The London School of Economics and Political Science

The International Investment Regime and Foreign Investors' Rights: Another View of a Popular Story

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Declaration

I certify that the thesis I have presented for examination for the PhD degree of the London School of Economics and Political Science is solely my own work other than where I have clearly indicated that it is the work of others (in which case the extent of any work carried out jointly by me and any other person is clearly identified in it).

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Abstract

The international investment regime (IIR) has been subject to several criticisms since the mid-2000s. There have been many calls for re-calibration and reconsideration of the purpose of this regime. In response, subsequent investment awards have shown changes in areas such as the degree of legal stability, deference, or emergency exceptions. However, the calls for rebalancing and reform have not ceased. In fact, they have recently gained new impetus. In the last years, most critical research has focused on investment arbitration. In this line of argument, apparently, the controversial issue is the remedy and not the substance of the rights. This thesis contributes to this debate from the premise that looking at the remedies only cannot suffice to address the social tensions that the IIR creates between foreign investors, host states and host communities.

Very limited attention has been devoted to the analysis of the potential effects international investment treaties may have on the very content of foreign investors' rights. By emphasising the procedural safeguards and guarantees international investment treaties provide, much of the legal debate implicitly overlooks whether or not investment tribunals are substantiating foreign investors' proprietary rights. This thesis addresses this gap in the literature examining the IIR as a legal regime that fulfils essential constitutional property functions: i.e. the substantiation and enforcement of proprietary rights. In case of an investment dispute, arbitrators very often define the measure of control that foreign investors enjoy over their assets. The content of foreign investors' rights depends on interpretation. The main argument of this thesis is that the interpretation of foreign investors' proprietary rights depends on the dominant justifications for foreign investment protection. As a result, contractualist and neo-utilitarian rationales constitute the basis to understand how investment tribunals substantiate foreign investors' rights over the resources of different countries.

Relying on this claim, this thesis examines the socio-relational effects of the IIR on host countries and local populations. It concludes that the challenge for this regime is to balance the excessive focus on wealth maximisation through foreign investment.

Acknowledgements

Sometimes, the reasons for doing a PhD are straightforward. They often relate to an academic vocation and an aspiration to pursue an academic career. My case was a little different: I was just extremely enthusiastic. I have long had the feeling that international investment law overlooks part of the story. In part, because of my professors of international relations, who constantly encouraged me to explore the relation between the political economy studies on multinational corporations and the international investment regime. In some other way, since I believe that international investment law and international economic law more in general remain under-theorised. The connection between these two beliefs led me to focus my attention on legal realism. Jhering, one of the first realists, taught us that legal theory can unearth the reality of the Law, particularly, of the struggle for Law. This thesis is an attempt to put together the political economy and the legal reality of foreign investor-host state relations. It is not up to me to judge if I was successful. None of the goods things I hope are contained in this thesis would have been possible without the support and patience of my two supervisors: Andrew Lang and Ken Shadlen. The goal would have remained unachieved without their encouragement, in particular, during the period I explored different formulas to turn my enthusiasm into an academic piece. Certainly, this thesis would have also been impossible without the generous financial support of the London School of Economics. My gratitude also goes for those at the LSE and BIICL who were interested in my work. I am thankful to Anthea Roberts, who was my second supervisor during the first year, Edmund-Philipp Schuster, Jan Kleinheisterkamp, Susan Marks, Norah Gallagher, Lauge Poulsen and Jonathan Bonnitcha.

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THE INTERNATIONAL INVESTMENT REGIME AND FOREIGN INVESTORS' RIGHTS: ANOTHER VIEW OF A POPULAR STORY

CHAPTER 2 – FOREIGN INVESTORS' RIGHTS AND THE INTERNATIONAL INVESTMENT REGIME

CHAPTER 3 – THE INTERNATIONAL INVESTMENT REGIME FROM A CONSTITUTIONAL PROPERTY PERSPECTIVE: THE QUEST FOR FOREIGN INVESTORS' RIGHTS

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CHAPTER 6 – EXPLORING THE LEGAL REASONING BEHIND FOREIGN INVESTORS' LEGITIMATE EXPECTATIONS

CHAPTER 7 – A NORMATIVE CRITIQUE OF FOREIGN INVESTORS' RIGHTS

INTRODUCTION

"As I read the evolution of international law under modern capitalism, as revealed from 1600 to 1914 in the detailed provisions of international treaties, one of its outstanding characteristics was its attempt to build legal protection for property and for private enterprise from the power activities of foreign states both in times of peace and in times of war."[1]

Jacob Viner, 1951

"The rights of man versus the rights of states, whether on the national or international level, seems to be the eternal conflict and indeed the eternal sermon."[2]

Eugene Austin, 1966

During the last fifty years, a prominent feature of international economic law has been the conclusion of international treaties for the protection of foreign investment. In 1951, Viner could not have foreseen that the trend he identified from 1600 to 1914 was going to intensify at an unprecedented pace, with four treaties a week being signed between 1994 and 1996.[3] Presently, countries all over the world (with the notorious exception of Brazil) have concluded investment treaties. According to the United Nations Conference on Trade and Development (UNCTAD), by the end of 2012 the International Investment Regime (IIR) consisted of 3,196 treaties, which included 2,857 bilateral investment treaties (BITs) and 339 integration or cooperation treaties including foreign investment protection.[4] Furthermore, in his work about the international economy, Viner could not have predicted that this trend was also going to undergo a few crucial transformations, beginning with the denomination of the treaties and the object of protection: international treaties presently focus on the protection of foreign investment; the idea of protecting property and private enterprise appears to belong to the past.

[1] Viner, Jacob, *International Economics: studies*, Glencoe, Illinois: Free Press, 1951, p. 218.
[2] Austin, Eugene, "Protection of Private Property and Investments of Foreigners Abroad: Foreign Investment Laws of Newly Emerging Nations," 12 *Howard Law Journal* (1966), p. 270.
[3] UNCTAD, "World Investment Report 2013: Global Value Chains: Investment and Trade for Development," New York and Geneva: United Nations, 2013, p. xx.
[4] *Ibid.*, p. xix.

As UNCTAD explicitly states, these 3,196 treaties constitute an international regime, sharing a number of essential similarities beyond the focus on foreign investment as the object of protection. A very important feature of most of them is the incorporation of investment arbitration to resolve any dispute between foreign investors and host states. This allows private foreign investors to demand *ad hoc* investment tribunals to enforce the protection provided in the treaties. In addition, the treaties use similar terminology, structures and standards of protection. The existing literature on international investment law concurs that, despite a few differences between the texts, these treaties constitute a regime with common "principles, norms, rules and decision making procedures,"[5] a network of treaties[6] or even a *de facto* multilateral regime.[7] To the characterisation of these 3,196 treaties as a regime, I would simply add the important role of the Convention of the International Centre for the Settlement of Investment Disputes (ICSID). Although investment arbitration is not limited to this arbitral forum, the historical and political reasons behind the constitution of the ICSID go hand in hand with the evolution of this network of treaties for the protection of foreign investment.

The simple idea behind the IIR is that foreign investment requires protection against host state actions, and that investment treaties provide this protection. The discourse of the World Bank has consistently focused on the need to protect investments and investors. In a publication dedicated to investment law reform, it advises:

> "If a country wants to attract significant levels of private investment and promote itself as a good place to do business, it must protect investments and investors in terms of the acquisition, management, conduct, operation, and sale or other disposition of the investments in the host country. This chapter reviews the fundamental guarantees that investors seek and that, over time, have become synonymous with a good, open, modern investment

[5] Salacuse, Jeswald, "The Emerging Global Regime for Investment," 51 *Harvard International Law Journal* (2010), p. 431; Schneiderman, David, *Constitutionalizing Economic Globalization. Investment Rules and Democracy's Promise*, New York: Cambridge University Press, 2008, p. 26. See also: Krasner, Stephen, "Structural Causes and Regime Consequences: Regimes as Intervening Variables," in Beth Simmons and Richard Steinberg (Eds.), *International Law and International Relations*, New York: Cambridge University Press, 2006, p. 3.

[6] Montt, Santiago, *State liability in investment treaty arbitration: global constitutional and administrative law in the BIT generation*, Oxford and Portland, Oregon: Hart Publishing, 2009, Chapter 2.

[7] Schill, Stephan, *The Multilateralization of International Investment Law*, New York: Cambridge University Press, 2009, pp. 15-22.

> policy, and thus investment legislation. It should be noted from the outset that all the obligations below are usually also included in a BIT or other international agreement and any violation could lead to the activation of the dispute settlement mechanism in such agreements."[8]

Historically, the World Bank, the Organisation for Economic Co-operation and Development (OECD) and UNCTAD have shown a strong interest in promoting the protection of foreign investment. In the foreword to the well-known commentary on the ICSID Convention, Lauterpacht explains that this Convention

> "carried forward a more general [initiative] for the protection of international investment that had begun in the Organisation for European Economic Co-operation (now the Organisation for Economic Co-operation and Development) in the late 1950s and that ended in the production in 1962 of the OECD Draft Convention on the Protection of Foreign Property."[9]

During the 1960s, as Lauterpacht explains, there was an important debate regarding the conclusion of a multilateral treaty for the protection of foreign investment. The Draft of the OECD was an effort in this direction that, however, was never implemented. Describing this negotiation process Fatouros tells us that "[t]he proponents of an investment code point[ed] out that [this initiative was] the simplest as well as the most effective means to assure the protection of private foreign investment."[10] He adds that "[m]ost of the proposed draft codes are one-sided in another way too. They provide for the protection of the investors' interests without attempting to safeguard the host state's interests."[11]

Today, most of the literature on investment law continues to approach the IIR from the perspective of foreign investment protection. This is its primary focus. The position of the World Bank and the OECD is reflected in the opening pages

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[8] World Bank, "Investment Law Reform. A Handbook for Development Practitioners," Washington: Investment Climate Advisory Services of the World Bank Group, 2010, p. 38.

[9] Lauterpacht, Elihu, "Foreword," in Christoph H. Schreuer, Loretta Malintoppi, August Reinisch and Anthony Sinclair, *The ICSID Convention: A Commentary*, Second Edition, New York: Cambridge University Press, 2009, p. ix.

[10] Fatouros, Arghyrios, "An International Code to Protect Private Investment-Proposals and Perspectives," 14:1 *The University of Toronto Law Journal* (1961), p. 99.

[11] *Ibid.*, p. 101.

of Dolzer and Schreuer's *Principles of international investment law*,[12] and is summarised well in the following passage from Schill's work about the multilateralisation of international investment law:

> "[P]romoting and protecting foreign investment behooves the establishment of institutions that reduce political risk and outweigh incentives for the host State to act opportunistically in order for private actors to unfold foreign investment activities."[13]

Many commentators see the protection of foreign investment against host state actions as constituting the object and purpose of investment treaties. This is the opinion of García-Bolivar,[14] Salacuse,[15] Alvarez,[16] Lowe,[17] McLachlan,[18] Akinsanya[19] and Asante.[20] Dalhuisen and Guzman, for instance, affirm that "[i]nternational investment law deals with expropriation, protection against which, in its various forms, is at the core of the topic."[21] Similarly, Vandevelde explains that "the protections offered by BITs are mostly against public action only, no private, although the latter could seriously undermine the value of the investment."[22] In brief, what transpires from the initiatives of international institutions and the corresponding scholarship is precisely that the mission of the IIR is to protect foreign investment against host state actions. Some host state actions are the problem, and international protection is the solution.

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[12] Dolzer, Rudolph and Christoph Schreuer, *Principles of International Investment Law*, New York: Oxford University Press, 2008, pp. 3-7.
[13] Schill, Stephan, *The Multilateralization of International Investment Law*, p. 3.
[14] García-Bolívar, Omar, "The Teleology of International Investment Law: The Role of Purpose in the Interpretation of the International Investment Agreements," 6:5 *The Journal of World Trade and Investment* (2005), p. 751.
[15] Salacuse, Jeswald, "The Treatification of International Investment Law," *13 Law and Business Review of the Americas* (2007), p. 155.
[16] Alvarez, José, "A BIT on Custom," 42 *International Law and Politics* (2009), p. 43.
[17] Lowe, Vaughan "Changing Dimensions of International Investment Law," University of Oxford, Faculty of Law Legal Studies Research Paper Series, Working Paper No 4/2007, pp. 1, 10.
[18] McLachlan, Campbell, "Investment Treaties and General International Law," 57 *International and Comparative Law Quarterly* (2008), p. 372.
[19] Akinsanya, Adeoye, "International Protection of Direct Foreign Investments in the Third World," 36 *The International and Comparative Law Quarterly* (1987), pp. 59-60.
[20] Asante, Samuel, "International Law and Foreign Investment: A Reappraisal," 37 *The International and Comparative Law Quarterly* (1988), p. 608.
[21] Dalhuisen, Jan and Andrew Guzman, "Expropriatory and Non-Expropriatory Takings Under International Investment Law," UC Berkeley Public Law Research Paper No. 2137107, p. 1.
[22] Vandevelde, Kenneth, "The Economics of Bilateral Investment Treaties," 41 *Harvard International Law Journal* (2000), p. 489.

The question that has created some debate in the literature is whether the establishment of a legal mechanism for foreign investment protection is an end in itself or whether there is a higher objective beyond the protection of foreign investment. Salacuse and Sullivan admit that the primary goal of home states with investment treaties was the "protection of investments made by their nationals and companies in foreign countries."[23] They argue however that the IIR advances a more complex objective: investment treaties represent a "Grand Bargain" according to which host states make "a promise of protection of capital in return for the prospect of more capital in the future."[24] Similarly, Roberts asserts that the text of the treaties that make up the IIR "often provides little help given continuing debates over whether such treaties exist to protect investors and investments (which might suggest that ambiguities should be resolved in favor of investors) or to promote public welfare by increasing foreign investment (which might require investment protections to be weighed against other policy goals)."[25] Thus, in short, the discussion in the literature regarding the object and purpose of investment treaties has remained limited to the dichotomy between foreign investment protection as a goal or as a means to some other end.

Another element in the literature that illustrates the dominant focus on foreign investment protection is the consensus that investment treaties do not aim to liberalise the movement of capital. Vandevelde points out that "BITs do not leave to the market the task of allocating international investment resources."[26] In the same way, comparing the international trade and investment regimes, Pauwelyn and DiMascio affirm that

> "[a]lthough they share a common origin (treatment of aliens), trade and investment disciplines have traditionally focused on different but complementary objectives: liberalisation of trade flows, in the case of trade, and protection and promotion of investment, in the case of investment."[27]

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[23] Salacuse, Jeswald and Nicholas Sullivan, "Do BITs Really Work?: An Evaluation of Bilateral Investment Treaties and Their Grand Bargain," 46 *Harvard International Law Journal* (2005), p. 76.
[24] *Ibid.*, p. 77.
[25] Roberts, Anthea, "Clash of Paradigms: Actors and Analogies Shaping the Investment Treaty System," 107:1 *The American Journal of International Law* (2013), p. 51.
[26] Vandevelde, Kenneth, "The Economics Of Bilateral Investment Treaties," p. 498.
[27] DiMascio, Nicholas and Joost Pauwelyn, "Nondiscrimination in Trade and Investment Treaties: Worlds Apart or Two Sides of the Same Coin?," 102 *The American Journal of International Law* (2008), pp. 53-54.

Presently, the liberalisation of trade and investment converges with investment protection in most free trade agreements – the North American Free Trade Agreement (NAFTA) was the first treaty to adopt this pattern.[28] However, the issues of investment liberalisation and protection remain divorced in most of the literature. Books and articles about international investment law are primarily about the enforcement of foreign investment protection, i.e. investment arbitration.[29]

The academic characterisation of the IIR maintains the focus on foreign investment protection, with investment arbitration as the dominant issue in the literature. The initial approach to investment arbitration was to liken it to private international law and commercial arbitration.[30] This view suffered an important backlash during the mid-2000s and has now mostly lost support. The second approach, which remains dominant, describes the IIR as a mechanism of *judicial review*. This view emphasises the public impact of the enforcement of foreign investment protection but does not move the focus away from protection against state actions. Arguably, the first commentators to have characterised the IIR as a mechanism of adjudicative review are Van Harten and Loughlin.[31] They argue that "[t]he effect of this combination of features, uniquely present in investment arbitration, is to subject the regulatory conduct of states to control through compulsory international adjudication to an unusual extent."[32] Several others have characterised the IIR as a form of judicial review, concentrating on the implications behind the enforcement of foreign investment protection. The most important examples are probably Kingsbury and Schill,[33] Schneiderman,[34] Montt[35] and Ortino.[36]

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[28] See Perrone, Nicolás, "Inversiones Extranjeras e integración regional. Una pieza importante de la estrategia de desarrollo," in Welber Barral, Luiz Otávio Pimentel and Carlos M. Correa (Eds.), *Direito, Desenvolvimento e Sistema Multilateral de Comércio*, Brazil, Florianópolis: Fundação Boiteux, 2008, pp. 351-386.

[29] See Wells, Louis, "The Emerging Global Regime for Investment: A response," 52 *Harvard International Law Journal* (2010), pp. 44-46.

[30] See Van Harten, Gus, *Investment treaty arbitration and public law*, New York: Oxford University Press, 2007, pp. 121-180; Roberts, Anthea, "Clash of Paradigms: Actors and Analogies Shaping the Investment Treaty System," p. 54.

[31] Van Harten, Gus and Martin Loughlin, "Investment Treaty Arbitration as a Species of Global Administrative Law," 17:1 *European Journal of International Law* (2006), pp. 121-150.

[32] *Ibid.*, p. 122.

[33] Kingsbury, Benedict and Stephan Schill, "Investor-State Arbitration as Governance: Fair and Equitable Treatment, Proportionality and the Emerging Global Administrative Law," New York University Public Law and Legal Theory Working Papers, Paper 146 (2009).

[34] Schneiderman, David, *Constitutionalizing Economic Globalization. Investment Rules and Democracy's Promise.*

All these scholars, with the exception of Schneiderman, have also categorised the IIR as a form of Global Administrative Law. This characterisation is consistent with the idea that the IIR is a form of judicial review. The focus remains fixed on those actions of the host state that can disturb foreign investment. As Wälde has noted, "[i]nvestment treaties as international law disciplines interfere in domestic regulatory and administrative sovereignty; that is their very purpose."[37] Arguably, then, host state behaviour is what links the object and purpose of investment treaties, the characterisation of the IIR as a form of judicial review, and the categorisation of this regime as part of Global Administrative Law.

It is worth stressing, nevertheless, that the books by Schneiderman and Montt indirectly point to another less explored side of the IIR. Although these two scholars introduce different normative views about this regime, they both explore the IIR in ways that differ from its characterisation as a form of judicial review. Schneiderman, for instance, reflects on the role of this regime in creating a category of individuals with a right to a rate of return on investment interests.[38] Similarly, Montt pays substantial attention to the question of property rights, although he sets this aside by the middle of his book to embrace Global Administrative Law.[39] The work of both these scholars thus signals that the IIR may be about more than foreign investment protection and host state actions.

The focus on foreign investment protection is also clearly present in institutional analyses of the IIR. The premise of these studies is that this regime serves to enforce the protection of foreign investment when domestic institutions, in particular the judiciary, do not guarantee this enforcement. As Lowe puts it:

> "[it is] much easier to buy into the system of investment guarantees that are provided by BITs than it is to build a reputation as a safe place for

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[35] Montt, Santiago, *State liability in investment treaty arbitration: global constitutional and administrative law in the BIT generation*.

[36] Ortino, Federico, "The Investment Treaty System as Judicial Review: Some Remarks on its Nature, Scope and Standards," 21 November 2012, Available at ssrn.com/abstract=2181103.

[37] Wälde, Thomas "Investment Arbitration under the Energy Charter Treaty: An Overview of Selected Key Issues Based on Recent Litigation Experience," in Norbert Horn and Stefan Kröll (Eds.), *Arbitrating Foreign Investment Disputes*, The Hague: Kluwer Law International, 2004, p. 210.

[38] Schneiderman, David, *Constitutionalizing Economic Globalization. Investment Rules and Democracy's Promise*, pp. 212, 229.

[39] Montt, Santiago, *State liability in investment treaty arbitration: global constitutional and administrative law in the BIT generation*, Chapter 4.

> investments. A reputation takes many years to build: a BIT can be signed with the stroke of a pen."[40]

A very influential institutional work in relation to the IIR was published by Guzman, who claims that BITs "have become the dominant international vehicle through which North-South investment is protected from host country behavior."[41] The IIR is a success because

> "BITs give an individual country the ability to make credible promises to potential foreign investors. As a result, the country is more attractive to foreign investors and will receive a larger volume of investment than it would without the ability to make such promises."[42]

In a second article, which Guzman wrote with Elkins and Simmons, the IIR is presented as an instrument for making credible commitments. In this sense, investment treaties constitute an "external commitment mechanism."[43] Ginsburg pursues a similar line of argument, his work being "primarily concerned with one increasingly popular form of international alternative to domestic institutional protection, the Bilateral Investment Treaty (BIT)."[44] In this vein, Ginsburg argues that investment treaties are an international institution to "enforce promises."[45] As we see, the view that shapes these institutional analyses is also based on the premise that the IIR is a regime for foreign investment protection.[46] For these commentators, the core of this regime is an alternative mechanism of enforcement – investment arbitration – that makes allegedly uncertain commitments credible. The existence, character and content of the promises or commitments are therefore eclipsed by the enforcement mechanism of the IIR.

Overall, the examination of the object and purpose of investment treaties, the characterisation of this regime as a form of judicial review and the institutional

[40] Lowe, Vaughan "Changing Dimensions of International Investment Law," pp. 51-52.
[41] Guzman, Andrew, "Why LDCs Sign Treaties that Hurt Them: Explaining the popularity of bilateral investment treaties," 38 *Virginia Journal Of International Law* (1998), p. 687.
[42] *Ibid.*, p. 688.
[43] Elkins, Zachary, Andrew Guzman and Beth Simmons, "Competing for Capital: The Diffusion of Bilateral Investment Treaties, 1960-2000," 60 *International Organization* (2006), p. 834.
[44] Ginsburg, Tom, "International Substitutes for Domestic Institutions: Bilateral Investment Treaties and Governance," 25 *International Review of Law and Economics* (2005), p. 107.
[45] *Ibid.*
[46] See also Van Aaken, Anne, "International Investment Law between Commitment and Flexibility: A Contract Theory Analysis," 12 *Journal of International Economic Law* (2009), pp. 507-538.

analyses of the IIR essentially describe this regime as a mechanism for foreign investment protection. This thread dominates the work of those who praise the IIR, those who denounce it, and those who advocate its reform. It is thus sensible, yet also obvious and possibly absurd, to conclude that foreign investment protection is unquestionable as the main theme of investment law literature. I will now suggest that this conclusion is only *half* true. While I do not claim that the focus of most of the literature is incorrect, I do propose that it is missing an important part of the story. My argument is that the literature has paid much less attention to a question that is *at least* as important as the enforcement of the protection, namely, foreign investors' rights.

It is important to clarify here that I mean something more comprehensive than the existing literature on foreign investors' rights. In a recent article, representative of the prevalent approach, Braun refers to foreign investors' rights as essentially a right to foreign investment protection.[47] This again highlights the focus of the investment law literature on enforcement. The claim I make in this thesis is that the significance of foreign investors' rights extends beyond the right to enforce protection through investment arbitration. The main rationale for foreign investors' rights is the control of the resources of different countries. Obviously, the right to launch an investment arbitration is highly relevant to this control but it is only relevant to the extent that foreign investors have a substantive right to enforce.

If we think of the expansion of private foreign investment as a form of expansion of international business activities, for instance, we find that business actors demand not only the enforcement but also the specification of their rights. Firms do not demand enforcement in the abstract. They request the enforcement of a measure of control of the resources that allows them to carry out their business activities and appropriate the benefits. The work of the World Bank stresses the interests of foreign investors when referring to the protection of the "acquisition, management, conduct, operation, and sale or other disposition of the investments in the host country."[48] Schneiderman does the same when he refers to foreign investors' profit.[49]

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[47] Braun, Tillmann, "Globalization-driven Innovation: The Investor as a Partial Subject in Public International Law – An Inquiry into the Nature and Limits of Investor Rights –," Jean Monnet Working Paper 04/13, NYU School of Law, 2013.
[48] See above footnote 8.
[49] See above footnote 38.

This view is consistent with certain strands of economic history, economics and the economic sociology of law. In his neoclassical theory of the state, North explains that to facilitate private economic activity states need to "specify and enforce property rights."[50] The correct fulfilment of this task would lead to economic growth. He stresses that "[f]or the economic historian, the key problems are to explain the kind of property rights that come to be specified and enforced by the state and to explain the effectiveness of enforcement."[51] Similarly, Olstrom and Schlager consider the importance of well-defined property rights by focusing on the rights that private property needs to include to grant individuals a sufficient level of control over resources.[52] In brief, these commentators' opinions suggest that the promotion of international business activities requires both the adequate specification and enforcement of foreign investors' rights.

A similar conclusion emerges in Max Weber's work on the role of law in the rise of capitalism. Again, if the promotion of foreign private investment is in some sense to be equated with the expansion of capitalism beyond national borders, the legal order needs to give foreign investors a mechanism to make economic life more *calculable*.[53] The expansion of capitalism requires the law to provide calculability for economic actors regarding their control of resources, which, in turn, implies rights and enforcement. Trubek explains that for Weber

> "though it is not necessarily true of every economic system, certainly the modern economic order under modern conditions could not continue if its control of resources were not upheld by the legal compulsion of the state; that is, if its formally 'legal' rights were not upheld by the threat of force."[54]

From the work of North, Olstrom, Schlager and Weber, it is possible to deduce one of the most important realist claims: the measure of control over resources is

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50 North, Douglas, *Structure and Change in Economic History*, New York: W.W.Norton, 1981, p. 21.
51 *Ibid.*
52 Olstrom, Elinor and Edella Schlager, "The Formation of Property Rights," in Susan Hanna, Carl Folke and Karl-Gȯran Mȧler (Eds.), *Rights to Nature: ecological, economic, cultural, and political principles of institutions for the environment*, Washington, D.C.: Island Press, 1996, p. 137.
53 See Swedberg, Richard, "Max Weber's Contribution to the Economic Sociology of Law," CSES Working Paper Series Paper # 31, revised February 2006.
54 Weber, Max, *Economy and Society*, Guenther Roth and Claus Wittich (Eds.), New York: Bedminster Press, 1968, Volume 1, p. 68. Cited by Trubek, David, "Max Weber on Law and The Rise of Capitalism," *Wisconsin Law Review* (1972), p. 742.

represented "as much [by] rights as remedies."[55] The importance of this premise cannot be overstated. The extent to which foreign investors are in a position to exercise effective control over the resources of different countries is clearly a function of both the content of the protected rights and the mode through which these rights are enforced.

Returning to the institutional analyses of the IIR, the question is whether it is accurate to characterise the IIR as only an external mechanism to enforce foreign investors' rights. Or, should these analyses incorporate the fact that the IIR not only enforces but should also play a role in the substantiation of these rights. One response would be that foreign investors' rights are very well defined and that there is no debate regarding their scope and content. In fact, institutional analyses seem to refer to foreign investors' rights as essentially undisputed contractual commitments. However, I argue that such a response overlooks the difficult task of arbitrators when they consider, for example, whether Philip Morris has an almost absolute right to use its brands in Australia, or if Metalclad has a right to operate a waste disposal facility in Mexico. These are not trivial questions: investment arbitrators cannot enforce rights when their content is unclear without interpretation.

It is only through the interpretation of foreign investors' substantive rights, for instance, that the arbitrators in *Methanex v U.S.A.* (2005) could affirm that

> "Certainly, the restrictive notion of property as a material 'thing' is obsolete and has ceded its place to a contemporary conception which includes managerial control over components of a process that is wealth producing."[56]

Against this background, we need to identify the implications (if any) of the excessive focus that the literature has placed on the enforcement of foreign investors' rights. I argue that the main consequence is that investment awards and scholarship often see foreign investors' rights in a formalistic manner. This view is the same as assuming that the main issue are host state actions: if we can

[55] Llewellyn, Karl, *Jurisprudence: Realism in Theory and Practice*, New Brunswick; London: Transaction Publishers, 2000, p. 63. See also: Dagan, Hanoch, "Remedies, Rights and Properties," 4:1 *Journal of Tort Law* (2011), pp. 5-6.
[56] *Methanex v U.S.A.*, UNCITRAL – NAFTA, Final Award of the Tribunal on Jurisdiction and Merits, 3 August 2005, Part IV, Ch. D, at 16-17.

distinguish arbitrary and abusive host state behaviour from regular activity, we will then have solved the conundrum of the specification and enforcement of foreign investors' rights. There is an apparent assumption that getting the enforcement side of the problem right, e.g. through the application of balancing and proportionality, would solve the issue by itself. As Caron affirms, "critiques of legitimacy – at least in legal scholarship – often are directed to procedural rather than substantive legitimacy."[57]

The general lack of interest in the content of foreign investors' rights and, in particular, in the way investment arbitrators substantiate these rights suggests that we are often at the risk of falling into a formalist trap. The measure of control over resources is not a natural or trivial question: it is very often a matter of a *struggle*.[58] The words of Austin cited at the start – as opposed to those of Viner – indicate that the main theme of foreign investment protection would lie in the struggle between the rights of foreign investors and host states. Reasonably, in the context of the IIR, a major part of this struggle is about the given specification of foreign investors' rights that are enforced. For both foreign investors and host states, enforcement only matters to the extent that it coincides with expectations for achieving business goals or materialising the preferences of host communities. The dominant literature may describe the IIR as the law that provides for the enforcement of foreign investors' rights, but I argue that this regime necessarily plays an important role in the "specification and enforcement" of foreign investors' rights. The popularity of this field of international economic law is comprehensible only if there is some correlation between the specification and the enforcement of these rights.

In this respect, the formalist trap mentioned above consists precisely of paying limited attention to this correlation. I claim that the dominant approach to international investment law has downplayed the significance of substantiating foreign investors' rights, leading us to overlook this part of the struggle between foreign investors and host states. The origin of this approach is arguably found in the debate in the 1950s and 1960s as reported by Lauterpacht and Fatouros.

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[57] Caron, David, "Investor State Arbitration: Strategic and Tactical Perspectives on Legitimacy," 32 *Suffolk Transnational Law Review* (2009), p. 514.

[58] Picciotto, Sol, "Property Rights and Regulation, Private and Public, Conference on Regulation in the Age of Crisis," Conference on Regulation in the Age of Crisis, University College, Dublin, 17th-19th June 2010, p. 34; Jhering, Rudolf von, *The Struggle for Law*, (Translated by John Lalor), Chicago: Callaghan, 1879, pp. 1-19.

During these years, an important part of the legal discussions did refer to the substance of foreign investors' rights. This issue is especially reflected in the work of García-Amador as rapporteur on State Responsibility for the United Nations. In his fourth report, García-Amador considers in significant detail the doctrine of acquired rights, whilst in his fifth and sixth report he examines the constituent elements of state responsibility and the reparation of injury.[59] Leaving aside the correctness of García-Amador's views, his analysis visibly covers the substantiation and enforcement of proprietary rights. This comprehensive approach, however, is later abandoned in the work of rapporteur Ago, who concentrates essentially on the constituent element of state responsibility and reparation.[60]

Since then, I argue, the most significant studies on international investment law have explicitly or implicitly overlooked the substance of foreign investors' rights. Thus, for instance, the literature has paid limited attention to the replacement of the doctrine of acquired rights, examined by García-Amador in the 1950s, by the doctrine of legitimate expectations. The debate in investment law literature has remained focused on investment arbitration and host state actions, whilst the discussion concerning the substance of foreign investors' rights has been limited to the doctrinal contours of legitimate expectations. The interpretation of foreign investors' rights has therefore never been the subject of serious in-depth discussion in the literature on the IIR. The shortfall of this approach is that it overlooks the content of property rights as a significant part of the struggle between foreign investors and host states.

The objective of this thesis is to focus precisely on this missing side of the story, undertaking a profound examination of foreign investors' rights. I will analyse the IIR from the perspective of foreign investors' control rights, by concentrating on the task of investment arbitrators in substantiating these rights. Regarding this I put forward two main arguments about the normative basis of arbitral interpretation. First, I claim that foreign investors' proprietary rights suffer from a *contractual* interference not too different from what has happened to property rights

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59 García-Amador, Franciso, "Fourth Report on State Responsibility," International Law Commission, A/CN.4/119, 1959; García-Amador, Franciso, "Fifth Report on International Responsibility," International Law Commission, A/CN.4/125 and Corr. 1, 1960; García-Amador, Franciso, "Sixth Report on International Responsibility," International Law Commission, A/CN.4/134 and Add.1, 1961.

60 Ago, Roberto, "First Report on State Responsibility – Review of previous work on codification of the topic of the international responsibility of States," International Law Commission, A/CN.4/217 and Corr.1 and Add.1, 1969, p. 127. See also: Allott, Philip, "State Responsibility and the Unmaking of International Law," 29:1 *Harvard International Law Journal* (1988), pp. 6-13.

in general. In this respect, Penner argues that part of the present problem in our understanding of the idea of property corresponds to the fact that this legal institution has "been spending all [its] time with that hustler Contract, hanging around in the market place."[61] Second, I claim that this contractualist approach to foreign investors' rights is based on a neo-utilitarian rationale that privileges the maximisation of individual preferences. In the case of the IIR, since the focus is fixed on the position of the foreign investor, this would mean that the ultimate purpose of this regime under this approach is to facilitate *wealth maximisation through foreign investment*.

In short, this thesis is an attempt to give foreign investors' rights the importance they deserve. In this respect, it is worth clarifying from the outset the material that is not pertinent to this study and that this thesis will therefore not cover. I will not engage with the issue of discrimination and the standards of national treatment and most favoured nation. Furthermore, I will concentrate only on foreign investors' rights that have a *proprietary* character. I will not discuss the IIR as a mechanism to enforce typical contractual claims either through umbrella clauses or regarding debt instruments (bonds, derivatives and financial contracts).

This thesis is organised in three parts, which correspond to three main objectives: to situate foreign investors' rights in the context of a property and constitutional property framework; to examine the basis on which investment arbitrators substantiate foreign investors' rights; and to consider the consequences of such substantiation for host countries and populations, stressing that public law tools may not suffice to counterbalance the potential negative effects. The first part includes Chapters 1 to 3. In Chapter 1 I illustrate the importance of the control of resources for foreign investor-host state relations. I argue that the measure of foreign investors' control is precisely equal to the content of proprietary rights, in particular to the ownership they enjoy over the resources. However, since ownership is inherently incomplete in the legal order, I stress that investment arbitrators play a crucial role in substantiating the content of foreign investors' rights. The conclusion is that the actual content of these rights is the outcome of arbitrators' interpretation.

In Chapter 2 I examine the importance of foreign investors' rights in international law under both the diplomatic protection model and the IIR,

[61] Penner, James, *The Idea of Property in Law*, New York: Oxford University Press, 2000, p. 2.

observing that most of these rights have a proprietary character. I criticise the dominant approach that limits the analysis to the *right to foreign investment protection*. Despite the significance of enforcement mechanisms, I argue that foreign investors' rights have always been a central aspect of the protection of foreign-owned property and foreign investment. In Chapter 3 I provide a framework capable of accommodating both functions of investment arbitrators: the substantiation of foreign investors' rights and their enforcement against host state actions. This framework is that of constitutional property. I argue that the IIR and any constitutional property regime focused on guaranteeing private property are closely related. In this respect, I claim that constitutional property and investment treaty clauses refer to the same problem (political risk) and provide the same solution (compensation). However, I note that these clauses rarely provide any information regarding the content of property rights. After examining the law applicable to foreign investors' rights, I conclude that investment arbitrators substantiate foreign investors' rights following the doctrine of legitimate expectations in accordance with investment treaties and international law.

The question of interpretation and the basis on which investment arbitrators substantiate foreign investors' rights is covered in the second part of the thesis, which includes Chapters 4 to 6. In Chapter 4 I claim that the interpretation of investment arbitrators is based on contractualist and neo-utilitarian justifications for private property. This constitutes the normative basis of foreign investors' rights. In Chapter 5 I consider this claim in the context of a study on the doctrine of legitimate expectations. I begin by contrasting this doctrine with the acquired rights doctrine, concluding that legitimate expectations are based on the concept of investment. I use this concept to demonstrate the influence of contractualist and neo-utilitarian rationales on the way investment arbitrators substantiate foreign investors' rights. In particular, I argue that the main purpose of the IIR – for foreign investors, host states and home states – is wealth maximisation through foreign investment. In Chapter 6 I show that the application of the doctrine of legitimate expectations in investment awards indeed corresponds to the bases laid by the concept of investment. Investment arbitrators focus mainly on the interests of the foreign investor, the promisee, overlooking the position of the host state, the promisor. I claim that this substantiation of foreign investors' legitimate expectations is the outcome of the reliance theory and a substantive rule of law, both approaches that are justified precisely by the maximisation of wealth through foreign investment.

The final part of this thesis, Chapters 7 and 8, concentrates on the implications for host countries and populations of the way investment arbitrators substantiate foreign investors' rights. In Chapter 7 I claim that investment disputes not only are about allegations of host state arbitrary actions but also affect the values of host communities. Thus, I argue that the IIR tends to favour wealth maximisation through foreign investment over other initiatives of the population to establish a decent order where foreign and national individuals can flourish. I claim that the way investment arbitrators substantiate foreign investors' rights is inconsistent with a procedural rule of law and democratic principles, and that it empowers the powerful and weakens the weak. The conclusion of this critical analysis is that the IIR creates some risks for social life in host countries. In Chapter 8 I consider whether public law tools, in particular proportionality, can balance the excesses of contractualism and a substantive rule of law. I claim that the means-ends test is highly influenced by the content of foreign investors' rights, and that ultimately the application of proportionality is very sensitive to the purpose of the IIR. Thus, wealth maximisation through foreign investment tends to prevail.

I conclude this thesis by stressing how important it is for the legitimacy of the IIR to review the way investment arbitrators substantiate foreign investors' rights. I argue that this evaluation should begin by reconsidering the purpose of this regime. Contrary to most of the literature, I suggest that the balance the IIR needs to strike is not only between the private and the public, but also a broader balance between wealth maximisation through foreign investment and the establishment of decent orders where foreign and national individuals can flourish. I suggest that this can only be achieved by shifting the prevalent interpretation in investment arbitration, particularly in relation to the doctrine of legitimate expectations, replacing the influence of contractualism and neo-utilitarianism with a more pluralistic approach to property rights over the resources of different countries.

CHAPTER 1 – THE STRUGGLE FOR THE RESOURCES OF DIFFERENT COUNTRIES: A PROPERTY RIGHTS STORY

Introduction

In this chapter, I argue that a struggle for resources lies at the core of foreign investor-host state relations, and that the tension between these two actors revolves around property rights. The key issue in understanding foreign investor-host state relations is therefore the control of resources. Foreign investors are not concerned with their rights in the abstract but with a certain measure of control necessary to fulfil their business expectations. Property rules granting this measure of control would make the plans of foreign investors more predictable. The literature on investment law appears to overlook this view of foreign investor-host state relations, creating the impression that the IIR does not influence the substance of this struggle, and that investment treaties do not affect foreign investors' rights. However, we cannot reach a final conclusion about whether the IIR affects the substance of these rights without a more comprehensive understanding of private property rights, and the relation between rights and remedies (i.e. foreign investors' rights and investment arbitration). The main objective of this chapter is to provide this analysis, showing that the content of foreign investors' rights is inherently incomplete, and therefore investment arbitrators very often need to substantiate these rights. Thus, one strategy for understanding the content of foreign investors' rights is to focus on the mechanisms through which we protect them.

A. Property and the struggle for the resources of different countries

"[W]hen resources are scarce, human societies formulate property rights to allocate use and regulate production."[1] Parisi is here describing the foundational premises of our civil societies as developed in the 18th and 19th centuries by thinkers such

[1] Parisi, Francesco, "The origins and evolution of property rights systems," in Enrico Colombatto (Ed.), *The Elgar Companion to the Economics of Property Rights*, Cheltenham: Edward Elgar Pub, 2006, p. 77.

as Adam Smith and Friedrich Hegel.[2] Indeed, for classical liberalism, the management of the struggle for resources was essential to make social life possible.[3] Locke's work is probably the most influential in this line of argument. He describes civil society as an essential step towards the implementation of a property system capable of managing this struggle:

> "But because no political society can be, nor subsist, without having in itself the power to preserve the property, and in order thereunto, punish the offences of all those of that society; there, and there only is political society, where every one of the members hath quitted this natural power, resigned it up into the hands of the community in all cases that exclude him not from appealing for protection to the law established by it."[4]

For new institutional economics, property rights are also crucial, mainly, to facilitate the use of resources and promote economic growth. For these scholars, the focus is on the promotion of economic activity rather than the establishment of a civil society. Libecap explains that "[f]or higher-valued assets where the number of competitors is large and where new entry is common and profitable [...] more formal governance structures, such as legally defined private property rights, become necessary."[5] In his view conflict is an obstacle to efficiency, and private property as a social institution is capable of "providing the basis for resource-use decisions."[6] In short, as North and Williamson remark, property rights constitute the basic rules of the economic game.[7]

Both these lines of argument are inextricably connected because establishing a civil society has a lot to do with organising the use of resources. According to

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[2] See Smith, Adam, *An Inquiry into the Nature and Causes of the Wealth of Nations*, Oxford: Clarendon Press, [1776] 1869; Hegel, Friedrich, *Philosophy of right*, (translated by S. W. Dyde), Amherst, N.Y.: Prometheus Books, [1820] 1996.

[3] See David Hume, *A treatise of human nature*, New York: Courier Dover Publications, [1739-1740] 2003, p. 344; Stuart Mill, John, *Principles of Political Economy*, New York: Cosimo Inc., [1848] 2006, p. 205.

[4] Locke, John, *Second Treatise of Government*, Arlington Heights, Ill.: H. Davidson, [1690] 1982, Section 87.

[5] Libecap, Gary, "A Transactions-Costs Approach to the Analysis of Property Rights," in Eric Brousseau and Jean-Michel Glachant (Eds.), *The Economics of Contracts-Theories and Applications*, Cambridge: Cambridge University Press, 2002, p. 142.

[6] *Ibid.*, p. 140.

[7] North, Douglas, *Structure and change in economic history*, New York: W.W.Norton, 1981, p. 24; Williamson, Oliver E., "Foreword. The New Institutional Economics Guidebook," in Brousseau, Éric and Jean-Michel Glachant (Eds.), *New institutional economics: a guidebook*, New York: Cambridge University Press, 2008, p. xxxv.

Waldron, thinkers such as Locke believe that "the competitive struggle for resources is itself the *locus* of the interests that are served by the existence of private property."[8] Property systems aim to manage this struggle by organising the use of resources. The literature distinguishes between private, communal or common models of property.[9] Presently, most legal orders have implemented private property systems. According to Knight, one of the founders of the Chicago School, "most projects of social betterment involve the substitution of some more consciously social or political form of control for private property and individual freedom of contract."[10]

From this perspective, a private property system manages the struggle for resources by allocating control to individuals. As Waldron explains, "[t]he organizing idea of a private property system is that, in principle, each resource belongs to some individual."[11] Individuals are given proprietary rights and remedies. Property rights grant control over the resource to the individual owner, whilst proprietary remedies allow him to prevent other individuals and the state from interfering with his use of the resources. Property rights, however, do not allocate unfettered control over resources. Thus, the amount of control remains in question, shaping relations particularly between individuals and the state.

There is no reason to believe that the struggle for resources does not shape foreign investor-host state relations in a similar manner. In his Roepke Lecture in Economic Geography, Dicken claims that this struggle provides a good framework for understanding this relationship.[12] On one hand, during the 19th and 20th centuries, there were several instances of violence and aggression directly related to the control of resources of different countries (e.g. gunboat diplomacy, revolutions, expropriations and intelligence interference).[13] Very often, institutions such as the World Bank refer to these risks and the lack of an adequate investment climate as obstacles to organising any economic activity involving foreign investors

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[8] Waldron, Jeremy, *The right to private property*, Oxford: Clarendon Press, 1988, p. 419.
[9] *Ibid*, pp. 6, 37-38.
[10] Knight, Frank, *Risk, Uncertainty and Profit*, Forgotten Books - Electronic journals, 1921, p. vii.
[11] Waldron, Jeremy, *The right to private property*, p. 38.
[12] Dicken, Peter, "The Roepke Lecture in Economic Geography Global-Local Tensions: Firms and States in the Global Space-Economy," 70 *Economic Geography* (1994), pp. 101-128.
[13] Sornarajah, M, *The international law on foreign investment*, Third Edition, New York: Cambridge University Press, 2010, p. 121; Financial Times, "In the picture: a short history of nationalisations," 17 April 2012.

and the resources of different countries.[14] On the other hand, whenever these actors have had a honeymoon period, large amounts of foreign investment has flowed into developing nations, in pursuit of resources, markets and labour. As Dunning puts it, in the last 50 years, the pendulum has swung from the "'honeymoon', to the 'confrontation' and the 'reconciliation' phases."[15]

Following Dicken's argument and this brief account of foreign investor-host state relations, I suggest we view the struggle between foreign investors and host states along the same lines that inspired the work of Smith, Locke, North and Williamson when thinking about private property. I propose this for analytical purposes only, recognising – with Waldron – that private property serves more goals than the allocation of resources.[16] Although the adoption of a private property system does not guarantee the betterment of a community – indeed, some distributions can do the contrary – it is reasonable to assume that the predictability of relations between foreign investors and host states benefits from a mechanism to govern the use of resources. Otherwise, foreign investment would always depend on the ups and downs described by Dunning.[17]

In the last thirty years, there has been a persistent increase in foreign investment flows to developing countries.[18] This arguably corresponds to a number of economic, political, legal and technological factors, which have combined to make multinational corporations a key player in the 21st century.[19] The evolution of private property rules within these spheres deserves some consideration. The unprecedented flows of foreign investment could be indicative of the emergence of private property rules capable of managing the struggle for resources more efficiently than in the 1950s-1980s. Although the current consensus is that a true

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14 World Bank, *World Development Report 2005: A Better Investment Climate for Everyone*, New York: World Bank and Oxford University Press, 2005, pp. 2, 10, 92-94; Broches, Aron, "The Convention on the Settlement of Investment Disputes between States and Nationals of Other States," 136 *Recueil des Cours* (1972-II), p. 343.

15 Dunning, John and S. M. Lundan, *Multinational enterprises and the global economy*, Second Edition, Cheltenham, UK; Northampton, MA: Edward Elgar, 2008, p. 675.

16 See Waldron, Jeremy, *The right to private property*, p. 419.

17 On the current situation of foreign investor-host state relations, see Johnson, Toni, "The Return of Resource Nationalism," *Council on Foreign Relations*, 13 August 2007; The Economist, "Resource nationalism in Africa Wish you were mine," 11 February 2012.

18 UNCTAD, "World investment report 2010 investing in a low-carbon economy," New York; Geneva: United Nations, 2010, p. 2.

19 Chandler, Jr., Alfred and Bruce Mazlish (Eds.), *Leviathans multinational corporations and the new global history*, Cambridge: Cambridge University Press, 2005.

international private property system does not exist,[20] there have been some legal developments that are either a cause or consequence of the increasing role of multinational corporations. The expansion of the IIR is probably one of these developments. According to Orrego Vicuña, the increasing level of multinational economic activity "create[d] a need for [individuals and corporations] to have access to dispute settlement, which thus far has been only a limited feature of the inter-state system."[21] This need was sufficiently satisfied in the 1990s after the expansion of the IIR. Orrego Vicuña dedicated his 2001 Hersch Lauterpacht Memorial Lecture to describing the process by which international law recognised individuals at the international level, in particular foreign investors, granting them a direct remedy, i.e. investment arbitration.[22]

The IIR may not constitute a comprehensive international property system, but the question is whether this regime has any reach beyond foreign investment protection. Is it just an arbitral remedy, or does it have effects beyond the enforcement of foreign investors' rights? Prominent scholars in investment law suggest that this regime has no or very limited consequences as regards the substantive content of these rights. Orrego Vicuña explains that "the evolution is not so much related to the nature of the rights but to the role of the individual in the international legal system."[23] Similarly, Douglas points out that "[t]he most important thing here is *who* interprets, not *what* is interpreted."[24] For him, the IIR is only a sub-system of international state responsibility.[25] Finally, McLachlan sees the purpose of the treaty framers as being "to enhance the mechanisms for the protection of rights, rather than to extend the rights themselves."[26]

However, other commentators do refer to the IIR as having some effect on foreign investors' control over resources. Stiglitz argues that "BITs give property

20 Sgard, Jérôme, "Are There Such Things as International Property Rights?," 27:3 *World Economy* (2004), pp. 387-401; Cottier, Thomas, "The Constitutionalism of International Economic Law," in Karl M. Meessen (Ed.), *Economic Law as an Economic Good. Its Rule Function and its Tool Function in the Competition of Systems*, Munich: Sellier, 2009, p. 329.

21 Orrego Vicuña, Francisco, *International dispute settlement in an evolving global society: Constitutionalization, Accessibility, Privatization*, Cambridge: Cambridge University Press, 2004, p. 29.

22 *Ibid.*

23 *Ibid.*, p. 53.

24 Douglas, Zachary, "Nothing if not Critical for Investment Treaty Arbitration: Occidental, Eureko and. Methanex," 22:1 *Arbitration International* (2006), p. 38.

25 Douglas, Zachary, "Other Specific Regimes of Responsibility: Investment Treaty Arbitration and ICSID," in James Crawford, Alain Pellet, and Simon Olleson (Eds.), *The Law of International Responsibility*, New York: Oxford University Press, 2010, pp. 819-820; 829-832.

26 McLachlan, Campbell, "Investment Treaties and General International Law," 57 *International and Comparative Law Quarterly* (2008), p. 372.

rights to investors, a result that may have distributional consequences."[27] From the perspective of foreign investor-host state relations, these consequences relate to the distribution of control over resources. In this respect, Vandevelde argues that the IIR does "not promote the movement of capital, but rather the movement of control over capital,"[28] and Tai-Cheng claims that

> "[o]nce triggers have been sprung, international investment law swiftly erodes state power and authority from all three branches of government […] The power and authority that international investment law drains from states does not vaporize [...] Among these transferees, the greatest beneficiaries are foreign and international tribunals and investors."[29]

In my opinion, to ascertain whether the IIR affects the content of foreign investors' control rights – beyond the mere right to foreign investment protection – we first need to understand private property rights and the relation between rights and remedies. The premise that the IIR may have a raison d'être beyond the enforcement of protection is supported precisely by the incentives of multinational corporations. The IIR would fit in with their plans to the extent that it enforces a certain measure of control. Indeed, according to property theory, the essential function of property is to enable the use of resources,[30] and the use of resources by individuals requires the *creation* and the *enforcement* of rights.[31]

B. Understanding the three dimensions of property

The idea of property fulfils different functions – not just the allocation of resources. The objective of this section is to consider the three most important: the commodification, the allocation and the ownership of resources. I concentrate in particular on the aspect of property related to control: i.e. ownership. If we

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27 Stiglitz, Joseph, "Regulating Multinational Corporations: Towards Principles of Cross-Border Legal Frameworks in a Globalized World: Balancing Rights with Responsibilities," 23 *American University International Law Review* (2008), p. 517.
28 Vandevelde, Kenneth, "The Economics Of Bilateral Investment Treaties," 41 *Harvard International Law Journal* (2000), p. 492.
29 Cheng, Tai-Heng, "Power, Authority and International Investment Law," 20 *American University International Law Review* (2005), p. 481, 492.
30 Penner, James, *The Idea of Property in Law*, Oxford: Oxford University Press, Electronic version, 2000, pp. 5-6, 202-203.
31 Lehavi, Amnon, "How Property Can Create, Maintain, or Destroy Community," 10:1 *Theoretical Inquiries in Law* (2009), pp. 61-62.

understand the way property rights grant control to individuals, we will be in a better position to judge whether the IIR has an impact on the substance of foreign investors' rights.

1. *Commodifying resources*

The first dimension of property determines which resources can be subjected to private property rights.[32] The lay observer could confuse the concept of property with the notion of resources, concluding that useful resources are by definition privately appropriable. However, the legal expert is aware that the first function of property rules is to define which resources are appropriable.[33] Property rules commodify a large range of resources, such as land, food, animals, ideas and works of art, but they also prohibit the commodification of others, in particular, human beings. For this reason, the notions of property and resources should not be treated as interchangeable. The concept of private property applies only to resources over which individuals can acquire control rights.[34] This possibility is not natural; it is legal and it has important social consequences.[35] On one hand, individuals cannot acquire property rights over the moon because no legislation has created them. On the other hand, commodification rules have changed substantially over time, and we should therefore not assume their temporal or geographical universality.[36] Historically, the fact that no state accepts the commodification of human beings is rather a novelty, as is the ability to acquire property rights over ideas.

A large part of the relevant legal scholarship relies on the concept of "things" and the category of *in rem* rights to delineate the domain of property law.[37] Penner suggests that a clear distinction between property and contractual rights lies in their different economic functions.[38] Private property is an individual right to a thing, whilst contracts allow individuals to exchange things. Although the concept of

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[32] I borrow the idea of the three dimensions of property from Sherwin, Emily, "Two-And Three-Dimensional Property Rights," 29 *Arizona Law Review* (1997), pp. 1075-1102.
[33] *Ibid.*, pp. 1084, 1087, 1090.
[34] Barrère, Christian, "Judicial System and Property Rights," in Enrico Colombatto (Ed.), *The Elgar Companion to the Economics of Property Rights*, Cheltenham: Edward Elgar Pub, 2006, p. 148; Penner, James, *The Idea of Property in Law*, p. 51.
[35] *Ibid.*, pp. 6-7.
[36] See Parisi, Francesco, "The origins and evolution of property rights systems," pp. 76-77.
[37] Merrill, Thomas and Henry Smith, *The Oxford Introductions to U.S. Law: Property*, New York: Oxford University Press, 2010, p. 8.
[38] Penner, James, *The Idea of Property in Law*, pp. 49-52.

things might appear outdated in a world where intangibles constitute the largest share of economic wealth, Penner's proposition distinguishes private property rights as the only legal tool that allows individuals to acquire and control resources.

It is worth pointing out, however, that viewing property as simply a right to resources has a significant shortcoming, as it can lead us to overlook the economic importance of those resources.[39] An excessive focus on the thing could disregard the fact that individuals acquire property rights to *use* resources. Economics is not interested in the practice of stockpiling resources, but rather using them to carry out economic activities and satisfy human needs. The concept of opportunity cost, for instance, takes into account the cost of any *use* measured in terms of the value of the next best alternative *use*. As Robbins argues, economics studies "human behaviour as a relationship between ends and scarce means which have alternative uses."[40]

2. *Allocating property rights*

The second dimension of private property establishes the owner of the commodified resources. This function is necessary to facilitate the use of those resources by the individual. The legal order employs presumptions and formal registries to provide a high level of certainty regarding the allocation of property rights, reducing the margin of doubt to negligible levels in the case of valuable resources. This is essential because

> "[i]n a private property system, the individual person whose name is attached to that object is to determine how the object shall be used and by whom. His decision is to be upheld by the society as final."[41]

Thus, for instance, this legal certainty facilitates the conclusion of contracts concerning private property rights. Transaction costs decrease when the parties can have confidence in the legality of the property title.[42]

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39 *Ibid.*, p. 50.

40 Robbins, Lionel, *An Essay on the Nature and Significance of Economic Science*, Second Edition, Revised And Extended, London: Macmillan, 1945, p. 16.

41 Waldron, Jeremy, *The right to private property*, p. 39.

42 Merrill, Thomas W. and Henry A. Smith, "Optimal Standardization in the Law of Property: The Numerus Clausus Principle," 110 *Yale Law Journal* (2000), pp. 68-69; Hansmann, Henry and Reinier

In relation to the exchange of property, it is important to distinguish between the act of exchange (the contract) and the object of the exchange (the property right).[43] Although there are other ways to transfer private property, e.g. inheritance, they are of very limited interest for the study of foreign investors' rights. Multinational corporations acquire private property from individuals or host states through contracts. The foreign investor may buy a controlling block of shares from a private or public actor. This transaction involves a contract of sale of shares and the property rights over those shares. These elements are substantively different. We should not confuse the legal act that materialises the transfer of rights with the substance of those rights. Making this distinction could be relevant in the resolution of a foreign investment dispute where what is often contradicted is not the allocation but the content of foreign investors' rights.

3. *Ownership of resources*

The third dimension of private property deals with the use of resources.[44] In his book *The Idea of Property*, Penner argues that property is the right that determines how resources "will be used."[45] Property scholars normally refer to this dimension through the concept of ownership. Waldron, for instance, explains that the concept of ownership describes "a correlation between individual names and particular objects, such that the decision […] about what should be done with an object is taken as socially conclusive."[46] The concept of ownership is central to understanding the use of resources as it determines the capacity of the owner to choose between a range of uses (e.g. to produce bricks) and to enjoy a number of incidents or entitlements (e.g. to enjoy the capital value of the resource).[47] Although the principle in a private property system is that individuals control the initiative over resources, their plans may be legitimately limited by the authority of the state.

Kraakman, "Property, Contract, and Verification: The Numerus Clausus Problem and The Divisibility of Rights," XXXI *Journal of Legal Studies* (2002), pp. 373-375.

43 Penner, James, *The Idea of Property in Law*, pp. 92-93.

44 Sherwin, Emily, "Two-And Three- Dimensional Property Rights," p. 1093.

45 Penner, James, *The Idea of Property in Law*, pp. 5-6.

46 Waldron, Jeremy, *The right to private property*, p. 52.

47 Clarke, Alison and Paul Kohler, *Property Law. Commentary and Materials*, New York: Cambridge University Press, 2005, pp. 192-193; Waldron, Jeremy, *The right to private property*, pp. 26-30.

In this respect, there are two alternative ways of conceptualising ownership depending on whether we focus on the private-public relationship or on the individual use of resources. Considering the position of both private and state authority, Katz conceptualises ownership as the individual ability to "set the overall agenda" for resources.[48] She explains that states can regulate property by narrowing or expanding these potential agendas, but they cannot block the ability of owners to exercise their "parallel agenda-setting authority."[49] In this account, ownership resembles the idea of a licence to choose from a number of legally permitted uses of the resources in question. The individual controls the resource within the terms of the entire legal order, i.e. the licence. This approach contrasts with the view of ownership as the independence to fulfil any individual objective.[50] Michelman distinguishes these two approaches, explaining that is not the same to argue that the constitution protects private property as to claim that it preserves the sphere of ownership.[51] The first proposition protects the ability to set and change the agenda, i.e. to choose between a number of uses, whilst the second guards concrete agendas from state intervention, e.g. to produce bricks.

If we concentrate on the use of resources pursued by the individual, we adopt the approach taken in economics. Rather than describing ownership as the ability to set the overall agenda for resources, an economic analysis concentrates on the uses selected by the individual. The focus is fixed on the human decisions regarding the use of resources. In this respect, Smith claims that

> "[e]conomically a 'property right' could be any of these individual sticks – any socially sanctioned expectation to be able to take valued actions with respect to a resource, availing against one or more others. So the expectation of sowing crops or building a house was property, as was the larger collection of property rights we might more conventionally call ownership."[52]

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[48] Katz, Larissa, "Red Tape and Gridlock," 23:1 *Canadian Journal of Law and Jurisprudence* (2010), p. 101.
[49] *Ibid.*, pp. 113-114.
[50] Dworkin, Ronald, *Taking rights seriously*, London: Duckworth, 1994 pp. 262-265; Ely, Richard, *Property and Contract in their Relation to the Distribution of Wealth*, New York: Macmillan, 1914, Volume 1, pp. 135-136.
[51] Michelman, Frank "Property as a Constitutional Right," 38 *Washington and Lee Law Review* (1981), pp. 1097-1114.
[52] Smith, Henry, "Introduction," in Kenneth Ayotte and Henry Smith (Eds.), *Research Handbook on The Economics of Property Law*, Cheltenham: Edward Elgar Publishing, 2011, p. 1.

Private property rules normally conceptualise ownership as a licence. The German Civil Code, for instance, establishes that "[t]he owner of a thing may, to the extent that a statute or third-party rights do not conflict with this, deal with the thing at his discretion and exclude others from every influence" (§ 903). In addition, the French Civil Code states that the owner has "the right to enjoy and dispose of things in the most absolute manner provided they do not make use prohibited by law or regulation" (Article 544). These two rules limit the scope of potential uses to the parameters of the legal order. As with the commodification and allocation of resources, the law is the main source of ownership. The sphere of private authority resembles a balloon that the legislator inflates and the individual enjoys to this extent.[53] After all, "the legislature could legitimately extend the range of prohibited noxious or dangerous uses beyond the bounds customarily recognized in the common law."[54]

The idea of ownership divides the authority of individuals and the state in a functional manner. In a private property system, the private and public spheres of authority do not compete to set the agenda for the resources. They are "vertically, not horizontally related."[55] States can exclude "certain kind[s] of private agendas [...] and even certain kinds of reasons for action."[56] In extreme terms, however, this position could be understood as the state's ability to annihilate or substantially alter the ability of the individual to decide the use of the resources. Excessive limitations on ownership can deprive the individual of the authority granted by his property right. If the scope of ownership is reduced to nearly nothing, it would be difficult to argue that the individual still has the ability to decide the use of the resources.

