibid*, para. 10.4.9.

<sup>53</sup> *ibid*, para. 10.4.10.

<sup>54</sup> *ibid*, para. 10.4.18.

delays were ‘certainly unsatisfactory in terms efficient administration of justice, neither has yet reached the stage of constituting a denial of justice’<sup>55</sup> especially as there was no suggestion of bad faith nor there existed a ‘particularly serious’ shortcoming.<sup>56</sup>

The tribunal’s findings were, however, different when it came to the test if India provided ‘effective means’ for the Claimant to assert its rights. Critically, the Tribunal noted that:

The “effective means” standard is different from and less demanding than the “denial of justice” standard. Moreover, with respect to a forward-looking promise by a State to provide “effective means” of enforcing rights and making claims, the relevance of the State's population or the current operation of its court system(s) (in assessing the undue nature of a delay) is limited. This is because the focus of such a *lex specialis* is whether the system of laws and institutions work effectively at the time the promisee seeks to enforce its rights / make its claims.<sup>57</sup>

Basing itself on the *Chevron v. Ecuador – Partial Award*, the tribunal assessed many of the same factors as concerning the legitimate expectations and denial of justice in this somewhat changed light, but also noted that ‘the issue of whether or not “effective means” have been provided by the host State is to be measured against an objective, international standard’.<sup>58</sup> It eventually concluded that Supreme Court’s inability to offer an expedited hearing in five and a half years, and the fact that Claimant had no further means of expediting the process, amounted to the breach of the ‘effective means’ obligation:

[i]n these circumstances, and even though we have decided that the nine years of proceedings in the set aside application do not amount to a denial of justice, the Tribunal has no difficulty in concluding the Indian judicial system's inability to deal with White's jurisdictional claim in over nine years, and the Supreme Court's inability to hear White's jurisdictional appeal for over five years amounts to undue delay and constitutes a breach of India's voluntarily assumed obligation of providing White with "effective means" of asserting claims and enforcing rights.<sup>59</sup>

Overall, there is certainly a lot to support the ultimate conclusion of the tribunal and the liability of the host State. Nine years to enforce an arbitral award certainly does not strike an impartial observer as effective. At the same time, it is questionable to what

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<sup>55</sup> *ibid*, para. 10.4.22.

<sup>56</sup> *ibid*, para. 10.4.23.

<sup>57</sup> *ibid*, para. 11.4.16 fn 78.

<sup>58</sup> *ibid*, para. 11.3.2; This was also based on the Claimant’s contention in para. 11.1.5.

<sup>59</sup> *ibid*, para. 11.4.19.

extent the assessment of an ‘objective, international standard’ for the efficiency of proceedings can be determined without at least some comparative recourse. Leaving aside for the moment the potentially contentious issue of the degree of influence of the host State’s circumstances on the ‘effective means’ test,<sup>60</sup> the tribunal’s assessment in the end does not itself make clear what (if anything) the tribunal used as an objective and even less so ‘international’ benchmark.

This is particularly pertinent as the tribunal earlier recognised that there are no such standards regarding the denial of justice, which would potentially serve as a baseline or a ‘floor’ in determining ‘effective means’. The tribunal’s deliberations remain very case-specific, apart from noting that the initial delays, before the Supreme Court took over, were caused by strenuous defence submissions and that ‘the pleadings schedule was not exceptional, either in the Indian context *or otherwise*.’<sup>61</sup> The ‘otherwise’ is never followed through, and the tribunal’s analysis of the subsequent Supreme Court delay makes no other references to comparable situations in other contexts.

If an objective standard of efficiency is to be suggested, it would arguably seem warranted to offer at least an overview of the length of proceedings in comparable situations in other legal systems, and to provide an attempt to approximate these into some form of benchmarks. It is possible to imagine such an exercise as a completely ‘global’ one, including therein equally the developing and developed countries and their practice. However, it would still seem preferable to distinguish to an extent in this sense between legal systems in countries with comparable circumstances.

A recourse to comparative practice, whether for the purpose of ‘global’ or more nuanced standards of effective means, might have also given the *White Industries* tribunal some reason for pause. For example, civil court procedures in (developed) country such as Italy are notoriously slow, and the length among OECD countries generally varies significantly.<sup>62</sup> According to the OECD, the *average* length of a civil dispute in Italy was 8 years (therefore quite close to the overall delay in *White Industries*) but for example it took a year in Switzerland, indicating a large (eight-fold) deviation.<sup>63</sup> Of course, the

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<sup>60</sup> See also section 5.3.3 below – Circumstances of the host State.

<sup>61</sup> *ibid*, para. 11.4.8.

<sup>62</sup> See on this also Bingham 2010, 88-89 and Alvarez 2016, 221.

<sup>63</sup> OECD 2013, 2.

strong possibility remains that even with this comparative insight the length of the proceedings would still be found as unsatisfactory for the ‘effective means’ test (and therefore also suggest that Italy might be found liable in a similar situation). Put differently, using a developed country example might not necessarily help the host State cause.<sup>64</sup> However, engaging with the comparative benchmarks and offering a more substantiated analysis as to where ‘effective’ ends and ‘ineffective’ begins would be a task beneficial for India, foreign investors and potentially (even if not primarily) for the wider spectrum of domestic stakeholders.

*Situations of recognised benefits of the comparative recourse – and problematic elaboration*

In a number of situations, comparative law, policy and practice were employed by the tribunals to support their findings. At the same time, the tribunals seem to have preferred the *idea* of comparative support more than its realization – and in some instances failed to provide anything more than broad assertions about how things are done in other States and regimes.<sup>65</sup>

The tribunal in *Noble Ventures v. Romania*, in deciding that the behaviour of Romania in initiating insolvency proceedings against the Claimant was not arbitrary, put a lot of emphasis on comparative support. The tribunals concluded that ‘[s]uch proceedings are provided for in all legal systems and for much the same reasons. [...] [Claimant] was in a situation that would have justified the initiation of comparable proceedings in most other countries. Arbitrariness is therefore excluded.’<sup>66</sup> There is, however, no indication whatsoever of a single other legal system that would provide support for such a statement, nor reference to any other non-national instrument or document related to the topic. Similarly, in *Roussalis v. Romania* and *Feldman v. Mexico – Award*, broad (and arguably broadly correct) assertions about particular policies being commonplace were however not substantiated with any examples illustrative for the case at hand.<sup>67</sup>

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<sup>64</sup> As Bingham 2010, 88, in the UK context some cases reach similar lengths and leave little place for complacency.

<sup>65</sup> On the lack of thorough comparative engagement see Vadi 2010, 97. Generally, IIL doctrine mostly focuses on comparative *procedural* insights, largely neglecting the substantive ones (Vadi 2010, 86).

<sup>66</sup> *Noble Ventures v. Romania*, para. 178.

<sup>67</sup> *Roussalis v. Romania*, para. 636 (on food and safety policies being commonplace); *Feldman v. Mexico – Award*, para. 115 (on cigarette smuggling policies). See similarly *ADF v. United States*, para. 188, where the comparative effort was substituted with a reference to Claimant’s counter-memorial.

The *AMTO v. Ukraine* award dealt with insolvency in a somewhat different context. Claimant in this case argued that the weaknesses of the Ukrainian insolvency legislation were so severe as to breach the obligation to provide ‘effective means for the assertion of claims and the enforcement of rights’ as found in Article 10 (12) of the ECT.<sup>68</sup> The tribunal was of the opinion that Ukrainian legislation should indeed meet at least minimum international standards in ‘qualitative’ terms, noted that Claimant failed to provide any comparative support for its claims, and also said that in its assessment will be guided, *inter alia*, by comparative considerations.<sup>69</sup> However, the ultimate finding of the tribunal - that Ukrainian legislation was not in breach of the ECT Article 10(12), and that is a ‘modern law’ with ‘some problems’ - does not in the end rely on any comparative analysis.<sup>70</sup> The farthest that the Tribunal went was consulting reports by Deloitte and Touche (which helped draft the relevant law), USAid and EBRD which discussed the law, with the EBRD report actually highlighting the weaknesses put forward by the Claimant.<sup>71</sup> None of the reports, however, seem to provide any comparative material either, and rather focus on the training programs necessary to efficiently implement the law. It remains puzzling what, if any, was the impact of Tribunal’s seemingly considerable emphasis on comparative support for finding the Ukrainian legislation acceptable.

Other tribunals were more interested in the sphere of comparative policy. For example, in adding support to its finding on the behaviour of Moldovan government concerning changes of the tax-free zone rules, the *Link-Trading v. Moldova* tribunal concluded: ‘[...] tax measures adopted by the Moldovan government, while unfavorable to Claimant, were not dissimilar to the policies of many countries in the world levying duties and taxes on imports into their customs territory [...]’.<sup>72</sup> However, this statement is again not followed by any comparative information beyond the tribunal’s assertion. Bearing in mind the ample availability of data on tax regimes and tax policy (something also touched upon in section 5.2.3. below), lack of at least a nominal effort to substantiate this claim does not seem justified.<sup>73</sup>

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<sup>68</sup> *AMTO v. Ukraine*, para. 85.

<sup>69</sup> *ibid*, paras. 85-88.

<sup>70</sup> *ibid*, para. 89.

<sup>71</sup> *ibid*, para. 86.

<sup>72</sup> *Link-Trading v. Moldova*, para. 72.

<sup>73</sup> See, for example, the data available at <http://www.oecd.org/tax/>, accessed 17 January 2017.

### *Concluding observations*

In terms of providing support for sensitive findings, the tribunals in many cases recognise the persuasive strength arising from a claim that particular legislation or policy is comparatively commonplace. However, the problematic aspect is that these comparative observations usually do not go beyond relatively unsubstantiated assertions, sometimes reduced to a single phrase or sentence. While the use of comparative benchmarks is arguably an excellent tool to assist the tribunals, and should have been employed in even more situations, there is little to be gained by a mere appearance of a comparative exercise.

At the same time, there are certainly important reasons why the tribunals might have been inclined to eschew the more thorough comparative effort. As the next section will discuss, the conceptual and practical challenges attached to it are far from negligible. At the same time, some suggestions are possible on how to tackle at least some of these challenges and therefore enhance the use of comparative benchmarks in practice.

#### **5.2.3. The challenges of using comparative benchmarks – finding suitable comparators and ascertaining the comparative content**

An investment tribunal aiming to use the comparative benchmarks faces at least two significant challenges. One is the adequate selection of comparators that can offer the most credibility to the tribunal's findings. The second, similarly to the ideal-type model,<sup>74</sup> is the problem of ascertaining the content of relevant laws, policies and practice. As the following sections will argue, neither of these issues is unsurmountable in the ISDS context, although some new developments (such as soft-law instruments) would significantly assist the comparative efforts.

#### *Suitable comparators*

Ideally, what should be sought by the tribunals would be a selection that is sufficiently instructive, and yet not liable to make the exercise meaningless through

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<sup>74</sup> See Chapter 4, section 4.6.

unrealistically demanding or unsatisfactorily lax comparators. Of course, comparative benchmarks should not present a straightjacket. A particular host State measure can be so innovative as not to be present comparatively – an outlier may be an innovator, and not a pariah. Proper fact-specific justification of host State efforts can certainly in those situations prevail over forced comparative parallels.<sup>75</sup>

Leaving those situations aside, the importance of careful comparative selection is highlighted by Montesquieu's famous words that: '[l]es lois politiques et civiles de chaque nation [...] doivent être tellement propres au peuple pour lequel elles sont faites, que c'est un grand hazard si celles d'une nation peuvent convenir à une autre.'<sup>76</sup> This was for him equally valid for both private and public law, including the constitutional and administrative branches.<sup>77</sup> As Otto Kahn-Freund noted in a seminal piece, legalistic spirit which *ignores the context* can be an abuse of comparative law.<sup>78</sup> In that sense and in normative terms, the proper recognition of the context can be expressed by an effort to seek the most suitable comparators.<sup>79</sup>

The selection of comparators in the subject matter of many FET disputes – administrative, constitutional, judicial issues – is certainly not a simple exercise.<sup>80</sup> As further observed by Kahn-Freund:

All rules which organise constitutional, legislative, administrative or judicial institutions and procedures, are designed to allocate power, rule making, decision making, above all, policy making power. These are the rules which [...] are *the ones most resistant to transplantation*.<sup>81</sup>

Comparative persuasiveness cannot thus be based on 'a head-count of decisions and codes adopted in other countries around the world, often against a background of

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<sup>75</sup> As Henckels notes, 'divergence from the practice of other states in the area being regulated should not be decisive of whether the measure is rationally connected to the objective; there may be good reasons why the local context requires a different approach.' (2015, 145). See similarly *Pausbok v. Mongolia*, para. 303 noting that a particular measure (windfall profit tax) that went beyond comparative standards was not because of that in itself contrary to the FET standard.

<sup>76</sup> Montesquieu 1832, 74.

<sup>77</sup> *ibid*, 75; Kahn-Freund 1974, 7.

<sup>78</sup> *ibid*, 27.

<sup>79</sup> There are proposals to use developed countries' standards as 'ceilings' for expectations from the developing host States (see for example Montt 2012, 227). While a sensible proposal in itself, the above-mentioned OECD examples indicate the reasons to be cautious about what 'developed country standards' actually mean.

<sup>80</sup> See also in this sense Van Harten 2010c, 632-633.

<sup>81</sup> Kahn-Freund, 1974, 17 (emphasis added).

different rules and traditions.<sup>82</sup> While the topic certainly merits further research, it is possible at least to make certain general suggestions. The two potentially key guideposts for the tribunals should be the similarity of the ideal-type framework concerning the particular legal situation, and the similarity of the (socio-political, economic, developmental) circumstances in the host State and the comparator(s).<sup>83</sup>

### The similarity of the ideal-type model

A reasonable direction for aiming comparative efforts is the sufficient similarity of the domestic instruments and international commitments regarding a particular legal situation involving the foreign investor. As for the domestic obligations, the countries sharing a common legal heritage would seem as particularly suitable prospects.<sup>84</sup> Useful examples are provided by the English courts that have, when engaging in comparative analysis, accorded a visibly predominant role to other common law and particularly Commonwealth legal systems.<sup>85</sup> In discussing *Arthur J. S. Hall & Co. v. Simons*, Lord Bingham's choice of words serves as an excellent example of what the reliance on 'linked' systems is aimed to achieve: '[i]f the public policy reasons relied on to support the rule did not accord with experience in a country *as like our own* as Canada, it was indeed difficult to see why they should apply here, and that was what a majority of the House decided.'<sup>86</sup>

Of course, the more contemporary transplantations can prove relevant as well. In situations where particular legislation was clearly adopted by using foreign law as a model, it can be warranted to have recourse to the practice of the 'source' State. A plausible argument can be made that this practice would be desirable for emulation as well by the adopting State,<sup>87</sup> thus further justifying the reliance of the tribunal.

The early ISDS cases of *Klöckner v. Cameroon* and *AMCO v. Indonesia* can perhaps demonstrate the advantages that the use of comparative benchmarks can have in opposition to attempts to establish a legally binding general principle. Both awards at

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<sup>82</sup> *Fairchild v. Glenhaven Funeral Services*, 66. See also Bingham 2010, 14-16.

<sup>83</sup> See also generally Maupin 2014b for the suggestion that investment disputes can be differentiated among their socio-legal, territorial and political dimensions.

<sup>84</sup> See also on this Picker 2013, 30.

<sup>85</sup> See Bingham 2010, 9-10, 12, 16, 18 and 22.

<sup>86</sup> Bingham 2010, 12-13 (emphasis added).

<sup>87</sup> See generally on this Berkowitz/Pistor/Richard 2003.



certain points dealt with French law and its relevance for the interpretation of existing or ascertainment of other rules to resolve the case. In the *Klöckner v. Cameroon - Award*, the tribunal essentially had recourse to French contract law doctrines requiring frankness and full disclosure in dealing, while couching them in the language suggesting their universal applicability as general principles.<sup>88</sup> The annulment committee decision focuses well on the cursory nature of the attempt made by the tribunal,<sup>89</sup> even without highlighting out a rather basic comparative contract law point that common law systems would hardly universally endorse such a principle.<sup>90</sup> Instead of persuasive strength of reasoning that could have been derived by pointing out the common legal heritage of Cameroonian and French law, and the accompanying interpretations, an arguably misguided comparative exercise eventually led to the annulment of the award.

In *AMCO v. Indonesia*, when faced with the claims that French legal concepts of administrative unilateral acts and administrative contracts were worthy of consideration as sources of international law, the tribunal refused to do so despite recognizing the importance of practice and provisions common to a number of nations as general principles.<sup>91</sup> As a matter of comparative grounding, the decision is correct – concept of administrative contracts is distinctively and predominantly French, despite certain ‘transplants’.<sup>92</sup> But it is highly questionable if these French concepts would provide useful comparative benchmarks either. The legal system of Indonesia is based on a rather idiosyncratic mix of Roman-Dutch heritage (mostly reflected in its civil code), customary law and new post-independence Indonesian law.<sup>93</sup> Unlike *Klöckner*, there is little to indicate the particular relevance of French legal concepts, thus essentially eliminating any significant enhancement of the persuasiveness of reasoning.

Beyond these links, a more common scenario in which the ideal-type model similarities can arise is the adherence to the same international instruments or finding inspiration in the same model laws. In such situations there is an additional justification for comparative insights as many of these instruments emphasise the need to promote

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<sup>88</sup> *Klöckner v. Cameroon – Award*, 105-106 and 109.

<sup>89</sup> *Klöckner v. Cameroon – Ad Hoc*, paras. 71-73.

<sup>90</sup> For English law, see the rejection of ‘good faith negotiations’ by the House of Lords in *Walford v. Miles*.

<sup>91</sup> *Amco v. Indonesia*, 461.

<sup>92</sup> Brown/Bell 1993, 192-193.

<sup>93</sup> Frederick/Worden 2011, xxxvi; See also *Country profile: Indonesia*, December 2004, Library of Congress – Federal Research Division, available at: <https://www.loc.gov/rr/frd/cs/profiles/Indonesia.pdf>, accessed 15 January 2016, 15-16.

uniformity of their application.<sup>94</sup> The situations in which the tribunals have to an extent indicated the compliance with a particular international instruments as relevant in assessing host State behaviour have been noted in Chapter 4.<sup>95</sup> Particularly in those situations, the analysis of legislation and other measures of other States aimed at complying with these instruments can be a relatively uncontroversial comparative benchmark.<sup>96</sup>

In the sphere of non-binding instruments such as model laws, the UNCITRAL Model Law on International Commercial Arbitration seems to offer a good example of the relevance of common practice. The countries basing their arbitration laws on the model law tend to be referred to as a group – ‘Model law countries’ and the analysis of particular issues in practice, as exemplified by the digest of the Model Law case law, does not deal with individual jurisdictions separately.<sup>97</sup> This suggests both the relevance of the common practice under same instruments, and the existence of valuable resources that investment tribunals could rely on, something also discussed further below.

#### The similarity of circumstances

A second important consideration, preferably combined with the similarity of the ideal-type framework, is the similarity of circumstances between the host State and the State(s) used for comparison. The relevance of the host State circumstances will also be touched upon in the context of corrective good faith factors below (section 5.3.3.), but the subject can certainly be influential for selecting comparators as well. Apart from the observations made in the context of examples discussed in section 5.2.2. above, the importance of considering the relevant context of involved States can be illustrated by an example found in *Frontier Petroleum v. Czech Republic*. The tribunal concluded in the FET context:

[...] in *Jan de Nul* and *Toto*, delays in court proceedings of ten and six years respectively did not amount to a violation of the fair and equitable treatment

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<sup>94</sup> See, for example, Bingham 2010, 39-40.

<sup>95</sup> See Chapter 4, section 4.2.

<sup>96</sup> The distinction between analysing secondary materials to ascertain the exact obligations arising under specific instruments and using comparative benchmarks would sometimes likely be fluid. See the above mentioned *White Industries v. India*, with several references to the need to ascertain common practice under the 1958 New York Convention (paras. 4.3.21, 4.4.6, 10.4.11 fn 69, 11.1.5).

<sup>97</sup> UNCITRAL 2012.

standard. Even if this Tribunal were to conclude that the entire delay was attributable to Respondent, it does not find that a delay of just over 3 years amounts to a breach of the fair and equitable treatment standard of the BIT in the present circumstances.<sup>98</sup>

The reasoning of the tribunal would seem to suggest that since in Egypt (*Jan de Nul*) and war-torn Lebanon (*Toto*) proceedings that took much longer were acceptable in the FET context, three years would *a fortiori* not be problematic. With due respect to the tribunal's attempts to achieve consistency in applying the FET standard, the investor did not choose to invest in those countries or even in those regions, nor should it expect arguments based on such comparisons to be relevant.<sup>99</sup> At the time the relevant events occurred, Czech Republic was close to becoming an EU member, one of the leading examples of the successful Central European transition, and solidly ranked in rule of law terms.<sup>100</sup> The persuasiveness of the comparisons offered by the tribunal, even if framed in the context of uniformity of the FET standard, is thus open to question.

The similarity of circumstances can be approached from different angles. As suggested by Julie Maupin, there is a need to give effect to 'the degree to which the basic features of the dispute itself and the circumstances in which it arises are likely to be viewed as mundane, ordinary, or commonplace—as opposed to radical, surprising, or contested[...]'.<sup>101</sup> As further suggested, the circumstances can be roughly grouped into 'ordinary times, times of economic crisis, and times of political crisis or transition.'<sup>102</sup> As suggested above in the context of the Argentinian crisis cases, aiming to derive comparative benchmarks from States in as approximate position as possible would arguably significantly contribute to the tribunal's findings.<sup>103</sup>

The specificities encountered in post-conflict or transitional countries are also recognised in other fields of legal research, and this can prove instructive for ISDS

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<sup>98</sup> *Frontier Petroleum v. Czech Republic*, para. 334 (footnotes omitted).

<sup>99</sup> Interestingly, some authors explicitly note a 10 year backlog of cases as an unacceptable situation, making ISDS preferable for dispute settlement (Salacuse 2000, 387).

<sup>100</sup> See, for example,

[http://ec.europa.eu/regional\\_policy/sources/docgener/studies/pdf/2010\\_government\\_1.pdf](http://ec.europa.eu/regional_policy/sources/docgener/studies/pdf/2010_government_1.pdf), 23.

<sup>101</sup> Maupin 2014b, 477.

<sup>102</sup> *ibid*, 479. The relevance of the circumstances is inherent in the doctrines such as necessity, *force majeure*, and changed circumstances in international and contract law (*ibid*, fn 37).

<sup>103</sup> Another potential example is *Toto v. Lebanon - Award*, where there were no attempts to offer comparative arguments on the functioning of administration in post-conflict states when deciding upon the amount of time it took domestic administration to perform certain acts (see paras. 182, 189-194).

tribunals. Post-conflict countries are often grouped together when examining their various legal aspects,<sup>104</sup> and so are the countries exhibiting various other forms of transition.<sup>105</sup> While the transition towards a market-driven economy has sometimes featured as relevant in certain awards (see section 5.3.3 below), there is certainly a lot more potential to make these circumstances significant in supporting the conclusions reached by the tribunals.

*Ascertaining the content of comparative benchmarks*

A different set of questions arises if and when the suitable comparators are chosen by the tribunal. The actual comparative research is often a complex effort that can be marred by both conceptual and practical obstacles.<sup>106</sup> It is not surprising that it is often geared towards the main legal systems of the world. As indicated by Schill:

[a]s a matter of practical convention, and in view of difficulties comparative lawyers face in terms of availability of foreign law sources and scholarship, the legal orders most often analysed are German, French, English and U.S.-American law. The reason for this choice is not one of legal hegemony, but rather the fact that these legal orders are *easily accessible* and, above all, have influenced the legal systems of many other countries.<sup>107</sup>

The considerations of influence are relevant and can justify relying on particular well-known legal systems, as also touched upon above. The distinction in accordance with the accessibility of materials would generally be less justifiable in normative terms, even if understandable in terms of practicality.

More generally, the proper use of the comparative method is a highly sophisticated task, prone to negligence and manipulation – and experience suggests that arbitrators can sometimes be overwhelmed and resort to superficiality and simplifications.<sup>108</sup> Lack of the required depth, rigour and transparency can result, as stated in the ECtHR context, in ‘[...]haphazard and overly casual assertions of similarities or divergences in national laws [that] constitute a serious weakness that

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<sup>104</sup> See, for example, Grenfell 2013; Dam-de Jong 2015; and a series of UN OHCHR publications on rule of law tools for post conflict countries at [www.ohchr.org](http://www.ohchr.org).

<sup>105</sup> See for example Buchanan/Zumbansen 2014 and Murell 2001.

<sup>106</sup> See more generally Smits 2012, 26-27 and Zweigert/Kötz 1998, 4-13.

<sup>107</sup> Schill 2012b, 148. See similarly Bingham 2010, 4. For criticism of Western-centric approach, see also Alvarez 2016, 220-221.

<sup>108</sup> Kleinheisterkamp 2015, 817-818.

undermines the legitimacy of the Court [...].<sup>109</sup> These inherent risks, particularly in the investment context and regardless of the used comparative methodology, indicate a need for reliable sources.<sup>110</sup>

Still, several factors support the plausibility of the recourse to comparative benchmarks. To a considerable extent, even without *de lege ferenda* improvements, the persuasive and sufficiently rigorous use of the comparative benchmarks is far from impossible. However, certain further instruments would arguably facilitate the comparative efforts of arbitrators, regardless for which purposes they are undertaken. These suggestions will be briefly elaborated in turn.

#### Existing methods and resources

In the comparative benchmarks context here suggested, the tribunals are not aiming at either grand contributions to the comparative law field, establishment of general principles or the imposition of legal transplants. The use of comparative benchmarks would be case-specific, and with a relatively narrow sphere of interest. In that sense, the considerable difficulties of applying the comparative law method properly are of a more limited impact, especially if what is sought is data on policy and practice.

If the focus is put more on the actual comparative content than on methodological issues, arguably most (if not all) arguments put forward within the context of ascertaining the content of the ideal-type model stand here as well.<sup>111</sup> To the extent that the tribunal would be open to comparative arguments, it is arguable that the parties themselves would be in a position to provide a sufficient wealth of materials to form a reasonably good comparative picture.<sup>112</sup> Likewise, the considerable possibilities remain open for the tribunals to ascertain the potentially relevant facts themselves.<sup>113</sup>

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<sup>109</sup> Carozza 1998, 1225.

<sup>110</sup> Montt 2012, 166.

<sup>111</sup> See generally Chapter 4, section 4.6.

<sup>112</sup> A hint of this is also the expert report touched upon in *Sempra v. Argentina - Award*, paras. 339 and 350 and *Enron v. Argentina - Award*, paras. 300 and 308, as discussed above.

<sup>113</sup> See Chapter 4, 4.6 - *The (lack of) dependence on the parties' submissions*.

Particularly in the sphere of ascertaining the comparative policy and practice, there already exists a wealth of available information. A large portion of the activity of numerous organizations, including the United Nations, World Bank Group and OECD is dedicated to the type of comparative research that can be of considerable relevance. For example, the World Bank hosts a wealth of information in the World DataBank – specifically in its Worldwide Governance Indicators that can provide information on issues such as government effectiveness, corruption, regulatory quality and rule of law for 215 jurisdictions globally.<sup>114</sup> Similarly, World Justice Project activities dedicated specifically to rule of law in countries around the world offer much needed insights into the overall state in a particular jurisdiction.<sup>115</sup>

OECD publications provide an excellent overview of the functioning of civil justice in member countries, including length of trials at various instances, pertinent issues and proposals for reform.<sup>116</sup> As for administrative efficiency and the functioning of public administration in general, it is possible to gather a plethora of information from the EU.<sup>117</sup> For discussing the particular industries it is possible, for example, to find comprehensive information on health services in OECD with problems, different models and best practices.<sup>118</sup> Furthermore, the UN work on the rule of law provides numerous documents in the area of governance, private sector, land and property in different regions of the world.<sup>119</sup> Research by the Bingham Centre on the Rule of Law offers, *inter alia*, the analysis of judicial independence issues in 53 Commonwealth countries,<sup>120</sup> and a specially dedicated selection of papers on the rule of law, development and international investment law.<sup>121</sup>

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<sup>114</sup> See <http://databank.worldbank.org/data/reports.aspx?source=worldwide-governance-indicators>, accessed 17 January 2017.