A potential solution to this problem is the rule that states cannot make or at least should be particularly careful when making retrospective changes. This would arguably prevent states from depriving individuals of their ability to set the agenda for the resources. Put in generic terms, however, this position is also untenable. As Waldron explains, not every legislative modification that comes into play is

53 Montt, Santiago, *State liability in investment treaty arbitration: global constitutional and administrative law in the BIT generation*, Oxford and Portland, Oregon: Hart Publishing, 2009, p. 178.
54 Scheiber, Harry, "Public Rights and the Rule of Law in American Legal History," 72:2 *California Law Review* (1984), p. 223.
55 Katz, Larissa, "Red Tape and Gridlock," p. 114.
56 *Ibid.*

suspicious.[57] The population can change its mind within the sphere of public authority. The non-existence of regulation of a particular issue cannot be interpreted as the state having relinquished its regulatory authority on the matter. Every prospective modification of the contours of ownership cannot be problematic in itself; otherwise, state authority would simply cease to exist whenever individuals own property rights over the affected resources. In fact, the principle is the opposite, "the legislature occupies a pre-eminent role in most legal systems, largely due to the fact that it is an institution set up explicitly – dedicated explicitly – to the making and changing of the law."[58]

In view of this difficulty, to understand the struggle for resources between the individual and the state we need to consider the interplay between private and public authority. Legal scholars often use a private law paradigm to describe ownership, and a public law paradigm to portray state authority. This position links state sovereignty to the language of the constitution and the administration, and private property to the language of individual rights. However, this distinction can blur rather than clarify the interplay.[59] Thus, for instance, Alexander advocates the recognition of social obligations within the concept of ownership. These obligations would emerge from the core principles of private law as duties of the owners towards the community.[60] Other scholars who share this concern use the framework of rights to refer to both state and individual authority. Rose favours treating state authority as public rights because this approach avoids losing "sight of the complementary character of public and private rights in any functioning property regime."[61] Similarly, Scheiber argues that "the public, and not only private parties, have 'rights' that must be recognized and honored if there is to be true rule of law."[62] For some, such as Dworkin, however, this position is

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[57] Waldron, Jeremy, *The rule of law and the measure of property*, Cambridge: Cambridge University Press, 2012, pp. 82-84.
[58] *Ibid.*, p. 95.
[59] Horwitz, Morton, "The History of the Public/Private Distinction," 130:6 *University of Pennsylvania Law Review* (1982), pp. 1424, 1423-1428; Kennedy, Duncan, "The Stages of the Decline of the Public/Private Distinction," 130:6 *University of Pennsylvania Law Review* (1982), pp. 1349-1357.
[60] Alexander, Gregory, "The Social-Obligation Norm in American Property Law," 94 *Cornell Law Review* (2008-2009), p. 749, 74-820.
[61] Rose, Carol, "A Dozen Propositions on Private Property, Public Rights, and the New Takings Legislation," 53 *Washington and Lee Law Review* (1996), p. 267.
[62] Scheiber, Harry, "Public Rights and the Rule of Law in American Legal History," p. 219.

controversial because moral-based arguments would not serve to support public rights.[63]

C. Analysing ownership

From a property perspective, the contours of ownership constitute the main source of tension between foreign investors and host states. As already mentioned, foreign investors are not interested in ownership in the abstract: their interest lies in a concrete measure of control compatible with their business expectations. In this section, I analyse some characteristics of the measure of control that ownership grants to individuals. I look at the content of ownership, the incomplete and plural character of ownership, and at different mechanisms to clarify its scope. Putting these pieces together will help provide an answer to the question of whether the IIR has an impact on the substance of foreign investors' rights.

1. *The content of ownership: rights v value*

According to Hohfeld's study of rights, it is possible to break property rights down into a set of personal rights. This gives rise to the idea of ownership as a "bag of tools" at the disposition of the individual property owner.[64] As Ackerman explains, "property is not a thing, but a set of legal relations between persons governing the use of things."[65] This approach replaces property's *in rem* character as a right to a thing with a set of *in personam* relations. Following Hohfeld's approach, Honoré summarises the standard units of ownership, coining the idea of a "bundle of rights." He argues that ownership includes the right to possession, use, management, income, capital value, transfer and to security against expropriation. Honoré also stresses that the owner has a duty to refrain from

[63] See Dworkin, Ronald, *Taking rights seriously*, Chapter 4 and Appendix: A reply to critics. In this regard, Scheiber has claimed that policy considerations are, in reality, "legitimate collective claims by the community," Scheiber, Harry, "Public Rights and the Rule of Law in American Legal History," p. 220. Scheiber relies on Greenawalt, Kent, "Discretion and Judicial Decision: The Elusive Quest for the Fetters that Bind Judges," 75 *Columbia Law Review* (1975), pp. 375-76.

[64] Hohfeld, Wesley, *Fundamental legal conceptions as applied in judicial reasoning: and other legal essays*, (Walter Wheeler Cook Ed.), New Haven : Yale University Press, 1923; Penner, James, "The 'Bundle of Rights' Picture of Property," 43 *UCLA Law Review* (1996), p. 714, 724-731.

[65] Ackerman, Bruce, *Private Property and the Constitution*, New Haven and London: Yale University Press, p. 27.

harming others through his property.[66] Despite the many advantages of this way of thinking, there is a central problem with Honoré's description of ownership: private property is a plural concept, and the scope of ownership depends on the type of resources and the values of the communities in question. This flaw is particularly significant when we think about less ordinary rights such as shares, intellectual property or indigenous rights over land.[67] It is also relevant when considering the IIR because foreign investors often acquire licences and concessions with respect to resources – in particular natural resources – that may not resemble the bundle of rights described by Honoré.

Nevertheless, this has not prevented the bundle of rights from becoming the dominant way of thinking about property in legal scholarship, particularly in the United States. The bundle of rights has evolved into an essential tool for realist and law and economics scholars to show that there are costs and benefits for individuals and the state.[68] Hohfeld's system of rights reveals "the ineluctable component of public choice in every possible legal decision."[69] In recent years, however, many property scholars have attacked this realist way of thinking about property because it deprives property of any definite meaning. They argue that property rights become just a bundle of personal relations between the owner and many different subjects, replacing property's ordinary character as a right to things (i.e. *in rem* rights).[70] This debate is only tangential to this study. What is valuable about the bundle of rights is that it allows adjudicators and academics to comprehend the effects of legal decisions: as Michelman puts it, "[t]here are no free lunches."[71] Indeed, some critics of the bundle of rights agree with the analytical use of this theory. Smith, for instance, has recently acknowledged that "[a]s an analytical device, the bundle picture can be very useful."[72]

What is not tangential to my argument, however, is the distinction between rights and value as the unit of measurement of ownership. An alternative – but inappropriate – way to focus on the content of ownership is to substitute the idea

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[66] Penner, James, "The 'Bundle of Rights' Picture of Property," pp. 731-739.
[67] Waldron, Jeremy, *The right to private property*, pp. 47-53; Ackerman, Bruce, *Private Property and the Constitution*, pp. 97-98.
[68] Singer, Joseph, "How property norms construct the externalities of ownership," in Gregory Alexander and Eduardo Peñalver (Eds.), *Property and Community*, New York: Oxford University Press, 2010, p. 65.
[69] Michelman, Frank, "There Have To Be Four," 64 Maryland Law Review (2005), p. 156.
[70] See Penner, James, "The 'Bundle of Rights' Picture of Property," pp. 713-820.
[71] Michelman, Frank, "There Have To Be Four," pp. 156-157.
[72] Smith, Henry, "Property as the Law of Things," 125 *Harvard Law Review* (2012), p. 1696.

of rights with that of economic value. The possibility of using monetary value to measure the content of ownership is flawed because private property rules define uses and entitlements, and markets incorporate this information into the price of the transaction.[73] Therefore, "[t]he market cannot constitute the fixed point since it requires another point of reference, the legal one."[74] In addition, the use of economic value to give content to ownership would put the values of markets before the values of the legal order. In this respect, Barrère argues that "market values, standards, and norms cannot be used as normative references."[75] Adjudicators may be tempted to look at the apparent precision of markets and prices but this could distort the social foundations of private property, favouring a model that "underwrite[s] the investor-profits of predatory and extractive enterprises."[76]

Nevertheless, the application of economic value to substantiate ownership should not be confused with the use of this variable to calculate compensation for expropriation. Market value plays an important role in determining a just, fair or equitable compensation at an international level.[77] There is a large consensus that the compensation should bear some relation to the price the individual would have received for a voluntary market transfer of his property rights.[78]

2. *The incomplete and plural character of ownership*

Legal orders do not define the content of ownership in a comprehensive and detailed manner.[79] The problem of ownership is that it derives from a "system of pre-established rights, which are disputable or even disputed."[80] On one hand, the law only defines, explicitly or implicitly, some of the rights included in ownership. Legal orders, for instance, often acknowledge that the individual has an entitlement

[73] Penner, James, *The Idea of Property in Law*, pp. 154-16; Barrère, Christian, "Judicial System and Property Rights," pp. 150-151.
[74] *Ibid.*, p. 151.
[75] *Ibid.,* p. 150.
[76] Waldron, Jeremy, *The rule of law and the measure of property*, p. 73.
[77] Cheng, Bin, "The Rationale of Compensation for Expropriation," 44 *Transactions of the Grotius Society*, Problems of Public and Private International Law, Transactions for the Year 1958-59 (1958), p. 300.
[78] Reinisch, August, "Legality of Expropriations," in August Reinisch (Ed.), *Standards of investment protection*, New York: Oxford University Press, 2008, pp. 195-199.
[79] Libecap, Gary, "A Transactions-Costs Approach to the Analysis of Property Rights," pp. 140-141; Barrère, Christian, "Judicial System and Property Rights," pp. 129, 147.
[80] *Ibid.*, p. 151.

to the capital value of his private property. I will refer to such rights that derive from formal and informal social norms as "legal" uses.[81] On the other hand, there is a broad range of uses that legal orders neither recognise nor prohibit. I will refer to these uses as "mere" uses.[82] An example from U.S. case law illustrates this second category. In the case of *Hadacheck v Sebastian* (1915), the individual produced bricks on his land as there was no law prohibiting this activity. However, because he did not have a legal use, he could not oppose (or demand compensation for) the decision to ban industrial activities in that region of the city.[83] As with most rights, private property systems operate on the basis of a closure principle.[84] The individual can use his property in many different ways provided he does not affect the legal interests of the community or any third party.

The incomplete character of ownership contrasts with the ideal Coasian world of well-defined property rights. Coase argues that the lack of well-defined property rights creates transaction costs:

> "If factors of production are thought as rights, it becomes easier to understand that the rights to do something which has a harmful effect (such as the creation of smoke, noise, smells, etc.) is also a factor of production."[85]

During the second half of the 20th century, Coase's ideas were very influential in both private and public law domains.[86] Nevertheless, economists such as Barrère and Libecap acknowledge that legal orders cannot define ownership comprehensively. This is not because states have taken a normative decision in favour of increasing transaction costs or not defining property rights well. Rather, legal orders cannot define in advance all the potential uses of a resource. Coase himself disagreed with the formulation of the Coase's theorem and the hypothesis of zero or low transaction costs.[87] History is full of examples where resources that

[81] Cole, Daniel H. and Peter Z. Grossman, "The Meaning of Property Rights: Law versus Economics?," 78:3 *Land Economics* (2002), p. 322.
[82] *Ibid.*
[83] See *Hadacheck v Sebastian*, 239 U.S. 394 (1915).
[84] See Campbell, Kenneth, "Legal Rights," in *The Stanford Encyclopedia of Philosophy* (Spring 2011 Edition), Edward N. Zalta (Ed.), URL = <http://plato.stanford.edu/archives/spr2011/entries/legal-rights/>.
[85] Coase, Ronald, "The Problem of Social Cost," 3 *Journal of Law and Economics* (1960), p. 44.
[86] See Barnett, Randy, "Foreword: Four Senses Of The Public Law-Private Law Distinction," 9 *Harvard Journal of Law & Public Policy* (1986), pp. 267-276.
[87] McCloskey, Deirdre "Other Things Equal: The So-Called Coase Theorem," 24:3 *Eastern Economic Journal* (1998), pp. 367-371

were once of little interest, such as oil, became increasingly valuable.[88] As Waldron affirms,

> "what markets can and cannot produce, how efficiently they are producing it (or what social goals they promote or retard in various circumstances) are not always calculable *a priori*. This too varies over time and with circumstances in face of social, economic, ecological, and demographic change."[89]

The content of ownership thus is neither atemporal nor universal. Lehavi explains that some theories of property, such as those of Locke or Coase, argue "for a "validity that transcends specific time and place."[90] However, this view, has been criticised by many property scholars.[91] Rather, the content of ownership emerges from a complex socio-political process that is not only the expression of the legislation but also of social practices and values.[92] In line with this, Waldron stresses that ownership derives from "the law as it is in the society in which [the lawyer] and his client live,"[93] and Dagan claims that

> "the meaning of property is not homogeneous but varies instead with its social settings and with the categories of resources subject to property rights."[94]

Given the incomplete character of ownership, judicial systems have the task of substantiating property rights whenever there is a conflict regarding the control of resources. Barrère explains that the task of judges is to "make the implicit rules explicit, to clarify them."[95] When there is an allegation that the state has affected

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[88] Libecap, Gary, "Property Rights in Economic History: Implications for Research," 23 *Explorations in Economic History* (1986), page 242-247.
[89] Waldron, Jeremy, *The rule of law and the measure of property*, pp. 104-105
[90] Lehavi, Amnon, "The Global Law of The Land," 81 *University Of Colorado Law Review* (2010), p. 457.
[91] *Ibid.*, pp. 459, 468-469. See also: Alexander, Gregory, Eduardo Peñalver, Joseph Singer and Laura Underkuffler, "A Statement of Progressive Property," 94 *Cornell Law Review* (2009), p. 743.
[92] Rosanvallon, Pierre, *La légitimité démocratique: impartialité, réflexivité, proximité*, Paris: Éditions du Seuil, 2008, pp. 207-209. Rosanvallon refers to the "electoral people," the "social people" and the "people as principle."
[93] Waldron, Jeremy, *The right to private property*, p. 52.
[94] Dagan, Hanoch, *Property, Values and Institutions*, New York: Oxford University Press, 2011, p. 44.
[95] Barrère, Christian, "Judicial System and Property Rights," pp. 143, 144-152.

property rights indirectly, e.g. through regulation, a major question for the adjudicators is whether the state has respected the terms of the licence granted to the individual. Largely, the issue is to decide whether the individual has been deprived of a legal or a mere use. This question can have different levels of complexity, depending on whether the individual rights emerge from formal legislation or social informal norms. García Amador, discussing this problem in international law, shows that adjudicators face three different scenarios.[96] First, the legal order may explicitly state that the individual has the particular right. For example, investment treaties explicitly grant foreign investors the right to transfer dividends and capital, as in the Belgium–Luxembourg and Hong Kong (China) BIT, which establishes that "[e]ach Contracting Party shall in respect of investments guarantee to investors of the other Contracting Party the unrestricted right to transfer their investments and returns abroad."[97] These are the easiest cases of legal uses, although formal legislation can always raise problems of ambiguity and vagueness (e.g. what or how much is a dividend?).

Second, social informal norms may grant the individual the right allegedly taken away by the state measure. Most of the content of ownership emerges from informal norms, some of which may have crystallised through legal precedents. In common law systems, "[h]istorically, the courts have recognized that judicial decisions represent the primary way rules of property, and therefore vested property rights, are created."[98] The decisions regarding the use of water resources in privately-owned land in the U.S. and Germany provide a good example of legal uses that emerge from social informal norms (and also illustrate their potential instability).[99]

Finally, adjudicators may consider that no social norm grants the rights asserted by the individual. This would be a case of simple mere uses. In the aforementioned case of *Hadacheck v Sebastian*, the courts did not regard the fact that the claimant had operated a brick factory for several years as enough justification

[96] García Amador, F. V., "International responsibility. Fourth report. Responsibility of the State for injuries caused in its territory to the person or property of aliens — Measures affecting acquired rights," A/CN.4/119, 1959, pp. 9-10.
[97] Belgium–Luxembourg and Hong Kong (China) BIT (1996), Article 6. See UNCTAD, "Bilateral Investment Treaties 1995–2006: Trends In Investment Rulemaking," New York and Geneva: United Nations, 2007, pp. 56-63.
[98] Schulz, Clifford and Gregory Weber, "Changing Judicial Attitudes Towards Property Rights in California Water Resources: From Vested Rights to Utilitarian Reallocations," 19 *Pacific Law Journal* (1987-1988), p. 1109.
[99] *Ibid.*, pp. 1031-1110; Alexander, Gregory, *The global debate over constitutional property: lessons for American takings jurisprudence*, Chicago: University of Chicago Press, 2006, pp. 139-147.

for resisting a new regulation prohibiting him from doing what was undeniably legal before.

All in all, any dispute between an individual and the state regarding the control of resources requires adjudicators to deal with the inherently incomplete scope of ownership. Adjudicators face a more complex task, and enjoy more interpretative flexibility, whenever there are no explicit rules in the legal order.[100] However, some level of interpretation is always necessary. This means that the sphere of individual authority is well-defined for the purposes of the dispute only following the decision. After all, "[t]he law (or the constitution) is what the courts say it is."[101]

3. *Defining the scope of ownership: contractual commitments, vested rights, acquired rights and legitimate expectations*

An important point made by utilitarian and neo-utilitarian scholars is that individuals need some certainty and predictability to pursue economic activities. From Bentham to Michelman, utilitarian arguments call for consideration of the demoralising effects that sudden and continuous legal modifications may have on individuals.[102] Private actors cannot carry out their business enterprises in a continuously changing legal environment. In an economy based on individual initiative, legal instability creates inaction and the inefficient use of resources. This in turn is detrimental for communities that aim to produce the goods and services people need to enjoy a comfortable life. Therefore, any private property right is expected to grant individuals some level of certainty and predictability. Presently, most legal orders include norms that address this need, materialising in formal legislation, such as the transfer of funds clause included in investment treaties, and in other mechanisms that grant individuals a concrete use of the resources in question.[103]

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[100] Barrère, Christian, "Judicial System and Property Rights," p. 149.
[101] Hart, H. L. A., *The Concept of Law*, Oxford - Clarendon Press; New York: Oxford University Press, 1994, p. 141.
[102] Waldron, Jeremy, *The rule of law and the measure of property*, pp. 56-57; Michelman, Franck, "Property, Utility, and Fairness: Comments on The Ethical Foundations of "Just Compensation" Law," 80 *Harvard Law Review* (1966-1967), p. 1214.
[103] Scheiber, Harry, "Public Rights and the Rule of Law in American Legal History," pp 218-220. On the origin of civil and common law notions of vested rights, see Smead, Elmer, "The Rule Against Retroactive Legislation: A Basic Principle of Jurisprudence," 20 *Minnesota Law Revue* (1935-1936), pp. 775-797.

First, states offer contractual commitments to individuals who plan to set up a business project. A common example is a tax stabilisation agreement. Legal orders authorise states to modify tax rates without paying compensation – at least within certain broad margins.[104] In principle, individuals have no entitlement to pay a fixed rate of tax. Nevertheless, states often acknowledge that some business undertakings entail long-term investments that cannot be planned without some certainty and predictability about the future tax rate. The usual practice is that states enter into agreements with foreign (and domestic) investors in order to assure a specific tax rate for a certain period of time.[105] These contractual commitments are relatively clear, and the applicable law determines any vagueness or ambiguity regarding the content of these legally binding promises.

Second, in the course of private investments, states explicitly authorise individuals to pursue certain uses of resources.[106] These legal interests constitute vested rights, and can range from a permit to sell food to a concession to produce minerals. Essentially, these are control rights of a proprietary nature.[107] States grant vested rights through either administrative or contractual acts. The content of these rights is normally governed by the conditions established in the applicable constitutional and administrative laws. The laws that govern vested rights are often fundamental to the host country and the population as they refer to key sectors of the economy. For example, natural resources are a source of exhaustible wealth, and their production may also disturb the local cultural and natural environment.[108]

Finally, individuals can rely either on social informal norms or on the probability that countries will not modify the legal order. These alternatives provide less certainty and predictability than entering into a contractual commitment or acquiring a vested right. Nonetheless, a rational investor may avoid entering into a contractual commitment as this could become onerous. For example, the investor may need to make a monetary commitment or agree to local content or job

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[104] Kades, Eric, "Drawing the Line Between Taxes and Takings: The Continuous Burdens Principle, and its Broader Application," 97:1 *Northwestern University Law Review* (2002), pp. 189-265.
[105] An analysis of state practice regarding stabilisation clauses can be found in Shemberg, Andrea, "Stabilization Clauses and Human Rights," International Finance Corporation and the United Nations Special Representative to the Secretary General on Business and Human Rights, 2008.
[106] Ely, Richard, *Property and Contract in their Relation to the Distribution of Wealth*, pp. 755-756, 773-774.
[107] Penner, James, *The Idea of Property in Law*, pp. 78-79.
[108] See Turner, Louis, "The (A)political Multinational: State-Firm Rivalry Revisited," in J. M. Birkinshaw, S. Ghoshal, C. C. Markides, J. Stopford and G. Yip (Eds.), *The Future of the Multinational Company*, Chichester: Wiley, 2003, pp. 10-12.

creation requirements. Thus, he might instead choose to take the risk and hope that the host state will not change the existing rules against his interests. With regard to the typical sticks in the bundle of rights, the risk is reasonably low and the state obligation to pay compensation highly likely. Thus, for instance, there is a large consensus in most legal orders that owners have a legal entitlement to the capital value of their private property. This is a socially sanctioned right and any new legislation modifying it would be considered as expropriation. However, large foreign investment disputes often raise complex and sensitive social issues. The conditions that govern permits in highly regulated sectors, such as waste disposal facilities, constitute very sophisticated pieces of regulation. Adjudicators have a tougher job deciding these cases. As Barrère emphasises, "[t]he growing role of the judicial system is correlated to more complex [property rights] and more complex uses of economic resources."[109]

Historically, when an individual claims that his rights have been taken away by state measures, adjudicators employ two doctrines to decide whether the allegation refers in effect to a legal or to a mere use of the resources. Since these two doctrines serve the same purpose, it is possible to find some overlap in their structure and application.[110] However, to simplify my argument, I will present them as opposites. On the social side is the doctrine of acquired rights, which I associate with the idea that adjudicators should look at the entire social environment to define ownership. On the individual side is the doctrine of substantive legitimate expectations, which focuses on the position of the individual, emphasising his need for certainty and predictability to use the resources.

The acquired rights doctrine (sometimes referred to as the vested rights doctrine) dominated the legal field during a large part of the 20th century. This doctrine was popular at the international and domestic level.[111] The decision of the Permanent Court of International Justice (PCIJ) in *Oscar Chinn* (1937) is a good example of the application of acquired rights. The PCIJ decided that "[f]avourable business conditions and goodwill are transient circumstances, subject to inevitable changes"

[109] Barrère, Christian, "Judicial System and Property Rights," p. 151.
[110] See Craig, P., "Substantive Legitimate Expectations in Domestic and Community Law," 55 *The Cambridge Law Journal* (1996), p. 290; García Amador, F. V., "International responsibility. Fourth report. Responsibility of the State for injuries caused in its territory to the person or property of aliens — Measures affecting acquired rights," p. 6.
[111] *Ibid.*, pp. 9-10.

and constitute "anything in the nature of a genuine vested right."[112] I suggest that the doctrine of acquired rights is closer to the position of authors such as Rose and Ackerman who have advocated for a vernacular or social component in the conceptualisation of ownership.[113] Ackerman ends his book about property and the Constitution with the argument that

> "the Constitution of the United States, as presently construed, contains a principle that requires the state to assess its manipulation of the economic environment not by a critical yardstick of its own devising but by one rooted in established social practice."[114]

The doctrine of substantive legitimate expectation, located on the individual side, emerged in the 1970-1990s together with other neo-liberal approaches to constitutional and administrative law.[115] In many jurisdictions, including international investment arbitration, legitimate expectations and investment-backed expectations have arguably replaced the acquired rights doctrine.[116] The central argument behind a substantive expectation is "that the law should protect the trust that has been reposed in the promise made by an official."[117] The existence of substantive legitimate expectations implies that the individual reasonably expects a particular outcome from the public body.[118] A change of mind could therefore constitute an arbitrary or abusive measure, opposed to the principle of legal certainty.[119] Mandelker has stressed the importance of market value and individual profit in the origin of the doctrine of investment-backed expectations in the United States. He explains that "[i]nvestment-backed expectations [arose] in property markets, where market participants invest with the expectation that they will obtain capital gains from the development of their property."[120] The decision of the U.S.

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112 *Oscar Chinn Case (Britain v Belgium)*, P.C.I.J., 1937, (Ser. A/B), No. 70, at 99.

113 Fenster, Mark, "The Takings Clause, Version 2005: The Legal Process of Constitutional Property Rights", 9:3 *Journal of Constitutional Law* (2007), pp. 702-706.

114 Ackerman, Bruce, *Private Property and the Constitution*, 1977, p. 189.

115 Arthurs, H.W., "The Administrative State goes to Market (And Cries 'Wee, Wee, Wee' All The Way Home)," 55 *University of Toronto Law Journal* (2005), pp. 807-815, 825-826.

116 For an analysis of this transformation in U.S. Constitutional Property Law, see Mandelker, Daniel, "Investment-Backed Expectations: Is There a Taking?," 31:3 *Journal of Urban and Contemporary Law* (1987), pp. 5-6.

117 Forsyth, Christopher, "Legitimate Expectations Revisited," ALBA Summer Conference 2011, ALBA/BEG, p. 2.

118 *Ibid.*, p. 9.

119 Craig, P., "Substantive Legitimate Expectations in Domestic and Community Law," pp. 298-300.

120 Mandelker, Daniel, "Investment-Backed Expectations: Is There a Taking?," p. 4.

Supreme Court in *Lucas v South Carolina Coastal Council* (1992) represents a paradigmatic example of the application of this doctrine. In this case, the regulatory agency barred David Lucas from building on a tract of land he had recently acquired. The U.S. Supreme Court decided that this use of the land deserved protection because the regulations left "the owner of land without economically beneficial or productive options for its use – typically, as here, by requiring land to be left substantially in its natural state."[121]

The case for substantive legitimate expectations has been the object of some cautions and criticisms. In the late 1990s, Forsyth argued in favour of the recognition of substantive legitimate expectations in English Public Law.[122] Indeed, his work has been cited by some investment tribunals,[123] albeit sometimes overlooking Forsyth's opinion regarding the limited scope of substantive legitimate expectations.[124] More recently, however, Forsyth has been more critical about the substantive side of this doctrine, claiming that "the scope of legitimate expectations is much narrower than is often supposed,"[125] and that

> "the substantive protection of expectations does raise difficult issues, primarily that such protection fetters the discretion of the decision-maker, contrary to the intent of Parliament that the decision-maker should freely judge where the public interest lies. [...] Once the expectation has passed through the prism of private law the public law considerations that support the free exercise of the decision-maker's discretion are squeezed out and substantive protection is justified."[126]

Furthermore, the focus on the position of the individual, arguably the foundation of the substantive doctrine of legitimate expectations, has been criticised by economic and legal scholars. Cole and Grossman describe this debate as "[t]he

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121 *David H. Lucas v South Carolina Coastal Council*, 505 U.S. 1003 (1992), at 1019.
122 Forsyth, Christopher, "The Provenance and Protection of Legitimate Expectations," 47:2 *The Cambridge Law Journal* (1988) pp. 238-260.
123 *Total v Argentina*, ICSID Case No. ARB/04/01, Decision on Liability, 27 December 2010, at 128, footnote 136.
124 Forsyth, Christopher, "The Provenance and Protection of Legitimate Expectations," pp. 238, 251, 254, 260.
125 Forsyth, Christopher, "Legitimate Expectations Revisited," p. 13.
126 *Ibid.*

meaning of property rights: Law versus Economics."[127] They begin with the provocative premise that "it might be expected that there would be some consensus in economic theory about what property rights are. But no such consensus appears to exist."[128] The argument of Cole and Grossman is that many economists have put aside the law as the measure of ownership, replacing it with individual-based visions of property for which mere uses are also essential elements of ownership. They submit that many economists assume a definition of property "at odds with the conventional understanding of legal scholars and the legal profession."[129] In essence, Cole and Grossman warn us about the effects of a view of private property that "can bias economic analyses and create the potential for cross-disciplinary misunderstanding."[130]

D. The substantiation of property: the relation between rights and remedies

Following this brief analysis of private property, I can return to the question of whether the IIR has an impact on foreign investors' rights, considering, at least theoretically, the potential significance of these effects. From a strict legal standpoint, I suggest that it would be incorrect to claim that the IIR grants foreign investors a completely new category of rights over resources. This regime only provides an entirely new international-based remedy: investment arbitration. However, a better understanding of private property demonstrates that it is formalistic to affirm that investment arbitration has no effects on the substance of foreign investors' rights. Foreign investors' ownership is incomplete, and the content of the rights is "disputable or even disputed." For this reason, whenever there is a controversy between foreign investors and host states, investment arbitrators very often need to substantiate foreign investors' rights. If they do it in any way that is qualitatively different from domestic courts, foreign investors' control over the resources will also be qualitatively different because in terms of "what can be done," as Llewellyn affirms, "[n]ot only 'no remedy no right,' but 'precisely as much right as remedy.'"[131]

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[127] "Cole, Daniel H. and Peter Z. Grossman, "The Meaning of Property Rights: Law versus Economics?," pp. 317-330.
[128] *Ibid.*, p. 317.
[129] *Ibid.*
[130] *Ibid.*, p. 318, 325-330.
[131] Llewellyn, Karl, *Jurisprudence: Realism in Theory and Practice*, New Brunswick; London:

An important lesson of legal realism is that to understand the actual content of rights we "must understand that remedies are constitutive features of rights."[132] This significant premise may have been left aside following the claim of Calabresi and Melamed that rights and remedies are independent,[133] but I want to stress that this view is problematic. The problem is that it focuses on the efficiency of the legal order, overlooking the purpose we want the right in question to serve. As Coleman and Kraus conclude, remedies are "devices for generating or specifying the *content* or *meaning* of such rights."[134] Michelman observes that these choices "inevitably favor and disfavor contending socioeconomic interests,"[135] as he stresses that the issue of efficiency can only be considered after "society's aims are set."[136] Thus, the problem with a view that divorces rights and remedies is that "one way we understand the meaning and content of a right is by looking at how we protect it."[137] Indeed, in his work on constitutional rights, Levinson highlights the importance of remedies for the substantiation of rights in constitutional adjudication. He claims that "[r]ights are dependent on remedies not just for their application to the real world, but for their scope, shape, and very existence."[138]

Overall, these theoretical insights suggest that investment arbitration plays an essential role in the substantiation of foreign investors' rights. We can understand "the meaning and content of these rights" by looking at this international-based remedy. The premise that ownership is inherently incomplete leads to the view that the actual content of foreign investors' rights is the upshot of the interpretation of arbitrators.

Conclusion

From the perspective of property, the main source of tension between foreign investors and host states is the control of resources. This premise suggests that property rules play an important role in the IIR because foreign investors have a

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Transaction Publishers, 2000, p. 63.

132 Dagan, Hanoch, "Remedies, Rights and Properties," 4:1 *Journal of Tort Law* (2011), p. 6.

133 Calabresi, Guido and A. Douglas Melamed, "Property Rules, Liability Rules, and Inalienability: One View of the Cathedral," 85:6 *Harvard Law Review* (1972), pp. 1089-1128.

134 Coleman, Jules and Jody Kraus, "Rethinking the Theory of Legal Rights," 95:7 *The Yale Law Journal* (1986), p. 1342.

135 Michelman, Frank, "There Have To Be Four," p. 157.

136 *Ibid.*

137 Dagan, Hanoch, "Remedies, Rights and Properties," p. 4.

138 Levinson, Daryl, "Rights Essentialism and Remedial Equilibration," 99:4 *Columbia Law Review* (1999), p. 858.

vital interest in assuring a measure of control that facilitates their investments. This chapter has thus explored the idea of property by focusing on the issue of control. I have shown that ownership represents the control that individuals enjoy over resources. Ownership consists of a number of rights that shape relations, regarding the use of resources, between owners, other individuals and the state. In this regard, I have stressed that we should not confuse the content of ownership with the market value of the resources. The source of ownership is the legal order. However, the legal order does not provide a complete enumeration of the rights that constitute ownership. In this respect, I have explained that the content of property rights depends on various variables. I have emphasised in particular that ownership is plural, depending on the economy, technology and preferences of communities. Finally, I showed that the incomplete character of ownership implies that whenever there is a conflict between individuals and the state regarding the control of resources, the adjudicators need to substantiate the private property rights involved in the dispute. I have examined two doctrines that serve this purpose – the acquired rights and the substantive legitimate expectations doctrines – stressing that they respectively adopt a social and an individual perspective on the use of resources. In sum, I have used this analysis of private property to suggest that investment arbitrators not only protect but also substantiate foreign investors' rights, as there is an intrinsic connection between rights and remedies in the substantiation of rights. In view of this connection, we can learn more about the content of foreign investors' rights by looking at investment arbitration and the role these rights play in the protection of foreign investment.

Chapter 2 – Foreign investors' rights and the International Investment Regime

Introduction

The objective of this chapter is to examine the role of foreign investors' substantive rights in the protection of foreign investment, considering in particular the character of these rights. Looking at the diplomatic protection model and the IIR, I argue that foreign investors' substantive rights are key in both mechanisms. Whilst the diplomatic protection model clearly illustrates the importance of these rights, its use of a legal fiction around private property is problematic. The IIR has arguably solved this problem by granting foreign investors an international-based remedy: investment arbitration. However, despite this paradigmatic change, the literature continues to focus on foreign investors' rights from the perspective of the remedy alone. This is inconsistent with the key role that foreign investors' substantive rights play in the resolution of any investment claim – except for an allegation of discrimination. In this respect, I suggest that one important element in the resolution of an investment arbitration is the characterisation of foreign investors' rights. I argue that under the IIR most foreign investors' rights have a proprietary character, which implies that only host states can create, deprive or affect these rights. This argument is consistent with the prevalent position in investment arbitration that a treaty claim necessarily involves host state sovereign acts.

A. Moving to a private international-based remedy: From diplomatic protection to investment arbitration

Historical analyses show that colonial institutions and international laws governing the resources of different countries have dealt principally with the situation of foreign-owned property.[1] This indicates that international law has always been very concerned with the struggle for these resources. Public international law has

[1] Lipson, Charles, *Standing Guard: Protecting Foreign Capital in the Nineteenth and Twentieth Centuries*, Berkeley: University of California Press, 1985; Frieden, Jeffry, "International investment and colonial control: a new interpretation," 48:4 *International Organization* (1994), pp. 559-560; Picciotto, Sol, *Regulating Global Corporate Capitalism*, New York: Cambridge University Press, 2011, p. 157.

focused substantially on the controversies regarding foreign-controlled resources between foreign investors, home states and host states. In this regard, Brownlie argues that "[t]he history [of diplomatic protection] has been primarily but not entirely concerned with the conflict of interest between investor states and the economically exploited hosts to foreign capital."[2] Similarly, Shaw points out that:

> "The expansion of the Western economies since the nineteenth century in particular stimulated an outflow of capital and consequent heavy investment in the developing areas of the world. This resulted in substantial areas of local economies falling within the ownership and control of Western corporations. However, with the granting of independence to the various Third World countries and in view of the nationalisation measures taken by the Soviet Union after the success of the communist revolution, such properties and influence began to come under pressure."[3]

During this first stage of western capitalist expansion, public international law addressed the pressure exerted on foreign-owned private property through the institution of diplomatic protection. This mechanism allowed home states to present a claim against the host state at an international level.[4] As Shaw explains, the international legal order had to address controversies related to foreign investors' rights over the resources of host countries. However, the diplomatic protection model, which was dominant during most of the 20th century, has little in common with a private property system. The rules of this model do not resemble typical private property rules. Customary international law does not commodify resources, nor does it govern the allocation of resources to individuals. There are also few, if any, international rules related to the content of ownership. More importantly, although public international law addresses the conflict between foreign investors and host states, in reality the diplomatic protection model only focuses on this question indirectly. Customary international law does not look at the struggle between private foreign investors and host states, but rather at any conflicting views about these controversies between home and host states.

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[2] Brownlie, Ian, *Principles of Public International Law*, Fourth Edition, New York: Oxford University Press, 1990, p. 521.
[3] Shaw, Malcolm, *International Law*, Sixth edition, New York: Cambridge University Press, 2008, pp. 827-828.
[4] Brownlie, Ian, *Principles of Public International Law*, p. 519.

In the diplomatic protection model, international law does not grant foreign investors rights or remedies they can assert against host states. Only home states can use diplomatic protection.[5] The protagonist in customary rules is a third subject that is not the owner of the resources according to either domestic or international law. According to Muchlinski "[t]his may be a legal fiction, given that the primary right giving rise to the claim is a right of the individual protected by international law."[6] Similarly, Brownlie claims that "the subject matter of the claim is the individual and his property: the claim is that of the state."[7] Both therefore suggest that diplomatic protection cannot be understood in isolation from private property rights.

The character and content of foreign-owned rights over resources plays an important role in the resolution of any controversy. Diplomatic protection only authorises home states to complain about host state measures in relation to the property rights of a national individual or corporation.[8] The traditional basis for diplomatic protection is the recognition of the interest of home states in the private property rights owned by their citizens. Grotius and Vattel originally developed the justification for this interest in the 16th and 17th centuries:[9]

> "In Vattel's view, foreigners' membership in their home state extended to their property, which remained part of the wealth of their home nation. As a result, a state's mistreatment of foreigners or their property was an injury to the foreigners' home state."[10]

The main features of diplomatic protection have not changed substantially. The *Barcelona Traction Case* (1970) underlines the importance of the connection between the holder of the property rights and his home state. According to the decision of

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5 Shaw, Malcolm, *International Law*, pp. 808-809.
6 Muchlinski, Peter, "The Diplomatic Protection of Foreign Investors: A Tale of Judicial Caution," in Christina Binder, Ursula Kriebaum, August Reinisch and Stephan Wittich (Eds.), *International Investment Law for the 21st Century Essays in Honour of Christoph Schreuer*, Oxford: Oxford University Press, 2009, p. 343.
7 Brownlie, Ian, *Principles of Public International Law*, Sixth Edition, New York: Oxford University Press, 2003, p. 459.
8 Orrego Vicuña, Francisco, *International dispute settlement in an evolving global society: Constitutionalization, Accessibility, Privatization*, Cambridge: Cambridge University Press, 2004, pp. 31-47.
9 Schneiderman, David, *Constitutionalizing Economic Globalization. Investment Rules and Democracy's Promise*, New York: Cambridge University Press, 2008, p. 57.
10 Newcombe, Andrew and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment*, The Netherlands: Kluwer Law International, 2009, p. 4.

the International Court of Justice (ICJ), the relationship between the owner and the home state needs be direct and, therefore, Belgium was not allowed to exercise diplomatic protection on behalf of the shareholders of a Canadian corporation.[11] Also, whilst the decision of the ICJ in the *LaGrand Case* (2001) may have further developed the institution of diplomatic protection by arguing that international law grants some rights directly to individuals,[12] this does not change the fact that general international law is hesitant about taking individual rights seriously, and continues to prioritise the rule of reason or political considerations.[13] In short, although international law claims that foreigners are not "obliged to submit, like other subjects, to all the commands of the sovereign,"[14] it is always up to the home state to exercise diplomatic protection as a means of asserting individual rights against the commands of the host state.

In view of the private property rights that individuals enjoy domestically, diplomatic protection comes across as highly inadequate for promoting the individual control of resources.[15] Foreign investors' rights are key to this model, but the private property rights that trump state measures on a domestic level simply amount to a political reason to request the involvement of the home state on an international level. Private foreign investors, however, have never openly criticised diplomatic protection. There are probably two reasons for this. Firstly, the political and economic interests of home states and foreign investors were substantially aligned, at least until the first half of the 20th century. In 1935, Staley described a world where "diplomacy serves investments" and "investments serve diplomacy."[16] Secondly, foreign investors probably had no real alternative for managing any conflict with host states regarding the use of resources. The alternatives to diplomatic protection and international customary law were domestic courts and municipal law. The competing paradigm for the diplomatic

[11] *Barcelona Traction, Light and Power Company, Limited* (*Belgium v. Spain*), ICJ, Judgements of 24 July 1964 and 5 February 1970.

[12] *LaGrand Case* (*Germany v. United States of America*), ICJ, Judgement of 27 June 2001, at 77.

[13] Wetter, J. Gillis, "Diplomatic Assistance to Private Investment: A Study of the Theory and Practice of the United States during the Twentieth Century," 29 *The University of Chicago Law Review* (1961-1962), pp. 325-326; Vagts, Detlev, "United States and Its Multinationals: Protection and Control," 20 *Harvard International Law Journal* (1979), pp. 242-243; Shaw, Malcolm, *International Law*, p. 138.

[14] Newcombe, Andrew and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment*, p. 4 (The authors rely on Vattel's The Law of Nations, 1758).

[15] Garcia-Amador, F. V., "Report on International Responsibility. First Report," International Law Commission, A/CN.4/96, 1956, p. 202.

[16] Staley, Eugene, *War and The Private Investor: A Study in the Relations of International Politics and International Private Investment*, New York: Doubleday, Doran & Company, 1935, Chapters 3; 6.

protection model was the Calvo doctrine, according to which foreigners that invested in host countries had the same rights and remedies as nationals.[17] Foreign investors, however, have always perceived domestic jurisdictions as biased against their interests.[18]

Arguably, the views of the international business sector began to change with the beginning of economic globalisation and the end of colonialism in Asia and Africa. These events produced an international business voice particularly interested in campaigning for an individual-based regime to manage the struggle for the resources of different countries. The world of global value chains and economic globalisation that Reich, and Stopford and Strange describe as a consolidated trend in the 1990s contrasts with the picture provided by Staley back in 1935.[19] Multinational corporations may now have diverging interests from home states. In the 1960s and 1970s, scholars began to note that when firms look for diplomatic intervention and protection, home governments may demand costly concessions.[20] These could be modifications to business strategies that favour host states, e.g. more exports from the home nation or less relocation to the host country. The diplomatic protection model thus presents foreign investors with the dilemma of choosing between two forms of state intervention in their investments.

In addition, the institution of diplomatic protection was ill-suited to the challenges posed by the post-colonial world.[21] Many new states perceived multinational corporations as arms of the former metropolis and a source of continuing foreign domination.[22] Private foreign investors needed to convince host states that they were not part of the old model, and the idea of requesting diplomatic protection from home states was not compatible with this. Regarding this, in 1967 just before he was appointed as U.S. Ambassador to the United

[17] Paulsson, Jan, *Denial of Justice in International Law*, New York: Cambridge University Press, 2005, pp. 20-21.
[18] *Ibid.* p. 149; Schreuer, Christoph, Loretta Malintoppi, August Reinisch and Anthony Sinclair, *The ICSID Convention: A Commentary*, Second Edition, New York: Cambridge University Press, 2009, p. 5.
[19] Reich, Robert, *The Work of nations: preparing ourselves for 21st. century capitalism*, New York: Vintage Books, 1992; Stopford, John and Susan Strange, *Rival states, rival firms: Competition for world market shares*, Cambridge: Cambridge University Press, 1991.
[20] Lipson, Charles, *Standing Guard: Protecting Foreign Capital in the Nineteenth and Twentieth Centuries*, pp. 28-29; Vernon, Raymond, "The Multinationals: No Strings Attached," 33 *Foreign Policy* (1978-1979), pp. 123-126.
[21] Parra, Antonio, *The History of ICSID*, Oxford: Oxford University Press, 2012, p. 11.
[22] Bergsten, Fred, Thomas Horst and Theodore H Moran, *American multinationals and American interests*, Washington D.C.: Brookings Institution, 1978, p. 314-329.

Nations, Ball suggested that the international business sector should be "stateless."[23]

In this context, bankers, executives and lawyers came up with several ideas in the 1950s to replace diplomatic protection with a model more attuned to the interests of the international business sector.[24] These initiatives advocated the recognition of foreign investors' rights and remedies at the international level. Rather than "stateless" corporations, these non-governmental initiatives involved creating an international substantive code and an international dispute settlement forum. There were three important private proposals: The 1949 International Chamber of Commerce International Code for Fair Treatment of Foreign Investment (state-to-state arbitration, Article 13), The 1948 International Law Association Draft Statutes of the Arbitral Tribunal for Foreign Investment and the Foreign Investment Court (foreign investor-state arbitration, Article 3[25]), and The 1959 Abs-Shawcross Draft Convention (foreign investor-state arbitration, Article VII). In one way or another, these initiatives were aimed at detaching foreign investors from the strings of home states through either state-to-state or foreign investor-state arbitration. And even if these drafts were never adopted, they "were significant in signaling both a conceptual and semantic change from the traditional notions of protection of aliens and their property."[26]

In the end, two less comprehensive efforts materialised in 1959 and 1965: the signature of the first BIT between Germany and Pakistan, and the conclusion of the Convention for the ICSID. These initiatives constitute the basis of the IIR not only in terms of its structure but also, and perhaps more importantly, because of the views they advance regarding the struggle for the resources of different countries. First, BITs are the outcome of a much broader proposal for a "Magna

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23 Ball, George, "Cosmocorp: the Importance of Being Stateless," 2 *Columbia Journal of World Business* (1967), pp. 25-30.

24 Schwarzenberger, Georg, "The Abs-Shawcross Draft Convention on Investments Abroad: A Critical Commentary," 9 *Journal of Public Law* (1960), p. 148; Proehl, Paul, "Private Investments Abroad," 9 *Journal of Public Law* (1960), p. 362; Brandon, Michael, "Recent Measures to Improve the International Investment Climate," 9 *Journal of Public Law* (1960), p. 126; Gardner, Richard, "International Measures for the Promotion and Protection of Foreign Investment," 53 *Proceedings of the American Society of International Law at its Annual Meeting*, 1921-1969 (1959), pp. 259-261; Fatouros, A., "An International Code to Protect Private Investment-Proposals and Perspectives," 14 *The University of Toronto Law Journal* (1961) , pp. 79-88.

25 Article 3(1). "A national of one of the Parties claiming that between him and a Party there exists a dispute within the meaning of Art. 1 may institute proceedings against this Party before the Arbitral Tribunal provided that the Party [...]."

26 Newcombe, Andrew and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* , p. 21.

Carta for Private Foreign Investors" made by Hermann Abs in 1957 at a Conference in San Francisco.[27] He took this opportunity to raise a point made earlier by other commentators, for instance Coudert and Lans in 1946.[28] According to these scholars, developing states would not attract enough private foreign investment unless they implemented political systems that assured the protection of foreign investors' property rights. It is worth pointing out that this view represented the opinion of businessmen and lawyers, like Hermann Abs and Lord Shawcross, who were involved in the Society to Advance the Protection of Foreign Investments, the French Association de Droit Minier et Pétrolier and the Association for the Protection and Promotion of Private Foreign Investment.[29]

Arguably, the main interest of international business lobbies was to reach sufficient levels of control and protection for the existent and increasing business opportunities in the developing world. The spirit of these projects can be summarised in Abs' eloquent phrase: "Let Investors Unite."[30] The solution proposed by Abs, which later materialised in BITs, was to outsource the institutions that were needed to manage the struggle for resources. His strategy was to conclude

> "an international convention by which all contracting parties […] undertake to treat foreign capital and other foreign interests fairly and without discrimination […] [s]uch a convention […] should provide for the establishment of a special international court of arbitration."[31]

This proposal first evolved into the Abs-Shawcross Draft Convention, then into the first BIT between Germany and Pakistan (granting state-to-state dispute settlement before the ICJ), and, by 1968, into the first BITs that allowed foreign investors to launch an arbitration against host states, i.e. investment arbitration.[32]

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27 Abs, Hermann, "The Safety of Capital," in James Daniel (Ed.), *Private investment: the key to international industrial development; a report of the San Francisco Conference*, October 14-18, 1957,sponsored by Time-Life International and Stanford Research Institute, McGraw Hill, New York, 1958, pp. 76-77.

28 Coudert, Alexis and Asher Lans, "Direct Foreign Investment in Undeveloped Countries: Some Practical Problems," 11:4 *Law and Contemporary Problems*: International Trade Barriers (1946), p. 759.

29 See above footnote 24; Shawcross, Hartley, *Life sentence: The memoirs of Hartley Shawcross*, London: Constable, 1995, pp. 307-308.

30 Abs, Hermann, "The Safety of Capital," p. 76.

31 *Ibid.*, pp. 76-77

32 Newcombe, Andrew and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment*, p. 44.

The ICSID Convention is a parallel development in the direction of establishing a private international-based remedy. To some extent a result of developing nations' resistance to concluding a convention on substantive standards of protection, the ICSID Convention entered into force in 1965 with the concrete objective of depoliticising foreign investment disputes.[33] In my view, this so-called *depoliticising* was in reality the minimisation of home state political involvement through two essential changes to the diplomatic protection model.[34] First, when a dispute is brought before the ICSID, home states cannot exercise diplomatic protection provided that host states abide by the convention.[35] Second, the ICSID Convention allows foreign investors to sue host states directly in an international arbitration.[36] As Broches recognises, the central goal of the ICSID was to put the individual private interest in control of the legal machinery dedicated to managing the struggle between foreign investors and host states.[37]

Although the evolution of the IIR and of investment arbitration was relatively slow for more than twenty years, the 1990s boom made this regime as relevant as the World Trade Organisation (WTO). At the start of the 1980s, there were just 250 investment treaties and only 9 registered cases at the ICSID. In this context nobody could have predicted the boom experienced by this regime during the early 1990s. In the period 1994-1996, states were signing an average of 4 investment treaties per week. Although the weekly average has decreased to 1, the present number of bilateral, regional and sector-specific investment treaties exceeds 3,000.[38] The caseload of the ICSID also reflects this boom. In 1997, the number of cases registered each year had already reached 10, and since 2000 the annual average has remained well above 20. Indeed, with 433 cases registered by June

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33 Shihata, Ibrahim "Toward a Greater Depoliticization of Investment Disputes: The Roles of ICSID and MIGA," in Kevin Lu, Gero Verheyen, and Srilal Perera (Eds.), *Investing with Confidence Understanding Political Risk Management in the 21st Century*, Washington D.C.: World Bank, 2009, pp. 4-5; Franck, Susan, "The ICSID Effect? Considering Potential Variations in Arbitration Awards," 51:4 *Virginia Journal of International Law* (2011), pp. 833-835.

34 In a similar line, see Douglas, Zachary, "Other Specific Regimes of Responsibility: Investment Treaty Arbitration and ICSID," in James Crawford, Alain Pellet, and Simon Olleson (Eds.), *The Law of International Responsibility*, New York: Oxford University Press, 2010, p. 829.

35 Article 27, ICSID Convention. Several BITs impose the same obligation on home states, see UNCTAD, "Bilateral Investment Treaties 1995–2006: Trends in Investment Rulemaking," New York and Geneva: United Nations, 2007, p. 100.

36 Article 25, ICSID Convention.

37 Broches, Aron, "The Convention on the Settlement of Investment Disputes between States and. Nationals of Other States," 136 *Recueil des Cours* (1972-II), pp. 343-345.

38 UNCTAD, "World Investment Report 2013: Global Value Chains: Investment and Trade for Development," New York and Geneva: United Nations, 2013, pp. xix-xx.

2013 (50 in 2012), the ICSID has clearly become the preferred route for resolving foreign investment disputes.[39]

This boom has been mainly quantitative as the IIR continues to rely on the same structure and vision of the first investment treaties and the ICSID Convention, two mechanisms that have been in close interaction since at least 1969.[40] The IIR also shares an essential feature with the diplomatic protection model: in both cases, the main theme is the struggle for resources between foreign investors and host states. However, the IIR tackles this struggle by focusing on the private owner of the rights comprising the investment. It entitles foreign investors to launch an international arbitration with the objective of solving – in accordance with the treaty standards of protection – any dispute regarding the investment. The privatisation of this remedy at the international level signals a paradigmatic change, which for most of the literature constitutes the main feature of the IIR, and has in fact attracted much comment.[41]

The IIR has become one of the international law regimes that serves as "a talisman for the protection of individuals *vis-à-vis*" host states.[42] Indeed, the IIR is probably the most paradigmatic example of this "talisman" for individual protection. Foreign investors face few restrictions when launching an investment arbitration against host states, i.e. there is either a limited or no requirement for the exhaustion of local remedies, and they can claim and receive large amounts of monetary compensation. The award rendered by the tribunal in *Merrill v Canada* (2010) provides a good summary of this "new liberal approach":

> "Parallel to the development of this second track, diplomatic protection gradually gave way to specialized regimes for the protection of foreign investments and other matters. The digest of cases concerning state responsibility in respect of acts of legislative, administrative and other state organs, published by the United Nations Secretariat in 1964 unequivocally

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[39] ICSID, The ICSID Caseload – Statistics (Issue 2013-2).

[40] Newcombe, Andrew and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment*, p. 45.

[41] See Shan, Wenhua, "From North-South Divide To Private-Public Debate: Revival of The Calvo Doctrine and The Changing Landscape in International Investment Law," 27 *Northwestern Journal of International Law and Business* (2007), pp. 655, 659-664; Mills, Alex, "Antinomies of Public and Private at the Foundations of International Investment Law and Arbitration," 14:2 *Journal of International Economic Law* (2011), pp. 488-491.

[42] Katz Cogan, Jacob, "The Regulatory Turn in International Law," 52:2 *Harvard International Law Journal* (2011), p. 323.

> illustrates a new liberal approach. Indeed, a host of successful claims were made without conceptual restrictions dealing with interference with and annulment of private rights, the breach of concession contracts by the state, acquired rights under the law in force at the time of the investment, the entitlement to money wrongfully withheld, the entitlement to the value of money orders, and the refusal to grant an export permit […] The trend towards liberalization of the standard applicable to the treatment of business, trade and investments continued unabated over several decades and has yet not stopped."[43]

After the boom of the IIR, international law scholars have paid significant attention to investment arbitration. The dominant themes in investment law have been foreign investment protection and the treatment of foreign investors by host states, i.e. host state actions. Despite the differences between the diplomatic protection model and the IIR, in particular the more prominent role of the foreign investor, the focus has remained fixed on the remedy, overlooking the individual rights. This approach is inconsistent with the importance of private rights over resources: after all, the control of resources is the raison d'être of the IIR. This is the major interest of the international business lobby, of businessmen, bankers and lawyers. Indeed, commentators such as Stiglitz and Vernon assert that the IIR governs relations between foreign investors and host states, based on foreign investors' proprietary rights.[44] In this respect, returning to the observations made by Brownlie and Muchlinski, the problem with the diplomatic protection model is the "legal fiction" around foreign investors' rights. The IIR has resolved part of this by providing the owners of these rights with an international-based remedy; however, the literature has not given foreign investors' rights the attention they deserve.

[43] *Merrill v Canada*, UNCITRAL, ICSID Administered Case – NAFTA, Award, 31 March 2010, at 205-207.

[44] Stiglitz, Joseph, "Regulating Multinational Corporations: Towards Principles of Cross-Border Legal Frameworks in a Globalized World: Balancing Rights with Responsibilities," 23 *American University International Law Review* (2008), pp. 468, 482-483, 517; Vernon, Raymond, "Sovereignty at bay - twenty years after," 20 *Millennium* (1991), p. 193.

B. The place of foreign investors' rights in investment law literature

The approach of investment law literature to foreign investors' rights is arguably inspired by the International Law Commission's attitude regarding State Responsibility, i.e. to overlook the rights of the offended party. What was at stake in 1949 when discussions began at the International Law Commission was highly relevant to the struggle for the resources of different countries, aligning the United States and Europe against those countries that favoured the Calvo doctrine. These conflicting views foreshadowed the difficult progress of the Commission. After García-Amador, the special rapporteur on State Responsibility who did concentrate on questions such as acquired rights, the Commission decided to appoint Ago as the new rapporteur in 1962, taking an approach that would "involve generalizing about the effect of unlawful acts without talking too much about any particular unlawful acts."[45] The main consequence of this approach was to divorce the rights from the remedy. As Allot affirms:

> "This middle category is a dangerous fiction, an unnecessary intrusion into the systematic structure of a legal system. […] Liability is not a consequence of some intervening concept of responsibility. It is a direct consequence flowing from the nature of the wrong (the content of the rights of the offended party and the duties of the offender) and from the nature of the actual wrongful act in the given case (in particular, the content of the specific rights and duties which have been affected by the breach in question)."[46]

Like the International Law Commission, most academic analyses of foreign investors' rights pay little attention to the control rights over resources. Indeed, when investment law literature does concentrate on these rights, it focuses mainly on the right to foreign investment protection and host state duties. Thus, for instance, some scholars refer to fair and equitable treatment and expropriation as

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[45] Allott, Philip, "State Responsibility and the Unmaking of International Law," 29:1 *Harvard International Law Journal* (1988), p. 7.
[46] *Ibid.*, pp. 11-12.

material rights that investment treaties confer on foreign investors.[47] However, these are in reality host state duties, the enforcement of which depends on the content of foreign investors' rights (i.e. the offended party). In the context of an investment dispute, then, the use of the term *material* to denote host state duties and the protection of ownership through investment arbitration can be misleading because neither relate to foreign investors' rights over the resources.

I will illustrate the dominant approach to foreign investors' rights by looking at the debate in three NAFTA claims: *Archer Daniels Midland v Mexico* (2007); *Corn Products v Mexico* (2008), and *Cargill v Mexico* (2009). In these arbitrations between U.S. American investors and Mexico, the main issue was whether the host state could justify its measure based on the breach of some obligations by the United States under NAFTA (i.e. a countermeasure).[48] The issue addressed by these tribunals, and subsequently many scholars, was whether the right to foreign investment protection is exercised by a foreign investor in his own right (the direct theory) or on behalf of the home state (the derivative theory).[49] In the case of the direct theory, Mexico would lose because the state owes investment protection directly to the foreign investor. However, with the derivative theory, the Mexican position could prevail because the breach by the United States could entitle Mexico to apply countermeasures if investment protection is owed to the home state. In his work, Braun considers extensively the awards in these three disputes, stressing that the arbitrators, directly or indirectly, dealt with the distinction between the procedural right to launch an arbitration and the material rights (expropriation and fair and equitable treatment) in accordance with the applicable treaty.[50] He concludes by favouring the direct theory with some reservations.[51]

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[47] See Newcombe, Andrew and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment*, p. 77; Schill, Stephan, *The Multilateralization of International Investment Law*, New York: Cambridge University Press, 2009, pp. 6 (footnote 20).

[48] *Archer Daniels Midland v Mexico*, ICSID Case No. ARB(AF)/04/05, Award, 21 November 2007; *Corn Products v Mexico*, ICSID Case No. ARB(AF)/04/01 (NAFTA), Decision on Responsibility, 15 January 2008; *Cargill v Mexico*, ICSID No. ARB(AF)/05/2 (NAFTA), Award, 18 September 2009.

[49] Douglas, Zachary, "The Hybrid Foundations of Investment Treaty Arbitration," 74 *British Yearbook of International Law* (2003), pp. 162-164; Douglas, Zachary, *International Investment Claims*, New York: Cambridge University Press, 2009, pp. 10-38; Roberts, Anthea, "Power and Persuasion in Investment Treaty Interpretation: The Dual Role of States," 140 *The American Journal of International Law* (2010), pp. 184-185; Braun, Tillmann, "Globalization-driven Innovation: The Investor as a Partial Subject in Public International Law – An Inquiry into the Nature and Limits of Investor Rights," *Jean Monnet Working Paper* 04/13, NYU School of Law, 2013.

[50] *Ibid.*, pp. 12-19.

[51] *Ibid.*, pp. 35-46.

In investment law literature, there is probably no consensus regarding this question. Douglas, for instance, argues that the foreign investor may own the right to launch an arbitration but not "the substantive obligations of investment protection."[52] Crawford shows little concern for solving this debate, stressing that "in the majority of the cases it will make no difference to the result."[53] Alvarez, on the contrary, claims that

> "[s]ooner or later the investment regime, or at least particular BITs, will also need to address more explicitly whether investor-state dispute settlement is really only a variation of old-fashioned espousal – where the states remain in full control of the process, including the waiver of claims – or whether investors are closer to full scale 'subjects' of international law such that only they, not their home states, control whether to waiver or assert claims."[54]

I agree with Crawford that this analysis is mainly – if not only – relevant when a tribunal needs to address the issue of countermeasures based on a breach by the home state or the ability of the foreign investor to waive foreign investment protection. However, this is obviously not the case for foreign investors' control rights: they are essential for the resolution of the merits phase of most investment arbitrations (with the only exception of allegations of discrimination). The jurisdiction of investment tribunals is normally limited to "disputes arising 'in connection with' an investment, 'arising out' of an investment, 'with respect to' an investment, 'concerning' an investment or 'related to' an investment."[55] This limitation in material scope shows that host state duties are meaningful when considered alongside the rights emerging from the foreign investment, i.e. a decision on responsibility requires the assessment of the rights of the offended party and the duties of the offender.

Otherwise, as Allot suggests, we may end up falling into the dangerous fiction of determining liability through the consideration of host state duties alone. The

[52] Douglas, Zachary, *International Investment Claims*, p. 35. Similarly, see McLachlan, Campbell, "Investment Treaties and General International Law," 57 *International and Comparative Law Quarterly* (2008), p. 384.
[53] Crawford, James, "Treaty and Contract in Investment Arbitration," 24:3 *Arbitration International* (2008), p. 355.
[54] Alvarez, José, "Why are We 'Re-calibrating' our Investment Treaties?," 4:2 *World Arbitration & Mediation Review* (2010), p. 155.
[55] UNCTAD, "Bilateral Investment Treaties 1995–2006: Trends in Investment Rulemaking," p. 102.

present practice of investment arbitration indicates that foreign investors launch, and arbitrators hear, claims regarding host state acts in breach of their duties that allegedly affect foreign investors' rights. In most investment disputes, the substantiation of the rights of the offended party makes an important difference to deciding whether the host state expropriated or treated the investment unfairly. The deprivation of a mere use cannot generate the obligation to pay compensation because in this case the foreign investor is not deprived of any right. Thus, an important question regarding an allegation of expropriation or unfair treatment is whether the host state measure affected a legal or a mere use. As anticipated in Chapter 1, however, determining the content of the rights is a complex task which depends on, amongst other things, the character of the rights in question.

C. The character of foreign investors' rights

The character of the foreign investors' rights that host states are accused of taking away is important for the resolution of investment disputes. The analysis I have presented thus far suggests that these rights have an essentially proprietary character. The main theme of the IIR is the struggle for resources of different countries. In this regard, most legal systems recognise two types of patrimonial rights: proprietary and contractual. Property rights are constitutive of markets.[56] They are the pillar of every legal rule relevant to the establishment of an economic system.[57] Broadly, then, the distinction could be drawn as follows: property rules refer to the commodification, allocation and ownership of resources, whilst contracts deal with the transfer of property, obligations to do (and not to do), and the clarification of ownership (contractual commitments such as stabilisation clauses). It is too early in this thesis to illustrate the importance of the characterisation of foreign investors' rights. I anticipate, however, that it is absolutely fundamental for the interpretation and substantiation of foreign investors' rights.

[56] Picciotto, Sol, "Property Rights and Regulation, Private And Public, Conference on Regulation in the Age of Crisis," University College, Dublin, 17th-19th June 2010, pp. 2-3.