<sup>115</sup> See <http://worldjusticeproject.org/rule-of-law-index>, accessed 17 January 2017.

<sup>116</sup> OECD 2013.

<sup>117</sup> See, for one example among numerous others, [http://ec.europa.eu/europe2020/pdf/themes/34\\_quality\\_of\\_public\\_administration\\_02.pdf](http://ec.europa.eu/europe2020/pdf/themes/34_quality_of_public_administration_02.pdf), accessed 17 January 2017.

<sup>118</sup> OECD 2010.

<sup>119</sup> See <https://www.un.org/ruleoflaw/>, accessed 17 January 2017.

<sup>120</sup> [http://www.biicl.org/documents/689\\_bingham\\_centre\\_compendium.pdf](http://www.biicl.org/documents/689_bingham_centre_compendium.pdf), accessed 17 January 2017.

<sup>121</sup> [http://www.biicl.org/documents/654\\_the\\_importance\\_of\\_the\\_rule\\_of\\_law\\_in\\_promoting\\_development.pdf](http://www.biicl.org/documents/654_the_importance_of_the_rule_of_law_in_promoting_development.pdf), accessed 17 January 2017.

To conclude, obtaining information is already not an insurmountable obstacle for comparative forays. The issue, rather, is the readiness of the tribunals to make them a more regular occurrence in their reasoning.

### Comparative law and a soft-law instrument

Regardless of the above, there is still room for making the comparative research tasks of the tribunals easier. This is especially so as gaining deeper understanding of the functioning of a particular system of law in order to be able to gain comparative insights can be a far more complex task than obtaining factual or statistical data.<sup>122</sup> There is thus still a lot to be said in favour of a focused, dedicated instrument that would serve the needs of substantive decision-making, both in the FET context and elsewhere.<sup>123</sup>

Bearing in mind the specificities of the field, a potential development could be a soft-law instrument providing an authoritative, systematic and accessible overview of comparative law and jurisprudence in (at least) the key areas of relevance – constitutional, administrative and contract law. The idea of a soft-law codification in the sphere of IIL has been recently brought up in different contexts, although the focus seems to be on concretising the IIA obligations rather than on offering source material for ancillary support.<sup>124</sup> However, a lot of the suggested elements can also be relevant for facilitating the use of comparative benchmarks. The idea of a re-statement or a pre-statement of principles of IIL based on comparative law has been recently presented in some detail by Jan Kleinheisterkamp in the context of the comparative public law approach.<sup>125</sup> This can serve as a good basis to emphasise the similarities and the potential modifications which would make such an instrument useful in several different contexts which involve comparative examinations.

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<sup>122</sup> See in particular Legrand 1996 and Legrand 1997, as well as Carozza 1998, 1233, as well as Goff 2000, 240-241.

<sup>123</sup> See, for a similar tone in a somewhat different context, the opinion of Lord Goff in *White v. Jones*, 263 B, suggesting that accessible comparative material can greatly assist the readiness to embark on a comparative law examination.

<sup>124</sup> See in that sense Chapter 3, section 3.1. as well as Bjorklund/Reinisch 2012 and Bjorklund 2012; and on the ultimately abandoned International Law Association attempt see <http://www.ila-hq.org/download.cfm/docid/058DBA5E-310B-44F9-AF9A0F0CBDB887CF>, accessed 1 February 2017.

<sup>125</sup> See generally Kleinheisterkamp 2015.

The instrument proposed by Kleinheisterkamp would be ‘a code-like, detailed and richly commented set of rules that embody a re-statement and, probably more so, a pre-statement of Principles of Investment Protection[...].’<sup>126</sup> Comparative research should provide the common core of constitutional and administrative standards of countries with the most stable traditions, yet with due considerations for flexibility required for the developed countries.<sup>127</sup> When this is not possible, at least insights into the best practices and experiences should be provided, and ultimately result in a code with solutions which have a sound balance between the private and public interests of the host States.<sup>128</sup>

While this would not necessarily coincide with the elements of the ideal-type model and the comparative benchmarks, there are a number of other points that can be fully supported. What is indeed needed ‘is a vehicle that will provide practice with a ready-to-use elaborate final product of the comparative approach’<sup>129</sup> and a ‘practical tool for navigating the rough sea of comparative law’.<sup>130</sup> Furthermore, it is also the case that a lack of central authoritative organ in IIL strongly advocates the creation of the instrument by a group combining legal experts and government officials, sufficiently representative in terms of legal backgrounds and ideally under the auspices of an recognized and authoritative international organization.<sup>131</sup>

Considering the previous discussions, a *three*-component instrument might present a more complete answer. The first component would contain a set of basic prescriptions for conducting a sufficiently rigorous comparative exercise and ascertainment of rules, to an extent similarly to the ILA Recommendations on Ascertaining the Contents of the Applicable Law in International Commercial Arbitration.<sup>132</sup> This methodological component should provide general guidelines for a case-specific comparative analysis. The second component would contain an accessible presentation of the relevant substantive rules in different jurisdictions (with a list of jurisdictions as comprehensive as possible, or at least containing representative of each

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<sup>126</sup> *ibid.*, 821-822.

<sup>127</sup> *ibid.*, 820.

<sup>128</sup> *ibid.*

<sup>129</sup> *ibid.*, 818.

<sup>130</sup> *ibid.*, 822.

<sup>131</sup> *ibid.*, 819-820.

<sup>132</sup> ILA Resolution 6/2008, available at: [www.ila-hq.org](http://www.ila-hq.org), accessed 17 January 2017.



legal ‘family’),<sup>133</sup> and would greatly assist the tribunal in its search for the content of legal regimes used as comparators. Finally, a third component could indeed be a codification-like set of rules based on the common or best solutions found in the second component.

Such an instrument would have different potential uses. The third component could promote the further development of IIL along the comparative public law lines, the second one the use of comparative benchmarks, but both can also be used by interested States for other goals. Having such an instrument could serve as an inspiration to States to ‘harden’ its rules, i.e. reform their existing or future IIAs, issue interpretive statements, further influence the development of arbitral practice through their argumentation, or even reform domestic law in accordance with what is identified as best practice. In the meantime, the exposition of the comparative methodology and sources would also largely facilitate the potential use of comparative benchmarks as set out in this Chapter.

#### **5.2.4. Comparative benchmarks – some concluding remarks**

The interplay of the variety of potential issues in dispute between investors and States and the vast existing reservoir of ways in which these issues have been regulated by other States and regimes, opens large possibilities for the comparative insights in the decision-making of arbitrators. Even with considerable efforts to elaborate a thorough ideal-type framework, the chances are that the room will remain open for sensitive and often discretion-laden determinations. Depending on the particular standard and method of review, the tribunals will find themselves in the position to pronounce on the suitability, necessity and reasonableness of various State measures, sometimes enacted under the circumstances of crisis and urgency. Apart from shaping the IIA interpretation and general principles of law as a source of international law, it stands to reason that comparative efforts can also be employed to offer very concrete support for specific conclusions of tribunals. Even if not binding or determinative *per se*, a persuasive finding that the host State did or did not do something in accordance with

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<sup>133</sup> For discussion on delineation of legal families and a common systematisation see Zweigert/Kötz 1998, 63-321.

comparative law, policy or practice can provide significant legitimacy and credibility for the tribunal's ultimate conclusions.

The recourse to comparative benchmarks is certainly not an easy endeavour, but the potential benefits of persuasiveness, legitimacy and even offering guidance for the host State reform arguably make the exercise worthwhile. In any case, there is already a plethora of available comparative materials that can be employed for these purposes as well as possibility to use the parties' and tribunals' own research. Furthermore, a possibility remains open for a soft-law instrument that would ideally combine different descriptive and prescriptive comparative elements and further facilitate the task of tribunals. The rich treasure chest of comparative benchmarks lays available to investment tribunals - ignoring it would be a needlessly missed opportunity for worthy additions to the legal reasoning process.

### **5.3. Corrective good faith factors**

The second element here discussed is the role of the good faith considerations in the FET decision-making. The focus on the NROL paradigm and the ideal-type model arguably limits the role good faith should play in deliberations. The evolution of FET jurisprudence shows that the principle of good faith often became the explicit or implicit foundation for defining host State obligations. Usually, it served as a basis for more specific concepts and doctrines. Instead, as the rule of law 'core' of the FET has sufficiently stabilized, the use of the principle should shifted towards a corrective, *ultima ratio* role of securing a fair outcome in an individual case. As is sometimes noted, at least regarding the civil law countries, the functions of the good faith principle can be seen in interpretation/concretisation, supplementation and correction.<sup>134</sup> If the ideal-type model would be relied on more in interpretation and application of the FET and its sub-principles, the good faith should thus be increasingly confined to the corrective role.<sup>135</sup>

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<sup>134</sup> Hesselink 2011, 626-627; Lenaerts 2010, 1146.

<sup>135</sup> To reiterate, good faith considerations can also play their corrective role at the stage of potential determination of compensation due to the foreign investor. This is, however, not the focus of the discussion here. See for example Viñuales 2017, 364-366 for an overview of good faith and the quantum phase.

This section thus outlines the *corrective good faith factors* as another corollary to the tribunals decision-making in FET claims, that also aims to contribute to the balancing of the IROL and NROL considerations. It argues that doctrines and factors based on good faith in existing jurisprudence should generally (with certain exceptions) be reimagined as coming sequentially after the steps outlined in the previous Chapter and in the previous section. After a brief overview of good faith in international law and IIL, and a suggestion for a shift in its role (5.3.1.), the sections below will examine the situations in which good faith remains of determinative importance more directly (5.3.2.) and finally the specific suggested corrective factors which can be taken into account on the side of both the host State and the investor (5.3.3.).

### 5.3.1. A brief overview of good faith in international law and IIL

The role of the principle of good faith in international law can hardly be overstated.<sup>136</sup> As is sometimes noted, it ‘permeates virtually every legal relationship’<sup>137</sup> and is often considered simultaneously both a general principle of law within the ICJ Statute 38(1)(c) and the general principle of international law,<sup>138</sup> as well as a part of customary international law.<sup>139</sup> It is featured perhaps most prominently in the UN Charter Article 2(2) requirement that all UN members ‘shall fulfil in good faith’ all obligations assumed under the Charter. The principle of good faith plays different important roles.<sup>140</sup> As indicated by the VCLT,<sup>141</sup> there exist the good faith obligation not to defeat the object and purpose of a treaty prior to its entry into force;<sup>142</sup> to perform treaty obligations in good faith;<sup>143</sup> and to interpret treaties in good faith.<sup>144</sup> More generally, negotiating and settling the disputes should be performed in good faith as

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<sup>136</sup> The situation is similar in national private laws (Hesselink 2011, 620) although its importance can reach far into the public law sphere as well (ibid, 634-635).

<sup>137</sup> Ziegler/Baumgartner 2015, 9. See similarly Paparinskis 2015b, 143; Reinhold 2013, 40. For a similar appreciation in ISDS jurisprudence see *Phoenix v. Czech Republic*, para. 107.

<sup>138</sup> Brownlie/Crawford 2012, 37-38; Shaw 2008, 103-104; Cheng 1953, 105; Pellet 2012, paras. 250 and 260. As Kotzur notes, ‘[g]ood faith belongs to the very few legal principles which do find resemblance in more or less all legal systems and legal cultures’ (2009, para. 5).

<sup>139</sup> Mitchell 2006, 445; Kotzur 2009, para. 22.

<sup>140</sup> See also Goodwin-Gill 2004, 88.

<sup>141</sup> See on this generally Reinhold 2013, 59-63.

<sup>142</sup> VCLT Article 18.

<sup>143</sup> VCLT Article 26.

<sup>144</sup> VCLT Article 31(1). For an overview of numerous other international law instruments referring to good faith see Kotzur 2009, paras. 7-14.

well as the exercise of rights.<sup>145</sup>

Regardless of its undisputed importance, the notion of good faith is notoriously hard to define.<sup>146</sup> In a somewhat tautological circle, the definitions suggest that acting in good faith entails the need to respect equally abstract concepts such as honesty, reasonableness, fairness and openness.<sup>147</sup> Particularly in the international sphere, cultural differences makes ‘universal good faith’ criteria difficult to achieve.<sup>148</sup> As Kolb suggests, the notion ‘cannot be entirely grasped by abstract definitions’.<sup>149</sup>

Bearing in mind this open-textured nature, and focusing for the purposes of this discussion on the principle of good faith as a source of substantive obligations, it is possible to distinguish between its autonomous sphere of operation and its more common role of serving as a basis for more concrete doctrines.<sup>150</sup>

The autonomous role for good faith as a source of obligation, whether stemming from its status as a general principle or part of customary international law, remains contentious.<sup>151</sup> Importantly, the ICJ has held that good faith is ‘not in itself a source of obligation where none would otherwise exist’<sup>152</sup> and is only relevant for the ‘fulfilment of existing obligations’.<sup>153</sup> While this position is certainly open to criticism,<sup>154</sup> it arguably reflects the justified general reluctance to impose binding and potentially justiciable obligations based on the abstract notions which are usually associated with defining good faith. The proximity of good faith to perhaps the broadest legal concept in existence, that of *justice*,<sup>155</sup> would seem to warrant such caution.

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<sup>145</sup> See above all the seminal work of Cheng 1953, 106-120, as well as Kotzur 2009, para. 15-17; Reinhold 2013, 56-57 and ICJ jurisprudence such as *Nuclear Tests (Australia v. France)*, para. 46 and *Gulf of Maine*, para. 87.

<sup>146</sup> Kotzur 2009, para. 1; Ziegler/Baumgartner 2015, 35-36; Reinhold 2013, 40.

<sup>147</sup> Ziegler/Baumgartner 2015, 11; Kotzur 2009, para. 22; Hesselink 2011, 621. For example, the *Phoenix v. Czech Republic* tribunal noted that good faith requires the parties to ‘deal honestly and fairly with each other, to represent their motives and purposes truthfully, and to refrain from taking unfair advantage [...]’ (para. 187).

<sup>148</sup> Lowe 2007, 117-119.

<sup>149</sup> Kolb 2006, 13. See similarly Hesselink 2011, 622.

<sup>150</sup> See on the latter Kolb 2000, 113.

<sup>151</sup> Ziegler/Baumgartner 2015, 14.

<sup>152</sup> *Border and Transborder Armed Actions - Nicaragua v. Honduras*, p. 69, p. 105, para. 94.

<sup>153</sup> *Land and Maritime Boundary between Cameroon and Nigeria*, p. 304, para. 59.

<sup>154</sup> See for example Kolb 2000, 157-158 and also Ziegler/Baumgartner 2015, 14.

<sup>155</sup> Kotzur 2009, para. 23; Hesselink 2011, 621.

International courts and tribunals rather refer to the particular concretisations of good faith.<sup>156</sup> The autonomous use of the principle would thus usually be restricted to situations in which a dispute cannot be settled on the grounds of its particular concretisations in treaty or customary law form.<sup>157</sup> The process of particularising the general principle of good faith is well-observed in national laws as well, and in that sense straddles the common/civil law divide.<sup>158</sup> In international law more generally, the principle of good faith has more or less directly served as the basis for doctrines<sup>159</sup> such as legitimate expectations,<sup>160</sup> *pacta sunt servanda*,<sup>161</sup> estoppel,<sup>162</sup> acquiescence,<sup>163</sup> equity,<sup>164</sup> and *abus de droit*.<sup>165</sup> Such a trend, to bring the discussion into the FET and IIL sphere more specifically, has certainly been prominent in ISDS.

As touched upon in the previous chapters, and perhaps even more than elsewhere in international law,<sup>166</sup> the ISDS tribunals have explicitly or implicitly taken the principle of good faith as a rule-generative tool, not the least in the FET context.<sup>167</sup> This was certainly in no small part inspired by both the language such as ‘fair’ and ‘equitable’ and by the wording of VCLT Article 31(1) rule on interpretation.<sup>168</sup> A number of important concepts essentially stem from the principle of good faith.<sup>169</sup> Perhaps most prominently,

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<sup>156</sup> Reinhold 2013, 47.

<sup>157</sup> Ziegler/Baumgartner 2015, 9-10. For similar considerations concerning national civil codes, see Hesselink 2011, 619.

<sup>158</sup> Kotzur 2009, paras. 3 and 6; Reinhold 2013, 41-42; Whittaker/Zimmermann 2000, 653-702; Hesselink 2011, 635 and 648-649; Lenaerts 2010, 1125-1126 and materials cited therein. One of the prominent examples is Article 242 of the German Civil Code, containing a general principle of good faith that has served as a source for numerous other concretisations. See Hesselink 2011, 623-624 and Reinhold 2013, 42-43 and materials cited therein. For similar considerations in European private law codification projects see Lenaerts 2010, 1145.

<sup>159</sup> Most of these doctrines have versions relevant for both substantive and procedural aspects. See Kotzur 2009, para. 24; Ziegler/Baumgartner 2015, 12.

<sup>160</sup> Ziegler/Baumgartner 2015, 17-18.

<sup>161</sup> *Nuclear Tests (Australia v. France)*, para. 46; Kolb 2000, 97-99; Ziegler/Baumgartner 2015, 18-19; Reinhold 2013, 47-49.

<sup>162</sup> Brownlie/Crawford 2012, 420; Cottier/Müller 2007, paras. 1-2; Ziegler/Baumgartner 2015, 20 and 22.

<sup>163</sup> *Gulf of Maine*, 305; Ziegler/Baumgartner 2015, 23-26; Reinhold 2013, 53-56.

<sup>164</sup> *Gulf of Maine*, 305; Paparinskis 2015b, 153-154.

<sup>165</sup> Reinhold 2013, 49-50; Mitchell 2006, 350; Ziegler/Baumgartner 2015, 30-35; For abuse of rights in EU law and jurisprudence, see Lenaerts 2010.

<sup>166</sup> As noted, ‘the ICJ and the WTO Appellate Body have thus far shown themselves extremely cautious in attaching a possible lack of good faith only to specific good faith norms or concepts, while investment tribunals have shown somewhat less restraint, probably due to differing adjudicatory mandates.’ (Ziegler/Baumgartner 2015, 35-36).

<sup>167</sup> Paparinskis 2015b, 144; Ziegler/Baumgartner 2015, 13. It is worth noting Hesselink’s remark that ‘[i]n reality, good faith is not a norm but a mouthpiece (*a porte parole*) for new rules [...]’ (2011, 641).

<sup>168</sup> ‘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’ (emphasis added). For suggestions to limit the role of good faith see Douglas 2014, 169.

<sup>169</sup> See, for example, Ziegler/Baumgartner 2015, 13 and 16 and Dolzer/Schreuer 2012, 156.

it serves as the origin of the ubiquitous doctrine of legitimate expectations as a concretisation of the FET standard.<sup>170</sup> As previously noted, the *Tecmed v. Mexico* tribunal found support for its vision of what the investor can expect from the host State in the principle of good faith in international law.<sup>171</sup> The principle has also, for example, served as a basis for a particular estoppel-like concept of non-arbitrariness in *Micula v. Romania*.<sup>172</sup>

There is, however, also support for the more autonomous obligation of good faith. Although not discussed completely outside the context of the IIA standards,<sup>173</sup> certain tribunals have suggested an autonomous scope of application for good faith. For example, the tribunal in *TECO* suggested that good faith was rather an independent obligation of the host State that had to be taken into account to assess the breach of the relevant standard.<sup>174</sup> Somewhat similarly, in response to the Respondent's assertion that good faith imposed no independent obligations, the tribunal in *Merill & Ring v. Canada* stated that good faith was a general principle that generates obligations which cannot be ignored, and which in particular circumstances might be closely related to securing stable legal environment and transparency.<sup>175</sup> Indeed, as is sometimes noted, the investment tribunals are at least theoretically in a position to explore the autonomous good faith obligation much more elaborately than some other fora (such as the WTO DSB) due to broad applicable law clauses and limited annulment grounds.<sup>176</sup>

The obligation to behave in good faith has also been bestowed on foreign investors as a result of their partial international legal personality stemming from the IIA-granted rights.<sup>177</sup> While also of considerable importance regarding the legality of investment as a jurisdictional issue,<sup>178</sup> and the potential abuses of the ISDS as a procedural mechanism,<sup>179</sup> the obligation of investors' good faith behaviour is also

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<sup>170</sup> More generally, Kotzur suggests that the legitimate expectations of parties are what good faith is essentially about (2009, para. 26). See also Brownlie/Crawford 2012, 616-619.

<sup>171</sup> *Tecmed v. Mexico*, paras. 154-155. See also Chapter 2, section 2.2.2. as well as Paparinskis 2015b, 144; Douglas 2006, 27; Potestà 2013, 92.

<sup>172</sup> *Micula v. Romania*, paras. 831-834.

<sup>173</sup> Ziegler/Baumgartner 2015, 16.

<sup>174</sup> *TECO v. Guatemala – Award*, para. 456.

<sup>175</sup> *Merill & Ring v. Canada*, para. 187. See also Paparinskis 2015b, 145.

<sup>176</sup> Ziegler/Baumgartner 2015, 16.

<sup>177</sup> Kotzur 2009, para. 25; Ziegler/Baumgartner 2015, 13.

<sup>178</sup> See, for example, *Vannessa Ventures v. Venezuela – Award*, paras. 125-127.

<sup>179</sup> See *Mobil v. Venezuela – Jurisdiction*, paras. 169-207.

concretised in examining the merits of the case, again often not the least in the FET context.<sup>180</sup>

Notwithstanding the refinements that the particular doctrines experienced in jurisprudence, as well as their interplay with other sources of international and national law, it could still be questionable if the principle of good faith is generally a good primary choice for concretising the FET standard. Standing alone, good faith is inherently abstract and leaves a broad margin of discretion to the decision-maker,<sup>181</sup> something which is not necessarily beneficial in interpreting the equally abstract notions such as ‘fair’ and ‘equitable’. This can lead to situations in which the process of certain good faith-based doctrines becoming the part of the IIL *acquis* is ‘not straightforward or obvious’.<sup>182</sup>

The principle of good faith in essence allows retaining flexibility for dispute-settlers, and while fleshing out particular doctrines certainly helps, it remains open to discussion if even these should be the first port of call when decisions are not rendered *ex aequo et bono*. As is sometimes noted, what the FET now requires is less generality of principles and standards, are more detailed rules of technical law.<sup>183</sup> In a system aiming to secure the precepts of the rule of law, and already under at least a suspicion of a ‘legitimacy crisis’, the overly broad use of good faith should be viewed with caution.<sup>184</sup>

With a parallel focus on the holistic examination of the national rule of law commitments, as exemplified by the ideal-type model, there is arguably a diminished need for good faith and its manifestations to (continue) to be the primary purveyors of meaning or preferable tools for decision-making. Excluding the situations that will be addressed in section 5.3.2. below, their role should be limited to a residual and carefully used power of arbitrators to secure the fairness of ultimate outcome.<sup>185</sup> This would

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<sup>180</sup> See generally Muchlinski 2006 and Viñuales 2017.

<sup>181</sup> As sometimes argued, good faith ‘is merely the mouthpiece through which new rules speak, or the cradle where new rules are born’ (Hesselink 2011, 645). See also in that sense Ziegler/Baumgartner 2015, 9.

<sup>182</sup> Paparinskis 2015b, 168.

<sup>183</sup> *ibid*, 171.

<sup>184</sup> Ziegler/Baumgartner 2015, 16-17 and 35-36; As Kotzur notes more generally, the use of good faith ‘may inevitably contain the risk of an all too ambitious judicial activism’ (2009, para. 26).

<sup>185</sup> As suggested by the VCLT preamble, there should be a room to settle disputes both ‘in conformity with the principles of *justice* and international law.’ (emphasis added).

therefore be a move towards the corrective or limitative function of good faith.<sup>186</sup> It should, among others, serve as a final check that ‘mere’ or ‘blind’ formalism<sup>187</sup> (insufficiently addressed through the ideal-type model) does not prevent what the tribunal would perceive as a fair outcome. As Paparinskis has observed:

[...] one should not rush to employ good faith as a ubiquitous shortcut to the conclusion of the legal argument, merely because the mundane exercise of competently identifying and applying the small print of international law turns out to be more vexing than expected.<sup>188</sup>

Instead of a shortcut towards a conclusion, good faith can thus be perceived rather as a potential and hopefully seldom needed modifier to it. Yet, before examining good faith factors in this context, it is warranted to briefly address the situations where good faith considerations and concretisations should still play a different role than just a corrective one.

### 5.3.2. Clear *mala fides* and good faith considerations within the ideal-type model

There are at least two exceptions to good faith coming into play only as an ultimate corrective. One is where there is sufficiently clear evidence of bad faith (*mala fides*) aimed against the investor. The second, and perhaps more likely, is the situation in which the ideal-type model sufficiently clearly contains specific good faith requirements/concretisations and can therefore already then be taken into account by the tribunal during its exercise of scrutiny.

As for the first situation, there would seem to be little point in constructing and using an overly elaborate ideal-type model as a reference if the evidence clearly indicates bad faith (*mala fides*) aimed against the investor or the investment. That, as is sometimes argued, would ‘be an automatic per se breach of the FET standard’.<sup>189</sup> This would be ‘intentionally harmful conduct, a pattern of behaviour consciously undertaken to procure damage’.<sup>190</sup> Such is, for example, a malicious or fictitious exercise of an existing

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<sup>186</sup> This role being recognised, for example, in numerous national legal systems and in the EU law *acquis* (Lenaerts 2010, 1146-1147 and 1149, especially fn 166).

<sup>187</sup> Paparinskis 2015b, 154; Kotzur 2009, para. 2.

<sup>188</sup> Paparinskis 2015b, 146.

<sup>189</sup> Draguiev 2014, 274.

<sup>190</sup> *ibid*, 278.



right, ‘for the sole purpose of causing injury to another’.<sup>191</sup> Such is also the case where the modifications of laws were made specifically to prejudice a particular investment<sup>192</sup> or when legal instruments are clearly used for purposes other than those for which they were created.<sup>193</sup> A recently proposed systematization<sup>194</sup> has grouped such *mala fides* situations as established or hypothetically mentioned in case law as those of ‘political engineering’,<sup>195</sup> ‘conspiracy’,<sup>196</sup> ‘abuse of powers’,<sup>197</sup> ‘coercion and harassment’<sup>198</sup> and in some situations ‘denial of justice and similar phenomena’.<sup>199</sup>

While these instances can often be intertwined and are sometimes difficult to discern,<sup>200</sup> the sufficiently persuasive indication of an action motivated by the *specific* desire to harm the investor or investment, for whatever reason, would make the holistic examination of the ideal-type model rather redundant.<sup>201</sup> The use of the already existing doctrines in international law dealing with such situations, such as abuse of rights, would arguably suffice to offer a persuasive resolution to the dispute. At the same time, care should be taken not to conflate a *political* motive with a motive to *harm*. A new government might have a legitimate political agenda to pursue (which might have gotten the government elected in the first place), and that agenda usually involves specific economic and social measures.<sup>202</sup> The fact that the motive for such measures can be broadly characterised as ‘political’ should not lead to automatic *mala fides*. Rather, the recourse to (e.g.) conspiracy and harassment in order to pursue those goals would lead into the territory of an automatic breach of both FET and other related standards, such as arbitrariness. Pursuing those goals in line with the ideal-type model should generally not.