[57] Ortino, Federico and Matteo Ortino, "Law of the Global Economy: In Need of a New Methodological Approach?," in Colin Picker, Isabella Bunn, and Douglas Arner (Eds.), *International Economic Law: The state and future of the discipline*, Oxford and Portland, Oregon: Hart Publishing, 2008, pp. 92-93.

The argument that foreign investors' rights have a proprietary character can be found in both investment awards and scholarship. For example, the *ATA v Jordan* tribunal (2012), when considering the commitment to submit a dispute to arbitration, affirmed that: "[a]n investment is not a single right but is, like property, correctly conceived as a bundle of rights."[58] Similarly, Douglas argues that "[i]nvestment disputes are about investments, investments are about property, and property is about the specific rights over tangibles and intangibles cognisable by the municipal law of the host state."[59]

It is necessary to mention, however, that the IIR also covers some foreign investors' contractual rights that are unrelated to the clarification of ownership. The scope of application of the IIR includes these non-proprietary rights when arbitrators interpret the umbrella clause as a mechanism for enforcing typical contractual obligations regardless of whether a sovereign act is the cause of the deprivation.[60] In addition, investment treaties explicitly cover contractual rights when they refer to debt instruments (such as bonds, derivatives, and financial contracts). Despite these cases, the evidence suggests that investment arbitration refers mainly to disputes about the control of resources, whilst the large number of contractual disputes is solved under different regimes. The statistics provided by the International Chamber of Commerce (ICC) and the ICSID seem to indicate this tendency. Although most ICC cases are not investment treaty arbitrations (confidentiality prevents certainty in this respect), this institution has had more disputes involving states or parastatal entities in the period 1999-2010 than the ICSID has had in its entire history.[61] In principle, then, everything indicates that most of the ICC cases involve typical contractual rights.

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58 *ATA v Jordan*, ICSID Case No. ARB/08/2, Award, 18 May 2012, at 96, 114-117.

59 Zachary Douglas, *International Investment Claims*, 2009, p. 52.

60 This question remains controversial in investment decision-making. In the affirmative, I claim that the umbrella clause would be mostly limited to contractual rights that relate to the clarification of foreign investors' proprietary rights. See *SGS Société Générale de Surveillance SA v. Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13, Decision on Jurisdiction, 6 August 2003; *Joy Mining v Egypt*, ICSID Case No. ARB/03/11, Decision on Jurisdiction, 6 August 2004; *El Paso v Argentina*, ICSID Case No. ARB/03/15, Decision on Jurisdiction, 27 April 2006; and *Gustav Hamester v Ghana*, ICSID Case No. ARB/07/24, Award, 18 June 2010. In the negative, however, I submit that this clause creates a contractual sub-regime. See *SGS Société Générale de Surveillance SA v. Republic of the Philippines*, ICSID Case No. ARB/02/6, Decision on Jurisdiction 29 January 2004; *CMS v Argentina*, ICSID case No. ARB/01/8, Award, 12 May 2005; *Noble Ventures v Romania*, ICSID Case No ARB/01/11, Award, 12 October 2005 and *BIVAC v Paraguay*, ICSID Case No. ARB/07/9, Decision on Jurisdiction, 29 May 2009.

61 In the period 1999-2010, the ICC had 7356 requests for arbitration, from which 769.8 (10.46 %) involved a state or a parastatal entity. On the contrary, the ICSID has registered 369 cases (in the

In this context, I consider in the following subsections whether most foreign investors' rights have a proprietary character, and if the character of state measures that trigger investment disputes is consistent with this account of these rights.

1. *The proprietary character of most assets in investment treaties*

According to investment treaties, assets are the minimum denominator of a foreign investment. This is common to most treaties as they define investment as a variable number of assets.[62] UNCTAD explains that in the period 1995-2006, "[m]ost countries continue[d] to conclude BITs with a broad asset-based definition of '*investment*,'" whilst "other countries have opted to use 'closed-list' definitions – an approach that defines 'investment' in terms of listing an ample but yet finite list of assets."[63] The concept of assets has no precise legal meaning. Its lay definition, however, refers to resources, suggesting that the rights enumerated in investment treaties have a proprietary character.[64] Here, I divide these assets/rights into four categories, from the clearest property rights to the more sophisticated cases of concessions and contractual commitments.

The first category of assets includes typical property rights. The list includes enterprises, shares, intellectual property rights, and "other tangible or intangible, movable or immovable property, and related property rights, such as leases, mortgages, liens, and pledges."[65] These are typical rights *in rem* that involve the three dimensions of property described in Chapter 1. They represent resources commodified by the law, allocated in accordance with the applicable legal rules, and over which foreign investors enjoy ownership.

The second category of assets consists of rights that are intrinsically related to the control of resources. As explained in Chapter 1, vested rights can explicitly grant foreign investors a particular use of the resources. Vested rights have a proprietary character because they serve to clarify one of the dimensions of property: ownership. The list of those contained in investment agreements is

period 1972-2011). See ICC Statistics available at http://www.iccwbo.org and ICSID Statistics available at https://icsid.worldbank.org.

62 UNCTAD, "Bilateral Investment Treaties 1995–2006: Trends In Investment Rulemaking," p. 8; OECD, "International Investment Law: Understanding Concepts and Tracking Innovations," OECD: Paris, 2008, pp. 49-50.

63 UNCTAD, "Bilateral Investment Treaties 1995–2006: Trends In Investment Rulemaking," pp. xi, 7.

64 Oxford Dictionaries Online, http://oxforddictionaries.com/.

65 Article 1, US Model BIT 2004.

comprehensive, including "licenses, authorizations, permits, and similar rights conferred pursuant to domestic law."[66] These are unilateral state acts that entitle the foreign investor to carry out a given activity, e.g. waste processing, and impose an obligation on host states and third-party individuals not to interfere with this specific use. Thus, vested rights provide foreign investors with greater certainty regarding the control of resources.

The third category of assets includes concessions, which according to the analysis of UNCTAD are defined by investment treaties as "business concessions, that is rights conferred by law or under contracts."[67] Concessions are different from permits because they often include rights with a proprietary character and other contractual elements. I want to focus on the proprietary rights that concessions allocate to foreign investors, which, it is worth remarking, would not alter the contractual character of any ancillary legally binding promise. Whilst permits grant foreign investors a particular use of the resources, a concession allocates resources, e.g. a mine or an oil field, but with more limited ownership terms than in the case of typical private property rights. Normally, the most important condition is that the resources should be used for the particular purpose defined in the concession, such as to produce minerals or oil. In addition, whilst the time span for private property is normally unlimited, concessions tend to have a fixed duration.[68]

In Chapter 1, I stressed the importance of distinguishing between the property rights transferred by contract and the contract itself. The key lies in separating the object of the allocation, e.g. an oil lease or a mineral estate, from the legal tool employed to assign it to the foreign investor. The mechanism for transferring or assigning the rights does not affect their proprietary character. On one hand, concession contracts may include clauses directly applicable to the content of these rights – either in addition to or modifying the existing general legal framework. These clauses may take the form of contractual commitments such as a tax stabilisation clause. On the other hand, what characterises a concession are the proprietary rights granted to the foreign investor to use the resources for a relatively well-defined purpose. A contractual commitment in a concession is only

[66] Article 1, US Model BIT 2004. This trend is similar in most investment treaties, UNCTAD, "Bilateral Investment Treaties 1995–2006: Trends in Investment Rulemaking," pp. 8-11; OECD, "International Investment Law: Understanding Concepts and Tracking Innovations," pp. 49-53.
[67] UNCTAD, "Bilateral Investment Treaties 1995–2006: Trends in Investment Rulemaking," p. 8.
[68] See Kuntz, Eugene, "The Rule Against Perpetuities and Mineral Interests," 8 *Oklahoma Law Review* (1955), pp. 183-202; Walker, A. W. Jr., "Nature of the Property Interests Created by an Oil and Gas Lease in Texas," 7 *Texas Law Review* (1928-1929), pp. 539-596.

valuable or useful when considered in connection with the mineral estate or the oil lease. In this context, obviously, any contractual commitment would be essential for the position of a foreign investor. As Jennings affirms:

> "It is, of course, possible to take a more restrictive view of the compensation due in cases where the State has a right to expropriate or nationalize. It is not the intention to enter upon that controversy here. The aim has been simply to show that there is a strong line of authority even in traditional international law to the effect that the provisions of a contract or concession are relevant both in the assessment of reparation and of compensation."[69]

Many of the Argentine disputes, according to some experts, relate to concessions that provided foreign investors with contractual commitments regarding the adjustment of public utility tariffs.[70] The government of Argentina could have enshrined this mechanism in the general legal framework but, instead, it decided to grant this entitlement contractually. The award in *Total v Argentina* (2010) describes this scenario. This tribunal decided that the contractual commitment regarding the adjustment of the tariffs was not applicable to Total, and hence the claimant did not enjoy the same rights that other foreign investors had in the same sector. After interpreting the general applicable framework in relation to the oil and gas sector, however, this tribunal found that Total still had an entitlement – albeit of different content – to adjust the tariffs.[71]

Finally, the last category of assets in the majority of investment treaties includes single contractual commitments. Although these agreements are often contained in concession contracts, foreign investors and host states can conclude them as stand-alone agreements. These contractual commitments are normally the outcome of discretionary state measures and not the result of administrative procedures. In either case, contractual commitments are legally binding promises according to which host states agree not to use their sovereign authority to modify some of the conditions governing the resources allocated to the foreign investor.

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[69] Jennings, R. Y., "State Contracts in International Law," 37 *British Yearbook of International Law* 1961, p. 173.

[70] Alvarez, José, "Book Review: Investment Treaty Arbitration and Public Law by Gus Van Harten," 102 *American Journal of International Law* (2008), p. 912.

[71] *Total v Argentina*, ICSID Case No. ARB/04/01, Award, 27 December 2010, at 166-169, 177 (and footnote 179).

As Douglas explains, "it is clear that 'contractual rights' in this context should be interpreted narrowly as those contracts that regulate the investor's rights to property in the host state."[72]

Since governments have a wide array of tools to alter the business goals of the foreign investor, it is possible to imagine an endless list of contractual commitments. After establishment of the project, foreign investors face the possibility of both political risk and legitimate changes in the laws. These modifications may affect their plans in relation to the assets that compose the investment, e.g. the tax rate paid for the production of oil. Contractual commitments are a way of preventing host states from legally intervening in their original plans. They guarantee certain conditions related to the use and enjoyment of the resources. A stabilised tax rate, thus, enriches foreign investors' ownership. This type of commitment would constitute a right regarding the tax rate applicable to the investment made in the resources. As Jennings observes, "there is good authority for the view that acquired rights are not confined to the notion of property in its narrowest sense, but also include rights derived from contract or concession."[73]

Overall, either as traditional private property rights or as more sophisticated legal rights, most of the assets included in investment treaties have a proprietary character. When these assets take the form of legally binding host state promises, these contractual commitments are made by virtue of the *sovereign* state authority to create and amend legislation regarding the resources. These claims and rights to performance, as in Schreuer's description of vested rights and concessions, can derive from either bilateral or unilateral acts.[74]

2. *The role of sovereign state authority in most investment disputes*

It is possible to argue against the characterisation of most foreign investors' rights as proprietary, and a few investment tribunals have described some of the assets

[72] Douglas, Zachary "The Hybrid Foundations of Investment Treaty Arbitration," p. 197 (footnote 219).
[73] Jennings, R. Y., "State Contracts in International Law," p. 173.
[74] Schreuer, Christoph and Ursula Kriebaum "The Concept of Property in Human Rights Law and International Investment Law," 2007, pp. 8-10.

included in investment treaties as *in personae* rights.[75] In *White Industries v India* (2011), for instance, there was a debate about whether foreign investor's rights only have an *in rem* character or can also have an *in personae* character. This tribunal decided that some of these assets may have an *in personae* character.[76] This conclusion, however, is not decisive enough to deny the proprietary character of foreign investors' rights. The implications of characterising foreign investors' rights as *in rem* or *in personae* are different if we describe property as a bundle of rights. According to Hohfeld's theory of rights, ownership consists of a set of personal relations. Thus, the question is not how we describe the relations that foreign investors' rights create but the property or contractual source of these relations.

An important difference between property and contracts is that only states can create property, i.e. the legal rules regarding commodification, allocation and ownership, whilst individuals can enter into contracts as much as states. Thus, one way to determine whether the source of the right is proprietary or contractual is to ask whether an individual could have created or modified the right in question. If the creation or modification of the right required the exercise of sovereign authority, this would suggest that it has a proprietary character. In practice, the problem with applying this criterion is that international law has followed a different approach in order to incorporate contractual rights into the scope of diplomatic protection and foreign investment-related litigation. This approach relies on the public goals behind state activity to *internationalise* what otherwise would have been a domestic contract, e.g. a loan.[77] As Jennings affirms, "there is a considerable body of international law concerning State contracts obscured under cover of claims for delict or for the takings of alien property."[78] The reason for this strategy was to allow home states and foreign investors to sue host states at the international level under an international cause of action. This would have been impossible or very difficult were the rights characterised as typically contractual.

[75] See *Southern Pacific Properties v Egypt*, ICSID Case No. ARB/84/3, Award, 20 May 1992, at 164-165; *Bayindir v Pakistan*, ICSID Case No ARB/03/29, Decision on Jurisdiction, 14 November 2005, at 255; *SD Myers v Canada*, NAFTA – UNCITRAL, Partial Award, 13 November 2000, at 281.

[76] *White Industries Australia v India*, UNCITRAL, Final award, 30 November 2011, at 5.1.6., 7.3.7 - 7.3.8, 7.4.1 - 7.4.7.

[77] See Schwebel, Stephen, "On Whether the Breach by a State of a Contract with an Alien is a Breach of International Law," in *Justice in International Law*, Cambridge: Cambridge University Press, 1994, p. 431; Asante, Samuel, "International Law and Foreign Investment: A Reappraisal," 37 *The International and Comparative Law Quarterly* (1988), p. 611.

[78] Jennings, R. Y., "State Contracts in International Law," p. 173.

I claim that the distinction between state acts with a public and a private purpose is independent from the categories of property and contractual rights. Supply agreements signed by a state or a state agency only create contractual rights, regardless of whether they are for candies, vaccines or weapons. For this reason, it would be incorrect to only describe state laws and regulations as acts *jure imperii*, whilst defining every state contractual agreement as acts *jure gestiones*. The obligation of the host state to comply with a supply contract for weapons derives from the *pacta sunt servanda* principle, although such a contract could be classified as *jure imperii* in many jurisdictions.[79] The commitment to pay for the weapons is always contingent on the existence of a contract, and both private and public actors can decide not to comply. Thus, even if it had a public purpose, the breach of such a contract would not require the exercise of sovereign authority.[80]

In accordance with my characterisation of foreign investors' rights under the IIR, most investment tribunals have limited the scope of investment jurisdiction to sovereign state acts (treaty claims as opposed to contractual disputes). Investment arbitrators define treaty claims as allegations of the unfair or arbitrary use of state sovereign authority with the purpose to deprive foreign investors of the assets that compose their investments.[81] The tribunal in *Waste Management v Mexico* - number 2 (2004), for instance, decided that "an enterprise is not expropriated just because its debts are not paid or other contractual obligations towards it are breached."[82] And even if some tribunals have decided that the IIR covers foreign investors' contractual rights, investment arbitration practice shows that most decisions rejecting jurisdiction relate to claims where the rights in question allegedly had a contractual character.[83]

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[79] Dixon, Martin, *Textbook on International Law*, New York: Oxford University Press, 2007, p. 180.

[80] For a different line of argument, see Mills, Alex, "Antinomies of Public and Private at the Foundations of International Investment Law and Arbitration," p. 497.

[81] See *Gustav Hamester v Ghana*, ICSID Case No. ARB/07/24, Award, 18 June 2010, at 325-331; *Waste Management v Mexico* (Number 2), ICSID Case No. ARB(AF)/00/3, Final Award, 30 April 30 2004, at 160; *Joy Mining Machinery Limited v Egypt*, ICSID Case No. ARB/03/11, Award on Jurisdiction, 6 August 6 2004, at 72; *Impregilo S.p.A. v Islamic Republic of Pakistan*, ICSID Case No. ARB/03/3, Decision on Jurisdiction, 22 April 2005, at 260; *Noble Ventures, Inc. v Romania*, ICSID Case No. ARB/01/11, Award, 12 October 2005, at 53; *Azurix v Argentina*, ICSID Case No. ARB/01/12, Award, 14 July 2006, at 315; *Bayindir v Pakistan*, ICSID Case No ARB/03/29, Decision on Jurisdiction, 14 November 2005, at 180; *Parkerings-Compagniet AS v Lithuania*, ICSID Case No. ARB/05/8, 11 September 2007, at 443.

[82] *Waste Management v Mexico (Number 2)*, ICSID Case No. ARB(AF)/00/3, Final Award, 30 April 30 2004, at 160. Similarly, see *Parkerings-Compagniet AS v Lithuania*, ICSID Case No. ARB/05/8, 11 September 2007, at 450.

[83] OECD, "International Investment Law: Understanding Concepts and Tracking Innovations," pp. 54-74.

Overall, the characterisation of foreign investors' rights as proprietary is consistent with the objective of investment treaties to institute a mechanism to protect foreign investors from host state political risk (and not private responsibility). Political risk implies the capacity to pass and modify the laws and regulations that create property rights. Indirect expropriation claims, for this reason, always involve considering "whether the administrative and legislative actions taken individually, or in concert, […] constitute an expropriation."[84]

Conclusion

In this chapter, I have shown that foreign investors' rights are essential for both the diplomatic protection model and the IIR. Focusing my attention on the IIR, I have explained that most foreign investors' rights in investment treaties have a proprietary character. The deprivation of proprietary rights, as opposed to the breach of contractual obligations, necessarily requires the passing of some legislation or regulation. I have mentioned that this is consistent with the prevalent opinion of investment tribunals that treaty claims involve host state sovereign acts. In this regard, I have stressed that foreign investors' proprietary rights are essential to the IIR because they play a leading role in the resolution of any dispute between foreign investors and host states: the question is whether the rights of the offended party have been deprived by the host state's breach of its duties. This importance, however, contrasts with the scant attention that investment law literature has paid to the substance of foreign investors' rights. I have argued that most of the debate in the scholarship and the awards relates to the right to foreign investment protection. This approach can be compatible with a characterisation of the IIR as a form of judicial review. Nonetheless, this excessive focus on the remedy – divorced from the rights – conceals the potential effects of the IIR on the content of foreign investors' rights. To examine these effects we need a framework that allows us to think simultaneously about the rights of foreign investors and the remedies against host sovereign state acts.

[84] *Glamis Gold v United States*, NAFTA – UNCITRAL, Award, 8 June 2009, at 356.

CHAPTER 3 – THE INTERNATIONAL INVESTMENT REGIME FROM A CONSTITUTIONAL PROPERTY PERSPECTIVE: THE QUEST FOR FOREIGN INVESTORS' RIGHTS

Introduction

In this chapter, I describe the IIR using the language of constitutional property rights. As in the case of constitutional property protection, the reason for foreign investment protection is political risk. These two mechanisms represent the organisation of distrust regarding democratic modes of governance and host states. Constitutional property regimes provide individuals with rights that they can assert against host states in case governments exceed their authority. In this way, rights and remedies work jointly to protect individuals from state measures. Based on these premises, I claim that the resolution of any breach of foreign investors' substantive rights begins with considering what these rights include. When foreign investors' rights are incomplete, vague or ambiguous, which is most of the time, investment arbitrators have to substantiate their content to resolve an investment dispute. In this context, I concentrate on the content of foreign investors' rights through a constitutional property framework. According to property scholars, the beginning of an answer to this question lies in the legislation. However, in the case of the IIR, this immediately raises the question, which legislation? I therefore analyse the law applicable to foreign investors' rights in investment disputes. I consider the opinion of various authors regarding the role of domestic and international law in investment disputes, and in line with most of the literature and the awards, I claim that the substantiation of foreign investors' rights is governed by investment treaties and international law. The consensus is that this issue is connected to host state liability, and should be decided in accordance with the doctrine of legitimate expectations.

A. Private Property, Constitution and the IIR

Although the bundle of rights in private property is heterogeneous and plural, private property rights have in common certain distinguishable features. In this section, I concentrate on the fact that private property binds everybody, paying particular attention to the way it governs the relation between individuals and the state. The IIR fulfils a typical property regime function to the extent that it allows foreign investors to assert their proprietary rights against host states. The use of a constitutional property framework to understand the IIR is appropriate provided we remain focused on this function. The relevance of this approach is that, under a constitutional property framework, both individual rights and the mechanism to enforce them are fundamental.

What distinguishes private property from any other patrimonial right is that these rights have an *in rem* character and a legislative (public) origin. As Alexander and Peñalver explain,

> "[o]ne of the distinctive features of property rights is their *in rem* quality. Property rights, unlike (say) contractual rights, are good against the entire world. They impose duties on everyone else to respect those rights."[1]

Along these lines, property rights are pieces of formal legislation, informal social norms and judicial decisions. Private property rights constitute a "political obligation" because they arise "between members of a particular political society out of their mutual relationship."[2] In practice, then, the *in rem* and legislative features of property are two sides of the same coin. The comprehensive scope of application of private property rights is justified by the political apparatus that creates them. For this reason, individuals cannot create property by contract. *Pacta sunt servanda* is a strong legal principle; however, it is not powerful enough to create rights enforceable against every individual and the state. Rousseau, Kant and Rawls agree that property rules cannot lie in individual promises.[3] Hart advances the same opinion when he concludes that the contractualist "mistake was to identify this right-creating situation of mutual restriction with the paradigm case of promising."[4]

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[1] Alexander, Gregory and Eduardo Peñalver, *An Introduction to Property Theory*, Cambridge: Cambridge University Press, 2012, p. 2.

[2] Hart, H. L. A. "Are there any natural rights?," 64:2 *Philosophical Review* (1955), pp. 185-186. Waldron has relied on Hart's ideas to distinguish between general-based and special-based arguments for private property. See Waldron, Jeremy, Waldron, Jeremy, *The right to private property*, Oxford: Clarendon Press, 1988, pp. 113, 106-115.

[3] See Waldron, Jeremy, "Property and Ownership," *The Stanford Encyclopedia of Philosophy* (Spring 2012 Edition), Edward Zalta (ed.), http://plato.stanford.edu/archives/spr2012/ entries/property/, section 4.

[4] Hart, H. L. A. "Are there any natural rights?," p. 186.

The rights of foreign investors under the IIR have the same features but are limited to the relations with host states. When an investment treaty is applicable, as in every private property system, the IIR governs any controversy between foreign investors and host states regarding the control of resources. There is no need for any further requirement or "contingent event."[5] Furthermore, the IIR was created by sovereign states. International treaties bind states as political units. The comprehensive scope of application of the IIR is possible and formally legitimate because this regime is a piece of inter-state legislation, which has direct effects in many countries at the domestic level.[6] For this reason, foreign investors could never achieve anything substantively similar to the IIR. Just as individuals cannot create private property rights, foreign investors cannot create *proprietary* rights or remedies. A foreign investor can sign an investment contract with a host state, which includes a choice of law and an arbitration clause, but this agreement would only govern his relationship with the host state concerning that particular undertaking.[7]

In spite of the broad coverage of the IIR in terms of assets/rights and controversies, most of the literature has not focused on this regime from a private property perspective. I suggest that this is due, or at least partly due to the fact that the IIR concentrates on just one of the two main levels of the struggle for resources. As Sherwin explains, property rules define "who controls what, when and to whom a wrong has been done, and who the necessary parties of a contract of exchange. They also draw jurisdictional lines between individuals and the state."[8] The distinction between the private-private and the private-public side of property rights is fundamental to understanding contemporary property regimes. Since most countries implemented market economy reforms in the 1990s, the large majority of legal orders have organised their property systems by distinguishing between the private and the public spheres of authority over resources.[9] The IIR should be understood through a property framework not only because its boom was part of the market reforms of the 1990s but also because this regime draws

[5] See Waldron, Jeremy, *The right to private property*, pp. 114-116.
[6] Perrone, Nicolás, "Tratados bilaterales de inversión y derecho interno: efectos en la jurisdicción Argentina," 249:B *Revista de Derecho Comercial y de las Obligaciones* (2011), pp. 25-50.
[7] For this reason, the IIR is substantively different from contractual protection. Against this position, see Yackee, Jason, "Pacta Sunt Servanda and State Promises to Foreign Investors before Bilateral Investment Treaties: Myth and Reality," 32:5 *Fordham International Law Journal* (2008), p. 4.
[8] Sherwin, Emily, "Two-And Three- Dimensional Property Rights," 29 *Arizona Law Review* (1997), p. 1075.
[9] Milhaupt, Curtis, "Property Rights in Firms," 84 *Virginia Law Review* (1998), p. 1147.

jurisdictional lines between foreign investors and host states. Lehavi and Licht stress this point, arguing that the IIR refers to "the legal relationship between the private investor/owner and the relevant government."[10]

In accordance with the claim that the IIR governs the struggle for resources between foreign investors and host states, I propose that the IIR be understood along the lines of a constitutional property regime. Foreign investors' rights over resources share with property rights their *in rem* and legislative character, and, within the scope of the IIR, they govern foreign investor-host state relations. In this respect, there is a parallel between the historical and political origin of constitutional property and the IIR as regimes designed to protect private property and foreign investment from political bodies. Alexander points out that "[t]here is an old debate over the relationship between private property and democracy, and the modern constitutional debate has revived much of that debate."[11] He describes this controversy, since the emergence of national states and capitalism, as whether "property undermines democracy" or "private property supports democracy."[12] Historically, the most ardent defenders of private property, such as contractualist and libertarian scholars, have been afraid of the political process and democracy.[13] They perceive in political bodies the risk of "democratic despotism,"[14] and describe the state as a serious threat because sovereign powers entitle governments to modify the laws that establish and govern private property rights. Individuals can trespass but they cannot modify property laws. In Alexander's words, this line of argument tells "the story of regulatory power and owner powerlessness."[15] The debate leading to the U.S. Constitution, for instance, illustrates this perception of risk in the political process and legislatures:

[10] Lehavi, Amnon and Amir N. Licht, "BITs and Pieces of Property," 36 *Yale Journal of International Law* (2011), pp. 117, 132-136.
[11] Alexander, Gregory, *The global debate over constitutional property: lessons for American takings jurisprudence*, Chicago: University of Chicago Press, 2006, p. 2
[12] *Ibid.*
[13] Fisher, William, "The significance of public perceptions of the takings doctrine," 88 *Columbia Law Review* (1988), 1782-1795.
[14] *Ibid.*, p. 1783.
[15] Alexander, Gregory, "Takings, Narratives, and Power," 88 *Columbia Law Review* (1988), pp. 1768-1773.

> "Madison, like most Federalists, was intensely interested in reducing the risk that either the extant state legislatures or the proposed federal legislature would abrogate private property rights."[16]

To a large extent, these fears influenced many constitutions during the 19th and 20th centuries. In the case of Argentina, for instance, the main author of that country's constitution argued that

> "[f]atally, the omnipotence of the nation becomes the omnipotence of its government, and, then, constitutes not only the denial of freedom, but also the negation of social progress, because it suppresses private initiative from reaching that progress."[17]

A detailed analysis of the historical process leading to the creation of constitutional private property or the inclusion of private property rights in domestic constitutions far exceeds the scope of this work. However, it is necessary not to lose sight of this broader process in order to think adequately about the IIR along the lines of a constitutional property framework. Following Rosanvallon's contribution in *Counter-Democracy - Politics in an Age of Distrust*, I locate the origin of the clash between private property rights and democracy in the potentially contradictory liberal promises of human equality and autonomy.[18] Private property systems manage the struggle for resources on the principle that the allocation may not be egalitarian. The sociological reality is that there is always some inequality in the allocation of resources. This scenario, however, contrasts with basic democratic principles of governance such as every individual having one vote.[19]

As Rosanvallon explains, this tension has developed in two directions.[20] First, modern democracies have set up institutions to "compensate for the erosion of trust through the organisation of distrust."[21] Constitutional property regimes are probably the most important of these institutions. Historically, defenders of

[16] Fisher, William, "The significance of public perceptions of the takings doctrine," p. 1783.
[17] Alberdi, Juan Bautista, "Speech delivered at the Law Faculty, University of Buenos Aires, 24th May 1880," in Matienzo, José, *Alberdi Juan Bautista: Conferencia dada en la Facultad de Filosofía y letras de Buenos Aires*, Imp. Monquat, 1910 (Translated by the author).
[18] Rosanvallon, Pierre, *La contre-démocratie: la politique à l'âge de la défiance*, Paris: Éditions du Seuil, 2006, p. 10.
[19] *Ibid.*, pp. 298-300.
[20] *Ibid.*, p. 11.
[21] *Ibid.* (Translated by the author).

private property have promoted the inclusion of private property rights in constitutions.[22] According to Buchanan, "when individual rights are initially defined, few persons would conceptually agree to wholly unconstrained departures from a unanimity rule for collective decision-making."[23] Constitutions minimise the political risk inherent in any democratic system of governance. They limit circumstantial majorities since a constitutional reform requires great political support. Constitutions, in addition, grant individuals a remedy by which they can assert their rights against state measures whenever they consider that the government has exceeded its authority. The constitutional property principle is that states cannot deprive individuals of the constitutional boundaries of their private property rights without paying compensation.

The IIR shares both the perception of distrust in host country political institutions and the objective of protecting foreign investors against political risk. In the 1960s, referring to BITs, Proehl and Brandon affirmed that these treaties would be more than or as difficult to modify as any domestic constitution.[24] In addition, Larson stressed that their "principal flaw" was their "one-sidedness" in favour of foreign investors.[25] However, rather than being a flaw, this is for property defenders the explicit objective of a constitutional property clause, and supporters and critics of the IIR agree that this is the goal of investment treaties. Schneiderman, a critic of the IIR, claims:

> "The investment rules regime is constitution-like, however, in many of these ways. It has as its object the placing of legal limits on the authority of government, isolating economic from political power, and assigning to investment interests the highest possible protection."[26]

Similarly, Wälde, one of the main promoters of the IIR, argues that

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[22] Alexander, Gregory, *The global debate over constitutional property: lessons for American takings jurisprudence*, pp. 2-3, 25-26.

[23] Buchanan, James, *The Limits of Liberty: Between Anarchy and Leviathan*, Indianapolis: Liberty Fund, 1999, paragraph 7.9.13.

[24] Proehl, Paul, "Private Investment Abroad," 9 *Journal of Public Law* (1960), pp. 367-368; Brandon, Michael, "Recent Measures to Improve the International Investment Climate," 9 *Journal of Public Law* (1960), pp. 125-126.

[25] Larson, Arthur, "Recipients Rights under an International Investment Code," 9 *Journal of Public Law* (1960), p. 172.

[26] Schneiderman, David, *Constitutionalizing Economic Globalization. Investment Rules and Democracy's Promise*, New York: Cambridge University Press, 2008, p. 4.

> "international investment law is aimed at promoting foreign investment by providing effective protection to foreign investors exposed to the political and regulatory risk of a foreign country."[27]

The second development that Rosanvallon traces in his work relates to a search for better alternatives to improve democratic governance.[28] Not surprisingly, strong constitutional property protection has been subject to criticism by commentators who defend democracy and valorise the community vis-à-vis the individual. Alexander argues that the "[c]onstitutionalization of property perpetuates the belief that it is possible (and desirable) categorically to isolate private interests from public involvement."[29] Likewise, Waldron has dedicated a book to the argument that legislation is not a suspicious form of political intervention but a "dignified mode of governance and a respectable source of law."[30] Rosanvallon shares these concerns and, from a broader perspective, has argued that there is a need to re-found the idea of equality under the basis of singularity, reciprocity and communality.[31]

It would be wrong to assume, however, that these scholars reject the premise that private property requires protection from state actions. What authors such as Alexander reject is a particular interpretation of constitutional property protection based on a guarantee-oriented view. In this interpretation, he explains, "the role of any constitutional property clause is to create a minimalist role for government by maintaining a radical divide between the private and the public spheres."[32] Alexander argues instead for a limitation-oriented interpretation according to which "constitutional property protection is a matter of constant adjustments between individual and social interests."[33]

Similar criticisms of constitutional property regimes, or at least of guarantee-oriented versions of these regimes, can and have been addressed to the IIR, for

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[27] *International Thunderbird v Mexico*, NAFTA - UNCITRAL, Thomas Wälde's Separate Opinion, 1 December 2005, at 4.

[28] Rosanvallon, Pierre, *La contre-démocratie: la politique à l'âge de la défiance*, p. 11.

[29] Alexander, Gregory, *The global debate over constitutional property: lessons for American takings jurisprudence*, p. 4.

[30] Waldron, Jeremy, *The dignity of legislation*, New York: Cambridge University Press, 1999, p. 2.

[31] Rosanvallon, Pierre, *La Société des égaux*, Paris: Seuil, 2011.

[32] Alexander, Gregory, *The global debate over constitutional property: lessons for American takings jurisprudence*, p. 58.

[33] *Ibid.*

example in the work of Schneiderman and Van Harten.[34] Schneiderman argues that the IIR constitutes a "constraining version" of a constitution that he compares and contrasts to an "enabling version."[35] The categories employed by Schneiderman and the structure of his analysis resemble those applied by Alexander. Thus, it is possible to see a similar line of argument in the critiques of both constitutional property protection and the IIR.

A popular critical stance in investment law scholarship at present, is that which considers the IIR responsible for an excessive limitation of host state authority. However, these contributions comprise at least two clearly distinguishable views on foreign investment protection. The first, and I would say historical view sees this regime as not only restricting policy space in excess but also shaping the host community by determining the use of the resources. In 1957, during the same conference where Abs presented his proposal for a Magna Carta for Private Foreign Investors, the governor of the Central Bank of Philippines disagreed with the proposition that foreign investment and foreign investment protection was a way of developing a strong "free enterprise system."[36] Similarly, in 1968, Metzger argued that foreign investment protection could become an obstacle to social experimentation in developing host countries.[37] The second, and currently most popular view argues that the IIR can restrict state policy space in excess, causing a chill of environmental or financial regulation.[38] The main difference between these two positions relates to the intensity of the effects of the IIR. The first focuses on the effects on host countries and populations, whilst the second concentrates essentially on the authority of host states.

This brief historical and political analysis has illustrated the closeness between constitutional property regimes and the IIR. Although most of the investment law literature has not considered the IIR from this perspective, some scholars have

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34 Schneiderman, David, *Constitutionalizing Economic Globalization. Investment Rules and Democracy's Promise*; Van Harten, Gus, *Investment treaty arbitration and public law*, New York: Oxford University Press, 2007.
35 Schneiderman, David, *Constitutionalizing Economic Globalization. Investment Rules and Democracy's Promise*, pp. 8-13.
36 Cuaderno Sr., Miguel, "The Anti-Capitalist Attitude ," in James Daniel (Ed.), *Private investment: the key to international industrial development*; a report of the San Francisco Conference, October 14-18, 1957, sponsored by Time-Life International and Stanford Research Institute, New York: McGraw Hill, 1958, pp. 52-61.
37 Metzger, Stanley, "Private Foreign Investment and International Organizations," 22 *International Organization* (1968) , p. 291.
38 See Spears, Suzanne, "The Quest for Policy Space in A New Generation of International Investment Agreements," 13:4 *Journal of International Economic Law* (2010), pp. 1037-1075.

noted the similarity between constitutional property and foreign investment protection. The work of Wälde and Kolo, Montt, Parvanov and Kantor shows that constitutional property regimes and the IIR concentrate on similar disputes, where individuals – foreign or domestic – consider a legislative or administrative measure to have exceeded host state legitimate authority, depriving them of their proprietary rights.[39] In this regard, a very significant point that emerges from thinking about the IIR along the lines of a constitutional property framework is the fundamental role of the institutional mechanism in interpreting and enforcing property rights against states.[40] Following this line of argument, I will now focus on investment arbitration and the starting point for the consideration of foreign investors' rights: the investment treaties.

1. *The enforcement of constitutional and IIR property rules*

There is no reason to assume that temporal state controlling majorities will voluntarily abide by the standards established in constitutional property regimes. Governments and legislatures may try different strategies to bypass constitutional limitations. This concern has been present at least since the inclusion of private property rights was debated in the case of the U.S. Constitution.[41] A constitutional rights framework counteracts the distrust of governments by granting each individual the ability to assert their rights against state measures that may have breached, amongst others, their constitutional property rights. In this way, constitutional property rights and remedies work jointly to protect the individual control of resources. Since the objective is to deter the state (and the majorities that control it) from abusing sovereign authority, the legal order delegates the resolution of any allegation of abuse to counter-majoritarian adjudicators. Constitutional property regimes empower a body independent from the political majority to decide whether governments have arbitrarily changed private property

[39] Wälde, Thomas and Abba Kola, "Environmental Regulation, Investment Protection and 'Regulatory Taking' in International Law," 50 *International and Comparative Law Quarterly* (2001), p. 846; Montt, Santiago, *State liability in investment treaty arbitration: global constitutional and administrative law in the BIT generation*, Hart Publishing, Oxford and Portland, Oregon, 2009, pp. 165-229; Parvanov, Parvan and Mark Kantor, "Comparing U.S. law and recent U.S. investment agreements: Much more similar than you might expect," in Karl Sauvant (Ed.), *The Yearbook on International Investment Law and Policy 2010/2011*, New York: Oxford University Press, 2012, pp. 741-836.

[40] Barrère, Christian, "Judicial System and Property Rights," in Enrico Colombatto (Ed.), *The Elgar Companion to the Economics of Property Rights*, Cheltenham: Edward Elgar Pub, 2006, p. 129.

[41] Fisher, William, "The significance of public perceptions of the takings doctrine," pp. 1781-1782.

rules. Judges thus have the responsibility of interpreting and enforcing private property rights. The independence of the adjudicators from political bodies is of utmost importance for property rights defenders. In the case of property, however, this independence is often confused with being apolitical or neutral. In reality, as Rose explains, "[s]ecurity of property is the political message in all this."[42]

Investment arbitration falls within the category of constitutional property remedies, as it allows foreign investors to assert their proprietary rights against host states. Investment treaties do not provide much, if any, security unless they provide foreign investors with an efficient way to hold host states accountable for their measures. In the case of the IIR, however, foreign investors demand a mechanism to isolate them from more than host state political majorities. Although political risk is the main reason for constitutional remedies and investment arbitration, foreign investors have a more acute need that makes the IIR's job more difficult. Multinational corporations do not only fear majorities but also domestic and local interests that could enjoy large support in the host country. As Stiglitz explains, multinational corporations prefer uniformity to rules tailored according to the preferences of local communities.[43] Similarly, Cohen argues that the issues in foreign investment relations are numerous but in most cases there is always a pervasive tension between the global and the local.[44]

Therefore, to reassure foreign investors, the IIR needs to cope with this additional *local* element in host state political risk. Part of the strategy for making this possible is to describe investment arbitration as a depoliticised and nationally neutral remedy. Investment law scholars with a generally positive opinion about investment arbitration tend to emphasise the transnational perspective that dominates international investment.[45] However, as mentioned above, these strong claims of being neutral and apolitical often hide a political objective. In this sense, I suggest that investment arbitration serves to promote not only the security of private property but also a transnational understanding of foreign investment. The global character of investment arbitration promotes uniformity and global views

[42] Rose, Carol, "Introduction: Approaching property," in *Property and Persuasion*, Colorado: Westview Press, 1994, p. 3.
[43] Stiglitz, Joseph, "Regulating Multinational Corporations: Towards Principles of Cross-Border Legal Frameworks in a Globalized World: Balancing Rights with Responsibilities," 23 *American University International Law Review* (2008), pp. 482-483.
[44] Cohen, Stephen, *Multinational corporations and foreign direct investment: avoiding simplicity, embracing complexity*, New York: Oxford University Press, 2007, p. 18.
[45] See Schill, Stephan, *The Multilateralization of International Investment Law*, New York: Cambridge University Press, 2009, pp. 3-8.

over local preferences and values. Indeed, this is the dominant perception of international arbitration. As Lew affirms,

> "[t]he ideal and expectation is for international arbitration to be established and conducted according to internationally accepted practices, free from the controls of parochial national laws, and without the interference or review of national courts."[46]

Now, rather than a bias, I claim that there is in investment arbitration a predominant view that the global is superior to the local. This observation is different to the argument made by Van Harten that investment arbitrators share and promote the views of transnational business groups.[47] I argue instead that we should consider this preference for the global in investment arbitration as an additional interpretative factor along the lines of a constitutional property framework. In this light, arbitrators' interpretation is predominantly guarantee as well as a transnational-oriented.

This tendency of investment arbitrators is the result of the institutional and social circumstances surrounding investment arbitration. First, investment arbitration is more counter-majoritarian than domestic judiciaries. The reason is quite obvious. Whilst only political bodies appoint domestic judges, international private actors and institutions play an important role in selecting and supervising investment arbitrators.[48] Checks and balances run both ways in a liberal democracy. Judges are accountable to domestic legislatures for their conduct. Investment arbitrators are also accountable, but to international arbitral institutions, foreign investors and states. As a result, the job of arbitrators depends less on domestic politics, and, for this reason, we should expect them to show a stronger detachment from the opinions of host communities – majorities and minorities alike. Second, investment arbitrators constitute a community that shares an international identity and interests. Although arbitrators are *ad hoc*, there is a relatively small community of frequently appointed arbitrators with an important common identity and

[46] Lew, Julian, "Achieving the Dream: Autonomous Arbitration," 22:2 *Arbitration International* (2006), p. 179.
[47] Van Harten, Gus, *Investment treaty arbitration and public law*, Chapter 7.
[48] See Articles 5.5, 5.6 LCIA rules; 8.4, 9 ICC rules; 3 and 4 ICSID rules.

transnational profile.[49] This small group has participated in enough disputes to leave its imprint on most investment awards (12 arbitrators have been involved in more than 60% of ICSID cases).[50] As in the domestic setting, this international legal community has created its own professional spirit, developing shared customs and habits within this legal field. According to Fontoura Costa, these professionals focus on the international society, sending a message of depoliticised investor-state dispute settlement that consists of "technical correctness, ideological neutrality and impartiality."[51]

2. *Constitutional property and IIR rules*

When enforcing foreign investment protection, the job of investment arbitrators begins with the text of investment treaties. The correspondence between the structure of the legal rules contained in constitutions and investment treaties facilitates and strengthens the grounds for using a constitutional property framework to think about the IIR. The fact that ownership is incomplete anticipates the importance of interpretation but this does not imply, nor should it be read as implying, that the text does not matter. As Alexander highlights, "[j]udicial interpretation of a constitutional property clause turns on many factors, among which is its text."[52] In this section, I rely on selected literature from the field of linguistics and reading research to illustrate the significant structural similarity between constitutional property and investment treaty clauses.[53] Essentially, these clauses describe the same problem, provide the same solution and omit the same information. They describe the problem of states depriving individuals of their private property, i.e. political risk, impose the solution of paying compensation, and are typically silent regarding the content of the object of protection. Although constitutional property rules may be more or less precise regarding the intensity of the protection and the amount or form of compensation,

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49 Fontoura Costa, Jose, "Comparing WTO Panelists and ICSID Arbitrators: the Creation of International Legal Fields," 1:4 *Oñati Socio-Legal Series*, Socio-Legal Aspects of Adjudication of International Economic Disputes (2011), pp. 18-20.
50 *Ibid.*, p. 11.
51 *Ibid.*, p. 18.
52 Alexander, Gregory, *The global debate over constitutional property: lessons for American takings jurisprudence*, p. 6.
53 See Meyer, Bonnie and Elizabeth Rice, "The structure of text," in David Pearson, Rebecca Barr, Michael Kamil and Peter Mosenthal, *Handbook of reading research*, New York: Longman, 1984, pp. 319-351.

they always rely on the abovementioned problem and solution as a way to govern the relationship between individuals and states concerning the control of resources.

Normally, constitution and investment treaty clauses describe the problem of political risk as events of direct expropriation, indirect expropriation, or other forms of property deprivation. These standards employ different wordings, some more and some less vague and ambiguous, but essentially they all aim to prevent states from taking advantage or exploiting resources that belong to individuals. The structure of the U.S. Constitution, to choose a comparator, is shared by the IIR and most constitutions that incorporate private property rights.[54] Whilst the relevant text of the Fifth Amendment establishes that "nor shall private property be taken for public use, without just compensation," Article 4.2 of the German BIT model, for instance, states that

> "[i]nvestments by investors of either Contracting State may not directly or indirectly be expropriated, nationalized or subjected to any other measure the effects of which would be tantamount to expropriation or nationalization in the territory of the other Contracting State except for the public benefit and against compensation [...]."

Interestingly, even if investment law scholars often blame the lack of precision of investment standards for some of the tensions created by the IIR, the clauses of investment treaties are not extremely vague or ambiguous.[55] Just comparing the U.S. Takings Clause with the German BIT model – by far less detailed than the U.S. or Canadian BIT models – shows that treaty clauses are more detailed than the U.S. Fifth Amendment.

In my view, the problem regarding both constitutional property and investment treaty clauses is that the range of political risk events has become larger and also more elusive. As Ackerman explains, this is a result of the emergence of the

[54] For instance, Basic Law for the Federal Republic of Germany, Article 14, "(3) Expropriation shall only be permissible for the public good. It may only be ordered by or pursuant to a law that determines the nature and extent of compensation. Such compensation shall be determined by establishing an equitable balance between the public interest and the interests of those affected. In case of dispute concerning the amount of compensation, recourse may be had to the ordinary courts." See also: Constitution of South Africa, Section 25; Constitution of Argentina, Section 17; Constitution of Japan, Article 29; Constitution of the Russian Federation, Article 35.

[55] See Yackee, Jason, "Toward A Minimalist System of International Investment Law?," 32 *Suffolk Transnational Law Review* (2009), p. 315 and references. For a different view on this question, see Ortino, Federico, "Refining the Content and Role of Investment 'Rules' and 'Standards': A New Approach to International Investment Treaty Making," 28:1 *ICSID Review* (2013), pp. 153-155.

regulatory state.[56] The clauses protecting property have become more difficult to interpret because they need to cope with more subtle forms of private property deprivation. As nationalisations and direct state control of the economy declined by the end of the 1970s, much of the constitutional property debate at the domestic and international level has in fact converged towards allegations of indirect and creeping expropriation. Presently, political risk is mainly regulatory risk. In response to this shift, investment arbitration has moved its focus away from expropriation clauses, concentrating more on allegations of unfair or inequitable treatment.[57] Indeed, the standard of fair and equitable treatment (FET) has been employed by investment arbitrators to judge allegations of complex or subtle deprivations of property. The focus on FET clauses, however, does not imply a substantial difference between constitutional property regimes and the IIR. On the contrary, every constitutional property regime was affected, albeit to different extents, by both the rise of the regulatory state and the emergence of neo-liberalism as a reaction against state activism.[58]

Investment law scholarship describes FET as a standard that provides both substantive and procedural protection.[59] Schreuer, for instance, includes in FET legitimate expectations, due process and judicial property.[60] From a constitutional property perspective, the substantive content of FET is of significant importance, although in saying this I do not want to disregard that procedural standards may interact closely with the substantive protection of property. The legitimate expectations that prevail in investment arbitration are substantive. There is a close similarity between legitimate expectations under FET and investment-backed expectations in U.S. Takings Law.[61] However, as investment scholars and awards

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[56] Ackerman, Bruce, *Private Property and the Constitution*, New Haven and London: Yale University Press, 1977, p. 1; Montt, Santiago, *State liability in investment treaty arbitration: global constitutional and administrative law in the BIT generation*, pp. 3-25.

[57] Panel Discussion, "Fair and Equitable Treatment: Evolution or Revolution?," in Ian Laird and Todd Weiler (Eds.*), Investment Treaty Arbitration and International Law*, Volume 2, Juris Publishing, 2009, p. 267.

[58] Alexander, Gregory, *The global debate over constitutional property: lessons for American takings jurisprudence,* p. 14; Arthurs, H.W., "The Administrative State goes to Market (And Cries 'Wee, Wee, Wee' All The Way Home)," 55 *University of Toronto Law Journal* (2005), pp. 797-831.

[59] Kläger, Roland, *Fair and Equitable Treatment' in International Investment Law*, New York: Cambridge University Press, 2011, pp. 154, 213.

[60] Schreuer, Christoph, "Fair and Equitable Treatment in Arbitral Practice," 6 *The Journal of World Investment and Trade* (2005), p. 386.

[61] Compare Epstein, Richard "Lucas v. South Carolina Coastal Council: A Tangled Web of Expectations," 45 *Stanford Law Review* (1992-1993), pp. 1369-1372, 1385-1392, with *Azurix v Argentina*, ICSID Case No. ARB/01/12, Award, 14 July 2006, at 341; *Fireman v Mexico*, ICSID Case

have noted, the doctrine of legitimate expectations that dominates investment arbitration is inspired by German, European, and to some extent English Administrative Law.[62]

As regards the procedural side of FET, this standard includes protection against the denial of justice, undue process and excessive burdens.[63] Since FET is a standard susceptible to including a vast array of elements at the procedural level, it is difficult to draw a direct comparison with constitutional property rules. The correct comparison, then, may be between FET and the judicial interpretation of constitutional property clauses. In this sense, if we look at the entire landscape of U.S. Constitutional Property, we can confirm the importance that procedural as well as substantial due process elements have in takings disputes.[64]

Moving to the solution to political risk, we find that in practice the IIR operates like any constitutional property regime: host states need to pay compensation (i.e. a liability remedy). The only concession that private property defenders agree to make to the public interest is that states can always take private property as long as they pay adequate compensation.[65] In U.S. Constitutional Property Law, this is established in the eminent domain doctrine, while in international law it has crystallised in the doctrine of permanent sovereignty over natural resources.[66] The dominant position in investment law literature is that tribunals should not order specific performance, albeit for pragmatic rather than legal reasons.[67] Indeed, only a few scholars have argued in favour of including primary remedies in the IIR

No. ARB(AF)/02/1 – NAFTA, Award, 17 July 2006, at 176; and *International Thunderbird v Mexico*, NAFTA - UNCITRAL, Thomas Wälde's Separate Opinion, 1 December 2005, at 26.

62 See *Total S.A. v. The Argentine Republic*, ICSID Case No. ARB/04/01, Decision on Liability, 27 December 2010, at 128-130 and references.

63 McLachlan, Campbell, Laurence Shore and Matthew Weiniger, *International Investment Arbitration Substantive Principles*, New York: Oxford University Press, 2008, pp. 226-247.

64 See Merrill, Thomas, "The Landscape of Constitutional Property," 86:5 *Virginia Law Review* (2000), pp. 960-990.

65 Epstein, Richard, *Takings: Private Property and the Power of Eminent Domain*, Cambridge, Massachusetts: Harvard University Press, 1985, pp. 19-25.

66 Merrill, Thomas and Henry Smith, *The Oxford Introductions to U.S. Law: Property*, New York: Oxford University Press, 2010, p. 241; Anghie, Antony, *Imperialism, Sovereignty and the Making of International Law*, New York: Cambridge University Press, 2004, pp. 212-215; Schrijver, Nico, *Sovereignty over Natural Resources: Balancing Rights and Duties*, New York: Cambridge University Press, 2008, p. 42.

67 Dolzer, Rudolph and Christoph Schreuer, *Principles of international investment law*, New York: Oxford University Press, 2008, p. 271; Douglas, Zachary, "Other Specific Regimes of Responsibility: Investment Treaty Arbitration and ICSID," in James Crawford, Alain Pellet, and Simon Olleson (Eds.), *The Law of International Responsibility*, New York: Oxford University Press, 2010, p. 829; Schill, Stephan, "Fair and Equitable Treatment, the Rule of Law, and Comparative Public Law," in Stephan W. Schill (Ed.), *International Investment Law and Comparative Public Law*, New York: Oxford University Press, 2010, p. 171.

regime.[68] Nonetheless, in my opinion, host states can always insist on paying compensation if the measure was taken for a public purpose, relying on the doctrine of permanent sovereignty over natural resources and relevant state practice.[69] This means that within the IIR, as within any other constitutional property regime, if host states insist and comply with the legal requirements, the foreign investor will lawfully lose his property but always obtain financial compensation in exchange.

Finally, I conclude the comparison between constitutional property and investment treaty clauses with what these texts do not include. The similarity in the structure of these clauses extends not only to what they refer to (the problem and the solution) but also to what they omit: the content of the object of protection. Discussing the U.S. Constitution, Michelman asks:

> "What can we say by way of defining the 'property' rights thus safeguarded by the Constitution, of describing their scope and content in general? What kinds of interests or relations, respecting what kinds of valued objects, fall within the category of protected interests or relations that the Constitution knows as 'property'? The constitutional text itself does not begin to answer the question."[70]

This question, however, is essential for judging any constitutional property or investment dispute. Rose explains:

> "You can only claim that you should be compensated for adverse effects to something that is within your property right. One might start, then, with the question, What 'takes' your property? But simply by looking at some cases,

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[68] See van Aaken, Anne, "Primary and Secondary Remedies in International Investment Law and National State Liability: A Functional and Comparative View," in Stephan W. Schill (Ed.), *International Investment Law and Comparative Public Law*, New York: Oxford University Press, 2010, p. 27 (footnote 63).

[69] According to Bin Cheng, "if the expropriation is lawful, a State is never under a duty to restitute the property expropriated, unless the expropriation was originally merely for the user of the property and the public need for the property expropriated has ceased to exist," Cheng, Bin, "The Rationale of Compensation for Expropriation," 44 *Transactions of the Grotius Society*, Problems of Public and Private International Law, Transactions for the Year 1958-59 (1958), p. 291.

[70] Michelman, Frank "Property as a Constitutional Right," 38 *Washington and Lee Law Review* (1981), pp. 1098-1099.

one quickly arrives at a more general question, namely, What does your property right include?"[71]

Rose here underlines the importance of the content of property rights for the resolution of any investment dispute. Investment arbitrators cannot enforce foreign investment protection without explicitly or implicitly substantiating foreign investors' rights. Finding that a host state has committed an expropriation or an unfair act requires considering the content of the rights of the offended party. Host state duties are meaningful only in relation to the content of foreign investors' rights because, after all, a host state cannot expropriate something the foreign investor does not own. Although the texts of investment treaties do not begin to answer what the rights include, the constitutional property literature fortunately tells us where to continue our examination. The work of Alexander and Van der Walt suggests that the beginning of an answer to Rose's question resides in civil and private law sources.[72] However, since the IIR is an international legal regime, this begets the important question: which civil or private law?

B. The law applicable to foreign investors' rights

Foreign investment disputes are more difficult to resolve than constitutional property cases because of the several international elements that are involved in investment arbitrations. In the context of the IIR, to begin substantiating foreign investors' rights is not as simple as applying one legal order and its private property system. Investment arbitrators need to decide first which laws should apply to this question. When there is no explicit choice of law, this matter should be resolved by the appropriate rules on conflict of laws. These rules define the legal order in which to situate the dispute and the controversial issues.

The domain of private property may create some additional difficulties in finding the applicable law given the variety of issues involved in this legal concept. Property has three different dimensions, and regarding the content of property rights, the answer that any legislation can provide is inherently incomplete. As

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[71] Rose, Carol "'Takings' and the Practices of Property: Property as Wealth, Property as 'Propriety'," in *Property and Persuasion*, Colorado: Westview Press, 1994, p. 50.

[72] Alexander, Gregory, *The global debate over constitutional property: lessons for American takings jurisprudence*, p. 60; Van der Walt, AJ, *Constitutional property clauses: a comparative analysis*, Cambridge, Mass.: Kluwer Law International, 1999, p. 127.

Alexander and Van der Walt suggest, the legislation is just a starting point for answering this question. Private international law provides a conceptual toolkit for tackling some of the difficulties created by property. The concept of *dépeçage* is particularly important because it describes the possibility that the different components of a legal relation may be governed by different laws.[73] This means that there is no theoretical problem with arguing that the different dimensions of private property, i.e. commodification, allocation and ownership, are governed by different laws. The most difficult challenge, however, refers to the substantiation of property rights when their content is unclear – which is most of the time. In this section, I argue that investment awards and the literature assume that when foreign investors' rights are incomplete, vague or ambiguous, the legal method for substantiating these rights is the doctrine of legitimate expectations in accordance with investment treaties and international law.

When dealing with property rights, the dominant principle in private international law is to situate the proprietary relation within the laws of the territory where the resources lie, i.e. the *lex rei sitae*.[74] These legal orders commodify the resources, govern the allocation of property rights, and provide the content of ownership. This rule of conflict of laws looks at the location of the resources and not at the origin or where they were created.[75] Foreigners bring resources and in exchange obtain property, vested rights and contractual commitments. The *lex rei sitae* applies to both resources brought into and acquired in the host country.[76] In the hypothesis of a foreign project to cultivate soya, for instance, this means that the domestic law would not only govern the land comprising the foreign investment, but also most of the assets that comprise the business project. Whilst there have been attempts to harmonise property right laws, only the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPs) has been really successful. However, even in the area of intellectual property the territorial principle remains dominant for the individual.[77] Although the technology may have been developed

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[73] Reese, Willis, "Dépeçage: A Common Phenomenon in Choice of Law," 73 *Columbia Law Review* (1973), pp. 58-75.

[74] The territorial principle evolved in opposition to "the original principle that law is an order of personal groups, tribes, cities, and peoples," Rabel, Ernst, *The conflict of laws: A comparative study*, Volume 4, Ann Harbour: University of Michigan Law School, pp. 7-8, 30.

[75] "[T]he territorial law governs not only persons (*statuta personalia*), but also things situated in the territory (*statuta realia*)," *Ibid.*, pp. 8, 8-14.

[76] Douglas, Zachary, *International Investment Claims*, New York: Cambridge University Press, 2009, pp. 54-55.

[77] *Ibid.*, pp. 67-68.

overseas, the patent is still an artefact of domestic laws. These laws would normally be harmonised according to the principles of TRIPs, but the individual cannot enforce TRIPs through the WTO system.[78]

The role of domestic laws regarding private property is consistent with the public international law principle that every foreigner who enters into a country accepts the application of host laws and regulations.[79] According to this principle, a foreigner consents to the application of the domestic property system to the resources he brings into and acquires in the host country. Foreigners confirm their implicit acceptance as they follow domestic procedures to register their property rights, apply for patents or sell their assets. This acquiescence, however, should not be confused with the type of consent that gives rise to promises under contract law. By entering into a country, foreigners place themselves under the authority of the sovereign, including the authority to pass legislation in relation to the resources that lie in the territory. Thus, the basic principles of public international law also indicate that host state laws govern private property rights.[80]

In opposition to the territorial principle, I argue that the IIR advances a global or internationalised view of the proprietary relationship between foreign investors and host states. This observation could be debatable given the partially inconsistent conflict of law rules contained in BITs and the ICSID. The U.S. Model BITs 2004 and 2012, for instance, establish that international law should judge any allegation of expropriation or unfair treatment, but give domestic law a broader role regarding contractual rights.[81] Conversely, the influential ICSID Convention gives greater or at least the same prominence to domestic law for both treaty and contractual claims. Article 42.1 establishes that

> "[t]he 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."

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78 TRIPs, Article 1.1.

79 This principle was first enunciated by Emmerich Vattel in *Law of Nations*, (J. Chitty, translator), Philadelphia: T. & J.W. Johnson & Co., Law Booksellers, 1883, Book II, Chapter VIII, §99-105.

80 Hiscock, Mary E., "The Emerging Legal Concept of Investment," 27 *Penn State International Law Review* (2009), p. 771.

81 U.S. Model BIT 2004 and 2012, Article 30.

Despite this partial contradiction, as I illustrate below, it is in fact the approach of the U.S. Model BITs that describes the dominant trend in investment awards and literature. This means that the IIR and international law play a larger role in disputes over the deprivation of proprietary rights through expropriatory or unfair acts of the host state.[82] This is very significant. If we contrast this feature of the IIR with the legal principle that private and public actors can choose the law applicable to their agreements, we find that this regime produces a result that no individual could otherwise obtain. Regarding the right to choose the applicable law, most domestic legal orders distinguish between mandatory rules and party autonomy. As opposed to contractual rules that are dispositive for the parties, property laws are mandatory. According to this legal principle, individuals are not allowed to contract their own property rules with the state, and therefore foreign investors are not allowed to contract the type of remedies (and rights) granted by the IIR. As Dalhuisen and Guzman claim, contracts with host states cannot "bind the state with respect to its public functions."[83]

The main observation I want to make is not that the IIR contradicts this legal principle. After all, this regime is the outcome of international treaties. Instead, I argue that the internationalisation of proprietary relations between foreign investors and host states has effects on the law applicable to foreign investors' rights, in particular, to the substantiation of these rights. In this respect, I claim that when ownership is incomplete in domestic laws – and this is the rule not the exception – investment arbitrators rely on investment treaties and international law. Although most of the scholarship appears to overlook the substantive consequences of investment treaties on foreign investors' rights, I suggest that a detailed look at this question can explain the "perpetual tension" that Crawford finds between the two following propositions:

[82] Cremades, Bernardo and David Cairns, "Contract and Treaty Claims and Choice of Forum in Foreign Investment Disputes," in Norbert Horn and Stefan Kröll (Eds.), *Arbitrating Foreign Investment Disputes*, The Hague: Kluwer Law International, 2004, p. 330; Reed, Lucy; Jan Paulsson and Nigel Blackaby, *Guide to ICSID Arbitration*, The Hague: Kluwer Law International, 2004, pp. 29-30 and pp. 46-47; Bishop, Doak; James Crawford and Michael Reisman, *Foreign investment disputes cases, materials, and commentary*, The Hague: Kluwer Law International, 2005, pp. 630-688 and pp. 689-704.

[83] Guzman, Andrew and Jan Dalhuisen, "The Applicable Law in Foreign Investment Disputes," available at SSRN: http://ssrn.com/abstract=2209503 (2013), p. 10.

> "[O]n the one hand, the proposition that a host state cannot rely on its own law as a justification for failing to comply with its international obligations, including those obligations arising under treaties for the protection of foreign investment; on the other hand, the proposition that an investment is, in the very first place and by definition, a transaction occurring in the host state and governed by its laws."[84]

In essence, my argument is built on the premise that any controversy between foreign investors and host states is governed by the IIR and international law. In their book on foreign investment disputes, Bishop, Crawford and Reisman affirm that "[i]n effect, international law is the governing law of the investment relationship, subject always to the terms of the applicable treaty."[85] According to Spiermann, to "put the parties on an equal footing by balancing the powers of the state,"[86] the IIR internationalises the legal relationship regarding the control of resources. In his view, the issue is not the lack of clarity in domestic law but its "inadequacy."[87] Spierman's opinion poses the question of what in the domestic legal order is inadequate.