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<sup>191</sup> Ziegler/Baumgartner 2015, 32.

<sup>192</sup> *Parkerings v. Lithuania*, para. 337. Although not explicitly, similar conclusion can be devised *a contrario* from *Link-Trading v. Modlova*, para. 69.

<sup>193</sup> Dolzer/Schreuer 2012, 158. As Mendelson notes, it may be legitimate to ascertain ‘whether the motive of the authorities was really to comply with their outside obligations, or whether these were just being used (perhaps ex post facto) as an excuse’ (2009, 493). Similarly *SD Myers v. Canada – First Partial Award*, paras. 214-215.

<sup>194</sup> See generally Draguiev 2014.

<sup>195</sup> E.g. *Vivendi v. Argentina – Award 2*, *Eureko v. Poland*, *Bivater v. Tanzania*. See Draguiev 2014, 285-291.

<sup>196</sup> E.g. *Waste Management v. Mexico*, *Bayindir v. Pakistan*. See Draguiev 2014, 291-292.

<sup>197</sup> E.g. *RDC v. Guatemala*. See Draguiev 2014, 292-293.

<sup>198</sup> E.g. *Desert Line v. Yemen*. See Draguiev 2014, 297-299.

<sup>199</sup> For example in situations such as ‘clear and *malicious* misapplication of the law’ (*Azinian v. Mexico*, para. 103, emphasis added). See Draguiev 2014, 293-296.

<sup>200</sup> Draguiev 2014, 300.

<sup>201</sup> See for example *Desert Line v. Yemen*, para. 179 and the host of rather clearly coercive *mala fides* measures.

<sup>202</sup> See similarly *AES v. Hungary – Award*, para. 10.3.23-10.3.24.

However, there are a number of reasons why this particular *mala fides* ‘trump card’ may be of more limited importance. It is not only that bad faith is not considered necessary for the breach of FET,<sup>203</sup> but also that the threshold for establishing its existence is high.<sup>204</sup> As is noted, ‘[n]o arbitral award has based its reasoning and conclusions entirely and exclusively on findings of bad faith in order to recognize breach of the FET’.<sup>205</sup> Arguably, the realities of the investor-State disputes only on occasion show a clear scenario where the host State actions are primarily motivated by the desire to harm the foreign investor. A much more realistic scenario can involve negligent behaviour that might have no underlying ulterior motive,<sup>206</sup> but should regardless be considered as relevant – in particular if the goal is to strengthen the national rule of law and good governance more generally. Opaqueness of the legal framework and deficiency in the work of the administrative and judicial apparatus is still capable of breaching the FET standard, even without *mala fides*.<sup>207</sup>

Leaving this sphere, the second and potentially more common situation would be where some of the instruments forming the host State ideal-model contain explicit requirements for the decision-makers to act in good faith or in accordance with one of the (national) doctrines concretising the general principle.<sup>208</sup> The tribunal could then rely on the domestic statutory, jurisprudential and doctrinal elaboration so as to offer a persuasive application in a particular case, along the lines of the *Dan Cake* award examined in the previous chapter.

A good example in that sense is the doctrine of legitimate expectations. Apart from its importance in the current FET standard context, the doctrine can be examined in a national law context.<sup>209</sup> To the extent that a tribunal does not persuasively determine that the doctrine has become a general principle of law as a source of

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<sup>203</sup> Dolzer/Schreuer 2012, 158; Paparinskis 2015b, 166-167. See in that sense also *Mondev v. United States*, para. 116 and *Loewen v. United States*, para. 132.

<sup>204</sup> *Parkerings v. Lithuania*, para. 307; *Bayindir v. Pakistan*, para. 223; Ziegler/Baumgartner 2015, 34; Dolzer/Schreuer 2012, 158.

<sup>205</sup> Draguiev 2014, 283. See also similarly 301 and Bonnitcha 2014, 160-161.

<sup>206</sup> Including behaviour ‘without deliberate purpose to harm’ and potentially ‘justified upon a legitimate regulatory concern’ (Draguiev 2014, 274). See also 283.

<sup>207</sup> *ibid*, 284.

<sup>208</sup> See in the context of administrative law Pérez Loose 2010, 392.

<sup>209</sup> See generally Schönberg 2003 and especially Mairal 2010.

international law, it can and should focus on the doctrine as a part of the ideal-type model in situations so deserving.

While there are certainly countries where the existence and/or scope of the doctrine is doubtful,<sup>210</sup> there are legal systems (including the EU law) where the ‘the protection of the expectations of individuals defeated by unforeseen decisions of the public authorities has developed into an important chapter of administrative law.’<sup>211</sup> In systems where the specific doctrine is not known, similar results can and are achieved by estoppel of *venire contra factum proprium*.<sup>212</sup> As suggested, with certain differences duly taken into account, the doctrine is known in various civil and common law systems, in Europe, US and also to an extent in Latin America.<sup>213</sup> While the level of development of the doctrine varies, and it might not be of help in a particular situation, due account of it by a the tribunal can put its reasoning on a firmer ground than when having to navigate the existing ISDS jurisprudence.

To briefly summarise, the possibility for using good faith and its particularisations would remain considerable even with the normative shift towards the NROL paradigm complementation. However, in the cases not covered above, the role should be a far more limited one.

### 5.3.3. Specific corrective factors and their potential use

To the extent that clear *mala fides* cannot be identified, and that specific good faith concretisations were not considered as a part of the ideal-type model, it is possible to suggest a non-exhaustive list of factors to potentially secure the case-specific fairness of outcome. These factors, or recurring fact-patterns, can relate to both the host State and the foreign investors. They can indicate whether a breach of the FET standard occurred regardless of the potentially different tentative conclusion coming from the scrutiny that involved the ideal-type model. Isolating recurring fact-patterns, as suggested above, has

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<sup>210</sup> See in that sense Potestà 2013, 93-98 and Paparinskis 2015b, 170.

<sup>211</sup> Mairal 2010, 413.

<sup>212</sup> *ibid*, 414. Generally, the estoppel and *venire contra factum proprium* doctrines have been treated in ISDS jurisprudence without much theoretical underpinning, and were sometimes conflated (see Ziegler/Baumgartner 2015, 22-23, and in particular *Duke v. Peru*, paras. 241–251 and 320–23).

<sup>213</sup> *ibid*, 414-419.

been present in doctrine to systematise the bad faith behaviour of States,<sup>214</sup> but it is possible to offer a (certainly non-exhaustive) systematisation of a different nature.

An illustrative starting point can be found in the *Lemire v. Ukraine – Jurisdiction v. Liability* award. The Tribunal suggested that the FET breach was to be established on a fact-specific, case-by-case basis and suggested that the relevant factors for the exercise include:

- whether the State has failed to offer a stable and predictable legal framework;
- whether the State made specific representations to the investor;
- whether due process has been denied to the investor;
- whether there is an absence of transparency in the legal procedure or in the actions of the State;
- whether there has been harassment, coercion, abuse of power or other bad faith conduct by the host State;
- whether any of the actions of the State can be labeled [*sic*] as arbitrary, discriminatory or inconsistent.<sup>215</sup>

In the following paragraph, the tribunal suggested some countervailing factors that also need to be taken into account before an FET breach is established:

- the State's sovereign right to pass legislation and to adopt decisions for the protection of its public interests, especially if they do not provoke a disproportionate impact on foreign investors;
- the legitimate expectations of the investor, at the time he made his investment;
- the investor's duty to perform an investigation before effecting the investment;
- the investor's conduct in the host country.<sup>216</sup>

To bring this into relation with the main arguments of this thesis, a number of these factors – namely the stable legal framework, due process, transparency of procedures, arbitrariness of actions, sovereign right to regulate, legitimate expectations – would be starting points to delve into an identification and examination of the host State's ideal-type model. Open bad faith, as suggested above, would remain a form of a 'trump card'.

But the remaining factors – specific representations to the investor, transparency of the overall legal framework (as opposed to the procedural one), investor's duty to investigate and the investor's own conduct – to the extent that they do not give rise to particular effects under the ideal-type model, can remain as separate and potentially

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<sup>214</sup> Draguiev 2014, 285.

<sup>215</sup> *Lemire v. Ukraine – Jurisdiction and Liability*, para. 285.

<sup>216</sup> *ibid*, para. 286.

mutually offsetting correctives to the scrutiny of the tribunal.<sup>217</sup> Another factor that should arguably be added to the side of the host State are circumstances (socio-political, historical, economic) that could influence its realisation of the ideal-type model obligations. The following sections will first touch upon the factors relating to the host State and then on those relating to the foreign investor.

#### *Factors relating to the host State*

##### Specific representations

The representations provided to the foreign investor are fairly commonly discussed in the FET context, particularly in the context of legitimate expectations.<sup>218</sup> As noted before, the reliance on the ideal-type model can in a way enhance the particular doctrine of legitimate expectations by creating a general presumed expectation that host State will act in accordance with that model. The focus would then turn on specific representations given to the foreign investor about the functioning of the domestic legal system/and or the manner in which the investment process would unfold. To the extent that these representations do not create legally protected expectations within the ideal-type model itself, they can become relevant at this ultimate stage.

This would include the situations in which the subsequent behaviour of the host State officials was in accordance with the ideal-type model, but with different and reliance-worthy representations about this behaviour being previously given to the investor. Such representations could be given at either the pre-investment or the post-investment stage. The potential difference between these situations can be the level of knowledge that the investor can be expected to have about the domestic legal framework when already settled and operating in the host State.

Specific representations given to the foreign investor could (depending also on interplay with other factors discussed below) trigger the breach of the FET standard. For example, representations of the sufficiently highly ranked or well-positioned host

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<sup>217</sup> See on the need to counterbalance of State and investor-related factors also Muchlinski 2008, 26-27.

<sup>218</sup> See, for example, Reisman/Arsanjani 2004.

State officials, in situations where there exists an opaqueness of the legal framework (as discussed below) and the investor proactively sought to clarify the legal situation (as also discussed below) could lead to a breach. At the same time, where sufficient possibility existed for the foreign investor (through its own investigation) to bring into question the specific given assurances, the impact of this factor is more limited. In the end, the representations provided should not be seen as an excuse not to partake in due diligence that can be expected from professional entities such as foreign investors.<sup>219</sup> This factor can also be brought in relation with the broader circumstances of the host State. As Viñuales suggests, ‘it would not be reasonable for an investor investing in a highly volatile political environment, whatever the assurances received, that the investment will no longer be affected by further disruptions.’<sup>220</sup>

The recent *Bilcon v. Canada* award can offer some illustration of the above considerations. The Claimant investor in the said case was interested in pursuing mining operations in the Canadian province of Nova Scotia.<sup>221</sup> Canadian officials at different levels of government expressed the support for this project and conviction in its beneficial realisation.<sup>222</sup> However, the licence for the project was eventually denied after a report of an environmental Joint Review Panel, that also took account of ‘community core values’.<sup>223</sup> This concept, the Claimant suggested, was not mentioned in the applicable legal framework for the JRP determinations.<sup>224</sup> The tribunal agreed, and determined that JRP report was fundamentally at variance with the applicable Canadian laws.<sup>225</sup> This was to such an extent that it warranted a finding of the breach of the Article 1105 of NAFTA, i.e. the minimum standard of treatment including the FET.<sup>226</sup>

Such findings on their own are reconcilable with an elaboration of the ideal-type model (applicable Canadian laws) followed by a scrutiny of the behaviour in accordance with the adopted standard of review (as derived from Article 1105 of NAFTA). However, the tribunal insisted that the integral part of finding the breach was the fact

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<sup>219</sup> Morris 2015, 67; Mairal 2010, 421.

<sup>220</sup> Viñuales 2017, 362-363. See similarly Kingsbury/Schill 2009a, 9.

<sup>221</sup> *Bilcon v. Canada – Award*, paras. 5, 8-9.

<sup>222</sup> *ibid*, paras. 458-471.

<sup>223</sup> *ibid*, paras. 502-506.

<sup>224</sup> *ibid*, paras. 20-24.

<sup>225</sup> *ibid*, paras. 530-535.

<sup>226</sup> *ibid*, 598-604.

that representations of Canadian officials at various points in time created legitimate expectation about the project. As the tribunal noted:

The basis of liability under [NAFTA] Chapter Eleven is that, after all the specific encouragement the Investors and their investment had received from government to pursue the project, and after all the resources placed in preparing and presenting their environmental assessment case, the Investors and their investment were not afforded a fair opportunity to have the specifics of that case considered, assessed and decided in accordance with applicable laws.<sup>227</sup>

Arguably, it seems hard to see what would be the particular role of specific representations that were made by Canadian officials. The general expectation that the investor will be treated in accordance with applicable laws should not depend on any specific assurances by the officials, which makes their role at best ancillary and at worst redundant. But if the focus is on some hypothetical assurances that the project will go through, giving these such an important role can rather be detrimental for the rule of law. Would the investor then legitimately expect that Canadian officials would ‘make sure’ that the investment went through even if it meant contravening the law? Such a rule of law-adverse expectation could hardly be protected.

However, as a corrective factor, the specific representations can be relevant in a different way. Provided that the JRP report was hypothetically eventually found to be in accordance with the ideal-type model, the investor could potentially still claim a breach if: a) the intensity of representations about how the investment will unfold was sufficient (coming from well-positioned officials and not being a marketing puff) and b) that the examination of countervailing factors, such as investor’s own proactive due diligence, shows that the representations given by the officials were sufficiently plausible. But from a rule of law point, there is little to be said against the primary relevance of whether the domestic authorities applied the law properly, and not what various officials in different contexts said about the unfolding of the investment process.

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<sup>227</sup> *ibid*, para. 603.

### Transparency of the legal framework

The requirement of ‘transparency’ of the host State behaviour can have at least two meanings. One is the actual transparency of operation of the host State organs applying the domestic legal framework, and the other is the broader transparency of the legal framework itself. As Martins Paparinskis has suggested in a somewhat different context, ‘the “complete lack of transparency and candour in an administrative process” of *Waste Management II*, and the expectation that a state acts “totally transparently in its relations with the foreign investor” of *TECMED* are not quite the same thing.’<sup>228</sup> Within the context of the discussion here, the transparency of the administrative process would be something that should initially requires an elaboration of the ideal-type model – i.e. assessing what ‘transparent’ means in the host State.

The meaning suggested here is different. The transparency of the legal framework would essentially represent the possibility of the foreign investor to be clear about the regulatory surrounding in which its investment operates.<sup>229</sup> Apart from the more practical aspects, such as the physical possibility of garnering information about the legal framework,<sup>230</sup> this would include the potentially more problematic situations where the relevant instruments are available but their interpretation and future application in practice remains contentious.<sup>231</sup>

An example of such a problematic situation can be found in the *Parkerings v. Lithuania* award. A particular legal issue - legality of hybrid fees for parking - was both important for the resolution of the dispute<sup>232</sup> and objectively quite unclear at the moment when the investment was made. The issue resulted in conflicting opinions of the government representatives and the Vilnius City council, before eventually being settled by the courts.<sup>233</sup> Importantly, the investor itself invested efforts in obtaining professional legal advice, resulting in two conflicting legal opinions of Lithuanian law

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<sup>228</sup> Paparinskis 2015b, 167 (references omitted).

<sup>229</sup> See similarly *Champion Trading v. Egypt – Award*, para. 164.

<sup>230</sup> See in that sense also the discussion in Chapter 4 in section 4.6. - *Ascertaining the content of the ideal-type model elements*.

<sup>231</sup> Another potential concern is if the long-observed, yet potentially legally problematic domestic instruments can be disregarded by the tribunal (Grigera Naón 2014, 104-105).

<sup>232</sup> *Parkerings v. Lithuania*, paras. 295-296, 306, 328.

<sup>233</sup> *ibid*, paras. 78-80 and 119-126.



firms.<sup>234</sup> In such a vexed situation, there might exist an obligation on behalf of the host State to provide extra efforts so that a (proactive) investor is not at loss for the opaqueness of the legal framework.

Whether the sufficiently grave lack of transparency should lead to the breach of the FET standard would however also depend on the interplay the extent of the investor's own attempts to clarify its legal position. Provided that the investor put genuine efforts, as was the case in *Parkerings*, the ball would in that sense be in the host State's yard. More generally, insistence on this factor has considerable rule of law strengthening potential, bearing in mind the requirement of clear and prospective rules that form the essence of the formal understanding of the term.

#### Circumstances of the host State

A question arising particularly in the context of application of FET and full protection and security standards in crisis situations is if and how the particular circumstances of the host State should affect the application of these standards. Although perhaps not so obviously, this factor has also been seen as related to good faith and justice, as it could be unfairly harsh to ignore the potentially dire circumstances in which the host State finds itself.<sup>235</sup> The approach towards this issue in ISDS jurisprudence has been rather heterogeneous.<sup>236</sup> Leaving aside the situations in which the host State circumstances were considered only relevant for the quantum stage of the proceedings,<sup>237</sup> there are examples of the tribunals considering these circumstances as relevant for the existence of an FET breach,<sup>238</sup> irrelevant, or only relevant for particular manifestations of the FET but not the others.<sup>239</sup>

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<sup>234</sup> *ibid*, para. 78-79.

<sup>235</sup> As suggested by (although in the context of determining compensation) in *Sempra v. Argentina – Award*, paras. 396-397, and also in the context of liability in *National Grid v. Argentina*, para. 180.

<sup>236</sup> See generally Gallus 2012 and Kriebaum 2011.

<sup>237</sup> *Sempra v. Argentina – Award*, paras. 396-397; *CMS v. Argentina – Award*, paras. 248 and 356; See generally Gallus 2012, 241-244 and Kriebaum 2011, 399-402.

<sup>238</sup> *National Grid v. Argentina*, para. 180; *Toto v. Lebanon – Jurisdiction*, para. 165; *Generation Ukraine v. Ukraine*, para. 20.37; See also for case law Gallus 2012, 233-235 and for a support of such a position also Tudor 2008, 235 and Kriebaum 2011, 384.

<sup>239</sup> As suggested in *Pantechniki v. Albania*, the examination of denial of justice as an absolute protection should not be subject to considerations of specific circumstances (para. 76). See similarly *Sempra v. Argentina*, paras. 396-397. See also Knoll-Tudor 2009, 340.

A particularly clear expression of the need to examine a wide array of circumstances, in the context of assessing the ‘legitimacy’ of investor’s expectations,<sup>240</sup> can be found in *Bayindir v. Pakistan*:

A second question concerns the circumstances that the Tribunal must take into account in analyzing the reasonableness or legitimacy of Bayindir’s expectations [...]. In so doing, it finds guidance in prior decisions including *Saluka*, *Generation Ukraine* and *Duke Energy* [...] which relied on ‘all circumstances, including not only the facts surrounding the investment, but also the political, socioeconomic, cultural and historical conditions prevailing in the host State.’<sup>241</sup>

As has been suggested, what is ‘reasonable’ should be influenced by the circumstances prevailing in the host State, and allow for IIL to take account of different developmental stages.<sup>242</sup> Such an approach can be generally welcomed, as it is a form of a complement to the position that the investor should be expecting the national rule of law vision as primarily relevant.<sup>243</sup>

There are certainly some reasonable limits in that sense. As suggested, some aspects of the prohibition of the denial of justice, such as right to be heard or to have an impartial tribunal should not depend on the economic or political situation.<sup>244</sup> Yet, even in denial of justice situations there is some possibility for taking the circumstances into account. Undue delay in the provision of justice is certainly a part of the denial of justice considerations, but whether a delay is ‘undue’ seems to be at least potentially open to influence of the host State circumstances.<sup>245</sup> Therefore, the finding that the procedural deadlines set out by the host State legal frameworks have been breached (a tentative breach of the ideal-type model) can be offset, depending on the intensity, by the consideration that host State courts are sorely lacking in resources.

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<sup>240</sup> As Ursula Kriebaum suggests, it ‘stands to reason’ that the level of development and circumstances of the host State are relevant in this context (2011, 384).

<sup>241</sup> *Bayindir v. Pakistan*, para. 192. The tribunal eventually applied this principle to find that Pakistan had not frustrated the claimant’s legitimate expectations. This approach is consistent with, for example, *Duke v. Ecuador*, para. 347 and *Parkerings v. Lithuania*, paras. 278 and 306.

<sup>242</sup> Kriebaum 2011, 384; Viñuales 2017, 82. See also recently *Urbaser v. Argentina – Award*, para. 623.

<sup>243</sup> See also Muchlinski 2006, 82 noting that ‘not only a transitional economy, but also a developing country economy, may require some special consideration on the part of the investor as to how they should work with the local authorities.’

<sup>244</sup> Kriebaum 2011, 403.

<sup>245</sup> See in that sense *White Industries v. India*, para. 10.4.18.

An oft-mentioned and legitimate concern in this regard is the fear that overly lenient attitude towards the host State can be a disincentive for improvements,<sup>246</sup> or that treating States in better circumstances more harshly than others would be a sort of punishment for their level of development.<sup>247</sup> The former concern is justified and the level of lenience shown towards the host State (to the extent that it also does not feature within the scrutiny under the ideal-type model) should be carefully thought-out so not to unduly further problems in the State's government apparatus. After all, the best efforts of the host State to optimally fulfil its adopted obligations under the ideal-type model should be presumed. Potential disturbances in those efforts should be given recognition, but should not make the adopted obligations purely aspirational. The foreign investor might not be entitled to perfection, but it would be unreasonable to justify whatever comes its way by arguing that the host State simply does not have the capacity to do better.

In that light, the latter concern about 'punishing' the host States in objectively better circumstances arguably has less foundation. As touched upon in Chapter 3, the concept of the ideal-type model of a *particular* host State almost necessarily implies higher expectations from the State that usually performs well when it comes to the rule of law. The investor can and should expect that it will experience the proper operation of the apparatus of *that* particular State.<sup>248</sup> Having less consideration for the constraints of those States (again, depending on particular facts) is justified in that sense. Strengthening of the national rule of law would remain a rather empty goal if the host State was not held up at least to the standard that it usually exhibits, but some lower one. Taken to the extreme, such treatment would rather be conducive to weakening the rule of law.

#### *Factors relating to the investor*

As a preliminary remark, the topic of obligations imposed on the investor *de lege lata* and *de lege ferenda* (such as human rights/business interplay) is an increasingly important one in IIL.<sup>249</sup> It is not within the scope of this discussion to examine these

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<sup>246</sup> *Pantechniki v. Albania*, para. 76. See also Gallus 2012, 231-233.

<sup>247</sup> *Pantechniki v. Albania*, para. 76; Kriebaum 2011, 404.

<sup>248</sup> See also in similar vein Behrens 2007, 174.

<sup>249</sup> See also on this Miles 2013, 173.

obligations in a broader sense.<sup>250</sup> Rather, what is examined here is the investor's behaviour 'as part of a State's defence against allegations for breach of an investment treaty',<sup>251</sup> and in the context of the ideal-type model correctives. Two primary and somewhat intertwined factors in that context are the due diligence of the investor in connection to the legal framework, and the investor's contribution to the dynamic of the dispute.

### Due diligence of the investor

In general, the foreign investor should bear its share of responsibility for being informed about the legal framework governing its investment. Failure to do so can limit or offset the potentially problematic above-mentioned factors in an individual case. There should be an expectation of a prudent businessperson to collect sufficient information before entering into business ventures, as well as to remain informed throughout.<sup>252</sup> As noted by Peter Muchlinski, investors 'must be aware of the regulatory environment in which they operate, ensure compliance with any applicable regulatory requirements and take relevant professional advice'.<sup>253</sup> Initiating operations abroad might militate an even higher expectation of careful due diligence.<sup>254</sup> While particular features of the legal and administrative environment might be problematic, the fact that investor knew (or should have reasonably known) about them and still proceeded without receiving specific assurances,<sup>255</sup> should not be ignored.

However, it is important to distinguish between the due diligence regarding the existing legal framework and regarding its potential changes. As argued in the previous chapters, the investor should always expect amendments to the legal framework, but should also expect these to be made in accordance with the legal framework existing at

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<sup>250</sup> See recently on this Jacob/Schill 2014 and Viñuales 2017.

<sup>251</sup> Viñuales 2017, 361.

<sup>252</sup> See, for example, *Anderson v. Costa Rica*, para. 58; *Plama v. Bulgaria*, para. 220; *Mondev v. United States*, para. 156; See also Sureda, 79-82 and Dolzer/Schreuer 2012, 145-149. See also more generally Kolb 2007, 623-627.

<sup>253</sup> Muchlinski 2006, 548. See also Mairal 2010, 444 and generally McLachlan/Shore/Weiniger 2007, 7.140 and materials cited therein.

<sup>254</sup> See Sureda 2012, 92 and also in earlier doctrine Brownlie 1977, 314. See in the same vein the suggestion of the prudence required when coming into a foreign country in *Olguín v. Paraguay*, para. 75.

<sup>255</sup> See on this Viñuales 2017, 362 and materials cited therein.

the time of its investment. It is questionable how much prospective due diligence can and should be expected from the investor,<sup>256</sup> and the tribunals might have on occasion been rather too strict in this sense. To illustrate, in discussing the pre-investment phase, the *Parkerings v. Lithuania* tribunal observed that:

[i]n 1998, at the time of the Agreement, the political environment in Lithuania was characteristic of a country in transition from its past being part of the Soviet Union to candidate for the European Union membership. Thus, legislative changes, far from being unpredictable, were in fact to be regarded as likely. As any businessman would, the Claimant was aware of the risk that changes of laws would probably occur after the conclusion of the Agreement. The circumstances surrounding the decision to invest in Lithuania were certainly not an indication of stability of the legal environment. Therefore, in such a situation, no expectation that the laws would remain unchanged was legitimate.<sup>257</sup>

As the saying goes - it is hard to make predictions, particularly about the future. In this particular case, one of the changes that the investor was meant to predict included prohibition of agreements on joint activity (essentially a form of private-public partnerships) between self-governments and private entities.<sup>258</sup> In an equally persuasive yet counter-factual manner, it could be said that the investor could have expected *more* liberalisation from EU ascension - not less. On this point, an investigation into what changes could have been expected in connection with the EU context, with a potential recourse to comparative benchmarks, would arguably be more persuasive. A useful illustration can be found in the *Eastern Sugar v. Czech Republic – Partial Award* discussion of the EU regulation of the sugar market and the ways in which the investor could have expected the host State to adapt to it.<sup>259</sup>

In any case, investors lack of diligence and effort in finding out about not only the basic regulations applicable to its transaction, but also the totality of the legal framework,<sup>260</sup> can be a strong countervailing factor to, among others, the potential opaqueness of the legal framework. The investors, more broadly, can hardly be treated as consumers requiring transparency for which the obligation lies only on the other party.

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<sup>256</sup> See on this also *Unglaube v. Costa Rica*, para. 258 and recently *Charanne v. Spain*, para. 507, suggesting that experienced, professional investors should expect regulatory changes during their investment period.

<sup>257</sup> *Parkerings v. Lithuania*, para. 335.

<sup>258</sup> *ibid*, paras. 133-134.

<sup>259</sup> *Eastern Sugar v. Czech Republic*, paras. 235-242.

<sup>260</sup> See Viñuales 2017, 362. See also Simma 2011, 591-596 for the suggestion that this can include diligence about the spectrum of human rights obligations of the host State.

### Investor's behaviour and contribution to the dynamic of the dispute

It appears almost intuitively clear that the behaviour of the investor can be relevant for assessing whether the State acted fairly, equitably or arbitrarily. However, this factor can be perceived in a broader (currently common) sense and a narrower sense that would better correspond to the paradigm focused on strengthening the national rule of law.