The dominant opinion in the literature is that domestic laws are not inadequate to govern the legality or validity of the foreign investment. The relevance of domestic law is acknowledged in relation to the commodification and allocation of resources. Indeed, many investment treaties incorporate an explicit rule that no assets can qualify as an investment unless the project is established "in accordance with" the laws of the host state.[88] Consequently, if a foreign investor does not follow the substantive limitations and the procedural formalities to acquire the rights, he will simply not be judged to have made an investment.[89] The tribunal in *Bayview Irrigation v Mexico* followed this approach regarding the existence of foreign

[84] Crawford, James, "Treaty and Contract in Investment Arbitration," 24:3 *Arbitration International* (2008), p.352.
[85] Bishop, Doak; James Crawford and Michael Reisman, *Foreign investment disputes cases, materials, and commentary*, p. 690.
[86] Spiermann, Ole, "Applicable Law," in Muchlinski, Peter; Federico Ortino and Christoph Schreuer (Eds.), *The Oxford handbook of international investment law*, New York: Oxford University Press, 2008, p. 95.
[87] *Ibid.*
[88] UNCTAD, "Bilateral Investment Treaties 1995–2006: Trends In Investment Rulemaking," New York and Geneva: United Nations, 2007, p. 8; *Inceysa Vallisoletana S.L. v. El Salvador*, ICSID Case No. ARB/03/26, Award, 2 August 2006, at 187-189.
[89] Douglas, Zachary, *International Investment Claims*, pp. 52-71; Schreuer, Christoph and Ursula Kriebaum "The Concept of Property in Human Rights Law and International Investment Law," pp. 4-5.

investors' rights, as it concluded that "it is plain that under the Mexican Constitution and Mexican law, the Claimants could have no such property rights in water in Mexican rivers."[90]

Questions about the commodification and allocation of resources, however, rarely solve disputes between foreign investors and host states. The core of any foreign investment controversy lies in the content of foreign investors' rights and the behaviour of the host state in relation to these rights. Yet, investment tribunals have not been particularly clear regarding the law applicable to the substance of these rights and the issue of liability. Douglas makes this important observation in his study on the law applicable to investment claims.[91] Similarly, Fauchald argues:

> "Moreover, ICSID tribunals often have competence to make decisions in accordance with international law, domestic law, and contractual obligations simultaneously. It may be difficult or even impossible to distinguish clearly between these legal bases in a given decision."[92]

There are few cases where the arbitrators have considered the applicable law, making this the exception rather than the rule in investment arbitration. In the award in *Vivendi v Argentina* (2002), for instance, the arbitrators concluded that "[e]ach of these claims will be determined by reference to its own proper or applicable law—in the case of the BIT, by international law."[93] However, the prevalent trend is that illustrated by *CMS v Argentina* (2005), where the tribunal adopted a "more pragmatic and less doctrinaire approach," explaining that domestic and international law governed the licence in question in an "inseparable" way.[94]

The majority of investment law literature, however, has been much clearer about these questions. It recognises that that the issues of legality and validity only have an incidental and secondary role in the resolution of investment treaty claims. At the same time, it reveals a consensus that the main question is liability, that this is

[90] *Bayview Irrigation v Mexico*, ICSID Case No. ARB(AF)/05/1, 19 June 19 2007, at 118.
[91] Douglas, Zachary, *International Investment Claims*, p. 41-42.
[92] Fauchald, Ole, "The legal reasoning of ICSID tribunals: an empirical analysis," 19:2 *European Journal of International Law* (2008), p. 312.
[93] *Vivendi v Argentina*, ICSID Case No. ARB/97/3, Decision on Annulment, 3 July 3 2002, at 96.
[94] *CMS v Argentina*, ICSID Case No. ARB/01/8, Award, 12 May 2005, at 116-118. Similarly, see *Enron v Argentina*, ICSID Case No. ARB/01/3, Award, 22 May 2007, at 207; *Sempra v Argentina*, ICSID Case No. ARB/02/16, Award, 28 September 2007, at 235-236.

what is inadequate about host state laws, and that this question is governed by the investment treaties and international law.[95] McLachlan explains that investment treaties are part of international law and, for this reason, they need to be interpreted in accordance with this legal order.[96] Newcombe and Paradell claim that "[t]he principle matter in an IIA dispute, the issue of liability of the host state for measures that breach the IIR is a matter of international law, not domestic law."[97] Similarly, in their *Guide to ICSID Arbitration*, Reed, Paulsson and Blackaby conclude that

> "[g]iven that BITs grant foreign investors direct access to arbitration to claim the substantive protections of the treaty itself, it is entirely logical that the substantive standards of the treaty are the primary source of applicable law."[98]

According to the majority of the literature, then, domestic law is inadequate to govern foreign investor-host state relations in respect of the use of the resources. This justifies the internationalisation of this relationship. In addition, the scholarship reveals an excessive focus on host state actions through emphasis on the issue of liability. This excessive focus on host state liability supports my claim that most of the literature has overlooked the importance of foreign investors' rights. By detaching the remedy from the rights, most scholars concentrate on the question of what takes away foreign investors' investment. As Rose explains, however, substantiating the content of these rights is key to determining state liability. To put it bluntly, investment arbitrators cannot decide any dispute simply by relying on an abstract notion of rights that trump state activity. Drawing a parallel with Waldron's analysis of *Lucas v South Carolina Coastal* (1992), we can easily see that whether the state abused Lucas's ownership depends to a large

[95] Spiermann, Ole, "Applicable Law," p. 108, 111-112; Newcombe, Andrew and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment*, Kluwer Law International, The Netherlands, 2009, p. 93-112; Montt, Santiago, *State liability in investment treaty arbitration : global constitutional and administrative law in the BIT generation*, pp. 316-317, 362-363; Bishop, Doak; James Crawford and Michael Reisman, *Foreign investment disputes cases, materials, and commentary*, pp. 689-690; Reed, Lucy; Jan Paulsson and Nigel Blackaby, *Guide to ICSID Arbitration*, pp. 46-48; McLachlan, Campbell, "Investment Treaties and General International Law," 57 *International and Comparative Law Quarterly* (2008), pp. 398-399.

[96] McLachlan, Campbell, "Investment Treaties and General International Law," p. 369-370

[97] Newcombe, Andrew and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment*, p. 98.

[98] Reed, Lucy; Jan Paulsson and Nigel Blackaby, *Guide to ICSID Arbitration*, p. 47.

extent on a previous decision regarding whether he ever had a right to build a house on his land.[99] Arguably, a new law that prohibited building on the beach would have a completely different effect on his property rights if he ever had such a right to build.

Given the significant role of international law in the IIR, it is expected that investment arbitrators rely on this legal order to substantiate foreign investors' rights. Indeed, tribunals apply the doctrine of legitimate expectations, which they derive from the standards of liability found in investment treaties – in most cases FET.[100] A look at investment awards confirms that the doctrine of legitimate expectations is grounded in international law.[101] In the award in *OKO v Estonia* (2007), for instance, the investment arbitrators stated: "If legitimate expectations are raised by the Respondent with a specific foreign investor that his investment will be treated fairly and equitably, such expectations must be honoured as a matter of international law."[102]

My claim that the substantiation of foreign investors' rights has become an issue of host state liability, which needs to be judged according to investment treaties and international law, can be further illustrated by contrasting my position with the stance taken by Douglas. In his study on investment claims, Douglas looks at the role of domestic law in investment disputes, justifying its use in answering preliminary questions based on the proprietary character of foreign investors' rights and the applicable conflict of law rules.[103] He claims to be in favour of the

> "basic distinction between the law applicable to the private rights comprising the investment in the host state (municipal law) and the law applicable to an assessment of whether the conduct of the host state in relation to those private rights is violative of the investment treaty standards (international law)."[104]

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[99] Waldron, Jeremy, *The rule of law and the measure of property*, Cambridge: Cambridge University Press, 2012.
[100] Crawford, James, "Treaty and Contract in Investment Arbitration," pp. 372-373; Spiermann, Ole, "Applicable Law," p. 95.
[101] *Total v Argentina*, ICSID Case No. ARB/04/01, Decision on Liability, 27 December 2010, at 128; *LG&E v Argentina*, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, at 130.
[102] *OKO v Estonia*, ICSID Case No. ARB/04/6, Award, 19 November 2007, at 274.
[103] Douglas, Zachary, *International Investment Claims*, pp. 52-71.
[104] *Ibid.*, p. 41.

According to this position, the domestic legal order would serve to substantiate the content of foreign investors' rights; however, Douglas comes to the same conclusion as most of the literature. As he acknowledges that liability is an issue of international law, he implicitly assumes that international law and investment treaties substantiate foreign investors' rights when they are incomplete, vague or ambiguous.

Douglas is inconsistent when he claims that "[t]he law applicable to an issue relating to the existence or scope of property rights comprising the investment is the municipal law of the host state, including its rules of private international law."[105] Here he assumes that the content of foreign investors' rights should be defined according to the laws of the territory where the resources lie. To support this interpretation, he cites few examples where domestic law plays a role in the definition of ownership (e.g. the rights granted by a mortgage).[106] Yet, Douglas never considers the premise that ownership is inherently incomplete and very often requires further interpretation. As he moves forward in his analysis, he implicitly accepts – like most of the scholarship – that international law governs the substantiation of ownership, particularly when he affirms that "[t]he 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," including the doctrine of legitimate expectations.[107]

All in all, I endorse the opinion of Böckstiegel who claims that investment treaties have become a stronger force for internationalisation than the *pacta sunt servanda* principle.[108] The most indisputable evidence in this respect is that claimants and respondents rarely plead domestic law in treaty claims.[109] The use of investment treaties and international law to substantiate foreign investors' rights cannot be justified by pointing to the more developed or complete character of these legal orders. On the contrary, the IIR and international law are more rudimentary and incomplete,[110] the only exception being the significant recognition

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[105] *Ibid.*, p. 52.
[106] *Ibid.,* p. 55.
[107] *Ibid.,* p. 81.
[108] Cited in Spiermann, Ole, "Applicable Law," p. 101.
[109] *Ibid.*, pp. 92-94; Newcombe, Andrew and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment*, p. 88-90.
[110] Alvarez, José, *International Organizations as Law Makers*, New York: Oxford University Press, 2005, p. 463.

of the right to transfer funds.[111] In this context, the doctrine of legitimate expectations does not emerge as an undisputed and clear formula to substantiate foreign investors' rights, but rather as an interpretative method borrowed from some decisions in U.S. Takings Law and some cases and literature on European Administrative Law. As elaborated in Chapter 1, the substantiation of ownership is a matter of judicial or, in the case of the IIR, arbitral interpretation.

Conclusion

Thinking about the IIR along the lines of a constitutional property framework has allowed us to consider the importance of foreign investors' rights for the resolution of an investment dispute. In a constitutional property regime, private property rights and enforcement work jointly to provide the individual with protection against political risk. To balance political authorities, these regimes delegate to counter-majoritarian bodies the resolution of any claim concerning property deprivation. In the case of the IIR, I have stressed that foreign investors demand protection not only from political majorities but also from host country local interests. In addition, I have pointed that the IIR and constitutional property clauses define the problem of political risk, and provide the solution of compensation. I have particularly emphasised that the resemblance in the structure of these clauses extends to what they omit: the substance of the object of protection. Relying on the work of Michelman and Rose, I have underscored that the content of foreign investors' rights is nevertheless the starting point for resolving any constitutional property and investment dispute. Property scholars suggest that to begin answering this question we need to look into civil or private law sources. In the context of the IIR, however, this implies first finding the law applicable to foreign investors' rights. In this respect, I have shown that investment awards and the literature have assumed a form of *dépeçage* regarding foreign investors' proprietary rights. Whilst the commodification and allocation of property is governed by domestic law, the question of ownership is indeed more complicated. According to Douglas, domestic laws serve to define the content of

111 On the importance of this clause see Vandevelde, Kenneth, "Investment Liberalization and Economic Development: The Role of Bilateral Investment Treaties," 36 *Columbia Journal of Transnational Law* (1998), p. 522; Vandevelde, Kenneth, "The Economics of Bilateral Investment Treaties," 41 *Harvard International Law Journal* (2000), p. 489.

foreign investors' rights when they clearly define a right in the bundle. However, when ownership is incomplete, which is the rule and not the exception, most of the literature assumes that the substantiation of foreign investors' rights is an issue related to liability. Most authors thus agree that arbitrators should apply the doctrine of legitimate expectations in accordance with investment treaties and international law. As explained in Chapter 1, this formula is essentially an interpretative method, the proper examination of which requires exploring further the interpretations made by investment arbitrators.

CHAPTER 4 – THE INTERPRETATION OF FOREIGN INVESTORS' RIGHTS

Introduction

Substantiating foreign investors' rights is essential for resolving investment disputes. The application of any given law to determine the content of these rights will always face the problem that proprietary rights are not well defined in the legal order. In this context, most of the investment law literature considers that the appropriate solution is to apply the doctrine of legitimate expectations in accordance with investment treaties and international law. The debate in this regard has remained limited to the boundaries of this doctrine and the existing awards. However, as I argue here, the real debate is normative. Property scholars agree that what determines the interpretation of property rights is the political morality or comprehensive view of the adjudicators, and that this normativity is reflected in the justifications for the recognition and protection of private property. I rely on this premise to focus on the way investment arbitrators substantiate foreign investors' rights. Along these lines, I explore the justifications for foreign investors' rights and protection in the context of the IIR, arguing that these justifications are grounded in contractualist and neo-utilitarian rationales for private property, based on a global perspective of foreign investment. This means that the content and the protection of foreign investors' rights is justified by the individual position of the foreign investor and his labour, and by the neo-utilitarian claim that foreign investment can be beneficial for foreign investors and host states.

A. The interpretation of constitutional property and foreign investors' rights

The incomplete character of ownership often imposes on investment arbitrators the task of substantiating the proprietary rights allegedly denied by the host state. The need to make this type of interpretative effort is usual in a constitutional rights framework. As Dworkin remarks, the "characterization of the rights is formal, of course, in the sense that it does not indicate what rights people have or guarantee, indeed, that they have any."[1] In this sense, the most important feature of a

[1] Dworkin, Ronald, *Taking Rights Seriously*, London: Duckworth, 1994, p. xi.

constitutional property regime is not the provision of clarity regarding the constitutional boundaries of private property rights. On the contrary, the main feature of these regimes is that if the judiciary finds that the state has deprived the individual of their rights, a judge may decide to *override* the state measure. As I have shown in Chapter 3, the inclusion of a property clause in a constitution has consequences for the functioning of a democracy. Neither of these consequences, however, implies the creation of well-defined property rights. Precisely for this reason, Waldron criticises the authority of judges to revise decisions taken by majoritarian political bodies. He argues against recognising rights as trumps vis-à-vis state measures because it is not possible to define what type of state behaviour is arbitrary without first substantiating the content of the rights.[2]

The constitutional protection of private property, including foreign investment protection according to the IIR, does not say much about the substance of property rights. It could be possible that the adoption of a constitutional property clause or the conclusion of an investment treaty provides the main guidelines for the substantiation of proprietary rights. However, constitutional property regimes and the IIR belong to a long but also extremely diverse liberal tradition regarding proprietary rights. We find that although private property can be important for a community, such as in the United States, the case law in that country is characterised as a *muddle*.[3] From this lack of consistent judicial decisions, we may anticipate that the work of investment arbitrators will not be easy: if the judicial decisions in the United States are inconsistent, it is likely that this is the case in most countries and, as we know, it is in investment arbitration. In deciding investment disputes, then, investment arbitrators cannot follow a clear long-standing body of domestic legal antecedents. The reason is that such a body of cases does not exist.

In her analysis of takings decisions in the United States, Rose explains that the precise reason for this muddle is that judges have followed different normative approaches to interpret private property rights.[4] Her work shows that the main questions concerning expropriation disputes are not doctrinal. Ackerman makes a similar claim, arguing that "it is only after resolving certain philosophical issues that

[2] Waldron, Jeremy, *Law and Disagreement*, New York: Oxford University Press, 1999, pp. 245-246.
[3] Rose, Carol "Mahon Reconstructed: Why the Takings Issue is Still a Muddle," 57 *Southern California Law Review* (1984), pp. 561-599; Rose-Ackerman, Susan "Against Ad Hocery: A Comment on Michelman," 88 *Columbia Law Review* (1988), pp. 1697-1711.
[4] Rose, Carol "Mahon Reconstructed: Why the Takings Issue is Still a Muddle," pp. 594-597.

one can make sense of the constitutional question, let alone pretend to expound a correct constitutional answer."[5] Ackerman's work on constitutional property starts with the premise that judges decide takings cases according to a number of values that summarise their "comprehensive view" in relation to private property and the legal order.[6] He explains that this comprehensive view can be based on different rationales, such as a moral rationale or one based on Bentham's utility or Posner's efficiency.[7] As Ackerman stresses:

> "To put the point more generally, the constitutional text has been conceived as a mandate for the analyst to, first, impute a Comprehensive View to the legal system as to determine the substantive principles of just compensation and, second, work out those compensation rules that will further the Comprehensive View in all litigated cases involving the taking of property rights."[8]

The view of Rose and Ackerman is shared by other prominent property scholars in the United States. Michelman, for instance, affirms that

> "Judges adjudicating claims under the property clauses of the Constitution can answer [what is the content of private property] – as answer they must – only by attributing to the Constitution some political theory, some principle or principles of political morality, that it does not itself enunciate."[9]

The premise that follows from Dworkin, Rose, Ackerman and Michelman's work is that the characterisation of foreign investors' rights as trumps vis-à-vis host state measures is formal, and that the substance of these rights depends on the interpretation adopted by investment arbitrators. A discussion about the doctrinal boundaries of legitimate expectations would not reveal the general lines of this interpretation because the question investment arbitrators pose, and not only the

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[5] Ackerman, Bruce, *Private Property and the Constitution*, New Haven and London: Yale University Press, 1977, p. 5.
[6] *Ibid.*, p. 23
[7] *Ibid.*, p. 11.
[8] *Ibid.*, 29
[9] Michelman, Frank "Property as a Constitutional Right," 38 *Washington and Lee Law Review* (1981), p. 1099.

answers they provide, are shaped by the interpretation they follow.[10] In this sense, some property scholarship claims that the interpretation adopted by adjudicators is reflected in the justifications regarding private property rights. Waldron argues that "the ·conception of private property we adopt is not a matter of independent choice; it is the upshot of the arguments we are convinced by."[11] It is worth remembering that, for Waldron, the conception of private property relates to "what detailed rights, powers, liberties, immunities, and so on should be accorded to owners at the level of concrete legal rules."[12]

Briefly, there are two main lines of argument that inspire the recognition and protection of property rights: the philosophical/moral and the utilitarian/economic.[13] Dworkin develops the moral line of argument in his theory of rights. He explains that the principles of political morality that inspire the substantiation of rights relate to the recognition and protection of some aspects of the individual and his life.[14] Rights frameworks are a means of concretising these aspects, granting individuals rights that are valid against the entire world. Dworkin also recognises that rights can be justified by other rationales, in particular, goal-based rationales. Although he rejects utilitarian arguments,[15] these justifications are very significant for other schools of legal thought. Economic rationality, for instance, is a foundational principle of law and economics.[16]

Taking my lead from property scholars, I concentrate in the following sections on the dominant justifications for foreign investors' rights and foreign investment protection. I place the IIR within the different perspectives on property rights, considering how much importance this regime gives to foreign investors' labour, foreign investors' autonomy, the maximisation of preferences, and the socio-relational implications of private property.[17] It is worth noting that the line of argument I follow focuses much less on *where* arbitrators draw or should draw the line in investment disputes. Instead, I concentrate on *how* they draw the line between foreign investors' and host states' control over resources.

[10] Ackerman, Bruce, *Private Property and the Constitution*, p. 9.
[11] Waldron, Jeremy, *The right to private property,* Oxford: Clarendon Press, 1988, p. 433.
[12] *Ibid.*, p. 61.
[13] See Claeys, Eric, "Exclusion and Private Law Theory: A Comment on Property as the Law of Things," 125 *Harvard Law Review* (2012), p. 134.
[14] See Dworkin, Ronald, *Taking rights seriously*, London: Duckworth, 1994, in particular the introduction.
[15] *Ibid.*, pp. 172-177.
[16] Swedberg, Richard, "Max Weber's Contribution to the Economic Sociology of Law," CSES Working Paper Series Paper # 31, revised February 2006, pp. 16-17.
[17] See Waldron, Jeremy, *The right to private property*, pp. 3-16.

B. The origin of private property and foreign investors' rights

In this section, I discuss the influence of contractualist arguments on foreign investors' rights. I look at contractualist and libertarian accounts of the origin of private property, considering how they are reflected in the obsolescing bargain model (OBM) and in contractual commitment models. Contractualist thinkers such as Locke and libertarians such as Nozick locate themselves in an alleged state of nature in order to explain how individuals originally acquire private property by "mixing [their] labour" with virgin resources.[18] Essentially, for them, the juxtaposition of labour and things is what transforms virgin resources into private property. They conceptualise private property as a natural right justified by a moral principle that promotes respect for individual labour. In Waldron's words:

> "Natural rights to property are, on Locke's view, rooted in certain relations that some individuals happen to establish between themselves and certain things – in particular the relation of labouring on virgin resources."[19]

This line of argument is intimately related to the organising idea of private property systems. It legitimises the allocation of the resources to certain individuals, i.e. the ones who combine their labour with the resources. Those who follow contractualist and libertarian arguments employ this account of original acquisition (and subsequent legal transfers) as justification for the protection of so acquired private property rights. In this respect, Singer argues that "Robert Nozick's libertarian theory of the minimal state suggests that property rights are legitimate if they have their source in a just system of acquisition and then are freely transferred."[20]

In contrast to the peaceful account of original acquisition, contractualist and libertarians systematically describe coercion as a threat to the allocation of private property that took place in the past. They never associate coercion with either the acquisition of private property or the establishment of property rules. Scholars

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[18] Waldron, Jeremy, *The right to private property*, p. 177; Wenar, Leif, "Original Acquisition of Private Property," 107:428 *Mind* (1998), p. 808.
[19] Waldron, Jeremy, *The right to private property*, p. 20.
[20] Singer, Joseph, "Original Acquisition of Property: From Conquest & Possession to Democracy & Equal Opportunity," 86 *Indiana Law Journal* (2011), p. 766.

who follow this line of argument see private property as a natural right, the existence of which does not depend on civil organisation, and the extent of which should therefore not be modified by the state.[21] They argue, in fact, that the only reason to enter civil society is that in the state of nature property rights are fragile. As Locke affirms, "government has no other end but the preservation of property."[22]

Such an account of the original acquisition of property has been criticised from different perspectives. I want to highlight two points about its internal consistency and to outline the main realist criticisms. There is a problem concerning the consistency of the description of the state of nature. Waldron claims that the state of nature is either "harmonious and peaceful" or "disorderly and chaotic."[23] It seems inconsistent to describe every original acquisition of private property as a peaceful process, and characterise most subsequent modifications of these rights as coercive actions. In addition, as pointed out in Chapter 3, the contractualist account mistakes the kind of consent that gives rise to contractual promises for the form of consent that creates political obligations. Only the latter can create rights that are valid against everybody. For this reason, there cannot be a natural right to private property.[24]

Realist criticisms of the account of the original acquisition of private property raise two important points. First, there is the concrete point that the idea of resources with no owner suitable for original acquisition contradicts the premise of an enduring struggle for resources. The original acquisition of private property depends on the existence of a historical moment where there was no scarcity and no social conflict. As Singer explains, the problem with "the original possession idea is the unfortunate fact that most things already do have owners, and if you grab something originally possessed by someone else, then you are not a first possessor."[25] Second is the more profound realist claim that not only the allocation but also the laws that implement private property systems are the result of a broader political struggle. As Jhering explains, there is a "struggle for the

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[21] Epstein, Richard, *Takings: Private Property and the Power of Eminent Domain*, Cambridge, Massachusetts: Harvard University Press, 1985, pp. 19-25

[22] Locke, John, *Second Treatise of Government*, H. Davidson, (First published 1690) 1982, Section 94.

[23] Waldron, Jeremy, *The right to private property*, p. 167.

[24] Hart, H.L.A. "Are there any natural rights?," 64:2 *Philosophical Review* (1955), p. 186.

[25] Singer, Joseph, "Original Acquisition of Property: From Conquest & Possession to Democracy & Equal Opportunity," p. 764.

law."[26] This idea of political "warfare" implies that different actors struggle to take command of the rule-creating apparatus in order to create laws aligned with their interests.[27] Thus, realists argue that property laws are not natural but the result of this social and political struggle. Private property systems, therefore, institutionalise power relations.[28]

The account of the original acquisition of property, contractualism in general, and the criticisms briefly described above are very relevant to the IIR, perhaps even more than to any other constitutional property regime. International business and investment law scholars normally describe the acquisition of foreign investors' rights in contractual terms, using a contractual commitment model or the OBM.[29] The concept of credible commitments comes from new institutional economics,[30] and has been applied and adapted to the IIR by scholars such as Guzman and Van Aaken.[31] The key argument is that the commitments host states make to foreign investors lack credibility. Investment treaties solve this problem by outsourcing the enforcement of these commitments to investment arbitration. The OBM was developed in 1971 by Raymond Vernon, and has become a paradigm for most business studies of multinational corporations.[32] Salacuse explains that the OBM constitutes a central principle of the IIR, justifying foreign investment protection.[33] The OBM asserts that after a foreign investor establishes his project, his "bargaining power diminishes, and the commitments received risk becoming obsolete in the eyes of the host government."[34] In one way or another, the

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26 Jhering, Rudolf von, *The Struggle for Law*, (Translated by John Lalor), Chicago: Callaghan, 1879, pp. 1-28.

27 Foucault, Michel, *Society must be defended: lectures at the Collège de France, 1975-76*, London: Penguin, 2004, p. 15.

28 Richardson, James, "Contending Liberalisms: Past and Present," 3:5 *European Journal of International Relations* (1997), pp. 8-10.

29 Yackee, Jason, "Bilateral Investment Treaties, Credible Commitment, and the Rule of (International) Law: Do BITs Promote Foreign Direct Investment?," 42:4 *Law & Society Review* (2008), p. 807.

30 Henisz, Witold, "The Institutional Environment for Economic Growth," 12:1 *Economics and Politics* (2000), p. 1; Henisz, Witold and Oliver Williamson, "Comparative Economic Organization Within and Between Countries," 1:3 *Business and Politics* (1999), pp. 261-265; Henisz, Witold, "The institutional environment for multinational investment," 16:2 *Journal of Law, Economics & Organization* (2000), pp. 334-364.

31 Guzman, Andrew; Zachary Elkins and Beth Simmons, "Competing for Capital: The Diffusion of Bilateral Investment Treaties, 1960-2000," 60 *International Organization* (2006), pp. 811-846; Van Aaken, Anne, "International Investment Law between Commitment and Flexibility: A Contract Theory Analysis," 12 *Journal of International Economic Law* (2009), pp. 507-538.

32 Vernon, Raymond, *Sovereignty at bay: The multinational spread of U.S. enterprises*, London: Longman, 1971.

33 Salacuse, Jeswald, "The Emerging Global Regime for Investment," 51 *Harvard International Law Journal* (2010), pp. 450-451.

34 *Ibid.*, p. 451.

contractual commitment model and the OBM converge on the idea of political risk, which Comeaux and Kinsella have described as "the risk that the laws of the country will unexpectedly change to the investor's detriment after the investor has invested capital in the country, thereby reducing the value of the individual's investment."[35] Many popular investment law books begin with, concentrate or build on a perspective of foreign investor-host state relations based on this contractualist and political risk account.[36]

I will develop my arguments with reference to the OBM, although most of them are also be applicable to the contractual commitment model. The OBM divides foreign investor-host state relations into three stages.[37] First, it predicts that foreign investors will have the upper hand in the negotiation or pre-establishment stage due to the increasing economic power of multinational corporations, and state competition for foreign investment. Second, the OBM describes the moment of establishment as the conclusion of a *bargain* (or a contractual commitment) between the foreign investor and the host state. Finally, the OBM identifies a shift of power from foreign investors to host countries because states can amend the laws that govern resources. The risk that states will use this authority to the detriment of the foreign investor essentially constitutes what new institutional economists and business scholars describe as political risk.

In practice, only the last two stages of the OBM have been very influential in the IIR: i.e. the idea of a bargain and the risk that host states might breach this bargain. In this sense, there is a parallel between the account of the original acquisition of property and the OBM/contractual commitment models. In the first case, the sequence is: original acquisition, coercion and property owners' need for a civil society; in the second it is: bargain, political risk and foreign investors' need for the IIR. In terms of this parallel, the bargains between foreign investors and host states is described as the outcome of a fair and peaceful process through which

[35] Comeaux, Paul and Stephan Kinsella, "Reducing Political Risk in Developing Countries: Bilateral Treaties, Stabilization Clauses and MIGA and OPIC Investment Insurance," 15:1 *New York Law School Journal of International and Comparative Law* (1994), p. 4.
[36] Dolzer, Rudolph and Christoph Schreuer, *Principles of international investment law*, New York: Oxford University Press, 2008, pp. 3-7; Schill, Stephan, *The Multilateralization of International Investment Law*, New York: Cambridge University Press, 2009, pp. 3-5; Montt, Santiago, *State liability in investment treaty arbitration : global constitutional and administrative law in the BIT generation*, Oxford and Portland, Oregon: Hart Publishing, 2009, pp. 85-86; Sornarajah, M., *The international law on foreign investment*, Third Edition, New York: Cambridge University Press, 2010, pp. 69-70.
[37] Vernon, Raymond, *Sovereignty at bay: The multinational spread of U.S. enterprises*, p. 46; Vernon, Raymond, "Sovereignty at Bay Ten Years after," 35:3 *International Organization* (1981), pp. 521522; Salacuse, Jeswald, "The Emerging Global Regime for Investment," p. 451.

foreign investors acquire rights over the resources that bring about their investments. This way of argumentation constitutes a typical contractualist justification for foreign investment protection, based on the alleged legitimacy of the acquisition and any eventual transfer of the rights. In fact, strengthening the parallel, investment law literature often describes coercion as a strategy only pursued by host states after the establishment stage.[38]

Like the account of the original acquisition of private property, the OBM has been subject to two main objections. Before turning to these, we should note the internal inconsistencies of this model as it has become popular in the IIR. Most investment law literature disregards the fact that foreign investors often have more bargaining power than host states during the pre-establishment stage. States compete with each other to host foreign investment, and, even when the location is essential – such as in the case of resource-seeking investments – foreign investors appear to be able to exert significant pressure in very sensitive areas such as taxes.[39] The lack of interest shown by investment law literature in the dynamic of the negotiations implies that it has overlooked the possibility that the bargains, as the outcome of economic forces, could be tainted by unfairness or imbalance.

Turning to the main criticisms of the OBM, recent literature has cast some doubt on its validity and descriptive power of this model. These scholars suggest that the bargain would not obsolesce in some sectors. The operation of the obsolescing bargain essentially depends on the corporate ability to pose a threat of disinvestment.[40] More importantly, the same literature insists that the idea of a *bargain* itself may be inaccurate, since there is in fact a continuous negotiating process that begins before and extends beyond the moment of establishment.[41] This weakens the relevance of the bargain or contractual commitment in two different ways. First, there is no reason to assume that there will always be a formal bargain or agreement. The foreign investor can acquire rights over the

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[38] See Vagts, Detlev, "Coercion and Foreign Investment Rearrangements," 72 *The American Journal of International Law* (1978), pp. 17-36; Jones, Oliver and Chido Dunn, "Consent, Forced Renegotiation and Expropriation in International Law," 26:3 *Arbitration International* (2010), pp. 391–408.

[39] Avi-Yonah, Reuven, "Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State," 113 *Harvard Law Review* (2000), pp. 1573-1676; Wettstein, Florian, *Multinational Corporations and Global Justice. Human Rights Obligations of a Quasi- Governmental Institution*, Stanford: Stanford University Press, 2009, p. 236.

[40] Eden, Lorraine Stefanie Lenway and Douglas A. Schuler, "From the obsolescing bargain to the political bargaining model," in Robert Grosse, *International business and government relations in the 21st century*, New York: Cambridge University Press, 2005, pp. 255-256.

[41] *Ibid.*, pp. 267-269.

resources that make up his investment without relying on contractual commitments or vested rights. Second, this criticism rejects the short-term perspective in favour of a long-term and political approach to foreign investor-host state relations. This is based on the realist objection made by Macaulay to the traditional view of contracts as one-off events.[42]

The second line of criticism has concentrated on the partiality of many of the models, such as the OBM, developed by the international business literature from 1970 to the 1990s.[43] Many of the claims put forward by this scholarship are seen as being focused on the interests and the position of multinational corporations.[44] Arguably, if the business sector was asked to present its views about foreign investor-host state relations, it would probably choose to emphasise its weak position and host state political risk, disregarding its strong sides and corporate risks. Thus, host state political risk would acquire a higher importance than potentially unbalanced deals for developing or least-developed countries. Wettstein, in particular, claims that much of the literature focuses excessively on the activity of multinational corporations and the political risk that host states pose for these initiatives. The threats that multinational corporations pose to host states are therefore made secondary although they are just as valid as the risks for the investors (if not more). They include threats deriving from the increasing power of multinational corporations, such as disinvestment, and cultural and social risk.[45]

Overall, these criticisms illustrate the role that the *bargain* plays in the IIR. The origin of foreign investors' rights seems to strongly resemble the account of the original acquisition of property. In addition, the business and neo-institutionalist origin of the OBM and the credible commitment model explains the contrast that most of investment law literature observes between the freely concluded and mutually beneficial bargain, and host state political risk. This leads me to suggest that the OBM may be shaping foreign investors' rights in the same way that the original acquisition of property shapes private property. According to Wenar, the

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42 Yackee, Jason, "Bilateral Investment Treaties, Credible Commitment, and the Rule of (International) Law: Do BITs Promote Foreign Direct Investment?," pp. 810-811.

43 Wettstein, Florian, *Multinational Corporations and Global Justice. Human Rights Obligations of a Quasi-Governmental Institution*, pp. 169-171.

44 Eden, Eden, and Evan Potter, *Multinationals in the global political economy*, New York: St. Martin's Press, 1993, pp. 33-34.

45 Wettstein, Florian, *Multinational Corporations and Global Justice. Human Rights Obligations of a Quasi-Governmental Institution*, pp. 213, 216, 230; Turner, Louis, "The (A)political Multinational: State-Firm Rivalry Revisited", in J. M. Birkinshaw, S. Ghoshal, C. C. Markides, J. Stopford and G. Yip (Eds.), *The Future of the multinational company*, Chichester: Wiley, 2003, pp. 10-12.

"original appropriation theories […] seek to ground strong private property rights, which are the sorts of property rights that libertarians characteristically defend – that is, rights unqualified enough to call into question the legitimacy of the normal expropriative and regulatory powers of the modem state."[46]

C. The justifications for constitutional property and foreign investors' rights

Having considered the dominant views regarding the origin of foreign investors' rights, I will now concentrate on the main justifications for the recognition and protection of these rights, using the same methodology. I will introduce the main moral and economic rationales for the recognition and protection of private property, contrasting these views with the justifications for foreign investors' rights and foreign investment protection.

The most popular moral-based justifications for private property rights have been developed by scholars of the stature of Aristotle, Locke, Kant and Hegel. Following Waldron, I will divide these arguments into two main categories.[47] First, Locke, Nozick and Epstein justify private property through individual labour based on the original acquisition of property. These authors claim that private property protects the labour that the individual has invested in the resources.[48] In Nozick's view, property rights are worthy of protection "[e]ven if a private property economy is against the general interest."[49] As Waldron explains, this position constitutes a special-right-based argument for property. These are special arguments because they describe private property as rights whose existence depends on a contingent event under the control of the individual, i.e. original acquisition.[50]

Second, Aristotle, Hegel and Kant offer general-right-based justifications for private property.[51] These scholars justify property through the need to ensure a

[46] Wenar, Leif, "Original Acquisition of Private Property," p. 803.
[47] Waldron, Jeremy, *The right to private property*, pp. 127-136.
[48] *Ibid.*, pp. 140, 147, 156
[49] *Ibid.*, p. 128.
[50] *Ibid.*, pp. 108-109, 127-128. As Waldron explains, Locke's position is less extreme than Nozick's view given his recognition of a "general right to subsistence," *Ibid.*
[51] *Ibid.*, p. 129. On the social dimension in Kant and Aristotle, see, respectively, Dagan, Hanoch, "The Public Dimension of Private Property," *King's Law Journal* (forthcoming 2013); Zhu, Rui,

sphere of autonomy for every individual. They draw a connection between this sphere of autonomy, the wellbeing of individuals, and the constitution of a community in which individuals have certain characteristics that help them flourish. According to Waldron, "Hegel is concerned rather with a person's moral or spiritual interest in being in control of or responsible for some external object connected essentially with his well-being."[52] In addition, as Alexander explains, the Aristotelian approach relies on the premise that "[l]ife within a society and webs of social relationships is a necessary condition for humans to flourish, i.e., for their lives to go maximally well."[53] These are general-right-based arguments because the creation of property does not rest on the individual nor is he the only reason for its existence. In contrast to libertarians, these scholars recognise the interest of communities in the use of the resources, opposing the unqualified or absolute content of ownership. This position is held by scholars with different views – egalitarian, progressive and communitarian – regarding the social interest in private property. For this reason, it is difficult to summarise. If these scholars have something in common, however, it is that they show some interest in the socio-relational importance of private property rights. In this sense, their arguments converge somewhere close to the premise that "property regimes are located in and managed by communities."[54]

In spite of the relevance of this debate, the presently dominant justifications for private property rights are neo-utilitarian. Economic rationales have gained substantial importance since the emergence of intellectual movements such as law and economics, neoliberalism and new institutional economics. However, these economic insights regarding private property are not new. Bentham is the unquestionable pioneer of utilitarian justifications for private property. In the 19th century, he challenged the idea of natural private property rights, arguing nevertheless for strong private property rights because this would encourage individuals to work more hours and would thus create positive economic effects.[55] More recently, the importance of economic efficiency to justify private property

"Distinguishing The Public From The Private: Aristotle's Solution To Plato's Paradox," XXV:2 *History of Political Thought* (2004), pp. 238-242.

52 Waldron, Jeremy, *The right to private property*, p. 129.

53 Alexander, Gregory, "Property's Ends: The Publicness of Private Law Values," Cornell Law Faculty Working Papers, Paper 107 (2013), p. 5.

54 Rose, Carol, "Introduction: Approaching property," in *Property and Persuasion*, Colorado: Westview Press, 1994, pp. 3-4.

55 Waldron, Jeremy, *The rule of law and the measure of property*, Cambridge: Cambridge University Press, 2012, pp. 53-57.

has been stressed by neoliberal and new institutional economic scholars. According to this economic paradigm, individuals – and foreign investors in particular – are most efficient at creating wealth, whilst market transactions can address negative externalities better than states.[56] This intellectual movement therefore advocates more individual freedom and well-defined property rights.[57] These neo-utilitarian premises are complemented by scholars such as Hayek and Buchanan, who have developed a political theory and a vision of public law consistent with a smaller role of the state.[58] Economic efficiency is not necessarily in favour of absolute ownership because states may need to intervene in the case of negative externalities, which affects the private control of resources. Neoliberalism, however, promotes a limited state based on the proposition that "[g]overnment regulation is a substitute for civil law."[59]

Finally, before contrasting this with the justification for foreign investors' rights, I want to briefly mention the connection between preference maximisation and the "moral and political universe."[60] Rose claims that there is an intrinsic connection between protecting individual labour and promoting preference maximisation. She explains that the moral principle behind these two rationales advances similar values and goals.[61] In essence, the protection of individual labour constitutes a mechanism for maximising preferences. After the implementation of a private property system,

> "we are busily investing that time and energy in our own resources and thus making them more valuable […] In a property regime, we are better off because property rights encourage us to enhance resources instead of dissipating them."[62]

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56 Coase, Ronald, "The Problem of Social Cost," 3 *Journal of Law and Economics* (1960), pp. 42-44; Petsoulas, Christian, *Hayek's Liberalism and Its Origins: His Idea of Spontaneous Order and the Scottish Enlightenment*, London: Routledge, 2001. p. 2.
57 Coase, Ronald, "The Problem of Social Cost," p. 44.
58 Hayek, Friedrich, *The Constitution of Liberty: The Definitive Edition*, Chicago: University of Chicago Press 2011; Hayek, Friedrich, *The Mirage of Social Justice*, London: Routledge, 1976; Buchanan, James, *The Limits of Liberty: Between Anarchy and Leviathan*, Indianapolis: Liberty Fund, 1999.
59 Wittman, Donald, *Economic foundations of law and organization*, New York: Cambridge University Press, 2006, p. 125.
60 Rose, Carol, "'Takings' and the Practices of Property: Property as Wealth, Property as 'Propriety'," in *Property and Persuasion*, Colorado: Westview Press, 1994, p. 56.
61 *Ibid.*, pp. 49-70.
62 *Ibid.*, p. 54.

This reflection is important to my argument because the justification for foreign investment protection is based on the moral value of foreign investors' labour/contribution and the developmental effects of foreign investment.

Now, I will rely on this picture to assess the justifications provided by investment law literature for foreign investment protection. I begin where I ended in the previous section, stressing that the IIR describes foreign investors' rights as the outcome of peaceful and legitimate bargaining processes. The argument starts with the premise that foreign investors invest their labour and capital to carry out business projects. After establishment, the IIR focuses on political risk, granting foreign investment protection against subsequent events of coercion resulting from the use of host state sovereign powers. Indeed, the argument appears more persuasive in the context of the IIR not only because host states have the ability to amend laws but also since foreign investors cannot vote for representatives in host countries.[63] This claim of an *aggravated* political risk is also strengthened by the argument that foreign investors have less knowledge of the host social and business culture.[64] Paulsson affirms that "[w]hatever the rosy rhetoric about the equality of treatment of nationals and foreigners, the very fact of being foreign creates an inequality."[65]

This narrative of an aggravated political risk constitutes one of the leitmotifs of the international protection of foreign investment. Several investment awards explicitly follow this line of justification.[66] The tribunal in *Joseph Charles Lemire v Ukraine* (2011), for instance, put it in the following terms:

> "The different treatment between foreign and domestic investors is a natural consequence of a BIT. However, this unequal treatment is not without justification: justice is not to grant everyone the same, but *suum cuique tribuere*. Foreigners, who lack political rights, are more exposed than domestic

[63] Wälde, Thomas, "Procedural Challenges in Investment Arbitration under the Shadow of the Dual Role of the State: Asymmetries and Tribunals' Duty to Ensure, Pro-actively, the Equality of Arms," 26:1 *Arbitration International* (2010), pp. 3-42.
[64] Separate Opinion of Thomas Wälde in *Thunderbird Gaming Corporation v Mexico*, UNCITRAL (NAFTA), Award, 1 December 2005, at 33.
[65] Paulsson, Jan*, Denial of Justice in International Law*, New York: Cambridge University Press, 2005, p. 149
[66] *TECMED v Mexico*, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, at 122; *Azurix v Argentina*, ICSID Case No. ARB/01/12, Award, 14 July 2006, at 310-311; Separate Opinion of Thomas Wälde in *Thunderbird v Mexico*, UNCITRAL (NAFTA), Award, 1 December 2005, at 4, 12, 33, 57.

investors to arbitrary actions of the host State and may thus, as a matter of legitimate policy, be granted a wider scope of protection."[67]

However, the claim of an aggravated political risk contrasts with a world where multinational corporations have demanded and obtained a private international-based remedy. First, as early as 1974, the Group of Eminent Persons to Study Multinational Corporations acknowledged that "[a]ction by multinational corporations in the political field can take less direct and obvious forms" in both home and host countries.[68] Second, this narrative is inconsistent with contemporary views on democracy. Recently, Rosanvallon has convincingly argued that the political importance of voting and being voted for has decreased in most democracies. At the same time, he describes the influence that individuals have acquired through indirect means of governance typical of regulatory and surveillance structures.[69] In this vein, if we look at foreign investor-host state relations, we find that most multinational corporations are in permanent contact with state authorities and have much more influence on a wide variety of regulatory aspects than most domestic citizens. Thus, for instance, regardless of whether the host state breached the BIT in this particular dispute, we see in the conflict between *Saluka* and *The Czech Republic* (2006) a large multinational bank that discusses directly with host state authorities questions as essential as financial stability.[70] This arguably puts foreign investors in a privileged rather than a weak position.[71]

In addition, the *foreign* character of the investors has been used to justify their reduced responsibilities towards the host country. Traditionally, foreign investors are characterised as citizens of their home states, and this has served to minimise their social obligations regarding the host population. This line of argument emerges from the work of relevant scholars and several awards rendered until the

[67] *Joseph Charles Lemire v Ukraine*, ICSID Case No ARB/06/18 , Award, 28 March 2011, at 57.
[68] United Nations, "Report of the Group of Eminent Persons to Study the Role of Multinational corporations on Development and International Relations," New York: United Nations, 1974, p. 45.
[69] Rosanvallon, Pierre, *La contre-démocratie: la politique à l'âge de la défiance*, Paris: Éditions du Seuil, 2006, pp. 35-121.
[70] *Saluka v Czech Republic*, PCA—UNCITRAL, Partial Award, 17 March 2006, at 84-163.
[71] See Schneiderman, David, *Resisting economic globalization: critical theory and international investment law*, Basingstoke: Palgrave Macmillan, 2013, pp. 162-163.

early 2000s.[72] Relying on a decision of the European Court of Human Rights,[73] for instance, the *TECMED v Mexico* (2003) tribunal affirmed that

> "although a taking of property must always be effected in the public interest, different considerations may apply to nationals and non-nationals and there may well be legitimate reason for requiring nationals to bear a greater burden in the public interest than non-nationals."[74]

More recently, however, the idea of a global community, with its own values regarding the use of the resources, has been growing. Schreuer and Kriebaum recently advanced the idea that foreign investors are responsible to a global community. They claim that the use of the resources of different countries should be aligned with an idea of development that in the historical and political context of the IIR arguably relates to *global* preferences.[75] In this sense, not surprisingly, the responsibility of the foreign investor is limited to promoting the development of the host country, respecting global environmental and human rights standards.[76]

The idea that foreign investment promotes development constitutes the second and most important justification for the protection of foreign investors' rights.[77] The tribunal in *Amco Asia Corporation v Republic of Indonesia* (1983), for instance, stressed this justification when it affirmed that

72 Schwebel, Stephen, "Speculations on Specific Performance of a Contract between a State and a Foreign National," in *Justice in International Law*, Cambridge: Cambridge University Press, 1994 (originally published in 1964), pp. 421-422; Report by the American Branch of the International Law Association, "Report of The Committee on Nationalization of Property. A Response by The Committee on the Nationalization of Property of The American Branch to the questionnaire of The International Committee On Nationalization," (1957-1958), p. 67; Higgins, Rosalyn, "The Taking of Property by the State: Recent Developments in International Law," 176 *Recueil des Cours* (1982), p. 370; Kissam, Leo and Edmond K. Leach, "Sovereign Expropriation Of Property And Abrogation Of Concession Contracts," 28 *Fordham Law Review* (1959-1960), p. 189.

73 *Case of James and others v The United Kingdom*, (Application no. 8793/79), 21 February 1986, at 63.

74 *TECMED v Mexico,* ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, at 122*; Azurix v Argentina,* ICSID Case No. ARB/01/12, Award, 14 July 2006, at 310-311.

75 See Chapter 1, Section A; Chapter 2, Section A.

76 Schreuer, and Christoph Ursula Kriebaum, "From Individual to Community Interest in International Investment Law," in Ulrich Fastenrath, Rudolf Geiger, Daniel-Erasmus Khan, Andreas Paulus, Sabine von Schorlemer, and Christoph Vedder, *From Bilateralism to Community Interest Essays in Honour of Bruno Simma*, New York: Oxford University Press, 2011, pp. 1079-1096.

77 Rigo Sureda, Andrés, "Investment and Economic Development – The World Bank Connection," in Miguel Ángel Fernández-Ballesteros and David Arias (Eds.), *Liber Amicorum Bernardo Cremades*, La Ley, 2010, pp. 1033-1046. For a critical view of this position, see Sornarajah, M., *The international law on foreign investment*, pp. 48-60.

> "the [ICSID] Convention is aimed to protect, to the same extent and with the same vigour the investor and the host state, not forgetting that to protect investments is to protect the general interest of development and of developing countries."[78]

The history of investment protection, the ICSID and BITs is full of references suggesting that host states could attract more private foreign investment through the protection of foreign investors' rights, which would be beneficial for their development. In fact, this argument was explicitly incorporated into some awards in contractual claims at least ten years before the IIR boom of the 1990s. The tribunals in *TOPCO/CALASIATIC v Libya* (1977) and *Revere v OPIC* (1978) saw the economic development character of these agreements as the main justification for the internationalisation of concession contracts and the provision of recourse to international arbitration.[79]

The significance of the development argument is consistent with the popularity of neo-utilitarian justifications for property. By recognising and protecting foreign investors' rights we "tap [foreign investors'] energies in order to make [foreign investors and host states] more prosperous."[80] For this reason, it is difficult not to associate the popularity of neoliberal policies during the 1990s – which have an important neo-utilitarian component – with the boom that the IIR experienced in this period. Relevant investment law scholars, such as Thomas Wälde and Stephan Schill, explicitly rely on Hayek and on a substantive version of the rule of law to justify foreign investment protection and the interpretation of the FET standard.[81]

[78] *Amco Asia Corporation v Republic of Indonesia*, ICSID Case No. ARB/81/1, Decision on Jurisdiction, 25 September 1983, at 23. See also: *Siemens A.G. v. The Argentine Republic*, ICSID Case No. ARB/02/8, Decision on Jurisdiction, 3 August 2004, at 81; *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v Argentina*, ICSID Case No. ARB/97/3, Award, 20 August 2007, at 7.4.4.
[79] *TOPCO/CALASIATIC v Libya,* Award on the Merits, 19 January 1977, at 45; *Revere Copper & Brass, Inc. v Overseas Private Investment Corp.,* Award, 24 August 1978, 17 ILM 1321 (1978), at 1331.
[80] Rose, Carol, "Introduction: Approaching property," *Property and Persuasion*, Colorado: Westview Press, 1994, p. 3.
[81] Schill, Stephan, "International investment law and general principles," in J. Behring, T. Braun, R. Lorz, S. Schill, C. Tams and C. Tietje (Eds.), *General Public International Law and International Investment Law - A Research Sketch on Selected Issues*, The International Law Association, German Branch, March 2011, p. 19; Schill, Stephan, "Fair and Equitable Treatment, the Rule of Law, and Comparative Public Law," in Stephan Schill (Ed.), *International Investment Law and Comparative Public Law*, New York: Oxford University Press, 2010, pp. 158, 179-180; Wälde, Thomas, "The "Umbrella" (or Sanctity of Contract/Pacta sunt Servanda) Clause in Investment Arbitration: A Comment on Original Intentions and Recent," 4 *TDM* 4 (2004), p. 4; Wälde, Thomas and Abba Kolo, "Environmental Regulation, Investment Protection and 'Regulatory Taking' in International Law," 50 *The International and Comparative Law Quarterly* (2001), p. 823.

In contrast to the influential contractualist and neo-utilitarian justifications for foreign investors' rights, arguments focused on the socio-relational implications of property rights are much less relevant in the IIR. In recent years, some scholars that have criticised this regime from a public law perspective have tried to incorporate into it a less individualistic view of foreign investment protection. Van Harten, for instance, argues that the foreign investor-host state relationship is a "regulatory relation between state and individual, rather than a reciprocal relationship between juridical equals."[82] In theory, the influence of contractualist and neo-utilitarian justifications for foreign investors' rights reduces the ability of host states to take initiatives without paying compensation. If we look at Epstein's work, we find that the outcome of a strong libertarian view of property rights is that states should pay compensation for most initiatives. According to Epstein, state authority to pass measures without paying compensation is limited to a narrow view of the police powers doctrine.[83] I am certainly not claiming that investment arbitrators follow such an extreme approach. Nevertheless, as subsequent chapters of this thesis show, contractualism and neo-utilitarianism influence the interpretation of investment arbitrators. Thus, for instance, a neo-utilitarian justification for foreign investors' rights determines that the exercise of public authority needs to be expressed and justified by technical knowledge whatever the political preferences of the host population.[84]

Conclusion

This chapter has established the basis for exploring how investment arbitrators substantiate foreign investors' rights. The nature of my enquiry has been essentially normative. I have relied on authors such as Rose, Ackerman, Michelman and Waldron to explain that the substantiation of property rights is determined by the justifications for private property followed by the adjudicators. In this context, I have argued that foreign investors' rights are justified by contractualist and neo-utilitarian arguments for private property, which are

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[82] Van Harten, Gus, *Investment treaty arbitration and public law*, New York: Oxford University Press, 2007, p. 45. See also: see Schneiderman, David, *Constitutionalizing Economic Globalization. Investment Rules and Democracy's Promise*, New York: Cambridge University Press, 2008, pp. 9-13.
[83] Epstein, Richard, *Takings: Private Property and the Power of Eminent Domain*, pp. 106-160.
[84] See Rose, Carol, "A Dozen Propositions on Private Property, Public Rights, and the New Takings Legislation," 55 *Washington & Lee Review* (1996), p. 292.

described through a global perspective. The contractualist justification focuses on the position of the foreign investor, the act of investing in the host country, and the perception that host states may breach the alleged bargain or commitment. The neo-utilitarian rationale is based on the premise that foreign investment is beneficial for both foreign investors and host states. In essence, these two rationales constitute the normative foundations of the way investment arbitrators substantiate foreign investors' rights when applying the doctrine of legitimate expectations. I consider this claim further in Chapter 5.

CHAPTER 5 – THE CONCEPT OF INVESTMENT AS THE BASIS FOR FOREIGN INVESTORS' RIGHTS

Introduction

In this chapter, I consider how contractualism and neo-utilitarianism shape the content of foreign investors' rights. There is a consensus in property theory that the constitutional content of property rights depends on the political morality of the adjudicators. The literature refers to this premise in different ways: Ackerman relies on the comprehensive view of judges, Rose concentrates on the normativity, and Waldron claims that the interpretation is informed by the justifications for private property. In accordance with the claim that foreign investors' rights are justified by contractualist and neo-utilitarian rationales, I argue in this chapter that the basis for understanding the substantiation of foreign investors' rights is the concept of investment. I illustrate this argument by contrasting the substantiation of foreign investors' rights in both the diplomatic protection model and the IIR. There are important lessons we can learn from comparing the doctrine of acquired rights and the doctrine of legitimate expectations: mainly, that legitimate expectations are *investment-backed* expectations. I trace the origin and function of the concept of investment in investment treaties and investment arbitration, and show that the two are consistent with my claim that foreign investors' rights are shaped by contractual and neo-utilitarian justifications.

Against this background, I conclude by revisiting the concept of investment as the substantive basis for foreign investors' legitimate expectations. I argue that foreign investor-host state relations have been subject to a process of contractualisation, and that for home states, foreign investors and host states the *common* purpose of the IIR is wealth maximisation through foreign investment. I show that there is a clear connection between the act of investing and maximising wealth. Thus, as the existence of the IIR is justified by the premise that foreign investors are the most efficient at maximising wealth, I argue that investment arbitrators consider it reasonable to follow interpretative paths that increase the certainty of foreign investors. At the same time, I claim that this purpose can accommodate both foreign investors' expectations and the preservation of some host state authority to regulate in accordance with and limited by the recalibration process that the IIR has undergone since the mid-2000s.

A. Defining foreigners' proprietary rights

As an important pillar of my argument is that the IIR represents a departure from the traditional diplomatic protection model, the starting point of my analysis should be to compare and contrast the way in which international tribunals in the diplomatic protection model and the IIR have tackled the problem of the incomplete character of ownership. In his separate opinion in *Suez v Argentina* (2010), Nikken makes a thought-provoking point suggesting that the standards included in BITs (he refers in particular to FET) should be characterised as liability standards only.[1] He argues that FET "could never lose its essence as a standard of conduct or conduct of the State with respect to foreign investments, which should not automatically translate into a source of subjective rights for investors."[2] Nikken considers the fact that the Vienna Convention of the Law of Treaties does not support the incorporation of the doctrine of legitimate expectations.[3] In his view, BITs never mention the doctrine of legitimate expectations,[4] and this silence is consistent with the object of these treaties, which is to protect and promote foreign investment:[5] In addition, Nikken provides a historical account of the minimum standard of treatment (MST), presenting this standard as a liability rule only.[6] For these reasons, he affirms that "BITs contain a list of the States' obligations regarding their respective investments, not a declaration of rights for investors,"[7] concluding therefore that the doctrine of legitimate expectations does not arise from investment treaties.[8]

Nikken's position relates to the view presented in Chapter 3 regarding the textual structure of investment treaty standards, but casts some doubt on my argument that the IIR necessarily affects the substance of foreign investors' rights. In my view, his claim could only be correct if he explained how investment arbitrators

[1] *Suez and others v Argentina*, ICSID Case No. ARB/03/17, Separate Opinion of Pedro Nikken, 30 July 2010.
[2] *Ibid.*, at 19.
[3] *Ibid.*, at 3.
[4] *Ibid.*, at 2, 25.
[5] *Ibid.*, at 4.
[6] *Ibid.*, at 12-19.
[7] *Ibid.*, at 19.
[8] *Ibid.*, at 21, 38-40.

can solve foreign investment disputes without defining the content of foreign investors' rights. Nikken's position implies that during the diplomatic protection period judges and arbitrators did not employ a doctrine anchored in international law to address the inherent incompleteness of foreign investors' ownership. However, in his separate opinion Nikken overlooks that for the longest part of the 20th century tribunals and scholars linked the MST to the acquired rights doctrine.[9] In the next two subsections, I explain the function and content of the doctrines of acquired rights and legitimate expectations. The application of these doctrines (or any other that fulfils a similar function) confirms that any tribunal considering a constitutional property claim, either national or international, needs to substantiate the content of the individual's rights.

1. *The acquired rights doctrine and the diplomatic protection model*

As explained in Chapter 2, foreign investors and home states shared many interests during the period when the diplomatic protection model was the essential mechanism for protecting foreign-owned property. They were both interested in acquiring and controlling resources located in colonial territories and newly independent countries. During the 19th century in particular, the powerful states of Europe and the United States dedicated much of their efforts to securing the raw materials demanded by their privately managed industries. The strategy was to transplant private property systems into the domestic legal orders of the different territories, commodifying the resources, facilitating their allocation to foreign investors, and defining the sphere of private ownership. As Lipson explains, this period focused primarily on the recognition of private property rights through either the implantation of property systems in colonial territories or the exercise of political influence over Latin American countries.[10]

During this same period the MST consolidated as the keystone standard of the diplomatic protection model. The content of the MST is independent of host state legal orders. It relies instead on minimum criteria that domestic legal orders have

[9] See *Ibid.*, at 18-19.

[10] Lipson, Charles, *Standing Guard: Protecting Foreign Capital in the Nineteenth and Twentieth Centuries*, Berkeley: University of California Press, 1985, pp. 8-19; Frieden, Jeffry, "International investment and colonial control: a new interpretation," 48:4 *International Organization* (1994), pp. 559-560; Kennedy, Duncan, "Three Globalizations of Law and Legal Thought: 1850–2000," in David Trubek and Alvaro Santos, *The New Law and Economic Development : A Critical Appraisal*, New York: Cambridge University Press, 2006, pp. 22, 28.

to meet to comply with international law.[11] The MST includes a procedural and a substantive side. As Borchard explains, this field of international law was limited to the arbitrary use of host state authority and the deprivation of foreigners' rights.[12] Under the diplomatic protection model, host states would incur international responsibility if they behaved in an outrageous, egregious or shocking manner, or withdrew foreigners' rights.[13] International tribunals employed the MST to condemn host states for their procedural misbehaviour, and dealt with the deprivation of property through the prohibition of expropriation.[14]

The relevant question from a constitutional property perspective is how international judges and arbitrators substantiated the content of foreign-owned proprietary rights. An analysis of the decisions and scholarship during this period shows that this function was carried out by the acquired rights doctrine (sometimes referred to as the vested rights doctrine). This doctrine was recognised as an important part of the MST. In 1926, the PCIJ declared that "the principle of respect of vested rights forms part of generally accepted international law."[15] More than sixty years later, little seemed to have changed. In 1988, Asante affirmed that "[t]he fundamental premise for the international minimum standard governing the treatment of foreign property is respect for acquired rights."[16]

According to the literature, the essential purpose of this doctrine was to protect the content of foreigners' rights in accordance with domestic law. Cheng explains that

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[11] Spiermann refers to this approach as "Pacta sunt servanda as a Rationale of Applicable Law (Vertical Approach)," Spiermann, Ole "Applicable Law," in Muchlinski, Peter; Federico Ortino and Christoph Schreuer (Eds.), *The Oxford handbook of international investment law*, New York: Oxford University Press, 2008,pp. 98-99.

[12] Borchard, Edwin, "Minimum Standard Of The Treatment Of Aliens," 38:4 *Michigan Law Review* (1940), pp. 448-454.

[13] *Ibid.*, pp. 454-455; McLachlan, Campbell, "Investment Treaties and General International Law," 57 *International and Comparative Law Quarterly* (2008), p. 366.

[14] See The Norwegian Shipowners' Claims (*Norway v United States Of America*), Permanent Court of Arbitration, 13 October 1922; The Case concerning the Factory at Chorzów (*Germany v Poland*), PCIJ, 26 July 1927. On claims dealing with the minimum standard, see *L. F. H. Neer and Pauline Neer (U.S.A.) v United Mexican States*, 15 October 1926, Reports of International Arbitral Awards, Volume IV, pp. 60-66; *Walter H. Faulkner (U.S.A.) v. United Mexican States*, 2 November 1926, Reports of International Arbitral Awards, Volume IV, pp. 67-74; *Harry Roberts (U.S.A.) v. United Mexican States*, 2 November 1926, Reports of International Arbitral Awards, Volume IV, pp. 77-81.

[15] German Interests in Polish Upper Silesia Case (*Germany v Poland*), PCIJ, 1926, Series A, No. 7, p. 42.

[16] Asante, Samuel, "International Law and Foreign Investment: A Reappraisal" 37 *International and Comparative Law Quarterly* (1988), p. 595.

> "[t]he effect of this principle of respect for acquired rights is that rights of foreigners which are created under or recognised by the territorial law may not be abrogated unless in virtue of a permissible rule of international law."[17]

This is consistent with the position of Bouchard who concludes that "the primary source of the alien's rights [was] municipal law,"[18] and with the opinion of the PCIJ in the case of *Oscar Chinn* (1937).[19]

The work of García Amador as the United Nations Special Rapporteur on International Responsibility confirms the importance of domestic law to the substantiation of foreign investors' ownership, the function of the acquired rights doctrine, i.e. to define foreign investors' proprietary rights, and the international character of the acquired rights doctrine.[20] García Amador explains that

> "[p]aradoxical though it may be, international law has established the principle of respect of acquired rights without defining or systematically classifying the rights in question. This is to be explained in part by the fact that under international law private patrimonial rights, whatever their nature or the nationality of their possessor, are governed, in the absence of treaties or of certain contractual relations between States and specific aliens, by municipal legislation. Nevertheless, certain questions raised by the nature and content of 'acquired rights' are undeniably international in character, and many of those questions seem to have been resolved in practice."[21]

In the diplomatic protection model, then, international judges and arbitrators followed the doctrine of acquired rights in accordance with international law. They relied on the domestic property system as a default regime to substantiate foreign investors' proprietary rights. The exception to the rule was, as García Amador recognises, the existence of treaties or certain contractual relations.

Now, what requires further elaboration is why home states and foreign investors did not find this dependence on domestic law and property systems problematic.

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[17] Cheng, Bin, "The Rationale of Compensation for Expropriation," 44 *Transactions of the Grotius Society*, Problems of Public and Private International Law, Transactions for the Year 1958-59 (1958), p. 283.
[18] Borchard, Edwin, "Minimum Standard Of The Treatment Of Aliens," p. 448.
[19] The Oscar Chinn Case (*Britain v Belgium*), PCIJ, 1937, (Ser. A/B), No. 70, at 98-101.
[20] García Amador, F. V., "International responsibility. Fourth report.," A/CN.4/119, 1959, pp. 3-9.
[21] *Ibid.*, p. 9.

In my view, this attitude seems less paradoxical if we see the transplantation of private property systems and the consolidation of the diplomatic protection model as part of the same legal-historical process. The thread of this process was arguably substantive: the goal was to create an international-based regime capable of consolidating the level of control over the resources gained through the transplantation of private property systems. Many foreign investment projects were established under these laws.[22] Looking at the MST, the substantive element obviously did not lie in the prohibition of egregious treatment but in the acquired rights doctrine: host states could only modify the laws that were transplanted during previous periods of foreign influence paying compensation to any aggrieved foreigner. According to Anghie, during the decolonisation period the acquired rights doctrine in fact operated as a mechanism for maintaining the control that home states and foreign investors had over the resources of different countries.[23]

Thus, during the diplomatic protection model's peak period, the content of proprietary rights was less of an issue because private property systems and the principles that inspired them, including the acquired rights doctrine,[24] were relatively homogeneous. This situation was not only a result of the process of transplantation. Until the 1930s crisis, the laissez-faire paradigm supported a stronger Blackstonian view of private property all over the world.[25] According to this, host states were only expected to intervene with the individual use of resources "more or less in conformity with the principles derived from the conception of the liberal capitalist state."[26] In addition, the lack of intense debate in international law about the content of foreign-owned proprietary rights can be attributed to the interpretation of the MST being less stringent than the interpretation of FET and the same MST today. In reality, however, these two explanations are complementary since host states intervened less with property rights, and the acquired rights doctrine focused on the risk that host states would substantially modify the legal order that had granted foreigners control over the resources.

[22] Frieden, Jeffry, "International investment and colonial control: a new interpretation," pp. 559-560.
[23] Anghie, Antony, *Imperialism, Sovereignty and the Making of International Law*, New York: Cambridge University Press, 2004, pp. 213-214.
[24] García Amador, F. V., "International responsibility. Fourth report.," pp. 12-13.
[25] Kennedy, Duncan, "Three Globalizations of Law and Legal Thought: 1850–2000," p. 35; Weston, Burns, "The Charter of Economic Rights and Duties of States and the Deprivation of Foreign-Owned Wealth," 75 *The American Journal of International Law* (1981), p. 456.
[26] Fatouros, A, "International Law and the Third World," 50:5 *Virginia Law Review* (1964), p. 811.

As Anghie suggests, the acquired rights doctrine suited its time. The main concerns of international law were revolution scenarios – such as the Bolshevik or the Mexican Revolution – that aimed to change the legal order applicable to the control of resources.[27] The main backlash against the acquired rights doctrine occurred when it was perceived as a mechanism for blocking paradigmatic *changes* in host countries.[28] During the first half of the 20th century, the most relevant disputes related to generalised, non-discriminatory, expropriatory initiatives. In the case of the Mexican Agricultural Reform, for instance, there was little controversy regarding the fact foreigners owned property rights in accordance with the previous domestic legal order. Instead, the discussion was about the more intermediate issue of compensation amounts.[29] The Mexican case constitutes the historical origin of the Hull rule, i.e. "prompt, adequate, and effective" compensation, inaugurating a debate that was more forceful and longer than the objections to the acquired rights doctrine.[30]

2. *Legitimate expectations and the IIR*

The acquired rights doctrine can help us to understand the doctrine of legitimate expectations. The acquired rights doctrine was an essential element of the MST, whilst presently most arbitrators and scholars locate the legitimate expectations doctrine within the FET standard. Although there is still interest in the connection between the procedural sides of the MST and FET, the link between the acquired rights and the legitimate expectations doctrines has not attracted much attention. I argue that acquired rights were to the diplomatic protection model what legitimate expectations are to the IIR today: the two legal tools serve precisely to substantiate foreign investors' rights. For this reason, focusing on acquired rights and legitimate expectations can be illustrative. This comparison reveals some of the starting premises that presently guide investment arbitrators. At the same time, looking at the differences between these two doctrines allows us to grasp better the

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27 House of Representatives, "Report on the Expropriation of American-Owned Property by Foreign Governments in the twentieth century,"2 *International Law Materials* (1963), p. 1074.

28 Metzger, Stanley, "Private Foreign Investment and International Organizations," 22 *International Organization* (1968) , p. 290-291.

29 House of Representatives, "Report on the Expropriation of American-Owned Property by Foreign Governments in the twentieth century," pp. 1079-1081.

30 Lipson, Charles, *Standing Guard: Protecting Foreign Capital in the Nineteenth and Twentieth Centuries*, p. 78.

implications of legitimate expectations. My claim is that whilst the acquired rights doctrine aims to minimise host state ability to change the transplanted private property systems, the doctrine of legitimate expectations targets the risk of subtle state regulatory intervention. Arguably, these two objectives require a different legal reasoning when defining foreign investors' rights as the scope of ownership is a more sensitive question in the regulatory state.

According to McLachlan, the doctrine of legitimate expectations focuses on foreign investors' legitimate expectations

> "by reference to the law of the host State at the time of investment, together with any specific assurances which the investor received from the agencies of the host State upon which he relied in deciding to invest."[31]

McLachlan explains that the *TECMED v Mexico* tribunal (2003) was the first to apply the doctrine of legitimate expectations.[32] These arbitrators considered their duty to be to assess the exercise of state action against "the deprivation of economic rights and the legitimate expectations of [those] who suffered such deprivation,"[33] and that the FET standard,

> "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."[34]

As Fietta shows, the emergence of a trend in favour of protecting foreign investors' expectations can be found in earlier awards such as *Metalclad v Mexico* (2000), *CME v the Czech Republic* (2001) and *Feldman v Mexico* (2002).[35] Fietta explains that these tribunals referred to the "breaches of assurances that had been given by responsible state authorities."[36] Two important points emerge from Fietta's work. The first is that the incorporation of the doctrine of legitimate

[31] McLachlan, Campbell, "Investment Treaties and General International Law," pp. 376.
[32] *Ibid.*, pp. 376-377.
[33] *TECMED v Mexico*, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, at 122.
[34] *Ibid.*, at 154.
[35] Fietta, Stephen, "Expropriation and the 'Fair and Equitable' Standard," 23:5 *Journal of International Arbitration* (2006), pp. 379-381.
[36] *Ibid.*, p. 380.

expectations was a gradual process that began with the boom of the IIR and investment disputes at the beginning of the 2000s. This doctrine has become an essential element of the IIR, arguably as important as acquired rights were to diplomatic protection. As Von Walter affirms, the "scope and the extent of the rights associated with an investment may also depend, at least in part, on the legitimate expectations of the investor."[37] The second point is that although the doctrine of legitimate expectations has played some role in expropriation cases, it has been consolidated as an inherent element of the FET standard.[38] In this respect, Wälde affirms that

> "[o]ne can observe over the last years a significant growth in the role and scope of the legitimate expectation principle, from an earlier function as a subsidiary interpretative principle to reinforce a particular interpretative approach chosen, to its current role as a self-standing subcategory and independent basis for a claim under the 'fair and equitable standard' as under Art. 1105 of the NAFTA."[39]

I will now compare and contrast the substantive and the procedural content of the FET standard in the context of investment awards. In *Waste Management v Mexico* - number 2 (2004), the tribunal first considered that

> "the minimum standard of treatment of fair and equitable treatment is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional or racial prejudice, or involves a lack of due process leading to an outcome which offends judicial propriety."[40]

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37 von Walter, André, "The Investor's Expectations in International Investment Arbitration," 6:1 *TDM* (2009) ,p. 6.

38 Fietta, Stephen, "Expropriation and the 'Fair and Equitable' Standard," pp. 378-385.

39 *International Thunderbird Gaming Corporation v Mexico*, NAFTA - UNCITRAL, Thomas Wälde's Separate Opinion, 1 December 2005, at 37.

40 *Waste Management v Mexico* (Number 2), ICSID Case No. ARB(AF)/00/3, Final Award, 30 April 2004, at 98.

And immediately after this, it explained that "[i]n applying this standard it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant."[41]

These representations (or assurances in *TECMED v Mexico*) are the legitimate expectations that the host state would have frustrated through arbitrary behaviour.[42] Thus, for instance, referring to *CME v the Czech Republic*, Wälde highlights that

> "CME had a legitimate expectation that its legal position recognised by the Czech regulator would be maintained and not changed without bona 'fine' purpose, to undermine its business, in particular favouring domestic investors."[43]

In addition, in the awards in *Pope & Talbot v Canada* (2000) and *Merrill v Canada* (2010), a crucial legal issue was whether the foreign investor had an expectation of exporting his production (*Pope & Talbot*)[44] or enjoying the export/market price (*Merrill*).[45] Finally, in *Lemire v Ukraine* (2010), we can see the interaction between the procedural and substantive side of the FET standard. In the same paragraph of this award, the arbitrators first define foreign investors' legitimate expectations, i.e. the expectation that his business "would be allowed to expand," and then set them against host state behaviour, deciding that these expectations were frustrated through the "absence of reasoning," a suspicious "immediate decision" and the "lack of official information."[46]

These awards show that the doctrine of legitimate expectations, i.e. the substantive side of the FET standard, serves to substantiate foreign investors' rights. Subsequent investment awards have consistently affirmed that tribunals can

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[41] *Ibid*. Similarly, the arbitrators in *BG v Argentina* explain that the "commitments to the investor are relevant to the application of the minimum standard," *BG Group Plc. v Argentina*, UNCITRAL, Award, 24 December 2007 at 294, 294-297.

[42] For a list of the uses and entitlements that investment arbitrators have considered relying on the FET and the doctrine of legitimate see UNCTAD, "Fair and Equitable Treatment. A sequel," New York and Geneva: United Nations, 2012, pp. 39-43.

[43] *International Thunderbird Gaming Corporation v Mexico*, NAFTA - UNCITRAL, Thomas Wälde's Separate Opinion, 1 December 2005, at 39.

[44] *Pope & Talbot Inc. v Canada*, UNCITRAL – NAFTA, Interim Award, 26 June 2000, at 96.

[45] *Merrill & Ring Forestry L.P. v Canada*, UNCITRAL, ICSID Administered Case – NAFTA, Award, 31 March 2010, at 142, 150.

[46] *Joseph Charles Lemire v Ukraine*, ICSID Case No. ARB/06/18, Decision on Jurisdiction and Liability, 14 January 2010, at 371.

rely on the doctrine of legitimate expectations for this purpose. In this context, the debate has remained limited to whether or not foreign investors have effectively acquired an expectation. The award and subsequent annulment in *MTD v Chile* (2004 and 2007) illustrates this consensus and debate.[47] The two awards state that investment arbitrators can use the doctrine of legitimate expectations to determine whether the foreign investor owns an expectation, but differ on the criteria for defining these expectations. The Annulment Committee in *MTD v Chile* considered that

> "legitimate expectations generated as a result of the investor's dealings with the competent authorities of the host State may be relevant to the application of the guarantees contained in an investment treaty. This is expressly accepted by the Respondent and in the case-law."[48]

However, in the case under consideration, the issue was "more a question of application of the standard than it [was] of formulation."[49]

This view is confirmed by the commentary made by Gaillard,[50] which concludes that legitimate expectations have functionally replaced acquired rights in the reasoning of investment arbitrators:

> "L'attente de l'investisseur – ou, dans un jargon dans lequel l'usage du pluriel semble donner plus de force à chaque formule, 'les attentes' de l'investisseur – paraissent constituer la clé de voûte de tout le système. L'attente de l'investisseur semble ainsi jouer, au début du XXIe siècle, le rôle de formule incantatoire analogue à celle qui était réservée à la notion de 'droit acquis' au début du XXe."[51]

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[47] *MTD v Chile*, ICSID Case No. ARB/01/7, Award, 25 May 2004, at 114-115; *MTD v Chile*, ICSID Case No. ARB/01/7, Annulment decision, 21 March 2007, *at* 67-71.
[48] *Ibid.*, at 69.
[49] *Ibid.*, at 71.
[50] Gaillard, Emmanuelle, "Chronique des sentences arbitrales –Centre International pour le Règlement des Différends Relatifs aux Investissements (CIRDI)," *Revue trimestrielle Lexis Nexis Juris Classeur* (2008), pp. 332-334. See also: Wälde, Thomas and Kolo, Abba, "Environmental Regulation, Investment Protection and Regulatory Taking in International Law," 50 *International and Comparative Law Quarterly* (2001), p. 840 (Contrast this point with page 844 of the same article where the authors refer to legitimate expectations as equivalent of contractual commitments); Fortier, Yves and Stephen Drymer, "Indirect Expropriation in the Law of International Investment: I Know It When I See It, or Caveat Investor," 19:2 *ICSID Review– Foreign Investment Law Journal* (2004), p. 306.
[51] *Ibid.*, p. 332.

Similarly, in his dissenting opinion in *EnCana Corporation v Ecuador* (2005)*,* Grigera Naón affirms that:

> "Such expectations constitute an interest that, because having an economic, and even pecuniary, value is a form of ownership (or *derecho de propiedad*) under the Treaty."[52]

The conclusion that the acquired rights and the legitimate expectations doctrines fulfil the same function justifies looking more carefully at the similarities and differences between them. Both are enlightening. Acquired rights are intrinsically connected to private property rights, and the law that creates and substantiates these rights. As García Amador explains, the source of foreigners' rights was the legal order and international treaties and contracts. Conversely, legitimate expectations substantiate foreign investors' rights based on any representation and the conditions in the host state at the moment of establishment. The investment literature highlights the contractual approach that lies behind the doctrine of legitimate expectations. Spiermann stresses that this doctrine as applied by investment arbitrators implies a contractual argument.[53] Newcombe and Paradell, in addition, note that investment arbitrators systematically rely on principles such as good faith, estoppel and *pacta sunt servanda*.[54]

Arguably, these differences can be explained by history and political economy. I claim that there is a connection between the reasons for the emergence of the IIR, which I described in Chapter 2, and the application of a substantive doctrine of legitimate expectations. The IIR has evolved from initiatives of the international business sector to cope with a postcolonial world and the globalisation of economic activities by the last decades of the 20th century. The main challenge for foreign investors was that host states began employing regulatory techniques to control the use of resources. As early as the end of the 1970s, the possibility that host states would comprehensively modify their private property systems was

[52] *EnCana Corporation v Ecuador*, LCIA Case No. UN3481, Partial Dissenting Opinion by Horacio Grigera Naón, 30 December 2005, at 17.
[53] Spiermann, Ole, "Applicable Law" in Muchlinski, Peter; Federico Ortino and Christoph Schreuer (Eds.), *The Oxford handbook of international investment law*, New York: Oxford University Press, 2008, p. 95.
[54] Newcombe, Andrew and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment*, The Netherlands: Kluwer Law International, 2009, pp. 97-98.

replaced with the threat that they could pass subtle measures changing some of the conditions of the investment. The literature in international business began describing state regulation as the new form of intervention in multinational corporate activities.[55] Indeed, the legitimate expectations described above have a regulatory aspect in common.

Wälde highlighted this point in 2000 when he explained that foreign investors presently face regulatory risk, and that investment treaties "have a positive, but limited effect" in addressing this risk.[56] Vandevelde, a former U.S. BIT negotiator, held a similar opinion.[57] Indeed, when this form of risk was manifested in the disputes triggered by the 2001 Argentine crisis, foreign investors did not prevail on expropriation grounds. They did prevail, however, on the grounds of FET and the doctrine of legitimate expectations.[58] This outcome shows that the IIR has responded to the regulatory threat primarily through this doctrine.

This conclusion does not provide much detail about how investment arbitrators substantiate foreign investors' rights. This is because the doctrine of legitimate expectations is not a uniform formula. There is a distinction between procedural and substantive expectations, and the latter can be further divided into individual and vernacular expectations, depending on whether the adjudicator focuses on the position of the individual or the community. In this regard, Brown explains that the doctrine of legitimate expectations has been recognised in many domestic legal orders, but with significant differences, whilst some legal orders continue to reject it, embracing instead the acquired rights doctrine.[59]

In the context of the IIR, however, some elements allow us to trace the normativity that could be guiding the substantiation of foreign investors' rights

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[55] Andersson, Thomas, *Multinational investment in developing countries: a study of taxation and nationalization*, Routledge, New York, 1991, p. 3-22; Bergsten, C. Fred, Thomas Horst and Theodore H Moran, *American multinationals and American interests*, Washington D.C.: Brookings Institution, 1978, pp. 369-399.

[56] Wälde, Thomas and Stephen Dow, "Treaties and regulatory risk in infrastructure investment - the effectiveness of international law disciplines versus sanctions by global markets in reducing the political and regulatory risk for private infrastructure investment," 34 *Journal of World Trade* (2000), pp. 60, 4.

[57] Vandevelde, Kenneth, "Investment Liberalization and Economic Development: The Role of Bilateral Investment Treaties," 36 *Columbia Journal of Transnational Law* (1998), p. 522.

[58] These investment tribunals rejected the expropriation claim since foreign investors remained under control of their investments. See *National Grid Plc. v Argentina,* UNCITRAL, Award, 3 November2008, at 154; *CMS v Argentina,* ICSID Case No. ARB/01/8, Award, May 12, 2005, at 263; *Enron v Argentina*, ICSID Case No. ARB/01/3, Award, 22 May 2007, at 246; *LG&E v Argentina*, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, at 200.

[59] Brown, Chester, "The Protection of Legitimate Expectations as a General Principle of Law: Some Preliminary Thoughts," 5:2 *TDM* (2008), pp. 5-6.

through the doctrine of legitimate expectations. I argue that they relate essentially to the concept of investment, which implies a normative shift from the idea of property: the idea of investment describes a way of using resources to maximise wealth. In this line of argument, it is possible to observe a connection between the neo-utilitarian justifications for the IIR, the action of investing and the foreign investment itself, as the basis for foreign investors' legitimate expectations. After all, foreign investors claim to have *investment-backed* expectations.

B. Exploring the concept of investment: investment versus property

For my argument, it is important not to think about the concept of investment as something that is self-evident. Indeed, if we look at the evolution of international law, we can see that the concept of investment has had two important competitors: private property and natural resources. First, the diplomatic protection model has evolved into two main fields: international investment law and international human rights. Most international human rights treaties protect the right to private property and do not incorporate the concept of investment.[60] In addition, it is worth mentioning that human rights standards do not discriminate: they apply equally to both nationals and foreigners in relation to their private property rights. Second, the concept of investment had to compete with the notion of natural resources incorporated in two important U.N. Resolutions of 1962 and 1974. On one hand, there is an evident connection between the notion of permanent sovereignty over natural resources and the idea of private property.[61] On the other hand, this notion offers a perspective much closer to the preferences of host countries. The U.N. Resolution on the "Permanent sovereignty over natural resources" provides in Article 1 that

> "[t]he right of peoples and nations to permanent sovereignty over their natural wealth and resources must be exercised in the interest of their

[60] White, Robin and Clare Ovey, *Jacobs, White and Ovey: the European Convention on Human Rights*, Fifth edition, New York : Oxford University Press, 2010, pp. 477-505; Perrone, Nicolás, "Artículo 21. Derecho a la Propiedad Privada," in Enrique Alonso Regueira (Ed.), *La Convención Americana de Derechos Humanos y su proyección en el Derecho Argentino*, Buenos Aires: La Ley, 2013, pp. 355-370.

[61] Hyde, James, "Permanent Sovereignty over Natural Wealth and Resources," 50:4 *The American Journal of International Law* (1956), pp. 854-855.

national development and of the well-being of the people of the State concerned."[62]

A similar approach is taken by Article 2.1 of the Charter of Economic Rights and Duties of States, which establishes that "[e]very State has and shall freely exercise full permanent sovereignty, including possession, use and disposal, over all its wealth, natural resources and economic activities."[63]

However, the IIR emerged at the end of the 1950s and was consolidated in the 1990s as the dominant international legal regime governing foreign investor-host state relations regarding the resources of different countries. In particular, investment treaties substituted the concept of *investment* for the idea of foreign-owned property.[64] The proximate objective of investment treaties, as their name suggests, is the promotion and protection of foreign investment. As the tribunal in *Caratube International Oil v Kazakhstan* (2012) put it recently, "[t]he primary subject-matter of the BIT is the treatment of investment."[65] In brief, *investment* – and not proprietary rights – constitutes the object of protection and, hence, the basis of foreign investors' legitimate expectations.

In this context, it is necessary to consider the implications of the use of the concept of investment if we want to fully understand the transformation brought about by the IIR. To do this, we need to contrast the idea of property with the concept of investment. Private property rights are artefacts of the law that constitute the general rules of the economic game. These rights are valid against the entire world. In this sense, private property grants the individual who owns the resources the capacity to decide their use, whilst it imposes on everybody the burden of respecting this decision as final. However, the potential uses of the resources remain dependent on the content of the legal order. As explained in Chapter 1, the idea of property does not converge with a given purpose for the resources. Property has a plural character. This view is compatible with the lay

[62] U.N. General Assembly resolution 1803 (XVII) of 14 December 1962.
[63] U.N. General Assembly resolution 3281 (XXIX) of 12 December 1974.
[64] Bishop, R. Doak; James Crawford and W. Michael Reisman, *Foreign investment disputes cases, materials, and commentary*, The Hague: Kluwer Law International, 2005, p. 38; Vandevelde, Kenneth, "A Brief History of International Investment Agreements," 12 *University of California Davis –Journal of International Law and Policy* (2005-2006), p. 159; UNCTAD, "Scope and Definition," New York and Geneva: United Nations, 1999, p. 7-9; Hiscock, Mary "The Emerging Legal Concept of Investment," 27 *Penn State International Law Review* (2009), p. 770; Sornarajah, M. "Power and Justice in International law," 28 *Singapore Journal of International and Comparative Law* (1997), pp. 54-55.
[65] *Caratube International Oil Company LLP v Kazakhstan*, ICSID Case no ARB/08/12, Award, 5 June 2012, at 350.

definition of property, as found in *The Oxford Dictionary*: "a thing or things belonging to someone; possessions collectively."[66]

Conversely, investment is mainly an economic concept. Samuelson and Nordhaus define investment as "economic activity that forgoes consumption today with an eye to increasing output in the future."[67] Similarly *The Economist* explains investment as "Putting money to work, in the hope of making even more money."[68] This view is compatible with the lay meaning of the concept, again in *The Oxford Dictionary*, which defines investment as "the action or process of investing money for profit."[69] It is also compatible with the view of investment arbitrators. In *Caratube International Oil Company LLP v Kazakhstan*, for instance, the tribunal explained that

> "[t]he parties clearly refer in the preamble to investment understood as a flow of capital from the U.S. to Kazakhstan and vice versa as a flow of capital stemming from nationals and capitals of the respective parties."[70]

In contrast to the idea of property, the concept of investment incorporates a particular purpose into the protection of foreign investors' proprietary rights: *wealth maximisation*. Private property rights describe resources under individual control, whilst a private investment represents a group of individually controlled resources directed towards a business activity. This neo-utilitarian feature of the concept of investment is consistent with the use of the term *assets* in investment treaties to describe foreign investors' proprietary rights. The use of this term does not change the nature of the proprietary rights but adds to them features such as *useful* and *valuable*.[71] What should be stressed is that this neo-utilitarian purpose is not an inherent element of private property but a particular justification for these rights. The concept of investment strengthens neo-utilitarian justifications for foreign

[66] Oxford Dictionaries Online, http://oxforddictionaries.com/definition/english/property?q=property.
[67] Samuelson, Paul and William Nordhaus, *Economics*, Sixteenth Edition, New York: McGraw-Hill, 1998, p. 748.
[68] Bishop, Matthew, *Essential economics*, London: The Economist in association with Profile Books, 2004, p. 145 (definition of investment).
[69] Oxford Dictionaries Online, http://oxforddictionaries.com/definition/english/investment?q=investment..
[70] *Caratube International Oil Company LLP v Kazakhstan*, ICSID Case no ARB/08/12, Award, 5 June 2012, at 350, 349-350.
[71] See the definition of assets at the Oxford Dictionaries Online, http://oxforddictionaries.com/definition/english/asset?q=assets.

investors' rights, and also facilitates the influence of this normativity in the definition of these rights.

This neo-utilitarian rationale can also affect the proprietary character of the relationship between foreign investors and host states. Whilst property evokes the idea of general rules, the concept of investment refers to private actions that serve to carry out a business activity. These private actions can take different legal forms; however, only a few of them can modify general property rules (i.e. contractual commitments). Instead, the concept of investment focuses more on the actions, undertakings or dealings made by the foreign investor to materialise the investment. This rhetoric could shift the characterisation of foreign investor-host state relations away from property towards *contractualism*, increasing the emphasis on foreign investors' individual choices for the substantiation of their rights.[72]

Having said this, there is a significant obstacle to examining how the concept of investment could be linked to a contractualist and neo-utilitarian way of substantiating foreign investors' rights. Investment awards and scholarship have rarely focused on the substantive importance of this concept. However, this does not imply that the concept of investment has no place in international investment law: it is probably the most relevant jurisdictional requirement to access investment arbitration. In this procedural sense, there is a large consensus that investment arbitral jurisdiction is limited to claims referring to the underlying expectations regarding the use of resources, provided that the assets constitute an *investment*. Given that there is a level of interdependence between rights and remedies, it is reasonable to assume that there could be a connection between the procedural concept of investment and how investment arbitrators define foreign investors' *investment-backed* expectations. In the following subsections, I explore the history of the concept of investment in investment treaties, and the importance of this concept for the jurisdiction of arbitral tribunals. I focus in particular on the debate in the context of the ICSID Convention. This exploratory work is necessary for laying the foundations of a substantive concept of investment.

[72] For a similar argument in the domain of corporate law, see Joo, Thomas, "Contract, Property and the Role of Metaphor in Corporations Law," 35 *UC Davis Law Review* 35 (2002), pp. 805-811.

1. The concept of investment in international investment treaties

After the celebration of the first BIT in 1959, the international law regarding the protection of foreign-owned property began to change. Amongst these changes, the substitution of the concept of investment for the concept of property has been very influential – influential enough at least to justify re-baptising the whole field as international investment law. Unfortunately, there is scarce evidence of the drafters' intentions because "the negotiation history of BITs is typically not documented."[73] For this reason, the legal tools provided by Article 31 of the Vienna Convention of the Law of Treaties are insufficient to understand the reasons for the inclusion of the concept of investment in BITs.

The main antecedents of BITs are also not very helpful. Most of the literature refers to the Abs-Shawcross draft as the main inspirational source for BITs.[74] This draft has many elements in common with the first agreements, but the concept of investment is only referred to once, in the title. The wording of the Abs-Shawcross draft consistently refers to "the property of the nationals of the other Parties." In addition, Lauterpacht explains in the Foreword to Schreuer's ICSID Commentary that the OECD Draft Convention on the Protection of Foreign Property – commissioned in 1960 and approved in 1967 – carried forward a more general initiative "for the protection of international investment."[75] This draft is also considered to be a source of modern investment treaties. However, again, it constantly uses the concept of property. The concept of investment is only included three times in reference to "investment of funds" (Article 1, b), "investment of capital" (Article 9, c, ii), and "property acquired or investment made" (Article 13). As opposed to these two major precedents, the first investment treaty between Germany and Pakistan does include the concept of investment throughout the text. This trend was followed by every subsequent BIT signed by a European nation.[76] In addition, at the end of the 1960s, all BITs had

[73] Schreuer, Christoph, "Diversity and Harmonization of Treaty Interpretation in Investment Arbitration," 2 *TDM* (2006), p. 9.
[74] Amongst others, Dolzer, Rudolph and Christoph, Schreuer, *Principles of international investment law*, New York: Oxford University Press, 2008,pp. 18-19.
[75] Lauterpacht, Elihu, "Foreword," in Christoph H. Schreuer, Loretta Malintoppi, August Reinisch and Anthony Sinclair (authors), *The ICSID Convention: A Commentary*, Second Edition, New York: Cambridge University Press, 2009, p. ix.
[76] The first agreements signed by Germany (with Pakistan in 1959), Belgium and Luxembourg (with Tunisia in1966), Denmark (with Indonesia in 1968), Italy (with Guinea in 1964), and the United Kingdom (with Egypt in 1975) refer to investments and make no or minor use of the concepts of

evolved towards today's dominant template, concentrating on the treatment of *investment* and referring to it as a variable number of *assets*.[77] This expansion of the concept of investment contrasts with the much slower diffusion of investment arbitration, for instance, which was only incorporated in a BIT by the end of the 1960s.[78]

This convincingly points to the importance of the concept of investment but says little about the reason for this relevance. The academic analysis of investment treaty drafting follows two lines of argument to explain the inclusion of the concept of investment. First, some scholars see this strategy as an attempt to include a broader set of assets, i.e. types of property rights, into the scope of protection. Otherwise, the protection of new forms of property rights (such as intellectual property intangibles) could have faced objections under domestic property laws.[79] The case of intellectual property illustrates the rationale for this argument. When developed countries built or influenced the foundations of domestic property rights in periphery countries, some of them did not have strong intellectual property rights – the United States is a good example. For this reason, when these developed countries decided to protect this new form of property, they had to exercise political influence to commodify ideas. BITs may appear to be a reasonable strategy to achieve this goal, although, as I have shown in Chapter 3, these treaties have rarely been used to commodify resources.

An alternative, consistent description of the role that the concept of investment could be playing adheres more closely to the economic and business meaning of this concept. This view highlights the replacement of the static notion of property with the more dynamic concept of investment, which implies a certain duration, movement, growth and return.[80]

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property or rights. The first treaty signed and ratified by France falls under the same category (with Zaire in 1972). The first treaties signed by Switzerland (with Tunisia in 1961), The Netherlands (with Tunisia in 1963) and Sweden (with Côte d'Ivoire in 1965) make primary use of the concept of investment, but also rely on the notions of property and rights. It may be worth mentioning, however, that the latter also include trade and navigation clauses.

77 Switzerland completely substituted the concept of investment for the notion of property and rights in 1971, after signing treaties with The Republic of Korea and Uganda. The same did Sweden in 1978, after concluding the treaty with Egypt, and The Netherlands in 1968, after entering into the treaty with Indonesia.

78 Newcombe, Andrew and Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment*, The Netherlands: Kluwer Law International, 2009, p. 44.

79 UNCTAD, "Scope and Definition," pp. 7-9; Sornarajah, M, *The international law on foreign investment*, Third edition, New York: Cambridge University Press, 2010, pp. 11-18.

80 Bishop, R. Doak; James Crawford and W. Michael Reisman, *Foreign investment disputes cases, materials, and commentary*, p. 38; Juillard, P., "L'évolution des sources du droit des investissements,"

The impact of these elements in the definition of foreign investors' rights has not been the subject of any systematic study. However, I have indicated here the importance that the concept of investment has gained at the jurisdictional level. Many scholars and arbitrators have explicitly drawn a connection between the dynamic features of the concept of investment and the measure of arbitral jurisdiction according to BITs.[81] This constitutes an important shift from the diplomatic protection model where the mere existence of foreign-owned property was enough for the home state to exercise diplomatic protection.[82] Although the role of the concept of investment in jurisdictional questions still divides investment scholars, the dominant position and the current debate show that investment arbitrators consider foreign investment to be qualitatively different to property (quantity or value are not defining elements of the concept of investment).[83] Next, I will expand my analysis of the concept of investment to the ICSID Convention, in relation to which the jurisdictional debate has been particularly important.

2. *The concept of investment and the ICSID Convention*

The debate about the concept of investment in the ICSID Convention began before its text was concluded and has remained open ever since.[84] It is therefore important to point out that I do not intend to fully describe let alone answer this question. My goal is to understand what is at stake in this discussion. I focus on the incorporation of the concept of investment as the key to accessing ICSID arbitration, and the methodology and arguments that investment arbitrators follow to contrast the economic operation of the project with the concept of investment

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250 *Recueil des cours* (1994), 9-216, p. 24; Carreau, Dominique and Patrick Juillard, *Droit international Économique*, Third Edition, Paris: Dalloz, 2007, pp. 416-417 (paragraphs 1171-1173).

81 Gaillard, Emmanuel, "Identify or Define? Reflections on the Evolution of the Concept of Investment in ICSID Practice," in C. Binder, U. Kriebaum, A. Reinisch and S. Wittich (Eds.), *International Investment Law for the 21st Century: Essays in Honour of Christoph Schreuer*, New York: Oxford University Press, 2009, p. 407; Douglas, Zachary, *International Investment Claims*, New York: Cambridge University Press, 2009, pp. 162, 189-191.

82 See, for instance, *Mexico City Bombardment Claims (Great Britain) v United Mexican States*, Decision No. 12, February 15, 1930, Reports of International Arbitral Awards, Volume V, pp. 76-90. This case concerned with "A. The claims of Walter Ralph Baker, Archibald William Webb, Herbert John Woodfin and George J. W. Poxon, all residents in the Hostel of the Young Men's Christian Association, for having lost property when the Hostel was occupied by troops. B. The claim on behalf of Daniel John Tynan for losses suffered when, as a result of a bombardment, a fire was started in his house and his property destroyed," p. 76.

83 See Mortenson, Julian, "The Meaning of 'Investment': ICSID's Travaux and the Domain of International Investment Law," 51:1 *Harvard International Law Journal* (2010), pp. 257-318.

84 UNCTAD, "Scope and Definition: A Sequel," New York and Geneva: United Nations, 2011, pp. 48-66.

provided by the Convention. In reality, the ICSID Convention does not define this concept. According to Article 25, its jurisdiction simply "extend[s] to any legal dispute arising directly out of an investment." However, as opposed to the scarce or negligible evidence on the drafting of investment treaties, the *travaux préparatoires* of the ICSID Convention provide several insights into the function and meaning of the concept of investment. Consequently, most of the research that deals with the concept of investment begins with and concentrates on the ICSID's antecedents.

The evidence shows that the World Bank wanted to open the ICSID facility to disagreements "concerning legal rights, contractual rights, or property rights, rather than political or commercial disputes."[85] The authorities of the bank had two concerns regarding the scope of jurisdiction. On one hand, they wanted to cover a large variety of disputes, but on the other hand, they aimed to leave aside political and commercial claims. The concept of investment represented a middle ground that served to leave these two categories outside the jurisdiction of ICSID.[86] Indeed, this emerges as the most adequate choice in light of the reasons that triggered the emergence of BITs and the ICSID Convention. As opposed to legal rights, the concept of investment is related to the idea of a private contribution to the host country's development.[87] Arguably, promoting private investment for development sounded more palatable to host states than protecting foreign-owned property and home state interests.

The promoter of the Convention, Aron Broches, clearly stated that he did not intend to incorporate any definition of the concept of investment. In his mind, access to the ICSID should remain as flexible as possible; only foreign investor and state consensus should govern the jurisdiction of the Centre. In addition, he thought that any agreement over the concept of investment and the jurisdictional scope of the Convention was going to be very difficult to reach. During the drafting process, however, many delegates expressed their preference for some sort of definition. In this context, two main proposals were considered.[88]

[85] Mortenson, Julian, "The Meaning of 'Investment': ICSID's Travaux and the Domain of International Investment Law," p. 282.
[86] *Ibid.*
[87] Parra, Antonio, *The History of ICSID*, Oxford: Oxford University Press, 2012, pp. 21-24.
[88] Schreuer, Christoph; Loretta Malintoppi, August Reinisch and Anthony Sinclair, *The ICSID Convention: A Commentary*, pp. 82-83, 114.

The first proposal defined investment as "money or other assets of economic value for an indefinite period or, if the period be defined, for not less than five years."[89] This description referred to assets, and included a minimum five-year period that would have operated as a jurisdictional requirement because the Convention was not intended to govern the existence or validity of foreign investors' rights. The fact that a foreigner invested only for two years would not have deprived him of his domestic property rights. It would simply have meant that his contribution did not amount to a foreign investment, and, hence, he had no access to ICSID arbitration. Thus, we can see the distinction between assets, and assets that would qualify as an investment and a contribution to development (i.e. assets invested for five or more years).

However, some delegates did not accept this definition because it was too imprecise.[90] Judging from the proposal later made by the Secretariat, I suggest that they demanded greater precision regarding the legal measure of jurisdiction. The Secretariat suggested the following text:

> "the term 'investment' means the acquisition of (i) property rights or contractual rights (including rights under a concession) for the establishment or in the conduct of an industrial, commercial, agricultural, financial or service enterprise; (ii) participations or shares in any such enterprise; or (iii) financial obligations of a public or private entity other than obligations arising out of short-term banking or credit facilities."[91]

The similarity of this list to the typical BIT structure is striking.[92] According to the Secretariat's proposal, ICSID jurisdiction would only have applied when foreign investors acquired property, contracts, shares or financial obligations. The ICSID Convention was not intended to define the object of protection, i.e. foreign investors' rights, which content would emerge from the applicable legal order. Nonetheless, this draft could have affected the justifications for foreign investors' property rights, describing their acquisition as "for the establishment or in the

[89] *Ibid.*, p. 115.
[90] *Ibid.*
[91] *Ibid.*
[92] A similar template can be found in the BITs signed between The Netherlands and Indonesia (1968), Switzerland and Korea (1971), and Germany and Iran (1968). It is worth stressing that this drafting trend is subsequent to the conclusion of the ICSID Convention.

conduct of an industrial, commercial, agricultural, financial or service enterprise." On one hand, this qualification would have obviously left some cases out of the scope of the ICSID, but on the other hand, it is difficult not to connect this purposive characterisation of the rights with some principles of political morality concerning the substantiation of these rights.

In the end, none of these alternatives prevailed. The Executive Directors of the World Bank supported the original view of Broches, explaining in the final report that "[n]o attempt was made to define the term investment."[93] Even though or perhaps because the ICSID Convention has not included a definition of investment, ICSID tribunals have been discussing the meaning of this concept as a limitation on their jurisdiction since the earliest cases.[94] In the context of investment treaty claims, there have been two main positions. Some arbitrators have given prominence to the consent provided in the investment treaty. In the Annulment decision in *CMS v Argentina* (2007), the arbitrators noted that

> "Article 25 of the ICSID Convention did not attempt to define 'investment.' Instead this task was left largely to the terms of bilateral investment treaties or other instruments on which jurisdiction is based."[95]

However, an important number of awards consider the concept of investment in the ICSID Convention to have a relevant meaning. In general, these decisions have relied on the premise that an investment implies a *contribution* to the host economy.[96] In *Fedax N.V. v. Republic of Venezuela* (1997), the arbitrators considered that

> "The basic features of an investment have been described as involving a certain duration, a certain regularity of profit and return, assumption of risk,

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93 Mortenson, Julian, "The Meaning of 'Investment': ICSID's Travaux and the Domain of International Investment Law," p. 292.

94 See *Holiday Inns S.A. v Morocco,* ICSID Case No. ARB/72/1, Decision on Jurisdiction, 23 September 1974. This award is unpublished but it has been analysed in Lalive, Pierre, "The First World Bank Arbitration (*Holiday Inns v Morocco*)—Some Legal Problems," 51 *British Yearbook of International Law* (1980), p. 123.

95 *CMS v Argentina*, ICSID Case No. ARB/01/8, Annulment Decision, 25 September 2007, at 71. Similarly, *Biwater Gauff (Tanzania) Ltd. v Tanzania*, ICSID Case No. ARB/05/22, Award, 24 July 2008, at 314.

96 Dolzer, Rudolph and Christoph, Schreuer, *Principles of international investment law*, pp. 60, 66-67; Gaillard, Emmanuel, "Identify or Define? Reflections on the Evolution of the Concept of Investment in ICSID Practice," pp. 403-407.

> a substantial commitment and significance for the host State's development."[97]

In addition, investment arbitrators have relied on the preamble of the Convention that characterises an investment as a contribution to the host state's economic development.[98] The first award incorporating this element was *Salini v Morocco* (2001):

> "The doctrine generally considers that investment infers: contributions, a certain duration of performance of the contract and a participation in the risks of the transaction [...]. In reading the Convention's preamble, one may add the contribution to the economic development of the host State of the investment as an additional condition."[99]

Subsequent decisions that give some relevant meaning to the concept of investment are not consistent regarding the characteristics of foreign investors' contributions. For those tribunals and scholars who follow the *Salini* test, the investment needs to constitute a substantial contribution for development. Other scholars and arbitrators follow a similar approach but criticise the substantial character of the contribution to development.[100] Finally, a third group regards the economic development of the host state as "not necessarily an element of the investment."[101] For the purposes of my analysis, however, the most important objective is to stress the characterisation of the investment as a contribution, and to identify the way in which investment arbitrators' assess the legal and economic materialisation of an investment. In this sense, as Schreuer illustrates in his commentary, arbitrators follow the theory of the unity of the investment

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[97] *Fedax N.V. v. Republic of Venezuela*, ICSID Case No. ARB/96/3, Decision on Jurisdiction, 11 July 1997, at 43.

[98] Gaillard, Emmanuel, "Identify or Define? Reflections on the Evolution of the Concept of Investment in ICSID Practice," pp. 404-407.

[99] *Salini Costruttori S.p.A. v. Kingdom of Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction, 31 July 2001, at 52.

[100] Douglas, Zachary, *International Investment Claims*, , p. 198; *Pantechniki S.A. v Albania,* ICSID Case No. ARB/07/2, Award, 30 July 2009, at 36-49.

[101] *Electrabel S.A. v Republic of Hungary*, ICSID Case No. ARB/07/19, Decision on Jurisdiction, Applicable Law and Liability, 30 November 2012, at 5.43.

operation.[102] Schreuer describes this theory by citing the award in *CSOB v Slovakia* (1999):

> "An investment is frequently a rather complex operation, composed of various interrelated transactions, each element of which, standing alone, might not in all cases qualify as an investment. Hence, a dispute that is brought before the Centre must be deemed to arise directly out of an investment even when it is based on a transaction which, standing alone, would not qualify as an investment under the Convention, provided that the particular transaction forms an integral part of an overall operation that qualifies as an investment."[103]

Additionally, in a different publication, Schreuer and Kriebaum explain that

> "[w]hen determining the existence of an 'investment', tribunals have emphasized repeatedly that what mattered was not so much ownership of specific assets but rather the combination of rights that were necessary for the economic activity at issue."[104]

According to Douglas, similarly, the existence of an investment needs to be assessed against the *entire* commitment of resources.[105] The rationale for this rule is simple: foreign investors' cause of action would hardly refer to all the assets that constitute the business project. The venture may include a property right over land and a permit to cultivate crops but the dispute itself may refer to foreign investor's entitlement to use underground waters to irrigate the crops.

A corollary of these awards and the scholarship is that the concept of investment includes the assets, circumstances and conditions that are necessary to carry out the concrete economic activity. The assets that make up an investment are defined as a contribution because of the neo-utilitarian purpose, i.e. the assumption of risk

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102 Schreuer, Christoph; Loretta Malintoppi, August Reinisch and Anthony Sinclair, *The ICSID Convention: A Commentary*, pp. 108-112.
103 *CSOB v The Slovak Republic*, ICSID Case No. ARB/97/4, Decision on Jurisdiction, 24 May 1999, at 72. Similarly, *Enron v Argentina*, ICSID Case No. ARB/01/3, Decision on Jurisdiction, 2 August 2004, at 70; *Duke v Peru*, ICSID Case No ARB/03/28, Decision on Jurisdiction, 1 February 2006, at 119-134.
104 Schreuer, Christoph and Ursula Kriebaum, "The Concept of Property in Human Rights Law and International Investment Law," p. 18.
105 Zachary Douglas, *International Investment Claims*, pp. 161-170.

and the expectation of a benefit. Investment arbitrators also look at the dealings, i.e. the actions of foreign investors that have served to materialise the investment. All these elements are *bundled* together because of, and in accordance with, a plan to maximise wealth. Thus, it is easier to relate the business project to the legislative and regulatory conditions that permit carrying out the foreign investment.[106]

All in all, the concept of investment gives a broader meaning to the idea of regulatory risk. Regulatory risk represents more than the possibility that host states may change the regulations. It denotes the risk of losing significant business advantages essential for the investment.[107] "Regulations, after all, rule out certain privately profitable behavior that a political or social perspective deems undesirable."[108] If the doctrine of legitimate expectations deals with regulatory risk, then it is reasonable to conclude that this doctrine – like the concept of investment – binds together business expectations and regulatory conditions.

C. Revisiting the concept of investment as the basis for foreign investors' legitimate expectations

The objective of this section is to build a framework explaining what guides investment arbitrators when defining foreign investors' legitimate expectations. The concept of investment is key to my argument because it describes the contractualist and neo-utilitarian rationales that not only justify the existence of the IIR but also – as I will demonstrate – shape the content of foreign investors' rights. I will rely on two conceptual bases to build this framework: Alexander's work on purposive interpretation in constitutional property, and Rose's insights regarding the connection between contractualist and neo-utilitarian justifications for private property. Alexander describes purposive interpretation in constitutional property as the approach that focuses on the "core purpose of constitutional protection of property, identifying the central constitutional value that such heightened protection is intended to serve, and asking whether that value is

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106 See Akbar, Yusaf, *The multinational enterprise, EU enlargement and Central Europe: the effects of regulatory convergence*, Chippenham and Eastbourne: Palgrave, 2003, pp. 48-49.

107 Coe, Jr., Jack and Noah Rubins, "Regulatory Expropriation and the Tecmed Case: Context and Contributions," in Todd Weiler (Ed.) *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law*, London: Cameron May, 2005, p. 624.

108 Encarnation, Dennis and Louis Wells, "Sovereignty en garde: negotiating with foreign investors," 39 *International Organization* (1985), 67.

immediately at stake under the circumstances before it."[109] In this respect, I will show that the core value of the IIR is intrinsically related to the concept of investment, i.e. wealth maximisation though foreign investment.

In addition, I will rely on Rose's claim regarding the argumentative connection between contractualist and neo-utilitarian justifications for private property.[110] Rose argues that if we justify property rights based on individual labour, we are promoting wealth maximisation through private initiative. Individual labour as the core value of a property system strengthens private property rights vis-à-vis host state authority. I claim that something similar happens if we justify foreign investors' rights and foreign investment protection through the OBM and a contractual commitment model, i.e. we are promoting wealth maximisation through foreign investors' initiatives. In this regard, I argue that what labour represents to Locke's theory of property, the action of investment represents to the IIR and the justifications for foreign investors' rights. This essentially means contractualism: foreign investors' legitimate expectations emerge at the moment of investment, and are closer to an individual-special than to a vernacular-general paradigm of rights.[111]

I will develop my framework starting with the contractualist side of my claim. In this respect, the connection between the concept of investment and the OBM and the contractual commitment model is present in investment awards. Investment arbitrators describe foreign investors' legitimate expectations as an outcome of the *bargaining-establishment* process. From this perspective, foreign investors decide to make the contribution, the first part of the bargain, and host states offer a series of legal and regulatory conditions, the second part of the bargain. The temporal element of this claim is systematically corroborated by investment awards: legitimate expectations emerge at the moment of establishment or at any later moment if there is a subsequent investment decision.[112] The arbitrators in *LG&E v Argentina* (2006) put it in the following terms: "It can be said that the investor's fair expectations have the following characteristics: they are based on the

[109] Alexander, Gregory, *The global debate over constitutional property: lessons for American takings jurisprudence*, Chicago: University of Chicago Press, 2006, p. 215.
[110] Rose, Carol, "'Takings' and the Practices of Property: Property as Wealth, Property as 'Propriety'," in *Property and Persuasion*, Colorado: Westview Press, 1994, pp. 49-70.
[111] See Chapter 4, Section C; Waldron, Jeremy, *The right to private property*, Oxford: Clarendon Press, 1988, pp. 127-136.
[112] Schreuer, Christoph and Ursula Kriebaum, "At What Time Must Legitimate Expectations Exist?" in Jacques Werner, Arif Ali (Eds.), *A Liber Amicorum: Thomas Wälde*, London: CMP Publishing Ltd, 2009, pp. 265-276, 269.

conditions offered by the host State at the time of the investment."[113] Furthermore, the moment of investment is the right parameter for exploring the legitimacy and reasonableness of the expectation. The tribunal in *Duke v Ecuador* (2008) explained that "[t]o be protected, the investor's expectations must be legitimate and reasonable at the time when the investor makes the investment."[114]

This way of thinking about legitimate expectations represents a contractual approach to foreign investor-host state relations. Investment arbitrators following this line of thought assume that foreign investors, by investing, can shape the rules that define their control over the resources. To define foreign investors' rights, this legal reasoning begins by looking at the individual position of foreign investors who consider different locations with the intention of achieving their goals (i.e. maximise wealth and their profit). The argument is that after allegedly considering the conditions offered by all the potential locations, foreign investors take a rational decision to establish themselves in the host country based on "the undertakings and assurances given in good faith to such aliens as an inducement to their making the investment."[115]

The influence of this contractual approach has been recently stressed by Reisman:

> "If there is one constant systemic implication in every application of international investment law, it is *pacta sunt servanda*: it is the maintenance of the belief in all relevant parties that the legitimate expectations of qualified investors based on legal commitments by states are meaningful and will be enforced. No more!"[116]

The *contractualisation* of foreign investor-host state relations describes an establishment-bargain scenario where the parties make, as Reisman suggests, legal commitments to each other. However, the declarations that host states make to induce foreign investors to invest are not presented as contractual commitments or

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[113] *LG&E v Argentina*, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, at 130; *BG Group Plc. v Argentina*, UNCITRAL, Award, 24 December 2007, at 298.
[114] *Duke v Ecuador*, ICSID Case No. ARB/04/19, Award, 18 August 2008, at 340.
[115] *Revere Copper & Brass, Inc. v Overseas Private Investment Corp.*, Award, 24 August 1978, 17 *ILM* 1321 (1978), at 1331. Similarly, *CME v The Czech Republic*, UNCITRAL, Partial Award, 13 September 2001, at 611; *BG Group Plc. v Argentina*, UNCITRAL, 24 December 2007, at 343-344, 409.
[116] Reisman, Michael, "Case Specific Mandates' versus 'Systemic Implications': How Should Investment Tribunals Decide? - The Freshfields Arbitration Lecture," 29:2 *Arbitration International* (2013), p. 151.

vested rights.[117] Inducement to invest, and not host state willingness to enter into a contractual commitment, appears to be the basis for legitimate expectations. Otherwise, the legal argument would be straightforward: the enforcement of contractual commitments has never depended on the application of the doctrine of legitimate expectations. The systemic importance of the moment of investing supports this view. On one hand, foreign investors and host states often enter into a number of contractual commitments to materialise the foreign investment. These contractual commitments may be executed a little before, at the moment of or after the investment: what matters here is the date of the contract. On the other hand, as mentioned in Chapter 4, these two actors frequently do not finalise concrete deals despite having been in formal and informal contact regarding a given project. Thus, declarations to induce investment that do not materialise in contractual commitments represent the scope of application of the doctrine of legitimate expectations.

The influence of this contractualist way of reasoning can be seen by looking at the importance that factual interpretation has in investment awards, in particular, regarding the application of the FET standard.[118] Facts are important to contracts – and much less to property – because they help to interpret and situate the individual choice that constitutes the contract. However, if we leave aside contractual commitments, the intensive reliance on facts could be due to foreign investments not always materialising in contracts or the contract not covering all the conditions that are necessary to carry out the investment. Arguably, investment arbitrators pay a lot of attention to facts because they rely on putative bargains in fact[119] or on hypothetical bargains[120] made in accordance with the doctrine of legitimate expectations.

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117 See Schill, Stephan, "Fair and Equitable Treatment, the Rule of Law, and Comparative Public Law," in Stephan Schill (Ed.), *International Investment Law and Comparative Public Law*, New York: Oxford University Press, 2010, p. 175.

118 Muchlinski, Peter, *Multinational enterprises and the law*, Oxford; Cambridge, Mass.: Blackwell Publishers, 1995, p. 625; Mann, Francis, "British Treaties for the Promotion and Protection of Investments," 52 *British Yearbook of International Law* (1981), pp. 241-244; *Spyridon Roussalis v Romania*, ICSID Case No. ARB/06/1, Award, 7 December 2011, at 318; *Merrill & Ring Forestry L.P. v Canada,* UNCITRAL, ICSID Administered Case – NAFTA, Award, 31 March 2010, at 210; *Joseph Charles Lemire v Ukraine*, ICSID Case No. ARB/06/18, Decision on Jurisdiction and Liability, 14 January 2010, at 284; *Siag and Vecchi v Egypt*, ICSID Case No ARB/05/15, Award, 1 June 2009, at 450.

119 "[T]he content of 'the bargain in fact,' is a factual issue," Zamir, Eyal, "The Inverted Hierarchy of Contract Interpretation and Supplementation," 97:6 *Columbia Law Review* (1997), pp. 1720, 1718.

120 Charny, David, "Hypothetical Bargains: The Normative Structure of Contract Interpretation," 89 *Michigan Law Review* (1991), p. 1815-1879.

In the context of the IIR, Wälde elaborates the reasons for following this contractual approach. He argues that focusing on foreign investors' actions at the moment of establishment increases their *certainty* regarding the control of the resources, and facilitates the fulfilment of their expectations. In his separate opinion in *Thunderbird v Mexico* (2005), Wälde explicitly links the importance of certainty in the interpretation of FET and the doctrine of legitimate expectations:

> "Investors need to rely on the stability, clarity and predictability of the government's regulatory and administrative messages as they appear to the investor when conveyed – and without escape from such commitments by ambiguity and obfuscation inserted into the commitment identified subsequently and with hindsight. […] Investors lack clairvoyance and need to make rapid decisions on the basis of the way facts are and can reasonably be perceived at the time they become known – not the way they appear after years of litigation."[121]

Wälde's position is relevant not only because of the prominence of his work but also since this is one of the few occasions where an arbitrator has tackled the purposive question directly. Kläger explains that

> "the fact-driven approach of arbitral tribunal often goes to such lengths that, in an award, the description of the facts is expatiated in dozens of pages, while the doctrinal concept of fair and equitable treatment is touched, if at all, in very few paragraphs. Excluding some enlightening explanations [Wälde's separate opinion], arbitrators obviously do not want to go out on a limb in such a shaky and controversial area as the doctrinal concept of fair and equitable treatment."[122]

The view promoted by Wälde represents a substantive rule of law along the lines described by Waldron in his Hamlyn Lecture, i.e. as a way to substantiate property

[121] *International Thunderbird Gaming Corporation v. The United Mexican States,* UNCITRAL, Thomas Wälde's Separate Opinion, 1 December 2005, at 5 and 47

[122] Kläger, Roland, *Fair and Equitable Treatment' in International Investment Law*, New York: Cambridge University Press, 2011, pp. 115-116.

rights.[123] The connection between Wälde's position and a substantive rule of law can be found by looking at the work of Bingham. Discussing the rule of law, Bingham argues that "[n]o one would choose to do business […] involving large sums of money, in a country where parties' rights and obligations were undecided."[124] To reach this conclusion, Bingham relies on Lord Mansfield's position that "[i]n all mercantile transactions the great object should be certainty."[125] Not only is this the same normative basis for Wälde's position, but he also cites a decision rendered by Lord Mansfield in 1761, in which he affirmed that "[t]he daily negotiations and property of merchants ought not to depend upon subtleties and niceties, but upon rules easily learned."[126]

The connection between a business planning narrative, such as the OBM, and the idea of certainty is also explored by Brower in his work on narratives and investment law. Brower claims that investment awards have developed a "business planning narrative," although he recognises that this narrative later evolved into a "guarantee of incremental protection."[127] He characterises the narrative of the first period as aimed towards "the enhancement of predictability," and the narrative of the second as paying increasing attention to "the preservation of regulatory space for host states." In my view, the best description of Brower's work is by Cheng:

> "Professor Brower does not, however, rely on personal stories to construct narratives. Interestingly, the more traditional narratives about protecting commercial bargained-for exchanges and about maintaining sovereign rights to domestic regulation are constructed by referring to familiar modes of legal reasoning in traditional legal materials. He canvasses dicta in the decisions of arbitral awards to construct the following story: Initially, investment treaty law supported bargained-for investment protections and expectations of investors for a stable investment environment insulated from regulatory

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123 Waldron, Jeremy, *The rule of law and the measure of property*, Cambridge: Cambridge University Press, 2012.

124 Bingham, Tom, *The rule of law*, London; New York : Allen Lane, 2010, p. 38.

125 Lord Mansfield in Vallejo v Wheeler (1774) 1 Cowp 143 (cited by Bingham at page 38.)

126 Lord Mansfield in *Hamilton v Mendez* (1761) 2 Bur. 1214 (cited by Wälde, see footnote 47).

127 Brower, II, Charles, "Corporations as Plaintiffs Under International Law: Three Narratives about Investment Treaties," 9 *Santa Clara Journal of International Law* (2011), pp. 196-197.

> interference; recently, however, it has given increasing weight to the legitimate desire of governments to protect their domestic authority."[128]

The work of Brower confirms the existence of a strong contractual approach in the substantiation of foreign investors' rights, suggesting however a recent decline in this trend. He explains this shift on the basis of the recalibration process undergone by the IIR since the mid-2000s. This process of recalibration was a gradual recognition that investment arbitration has public impacts, and that host states need to regulate their economies.[129] Arguably, a possible implication of this process could be the lesser influence of the business planning narrative and the contractual approach on foreign investor-host state relations. However, I will explain below why this is not the case. In fact, I will rely on this explanation to develop my second argument in this section, that the purpose of the IIR is wealth maximisation through foreign investment, and this purpose influences the substantiation of foreign investors' rights.

I suggest that Brower may have overstated the importance of this new narrative focusing on the preservation of host state regulatory space. The description that Brower gives of the recalibration narrative relies on the treaty strategy, not investment awards, of states such as Canada, the United States and Norway (the latter model was never implemented).[130] This trend is obviously important but it provides only the views of the respondents in investment disputes. When it comes to investment awards, Brower develops his claim based on three cases all against the United States, i.e. *Loewen* (2003), *Methanex* (2005) and *Glamis* (2009).[131] The circumstances surrounding the *Loewen* case[132] and the fact that he relies only on cases against the United States weakens Brower's claim of a *paradigmatic* shift from a business planning to a police or regulatory power narrative. This does not question the actual existence of a recalibration process, yet it casts some doubt on a much stronger claim that the main narrative of investment awards has moved its

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128 Cheng, Tai-Heng, "Developing Narratives in International Investment Law," 9 *Santa Clara Journal of International Law* (2011), p. 218.

129 Alvarez, José, "Why are We Re-calibrating our Investment Treaties?," 4:2 *World Arbitration & Mediation Review* (2010), pp. 143-161.

130 Brower, II, Charles, "Corporations as Plaintiffs Under International Law: Three Narratives about Investment Treaties," pp. 192-96.

131 *Ibid.*, pp. 191-192.

132 See Stumberg, Robert, "Reform of Investor Protections. Review of the Model U.S. Bilateral Investment Treaty," U.S. Department of State & Office of the U.S. Trade Representative, July 29, 2009, p. 6.

focus to the "preservation of host state authority to regulate," which even contradicts the objective of the IIR to protect foreign investment.

Instead, I submit that the business and the regulatory narratives coexist in investment awards. The recalibration process constitutes the emergence of a narrative acknowledging that certainty needs to have some limitations. After the *Methanex* and *Glamis* cases were decided, in fact, other investment tribunals continued to recognise the importance of certainty and predictability for foreign investors. In the award in *Suez v Argentina* (2010), for instance, the arbitrators affirmed that "a recognized goal of international investment law is to establish a predictable, stable legal framework for investments."[133]

The recognition of these two *coexisting* narratives in the IIR is an important step in identifying a more comprehensive value that constitutes the present purpose of the IIR. The assumption is that investment arbitrators' interpretations are guided by a core value – and not by an attitude that favours either business or host state interests. In accordance with Alexander's work on purposive interpretation, the identification of this core value is an essential element in understanding how investment arbitrators substantiate foreign investors' rights. The core value of the IIR needs to accommodate both the business planning and regulatory narratives. Looking at the constellation of potential common values in the IIR, I suggest we should focus on the concept of investment. Although foreign investment protection is a demand of foreign investors only, the promotion of foreign investment is a common goal of home states, host states and foreign investors. This goal is obviously a means and not an end in itself. The ultimate end is wealth maximisation through foreign investment.