This broader understanding that puts considerable emphasis on investor's behaviour is expressed well by Muchlinski – 'a central question in any defence to a claim of unfair and/or inequitable treatment on the part of the investor must be: what was the investor doing to engage the allegedly unfair administrative response?'<sup>261</sup> In a number of cases, the behaviour of the investor (negligent, reckless, or otherwise problematic) was an important factor as it was deemed to have caused the response by the host State.<sup>262</sup> This is certainly important in order to identify e.g. the naked arbitrariness of the host State behaviour. Adverse measures against the foreign investor which provided no reason for them (or under the flimsiest of pretexts) would arguably offer good grounds for establishing *mala fides* and automatic host State liability (as discussed above).<sup>263</sup>

However, the existing jurisprudence would also suggest that conduct of the investor in the host State can itself be a direct counterbalance to the behaviour of the State within the preliminary determination if the FET was breached.<sup>264</sup> If the focus is put on the strengthening of the national rule of law and the ideal-type model, this would not seem adequate. It would mean that the problematic behaviour of the foreign investor can *per se* offset the fact that the host State has breached its rule of law framework. Simply put, the very fact that an investor caused a reaction by the host State could potentially make the illegality of such an action justifiable.

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<sup>261</sup> Muchlinski 2006, 528.

<sup>262</sup> See, for example, *Azinian v. Mexico*, paras. 103-105; *Genin v. Estonia*, para. 361. See also Viñuales 2017, 361.

<sup>263</sup> The conduct of the investor has also been examined within the context of causality and contributory fault, and has been relevant on the determinations in the quantum phase. See, for example, *Copper Mesa v. Ecuador*, paras. 6.91, 6.97 and 6.102; *Veteran Petroleum v. Russia*, para. 1274.

<sup>264</sup> See paras. 285-286 of *Lemire v. Ukraine – Jurisdiction and Liability* discussed above.

This is arguably not what the investor should expect. Generally, the fact that the investor's behaviour may contravene the domestic legal framework is nothing so exceptional that it should justify leniency towards the host State. The legal frameworks are put in place, among other reasons, exactly to deal with these situations. And it is just the manner in which the host State has dealt with the problematic behaviour of the investor that should be assessed with the help of the ideal-type model. Normatively speaking, when the investor enters the host State, it should not only expect that it will have to obey the domestic legal framework, but that in the case that it does not, it will be sanctioned in accordance with it. Therefore, the fact that the investor caused the reaction of the host State should not *per se* be of particular relevance. It is simply a fact that triggered the application of other relevant norms of the domestic legal framework, application that is now to be assessed by the tribunal, hopefully through both the IROL and NROL paradigm lens.

The importance of the investor's behaviour as a corrective factor would be something more limited in scope. The focus should be on determining whether investor's behaviour after the outset of the dispute hampered or prevented the host State in acting in accordance with the ideal-type model. For example, as noted by Muchlinski, 'should a dispute arise with the local administrative authorities, the investor is bound to take advantage of any available local remedies that are capable of correcting the alleged administrative wrong.'<sup>265</sup> More generally, the investor should be responsible for the choices made in pursuing the resolution of a dispute with the host State. It should not be automatically expected that the host State will go above, beyond or outside its legal framework for the investor's benefit, without the accompanying care of the investor in pursuing the potentially available remedies. This does not equal the re-introduction of the need to exhaust all available local remedies in order to obtain protection. It is rather a demand for reasonableness so to make possible the proper operation of the host State's rule of law framework.

A rather straightforward example is provided by the *GEA v. Ukraine* award. The Claimant based its claim for the breach of the full protection and security standard by arguing that the host State should have initiated proceedings to inquire into a theft of the claimant's property. However, the Claimant itself did not bring a criminal

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<sup>265</sup> Muchlinski 2006, 548.

complaint, causing the Tribunal to reject the claim.<sup>266</sup> Otherwise, the suggestion would be that the State had to *ex officio* investigate a claim in situation not so deserving, just because it involved a foreign investor. This would arguably be going too far, except perhaps in very specific situations where the investor itself could not for some reason avail itself of the possibility to lodge a complaint.

A more nuanced example can be found in *White Industries v. India*, already mentioned above. As discussed, a key determination to be made by the tribunal was whether court proceedings lasting for 9 years were to be considered either a denial of justice or a failure to provide ‘effective means’ of asserting claims.<sup>267</sup> One line of argumentation offered by the Respondent, partially based on an allegedly *a contrario* situation to a determination made in *Chevron v. Ecuador – Partial Award*, was that the Claimant’s litigation strategy, which involved raising a number of legally complex issues, was the principal contributing factor to any delay.<sup>268</sup> In the end, the tribunal was not convinced that the delay was indeed ‘entirely’ attributable to the Claimant, and rather concluded that ‘White cannot properly be criticised for seeking to be treated by India’s courts in accordance with what it *reasonably believed* were India’s New York Convention obligations.’<sup>269</sup>

Therefore, the existence of the delay could be assessed under the ideal-type model, including here for sure both the New York Convention and the relevant Indian statutes dealing with court proceedings. The tentative breach of the FET standard could then *potentially* be offset by the investor’s own contribution to this breach, in this particular case by an unreasonable litigation strategy that led to unwarranted delays.

## 5.4. Conclusion

The broad focus on strengthening the national rule of law through substantive-decision making does not end with an elaboration of the ideal-type model. That element is perhaps the most considerable addition to the IROL paradigm of the autonomous meaning of the FET standard, but other potential implications for the legal reasoning

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<sup>266</sup> *GEA v. Ukraine*, paras. 247-249.

<sup>267</sup> See section 5.2.2. above.

<sup>268</sup> *White Industries v. India*, para.5.2.16-5.2.17 and 5.4.5.

<sup>269</sup> *ibid*, para. 10.4.15.



process can be suggested as well. This Chapter has focused on two elements in that sense.

Apart from other roles suggested in practice and doctrine, this Chapter has argued that comparative law, policy and practice (here dubbed comparative benchmarks) can serve as an important tool for the tribunals in adding persuasiveness to their reasoning. While the ideal-type model can provide one additional set of coordinates under which the host State should have acted, how it actually performed is a matter upon which the tribunal might have to make sensitive pronouncements. The parameters themselves can leave considerable discretion to the host State decision-makers, and complicate the task of pronouncing how that discretion was exercised. The standards and methods of review can involve complex determinations such as what represents suitable, necessary or reasonable measures by a State. In that sense, pointing towards the examples from comparable States and regimes that support the tribunal's findings can help in this task and also limit the appearance of discretionary, 'I know it when I see it' decision-making. These benchmarks, provided that they are well chosen and elaborated upon, can also help the host State alter its future behaviour and avoid new claims in a particular sphere of activity.

The focus on the ideal-type model also implies that the rule-generative role for the principle of good faith should be increasingly limited in the FET context. Barring clear instances of *mala fides* and leaving aside the concretisations of good faith within the ideal-type model itself, good faith considerations should primarily perform a corrective role. The corrective good faith factors would thus be safety valve for (hopefully not common) situations where the examination of the ideal-type model and other relevant factors does not secure what the tribunal perceives as a fair outcome of a dispute. This chapter has thus touched upon a non-exhaustive account of some of the key factors that in one form or another make an appearance in the existing ISDS jurisprudence, and which relate to both the host State and the foreign investor. These (potentially mutually offsetting) factors include on the side of the host State the specific representations given to the investor, the overall transparency of the domestic legal framework, and the broader circumstances of the host State. On the side of the foreign investor, these would primarily include the level of the investor's due diligence and its behaviour and contribution to the dynamic of the dispute.

Taken together, comparative benchmarks and corrective good faith factors should complement the efforts towards strengthening the national rule of law as grounded in the elaboration of the ideal-type model. They should allow the recourse to the vast comparative experience, and at the same time seek to limit the good faith considerations outside the ideal-type model to serious and hopefully exceptional instances. Even if considerable discretion is allowed by the applied methods of scrutiny, these elements should help assure both the investor and the host State that the determinations made by the tribunal are grounded in more than just the subjective impressions. The national rule of law and the legitimacy of IIL more broadly can only fare better in that case.

## Conclusion

The story of international investment law is remarkable in many ways. Arising out of the sometimes-alleged thousands of years of efforts to secure the property and peaceful operation of business people abroad, it has towards the end of the XX century become one of the fastest growing and most controversial spheres of international law. It exhibits a peculiar mixture of features that attracts attention from different quarters – from legal ones with direct involvement in the process of investor-State dispute settlement (ISDS), through development agencies and political economists, to civil society NGOs and the wider public.

IIL is today overwhelmingly seen as a single regime, even if the agreement on its exact contours sometimes remains elusive. Regardless, certain important features stand out. The extensive power of investment tribunals to sanction the unacceptable behaviour of host States towards foreign investors is coupled with remarkably open-textured norms serving as a basis for such an exercise. The limited possibility to review these decisions is coupled with a strong enforcement regime. And the possibility of issuing awards containing some of the highest compensations in the history of international adjudication is coupled with a clear possibility that subsequent awards can reach opposite conclusions on the same or similar set of facts. The potential for such a regime to influence the participating host States is in some ways unprecedented – but the guidance for exerting such influence remains open to further development and contestation.

It is thus hardly surprising that the assessments of the IIL regime and the ISDS vary from them being ‘one of the most progressive developments in international law and relations in the history of international law’<sup>1</sup> to accusations that IIL ‘has ensnared hundreds of countries and put corporate profit before human rights and the environment.’<sup>2</sup> Nor is the variety of reform proposals – aimed at structural, procedural and substantive aspects – surprising in that sense. It remains to be seen what is the future of the proposals aimed (e.g.) at centralising the dispute settlement mechanism or

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<sup>1</sup> Schwebel 2016, 1.

<sup>2</sup> Eberhardt/Olivet 2012, 7.

re-calibrating international investment agreements (IIAs) towards a new balance between States' and investors' interests. The outcome, as uncertain as it seems now, can substantially change some of the basic tenets of IIL.

However, both irrespective and potentially complementary to such proposed reforms, there is considerable space to think about reforming the substantive decision-making process and practice of arbitrators.<sup>3</sup> In particular, the most ubiquitous standard of protection of foreign investors, the fair and equitable treatment standard, can be seen as a main focal point for such an exercise. The focus of this thesis has in that sense been on normative paradigms that should guide the substantive decision-making in resolving claims launched under this standard. Amongst the different potential perspectives, the one suggested here as particularly potent in orienting the power of investment tribunals is *securing the provision of the rule of law* to foreign investors in the host State. This would in itself seem to be a largely uncontroversial starting position, and one that has found support in existing FET jurisprudence. The requirements or sub-principles of the FET have so far been elaborated in such a way that resembles commonly accepted requirements for the existence of the rule of law. Furthermore, the notion of the 'rule of law' is almost universally appealing and its provision seen as desirable.

The generally acceptable view of FET's 'mission' to secure the rule of law to foreign investors thus offers a relatively uncontroversial starting point, with both description and prescription in mind. In that sense, this thesis has suggested that the currently dominant paradigm of the FET being there to secure the *international* rule of law (IROL) for foreign investors should for a number of normative reasons be complemented with the NROL paradigm – and FET standard as a tool to strengthen the *national* rule of law. In brief, the attempts to create and consistently enforce supranational rule of law tenets aimed at regulating host States' behaviour (the IROL paradigm) should be complemented with an effort to systematically examine if the foreign investor has been treated in accordance with the vision of the rule of law that the host State itself (at least formally) adopts.

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<sup>3</sup> Sometimes referred to as reforming IIL 'from within' (Schill 2014).

As a background for suggesting the complementing of the IROL paradigm with an NROL one, Chapters 1 and 2 have respectively provided an overview of first the foundations and then the operation of the IROL paradigm and the legal feasibility of its complementation. Chapter 1 dealt with the normative positions and developments in the practice and doctrine of IIL more generally that have eventually critically contributed to the constitution of the IROL paradigm regarding the FET standard. These revolve around the basic idea of establishing and consistently applying a set of supranational rule of law benchmarks through the vehicle of ISDS. These benchmarks, for the purposes of assessing host State compliance, do not have to incorporate or relate to the domestic (rule of) law protections and provisions. As sometimes suggested, the '[a]rbitrators have developed a *supranational rule of law* that has helped to create *uniform standards for acceptable sovereign behavior*.'<sup>4</sup>

At the same time, Chapter 1 also suggested that there are at least two factors relating to the foundations of IIL that question such a normative vision. One is the predominantly bilateral nature of the network of IIAs, coupled with a prominent failure of formal multilateralization efforts. This at least normatively raises the question if regime-building multilateralization is acceptable or whether the specificities of particular State-State IIA dyads should have been given more recognition regarding the operation of individual standards such as the FET. Secondly, the reality of the IIA conclusion for a considerable number of countries suggests that the level of awareness about what IIL obligations (will) entail was questionable, further making the normative case for inevitability of the IROL paradigm problematic. Simply put, both factors are indications that States did not necessarily intend for a *de facto* multilateral and IROL-inducing regime of IIL.

These problematic factors were initially made relatively unimportant by the long dormancy of ISDS. Still, the sudden (re-)‘discovery’ and rise of investment arbitration towards the end of the XX century necessitated answers about the dominant paradigm. The explosive ISDS-led development of IIL in the post-Cold War setting, coupled with a relatively small epistemic arbitral community and *de facto* precedent as a master regime-

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<sup>4</sup> Rivkin 2012, 2.

building tool crucially contributed to the dominance of the IROL paradigm in FET decision-making. Still, the normative conclusion that can be derived is that there is nothing necessarily inevitable in the way IIL came to its present form. The potential for different normative visions of its operation, particularly regarding substantive decision-making, still exists.

The broader normative possibility of adding complementing paradigms to decision-making does not necessarily imply a *need* for them. Chapter 2 therefore further examined and problematized certain aspects of the IROL paradigm as operating in practice, and also illustrated that NROL paradigm complementation is a possibility under the formal legal framework. In particular, this Chapter set out three important propositions as a relevant background for the normative discussion in Chapter 3.