There is a consensus in the literature regarding the need to both support business expectations and preserve some state regulatory goals. In his review of an important part of the literature on international investment law, Schill recognises that the mainstream literature has set aside the political economy question to concentrate on the doctrinal aspects of the IIR.[134] He mentions that the work of Van Harten and Schneiderman reacted against this trend, pointing to the public issues that were involved in these disputes.[135] Schill explains that according to the

[133] *Suez and others v Argentina*, ICSID Case No. ARB/03/17, Decision on Liability, 30 July 2010, at 189.

[134] Schill, Stephan, "W(h)ither Fragmentation? On the Literature and Sociology of International Investment Law," 22:3 *The European Journal of International Law* (2011), pp. 884-885.

[135] *Ibid.*, p. 894.

mainstream literature, the work of these two authors "did injustice to the concern of investment treaty arbitration and investment law to provide a neutral, independent, and impartial forum for the resolution of disputes between foreign investors."[136] He claims that his own work and that of Montt constitute a different approach, sensitive to both the governance impact and benefits brought about by the IIR.[137] Schill and Montt's main argument is that the IIR promotes the rule of law as it is apparently embodied in the laws of most developed countries.[138] Schill is probably the investment law scholar who has most strongly advocated an interpretation of FET that is aligned with a substantive rule of law.[139] As Sornarajah recently put it, Schill's position inspired by Global Administrative Law presently dominates the IIR and the process of recalibration.[140]

A good summary of this position and the views that inspire it can be found in Montt's recommendation that

> "the BIT generation must work in tandem with the regulatory state – not against it. This regulatory state is a fundamental dimension of modern life; like it or not, it is a key player in the pursuit of collective goals that include, but also transcend, efficiency and maximisation of wealth."[141]

That Schneiderman's criticism is compatible with Montt's view is evidence of the influence of this position in the IIR. Schneiderman claims that this regime is an attempt to "institutionalize a model of constitutional government intended primarily to facilitate the free flow of goods, services and persons […] that places substantive limits on state capacity in matters related to markets."[142] In addition, he argues that the World Bank explicitly connects the principles of rule of law and

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136 *Ibid.*, p. 899.
137 *Ibid.*, p. 899-902.
138 *Ibid.*, pp. 900-901; Montt, Santiago, *State liability in investment treaty arbitration: global constitutional and administrative law in the BIT generation*, Oxford and Portland, Oregon: Hart Publishing, 2009, pp. 366-374. Montt's views are more nuanced that Schill's. See pp. 23, 77, and 374.
139 Schill, Stephan, "International investment law and general principles," in J. Behring, T. Braun, R. Lorz, S. Schill, C. Tams and C. Tietje (Eds.), *General Public International Law and International Investment Law - A Research Sketch on Selected Issues*, The International Law Association, German Branch, March 2011, pp. 13-30; and Schill, Stephan, "Fair and Equitable Treatment, the Rule of Law, and Comparative Public Law," pp. 152-183.
140 Sornarajah, M., "Starting anew in international investment law," 74 *Columbia FDI Perspectives*, 16 July 16 2012.
141 Montt, Santiago, *State liability in investment treaty arbitration: global constitutional and administrative law in the BIT generation*, p. 374
142 Schneiderman, David, *Constitutionalizing Economic Globalization. Investment Rules and Democracy's Promise*, New York: Cambridge University Press, 2008, p. 2.

good governance as "institutional supports that protect property and markets from 'arbitrary government action."[143] Thus, leaving aside the normative disagreement between these scholars, I claim that both provide a similar description of the IIR in which the purpose of this regime is wealth maximisation through foreign investment.

In this respect, it is important to stress that Montt's view – as well as the view of the recalibration process – implies a rejection of the idea that BITs freeze host state legal orders, and a recognition that changes need to be consistent with foreign investors' rights because this is necessary to attain wealth maximisation. This attitude highlights the influence of a substantive rule of law,[144] and it is worth emphasising that it is not that different to the views of other mainstream authors, such as Dolzer and Schreuer, who link the IIR with the idea of good governance.[145]

This core neo-utilitarian value has been incorporated in the preambles of investment treaties. In particular, the 1984, 2004 and 2012 U.S. Model BITs – and many treaties inspired by these models involving other countries – explicitly link the idea of certainty or stability with the goal to maximise wealth:

> 1984: "a stable framework for investment and *maximum effective utilization of economic resources;*"
> 2004: "a stable framework for investment will *maximize effective utilization of economic resources* and improve living standards;"
> 2012: "a stable framework for investment will *maximize effective utilization of economic resources* and improve living standards."

There is in fact a recent arbitral interpretation of this connection that relies on the text of the 1984 U.S. Model BIT, and supports my view that wealth maximisation can accommodate both foreign investors' demand for certainty and the preservation of some host state authority. In the following passage of the award in *El Paso v Argentina* (2011), the tribunal considered that

143 *Ibid.*, pp. 213, 208-213.
144 See Cass, Ronald, "Property Rights Systems and the Rule of Law," in Enrico Colombatto (Ed.), *The Elgar Companion to the Economics of Property Rights*, Cheltenham: Edward Elgar Pub, 2006, pp. 222-223.
145 Dolzer, Rudolph and Christoph Schreuer, *Principles of international investment law*, p. 11; Dolzer, Rudolf, "The Impact of International Investment Treaties on Domestic Administrative Law," 37 *International Law And Politics* (2005), pp. 953-971.

> "if FET is desirable in order to maintain a stable framework for investment and maximum effective use of economic resources, this implies that a stable framework is an essential element of FET, it should also be concluded that the maximum effective use of economic resources should be considered an essential element of that standard."[146]

And it concluded that

> "in the two cases mentioned earlier [*CMS v Argentina* and *LG&E V Argentina*], the reference to the Preamble said that its object and purpose was to maintain 'a stable framework for investment and maximum effective use of economic resources;' however, in determining what these purposes implied for the interpretation of FET, the tribunals in these two cases only retained the first purpose, in order to conclude that a stable legal and business environment is an essential element of fair and equitable treatment, without taking into account the goal that any State has to pursue as well, which is to guarantee to its population maximum effective use of its economic resources."[147]

Overall, this analysis supports my argument that the main purpose of the IIR is wealth maximisation through foreign investment. This regime assumes that a primary goal of host states is to assure their populations the maximum effective use of their resources. The relation between the act of investment and this neo-utilitarian rationale falls within the claim made by Rose. The contractualisation of foreign investor-host state relations is justified precisely by wealth maximisation. In this scenario, I suggest that investment arbitrators tend to facilitate foreign investors' expectations by looking at their position at the moment of investment. I have stressed, however, that investment arbitrators do not look at contractual commitments or vested rights. Otherwise, the application of the doctrine of legitimate expectations would not be necessary. The key to legitimate expectations does not lie in the intention of host states but in the reliance of foreign investors.

[146] *El Paso Energy International Company v Argentina*, ICSID Case no ARB/03/15, Award, 31 October 2011, at footnote 307 (paragraph 346).
[147] *Ibid.*, at 369. Similarly, *Ulysseas, Inc. v Ecuador*, UNCITRAL, Award, 12 June 2012, at 248.

This indicates that the contractual approach in investment awards follows a *reliance* as opposed to a promissory theory of contracts.

In addition, I have shown that investment arbitrators can find and have found a purpose consistent with foreign investors' certainty and host state regulatory authority in wealth maximisation. This purpose can accommodate the two narratives in investment awards. Wealth maximisation is not necessarily against the preservation of host state regulatory authority. In fact, passing regulation to curb foreign investors' negative externalities can be a way to achieve higher levels of wealth. Nonetheless, it is necessary to be cautious regarding the extent to which the use of state authority is compatible with the purpose of the IIR. The formula that we find in the U.S. Model BITs is that business stability is a means of wealth maximisation, whilst in the more recent models wealth maximisation is described as a means of improving living standards. The advancement of the community is meant to be the outcome of tapping foreign investors' energies. As Wälde, Bingham and Lord Mansfield emphasise, there is a direct connection between individual certainty and the promotion of private business initiatives. However, the link between wealth maximisation and the improvement of social life is, at the most, indirect. This describes a neo-utilitarian rationale along the lines presented in Chapter 4. The justification for foreign investment protection is based on the premise that by empowering and protecting the individual we reach the desired material objective for all the involved parties: in the case of the IIR, foreign investors' profit and host state development. The exercise of host state authority, therefore, is acceptable provided it is compatible with such normativity, i.e. with a substantive rule of law.

Conclusion

In this chapter I have argued that the idea of protecting foreign investment, and not foreign-owned property, represents an important change of paradigm. This has implications for the substantiation of the rights that make up this arguably different object of protection. I have illustrated this new approach by focusing on the distinction between the doctrine of acquired rights and the doctrine of legitimate expectations: what decolonisation was to acquired rights, subtle regulatory intervention is to legitimate expectations. A framework to explain the substantiation of foreign investors' rights in the IIR needs to begin with the premise that regulations are essential elements of a foreign investment. The exploitation of a mine or a nuclear facility could become impossible if there is a change in the regulations. Assuming that the purpose of the IIR is to maximise wealth through foreign investment, it follows that this regime aims to provide some certainty regarding these regulatory conditions. Otherwise, the purpose of wealth maximisation would be undermined. I have suggested that the contractualisation of foreign investor-host state relations plays an important role in facilitating foreign investors' expectations. In addition, I have shown that there is connection between the neo-utilitarian purpose of the IIR and contractualism, yet I have recognised that the purpose of wealth maximisation also serves to preserve some host state regulatory authority.

In investment arbitration practice, things are obviously not that simple. I have explained that legitimate expectations mainly emerge from host state declarations and the reliance of foreign investors. At the same time, the recalibration process has rejected the premise that the conditions of the investment should be frozen. The principle advanced by scholars such as Schill and Montt is that changes need to be in accordance with a procedural and a substantive rule of law. Thus, in short, the two essential questions that appear to determine the substance of foreign investors' rights are when a foreign investor has relied on a declaration, and when a foreign investor can reasonably expect that his expectations will not be disappointed.

Chapter 6 – Exploring the legal reasoning behind foreign investors' legitimate expectations

Introduction

In this chapter, I show that contractualist and neo-utilitarian arguments not only justify the existence of the IIR but also determine the substance of foreign investors' rights. The content of these rights is the outcome of a number of normative choices that investment arbitrators make when resolving a dispute. These choices are made when framing and answering two central questions. I argue that the question of whether the foreign investor has relied on the conditions in the host country, perhaps because the state used these conditions as an inducement, leads to the application of the reliance theory. In a contractual context, the reliance theory shifts the justification for rights from the intention of the *promisor*, in this case the host state, to the expectations of the *promisee*, i.e. the foreign investor. I claim that this approach can be disruptive from a property standpoint. In addition, I argue that the question of whether the foreign investor can reasonably expect the changes implemented by the host state is based on the application of a substantive rule of law. Investment arbitrators rely on this doctrine to strengthen the content of foreign investors' legitimate expectations. A substantive rule of law is often described and defended as a way of specifying and enforcing private property rights. I claim that the application of this doctrine constitutes another normative choice, which minimises and limits the scope of *change* in the legal order.

A. The foundation of foreign investors' legitimate expectations: the reliance theory and a substantive rule of law

Investment arbitrators define foreign investors' legitimate expectations by focusing on two main questions. First, they ask if the foreign investor can rely on the conditions in the host state at the moment of establishment. They focus on this question from a contractualist point of view without looking for an actual bargain or host state intention. Instead of a promissory theory of contracts, they apply a reliance theory. This is a contractual theory that minimises the importance of bargains and contractual commitments in favour of the position of the promisee. The reliance theory has been employed to explain "cases whose only common characteristic was the absence of a bargain."[1] Second, investment arbitrators ask under what circumstances foreign investors should expect these legitimate expectations not be negatively affected by changes in the host state legal order. The dominant trend in investment awards does not address this question by focusing on the stability of the existent conditions in the host state. Indeed, investment arbitrators concentrate on the way in which the IIR manages change regarding foreign investors' legitimate expectations. They consider procedural and substantive limitations to change. Substantive limitations can be described as part of a substantive rule of law aimed essentially at slowing, minimising and even impeding some types of change.

In the following subsections, I consider the most important features of the reliance theory and a substantive rule of law. It is necessary to conduct this analysis before considering investment awards because the application of these two approaches is a normative decision that shapes not only the answers but also the questions. In this respect, it is worth stressing that there is nothing *natural* or *obvious* about the application of a contractual approach based on the reliance theory, or in the use of a substantive rule of law. On the contrary, I argue that these two approaches correlate with the justifications for foreign investors' rights – contractualism and neo-utilitarianism – which I explored in Chapters 4 and 5.

1. *The reliance theory*

The reliance theory was developed in the 1930s as an alternative justification for contractual obligations and liability.[2] In contract law, the traditional view of contractual rights has relied on promissory approaches.[3] The essential distinction between these two theoretical models lies in the focus of the legal reasoning. Whilst the reliance theory concentrates on the position of the *promisee*, i.e. the foreign investor, promissory theories focus on the position of the *promisor*, i.e. the host state.[4] The reliance theory is the basis for relevant legal doctrines such as

[1] Barnett, Randy, "The Death of Reliance," 46 *Journal of Legal Education* (1996), p. 524.
[2] Barnett, Randy, "The Death of Reliance," pp. 518-520.
[3] Gold, Andrew, "A Property Theory of Contract," 103:1 *Northwestern University Law Review* (2009), pp. 19, 22.
[4] *Ibid.*, pp. 19-24.

promissory estoppel in private law, and substantive legitimate expectations in administrative law.[5] Using the reliance theory, investment arbitrators substantiate foreign investors' rights by concentrating on the position of the foreign investor and his reliance on the conditions in (or the inducements provided by) the host state. I show later that although the position taken in investment awards may vary according to the characteristics of host state declarations that can give rise to expectations, such as their *specificity*, tribunals have consistently affirmed that foreign investors' legitimate expectations can emerge *beyond* formal and informal property rules and *in the absence of* contractual commitments or vested rights. Foreign investors' legitimate expectations emerge from host state representations, promises, assurances and conditions; these are all contractual concepts related to the reliance theory.[6]

What should be stressed is that the reliance theory does not tackle the problem of missing formalities in promises where the intention of the promisor to bind itself emerges from the circumstances. Conversely, as Barnet observes, the application of the reliance theory serves to expand "enforcement beyond the requirement of a bargain by identifying an additional factor or factors which justify enforcement. When (and only when) such factors exist, reliance will be protected."[7]

The factor or factors that justify enforcement "beyond the requirement of a bargain" are that host states may have used the conditions in the country to induce the foreign investor to establish there. In a competitive environment for foreign investment, such inducements do not represent a host state intention to bind itself, in the same way that the declarations of a foreign investor regarding the number of jobs involved in a project does not create a legally binding commitment to create those jobs. An individual may induce reliance "without being in a position to know he has done so."[8] Host state intention, therefore, is not a good justification for enforcing the conditions on which foreign investors rely. However, as the reliance theory shifts the focus to the promisee, the reasoning would not begin with the intentions of host states but with the reliance of foreign investors. Thus, foreign investors' detrimental reliance can lead to host state responsibility for the

[5] Barnett, Randy, "The Death of Reliance," pp. 518-520; Schønberg, Søren, *Legitimate expectations in administrative law*, New York: Oxford University Press, 2000, pp. 9-11.
[6] See Garner, Bryan and Henry Black, *Black's Law Dictionary*, Ninth Edition, St. Paul, Minn.: West, 2009; Martin, Elizabeth (Editor), *A Dictionary of Law*, Fifth Edition, Oxford: Oxford University Press, 2003.
[7] Barnett, Randy, "The Death of Reliance," p. 522.
[8] Gold, Andrew, "A Property Theory of Contract," pp. 23, 22-23.

harm they incur, although it is unclear from this theory whether the host state is in fact to blame for that harm.[9]

As Raz explains, and this point I want to underscore, whether we recognise and enforce declarations/inducements without focusing on the intention of the promisor is a normative question. The answer depends on the role and position of the actors involved in foreign investment relations.[10] There is obviously a reason to choose and follow a contractual approach based on the reliance theory. This theory stresses the neo-utilitarian justification for foreign investors' rights. According to this formula, the conditions in the host country at the moment of investment are *directly* relevant for the success of the project and *indirectly* necessary for wealth maximisation. This is consistent with the view of Barnett who claims that what creates expectations is "the fundamental fact that commitments are often made to promote economic activity and obtain economic benefits without any specific bargained-for exchange."[11]

In principle, the use of a contractual approach to define the content of foreign investors' rights over resources does not need to be incompatible with the proprietary character of these rights. In a property view of foreign investor-host state relations, the individual takes property rules to be the general applicable rules (he is a rule taker).[12] Private property rights are *in rem* rights that are valid against everybody precisely because of their social foundation. The idea of property implies that there are several uses individuals can apply to their resources but, at the same time, some of them may be subsequently prohibited by legislation. The premise that the content of property rights can legitimately vary with changes in the law concurs with Waldron's argument that retroactivity is not a good variable to consider taking allegations.[13] In the domain of constitutional property, accordingly, the moment of acquisition of the rights is not a central criterion to assess individual-state disputes. Contracts are essentially different because contractual commitments are supposed to remain unchanged and to be fulfilled.

[9] *Ibid.*, p. 23; Fried, Charles, *Contract as Promise: A Theory of Contractual Obligation*, Cambridge, Mass.: Harvard University Press, 1981. pp. 10-11.

[10] See Raz, Joseph, "Promises in Morality and Law" (A Book review of Promises, Morals, and Law by P. S. Atiyah), 95:4 *Harvard Law Review* (1982), pp. 928-936. In this book review, Raz does not concentrate on legal obligations in relation to property rules, such as contractual commitments, that affect the entire community.

[11] Barnett, Randy, "The Death of Reliance," p. 524.

[12] Joo, Thomas, "Contract, Property and the Role of Metaphor in Corporations Law," 35 *UC Davis Law Review* (2002), p. 806.

[13] Waldron, Jeremy, *The rule of law and the measure of property*, Cambridge University Press, Cambridge, United Kingdom, 2012, pp. 83-84.

Although there is more space for subsequent changes in administrative contracts, the main principle remains that states have to fulfil their commitments.[14] Foreign investors enter into contracts regarding resources in order to obtain some certainty about particular uses. As I have explained in Chapters 1 and 2, the possibility of entering into these contracts is widely accepted: individuals can negotiate with the state contractual commitments or vested rights in relation to the resources. However, these special rights are exceptions to the content of formal and informal social property norms, requiring a certain formality, clarity, specificity and certainty because of the social effects of property rules. After all, uses and entitlements regarding resources may imply that a waste disposal facility will operate in your backyard whilst subsequent changes will be rather limited.

However, the application of the reliance theory can upset the balance between the individual foreign investor and the social repercussions implied in the substantiation of his rights. This is because this theory fixes the focus on the expectations of the promisee. The potential effects of this shift are considered by Joo in his work on contract, property and metaphors in corporate law:

> "[w]hile the economic analysis of 'contract' […] discounts the importance of the state in the interpretation and enforcement of agreements, economic analysis of 'property' openly acknowledges the fact that the state determines the nature and extent of property rights."[15]

The reliance theory emphasises the individual choice of the foreign investor, paying less attention to the preferences of the population concerning social and welfare issues.[16] When applying the doctrine of legitimate expectations under the FET standard, investment arbitrators are not asking if the foreign investor can still decide the use of the resources from a range of legally recognised options. Instead, they are asking if he is still entitled to carry out his investment in accordance with his expectations as created at the moment of establishment. This leads to the application of retroactivity as a central criterion to resolve a dispute. On one hand, as I have underlined, foreign investors enter into many contractual agreements

[14] See Langrod, Georges, "Administrative Contracts: A Comparative Study," 4:3 *The American Journal of Comparative Law* (1955), pp. 330-332, 341-343, 362-364.
[15] Joo, Thomas, "Contract, Property and the Role of Metaphor in Corporations Law," p. 806.
[16] *Ibid.*, pp. 808, 816, 818-820.

with host states precisely to obtain certainty regarding the project. On the other hand, the scope of application of the doctrine of legitimate expectations in accordance with the reliance theory is more general than contractual cases.

In this regard, it is relevant to examine the problem, when applying the reliance theory, of justifying the enforcement of legitimate expectations "beyond the existence of a bargain." Individual reliance may not be enough to justify the substantiation and enforcement of rights. For this reason, the reliance theory has developed different approaches to assessing whether the individual can reasonably rely on the statements that support his expectations.[17] I show later that this is precisely the strategy that investment arbitrators have followed. They have come up with a set of criteria to assess if the act of reliance was reasonable, whilst recognising that foreign investors' legitimate expectations are *non-legally binding* obligations.[18] This way of justifying the substantiation and enforcement of foreign investors' rights is different from a promissory approach. There is no case to my knowledge in which a clear stabilisation clause was not enforced because it was judged unreasonable for the foreign investor to rely on a clear legally binding commitment. In addition, the reasonableness test creates a set of complex issues. On one hand, it requires that investment arbitrators create a model of a reasonable foreign investor, a task that is highly political and opens up an area of potential disagreement between tribunals. On the other hand, this approach implies that whilst the views of a reasonable promisee matter, the views of a reasonable promisor are secondary.[19]

2. *A substantive rule of law*

The doctrine of the rule of law refers to a set of standards that are applicable to state activity directed towards individuals. A substantive rule of law advances the premise that changes in the legal order are valid and legitimate only if they are compatible with private property rights.[20] This rationale aims to promote

[17] Gold, Andrew, "A Property Theory of Contract," p. 22.
[18] See below Section B.
[19] See DiMatteo, Larry, "The Counterpoise of Contracts: The Reasonable Person Standard and the Subjectivity of Judgment," 48:2 *South Carolina Law Review* (1997), pp. 333, 317-336.
[20] Cass Ronald, "Property rights systems and the rule of law," in Enrico Colombatto (ed.), *The Elgar Companion to the Economics of Property Rights*, Cheltenham: Edward Elgar Pub, 2006, pp. 222, 231.

individual certainty in the legal order.[21] A good strategy for clarifying the substantive content of the rule of law is to contrast it with the procedural content of this doctrine.[22] A procedural rule of law refers to a set of standards of procedure that states need to follow to pass legitimate measures. For instance, every person who has an interest in a decision should be heard. The state is abusing its powers if it passes the measure without hearing an individual whose rights are being affected. Thus, as opposed to a substantive version, a procedural rule of law focuses on the legitimate procedure to make changes.

Investment arbitrators rely both on a substantive and a procedural rule of law when assessing host states' treatment of foreign investors. I am only interested in a substantive rule of law because this interpretation of the doctrine can serve to substantiate foreign investors' rights. I rely on Waldron's Hamlyn Lecture on *The Rule of Law and the Measure of Property*. In this lecture, Waldron criticises the "World Bank model" of investment expectations, which aims to provide foreign investors with an ideal legal climate to maximise wealth through employing the resources of different countries.[23] He explains that the "connection established between private property and the Rule of Law" is "advanced as a major plank in state-building so that foreign investors can have some advance assurance of the amount of wealth they can extract from a developing economy."[24] Waldron shows how Benthamite (utilitarianism) and Hayekian (neo-utilitarianism) premises regarding private property and the rule of law constitute arguments for certainty that can substantiate property rights.[25]

The discourse of certainty has been very influential in investment awards. I show in the following sections how investment arbitrators rely on a substantive rule of law to *strengthen* foreign investors' legitimate expectations. Investment tribunals very often consider the question of whether the foreign investor had reasonable grounds to expect the type of change that triggered the dispute, or, alternatively, whether he should receive compensation because he could not have expected such a change. This particular use of a substantive rule of law serves to justify the substantiation and enforcement of legitimate expectations in accordance with the

[21] Waldron, Jeremy, *The rule of law and the measure of property*, pp. 15-20
[22] *Ibid.,* pp. 14, 40, 42, 45, 50, 55-56, 65, 77, 81, 82 (procedural rule of law); 4, 5-6, 15-20, 41, 42-43, 47, 58, 65, 68, 81(substantive rule of law).
[23] *Ibid.*, pp. 10, 49, 78, 90-93, 108.
[24] *Ibid.*, pp. 73, 70-73, 75, 86-94.
[25] *Ibid.*, pp. 17, 15-20, 53-57. See also: Cass Ronald, "Property rights systems and the rule of law," pp. 225-226.

reliance theory. In his work on legitimate expectations and administrative law, Schønberg recognises this important role of the rule of law.[26]

Before moving on to the analysis of investment awards, there are two observations to make in relation to a substantive rule of law and, to a lesser extent, to the reliance theory. In line with the recalibration process described in Chapter 5, we can observe a shift in investment awards since the mid-2000s. Before this date, we find that investment awards advanced a strong discourse in favour of stability that limited host states' ability to amend the conditions existent at the moment of investment. Since the mid-2000s, investment awards have been focusing instead on the system of change taking into consideration foreign investors' legitimate expectations. The first period highlights the important influence of contractualist arguments. However, I submit that investment awards after the mid-2000s follow the main rationale of a substantive rule of law, which – to borrow Waldron's words – advances a case for

> "slowing down the pace of change and minimising the impact of change on rights of private property and the operations of free markets, for it is in these areas that security of expectation is particularly important and the confidence of proprietors and investors must be particularly paid attention to."[27]

In addition, the analysis I conduct of investment awards only examines the perspective of the promisee, i.e. the foreign investor and his expectations. Investment arbitrators consider the type of changes that foreign investors can reasonably expect. While saying this I acknowledge that the analysis of the spectrum of change permitted by the IIR also requires the consideration of the enforcement of foreign investors' rights (including questions such as the minimum threshold, deference and proportionality). I am intentionally leaving these questions for the last part of my thesis because I first want to introduce my normative criticisms regarding the way investment arbitrators substantiate foreign investors' rights. This strategy will allow me to consider, in the final chapter, the implications of the interplay between foreign investors' rights and the arbitral review of host state authority.

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[26] Schønberg, Søren, *Legitimate expectations in administrative law*, pp. 11-15.
[27] Waldron, Jeremy, *The rule of law and the measure of property*, p. 102.

B. Investment awards and the reliance theory

In this section, I show that the reliance theory constitutes the heart of foreign investors' legitimate expectations. Most investment tribunals deviate from the premise that the main sources of property rights are formal and informal social norms, plus any contractual commitments and vested rights. This constitutes a shift from the principle that foreign investors accept the domestic property system, i.e. the basic rules of the host economy, to the extent that they have not negotiated any specific condition. A characteristic of investment awards is that arbitrators pay less attention to the existence of a bargain or to host state intention. With regard to this, I highlight some awards that explicitly characterise legitimate expectations as *non-legally binding* obligations. This suggests that there is a qualitative difference between contractual commitments, indisputable legal obligations, and legitimate expectations. I conclude by exploring how investment arbitrators address the reasonableness of foreign investors' reliance and the enforcement of their legitimate expectations.

Foreign investors' reliance constitutes the basis of their legitimate expectations. Investment tribunals affirm that legitimate expectations deserve protection because foreign investors have acted through reliance on the conditions in (or the inducements given by) the host state. This position emerges from influential awards such as *TECMED v Mexico* (2003),[28] *Waste Management v Mexico* - number 2 (2004)[29] and *Duke v Ecuador* (2008).[30] The considerations made by different investment tribunals rarely leave any space for doubt regarding the application of the reliance theory. In the award in *Suez v Argentina* (2010), for instance, the arbitrators stressed that

> "an important element of such cases has not been sufficiently emphasized: that investors, deriving their expectations from the laws and regulations adopted by the host country, acted in reliance upon those laws and regulations and changed their economic position as a result."[31]

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[28] *TECMED v Mexico*, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, at 154

[29] *Waste Management v Mexico* (Number 2), ICSID Case No. ARB(AF)/00/3, Final Award, 30 April 2004, at 98.

[30] *Duke v Ecuador*, ICSID Case No. ARB/04/19, Award, 18 August 2008, at 340.

[31] *Suez and others v Argentina*, ICSID Case No. ARB/03/17, Decision on Liability, 30 July 2010, at 207.

In addition, in *Merrill v Canada* (2010), the arbitrators explained that

> "[l]egitimate expectations are no doubt an important element of a business undertaking, but for such expectation to give rise to actionable rights requires there to have been some form of representation by the state and reliance by an investor on that representation in making a business decision."[32]

This position is consistent with the underlying neo-utilitarian argument that informs the reliance theory: the conditions that allow the economic activity should be recognised and enforced. The reason for this interpretative choice emerges in the *Biwater v Tanzania* (2008) award, where the arbitrators described the role of the IIR as "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"[33]

The implication of the reliance theory is that to substantiate foreign investors' rights investment arbitrators do not just apply formal and informal social norms, contractual commitments and vested rights. They also rely on other forms of state activity, paying less attention to host states' intention to bind themselves. Investment tribunals have found that foreign investors can legitimately rely on host state representations,[34] promises,[35] assurances[36] and conditions.[37] These are arguably *not* synonymous with contractual commitments. In addition, the tribunals in *Total v Argentina* (2010),[38] *Frontier Petroleum v The Czech Republic* (2010),[39] *Parkerings-*

[32] *Merrill v Canada*, UNCITRAL, ICSID Administered Case – NAFTA, Award, 31 March 2010, at 150.

[33] *Biwater Gauff (Tanzania) Ltd. v Tanzania,* ICSID Case No. ARB/05/22, Award, 24 July 2008, at 602. This tribunal consolidates the awards rendered on this subject in *CME v Czech Republic*, UNCITRAL, Award, 14 March 2003, at 611; *Waste Management v Mexico* (Number 2), ICSID Case No. ARB(AF)/00/3, Final Award, 30 April 2004, at 98, 305;
Saluka v Czech Republic, UNCITRAL, Partial Award, 17 March 2006, at 63, 164; *Occidental v Ecuador* (Number 1), LCIA Case No. UN3467, Award, 1 July 2004, at 183.

[34] *Frontier Petroleum v Czech Republic*, Final Award, PCA—UNCITRAL Arbitration Rules, at 285.

[35] *PSEG v Turkey* , ICSID Case No. ARB/02/5, Award, 19 January 2007, at 241.

[36] *Grand River v United States*, UNCITRAL – NAFTA, Award, 12 January 2011, at 141.

[37] *LG&E v Argentina*, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, at 130.

[38] *Total v Argentina*, ICSID Case No. ARB/04/01, Decision on Liability, 27 December 2010, at 120.

[39] *Frontier Petroleum v The Czech Republic*, UNCITRAL, Award, 12 November 2010, at 285.

Compagniet AS v Lithuania (2007),[40] and *Grand River v United States* (2011)[41] stressed that *explicit* and *implicit* host state representations can constitute the grounds of foreign investors' reliance. The tribunal in *Electrabel v Hungary* (2012) recently affirmed that "[w]hile specific assurances given by the host State may reinforce the investor's expectations, such an assurance is not always indispensable."[42] These views are consonant with the opinion of scholars as prestigious as Schreuer.[43]

To illustrate the characteristics of these representations, I will quote a short excerpt from the award in *National Grid PLC v Argentina* (2008) where the arbitrators considered that

> "[i]t is disingenuous for the Respondent now to rely on the disclaimers in the *prospectus* in order to distance itself from the information given therein. The *prospectus* was prepared by respectable bankers on behalf of the Respondent and key Argentine government officials participated prominently in the road show. If information in the *prospectus* had been incorrect or misleading, the Tribunal has no doubt that the Respondent would have had the prospectus changed accordingly."[44]

This shows that the intention of the host state to bind itself to the foreign investor – the inclusion of the disclaimer indicates that there was no such intention – is less relevant for investment arbitrators. As explained above, the criticism advanced against the reliance theory cannot be answered simply by arguing that the expectations "arise through targeted" inducements.[45] Any inducement is by definition targeted at somebody. However, this does not lead to the conclusion that the host state (or hypothetically the foreign investor) had the intention to create legally binding obligations.

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40 *Parkerings-Compagniet AS v Lithuania*, ICSID Case No. ARB/05/8, Award, 11 September 2007, at 331.

41 *Grand River v United States*, UNCITRAL – NAFTA, Award, 12 January 2011, at 141.

42 *Electrabel S.A. v Hungary*, ICSID Case No. ARB/07/19, Decision on Jurisdiction, Applicable Law and Liability, 30 November 2012, at 7.78. The tribunal relies on the awards in *MTD v Chile*, ICSID Case No. ARB/01/7, Award, 25 May 2004, *GAMI Investments v Mexico*, UNCITRAL – NAFTA, Final Award, 15 November 2004; *SD Myers v Canada*, UNCITRAL – NAFTA, Second Partial Award, 21 October 2002.

43 Schreuer, Christoph, "Fair and Equitable Treatment in Arbitral Practice," 6:3 *The Journal of World Investment & Trade* (2005), p. 374.

44 *National Grid Plc. v Argentina*, UNCITRAL, Award, 3 November 2008, at 177. Similarly, see *Sempra v Argentina*, ICSID Case No. ARB/02/16, Award , 28 September 2007, at 113, 147; *MTD v Chile*, ICSID Case No. ARB/01/7, Award, 25 May 2004, at 63, 133.

45 See *Grand River v United States*, UNCITRAL – NAFTA, Award, 12 January 2011, at 141.

Recent investment awards have referred to the *specificity* of the representations when applying the reliance theory.[46] In theory, this trend could indicate that arbitrators are paying more attention to the intention of host states. I assess this possibility contrasting the approach taken in these recent awards with the position in public international law. Although this is relatively inadequate as public international law assumes a contractual scenario for state-to-state relations, I still undertake this comparison because investment tribunals often rely on general principles of inter-state international law. I show that the importance of the reliance theory is greater in the IIR than in public international law. This is an important conclusion given the above caveat regarding the suitability of this comparison.

The position of the ICJ is that state acts need to be unconditional, definitive and very specific to legally bind a state to behaviour that is consistent with previous unilateral declarations.[47] In addition, the work of the International Law Commission that concluded in the "Guiding Principles applicable to unilateral declarations of States capable of creating legal obligations" agrees with this view.[48] Article 7 establishes that the creation of unilateral obligation between states requires unilateral declarations "stated in clear and specific terms [and] [i]n case of doubt [...], such obligations must be interpreted in a restrictive manner." It is true that the International Law Commission has noted that

> "it is often difficult to establish whether the legal effects stemming from the unilateral behaviour of a State are the consequence of the intent that it has expressed or depend on the expectations that its conduct has raised among other subjects of international law."

Yet, it explicitly mentions that the guiding principles only refer to "unilateral acts *stricto sensu*, i.e. those taking the form of formal declarations formulated by a State with the intent to produce obligations under international law."[49] Arguably, then, although there is a debate regarding the applicable framework to unilateral

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[46] *EDF v Romania*, ICSID Case No. ARB/05/13, Award, 8 October 2009, at 217; *Ulysseas, Inc. v Ecuador*, UNCITRAL, Award, 12 June 2012, at 248-249. See below footnotes 50 to 53.

[47] Nuclear Tests Case (*Australia v France*), 1974, ICJ Reports, at 46 (p. 472).

[48] International Law Commission, "Guiding Principles applicable to unilateral declarations of States capable of creating legal obligations," adopted by the International Law Commission at its 58th session in 2006 (ILC Report, A/61/10, 2006, Chapter IX).

[49] *Ibid.*, preamble.

declarations, the position of the ICJ and the International Law Commission stresses the importance of state *intention* in public international law.

Conversely, the investment awards that have focused on the specificity of host state acts continue to apply the reliance theory. Although these arbitrators have given some consideration to host state intention, such elements are merely embryonic and have not consolidated into a concrete shift to a promissory theory. I illustrate this point through the award in *El Paso v Argentina* (2011) and *Continental v Argentina* (2008), where the arbitrators considered that

> "[a] reasonable general regulation can be considered a violation of the FET standard if it violates a specific commitment towards the investor. The Tribunal considers that a special commitment by the State towards an investor provides the latter with a certain protection against changes in the legislation, but it needs to discuss more thoroughly the concept of 'specific commitments.' In the Tribunal's view, no general definition of what constitutes a specific commitment can be given, as all depends on the circumstances. However, it seems that two types of commitments might be considered 'specific': those specific as to their addressee and those specific regarding their object and purpose."[50]

In this respect, the *El Paso v Argentina* tribunal made several considerations about specificity. They explained that

> "there can indeed exist specific commitments directly made to the investor – for example in a contract or in a letter of intent, or even through a specific promise in a person-to-person business meeting – and not simply general statements in treaties or legislation which, because of their nature of general regulations, can evolve."[51]

> "[A] commitment can be considered specific if its precise object was to give a real guarantee of stability to the investor. Usually general texts cannot contain such commitments, as there is no guarantee that they will not be modified in due course. However, a reiteration of the same type of

[50] *El Paso v Argentina*, ICSID Case No. ARB/03/15, Award, 31 October 2011, at 375.
[51] *Ibid.*, at 376.

> commitment in different types of general statements could, considering the circumstances, amount to a specific behaviour of the State, the object and purpose of which is to give the investor a guarantee on which it can justifiably rely."[52]

> "The tribunal in *Continental* addressed the question of what can be considered a special commitment giving 'reasonable legitimate expectations' to the foreign investor with care and insight. It insisted on 'the specificity of the undertaking' that can give rise to reasonable legal expectations, and for that purpose distinguished: – Political statements which can – 'regrettably but notoriously' says the tribunal – create no legal expectations; – general legislative statements which 'engender reduced expectations;' – contractual undertakings by governments which can create more legitimate expectations and 'deserve clearly more scrutiny,' as 'they generate as a rule legal rights and therefore expectations of compliance.'"[53]

The considerations of the tribunal in *El Paso v Argentina* represent for *Investment Arbitration Reporter* "a friendly reading of some investment treaty protections" for host states.[54] Thus, they constitute a fair baseline for assessing the question of the specificity of the representations and the intention of host states: this is the best possible scenario for host states. The paragraphs just quoted, however, make some inconsistent points on the issues of specificity, clarity and transparency as alleged requirements to create host state obligations out of declarations or inducements. The threshold for specificity appears to remain flexible when the tribunal equates a contract with a letter of intent or a "specific promise in a person-to-person business meeting," or admits that general legislative statements can constitute certain types of reduced expectations (as in *Continental v Argentina*). In addition, the tribunal disregards that most investment treaties grant foreign investors the right to transfer funds. These are general clauses in treaties that clearly substantiate foreign investors' rights.

[52] *Ibid.*, at 377.
[53] *Ibid.*, at 378; *Continental v Argentina*, ICSID Case No. ARB/03/9, Award, 5 September 2008, at 261.
[54] Hepburn, Jarrod, "Newly-Published Award finds Argentina treated El Paso 'Unfairly' but arbitrators take state-friendly reading of some investment treaty protections," *IAReporter*, 29 January 2012.

But the most notorious inconsistency in the award in *El Paso v Argentina* is between the premise that a host state commitment is meant to "give a real guarantee of stability to the investor," and the position of the same arbitrators in the same award when they affirm that

> "[t]he important aspect of the commitment is not so much that it is legally binding – which usually gives rise to some sort of responsibility if it is violated without a need to refer to FET – but that it contains a specific commitment directly made to the investor, on which the latter has relied."[55]

This shows that these arbitrators describe legitimate expectations as something *qualitatively* different from contractual commitments. The argument that foreign investors' legitimate expectations are not legally binding is illustrative, and has been used in other instances such as the annulment decision in *CMS v Argentina* (2007)[56] and the award in *Grand River v United States*.[57] On one hand, the use of the term "specific commitment" suggests that we are dealing with host state intention to bind itself. On the other hand, investment arbitrators still substantiate these commitments in accordance with the reliance theory.[58] The characterisation of legitimate expectations as non-legally binding commitments indicates the influence of the reliance theory and the focus on the position of the promisee. It is easy to see the connection between this approach and the position of some investment and administrative law scholars who claim that informal administrative representations constitute "less than rights" that can nonetheless substantiate foreign investors' legitimate expectations.[59]

The conundrum of this approach is that it remains unclear what exactly is meant by legitimate expectations not being legal obligations when, in reality, host states need to comply with them as if they were legally binding obligations and foreign investors rely on these expectations as rights that can trump host state measures. In a constitutional property framework, this means that host states need to pay compensation. In addition, the premise that legitimate expectations are not legally

[55] *El Paso v Argentina*, ICSID Case No. ARB/03/15, Award, 31 October 2011, at 376.
[56] *CMS v Argentina*, ICSID Case No. ARB/01/8, Annulment Decision, 25 September 2007, at 89.
[57] *Grand River v United States*, UNCITRAL – NAFTA, Award, 12 January 2011, at 140.
[58] *El Paso v Argentina*, ICSID Case No. ARB/03/15, Award, 31 October 2011, at 355.
[59] Mairal, Héctor, "Legitimate Expectations and Informal Administrative Representations," in Stephan Schill (Ed.), *International Investment Law and Comparative Public Law*, New York: Oxford University Press, 2010, p. 422.

binding commitments contrasts with the alternative claim that they are constructive (bilateral or unilateral) obligations. The basis of this argument is precisely that we are talking about binding obligations in spite of the missing formalities. In short, legitimate expectations have the structure and fulfil the function of rights, in spite of being characterised as non-legally binding commitments or less than rights.

Thus, although the awards in *El Paso v Argentina* and *Continental v Argentina* may indicate an incipient shift, foreign investors' legitimate expectations continue to be – at least to a large extent – the outcome of the reliance theory. These awards may imply a shift away from some forms of implicit representation; however, the position is still far from the consensus in general public international law where the focus remains largely fixed on intention, and the premise is that if specificity and clarity are missing, the interpretation of any legal binding effects should be restrictive.

The consequences of applying the reliance theory to substantiate foreign investors' rights are illustrated by Jürgen Voss's dissenting opinion in *Joseph Lemire* v *Ukraine* (2011). As I explained in the Chapter 5, in this dispute the question was whether the foreign investor had a right to expand his business. In this respect, Voss highlights the difference between legally binding rights and the foreign investor's legitimate expectation:

> "Claimant's business expansion plans and expectations provide no basis for supporting his claims under the FET standard with respect to Respondent's failure of awarding additional frequencies to Gala. The National Council had no obligation to consider such plans and expectations in its decisions on Claimant's tender applications. Claimant could legitimately only expect that the applications be assessed and decided upon on a case-by-case basis and on an equal footing with competing applications in accordance with the criteria and guidelines set forth in the LTR."[60]

Now, what can be argued against my analysis is that an alternative interpretation, consonant with this position, would empty the FET of any significant content. In this regard, Schreuer argues that the main function of the FET standard is "the

[60] *Joseph Lemire v Ukraine*, ICSID Case No. ARB/06/18, Dissent of Dr Jürgen Voss, 1 March 2011,at 60. See also: at vi-vii, 40-60.

protection of the investor's legitimate expectation."[61] In my view this criticism is only valid if we assume that the IIR mandates a contractual approach to foreign investor-host state relations based on the reliance theory. If we disagree with these premises, however, this objection becomes less relevant. This normative choice serves to determine the content of foreign investors' rights but has little to do with the text of investment treaties. Instead, it represents the political morality that presently dominates investment awards. In an alternative view of foreign investors' rights, for instance, the FET standard could serve to define foreign investors' ownership according to vernacular legitimate expectations unless the foreign investors have acquired contractual commitments or vested rights. These two categories, it is worth emphasising, are included in most definitions of assets in investment treaties. But even if this approach were considered inappropriate, the FET standard would not be emptied of content simply because it would always maintain its procedural dimension (as Voss explains in his separate opinion), and investment arbitrators would still need to develop an alternative approach to define foreign investors' rights.

In addition, I claim that the similarly intentioned argument that a foreign investor can enforce specific contractual commitments without the FET standard or the IIR is not convincing.[62] When a national investor and the state enter into a tax stabilisation agreement in any domestic jurisdiction, such an agreement is enforceable in two ways. On one hand, the individual can claim a contractual breach that has materialised in a tax increase, but on the other hand, if the state modified the general laws, making the stabilisation agreement null and void, his only option would be to claim expropriation before constitutional or administrative courts. I claim that the same happens in the foreign investment scenario. In Chapters 1 and 2, I explained that we need to distinguish contractual commitments aimed at substantiating ownership from contractual commercial obligations. The first are particular types of contracts that only states can enter into, and their content can only be breached by sovereign acts. As we know, the FET standard and the IIR are relevant when host states abuse their sovereign powers to deprive the foreign investor of his legitimate rights (proprietary or contractual), and not when host states breach a mere contractual obligation.

[61] Schreuer, Christoph, "Fair and Equitable Treatment: Interactions with other Standards," 4:5 *TDM* (2007), p. 17.
[62] *El Paso v Argentina*, ICSID Case No. ARB/03/15, Award, 31 October 2011, at 376.

To conclude this section, I want to highlight two additional elements that illustrate the influence of the reliance theory in investment awards: the need to determine whether foreign investors' reliance was reasonable and legitimate, and the justification for host state obligation to behave in accordance with foreign investors' expectations. The importance of considering whether foreign investors' reliance was reasonable is the flipside of the fact that investment arbitrators pay less attention to host state intention. In *OKO v Estonia* (2007), the arbitrators posed this question clearly:

> "It follows that, where such a representation is made by the host state under this BIT, the factual issue is whether in all the circumstances it was reasonable and justifiable for the investor to rely upon that representation; and, if so, whether there was in fact such reliance."[63]

Investment arbitrators rely on the reasonableness of legitimate expectations to justify the application of the reliance theory. In this respect, they acknowledge that "[b]ilateral [i]nvestment [t]reaties are not insurance policies against bad business judgments,"[64] and that "[l]egitimate expectations cannot be solely the subjective expectations of the investor."[65] Investment tribunals have stressed that the analysis of the reasonableness of foreign investors' expectations needs to be objective, incorporating "host State's power to regulate its economic life in the public interest,"[66] and "the political, socioeconomic, cultural and historical conditions prevailing in the host State."[67] This tendency illustrates what I anticipated in the previous section. As a result of applying the reliance theory, investment arbitrators need to develop a model of a *reasonable foreign investor*, the reasonable promisee.

Tribunals, however, pay less attention to the perspective of a reasonable host state, i.e. the promisor. The issue in the awards is always what a reasonable foreign investor should have expected. To my knowledge, there is no award that considered the argument that no reasonable host state would have created the

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[63] *OKO v Estonia*, ICSID Case No. ARB/04/6, Award, 19 November 2007, at 247.
[64] *Maffezini v Spain*, ICSID Case No. ARB/97/7, Award, 13 November 2000, at 64. Similarly, *Biwater Gauff (Tanzania) Ltd. v Tanzania,* ICSID Case No. ARB/05/22, Award, 24 July 2008, at 601.
[65] *EDF v Romania*, ICSID Case No. ARB/05/13, Award, 8 October 2009, at 219; *MTD v Chile,* ICSID Case No. ARB/01/7, Annulment decision, 21 March 2007, at 67, 69.
[66] *EDF v Romania*, ICSID Case No. ARB/05/13, Award, 8 October 2009, at 219.
[67] *Duke v Ecuador*, ICSID Case No. ARB/04/19, Award, 18 August 2008, at 340; *Methanex v U.S.A.*, UNCITRAL – NAFTA, Final Award, 3 August 2005, at part IV, chapter D, at 9.

alleged expectations by inducing the foreign investor or implementing a general law. Instead, any assessment of the attitudes of a reasonable host state is favourably related to the position of the foreign investor. In the award in *Walter Bau v Thailand* (2009), for instance, the arbitrators considered that the host state "could not reasonably have expected that foreign investors would enter into an arrangement of the nature proposed, over such a long period, without being fairly confident of a reasonable rate of return on investment."[68] This tribunal put forward this view although "there was no guarantee by the Respondent of an explicit rate of return."[69]

Finally, investment tribunals justify foreign investors' rights on contractual grounds. The principle of good faith is employed by most investment arbitrators. In *Waguih Elie George Slag v Egypt* (2009), the arbitrators affirmed that "the host State's duty to respect the investor's legitimate expectations arises from its more general duty to act in good faith towards foreigners."[70] The principle of good faith justifies the obligation of host states to comply with their commitments but it does not serve to validate the content or existence of these commitments. This principle is only a moral justification for the binding character of contractual obligations.[71] As the ICJ has established, "[t]he principle of good faith is 'one of the basic principles governing the creation and performance of legal obligations'; it is not in itself a source of obligation where none would otherwise exist."[72] The principle of good faith is useful for investment arbitrators. However, they may find it difficult to support host state obligation to pay compensation solely on the grounds of good faith.

Tribunals and scholars have used different formulas to justify the content of foreign investors' legitimate expectations. Although some arbitrators have applied the theory of estoppel,[73] Brown distinguishes the notion of estoppel from the

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68 *Walter Bau AG v Thailand*, UNCITRAL, Award, 1 July 2009, at 12.1., at 12.1. (c).
69 *Ibid.*, at 12.3.
70 *Waguih Elie George Siag v Egypt*, ICSID Case No. ARB/05/15, Award, 1 June 2009, at 450. Similarly, see *Total v Argentina*, ICSID Case No. ARB/04/01, Decision on Liability, 27 December 2010, at 128; *El Paso v Argentina*, ICSID Case No. ARB/03/15, Award, 31 October 2011, at 348.
71 Gold, Andrew, "A Property Theory of Contract," pp. 19-21.
72 Border and Transborder Armed Actions Case, (*Nicaragua v Honduras*), Jurisdiction and Admissibility, Judgment, 20 December 1988, ICJ Rep 69, at 105. Similarly, Nuclear Tests Case (*Australia v France*), 1974, ICJ Reports, at 46 (p. 268).
73 See *International Thunderbird Gaming Corporation v Mexico*, NAFTA - UNCITRAL, Thomas Wälde's Separate Opinion, 1 December 2005, at 27.

doctrine of legitimate expectations in international law.[74] This is consistent with the view of Forsyth who explains that estoppel "has but a small part to play in administrative law" because "to hold [the decision maker] bound by his undertaking would be to create that legal horror: a body that can set its own limits to its jurisdiction."[75] In his work on legitimate expectations, Schønberg addresses this problem in the field of general administrative law.[76] Taking his lead, the search for grounds to justify the specification and enforcement of foreign investors' legitimate expectations takes us to the second half of my argument in this chapter concerning a substantive rule of law.[77] Foreign investors' legitimate expectations are able to trump host state measures because, to be in accordance with the IIR, host states need to behave in accordance with this normativity.

C. Investment awards and a substantive rule of law

In the following sections, I show that a substantive rule of law *strengthens* foreign investors' rights following a neo-utilitarian rationale. I look at the awards rendered during the two main periods of the IIR (before and after recalibration). I focus on this second period to illustrate that investment arbitrators rely on a substantive rule of law to minimise the impact and restrict some changes to foreign investors' legitimate expectations. For this purpose, it is important to stress the connection between the reliance theory and a substantive rule of law: foreign investors' legitimate expectations constitute the substantive *baselines* for reviewing any change implemented by the host state. I therefore argue that a substantive rule of law sets the *level* of consistency and predictability of change. Briefly, my claim is that the argument made by Salacuse in 2007 remains valid:

> "[t]he BITs' intent was [and I would say is] to restrain host country action against the interests of investors – in other words, to enable the form of legal

[74] Brown, Chester, "The Protection of Legitimate Expectations as a General Principle of Law: Some Preliminary Thoughts," 5:2 *TDM* (2008), pp. 9-10.
[75] Forsyth, Christopher, "The Provenance and Protection of Legitimate Expectations," 47:2 *The Cambridge Law Journal* (1988), p. 240.
[76] Schønberg, Søren, *Legitimate expectations in administrative law*, p. 11.
[77] *Ibid.*, pp. 11-12.

> commitments made to investors to resist the forces of change often demanded by the political and economic life in host countries."[78]

However, where Salacuse said legal commitments I argue we should also read legitimate expectations and reliance theory.

The first period I want to examine spans the IIR boom in the late-1990s to the mid-2000s. There is a clear tendency in this period to favour the stability demanded by the international business sector for it to invest globally. The award in *Occidental v Ecuador* (2004) reflects this position:

> "Although fair and equitable treatment is not defined in the Treaty, the Preamble clearly records the agreement of the parties that such treatment 'is desirable in order to maintain a stable framework for investment and maximum effective utilization of economic resources.' The stability of the legal and business framework is thus an essential element of fair and equitable treatment."[79]

Similarly, the tribunal in *MTD v Chile* (2004) described host state commitments under BITs as a positive obligation to create a stable framework to facilitate foreign investment. These arbitrators emphasised that the terms of the investment treaty

> "are framed as a proactive statement – 'to promote,' 'to create,' 'to stimulate' – rather than prescriptions for a passive behavior of the State or avoidance of prejudicial conduct to the investors"[80]

Although the *TECMED v Mexico* award belongs to the pre-recalibration period, I suggest that this tribunal took a different approach to the question of the change of laws affecting foreign investors' legitimate expectations. Rather than stability,

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[78] Salacuse, Jeswald, "The Treatification of International Investment Law," 13 *Law and Business Review of the Americas* (2007), p. 156.

[79] *Occidental v Ecuador* (Number 1), LCIA Case No. UN3467, Award, 1 July 2004, at 183. Similarly, see *CMS v Argentina,* ICSID Case No. ARB/01/8, Award, May 12, 2005, at 274*; LG&E v Argentina*, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, at 125; *Azurix v Argentina*, ICSID Case No. ARB/01/12, Award, 14 July 2006, at 360.

[80] *MTD v Chile*, ICSID Case No. ARB/01/7, Award, ICSID Case No. ARB/01/7, 25 May 2004, at 113. Similarly, see *Biwater Gauff (Tanzania) Ltd. v Tanzania*, ICSID Case No. ARB/05/22, Award, 24 July 2008, at 525.

these arbitrators focused on the system of change and the legitimacy of subsequent changes. In this light, the perspective of the legal question shifted from the stability of the legal order to the type of changes foreign investors should reasonably expect. These arbitrators considered that

> "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, […] The foreign investor also expects the host State to act consistently, i.e. without arbitrarily revoking any preexisting decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities. The investor also expects the State to 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 not to deprive the investor of its investment without the required compensation."[81]

The award in *TECMED v Mexico* has been criticised for describing a "perfect public regulation in a perfect world."[82] This is a well-made point. This award restricted host state ability to implement changes to a significant degree. However, this position does not challenge my suggestion: the passage quoted above avoids the language of stability, concentrating instead on foreign investors' expectations regarding change in the legal order. In this sense, I suggest that the approach taken in *TECMED v Mexico* constitutes a shift vis-à-vis awards such as *Occidental v Ecuador*. The recalibration process of the IIR, as I show below, is essentially the acknowledgement that the IIR cannot assume the stability of the law but can still discipline change in host states' legal orders. This view is aligned, and not at odds, with the idea of a substantive rule of law which aims to strengthen the specification and enforcement of property rights.[83] Foreign investors should reasonably expect some changes regarding the measure of control over the resources of different

[81] *TECMED v Mexico*, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, at 154. See also: *Metalclad v Mexico*, ICSID Case No. ARB(AF)/97/1, Award, 30 August 2000, at 76.

[82] Douglas, Zachary, "Nothing if not Critical for Investment Treaty Arbitration: Occidental, Eureko and. Methanex," 22:1 *Arbitration International* (2006), p. 28. Similarly, the experts for Chile, Jan Paulsson and Sir Arthur Watts as well as members of the Annulment Committee in *MTD v Chile* have criticised the *TECMED v Mexico* award. See *MTD v Chile*, ICSID Case No. ARB/01/7, Annulment decision, 21 March 2007, at 66-67, respectively.

[83] Cass Ronald, "Property rights systems and the rule of law," pp. 222-223.

countries. However, as I will now show, these changes need to be consistent and predictable.

The basic premise of the recalibration process is that the legal order changes. The arbitrators in *El Paso v Argentina* affirmed that they "cannot follow the line of cases in which fair and equitable treatment was viewed as implying the stability of the legal and business framework. Economic and legal life is by nature evolutionary."[84] Similarly, the tribunal in *EDF v Romania* considered (2009) that "the FET obligation cannot serve the same purpose as stabilization clauses specifically granted to foreign investors."[85]

The difficult task is to distinguish changes that foreign investors should expect and tolerate from changes that would trigger a host state obligation to pay compensation. Although I focus on this issue from the perspective of substantive limitations to change, it is necessary to highlight that procedural requirements can also constitute substantive restrictions if interpreted in an extreme manner. The principle of transparency has been recognised in many awards.[86] Indeed, political bodies need to be transparent not only for foreign investors but for the entire host community. However, the principle of transparency can acquire a substantive character when interpreted as an obligation to provide certainty regarding the applicable legal framework. The position of the tribunals in *Metalclad v Mexico* (2000), *TECMED v Mexico* and *LG&E v Argentina* (2006) exemplifies this approach when they describe transparency as a principle requiring that "all relevant requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made under an investment treaty should be capable of being readily known to all affected investors."[87] According to the doctrine of legitimate expectations, if this position was accepted, it would increase the grounds on which foreign investors can acquire expectations regarding every single rule that matters for their business goals.

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84 *El Paso v Argentina*, ICSID Case No. ARB/03/15, Award, 31 October 2011, at 352, 341-344.

85 *EDF v Romania*, ICSID Case No. ARB/05/13, Award, 8 October 2009, at 218.

86 *Waste Management v Mexico* (Number 2), ICSID Case No. ARB(AF)/00/3, Final Award, 30 April 2004, at 98; *Saluka v Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, at 307, 407; *Joseph Charles Lemire v Ukraine*, ICSID Case No. ARB/06/18, Decision on Jurisdiction and Liability, 14 January 2010, at 284; *El Paso v Argentina*, ICSID Case No. ARB/03/15, Award, 31 October 2011, at 358; *EDF v Romania*, ICSID Case No. ARB/05/13, Award, 8 October 2009, at 219; *Ioannis Kardassopoulos v Georgia*, ICSID Case No. ARB/05/18, Award, 3 March 2010, at 438; *Biwater Gauff (Tanzania) Ltd. v Tanzania,* ICSID Case No. ARB/05/22, Award, 24 July 2008, at 602.

87 *Metalclad v Mexico*, ICSID Case No. ARB(AF)/97/1, Award, 30 August 2000, at 76. See also: *TECMED v Mexico*, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, at 154; *LG&E v Argentina*, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, at 128.

Essentially, a substantive rule of law puts forward some limitations to change based on foreign investors' legitimate expectations, which are probably substantiated in a scenario like that described above. According to investment awards, the most important restriction appears to be the consistency[88] and predictability[89] of legal changes. Assuming that change implies some level of inconsistency with the previous scenario, the main issue to consider is how much *inconsistency* foreign investors should expect and tolerate. The predominant view that emerges from investment awards is that host states need to consider the legitimate expectations of the foreign investor when considering change. Thus, legitimate expectations constitute the baseline for considering the consistency and predictability of host state measures.[90] The tribunal in *PSEG v Turkey* (2007), relying on the award in *Saluka v The Czech Republic* (2006), explained that

> "[w]hile noting that no investor 'may reasonably expect that the circumstances prevailing at the time the investment is made remain totally unchanged,' the Tribunal in Saluka held that the investor can still expect that the conduct of the host State subsequent to the investment will be fair and equitable as the investor's decision to invest is based on 'an assessment of the state of the law and the totality of the business environment at the time of the investment.'"[91]

Similarly, the award in *Frontier Petroleum v The Czech Republic* concluded that

[88] *Saluka v Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, at 307, 407; *Joseph Charles Lemire v Ukraine*, ICSID Case No. ARB/06/18, Decision on Jurisdiction and Liability, 14 January 2010, at 284; *El Paso v Argentina*, ICSID Case No. ARB/03/15, Award, 31 October 2011, at 358; *EDF v Romania*, ICSID Case No. ARB/05/13, Award, 8 October 2009, at 219; *Ioannis Kardassopoulos v Georgia*, ICSID Case No. ARB/05/18, Award, 3 March 2010, at 438; *Biwater Gauff (Tanzania) Ltd. v Tanzania,* ICSID Case No. ARB/05/22, Award, 24 July 2008, at 602.

[89] *Saluka v Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, at 500; *Joseph Charles Lemire v Ukraine*, ICSID Case No. ARB/06/18, Decision on Jurisdiction and Liability, 14 January 2010, at 284; *Parkerings-Compagniet v Lithuania*, ICSID Case No. ARB/05/8, Award, 11 September 2007, at 333.

[89] *Metalclad v Mexico*, ICSID Case No. ARB(AF)/97/1, Award, 30 August 2000, at 76. See also: *TECMED v Mexico*, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, at 154; *LG&E v Argentina*, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, at 128.

[90] *Alpha v Ukraine*, ICSID Case No. ARB/07/16, Award, 8 November 2010, at 420.

[91] *PSEG v Turkey* , ICSID Case No. ARB/02/5, Award, 19 January 2007, at 255.

> "[w]hile the host state is entitled to determine its legal and economic order, the investor also has a legitimate expectation in the system's stability to facilitate rational planning and decision making"[92]

And, more recently, the tribunal in *Electrabel v Hungary* considered that

> "the requirement of fairness must not be understood as the immutability of the legal framework, but as implying that subsequent changes should be made fairly, consistently and predictably, taking into account the circumstances of the investment."[93]

This line of argument can be traced in investment awards that have considered legitimate expectations based on the existing legal order at the time of investing. The arbitrators in *Toto v Lebanon* (2012) affirmed that

> "changes in the regulatory framework would be considered as breaches of the duty to grant full protection and fair and equitable treatment only in case of a drastic or discriminatory change in the essential features of the transaction."[94]

Likewise, the tribunal in *PSEG v Turkey* decided that "the fair and equitable treatment obligation was seriously breached by what has been described above as the 'roller-coaster' effect of continuing changing legislation."[95] And the arbitrators in *Enron v Argentina* (2007) considered that "[a] decade later, however, the guarantees of the tariff regime that had seduced so many foreign investors, were dismantled. Where there was certainty and stability for investors, doubt and ambiguity are the order of the day."[96]

By concentrating on the position of foreign investors, i.e. their expectations, investment arbitrators promote the core value of a substantive rule of law. Foreign investors expect that host states will not interfere with their projects unless they

[92] *Frontier Petroleum v The Czech Republic*, UNCITRAL, Award, 12 November 2010, at 285.
[93] *Electrabel S.A. v Hungary*, ICSID Case No. ARB/07/19, Decision on Jurisdiction, Applicable Law and Liability, 30 November 2012, at 7.77.
[94] *Toto v Lebanon*, ICSID Case No. ARB/07/12, Award, 7 June 2012, at 244.
[95] *PSEG v Turkey* , ICSID Case No. ARB/02/5, Award, 19 January 2007, at 250.
[96] *Enron v Argentina*, ICSID Case No. ARB/01/3, Award, 22 May 2007, at 266. Similarly, *Sempra v Argentina*, ICSID Case No. ARB/02/16, Award, 28 September 2007, at 303.

have *good reasons*.[97] Investment tribunals review the consistency and predictability of any alleged good reason by focusing on the conditions that foreign investors considered necessary to carry out their business activities at the moment of establishment. Responding to a neo-utilitarian rationale, thus, the entire reasoning behind a substantive rule of law is based on the need to discipline change in order to assure foreign investors some level of certainty regarding their control over the resources.

The deliberations of the tribunal in *Suez v Argentina* provide us with a precise picture regarding the system of change envisioned by investment arbitrators:

> "When an investor undertakes an investment, a host government through its laws, regulations, declared policies, and statements creates in the investor certain expectations about the nature of the treatment that it may anticipate from the host State. The resulting reasonable and legitimate expectations are important factors that influence initial investment decisions and afterwards the manner in which the investment is to be managed. The theoretical basis of this approach no doubt is found in the work of the eminent scholar Max Weber, who advanced the idea that one of the main contributions of law to any social system is to make economic life more calculable and also argued that capitalism arose in Europe because European law demonstrated a high degree of 'calculability.' An investor's expectations, created by law of a host country, are in effect calculations about the future."[98]

The view that foreign investors' expectations regarding change should be understood according to Weber's economic sociology of law, i.e. in connection with the expansion of capitalist activities, is consistent with my claim that we need to consider the IIR from a constitutional property perspective.[99] According to Swedberg, Weber sees higher control and certainty over resources as constituting the main contribution of the legal order to the expansion of modern capitalism.[100]

[97] *Continental v Argentina*, ICSID Case No. ARB/03/9, Award, 5 September 2008, at 254; *El Paso v Argentina*, ICSID Case No. ARB/03/15, Award, 31 October 2011, at 370.
[98] *Suez and others v Argentina*, ICSID Case No. ARB/03/17, Decision on Liability, 30 July 2010, at 222.
[99] See Chapter 1, Section A; Chapter 3, Section A.
[100] Swedberg, Richard, "Max Weber's Contribution to the Economic Sociology of Law," CSES Working Paper Series Paper # 31, revised February 2006, pp. 12-13; Trubek, David, "Max Weber on Law and The Rise of Capitalism," *Wisconsin Law Review* (1972), pp. 720-753.

This view is compatible with the main justification for constitutional private property, which is to assure individual control over resources vis-à-vis the authority of states. In addition, Weber claims that "economic interests are among the strongest factors influencing the creation of law."[101] This neo-utilitarian rationale leads Weber to emphasise calculability as the core role of law in modern rational capitalism: "what is needed for economic operations to be calculable is not primarily formal elegance and coherence but predictability."[102] Finally, for my purposes, it is important to stress that the arbitrators in *Suez v Argentina* could not have relied on a different interpretation of Weber because they explicitly cited Swedberg and Trubek's work.[103]

The final element I want to explore with regard to a substantive rule of law refers to the role of this doctrine in setting the baseline for judging the requirements of consistency and predictability. A substantive rule of law and the IIR are connected by a common purpose: wealth maximisation. This connection emerges particularly from the way investment arbitrators evaluate the effects of the changes that matter to foreign investors. As a result of the neo-utilitarian approach, the focus of the awards partially shifts away from the ability to set the overall agenda for the resources, concentrating more on the ability to earn benefits in accordance with the conditions at the moment of investing. This feature emerges in investment awards concerning expropriation, although it should be observed that to find an indirect expropriation the intensity of the effects needs to be substantial. In addition to these decisions, I consider the award in *Total v Argentina*, where the arbitrators judged the consistency of legal changes in relation to foreign investors' expectations of a reasonable profit under the FET standard.

In the awards concerning indirect expropriations, investment arbitrators have taken two apparently different paths. They have considered either the deprivation of the right to income or the loss of value in the investment.[104] Normally, the outcome of these two tests would be very different. On one hand, the deprivation of the right to income refers to a scenario where the foreign investor cannot

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101 Weber, Max, *Economy and Society: An Outline of Interpretive Sociology*, Berkeley, CA: University of California Press, [1922] 1978, p. 334 (cited in Swedberg, p. 9).

102 Swedberg, Richard, "Max Weber's Contribution to the Economic Sociology of Law," p. 15.

103 In the footnote 158 of the commented award, the arbitrators refer to "Max Weber, Economy and Society 847, 855 (1922), David Trubek, 'Max Weber and the Rise of Capitalism' Wisconsin Law Review 720-53 (1971) and Richard Swedberg, 'Max Weber's Contribution to the Economic Sociology of Law' 2 Annu. Rev. Law Soc. Sci..61–81 (2006)."

104 *Telenor v Hungary*, ICSID Case No. ARB/04/15, Award, 13 September 2006, at 65; *El Paso v Argentina*, ICSID Case No. ARB/03/15, Award, 31 October 2011, at 249.

acquire the benefits resulting from legal economic activities. On the other hand, the loss of value refers to state measures that reduce the economic value of the particular investment, primarily those that prevent the foreign investor from carrying out the planned activity. In reality, I argue that the distinction between these two approaches in investment awards is less clear because tribunals focus on the particular investment project and not on the ability to carry out economic activities. This results in an interpretation that is much closer to considering the loss of value or expected benefit. Following a neo-utilitarian rationale, arbitrators normally consider the deprivation of the right to income, but from the concrete activity. As I explained in Chapter 1, however, this approach is inadequate because the consideration of the loss of particular benefits depends on a legal point of reference.[105] In this regard, what matters most is the right to carry out the concrete activity in the conditions under discussion.

The award in *TECMED v Mexico* relied on the deprivation of the right to income.[106] These arbitrators affirmed that host state measures are expropriatory if they

> "radically deprived [the investor] of the economical use and enjoyment of its investments, as if the rights related thereto – such as the income or benefits related to the [investment] or to its exploitation – had ceased to exist."[107]

In most legal orders, the right to the income is a core element of private property and its deprivation would normally require compensation. It is less obvious, however, whether the foreign investor had a right to operate a waste processing facility. This right would be clearly defined if the government of Mexico had issued a contractual commitment or a permit to *TECMED*. Otherwise, it is improbable that a foreign investor or any individual had a legal entitlement to this particular use of the resources. However, the case in *TECMED v Mexico* was decided within the grey boundaries of the doctrine of legitimate expectations as the arbitrators were of the opinion that the foreign investor had expected to obtain

[105] See Chapter, 1, Section C.1.

[106] This antecedent has been widely cited and quoted, see *Compañía de Aguas del Aconquija S.A. v Argentina*, Award, ICSID Case No ARB/97/3, Award, 20 August 2007, at 7.5.12; *LG&E v Argentina*, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, at 192; *National Grid v Argentina*, UNCITRAL, Award, 3 November 2008, at 149; *LESI SpA and ASTALDI SpA v Algeria*, ICSID Case No ARB/05/3, Award, 12 November 2008, at 132.

[107] *TECMED v Mexico*, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, at 115.

such a permit.[108] As we can see, the essential question in this dispute was the ability to carry out the concrete activity, and not the right to the income related to the investment.

The focus on the deprivation of the right to income from a particular activity is much closer to the consideration of the loss of benefits or economic value.[109] As the tribunal in *Burlington v Ecuador* (2012) put it:

> "When a measure affects the environment or conditions under which the investor carries on its business, what appears to be decisive, in assessing whether there is a substantial deprivation, is the loss of the economic value or economic viability of the investment. In this sense, some tribunals have focused on the use and enjoyment of property. The loss of viability does not necessarily imply a loss of management or control. What matters is the capacity to earn a commercial return. After all, investors make investments to earn a return. If they lose this possibility as a result of a State measure, then they have lost the economic use of their investment."[110]

Since this is an area of debate in investment arbitration, I rely on the considerations of the tribunal in *El Paso v Argentina* to further illustrate my claim. As these arbitrators affirmed, the most cited formulation of the loss of value approach is found in the award in *Metalclad v Mexico,*[111] where the tribunal held that an expropriation "has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State."[112] In relation to this approach, the arbitrators in *El Paso v Argentina* made a similar point to the one I am making. They explained that

108 *Ibid.*, at 88.
109 See *Telenor v Hungary*, ICSID Case No. ARB/04/15, Award, 13 September 2006, at 66 (footnote 13); *Parkerings-Compagniet v Lithuania*, ICSID Case No. ARB/05/8, Award, 11 September 2007, at 455.
110 *Burlington v Ecuador*, ICSID Case No. ARB/08/5, Decision on Liability, 14 December 2012, at 397.
111 See *El Paso v Argentina*, ICSID Case No. ARB/03/15, Award, 31 October 2011, at 252.
112 *Metalclad v Mexico*, ICSID Case No. ARB(AF)/97/1, Award, 30 August 2000, at 103.

> "the loss of benefits is a result of a deprivation of the use of the investment [and] that the tribunal in Metalclad did not hold that there was an expropriation because the benefits of the investor were not as expected."[113]

The difference between this and my observation is a matter of perspective. For my argument, the interesting question is why investment tribunals continue referring to the loss of the ability to earn the expected benefits from the concrete activity as something that matters for a decision (The award in *Burling v Ecuador* was rendered after the decision in *El Paso v Argentina*). It is obvious that if the foreign investor cannot carry out the concrete investment, he will not earn the expected benefit from that project. If TECMED was not allowed to run the waste disposal unit, it would not make any return from this activity. However, the foreign investor may be allowed to carry out many other activities and acquire those benefits. Since the loss of benefits or value from the concrete activity only matters for quantifying the compensation, after a decision on liability, the focus on these elements is only explicable through the neo-utilitarian rationale that lies in the foundations of a substantive rule of law, i.e. assuring foreign investors some level of calculability regarding their expected income and benefits. As the tribunal in *Burlington v Ecuador* put it, "[a]fter all, investors make investments to earn a return."

Finally, I turn to the award in *Total v Argentina* to show that this neo-utilitarian rationale also applies to awards regarding foreign investors' legitimate expectations in the context of the FET standard. The award in *Total v Argentina* considered that

> "[t]he fair and equitable treatment standard of the BIT has been objectively breached by Argentina's actions, in view of their negative impact on the investment and their incompatibility with the criteria of economic rationality, public interest (after having duly considered the need for and responsibility of governments to cope with unforeseen events and exceptional circumstances), reasonableness and proportionality. A foreign investor is entitled to expect that a host state will follow those basic principles (which it has freely established by law) in administering a public interest sector that it has opened to long term foreign investments. Expectations based on such principles are reasonable and hence legitimate, even in the absence of

[113] *El Paso v Argentina*, ICSID Case No. ARB/03/15, Award, 31 October 2011, at 252.

specific promises by the government. Hence, the fair and equitable standard has been breached through the setting of prices that do not remunerate the investment made nor allow reasonable profit to be gained contrary to the principles governing the activities of privately owned generators under Argentina's own legal system. This is especially so in the utility or general interest sectors, which are subject to governmental regulation (be it light or strict), where operators cannot suspend the service, investments are made long term and exit/divestment is difficult."[114]

This passage suggests that host states cannot modify policies freely established by law at the moment of establishment. The notion that Argentina could make reasonable and proportionate changes is qualified by an economic rationality that these changes would need to follow and respect. According to this trend just illustrated in indirect expropriation cases, the host country would have needed to consider whether the foreign investor would have continued to receive an adequate remuneration and a reasonable profit for the investment. Whilst saying this, it is important to note that the arbitrators in *Total v Argentina* also found that the Claimant had an acquired right to have the tariff adjusted in accordance with Argentine Law. This point leads precisely to the same observation made before. It is not the same to claim that Total had acquired a right to charge a particular amount, which Argentina had to respect, as to argue that changes in host state policies need to be compatible with foreign investors' expected remuneration and profit, arguably in accordance with the conditions at the moment of the investment.

This second way of reasoning focuses on the neo-utilitarian rationale that guides a substantive rule of law, turning this argument into an important variable for assessing the consistency and predictability of changes. The implications of this approach emerge from the following passage of *Total v Argentina*:

"In the case of a 'normal' devaluation of the peso, the de-dollarisation of the gas tariffs would not have been economically justified nor socially necessary,

[114] *Total v Argentina*, ICSID Case No. ARB/04/01, Decision on Liability, 27 December 2010, at 333.

and might thus be objectionable under the fair and equitable treatment clause of the BIT."[115]

In principle, the monetary policy of a country is part of the general legislation, and individuals do not have a right vis-à-vis changes in these rules unless they enter into contractual commitments with the host state. Thus, the consideration of the *Total v Argentina* tribunal regarding the consequences of a normal devaluation appear to be the result of a reasoning very much based on a substantive rule of law following a neo-utilitarian rationale. The arbitrators did not provide much detail regarding this alleged right against normal devaluations, however, given that the circumstances in the dispute were far from normal.[116]

Furthermore, the application of this way of reasoning gives rise to new questions. For instance, tribunals will need to determine what constitutes a reasonable profit margin and which circumstances need to be considered for its calculation. In addition, the generalisation of this approach can create problematic implications for relations between foreign investors and host states. If every tribunal followed this idea of economic rationality, i.e. that the consistency and predictability of changes needs to pay attention to foreign investors' expected benefits, many legal changes could trigger the need for compensation on the basis that an oil or a mining project, for example, could not continue making such a level of profit.

All in all, some investment awards rendered before the recalibration process, such as *TECMED v Mexico*, and most decisions taken after the mid-2000s show the influence of a substantive rule of law. The general position is that any change in the legal order needs to be consistent and predictable for the foreign investor. The analysis of investment awards shows that no investment tribunal begins with the premise that foreign investors should expect any change that is procedurally fair and legitimate (no matter how inconsistent with the previous order) provided that it does not deprive them of their property rights over the resources (i.e. their ownership in accordance with formal and informal social norms, –vernacular legitimate expectations – plus any contractual commitment or vested right). Conversely, foreign investors' expectations, as defined by the reliance theory, constitute the *baseline* for judging the consistency of any change in the legal order. I have explained that the maintenance of the existing legal framework, with

[115] *Ibid.*, at 161.
[116] *Ibid.*, at 145-150; 151-158.

necessary adjustments due to economic and social change, and foreign investors' ability to earn a reasonable profit in view of the initial conditions of the investment are some of the elements that guide investment arbitrators when considering the consistency and predictability of changes. This conclusion does not disregard that these criteria and the position regarding the exercise of host state authority have relaxed since *TECMED v Mexico*, however the question is whether this relaxation (or recalibration) can redress the potential excesses I have illustrated in the substantiation of foreign investors' rights.

Conclusion

This chapter has examined the formulation of and answer to the two questions that substantiate foreign investors' rights in accordance with the doctrine of legitimate expectations. The reliance theory and a substantive rule of law not only answer but also shape the questions that determine the interpretation of investment arbitrators. I have shown that investment arbitrators substantiate foreign investors' legitimate expectations using a contractual approach based on the reliance theory, and a neo-utilitarian rationale according to a substantive rule of law. An analysis of the reliance theory in investment awards shows that foreign investors' legitimate expectations are recognised and enforced independently from the intention of host states and a bargain. The application of the reliance theory focuses on the position of the *promisee*: i.e. the foreign investor. Although I have acknowledged an incipient tendency in investment awards to pay more attention to the specificity of host state acts, I have explained that foreign investors' expectations continue to be – to a large extent – the outcome of the reliance theory. In addition, I have shown the importance of a substantive rule of law for the substantiation of foreign investors' legitimate expectations. The prevailing interpretation in investment awards describes this principle as a mechanism for slowing down and circumscribing the boundaries of change. The premise is that changes need to be consistent and predictable, and, I have claimed, the baseline for assessing these standards is precisely foreign investors' expectations.

Against this background, it is necessary to consider the consequences of these interpretative choices beyond legal doctrine. I have anticipated in this chapter that the substantiation of foreign investors' rights can be conflicting with some of the principles that govern property rights. However, I have not yet concentrated on the social implications of this interpretative approach.

CHAPTER 7 – A NORMATIVE CRITIQUE OF FOREIGN INVESTORS' RIGHTS

Introduction

The objective of this chapter is to explore the normative implications of the interpretative choices made by investment arbitrators when substantiating foreign investors' rights. I am referring to the application of the reliance theory and a substantive rule of law. I rely on a socio-relational understanding of property to illustrate the potential effects that foreign investors' rights can have on host countries and populations. Whilst this approach has been championed by realist and progressive scholars, authors such as Madison and Coase also agree with the premise that property rights shape individual behaviour. Adopting this line of argument, I claim that the substantiation of foreign investors' rights can have problematic implications for the social institutions and practices in host countries. Although it would be disproportionate to claim that the IIR has the ability to destroy communities, I do argue that investment arbitration can create effects similar to those of any domestic constitutional property jurisdiction. Thus, for example, through the consideration of alleged construction rights these two mechanisms can have repercussions on the urban shape of a town. On a more abstract level, I claim that the IIR may be privileging wealth maximisation over the ability of host countries to establish a decent order where foreign and national individuals can flourish.

I examine two ways in which the IIR has gone *too* far in the substantiation of foreign investors' rights. First, I argue that the application of the reliance theory, and especially the focus on the position of the foreign investor, deprives people in host countries of their ability to participate in deliberations and oppose the creation of legitimate expectations. In fact, local populations may only learn about the existence of these expectations when there is a threat of an investment arbitration. This affects a procedural rule of law and democratic principles. Second, I claim that investment arbitration implies more than the protection of foreign investment from political risk: it is a way of enhancing the position of already powerful multinational corporations. Given the negotiation dynamics of foreign investment, I argue that the IIR has a greater impact on developing and least developed countries, making the weak weaker.

A. The socio-relational implications of foreign investors' rights

The specification and enforcement of foreign investors' rights is not a simple doctrinal question. To some extent, this is because what shapes the content of these proprietary rights are the normative choices of adjudicators. Understanding the interpretation of foreign investors' rights requires therefore penetrating the political morality or comprehensive view of investment arbitrators. Lehavi recognises, in this regard, that the substantiation and enforcement of property rights is not only about preventing abuse. Property rights incorporate "ideas about ethics, justice, morality, or any other values and goals."[1] In this light, then, the main reason why this question is not simply doctrinal refers to the potential effects that the substantiation of foreign investors' rights can have on the people living where the resources are located. The recognition or rejection of certain values in the underlying rights to these resources has an impact on the local population.[2]

In property theory, it has been recognised that property norms shape inter-individual as well individual-state relations. According to Rose, property has an "intensely social nature."[3] She remarks that if property is the keystone right of our liberal societies, the reason "might lie in whatever truth there is in the civilising argument."[4]: "[P]roperty inculcates the moral and civil behavior on which rights depend"[5] This claim is neither completely new nor limited to a progressive position. Madison defends the incorporation of private property in the bill of rights for the "impact it might have on the 'sentiment' of the people."[6] Similarly, Coase sees a connection between the substance of property rights and individual behaviour when he defines the question of private property rights as "the choice of different social arrangements for the solution of economic problems."[7] His

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[1] Lehavi, Amnon, "The Global Law Of The Land," 81 *University Of Colorado Law Review* (2010), p. 469.
[2] On the broad role of law as "the central art by which community and culture are established, maintained and transformed," see Boyd White, James "Law as Rhetoric, Rhetoric as Law: The Arts of Cultural and Communal Life," 52:3 *The University of Chicago Law Review* (1985), pp. 684-702.
[3] Rose, Carol, "Introduction: Approaching property," in *Property and Persuasion*, Colorado: Westview Press, 1994, p. 4.
[4] Rose, Carol, "Property as the Keystone Right?," 71:3 *Notre Dame Law Review* (1996), p. 364.
[5] *Ibid.*, p. 351.
[6] Fisher, William, "The significance of public perceptions of the takings doctrine," 88 *Columbia Law Review* (1988) p. 1783.
[7] Coase, Ronald, "The Problem of Social Cost," 3 *Journal of Law and Economics* (1960),p. 43.

suggestion, ultimately, is to think about factors of production as property rights assuming that this would affect social patterns of behaviour.[8]

The premise that the content of foreign investors' proprietary rights has intense social implications may be new to international investment scholarship but it is not new to property theory.[9] The effects created by the substantiation of rights, particularly in the area of property, have been recognised by several scholars. Nedelsky argues that rights are a means of "articulating society's core values and for holding government accountable to those values."[10] In this regard, she recognises together with Singer and Alexander the relational character of property.[11] Singer illustrates this point as follows:

> "Property norms are standards that help allocate and define the legitimate interests of persons with respect to control of valued resources. More fundamentally, property norms shape our understanding of the meaning of property rights and the legitimate contours of social relationships."[12]

The relational character of property shows that there is not a clear distinction between the private and the constitutional domains of property law. As Alexander argues, the "the private and the public are inevitably interdependent."[13] Although property law is often divided into private property and constitutional property law, this distinction can obscure the implications that the enforcement of private property rights against states can have on the community. The Constitutional interpretation of property guides all property legislation.[14] In this respect, Lehavi argues that the fact that the IIR only governs the relation between foreign

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[8] *Ibid.*, pp. 43-44.

[9] See Lehavi, Amnon and Amir Licht, "BITs and Pieces of Property," 36 *Yale Journal of International Law* (2011),pp. 115-166; Pistor, Katharina, "Contesting Property Rights: Towards an Integrated Theory of Institutional and System Change," 11:2 *Global Jurist, Frontiers* (2011), article 6.

[10] Nedelsky, Jennifer, *Law's Relations: A Relational Theory of Self, Autonomy, and Law*, New York: Oxford University Press, 2012, p. 232.

[11] Singer, Joseph, "The Reliance Interest in Property," 40:3 *Stanford Law Review* (1988), pp. 611-751; Nedelsky, Jennifer, *Law's Relations: A Relational Theory of Self, Autonomy, and Law*, Chapter 6; Alexander, Gregory, *The global debate over constitutional property: lessons for American takings jurisprudence*, Chicago: University of Chicago Press, 2006, p. 4.

[12] Singer, Joseph, "How property norms construct the externalities of ownership," in Alexander, Gregory and Eduardo Peñalver, *Property and Community*, New York: Oxford University Press, 2010, p. 65.

[13] Alexander, Gregory, *The global debate over constitutional property: lessons for American takings jurisprudence*, p. 4.

[14] See van der Walt, A, *Property and constitution*, Pretoria: Pretoria University Law Press, 2012.

investors and host states does not mean that investment arbitration has no consequences for the local population and the domestic private law.[15]

The analysis of these consequences requires exploring further the connection between property and community. In property theory, authors generally refer to community as "social institutions and practices."[16] For them, property norms shape social institutions. Given that this conception of community aims to convey the relation between the private and the public domains, I suggest it is useful to draw a parallel with Aristotle's idea of common interest.[17] According to Aristotle, as Zhu explains, individuals may have different ideas about common interest but these ideas tend to converge amongst those individuals who share social institutions and practices in a particular place and time.[18] Some property scholars think about property and community in these terms, recognising that "[a]s a social institution, community exhibits a remarkable diversity of forms, covering a wide spectrum of practices."[19] Alexander, Peñalver, Singer and Underkuffler stress that property incarnates "plural and incommensurable values."[20]

Indeed, Lehavi claims that "property can create, maintain, or destroy community."[21] He explains that "[o]ne prominent setting in which communal property is considered to play a constitutive role in the definition and understanding of 'community' is that of self-perceived insular religious, ethnic, or ideological groups."[22] However, "the interconnectivity between property and community is much more complicated and multifaceted than the specific instance of collectively-owned property within highly distinctive sub-society enclaves."[23] The work of Lehavi focuses on how states by modifying property laws can affect the social practices of a group of people living in the national territory.[24] In this respect, he provides a framework for understanding the relations between local groups and states regarding property rights. He claims that property rules can

[15] Lehavi, Amnon and Amir N. Licht, "BITs and Pieces of Property," pp. 117, 130, 134.
[16] Alexander, Gregory, "Unborn Communities," Cornell Law School research paper No. 13-83 (2013), p. 5.
[17] Zhu, Rui, "Distinguishing The Public from The Private: Aristotle's solution to Plato's Paradox", XXV:2 *History of Political Thought* (2004), p. 238.
[18] *Ibid.*
[19] Alexander, Gregory, "Unborn Communities," p. 5.
[20] Alexander, Gregory, Eduardo Peñalver, Joseph Singer and Laura Underkuffler, "A Statement of Progressive Property," 94 *Cornell Law Review* (2009), p. 743.
[21] Lehavi, Amnon, "How Property Can Create, Maintain, or Destroy Community," 10:1 *Theoretical Inquiries in Law* (2009), Article 3.
[22] *Ibid.*, p. 44.
[23] *Ibid.*, p. 45.
[24] *Ibid.*, pp. 44-45, 67.

become an important issue in the relationship between these two actors, accepting that in some circumstances state institutions are justified in intervening in the community.[25]

The work of Lehavi provides some useful tools for considering the consequences that the substantiation of foreign investors' rights can have on the population living in the location of the foreign investment. It is true that investment arbitration cannot be compared to host states, as investment tribunals do not have the political power to pass general legislation. However, as I have shown in previous chapters, investment arbitrators very often substantiate foreign investors' rights, and this interpretation can affect the values of the local population. The effects of investment tribunals are not on the same scale as the effects of state reforms. Nevertheless, it is formalistic to disregard these effects with regard to social practices and values. The propensity for smoking, for instance, may not destroy a community but it can have other subtle and nuanced implications for local populations. Thus, we can arguably see the effects created by investment arbitration as equivalent to those of any domestic constitutional property jurisdiction.

Investment disputes usually refer to issues that are socially sensitive and matter for the local population. The socio-relational repercussions of investment arbitration show that the IIR does not operate simply as a mechanism for enforcing foreign investors' rights against host state behaviour. The initiatives of host states are supposed to be closely related to the preferences and values of local populations. What is at stake, therefore, it is not an abstract idea of state sovereignty.[26] Investment arbitrators can affect the community when substantiating foreign investors' rights. Thus, for instance, we can imagine the situation of a group of people who live near a waste disposal unit as in the cases of *TECMED v Mexico* (2003)[27] and *Metalclad v Mexico* (2000).[28] Describing the issue in these disputes as a problem concerning foreign investors' legitimate expectations and host state potential arbitrary behaviour overlooks the position of the local inhabitants. It is difficult not to see that what lies behind a state initiative could be the preference of the population to live in a clearer environment. This does not

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[25] *Ibid.*, pp. 66-67.
[26] See Dreyer, Michael, "German Roots of the Theory of Pluralism," 4:1 *Constitutional Political Economy* (1993), pp. 12-13.
[27] *TECMED v Mexico*, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003.
[28] *Metalclad v Mexico*, ICSID Case No. ARB(AF)/97/1, Award, 30 August 2000.

mean that the local preferences should prevail. However, the issue is that the substantiation of foreign investors' legitimate expectations can inadequately regard these preferences.

A similar observation can be made in relation to many other cases in investment arbitration. The situation of a town close to a nuclear plant as in the case of *Vattenfall v Germany* (2011 and pending) is not very different to the disputes regarding waste disposal facilities in Mexico.[29] People living in these locations could be afraid of nuclear energy or may oppose this type of activity on moral grounds. Similarly, the exploitation of minerals can affect the life of locals as in *Pacific Rim v El Salvador* (pending);[30] entire countries may have to live in a society with a higher propensity for smoking as in *Philip Morris v Uruguay* (pending)[31] and *Philip Morris v Australia* (pending);[32] or a whole nation could be obstructed in its attempts to redress historical inequalities as in *Foresti v South Africa* (2010).[33] The list goes on.

Following this line of analysis, it is possible to distinguish on a more abstract level the "background understandings" that shape foreign investors' rights and affect local populations.[34] This allows us to consider in more detail the subtle and problematic implications of the doctrine of legitimate expectations. For this, I rely on Rose's and Alexander's work to identify two extremes in the normative spectrum: wealth maximisation and a decent order where individuals can flourish. An important premise of my work is that investment arbitrators need to assess the content of foreign investors' rights to determine whether the host state has abused its political authority. In this regard, I have engaged with the work of many property scholars who ultimately claim that the core of takings disputes lies in an arguably more difficult question. Rose puts this very clearly. She claims that in response to the question "what does your private property right include?," we should ask another more complex question: "what are we trying to accomplish with a private property regime?"[35] In the case of the United States, Rose affirms that private property includes values in favour of the "maximization of preference

[29] *Vattenfall v Germany*, ICSID Case No. ARB/09/6, Award, 11 March 2011; *Vattenfall v Germany*, ICSID Case No. ARB/12/12.
[30] *Pac Rim Cayman LLC v El Salvador*, ICSID Case No. ARB/09/12.
[31] *Philip Morris v Uruguay*, ICSID Case No. ARB/10/7.
[32] *Philip Morris v Australia*, UNCITRAL, PCA Case No. 2012-12.
[33] *Piero Foresti v South Africa*, ICSID Case No. ARB(AF)/07/01, Award, 4 August 2010.
[34] See Singer, Joseph, "How property norms construct the externalities of ownership," p. 67.
[35] Rose, Carol "'Takings' and the Practices of Property: Property as Wealth, Property as 'Propriety'," in *Property and Persuasion*, Colorado: Westview Press, 1994, p. 50.

satisfactions" to "increase the size of the bag of goods," and a norm that tries to present property as a "vehicle for propriety and decent good order."[36] She refers to the second approach as "property as propriety."[37]

More recently, Alexander has argued that the purpose of property should be to make humans flourish. Accordingly, a decent order would provide every person with "the opportunity to live a life as fulfilling as possible for him or her."[38] Alexander recognises the importance of utilitarianism in his work but, like Michelman[39] and Waldron,[40] he shifts the focus to the goal that is being pursued efficiently (wealth maximisation, plural individual preferences or human flourishing). In this respect, he reminds us of the civil republican position for which the purpose of property is not wealth maximisation but the assurance of individual autonomy.[41] The focus on individual autonomy gives property a plural character as opposed to the singular objective of wealth maximisation.

The common denominator between the positions of Rose and Alexander is that the social institution of property should not be about wealth maximisation only. Both scholars have criticised the excessive focus on neo-utilitarianism. There is important literature claiming that the goal of states and individuals when specifying and enforcing private property rights is to maximise wealth. For instance, the goal of North's neoclassical state is economic growth.[42] Rose explains that utilitarian and neo-utilitarian justifications for private property are good arguments because they concentrate on the wealth creation dimension in property. The question of distribution, for instance, makes no sense if there is nothing to distribute.[43] Thus, it would be a mistake to minimise the importance of wealth maximisation for property institutions, or to assume that people do not care about wealth maximisation. Nevertheless, an excessively neo-utilitarian approach marginalises individual autonomy and the socio-relational character of property. Wealth maximisation cannot be the only purpose of property. There is a need for balance in property regimes. In this regard, Richard Ely explained a century ago that

[36] *Ibid.*, p. 64.
[37] *Ibid.*, pp. 58-65.
[38] Alexander, Gregory, "Property's Ends: The Publicness of Private Law Values," Cornell Law Faculty Working Papers, Paper 107 (2013), pp. 2-3.
[39] Michelman, Frank, "There Have To Be Four," 64 *Maryland Law Review* (2005), p. 157.
[40] Waldron, Jeremy, *The right to private property*, Oxford: Clarendon Press, 1988, pp. 73-79
[41] Alexander, Gregory, "Property's Ends: The Publicness of Private Law Values," pp. 6-7.
[42] North, Douglas, *Structure and Change in Economic History*, New York: W.W. Norton & Company, 1981, pp. 20-21.
[43] Rose, Carol, "Introduction: Approaching property," pp. 3-4.

property is made by "the individual side and the social side. If one disappears, it ceases to exist because private property will destroy social life."[44]

Against this background, I argue that the IIR creates an imbalance in favour of wealth maximisation to such an extent that it can affect the values of local populations. My principal argument is that investment awards may have gone too far in defining foreign investors' rights using methods of reasoning that privilege wealth maximisation through foreign investment. Waldron, for instance, claims that the use of a substantive rule of law as a way of justifying and substantiating property rights

> "takes the perspective of an outsider, interested only (like the investor that Robert Barro referred to when he talked about the Sale and Purchase of Rule-of-Law indexes) in what can be extracted from a given society."[45]

Investment arbitrators mainly focus on the expectations of foreign investors and the allegations of host state abusive or arbitrary behaviour. However, the issue is not only whether the state has abused its political authority. Investment disputes very often concern populations and individuals who also have plans and expectations. A significant effect of the way investment arbitrators substantiate foreign investors' rights is that local populations can be left in the position of mere witnesses in the enduring struggle for the content of the proprietary rights. It is understandable that foreign investors would prefer a world where the purpose of property rights was global wealth maximisation. For multinational corporations, plural and local property norms varying in accordance with the values of local populations do not constitute the ideal setting for wealth maximisation.

Along these lines, I argue that there are two concrete ways in which the substantiation of foreign investors' rights can constitute an obstacle to establishing a decent order where foreign and national individuals can flourish. First, when applying the doctrine of legitimate expectations investment arbitrators overlook the fact that some foreign projects can be extremely disturbing for local populations. The exploitation of land and other natural resources can create

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[44] Ely, Richard, *Property and Contract in their Relation to the Distribution of Wealth*, Volume 1, New York: Macmillan, 1914, p. 165.

[45] Waldron, Jeremy, *The rule of law and the measure of property*, Cambridge: Cambridge University Press, 2012, pp. 105-106.

prospects of "great evils" that are "not always tolerable."[46] The key to this argument is that by accepting that foreign investors can rely on inducements, declarations, speeches and the general legislation of the host state, the IIR deprives the population in host countries of the ability to oppose the creation of legitimate expectations before it is too late. Second, I claim that the substantiation of foreign investors' rights makes the powerful more powerful. The original and still most popular justification for the IIR is the need to limit host state abuse of power after the establishment of the project. However, investment awards have effects regarding the distribution of control that are unrelated to protection against political abuse. In particular, the negotiation dynamics of foreign investment in the case of developing and least-developed countries can contribute to "extreme and growing inequalities."[47] I explore these two arguments further in the following sections.

B. The rights of local populations to know and participate in decisions regarding the use of resources

The reliance theory fixes the focus of the legal reasoning on the expectations of the promisee. Host states make inducements or underline the pro-investor features of their legal order to attract foreign investors, and foreign investors often rely on these declarations. The argument is that disregarding these expectations is unfair. This interpretative approach essentially concentrates on the certainty and predictability for foreign investors regarding the conditions that will govern their investments. In Chapter 6, I explained that this approach is justified by a neo-utilitarian rationale. In practice though, the reliance theory may or may not facilitate wealth maximisation through foreign investment. In either case, I argue that this method of interpretation overlooks socio-relational implications, affecting the right of the people living in that location to express their views regarding the use of the resources.

Let us critically examine the position of Reisman and Arsanjani as a starting point for this argument. These authors claim:

[46] *Ibid.*, p. 103. See Stiglitz, Joseph, *Making globalization work: the next steps to global justice*, New York: W.W. Norton & Company, 2006, p. 187; Muchlinski, Peter "The Bhopal Case: Controlling Ultra hazardous Industrial Activities Undertaken by Foreign Investors," 50:5 *The Modern Law Review* (1987), pp. 545-587.

[47] Waldron, Jeremy, *The rule of law and the measure of property*, p. 104.

"In the context of foreign investment it is common for heads of state and ministers of developing countries to address groups of foreign investors with the intention of encouraging them to invest in their countries. With the availability of on-line communication systems, websites of embassies or other government websites provide information about domestic law, and government policy with regard to foreign investment. Where statements are made either orally or distributed in writing in either hard copy or on-line, clearly promising certain conditions or treatment for foreign investors and such statements are made public and are made repeatedly and foreign investors relied on them, and governments do not retrieve or qualify those statements of commitment before the conclusion of contracts with foreign investors, they should, in our view, bind the state. Even if such statements and declarations were inconsistent with domestic law or provided terms more generous and above the indulgences found in a relevant BIT, they could be binding as a matter of international law. Such a conclusion in a particular case would be consistent with the rules of international law of attribution of an *ultra vires* act to a state and reflects the fundamental policy of law, *pacta sunt servanda*."[48]

At first glance, we see that Reisman and Arsanjani point to some elements that are not necessarily the rule in investment awards and in foreign investment practice. They stress the public character of the inducements for instance, a point that has not been highlighted as crucial in investment awards. I have referred to some awards that have developed the issue of the specificity of the representations. However, even in these cases, tribunals have not stressed the public character of the representations or assurances. I suggest that what Reisman and Arsanjani mean by the public character of the inducements is in fact unclear, unless they are referring to business meetings or gatherings where government officers and representatives of foreign investors meet and discuss the potential investment. These business meetings, however, are not really public even if some information may reach the press, whilst at public events government officers always speak in

[48] Reisman, Michael and Mahnoush Arsanjani, "The Question of Unilateral Governmental Statements as Applicable Law in Investment Disputes" 19:2 *ICSID Review – Foreign Investment Law Journal* (2004), p. 343.

general terms to a broad audience. The reality of foreign investment negotiations is more their lack of transparency for the general public (beyond the foreign investor and the state).[49] Thus, what may reach the general public domain are simply acknowledgements that the negotiations have taken place or the establishment of the project, but there is little or no information regarding declarations that could serve as bases for legitimate expectations.

Furthermore, Reisman and Arsanjani refer to legitimate expectations arising from host state declarations as if foreign investors and host states always conclude a contract covering all the relevant issues. I have stressed that in reality these actors may never sign a contract at all, or may never sign a contract covering the issue that was the object of the declaration. Now, when they sign a contract, according to the position advocated by Reisman and Arsanjani, this implies that the alleged inducements become binding unless the agreement explicitly states the contrary. As I have explained, the dominant position in investment awards is slightly different and representations can give rise to legitimate expectations even if no contract was in fact executed. The award in *Glamis v U.S.A.*, which has been criticised for being host state friendly, accepts that legitimate expectations can emerge from a quasi-contractual scenario.[50]

In this doctrinal context, I claim that the broader question that has not been posed directly is how do we expect local populations to participate in the negotiation process and oppose the formation of these legitimate expectations? According to the view that emerges from the awards and the doctrine, it will certainly not be by controlling the execution of contractual commitments or the issue of permits or licences. Several awards explain that legitimate expectations are not legally binding obligations and can emerge from implicit representations. Reisman and Arsanjani probably go further. They claim that the inducements may be the outcome of *ultra vires* or illegal behaviour in relation to domestic law, but

[49] See International Institute for Sustainable Development, "Lifting the Lid on Foreign Investment Contracts: The Real Deal for Sustainable Development," 1 *Sustainable Markets* (2005), pp. 2-4; Shemberg, Andrea, "Stabilization Clauses and Human Rights," International Finance Corporation and the United Nations Special Representative to the Secretary General on Business and Human Rights (2008), p. 41.

[50] Ryan, Margaret, "Glamis Gold, Ltd. V. The United States and the Fair And Equitable Treatment Standard," 56:4 *McGill Law Journal* (2011), pp. 919-958; *Glamis v USA*, UNCITRAL – NAFTA, Award, 8 June 2009, at 766.

that these circumstances should not prevent legitimate expectations from being enforced against host states.[51]

The local population has a chance to participate in the legislative deliberations. In the investment disputes regarding plain packaging in Australia and Uruguay, however, it is worth considering when people were informed about a law granting tobacco companies the absolute right to use their brands for marketing purposes. Similarly, individuals and NGOs can participate in an administrative process and challenge any final decision. Yet, in the cases of *Metalclad v Mexico* and *TECMED v Mexico*, the issue was precisely that the foreign investors had an expectation of a permit even if this vested right was never issued. Again, the question is when did the population of Mexico have the opportunity to oppose the creation of the legitimate expectations? As UNCTAD notes, "[m]inisterial signature of a contract may be a requirement, and there may be other specific procedures for review and scrutiny of the contract."[52]

Bypassing these procedures affects host populations, making the reliance theory in the context of the IIR subject to the criticism made by Barnet in the domain of contract law: "Freedom of contract entails both freedom to contract – the power to effect one's legal relations by consent – and freedom from contract – the immunity from having one's right to resources transferred without one's consent."[53] The IIR, however, is not about inter-individual relations that have limited effects on third parties. The doctrine of legitimate expectations and the reliance theory can affect entire cities or countries. By the time people suffer the effects of the foreign investment, the legitimate expectations are already there. Individuals in the host country may be unaware of the expectations of the foreign investor until they face a water crisis. Later, entire populations can pressure their own governments but the ghost of the investment arbitration can become an obstacle to their requests being fulfilled.[54]

It is possible to object that I am describing an idealist view of the process in Congress or the administration, but the fact that the local legislative body and

[51] This view is shared by other scholars and tribunals. See von Walter, André, "The Investor's Expectations in International Investment Arbitration," 6:1 *TDM* (2009), pp. 4-5; *Southern Pacific Properties v Egypt,* ICSID Case No. ARB/84/3, Award, 20 May 1992, at 82-83.
[52] UNCTAD, "State Contracts," New York and Geneva: United Nations, 2004, p. 4.
[53] Barnett, Randy, "The Sound of Silence: Default Rules and Contractual Consent," 78 *Virginia Law Review* (1992), p. 828.
[54] See *Aguas del Tunari v Republic of Bolivia*, ICSID Case No. ARB/02/3; Anderson, Sarah and Sara Grusky, "Challenging Corporate Investor Rule," Food and Water Watch (2007), p. 18.

administration are deficient in the host state should not serve to justify the problematic implications of the IIR. According to my argument, the outcome of many investment awards regarding legitimate expectations is the promotion of a political environment that limits political participation. If the domestic system already limits this participation substantially, the IIR either stresses or consolidates this trend. This goes against a procedural rule of law and democratic principles. Waldron elaborates the importance of the legislative due process for the rule of law. In his Hamlyn lecture, he claims that a substantive rule of law threatens principles that are essential for a democracy.[55] In addition, Rosanvallon explains that indirect means of participation are essential in contemporary democracies. His work shows that the importance of voting representatives has declined in modern democracies, whilst people's participation through regulatory bodies has acquired an unprecedented significance.[56] Finally, many scholars claim that the justification for democracy lies precisely in this process of deliberation. The most important in this respect is probably Habermas, who focuses on the relevance of the procedural elements of the rule of law as the foundations of a democracy.[57]

What is more, the effects of the IIR in relation to people's right to participate in decisions regarding the use of resources can constitute violations of human rights provisions. Some human rights instruments protect the right to participate in government (and not only to elect and be elected). This is the case in the American Convention of Human Rights (Article 23), and the International Covenant on Civil and Political Rights (Article 25).

A more sophisticated critique of my claim would point out that investment arbitration reduces political participation in similar ways to domestic constitutional property disputes. Individuals cannot predict how judges will decide, and these decisions also have socio-relational effects. In this respect, Van Harten has already argued in response that an important difference between the domestic jurisdiction and investment arbitration is that populations have some control over judges, which they do not have in the case of investment arbitrators.[58] In addition to this procedural point, I argue that the crucial issue is the way investment arbitrators

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[55] Waldron, Jeremy, *The rule of law and the measure of property*, p. 107.

[56] Rosanvallon, Pierre, *La contre-démocratie: la politique à l'âge de la défiance*, Paris: Éditions du Seuil, 2006, pp. 35-121.

[57] Habermas, Jürgen, *The Inclusion of the Other: Studies in Political Theory*, Cambridge, Massachusetts: MIT Press, 1998, pp. 129-155.

[58] See Gus, Van Harten, Gus, *Investment treaty arbitration and public law*, New York: Oxford University Press, 2007, pp. 152-175.

substantiate foreign investors' rights. I am referring to the disproportionate effects of the reliance theory and a substantive rule of law. The scale of the reduction of political participation resulting from the IIR is highly significant. Once legitimate expectations are established, the scope for making changes without paying compensation is reduced. On the contrary, in a scenario without legitimate expectations, the host country would have more political scope to debate the effects of a foreign investment, and more authority to consider subsequent changes without paying compensation.

In brief, the reliance theory limits the scope for the deliberation and participation of the local population in relation to the use of resources. With regard to establishing a social order based on democratic principles such as participation, this is counterproductive. The lack of participation arguably increases the chances that foreign investment will lead to intolerable scenarios. In a democracy, the premise is that every individual has a right to give their opinion when a decision can affect them. This is a procedural but very important right. To be clear, I am not claiming here that local populations have an inalienable right to live, for instance, free of a waste disposal unit. My argument is not about substantive rights. On the contrary, this type of substantive view is put forward by investment awards when they affirm that foreign investors have a right to their legitimate expectations, instead of claiming that these individuals have a right to *fair and equitable* political treatment like any other good citizen of the host country.

C. Empowering foreign investors; making the weak weaker

Multinational corporations are economically powerful and politically influential,[59] and the literature concerning the increasing power of the usual foreign investors is abundant.[60] In the first part of this thesis, I presented the birth of the IIR as evidence of this power. Foreign investors need the IIR because, despite all their political influence, they cannot pass, modify or repeal laws. This is an important

[59] Dunning, John and Sarianna Lundan, *Multinational enterprises and the global economy*, Second Edition, Cheltenham, UK; Northampton, MA: Edward Elgar, 2008, p. 696.

[60] See Stopford, John and Susan Strange, *Rival states, rival firms: competition for world market shares*, Cambridge: Cambridge University Press, 1991; Reich, Robert, *The work of nations: preparing ourselves for 21st-century capitalism*, New York: Vintage Books, 1992; Chandler, Jr., Alfred and Bruce Mazlish (Eds.), *Leviathans multinational corporations and the new global history*, Cambridge: Cambridge University Press, 2005; Oman, Charles, "Policy Competition for Foreign Direct Investment," Paris: OECD, Development Centre, 2000, p. 77-80.

reason why the international business sector has lobbied and continues to lobby for the preservation of the IIR. Investment arbitration is described by the literature as the solution to the political risk that foreign investors face after establishment, i.e. the risk of change in the legal order.[61] However, I have shown that the IIR serves not only to cope with political risk but also to increase foreign investors' control over the resources of different countries. The application of the reliance theory and a substantial rule of law arguably enhances the power of multinational corporations, making the strong even stronger. In particular, I suggest that the form of empowerment resulting from the IIR has greater effects on developing and least-developed countries.

In previous chapters, I have shown that investment awards do more than enforce foreign investment protection: tribunals substantiate foreign investors' rights. I have concluded that investment arbitrators substantiate these rights relying on the reliance theory and a substantive rule of law. This interpretative approach focuses excessively on the position of the foreign investor. I have claimed that this is an expansive way of substantiating foreign investors' rights, beyond a bargain and the domestic legal order.

It is important to be clear regarding the effects of the IIR on foreign investors' rights. I have explained that investment treaties do not commodify resources that are inalienable according to host state laws. For instance, foreign investors cannot acquire rights over a river when this is impossible under host state laws. In addition, the IIR does not affect the rules allocating ownership to an individual. A foreign investor can only claim a right over a tract of land when they have completed the necessary formalities. However, I have explained that investment awards substantiate foreign investors' rights over the resources. Unless the domestic law or a contractual commitment provide clarity regarding the content of foreign investors' ownership, investment arbitrators need to consider the substance of the rights allegedly denied by host states. Following my argument that they do it in an expansive manner, we can conclude that the IIR enlarges foreign investors' control over resources.

This outcome is unrelated to and beyond the protection against political risk after the establishment of foreign investors. Indeed, since the investment arbitration

61 Salacuse, Jeswald and Sullivan, Nicolas "Do BITs Really Work?: An Evaluation of Bilateral Investment Treaties and Their Grand Bargain," 46 *Harvard International Law Journal* (2005), pp. 67-130.

boom of the 1990s, awards show as much concern for the procedural as for the substantive component of the FET standard. Thus, for instance, Philip Morris cannot only use its economic muscle and political influence to deter Uruguay and Australia from passing new anti-smoking legislation,[62] it can also launch an investment arbitration claiming that these countries are acting in breach of its *substantive* legitimate expectations regarding the use of its brand. The issue in these disputes relates neither to discrimination nor to political mistreatment. Philip Morris can file these claims with some prospect of them prevailing because investment awards substantiate foreign investors' rights according to the reliance theory and a substantive rule of law. Although the two cases regarding tobacco plain packing are pending, we should not disregard that the prospect of a claim prevailing is already a form of empowerment.

Furthermore, it is important to stress that the economic and political power of multinational corporations is not the same in relation to all countries. The political and economic power of the United States, Germany or France cannot be compared to that of El Salvador, Ecuador, or Bangladesh. These differences have implications for their dealings with foreign investors. A significant problem for many developing and least-developed countries is that they can lack the adequate skills to negotiate with multinational corporations.[63] Also, there is arguably a connection between skills, negotiation dynamics and the institutions of the host country.[64] Democratic institutions foster the development of mechanisms to take into consideration the situation and voice of the local population.[65] Finally, countries find themselves in weaker positions when they need foreign currency or a boost in their domestic economies.[66]

The evidence shows that countries deal with foreign investors differently.[67] A study conducted for the United Nations Special Representative to the Secretary

[62] An insight on the strategies employed by Philip Morris to prevent the issuance of plain packing laws can be found in Doward, Jamie, "Revealed: tobacco giant's secret plans to see off plain cigarette packets," *The Observer*, 27 July 2013.
[63] Dunning, John and Sarianna Lundan, *Multinational enterprises and the global economy*, p. 671.
[64] Li, Quan and Adam Resnick, "Reversal of Fortunes: Democratic Institutions and Foreign Direct Investment Inflows to Developing Countries," 57 *International Organization* (2003), pp. 175-211.
[65] See Frankel, Jeffrey, "The Natural Resource Curse: A Survey," HKS Faculty Research Working Paper Series, RWP10-005, John F. Kennedy School of Government, Harvard University (2010), pp. 15-17.
[66] Elkins, Zachary; Andrew Guzman and Beth Simmons, "Competing for Capital: The Diffusion of Bilateral Investment Treaties, 1960-2000," 60 *International Organization* (2006), pp. 811-846.
[67] See Dunning, John and Sarianna Lundan, *Multinational enterprises and the global economy*, pp. 686-687; Encarnation, Dennis and Louis Wells, "Sovereignty en garde: negotiating with foreign investors," 39 *International Organization* (1985), p. 55.

General on Business and Human Rights found that developed countries provide less or weaker stabilisation clauses than developing and least-developed nations.[68] Similarly, UNCTAD notes that the practice of signing state contracts with foreign investors is more frequent in developing countries.[69] In this respect, arguably, countries that need to provide more and stronger contractual commitments also make more declarations about the pro-investor character of their legal order. They need to show that their country is foreign investor *friendly*, for instance, by concentrating on their ranking in rule of law indexes.[70] This hypothesis is consistent with the scenario described by Reisman and Arsanjani in which only developing countries appear to be making inducing declarations. As a result, these countries negotiate with foreign investors in a more dangerous way given the risks posed by the reliance theory and a substantive rule of law. Their governments provide foreign investors with more grounds for the creation of legitimate expectations, amplifying the controversial effects of the IIR regarding the empowerment of foreign investors.

This argument can always be contested by referring to the benefits of attracting foreign investment through investment treaties. In some ways, these investments can improve the situation of the local population. Although the IIR seems to be an obstacle to people's participation and host countries' democracy, it can compensate for this by increasing wealth. In my view, however, this is still politically unfair, and could result, for instance, in an imbalanced distribution of the emerging benefits.

The literature not only finds problems in justifying the IIR on its own grounds, i.e. as a means to maximise wealth, but also identifies signs related to this imbalance. As Alvarez and Khamsi explain, the legitimacy of this regime is based on two premises: foreign investment is positive for development, and investment treaties attract foreign investment.[71] Yet, these two premises are contested. There is a long debate concerning the relation between foreign direct investment (FDI)

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68 Shemberg, Andrea, "Stabilization Clauses and Human Rights," pp. 32-34.

69 UNCTAD, "State Contracts," pp. 1-3.

70 Waldron, Jeremy, *The rule of law and the measure of property*, pp. 10-11, 49, 90-91 108;
Egan, Patrick, "Hard Bargains: The Impact of Multinational Corporations on Economic Reform in Latin America," 52:1 *Latin American Politics and Society* (2010), p. 10.

71 Alvarez, Jose and Khamsi, Kathryn, "The Argentine Crisis and Foreign Investors. A Glimpse into the Heart of the Investment Regime," in Karl Sauvant (Ed.), *The Yearbook on International Investment Law and Policy 2008/2009*, New York: Oxford University Press, 2009, p. 473.

and development. Sumner reviews several works regarding the connection between foreign investment and development, concluding that

> "FDI has become increasingly significant in developing countries. What does this mean for economic growth and poverty reduction? FDI is probably good for aggregate growth, but whether FDI is good for raising per capita incomes and thus reducing income poverty is still an open question."[72]

The best answer to this question is probably given by Cohen in his book about multinational corporations: "It depends."[73]

Some studies reveal some correlations between the lack of democratic institutions and foreign investment, and between the lack of democratic institutions and the negative effects of foreign investment on host populations and wealth distribution. A recent work by Asiedu and Lien on the relation between foreign direct investment in natural resources and democracy concludes that there is a negative correlation between democracy and the attraction of foreign investment in countries whose exports are dominated by natural resources.[74] In addition, according to Frankel, the governments of these countries would have little or no incentive to promote social equality.[75]

Furthermore, the evidence is not very favourable towards the IIR regarding the positive effects of investment treaties on attracting foreign investment. A survey of different works by UNCTAD shows that most studies come to different conclusions and that the effects, when positive, are relatively minor.[76] The positive consequences of the IIR could still be defended on the basis that signing investment treaties reduces the political risk perception. This constitutes the "Grand Bargain" described by Salacuse and Sullivan.[77] A recent study by Poulsen,

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72 Sumner, Andrew, "Is foreign direct investment good for the poor? A review and stocktake," 15:3-4 *Development in Practice* (2005), pp. 281, 269-285

73 Cohen, Stephen, "Multinational corporations and foreign direct investment: avoiding simplicity, embracing complexity," New York: Oxford University Press, 2007, p. 180.

74 Asiedu, Elizabeth and Donald Lien, "Democracy, foreign direct investment and natural resources," 84 *Journal of International Economics* (2011), pp. 99-111.

75 Frankel, Jeffrey, "The Natural Resource Curse: A Survey," p. 15.

76 See UNCTAD, "The Role of International Investment Agreements in Attracting Foreign Direct Investment to Developing Countries," New York and Geneva: United Nations, 2009.

77 Salacuse, Jeswald and Sullivan, Nicolas "Do BITs Really Work?: An Evaluation of Bilateral Investment Treaties and Their Grand Bargain," p. 77.

however, shows that investment treaties may not have an impact on the risk perception of political insurers.[78]

All in all, my analysis suggests that some of the investment law scholarship presents a view of the IIR that is at least partially distorted. I am referring to those commentators who describe the IIR as a regime aimed at addressing the political weakness of foreign investors. There is a difference between what the IIR is supposed to be and what this regime really is. As shown, political risk in fact serves as the normative basis for a regime that enhances the position of foreign investors vis-à-vis host states. The IIR does more than protect foreign investors from host state abusive behaviour as it increases their control over resources. This has consequences for host countries and local populations. The contribution of the IIR to the strengthening of multinational corporations is probably modest; yet, it consolidates negative scenarios for the people that live with foreign investments, particularly for those in developing and least-developed countries.

Conclusion

In this chapter, I have shown that investment arbitration very often affects the contours of social relations in host countries. An investment dispute normally involves more than an allegation of host state abusive or arbitrary behaviour: it also relates to the values of the local population. The argument that follows this premise is not that host states should always prevail. Investment tribunals have been established to assure that foreign investors' rights are respected and not denied by arbitrary measures. However, this task is more delicate than the investment literature assumes. Investment arbitration can hinder host social institutions and practices. Although investment tribunals do not have the political power to destroy a community, the outcome of an arbitration can have problematic implications regarding the use of the resources, the environment and reparation policies. On a more abstract level, I have argued that the imbalance created by investment awards accords with the excessive focus on wealth maximisation through foreign investment.

[78] Skovgaard Poulsen, Lauge "The importance of BITs for foreign direct investment and political risk insurance: revisiting the evidence," in Karl Sauvant (Ed.), *Yearbook on International Investment Law & Policy 2009/2010*, New York: Oxford University Press (2010).

In this regard, I have pointed to two concrete ways in which the application of the reliance theory and a substantive rule of law undermine the establishment of a decent order where foreign and national individuals can flourish. First, the substantiation of foreign investors' rights reduces people's participation in decisions about the use of resources, i.e. the creation of foreign investors' expectations. This result goes against a procedural rule of law and democratic principles. In addition, the doctrine of legitimate expectations further enhances the position of foreign investors, most of them already powerful multinational corporations. Investment awards have an expansive approach to the definition of foreign investors' rights. They substantiate these rights beyond a bargain and beyond domestic law. In particular, I have explained that given the negotiation dynamics of foreign investment, developing and least-developed countries tend to provide more grounds for the creation of legitimate expectations. This makes weak countries and populations weaker.

In brief, the conclusion of my analysis is that the substantiation of foreign investors' rights has gone too far in favour of wealth maximisation through foreign investment. This regime can produce problematic imbalances for the social life in host countries. The question that follows is whether the recalibration process and the public law tools for balancing and proportionality can neutralise these imbalances.

Chapter 8 – The interplay between foreign investors and host state authority

Introduction

The objective of this chapter is to consider whether public law tools, in particular balancing and proportionality, can save the IIR from the normative criticisms made in Chapter 7. The critique regarding the expansive substantiation of foreign investors' rights is only pragmatically relevant if investment tribunals enforce this content of the rights. After all, the extent to which foreign investors are in a position to exercise effective control over the resources of different countries is a function of both the content of their rights and the way in which investment arbitrators enforce these rights against host states. I argue that proportionality cannot save the IIR from my criticisms. In this respect, I put forward three main arguments. First, I claim that the application of a contractual approach based on the reliance theory shapes not only the substantiation of foreign investors' legitimate expectations but also the enforcement of these expectations. This reduces the importance that the threshold and the denominator normally have in constitutional property disputes. Second, I argue that proportionality may not be capable of balancing wealth maximisation with the establishment of a decent order where foreign and national individuals can flourish. For this, I rely on three premises: I show that balancing and proportionality analyses are neoformalist public law tools that have an intrinsic mediating character; I explain that the normative view that guides investment arbitrators' assessment of the circumstances favours scientific-based measures, and I point that investment arbitrators have applied proportionality when they were at least sceptical regarding the existence of foreign investors' expectations. Finally, I submit that even if investment arbitrators were to improve the application of proportionality, the essential issue lies in the purpose or core value of the IIR. In this respect, I argue that the challenge for this regime is to balance the excessive focus on wealth maximisation through foreign investment.

A. The interplay between foreign investors and host state authority: excessive burdens, balancing and proportionality

In a constitutional system, the authority of states to realise the preferences of the population is limited by the rights of individuals. Democratic states are expected to consider and pass new laws and regulations according to fair political and administrative procedures. These procedures not only need to be followed but they also need to be legitimate. If they are not, the measures could be found to be unconstitutional. In addition, if we take individual rights seriously, we assume that they can trump procedurally legitimate public measures. According to most constitutions and the IIR, this includes private property rights. The core of this thesis has concentrated on how investment arbitrators substantiate foreign investors' rights such in a way that they can trump state measures. Dworkin recognises that the characterisation of rights as political trumps is formal in the sense that it is the content of these rights that makes the difference in any concrete dispute.[1] However, the substantiation of foreign investors' rights is not the only legal question to resolve before ordering a host state to pay compensation. The decision that, for example, an agricultural foreign investment includes the right to use the water beneath for irrigation purposes does not necessarily imply that the state will need to pay compensation if it prohibited this particular use. A judgment that recognises the deprivation of a right over the resources plays an essential role in an investment dispute, but it does not necessarily lead to compensation unless we assumed that foreign investors must be compensated for any burden created by state authority, i.e. a sort of strict international liability rule.

Investment tribunals have consistently decided, at least formally, that host states do not need to pay compensation for every burden created for foreign investors and their investments. In the context of the IIR, this position can be at least traced back to the award in *TECMED v Mexico* (2003).[2] During the recalibration process, this trend has consolidated in awards such as *Saluka v the Czech Republic* (2006) and *Glamis v U.S.A.* (2009).[3] Expropriation and the substantive doctrine of legitimate expectations focus explicitly on the problem of host state intervention in the

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[1] Dworkin, Ronald, *Taking Rights Seriously*, London: Duckworth, 1994, p. xi.
[2] *TECMED v Mexico*, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, at 115.
[3] *Saluka v the Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, at 305-307; *Glamis v U.S.A.*, UNCITRAL – NAFTA, Award, 8 June 2009, at 357.

substance of foreign investors' rights. These standards aim to identify scenarios of political risk, distinguishing them from the regular use of host state authority. The text of investment treaties does not include principles or rules establishing the compensation for every burden affecting foreign investors. It is true that this probably contrasts with foreign investors' preference for preventing host states from passing any change that goes against their interests. As I have said, although some early investment awards described the IIR as a regime that stabilised host states' legal orders, this view was abandoned relatively quickly.

The premise that host states can exercise their authority over the resources utilised by foreign investors to carry out their projects begets the question of what the boundaries of this authority are. I rely on Michelman's seminal work on constitutional property disputes to consider the general contours of this question or the *meta-question*.[4] Michelman distinguishes four tests that guided most U.S. takings decisions until the late 1960s and, as it will become clear from my exposition, inform most investment awards today. These are physical invasion,[5] magnitude of the harm,[6] balancing private fault and public benefit,[7] and balancing social gains against private losses.[8] The first two tests refer to the *effects* that host measures have on foreign investors' rights. The second two constitute balancing ways of reasoning. They concentrate on the relation or equilibrium between a number of interdependent variables. These two categories operate differently regarding the interplay between foreign investors and host states authority. In the case of the effects tests, the investment tribunal increases or reduces host state authority by raising or lowering the threshold for compensation. Analytically, effects tests entail the identification of a denominator to assess the effects of a measure, and the determination of a threshold above which states need to pay compensation.[9] Balancing and proportionality tests operate in a more complex

[4] Michelman, Franck, "Property, Utility, and Fairness: Comments on The Ethical Foundations of 'Just Compensation' Law," 80 *Harvard Law Review* (1966-1967), pp. 1184, 1165-1258. See also: Fischel, William, "The rest of Michelman 1967," in Kenneth Ayotte and Henry Smith (Eds.), *Research Handbook on the Economics of Property Law*, Cheltenham: Edward Elgar Publishing, 2011, pp. 372-381.
[5] Michelman, Franck, "Property, Utility, and Fairness: Comments on The Ethical Foundations of 'Just Compensation' Law," pp. 1184-1190.
[6] *Ibid.*, pp. 1190-1193. In this work, Michelman refers to either diminution of value or magnitude of the harm, pp. 1191, 1233.
[7] *Ibid.*, pp. 1196-1201.
[8] *Ibid.*, pp. 1193-1196.
[9] See Montt, Santiago, *State liability in investment treaty arbitration: global constitutional and administrative law in the BIT generation*, Oxford and Portland, Oregon: Hart Publishing, 2009, pp. 177-191.

manner because they consider a series of circumstances surrounding the measures – and not only their effects.[10] Due to this broader spectrum, proportionality is more sensitive to social implications. On one hand, this is unquestionable because proportionality can turn a deprivation of foreign investors' rights into a non-compensable measure, as long as the measure is non-discriminatory and proportionate to a legitimate state goal. However, on the other hand, proportionality may not necessarily preclude liability below a certain threshold. This depends on the relation between effects and balancing tests, in particular, whether or not arbitrators apply proportionality only when they have identified a burden that otherwise would require compensation. I consider these two categories of tests in the context of the IIR in the following sections.