Firstly, the FET jurisprudence does indicate an unequal and divergent approach to the interpretation and application of the FET sub-principles, both in terms of the autonomous understanding what the FET standard specifically entails and in terms of the relationship towards national law and international obligations of the host State. Secondly, and relatedly, there *are* examples in jurisprudence that clearly demonstrate the readiness of tribunals to duly take into account the parallel obligations of the host State and incorporate them into the FET decision-making. This shows that the NROL paradigm as such is not a groundless proposal even when considering the existing jurisprudence. Furthermore, and thirdly, this Chapter argued that both in terms of rules of interpretation and through choice and weighing of relevant facts, investment tribunals do have at their disposal the necessary formal tools to make the suggested NROL paradigm a regular complementary feature of deciding the FET claims.

Conclusion to this chapter also offered an overview of certain common points arising from the first two chapters, which sketched a normative way forward towards a complementary NROL paradigm. The general normative desirability and further potential benefits of introducing a focus on the national rule of law were then elaborated upon in Chapter 3.

The discussion in Chapters 1 and 2 sought thus to show that there is a possibility and a need for a normative orientation that retains the focus on securing the rule of law for foreign investors, but while also aiming to tackle the problematic aspects of the IROL paradigm. Chapter 3 thus set out a normative case for introducing a complementary paradigm aimed at strengthening the *national* rule of law in the host State. Instead of only focusing on building a supranational set of rule of law precepts, the power of ISDS through the FET standard should likewise be used to secure (to the extent possible) that the host State acted in accordance with its own vision of the rule of law. This vision should be seen as expressed in the constellation of international and municipal instruments beyond the IIA that regulate and constrain the behaviour of the host State in a particular legal situation involving the foreign investor. While the IROL paradigm as a starting point – and the international character of the FET standard – are a necessary safety valve for unacceptable national idiosyncrasies, a careful and holistic examination of how the host State fared under the constraints imposed by its international and domestic obligations should be a regular and thoroughly approached feature for assessing the compliance with the FET standard. Chapters 4 and 5 dealt with the more practical implications, but the core of Chapter 3 sets out the four main normative reasons why the focus on the national rule of law should be seen as a desirable complement to the IROL paradigm.

The first reason is the substantive richness of domestic law. This allows enhanced *ex ante* discoverability of *rules* (as opposed to standards/principles) for both foreign investors and host State officials. The second is that the focus on ‘national choice’ on how rule of law should look like is supported by the considerations of sovereignty, plurality and subsidiarity in international law. It demonstrates respect for the States’ right to opt for a particular vision of social and economic life on its territory. It is also a perhaps welcome check on overly Western-centric understandings of how the rule of law should look like.

The third reason is that the unavoidable importance of the domestic legal framework for regulating the life of an investment should be seen as reasonably expected by both foreign investors and host State officials. This makes it a normatively

desirable reference point for examining the behaviour of the parties and limits the appearance *ex post facto* standards. The final reason goes to the underlying *telos* of IIL and the expectations of host States in this sense. If, as it is strongly arguable, the ultimate goal of IIL should be effectuating economic development in the participating States, then the focus on strengthening the national rule of law through one of its critical standards (FET) is a desirable path. Enhancing the national rule of law, among other advantages, helps achieve the goal of economic development more profoundly by making its benefits available to both foreign and domestic actors. Taken together, these reasons suggest that the careful focus on the national rule of law can be a way for ISDS to sustain and enhance its legitimacy and further the interests of host States beyond just the attraction of foreign investment.

To realise this, the focus on the national rule of law should result in practical implications for the decision-making process. Different potential ways of translating this focus into practice certainly remain open for further research. With this in mind, Chapters 4 and 5 focus on three important elements that should be the part of the decision-making process of investment tribunals.

Chapter 4 dealt with the elaboration of the *ideal-type model of the national rule of law* (ideal-type model). This model is an overview of all international and domestic obligations of the host State (beyond the IIA) which are relevant for a particular legal situation involving the foreign investor. In addition to establishing universally applicable meanings of concepts such as ‘fair’, ‘equitable’ and (non-)‘arbitrary’, the approach to interpreting and applying these requirements in a particular case should regularly include the assessment of the State behaviour under this ideal-type model. It provides the parameters which the host State decision-makers *should have* had in mind when acting, and which the investor *could have* expected the host State to obey – before and regardless of any FET dispute taking place.

Depending on a specific legal situation involving the foreign investor, the ideal-type model could be constructed from the treaty obligations of the host State, constitutional provisions and statutory provisions, all further clarified through recourse to secondary sources such as jurisprudence and doctrine. This ideal-type model thus represents the set of parameters within which the foreign investor could have expected



the host State decision-makers to operate. Its regular examination as an important factor in the FET decision-making should also indicate to the host State organs the need to holistically and prospectively account for their obligations, and therefore promote the respect for the rule of law beyond the focus on (e.g.) just the directly applicable statute.

The scrutiny of how well the host State actors lived up to the ideal-type model and if there thus exists a breach of the FET standard ultimately remains a distinct issue. It depends on the standard and method of review, including the level of deference to be granted to host State decision-makers. Aside from matters discussed in Chapter 5, the issue of choosing the most appropriate standard and method remains an issue requiring a separate interpretation and is not addressed within the scope of this thesis. The inquiries into whether certain standards or methods are more suitable for promoting the national rule of law than others, or whether the ideal-type model itself could influence the choice, remain open for further research. What is important to note, however, is that the elaboration of the ideal-type model is compatible with the dominant existing approaches. It simply provides a more holistic understanding of the context in which the scrutiny is to be conducted.

As further touched upon in Chapter 4, the holistic approach to the relevant legal framework and/or persuasive engagement with primary and secondary sources is certainly not alien to ISDS jurisprudence. The example of *Dan Cake v. Hungary* (with due regard to other examples in previous chapters) serves as a useful indicator. Tribunals can and sometimes do systematically and persuasively expound on the failings of the domestic actors to obey the relevant domestic legal framework in the rule of law context. The examples like these thus both support the practical feasibility of constructing a persuasive ideal-type model, and also arguably show how to properly send ‘good governance signals’<sup>5</sup> to the host State.

While not thus suggesting a particular method or review, Chapter 5 dealt with two further elements - recourse to *comparative benchmarks* and the use of *corrective good faith factors* – which relate to the employed legal reasoning process. These elements support the strengthening of the national rule of law in different ways. Comparative benchmarks

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<sup>5</sup> *International Thunderbird v. Mexico – Separate Opinion Wälde*, para. 125 (emphasis added).

are aimed at enhancing the persuasiveness of the tribunals' reasoning and at offering further potential guidance for the host States. Corrective good faith factors aim to leave sufficient leeway for good faith considerations, but without over-relying on this discretion-laden principle as a way to concretise the FET obligations.

Comparative benchmarks – consisting of comparative law, policy and practice – should be utilized to provide support for tribunals' scrutiny in situations when it has to decide if particular measures of the host State were (e.g.) a 'least onerous way' of achieving a goal generally in accordance with the ideal-type model, or if there existed an 'undue delay' in behaviour of judiciary and/or administration. The matters before an investment tribunal are often not novel in comparative terms. 'I know it when I see it' type of reasoning in identifying problems with the host State legislation, policies and practice can thus be supplemented or replaced by a recourse to carefully chosen comparators. This can and should considerably enhance the persuasiveness of tribunals' findings. Care should be taken to, e.g., use benchmarks from States with sufficiently similar ideal-type models and socio-economic circumstances. If this is so, this element can also potentially lead to 'best practice' guidance for the host State in future legislation, policy and practice that would accord better with its own ideal-type model.

Finally, the normative emphasis on the national rule of law and the holistic legal framework would suggest a shift for the role of good faith in concretising obligations stemming from the FET standard. Currently, the principle of good faith and its different emanations such as the doctrine of legitimate expectations play a critical role in attempting to refine the obligations stemming from it. If the focus is shifted more towards the ideal-type model and the NROL paradigm, the need for this role arguably diminishes. At the same time, there is little doubt that the clearly apparent bad faith towards the foreign investor would sometimes largely negate the need to go through an extensive inquiry into the ideal-type model. Likewise, the principle of good faith and specific related doctrines remain important to the extent that they can be persuasively shown to form a part of the host State's ideal-type model itself. In that sense, they can be duly accounted for in the tribunal's scrutiny.

But beyond these situations, the role of the principle of good faith should be reimagined as an *ultima ratio* one, in the form of (what was here dubbed) corrective good

faith factors. These would be specific circumstances or fact patterns occurring on the side of both the host State and the foreign investor. They can (depending on their intensity and context) lead to a potentially different conclusion on the existence of an FET breach than would be tentatively reached through the scrutiny under the ideal-type model. On the side of the host State, relevant factors can include the specific representations and assurances given to the foreign investor, the social, economic and political circumstances of the host State which might influence the fulfilment of the ideal-type model, and the transparency or possibility to gain knowledge about relevant law which forms that model. On the side of the foreign investor, factors to take into account can comprise the level of due diligence prior to and during the investment operation, and the behaviour of the investor in terms of contributing to the dynamic of the dispute.

All these factors, to reiterate, might also be given relevance for assessment under the ideal-type model - e.g. specific representations can give rise to the doctrine of legitimate expectations in form which is specific to the particular national law. But to the extent that this is not (sufficiently) the case in tribunal's view, they can then be employed as a corrective and a manifestation of the residual power of tribunals to secure a fairness of outcome. The examination of these factors almost certainly involves their interplay. Finding an unacceptable opaqueness of the host State's legal framework should hardly be determinative without at the same time examining the investor's due diligence efforts to clarify the legal issues relating to its operation. Problematic behaviour on both sides should be seen as mutually offsetting, and the threshold for these factors to affect the ultimate outcome of the tribunal's assessment should in any case be relatively high.

Taken together, the ideal-type model, comparative benchmarks and corrective good faith factors should allow for awards that recognise the reality of the national rule of law being one of the primary concerns for foreign investors, while at the same time clearly and persuasively pointing out what (if anything) went wrong in host State compliance with these rule of law requirements. In their ultimate effect, these elements should help that the benefits of ISDS scrutiny reach other domestic business entities, and ultimately the public at large.

*III. and strengthening the national rule of law – themes for the future*

The proposed complementation of decision-making with an NROL paradigm can be relevant beyond the decisions on liability in the FET context. It is a call to use the extensive power that has been, somewhat ‘accidental[ly]’,<sup>6</sup> put into the hand of arbitrators in a way that not only accords better with the realities of the investment processes, but also aims to help realise the more fundamental interests of the host States as the ultimate masters of the IIL regime.

The opportunities for focusing on the national rule of law arise at other junctions in the decision-making process. For example, the jurisdictional issues such as the illegality of the investor’s conduct – in particular the existence of corruption – as well as determining the quantum of compensation can all be such opportunities. The illegality of the investor’s conduct opens the possibilities for elaborating relevant ideal-type models of the domestic rule of law. The determinations on quantum can also be influenced, especially bearing in mind the actual and potential role for domestic in this sphere.<sup>7</sup> Even if host State liability is found to exist, the degree to which the State acted in accordance with its own rule of law vision could thus also be reflected in quantum of damages.

But perhaps the most interesting sphere for future research is how the jurisdictional, substantive and procedural issues can all be mutually affected by the normative orientation towards the national rule of law. The important issue of corruption in the State-investor dealings can be a good example in this sense. The currently predominant trend in jurisprudence is to decline jurisdiction in cases where the investment has been obtained by the investor through corrupt means.<sup>8</sup> On its own, such an approach (aimed at preventing the investor from capitalising on its own misbehaviour) also helps the national rule of law by serving as a disincentive on the side of investor to engage in corrupt practices. On the other hand, the extent to which this disincentive exist for the host State officials is more questionable. Knowledge that the jurisdiction will be declined can arguably cause a form of moral hazard, where the lack

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<sup>6</sup> Pauwelyn 2014, 416.

<sup>7</sup> See on this in particular Hepburn 2017, 69-99.

<sup>8</sup> See for example Douglas 2014, 155-157 and materials cited therein.

of consequences (apart from potential legal costs) does little to prevent officials for (e.g.) demanding bribes.

If the normative focus is put on the strengthening of the national rule of law, there are different potential paths for jurisdictional, procedural and substantive developments. For example, there can be a case for accepting jurisdiction over a dispute, for the reason of preventing the jurisdictional ‘shield’ incentivising corruption and also so to illuminate more thoroughly all the circumstances of a particular transaction. Even if, ultimately, the award of compensation might be denied due to the lack of clean hands on investor’s behalf, the possibility of closer scrutiny over potentially glaring failings of the rule of law should be taken. There can also be a case for the introduction of innovative remedies aimed at tackling corruption,<sup>9</sup> including potentially the need for the host State to make sure that the relevant parts of the award identifying corruption are made available to the wider public. Finally, a strong argument can be made that both the national rule of law considerations and the international public policy may warrant the tribunals to override parties’ attempts to keep the decisions and awards identifying corruption confidential. To what extent all these paths are possible *de lege lata* and which would require *de lege ferenda* reform is also a topic requiring further examination.

The international investment law is a manifestation of a new type of international law that deeply intertwines with the national regulatory spheres. It can affect both the host State government apparatus and the individual entities to a largely unprecedented extent. It should thus require innovative thinking so its power can be harnessed in a way which is the most beneficial for the widest range of actors. This thesis has presented one such normative path. Other paths remain possible and worthy of exploration. But what inspired the proposals made here, and should steer the decision making of investment tribunals, is the recognition that ‘[i]ndeed it is not too much to say that [...]

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<sup>9</sup> There are signs of this already occurring in practice. The prime example seems to be the still confidential *Spentex v. Uzbekistan* award (ICSID Case No. ARB/13/26). As reported, the dismissal of claimant’s claim due to existence of corruption was accompanied by the tribunal ‘urging’ Uzbekistan to contribute to a UN anti-corruption project to be conducted in the host State at the threat of an adverse cost award. Uzbekistan reportedly complied with this so far ‘unprecedented’ anti-corruption measure. See IAREporter story (<http://tinyurl.com/y9334ayy>, accessed 20 July 2017) for more details.

the role of international law is to reinforce, and on occasions to institute, the rule of law internally.<sup>10</sup> The possibilities for doing so lay open.

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<sup>10</sup> Crawford 2003, 8.

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