B. Excessive burdens

As Ackerman explains in his book on constitutional property, the application of the bundle of rights theory in constitutional property disputes provides adjudicators with a framework for focusing on the effects of the measure.[11] From the perspective of the bundle of rights, the controversial issue is whether host states need to pay compensation for taking one or a few rights from the bundle. In United States case law, there is a consensus that the constitutional property regime protects individuals from state measures that impose excessive burdens or substantial diminutions of rights without providing adequate compensation.[12] This protection applies even if these measures are imposed for the benefit of the

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[10] Michelman, Frank, "Takings 1987," 88 *Columbia Law Review* (1988), p. 1621; Rose-Ackerman, Susan "Against Ad Hocery: A Comment on Michelman," 88 *Columbia Law Review* (1988), pp. 1699-1700.

[11] Ackerman, Bruce, *Private Property and the Constitution*, New Haven and London: Yale University Press, 1977.pp. 1-10.

[12] Most decisions in the United States describe the test as diminution of value. See Fenster, Mark, "The Takings Clause, Version 2005: The Legal Process of Constitutional Property Rights," 9:3 *Journal of Constitutional Law* (2007), pp. 678, 680; Michelman, Franck, "Property, Utility, and Fairness: Comments on The Ethical Foundations of 'Just Compensation' Law," pp. 1190-1193; Rose, Carol "Mahon Reconstructed: Why the Takings Issue is Still a Muddle," 57 *Southern California Law Review* (1984), p. 566.

community.[13] However, there is a lack of agreement regarding what constitutes an excessive burden or a substantial diminution of rights.[14]

An important controversy in this respect relates to the determination of the denominator.[15] If, as Epstein predicates, constitutional property rights focus on property as every use included in ownership, states need to pay compensation when they completely deprive owners of any right in the bundle. The logic of this proposition relies on the idea of partial expropriations. There is a broad consensus that individuals are entitled to adequate compensation when the state takes full control of half their tract of land. In accordance with this rationale, Epstein concludes that we should apply the same approach to every right in the bundle.[16] Michelman disagrees with this position, arguing that the constitutional "concern is with the right to property" and not with "the rights of ownership."[17] Thus the state needs to pay compensation only when the measure constitutes an excessive burden or a substantial diminution of a right. During the first decades of the 20th century, realist scholarship favoured the application of the bundle of rights theory to justify this second approach.[18] For this reason, with the exception of Epstein, the bundle of rights has been the object of academic criticism by conservative scholars.[19]

The debate in the IIR regarding excessive burdens and the denominator has not been as important as the controversy in the United States. The expropriatory threshold in investment awards has been set substantially high, but the question of the denominator in investment arbitration has not received as much attention as it has in U.S. American case law and scholarship. In principle, this interpretative attitude favours the exercise of host state authority, which prompts the question of why some literature (including Chapter 7 of this thesis) has criticised the IIR for

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13 Fenster, Mark, "The Takings Clause, Version 2005: The Legal Process of Constitutional Property Rights," p. 694; Michelman, Franck, "Property, Utility, and Fairness: Comments on The Ethical Foundations of 'Just Compensation' Law," pp. 1224-1226.

14 Rose, Carol "Mahon Reconstructed: Why the Takings Issue is Still a Muddle," pp. 566-571; Michelman, Franck, "Property, Utility, and Fairness: Comments on The Ethical Foundations of 'Just Compensation' Law," pp. 1190-1193.

15 Fee, John, "Unearthing the Denominator in Regulatory Taking Claims," 61:4 *The University of Chicago Law Review* (1994), pp. 1538-1549.

16 Epstein, Richard, "Lucas v. South Carolina Coastal Council: A Tangled Web of Expectations," 45 *Stanford Law Review* (1992-1993), pp. 1374-1377; Epstein, Richard, "Bundle-of-Rights Theory as a Bulwark against Statist Conceptions of Private Property," 8:3 *Econ Journal Watch* (2011), pp.233-234.

17 Michelman, Frank, "Property as a Constitutional Right," 38 *Washington and Lee Law Review* (1981), p. 1114.

18 See Michelman, Frank, "There Have To Be Four," 64 *Maryland Law Review* (2005), pp. 156-157.

19 See Klein, Daniel B. and John Robinson, "Property: A Bundle of Rights? Prologue to the Property Symposium," 8:3 *Econ Journal Watch* (2011), pp. 196-201.

affecting host states and local populations. After all, the measure of control over the resources is a variable of both foreign investors' rights and their enforcement: an excessive substantiation of rights remains abstract if these allegedly excessive rights are not enforced. I will concentrate on this question next.

1. *Investment arbitration, excessive burdens, and a contractual solution to the threshold and the denominator*

The interdependence between substantiating and enforcing foreign investors' rights is manifested when investment arbitrators decide if a concrete deprivation of ownership reaches a threshold that requires compensation. A decision stating that a host state measure deprived a foreign investor of a legal use or entitlement does not necessarily lead to compensation: amongst other things, the deprivation can always be judged to be *de minimis*.[20] The enforcement of a threshold is a critical variable for understanding how investment arbitrators decide foreign investment disputes. In the award in *Nykomb v Latvia* (2003), for instance, the arbitrators explained that "[t]he decisive factor for drawing the border line towards expropriation must primarily be the degree of possession taking or control over the enterprise the disputed measures entail."[21] Now, it is important to mention in advance that the application of a contractual approach, based on the reliance theory, has implications regarding the threshold and the denominator when investment arbitrators are determining the potential deprivation of foreign investors' legitimate expectations. I show that whilst investment arbitration has set the threshold for an indirect expropriation substantially high, the denominator has not attracted a lot of attention. I argue that this lack of interest in the denominator is because investment tribunals concentrate on potential breaches of legitimate expectations as if they were *contractual* breaches.

Presently, investment awards point to a broad consensus regarding a substantial expropriatory threshold. Tribunals demand the existence of significant or excessive burdens to find host states liable for an expropriation. Investment scholars emphasise that the threshold for an expropriation has become particularly

[20] See Dalhuisen, Jan and Andrew Guzman, "Expropriatory and Non-Expropriatory Takings Under International Investment Law," UC Berkeley Public Law Research Paper No. 2137107, p. 6.
[21] *Nykomb v Latvia*, SCC, Award, 16 December 2003, at 4.3.1.

high since the awards in *Metalclad v Mexico* (2000) and *Tecmed v Mexico.*[22] The present consensus is outlined in the following passage of the award in *National Grid v Argentina* (2008):

> "In *CME* the tribunal referred to measures that 'effectively neutralize the benefit of the property of the foreign owner.' Similarly in *Lauder* the tribunal refers to a measure that effectively neutralizes the enjoyment of the property. In *Middle East Cement* the measures constituting indirect expropriation are described as measures with the effect of depriving the investor of the use and benefit of his investment. In *Santa Elena* we read that governmental interference 'deprived the owner of his rights or has made those rights practically useless,' and had caused the irretrievable loss of 'the practical and economic use of the Property.' *TECMED* refers to radical deprivation of 'the economical use and enjoyment of its investments, as if the rights related thereto…had ceased to exist.' *Pope & Talbot* finds that a particular interference with business activities amounts to an expropriation if 'that interference is sufficiently restrictive to support a conclusion that the property has been 'taken' from the owner […] The terms used in these cases convey the effect that the measures concerned must have: neutralization, radical deprivation, irretrievable loss, inability to use, enjoy or dispose of the property."[23]

Bearing in mind the substantial expropriation threshold and the debate concerning the IIR not being host state friendly, it is surprising that the issue of the denominator has attracted little comment in the field. The relevance of this question was highlighted by the arbitrators in *GAMI v Mexico* (2004):

> "Should *Pope & Talbot* be understood to mean that property is taken only if it is so affected in its entirety? That question cannot be answered properly before asking: what property? The taking of 50 acres of a farm is equally

[22] Reisman, Michael and Rocio Digón, "Eclipse of Expropriation?," in Arthur Rovine (Ed.), *Contemporary issues in International Arbitration and Mediation, The Fordham Papers*, Leiden: Martinus Nijhoff, 2009, pp. 27-46; Panel Discussion, "Fair and Equitable Treatment: Evolution or Revolution?," in Ian Laird and Todd Weiler (Eds.), *Investment Treaty Arbitration and International Law*, Volume 2, Juris Publishing, 2009, p. 267.
[23] *National Grid v Argentina*, UNCITRAL, Award, 3 November 2008, at 149.

> expropriatory whether that is the whole farm or just a fraction. The notion must be understood as this: the affected property must be impaired to such an extent that it must be seen as 'taken.'"[24]

Additionally, the importance of the denominator was acknowledged by the arbitrators in *Burlington v Ecuador* (2012),[25] and in *Methanex v U.S.A.* (2005) when they considered that "these items may figure in valuation. But it is difficult to see how they might stand alone, in a case like the one before the Tribunal."[26] These considerations of the denominator, however, have been limited to secondary remarks in a few investment awards.

The centrality of the denominator in constitutional property disputes, particularly if the threshold is substantially high, contrasts with the minor role that this question has played in investment awards and scholarship. I argue that the scholarship shows little interest in the denominator because the awards have tackled host state actions through the FET standard and the doctrine of legitimate expectations. The absence of recent findings for indirect expropriation does not imply that host states have been behaving in accordance with the IIR's expectations. In fact, in recent years, there have been many awards condemning host states for breaching the FET standard and the doctrine of legitimate expectations.[27] This tendency is consistent with the political economy and historical scenario that paved the way for the emergence of the doctrine of legitimate expectations: the increase in host state regulatory risk.[28] The possibility that the FET standard constituted a residual category for condemning host states for non-excessive or regulatory burdens was envisioned by some negotiators and scholars, including Vandevelde and Mann. Vandevelde explained in 1992 that

> "[t]he clause [in the USA's model BITs of 1983-1987 providing for fair and equitable treatment'] provides a baseline of protection which will be useful

[24] *GAMI v Mexico*, UNCITRAL – NAFTA, Award, 15 November 2004, at 126.
[25] *Burlington v Ecuador*, ICSID Case No. ARB/08/5, Decision on Liability, 14 December 2012, at 430, 456.
[26] *Methanex v U.S.A.*, UNCITRAL – NAFTA, Final Award of the Tribunal on Jurisdiction and Merits, 3 August 2005, Part IV - Chapter D, at 17.
[27] Bernasconi-Osterwalder, Nathalie and Jha Vyoma, "Recent Developments in International Investment Disputes: Investment treaty cases from September 2010 to October 2011," International Institute for Sustainable Development (2012), p. 11.
[28] See Chapter 5, Section A.2.

> principally in situations where other substantive provisions of international and national law provide no protection."[29]

In the following paragraphs, I will show how FET and the doctrine of legitimate expectations circumvent the question of the threshold and the denominator. The importance of the threshold, stressed so much by investment arbitrators when considering an expropriation, appears to be secondary when investment tribunals consider claims under the FET standard and the doctrine of legitimate expectations. There are few awards where arbitrators have focused on whether host state measures have reached a threshold for the violation of foreign investors' legitimate expectations. In addition, the few awards where arbitrators have referred to the existence of a threshold provide only vague guidance. The tribunal in *Lemire v Ukraine* (2010) noted that a breach of the FET standard "requires an action or omission by the State which violates a certain threshold of propriety."[30] In addition, the arbitrators in *Swisslion v Macedonia* (2012) mentioned that the finding of a breach of FET was "a close call; while it does not consider the breach to be de minimis, it also does not wish to overstate the finding."[31] As we can see, this interpretative attitude contrasts with the opinion of the tribunals regarding the importance of the threshold in expropriation claims.

When the threshold for the standard of protection is set substantially high, let us say the current expropriation threshold, a hypothetical investment arbitrator would have difficulties deciding that the full deprivation of a single use requires compensation. An alternative is to consider that this concrete use, and not the entire property right, should be the denominator. On some occasions, this strategy has been employed by U.S. courts. Radin describes it as "conceptual severance," where a taking or a treaty violation for the purposes of the IIR consists "of just what the government action has removed from the owner, and then asserts that particular whole thing has been permanently taken."[32] I argue that investment arbitrators in the IIR arrive at a similar conclusion but through different

[29] Vandevelde, Kenneth, *United States Investment Treaties: Policy and Practice*, Boston: Kluwer Law and Taxation, 1992, p. 76; Mann, Francis, "British Treaties for the Promotion and Protection of Investments," 52 *British Yearbook of International Law* (1981), p. 244.

[30] *Joseph Lemire v Ukraine*, ICSID Case No. ARB/06/18, Decision on Jurisdiction and Liability, 14 January 2010, at 284; *Bosch International v Ukraine*, ICSID Case No. ARB/08/11, Award, 25 October, 2012, at 212-217.

[31] *Swisslion v Macedonia*, ICSID Case No. ARB/09/16, Award, 6 July 2012, at 300.

[32] Radin, Margaret, "The Liberal Conception of Property: Cross Currents in the Jurisprudence of Takings," 88:8 *Columbia Law Review* (1988), p. 1676.

interpretative means. I claim that tribunals assume that, instead of severing ownership, the full deprivation of a single expectation is enough to condemn a host state for a breach of FET. This outcome is possible because arbitrators perceive this violation as a contractual rather than a proprietary breach. Schneiderman and Montt claim that the doctrine of conceptual severance has played a role in the IIR, however, they have limited their arguments to the domain of expropriations. Schneiderman explains that the "doctrine of conceptual severance has been embraced in international law," but he only refers to expropriation cases.[33] Similarly, Montt examines some investment awards on indirect expropriation suggesting that these tribunals may have applied the doctrine of conceptual severance.[34]

My claim is different because I offer an alternative explanation according to which the FET and the doctrine of legitimate expectations reach a similar outcome facilitating awards against host states for the deprivation of a single use or entitlement. The explanation I propose is based on the application of a contractual approach and the reliance theory. Arguably, the reliance theory does not only serve to substantiate foreign investors' rights but also to strengthen their enforcement vis-à-vis host state authority. Whilst in constitutional property the idea of a threshold plays a critical role, the approach is very different in contract law and theory. The *de minimis* principle in contract law is more limited. Decisions for relatively small breaches in relation to the total amount of contracts are common.[35] Thus, the enforcement of foreign investors' rights is strengthened, and consequently investment arbitrators can decide against host states whilst avoiding the problem of the denominator. Here, again, we can perceive the interplay between rights and remedies. The difference between finding in favour of the foreign investor and finding in favour of the host state lies not only in assuming that the foreign investor has a legitimate expectation but also in claiming that the violation of any single expectation – as if it was a commitment in a contractual relation – requires compensation. This interpretation favours foreign investors' control over the resources as it provides a more powerful enforcement of their

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[33] Schneiderman, David, *Constitutionalizing Economic Globalization. Investment Rules and Democracy's Promise*, New York: Cambridge University Press, 2008, pp. 64-65.

[34] Montt, Santiago, *State liability in investment treaty arbitration: global constitutional and administrative law in the BIT generation*, pp.188-191, 268-270

[35] See Monahan, Geoff, *Essential Contract Law*, London: Routledge, 2001, pp. 138-139; Oughton, David and Martin Davis, *Sourcebook on Contract Law*, London: Routledge, 2000, p. 454.

rights. The award in *Lemire v Ukraine* for the breach of the legitimate expectations to expand the business operations is an example of this trend.[36]

In sum, a contractual approach based on the reliance theory sets to one side the issue of the threshold and the denominator in investment disputes under the FET standard. The boundaries of host state authority suffer some pressure resulting from the specification and enforcement of foreign investors' legitimate expectations. It is true that host states can reasonably expect that most measures will not constitute an expropriation unless they have radical effects. However, this does not rule out liability under investment treaties: smaller burdens that otherwise would not require compensation can still result in liability for host states. For this reason, I claim that effects tests in investment arbitration do not serve to balance wealth maximisation with the establishment of a decent order where national and foreign individuals can flourish. I will now examine the prospects of success for balancing and proportionality analyses.

C. Balancing and proportionality

In principle, proportionality can be a useful tool for *balancing* the socio-relational effects of foreign investors' rights. The premise is that burdens created by host state measures do not require compensation if they are proportionate to a legitimate public goal. In the IIR, this means that proportionality does not serve to turn excessive expropriatory burdens into non-compensable measures. As the threshold has been set substantially high in this domain, it is unlikely that an investment tribunal will find such a burden proportionate. However, the use of proportionality sounds more promising in claims regarding the FET standard and the doctrine of legitimate expectations. The arbitrations in *Saluka v the Czech Republic* considered that

> "international law has yet to identify in a comprehensive and definitive fashion precisely what regulations are considered 'permissible' and 'commonly accepted' as falling within the police or regulatory power of States and, thus, noncompensable. In other words, it has yet to draw a bright and easily distinguishable line between non-compensable regulations

[36] *Joseph Lemire v Ukraine*, ICSID Case No. ARB/06/18, Decision on Jurisdiction and Liability, 14 January 2010. See Chapter 6, Section B.

on the one hand and, on the other, measures that have the effect of depriving foreign investors of their investment and are thus unlawful and compensable in international law."[37]

When a tribunal considers that there is a potential breach of foreign investors' rights, it has the option to move forward and apply balancing or proportionality. These methods of reasoning help to determine whether an alleged breach of foreign investors' legitimate expectations – defined in accordance with the reliance theory and a substantive rule of law – can still constitute a non-compensable burden. The premise for proportionality in constitutional property disputes is probably shared by most tribunals and courts around the world: as long as there is a balance between the burden and the public purpose, the public measure can be considered legitimate.[38]

However, there are several questions and complications related to the application of proportionality. Kennedy explains that a particular characteristic of the present paradigm of legal thought (which he refers to as the Third Globalisation), is the dominance of neoformalist ways of reasoning in public law. He includes in this category balancing and proportionality analyses.[39] Kennedy explains that public law neoformalism "rebels in the name of 'absolutes' outraged in a particular context"[40] and has, therefore, a mediating character.[41] This assessment coincides with Alexy's view on proportionality. He conceived this interpretative principle on the assumption that neither of the balanced principles should eliminate the other.[42] In addition, Kennedy's argument is compatible with Rose-Ackerman's description of balancing in U.S. Takings case law as a kind of "Ad Hocery."[43] The *ad hoc* character of the decisions can be attributed to the mediating activity pursued by the judges.

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[37] *Saluka v the Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, at 263.
[38] This is the position of Michelman, although he distinguishes between inefficient and efficient measures. See Michelman, Franck, "Property, Utility, and Fairness: Comments on The Ethical Foundations of "Just Compensation" Law," pp. 1172-1183.
[39] Kennedy, Duncan, "Three Globalizations of Law and Legal Thought: 1850–2000," in David Trubek and Alvaro Santos, *The New Law and Economic Development: A Critical Appraisal*, New York: Cambridge University Press, 2006, p. 63.
[40] *Ibid.*, p. 65.
[41] *Ibid.*, p. 70.
[42] Alexy, Robert, *A theory of constitutional rights*, New York: Oxford University Press, 2010, pp. 101-109.
[43] Rose-Ackerman, Susan "Against Ad Hocery: A Comment on Michelman," pp. 1697-1711.

The work of Kennedy is important to the analysis of proportionality in the IIR for two reasons. First, the mediating character of proportionality facilitates the exercise of some types of host state authority. This is consistent with the goals of the recalibration process. However, this mediating effect also consolidates the position of foreign investors to the extent that host state measures need to be compatible with their expectations. This is because proportionality aims to find a middle ground between foreign investors' rights and host state authority. Thus, the substantiation of foreign investors' rights plays a central role in the operation of proportionality: where investment arbitrators draw the *middle* line varies according to the content of these rights. Second, the neoformalist character of public law tools implies that the application of proportionality is not enough to characterise the approach followed by investment tribunals in relation to the interplay between foreign investors and host state authority. For this reason, we need to pay special attention to the normativity that lies behind the application of this way of reasoning.

The work of Alexander on the role of proportionality in constitutional property disputes provides two additional insights for the analysis of this way of reasoning in the context of investment arbitration. Alexander suggests that U.S. Takings Law could benefit from "becoming more familiar with" proportionality analysis.[44] However, he adds two important caveats to his argument. First, he warns that "[p]roportionality should be analyzed only if the court has determined that the regulation has encroached upon the proper constitutional boundaries of the affected property interest."[45] Accordingly, investment tribunals should not apply proportionality to double check if there is a deprivation of rights but to distinguish between compensable and non-compensable burdens. This view advances a particular relation between effects and balancing tests where only burdens reaching the compensatory threshold should be balanced against host state measures. Second, Alexander cautions that "[s]ubstantively, there is no guarantee that the proportionality principle in takings cases would significantly add clarity to American Takings doctrine."[46] He explains that this would depend on the purpose or core value of the property regime.[47] As long as there is no consensus regarding

[44] Alexander, Gregory, *The global debate over constitutional property: lessons for American takings jurisprudence*, Chicago: University of Chicago Press, p. 214.
[45] *Ibid.*, p. 207.
[46] *Ibid.*
[47] *Ibid.*, pp. 207-208, 214-218.

this purpose, he concludes, "[p]roportionality analysis would then become the *locus* of the political war that is the background of takings jurisprudence today."[48]

The need to consider the purpose and the normativity that guides investment arbitrators when applying proportionality again leads the analysis to my claim that the core value of the IIR is wealth maximisation through foreign investment. I have suggested that the purpose of a constitutional property regime refers to what we want to accomplish with property. Thus, it is reasonable to assume that the purpose of the IIR not only shapes foreign investors' rights but also host state authority. Indeed, the evolution of notions such as "public and public law" has played a very relevant role in the elaboration of most doctrines that justify state intervention in private property. In the U.S., for instance, the doctrine of eminent domain relates to *public* use; the nuisance doctrine connects with rights common to the *public;* police powers have to do with health, safety and morals of the *public*, and public utilities relate to a service that is "'affected with the *public* interest."[49]

Therefore, the premise that the IIR needs to strike a balance between private and public elements requires first developing a notion of host state public and public law. Since Van Harten's book about investment arbitration and public law,[50] there has been a stable tendency in investment law scholarship to favour the recognition of the public impact of the IIR and the necessity to balance these consequences relying on global administrative law and public law tools: essentially proportionality.[51] I have described this movement as the recalibration process. In this context, Kingsbury, Schill and Stone-Sweet were arguably amongst the first

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[48] *Ibid.*, p. 208.

[49] Merrill, Thomas, "Private property and public rights," in Kenneth Ayotte and Henry E. Smith (Eds.), *Research Handbook on the Economics of Property Law*, Cheltenham: Edward Elgar Publishing, 2011, p. 85.

[50] Van Harten, Gus, *Investment treaty arbitration and public law*, New York: Oxford University Press, 2007.

[51] See Kingsbury, Benedict and Schill, Stephan, "Public Law Concepts to Balance Investors' Rights with State Regulatory Actions in the Public Interest - The Concept of Proportionality," in Stephan Schill (Ed.), *International Investment Law and Comparative Public Law*, New York: Oxford University Press, 2010, p. 97.; Stone-Sweet, Alex, "Investor-State Arbitration: Proportionality's New Frontier," 4:1 *Law and Legal Ethics of Human Rights* (2010), pp. 48-76; Burke-White, William and Andreas von Staden, "Private Litigation in a Public Law Sphere: The Standard of Review in Investor-State Arbitrations," 35 *The Yale Journal of International Law* (2010), pp. 283-346; Henckels, Caroline, "Balancing Investment Protection and the Public Interest: The Role of the Standard of Review and the Importance of Deference in Investor-State Arbitration," 4:1 *Journal of International Dispute Settlement* (2013), pp. 197-215; [51] Leonhardsen, Erlend, "Looking for Legitimacy: Exploring Proportionality Analysis in Investment Treaty Arbitration," 3:1 *Journal of International Dispute Settlement* (2012), pp. 95-136.

authors to advocate the use of proportionality in the IIR.[52] In fact, Kingsbury and Schill observe that "arbitral tribunals increasingly link fair and equitable treatment to the concepts of reasonableness and proportionality, controlling the extent to which interferences of host states with foreign investments are permitted."[53] The proposal for proportionality in investment arbitration implies starting from a premise that is difficult to challenge: the recognition of host state authority and the right to regulate, but limited by investment arbitration review.[54] Because proportionality is a neoformalist way of reasoning, however, it was to be expected that the application of this test would not end the academic debate but rather provoke a discussion regarding the notion of host state public and public law.

In this respect, Roberts asserts that the standards of review in investment treaty arbitration constitute "the next battleground."[55] She explains that these standards can give states "wider latitude to determine what policy goals they wish to achieve and how best to achieve them."[56] Roberts claims in this regard that the key question is how deferential investment arbitrators are in relation to host state goals.[57] Although she does not concentrate on it explicitly, the application of proportionality can also place some limitations on host state authority.

The existing debate in investment scholarship has recognised some ways in which proportionality can restrict host state authority. Burke-White and von Staden stress that an adequate balancing of host state goals requires a level of proximity to the reality of a country, which investment arbitrators arguably lack.[58] These scholars claim that investment arbitrators are balancing values and their "concrete determination" for the case at hand.[59] This view is consistent with the conclusions of my socio-relational approach to foreign investors' rights. If investment arbitrators focus on the values underlying foreign investors' rights from a global and uniform perspective, inspired in neo-utilitarianism, the definition of host state

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52 Kingsbury, Benedict and Schill, Stephan, "Public Law Concepts to Balance Investors' Rights with State Regulatory Actions in the Public Interest - The Concept of Proportionality," pp. 77-79; Stone-Sweet, Alex, "Investor-State Arbitration: Proportionality's New Frontier," pp. 75-76.

53 Kingsbury, Benedict and Schill, Stephan, "Public Law Concepts to Balance Investors' Rights with State Regulatory Actions in the Public Interest - The Concept of Proportionality," p. 97.

54 See *TECMED v Mexico*, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, at 119-120.

55 Roberts, Anthea, "The Next Battleground: Standards of Review in Investment Treaty Arbitration," 16 *International Council for Commercial Arbitration Congress Series* (2011), pp. 170-180.

56 *Ibid.*, p. 172.

57 *Ibid.*, p. 171-173.

58 Burke-White, William and Andreas von Staden, "Private Litigation in a Public Law Sphere: The Standard of Review in Investor-State Arbitrations," pp. 329-333, 336, 345.

59 *Ibid.*, p. 336.

authority will probably lack a plural and local component. As Lehavi explains, the popularity of law and economics has resulted in a series of non-local normative theories about property.[60] These theories put forward a concept of private property that is independent from place and time as they concentrate on utility and efficiency. Thus, for instance, if a tribunal has to determine what constitutes a reasonable benefit, this varies depending on whether the reasonableness criterion is described from the viewpoint of the host country or the global markets.

As I explained in Chapter 4, there is a growing idea, propelled by authors such as Schreuer, that investment arbitrators and foreign investors are part of and should be responsible to a global community. This initiative needs to be put into perspective with two important global movements. On one hand, I explained in Chapter 5 that global administrative law is very influential in the work of important investment law scholars, such as Schill and Montt. On the other hand, the practice of international arbitration is closely connected to an idea of a global community. International arbitrators market this legal service as a way to overcome plural problems through a global perspective. Indeed, Paulsson has recently claimed that international arbitration can foster global cooperation by solving questions such as "the existence of water rights."[61] In his view, international arbitration "can overcome the clash of cultures, […] can bring people together under a big tent, [and] can even save the world!"[62]

In the domain of property, the proliferation of ideas such as global community and global administrative law can constitute threats to the social practices of host populations, calling for a global-local balance. Most of the investment law literature, however, concentrates on the need to balance private and public impacts. I argue that the risk involved in these global ideas will be overlooked for as long as the discussion in the literature remains limited to a private-public dichotomy. Because of their formal character, these categories are inappropriate for uncovering the socio-relational implications of foreign investors' rights. Duncan Kennedy argues that private and public are not two distinctive areas but rather a continuum on which different fields of law may draw different

[60] Lehavi, Amnon, "The Global Law Of The Land," 81 *University Of Colorado Law Review*(2010), p. 457.
[61] Paulsson, Jan "Universal arbitration – what we gain, what we lose," The Alexander Lecture - Chartered Institute of Arbitrators, 29 November 2012 (Draft: 3 December 2012), p. 10.
[62] *Ibid.*, p. 4.

distinctions.[63] Along this continuum, there are many potential private-public (individual-state) arrangements, for instance, one pertinent to a Hayekian view and one appropriate to a Keynesian approach. In this respect, David Kennedy shows how legal thought around the world has approached economic disputes influenced first by the nuisance doctrine, later by a progressive model, and presently by a neo-utilitarian paradigm.[64]

According to the work of Singer, these particular arrangements between the private and the public manifest their influence in constitutional property disputes through different normative views about externalities.[65] If we go back to Michelman's seminal work, we find that he divides balancing into whether the state was addressing private faults for public benefit or creating private losses for social gains. Singer claims that these two scenarios are interchangeable to the extent that we can characterise the same scenario as foreign investors' fault or as their harm. The choice then becomes essentially normative.[66] Singer illustrates this argument by considering the case of a U.S. citizen who decides to hang the national flag in his flat. He argues that the central question in this property dispute is whether the individual is creating a nuisance or whether the prohibition on hanging the flag would strip him of his right (and constitute harm).[67] In his work, Singer divides the intellectual history of externalities between the domain of law and economics, and legal realism, where the first concentrates on efficiency in maximising wealth and the second pays more attention to the socio-relational implications of property.[68]

Against this background, I suggest that proportionality in investment arbitration can preserve some host state regulatory authority. The recalibration process is to be praised for this measure of the host public and public law. However, I argue that investment arbitration – in spite of proportionality – restricts host state ability to implement democratically decided changes inspired by the social preferences of local populations. The application of the reliance theory and a substantive rule of

63 Kennedy, Duncan, "The Stages of the Decline of the Public/Private Distinction," 130:6 *University of Pennsylvania Law Review* (1982), p. 1351. Similarly, see Horwitz, Morton, "The History of the Public/Private Distinction," 130:6 *University of Pennsylvania Law Review* (1982), pp. 1423-1428.
64 Kennedy, David, "The 'Rule of Law,' Political Choices, and Development Common Sense," in David Trubek and Alvaro Santos, *The New Law and Economic Development: A Critical Appraisal*, New York: Cambridge University Press, 2006, pp. 95-173.
65 Singer, Joseph, "How property norms construct the externalities of ownership," in Gregory Alexander and Eduardo Peñalver, *Property and Community*, New York: Oxford University Press, 2010, pp. 57-77.
66 *Ibid.*, pp. 61, 64, 65.
67 *Ibid.*, pp. 57-58.
68 *Ibid.*, pp. 68-70.

law to substantiate foreign investors' rights can distort many efforts to build a decent order, at least those aimed at establishing a democratic and participatory order, and those attempting to reduce the influence of the powerful. In my view, proportionality cannot resolve this imbalance because, as Alexander claims, any hope that we have for this way of reasoning depends on the purpose or core value of the regime. From this perspective, paraphrasing Richard Ely, there seems to be little that proportionality can do to save social life.[69] If the purpose of the IIR is in fact wealth maximisation through foreign investment, the present debate about host state deference will be confined to neo-utilitarian arguments, recognising – like the tribunals in *El Paso v Argentina* (2011)[70] and *Ulysseas v Ecuador* (2012)[71] – that this is compatible with the preservation of some host state authority. This purpose will thus inform the application of new investment treaty clauses that explicitly refer to the right to regulate for public health and environmental reasons.[72]

Now, as opposed to the need to substantiate foreign investors' rights, investment tribunals can decide disputes without applying proportionality. Acknowledging the limitations that this lower number of awards creates, I illustrate my argument in the following subsections. First, I show how investment arbitrators analyse the circumstances around investment disputes. In particular, I consider how they approach the question of foreign investors' externalities. I argue that they look at these externalities from a technocratic rather than a democratic standpoint. Later, I review the existing awards on proportionality to stress the importance of foreign investors' rights and investment arbitrators' views on deference. I concentrate on the importance of the substantiation of foreign investors' rights and the mediating character of proportionality. Finally, I examine the application of proportionality in expropriation and FET claims. I show that these awards did not use proportionality correctly if they aimed to consider whether potentially compensable breaches should nevertheless be judged to be legitimate non-compensable measures.

[69] Ely, Richard, *Property and Contract in their Relation to the Distribution of Wealth*, Volume 1, New York: Macmillan, 1914, p. 165.
[70] *El Paso v Argentina*, ICSID Case no ARB/03/15, Award, 31 October 2011, at 369.
[71] *Ulysseas, Inc. v Ecuador*, UNCITRAL, Award, 12 June 2012, at 248.
[72] See Spears, Suzanne, "The Quest for Policy Space in a new Generation of International Investment Agreements," 13:4 *Journal of International Economic Law* (2010), pp. 1060-1062.

1. Examining the circumstances in investment disputes

An alleged advantage of balancing tests, particularly proportionality, is that they allow investment arbitrators to pursue a more comprehensive examination of host state measures in relation to foreign investors' rights. A tribunal applying proportionality does not base its decision solely on the effects of the measure. This can be positive for host states. However, it is also possible to see how investment tribunals need to assess a number of circumstances whenever the challenged measure has a regulatory nature. If the initial premise of an investment tribunal is that host states can pass regulations without paying compensation, an analysis of the circumstances helps to identify cases in which these regulations are illegitimate and require compensation. From this point of view, considerations of the circumstances serve to override a presumption in favour (and not against) host states. Commenting on the Restatement of The Foreign Relations Law of the United States, the arbitrators in *Feldman v Mexico* (2002) considered this question:

> "It is notable that the Restatement comment specifically includes 'taxation' as a possible expropriatory action and establishes state responsibility, inter alia, for unreasonable interference with an alien's property. At the same time, non-discriminatory, bona fide general taxation does not establish liability. The Reporter's Notes to the Restatement further suggest that 'whether an action by the state constitutes a taking and requires compensation under international law, or is a police power regulation or tax that does not give rise to an obligation to compensate even though a foreign national suffers loss as a consequence' must be determined in light of all the circumstances."[73]

Most investment tribunals begin the analysis with the premise that host states have a right to regulate. This attitude is not necessarily new in investment arbitration. The arbitrators in *TECMED v Mexico*, for instance, recognised that state measures can be the outcome of the "ordinary expression of the exercise of the state's police power."[74] In addition, investment awards rendered before the

[73] *Feldman v Mexico*, ICSID Case No. ARB(AF)/99/1 , Award, 16 December 2002, at 106. See also: *Saluka v the Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, at 309.
[74] *TECMED v Mexico*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, at 115.

recalibration process recognised the existent legal order at the moment of establishment, and found no liability if the host state measure was consistent with the pre-existing regulatory framework. This is the case in the awards in *Thunderbird v Mexico* (2006, gambling regulation)[75] and *Genin v Estonia* (2001, financial regulation).[76] It is true, nevertheless, that tribunals have been focusing more on the preservation of some host state authority since the recalibration process. The award in *Saluka v the Czech Republic* stressed that investment arbitration pays a "high measure of deference" to host states to define their goals,[77] and the arbitrators in *Glamis v U.S.A.* affirmed that regulations can only be found a violation if they "exhibit a manifest lack of reasons."[78]

Accepting the importance of this initial premise in favour of host state authority to regulate, I want to draw my attention to the views that guide investment arbitrators' examination of all the circumstances. This inquiry is relevant because I argue that we should be sceptical about the claim that examining all the circumstances necessarily favours host states. In this regard, the relevant variable is the normative choices that investment arbitrators make when considering foreign investors' externalities. Judging from the awards in *Methanex v U.S.A.*, *Chemtura v Canada* (2010), *Glamis v U.S.A.*, I suggest that investment tribunals are comfortable deciding in favour of host states when they find scientific and technocratic evidence of the impact of the foreign investment on public health or the environment.[79] The award in *TECMED v Mexico* stands out from this group of cases because the challenged measure was described as a preference for change of the host population (and not as the outcome of foreign investors' negative externalities).

I will illustrate this distinction looking in more detail at the awards in *TECMED v Mexico* and *Methanex v U.S.A.* These two decisions started with the premise that host states have a right to regulate, and continued by considering the circumstances

[75] *Thunderbird v Mexico*, NAFTA - UNCITRAL, Award, 26 January 2006, at 123, 127.
[76] *Genin v Estonia*, ICSID Case No. ARB/99/2, Award, 25 June 2001, at 370.
[77] *Saluka v the Czech Republic*, UNCITRAL, Partial Award, 17 March 2006, at 305.
[78] *Glamis v U.S.A.*, UNCITRAL – NAFTA, Award, 8 June 2009, at 803. Similarly, *Continental v Argentina*, ICSID Case No. ARB/03/9, Award, 5 September 2008, at 230.
[79] See Ortino, Federico, "The Investment Treaty System as Judicial Review: Some Remarks on its Nature, Scope and Standards," 21 November 2012, Available at ssrn.com/abstract=2181103, pp. 22-27; Henckels, Caroline, "Balancing Investment Protection and the Public Interest: The Role of the Standard of Review and the Importance of Deference in Investor-State Arbitration," p. 212. See also: Rose, Carol, "A Dozen Propositions on Private Property, Public Rights, and the New Takings Legislation," 55 *Washington & Lee Review* (1996), p. 292.

leading to the measures that triggered the complaints.[80] The tribunal in *TECMED and Mexico* described a scenario where there were several demonstrations by the local population calling for the termination of the operation of a waste disposal facility in the area.[81] These arbitrators showed some scepticism about the state measure that realised this social preference. They saw the measure as the outcome of "political circumstances" and "community pressure."[82] Finally, they concluded that only in extreme circumstances, when the situation reaches "a serious emergency situation, social crisis or public unrest," could they accept civil pressure as a valid reason to pass a measure.[83]

From a regulatory point of view, the approach of the tribunal in *Methanex v U.S.A.* looks very different. These arbitrators appear to have been more deferential to the public goal because the challenged measure was taken to be in accordance with a regulatory paradigm. They found that

> "Methanex entered a political economy in which it was widely known, if not notorious, that governmental environmental and health protection institutions at the federal and state level, operating under the vigilant eyes of the media, interested corporations, non-governmental organizations and a politically active electorate, continuously monitored the use and impact of chemical compounds and commonly prohibited or restricted the use of some of those compounds for environmental and/or health reasons"[84]

The favourable disposition towards scientific evidence of the investment tribunals in *Methanex v U.S.A.*,[85] *Chemtura v Canada*,[86] *Glamis v U.S.A.*[87] shows that social preferences have a secondary role in the assessment of the circumstances around a dispute. Arguably, changes in accordance with scientific evidence are

[80] *TECMED v Mexico*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, at 115; *Methanex v U.S.A.*, UNCITRAL – NAFTA, Final Award of the Tribunal on Jurisdiction and Merits, 3 August 2005, Part IV, Chapter D, at 7.
[81] See Gaines, Sanford, "Environmental policy implications of investor-state arbitration under NAFTA Chapter 11," 7 *International Environmental Agreements* (2007), pp. 181–182.
[82] *TECMED v Mexico*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, at 127, 128. Similarly, see *Azurix v Argentina*, ICSID Case No. ARB/01/12, Award, 14 July 2006, at 378.
[83] *TECMED v Mexico*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, at 133.
[84] *Methanex v U.S.A.*, UNCITRAL – NAFTA, Final Award of the Tribunal on Jurisdiction and Merits, 3 August 2005, Part IV, Chapter D, at 9.
[85] *Ibid.*, at Part III.A.
[86] *Chemtura v Canada*, UNCITRAL – NAFTA, Award, 2 August 2010, at 124-225.
[87] *Glamis v U.S.A.*, UNCITRAL – NAFTA, Award, 8 June 2009, at part II and 756-829.

more consistent with foreign investors' expectations. Measures implemented because of foreign investors' negative externalities are more predictable than changes in accordance with the preferences of the local population. This interpretative attitude, however, can hinder the ability of the IIR to balance the excessive substantiation of foreign investors' rights. As Boyd White explains:

> "The pressure of bureaucratic discourse is always to think in terms of ends and means; but in practice ends-means rationality is likely to undergo a reversal by which only those things can count as ends for which means of a certain kind exist."[88]

2. *Investment awards and the application of proportionality*

The distinctive feature of proportionality is the particular formula it offers for assessing the circumstances around a dispute. The premise of a court of law is that it must consider the interests of both parties in a complaint and provide reasons for the outcome.[89] Otherwise, the decision will be biased and arbitrary. As the Annulment Committees in *Vivendi v Argentina* (2002) and in *MTD v Chile* (2007) stressed "tribunals must often struggle to balance conflicting considerations."[90] For this reason, the investment tribunal in *SGS v Philippines* allegedly followed an arbitrary approach when it argued that "[i]t is legitimate to resolve uncertainties […] so as to favour the protection of covered investments."[91] The assessment of the interests of the two parties, however, is not equal to proportionality. Proportionality is a particular formula for carrying out the analysis based on the premise that neither foreign investors' rights nor host state authority should be completely disregarded. Thus, for instance, the opinion of the arbitrators in *Grand River v U.S.A.* (2011) was close to this view when they considered that "NAFTA

88 Boyd White, James "Law as Rhetoric, Rhetoric as Law: The Arts of Cultural and Communal Life," 52:3 *The University of Chicago Law Review* (1985), p. 698.

89 Ortino, Federico, "Legal Reasoning of International Investment Tribunals: A Typology of Egregious Failures," 3:1 *Journal of International Dispute Settlement* (2012), pp. 33-35.

90 *Compañía de Aguas del Aconquija S.A. v Argentina*, ICSID Case No. ARB/97/3, Annulment Decision, 3 July 2002, at 65; *MTD v Chile*, ICSID Case No. ARB/01/7, Annulment decision, 21 March 2007, at 50.

91 *SGS v Philippines*, ICSID Case No. ARB/02/6, Decision on Objections to Jurisdiction, 29 January 2004, at 116. Douglas has claimed that "[a]n interpretative approach that systematically favours the interests of one of the disputing parties need only be articulated to be proven unsound," Douglas, Zachary, "Nothing if not Critical for Investment Treaty Arbitration: Occidental, Eureko and. Methanex", 22:1 *Arbitration International* (2006), p. 51.

involves a balance of rights and obligations, and does not point unequivocally in a single direction."[92]

The main circumstances that shape a proportionality analysis are foreign investors' rights: their legitimate expectations and their reliance; and the exercise of host state authority: the public interest (essentially, the relation between the deprivation of rights and the public goal). The award in *Lemire v Ukraine* enunciates all of them in the following passage:

> "The evaluation of the State's action cannot be performed in the abstract and only with a view of protecting the investor's rights. The Tribunal must also balance other legally relevant interests, and take into consideration a number of countervailing factors, before it can establish that a violation of the FET standard, which merits compensation, has actually occurred:
> - 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."[93]

Proportionality offers a formula for assessing these circumstances based on a three-pronged test: reviewing the legitimacy of the public purpose, the means-ends relation and the possibility of a less restrictive measure to achieve a similar outcome. Although few tribunals have followed proportionality comprehensively, i.e. considering the three stages in the analysis, many awards include one or more of these stages.[94] I suggest that investment tribunals rarely disqualify a measure because it does not pursue a public purpose. Given the neoformalist and mediating character of proportionality analysis, I argue that investment arbitrators

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[92] *Grand River v U.S.A.*, UNCITRAL – NAFTA, Award, 12 January 2011, at 69.

[93] *Joseph Lemire v Ukraine*, ICSID Case No. ARB/06/18, Decision on Jurisdiction and Liability, 14 January 2010, at 285

[94] Leonhardsen, Erlend, "Looking for Legitimacy: Exploring Proportionality Analysis in Investment Treaty Arbitration," pp. 120-136; Kingsbury, Benedict and Schill, Stephan, "Public Law Concepts to Balance Investors' Rights with State Regulatory Actions in the Public Interest - The Concept of Proportionality," pp. 88-102.

would rather reject the measure on the grounds that it was disproportionate or that a similar goal could have been attained by less restrictive means.

In investment arbitration, the means-ends test is a very popular tool for assessing host state measures. When considering the possibility of discrimination, the arbitrators in *Saluka v Czech Republic* explained

> "that any differential treatment of a foreign investor must not be based on unreasonable distinctions and demands, and must be justified by showing that it bears a reasonable relationship to rational policies not motivated by a preference for other investments over the foreign-owned investment."[95]

In addition, in relation to the deprivation of foreign investors' rights, the arbitrators in *LG&E v Argentina* (2006) considered that a legitimate measure

> "would include a consideration of the effect of a measure on foreign investments and a balance of the interests of the State with any burden imposed on such investments. Certainly a State that fails to base its actions on reasoned judgment, and uses abusive arguments instead, would not 'stimulate the flow of private capital.'"[96]

As the tribunal in *Saluka v the Czech Republic* shows, reviewing the reasonableness of a host state measure can allow investment tribunals to identify arbitrary or idiosyncratic preferences. This use of proportionality is similar to the one we find in the panels or the Appellate Body of the WTO when considering the general exceptions in Article XX GATT and Article XIV GATS.[97] In this context, proportionality is employed to detect instances of discrimination. However, the application of proportionality regarding a substantive claim can create a different set of issues. In this setting, the objective of the means-ends test is to determine whether the deprivation of foreign investors' rights is a proportionate and adequate

[95] *Saluka v the Czech Republic*, PCA—UNCITRAL, Partial Award, 17 March 2006, at 307. Similarly, *Parkerings-Compagniet AS v Lithuania*, ICSID Case No. ARB/05/8, Award, 11 September 2007, at 368.

[96] *LG&E v Argentina*, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, at 158.

[97] Trebilcock, Michael and Robert Howse, *The regulation of international trade*, Second Edition, London: Routledge, 1999, pp. 155-156, 381-404, 496; Andenas, Mads and Stefan Zleptnig "Proportionality and balancing in WTO law: a comparative perspective," 20:1 *Cambridge Review of International Affairs* (2007), pp. 81-82.

means to achieve the public goal. The tribunal in *Total v Argentina* (2010) explained that "[t]he determination of a breach of the standard requires, therefore, 'a weighing of the Claimant's reasonable and legitimate expectations on the one hand and the Respondent's legitimate regulatory interest on the other.'"[98] In this sense, the previous substantiation of foreign investors' rights will determine – at least to some extent – the outcome of proportionality. An excessive substantiation of foreign investors' rights will always make a difference when applying proportionality: the larger the burdens the lower the chances that host state measures would be considered proportionate.

Finally, investment tribunals employ the necessity test when reviewing host state measures. The main variable for deciding the necessity test refers to the margin of deference provided by the tribunal. The arbitrators in *SD Myers v Canada* (2000) embraced the premise that they should not second-guess government decision-making when considering alternative measures to achieve a public goal, emphasising their deferential approach to public interests.[99] In this context, these arbitrators required the host state to show whether similar results "could have been achieved by other measures" less restrictive to the position of the foreign investor.[100] In spite of the alleged initial level of deference, they found that a ban on exporting PCB waste constituted a breach of NAFTA without elaborating on any alternative measure.[101] In addition, the necessity test has been applied in disputes concerning the Argentine crisis.[102] Investment tribunals have followed both narrow and broader approaches regarding the issue of deference in these cases. In *CMS v Argentina* (2005), for instance, the arbitrators framed the necessity test as whether the measures taken by Argentina were the "only step available."[103] Conversely, in *Continental v Argentina* (2008), the arbitrators considered whether Argentina could have applied "less inconsistent […] reasonable available" measures.[104]

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[98] *Total v Argentina*, ICSID Case No. ARB/04/01, Decision on Liability, 27 December 2010, at 123.
[99] *SD Myers v Canada*, UNCITRAL - NAFTA, Partial Award, 13 November 2000, at 261, 263.
[100] *Ibid.*, at 195.
[101] *Ibid.*
[102] See Kurtz, Jürgen, "Adjudging the Exceptional at International Investment Law: Security, Public Order and Financial Crisis," 59 *International and Comparative Law Quarterly* (2010), pp. 325-371.
[103] *CMS v Argentina*, ICSID Case No. ARB/01/8, Award, May 12, 2005, at 324.
[104] *Continental v Argentina*, ICSID Case No. ARB/03/9, Award, 5 September 2008, at 195, 193-195.

The different positions emerging from these awards show that deference matters when applying the necessity test.[105] Investment arbitrators' views on host state authority and foreign investors' externalities play an important role in this part of the reasoning. If investment arbitrators have a tolerant and plural approach to host communities, the necessity test would imply that host state measures are fair and equitable when they expressly aim to achieve democratically decided goals with less restrictive effects on the foreign investor.[106] The only exception would be the case of excessive burdens. However, I have just argued that there seems to be a tendency in investment arbitration to favour technocracy and curbing negative externalities. To my knowledge, on the contrary, there is no award where a democratically decided goal has been preserved simply because of its democratic legitimacy.

a. Expropriation and proportionality

The objective of this subsection is to consider the application of proportionality in expropriation claims. Initially, the application of proportionality in cases of excessive burdens reaching the expropriatory threshold sounds counterintuitive. As excessive burdens appear to be by definition disproportionate, it is difficult to envision a scenario where the host state does not need to pay compensation. This is particularly the case in the IIR where the expropriatory threshold has been set substantially high. Some investment tribunals have made this point explicitly. In *TECMED v Mexico*, quoting the decision of the European Court of Human Rights in *James and Others* (1986), the arbitrators relied on the premise that "[t]he requisite balance will not be found if the person concerned has had to bear 'an individual excessive burden."[107] A similar approach has been followed by the tribunals in *Compañía del Desarrollo de Santa Elena v Costa Rica* (2000) and *LG&E v Argentina*.[108] In addition, the tribunal in *Azurix Corp v Argentina* (2006) developed this point

105 Roberts, Anthea, "The Next Battleground: Standards of Review in Investment Treaty Arbitration," p. 172.
106 See Leonhardsen, Erlend, "Looking for Legitimacy: Exploring Proportionality Analysis in Investment Treaty Arbitration," pp. 134-135.
107 *TECMED v Mexico*, ICSID Case No. ARB (AF)/00/2, Award, 29 May 2003, at 122, 121-122.
108 *Compañía del Desarrollo de Santa Elena v Costa Rica*, ICSID case No. ARB/96/1, Award, 17 February 2000, at 72; *L&E v Argentina*, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, at 191.

further, using the work of Higgins on expropriations.[109] Higgins claims that a measure with similar effects to an expropriation, i.e. an excessive burden, still requires compensation even if it was passed for a public purpose.[110]

Against this background, it is necessary to consider why and for what purpose the arbitrators in *TECMED v Mexico* and *LG&E v Argentina* engaged in a proportionality analysis in relation to claims of expropriation. In *LG&E v Argentina*, the arbitrators explained that

> "there must be a balance in the analysis both of the causes and the effects of a measure in order that one may qualify a measure as being of an expropriatory nature."[111]

I argue that in these two awards we find that proportionality is not employed to justify the deprivation of foreign investors' rights by virtue of a host public reason. Instead, the *LG&E v Argentina* and *TECMED v Mexico* tribunals applied proportionality to *double-check* the existence of an expropriation. In this respect, I agree with Leonhardsen that

> "the *TECMED* Tribunal […] used the proportionality test in order to determine whether an expropriation had occurred, whereas in the ECtHR jurisprudence it refers to it is used to decide whether deprivations that have occurred are justified."[112]

On one hand, this trend implicitly confirms that excessive burdens cannot be found to be proportionate, particularly if the threshold is set substantially high. Presently, I suggest that an expropriation would barely pass the balancing test set by the arbitrators in *Fireman v Mexico* (2006) based on the U.S. Supreme Court decision in *Penn Central v New York City* (1978).[113] On the other hand, if Leonhardsen and I are correct, the use of proportionality in expropriation claims

[109] *Azurix v Argentina*, ICSID Case No. ARB/01/12, Award, 14 July 2006, at 309-311.

[110] Higgins, Rosalyn, "The Taking of Property by the State: Recent Developments in International Law," 176 Recueil des Cours (1982), p. 331.

[111] *LG&E v Argentina*, ICSID Case No. ARB/02/1, Decision on Liability, 3 October 2006, at 194. Similarly, see *TECMED S.A. v Mexico*, ICSID Case No. ARB(AF)/00/2, Award, 29 May 2003, at 115.

[112] Leonhardsen, Erlend, "Looking for Legitimacy: Exploring Proportionality Analysis in Investment Treaty Arbitration," p. 124.

[113] *Fireman v Mexico*, ICSID Case No. ARB(AF)/02/1 – NAFTA, Award, 17 July 2006, at 176.

can favour either the foreign investor or the host state whenever the tribunal has doubts regarding the existence of an excessive expropriatory burden. This is arguably an effect of the mediating character of proportionality.

Having said this, I think it would be incorrect to conclude that there is no role for proportionality and public interest in cases of excessive burdens. The point is that this role would be different to a full justification of substantial burdens. Investment tribunals could balance the amount of compensation. A debate regarding this possibility could probably benefit from studying the position of developing countries in the 1960s and 1970s. These countries proposed a more flexible approach to standards of compensation to facilitate their reform initiatives after decolonisation.[114]

b. Fair and Equitable Treatment and proportionality

This subsection considers the application of proportionality in disputes about FET and the doctrine of legitimate expectations. In investment arbitration, the use of proportionality analysis can make a difference when judging non-excessive burdens. A premise of this chapter is that host states' liability for regulatory measures affecting foreign investors' rights are normally judged against the FET standard and the doctrine of legitimate expectations. This type of dispute represents the current trend in investment arbitration as host states rarely take radical measures. Although investment tribunals have not applied proportionality very often in the domain of FET and the doctrine of legitimate expectations,[115] this may be changing.[116] Here, I consider the two most important uses of proportionality in FET claims about legitimate expectations: these are the awards in *EDF v Romania* (2009) and *Total v Argentina*. I show that these tribunals applied proportionality in cases where the arbitrators were highly sceptical or even concluded that the foreign investor did not have a right, i.e. a legitimate expectation, regarding the use or entitlement in question.

114 See Anghie, Antony, *Imperialism, Sovereignty and the Making of International Law*, New York: Cambridge University Press, 2004, p. 213-223.
115 Kingsbury, Benedict and Schill, Stephan, "Public Law Concepts to Balance Investors' Rights with State Regulatory Actions in the Public Interest - The Concept of Proportionality," pp. 96-98; Leonhardsen, Erlend, "Looking for Legitimacy: Exploring Proportionality Analysis in Investment Treaty Arbitration," pp. 135-136.
116 *Ibid.*, p. 135.

In the award in *EDF v Romania*, the tribunal applied proportionality to consider the allegation of a breach of the foreign investor's legitimate expectation to continue operating a duty free business.[117] These arbitrators explained that

> "[a]s held by other tribunals, in addition to a legitimate aim in the public interest there must be 'a reasonable relationship of proportionality between the means employed and the aim sought to be realized; that proportionality would be lacking if the person involved 'bears an individual and excessive burden.' The aim of GEO 104 to combat corruption was certainly legitimate and in the public interest. In addition, the proportionality requirement was met as shown by the fact that the adverse effect of this measure regarding Claimant was limited to the latter's duty free operation at Constanta Airport. The compensation claimed by Claimant in that regard amounts to USD400,000.00, which is not an excessive burden in itself and in the context of Claimant's overall claim for compensation of USD132.576.000,00."[118]

These considerations show two of the stages of the proportionality analysis (the tribunal did not employ the necessity test). The arbitrators identified the public purpose, i.e. to fight corruption, and analysed the reasonableness of the concrete measure for achieving this goal.[119] In addition, they employed an unusual way of reasoning to conclude that the measure did not constitute an excessive burden. The arbitrators contrasted the amount of the entire claim to the amount asked for by the foreign investor under the particular item. Now, the point I want to underline in relation to this award is that that these arbitrators were not convinced that the foreign investor had a legitimate expectation to continue operating the duty free business in the first place. They concluded "that ASRO would have been excluded from further auctions in any case, independent of GEO 104."[120] This proves that the tribunal in *EDF v Romania* employed proportionality to assess a *hypothetical* burden and confirm the non-existence of responsibility.

[117] *EDF v Romania*, ICSID Case No. ARB/05/13, Award, 8 October 2009, at 287.
[118] *Ibid.*, at 293.
[119] *Ibid.*, at 292.
[120] *Ibid.*, at 297, 296-297.

The award in *Total v Argentina* constitutes, according to Leonhardsen, "the best use of proportionality analysis in investment treaty arbitration."[121] These arbitrators applied proportionality to consider the first two of the three claims for breach of foreign investor's legitimate expectations under the FET standard.[122] These allegations were

> "- the elimination of the calculation of the tariffs in US dollars;
> - the elimination of the automatic adjustments of the US dollar tariffs every six months in accordance with the US PPI, distinguishing in this respect the 6-month automatic adjustment in itself from its pegging to the US dollar based PPI;
> - the non-application or elimination of the promises of economic equilibrium and a reasonable rate of return through the ongoing suspension of the Five-Year and Extraordinary Reviews, thus freezing the tariffs since 2002."[123]

Regarding the first two expectations, the *Total v Argentina* tribunal began considering the reasonableness of the measures issued by Argentina to handle the severe economic crisis. Later, these arbitrators described the need to assess the appropriateness of the measure in the light of the means-ends test. This part of the analysis was described as whether the measures passed by Argentina were non-discriminatory, reasonable, and proportionate

> "both in the light of their objective effects but also in the light of the reasons that led to their adoption (subjective good faith, proportionality to the aims and legitimacy of the latter according to general practice)."[124]

Although the arbitrators did not engage with the necessity test at this point, they engaged with it later when assessing the necessity defence under customary international law.[125] In the end, the *Total v Argentina* tribunal found in favour of Argentina regarding the two U.S. dollar related expectations because the measures

[121] Leonhardsen, Erlend, "Looking for Legitimacy: Exploring Proportionality Analysis in Investment Treaty Arbitration," p. 125.
[122] *Total v Argentina*, ICSID Case No. ARB/04/01, Decision on Liability, 27 December 2010, at 162.
[123] *Ibid.*, at 135.
[124] *Ibid.*, at 163-164.
[125] *Ibid.*, at 223.

could not ”be considered unfair in the circumstances,” particularly due to “the reasons that led to their adoption.”[126]

However, again, we find that the arbitrators in *Total v Argentina* applied proportionality analysis to two legitimate expectations, which, according to the same award, the foreign investor never had. Regarding the two U.S. dollar related expectations, the commented award stated “that the denomination of the tariffs in U.S. dollars was not the object of a promise or a commitment to Total,”[127] and “Total's alleged full reliance on the mechanism for adjusting tariffs based on the U.S. PPI was misplaced.”[128] This approach contrasts with the attitude of the tribunal when considering the legitimate expectation to have the tariffs readjusted independently of the US dollar or the US PPI. On this issue, the arbitrators decided that the foreign investor had such an entitlement supporting their opinion in international and Argentine Law.[129] For this reason, they concluded that Argentina had breached the FET standard, but this time without engaging in a proportionality analysis.[130]

In short, in accordance with Alexander's work, we should not be very optimistic about proportionality if it is employed when foreign investors' rights have not been breached or this is at least doubtful. The awards in *EDF v Romania* and *Total v Argentina* show a similar deficiency: they disregard that only foreign investors' rights matter. When there is no deprivation of rights, if we are willing to take rights seriously, the claim should be dismissed without further analysis.

Conclusion

In this chapter, I have shown that public law tools as currently used by investment arbitrators cannot balance the excessive substantiation of foreign investors' rights. Neither the effects nor the balancing tests can compensate for the lower social participation in the recognition of foreign investors' expectations, the empowerment of multinational corporations and the weakening of developing and least-developed countries. In this regard, I have explained that foreign investors' legitimate expectations under the FET standard circumvent the threshold and the

126 *Ibid.*, at 164.
127 *Ibid.*, at 150.
128 *Ibid.*, at 158.
129 *Ibid.*, at 167-169
130 *Ibid.*, at 175.

denominator. This is possible thanks to the application of a contractual approach and the reliance theory for the substantiation and enforcement of foreign investors' rights. In addition, I have explained that we should not have high expectations of proportionality as a way to counterbalance the excessive focus on the position of the foreign investor. First, I have argued that the mediating character of this way of reasoning suggests that investment arbitrators favour host state measures that are consistent with foreign investors' expectations. In this respect, I have submitted that the expansive substantiation of foreign investors' rights shapes the means-ends test. Second, I have explained that the application of proportionality depends on investment arbitrators' views regarding the circumstances surrounding a dispute. In this respect, I have shown that arbitrators seem to favour technocracy to democracy. Third, I have proved that investment awards have not made an ideal use of proportionality as a tool for strengthening host state authority. The awards in *EDF v Romania* and *Total v Argentina* have applied proportionality in scenarios where the arbitrators were at least sceptical about there being an actual deprivation of foreign investors' legitimate expectations.

To conclude, I have argued that the main reason why proportionality does not guarantee a substantial change in the direction of investment awards refers to the purpose or core value of the IIR. Most investment law scholars acknowledge the need to balance the private and public interests involved in investment arbitration. I have suggested that the real imbalance, however, lies in the excessive focus on wealth maximisation and foreign investors' expectations. Arguably, then, the IIR may need to explore other alternatives to assess the plural ways in which host countries aim to establish decent orders where foreign and national individuals can flourish. This second challenge should be *qualitatively* different.

CONCLUSIONS

This thesis has focused on an element of the IIR that has been overlooked by most international investment law literature: foreign investors' rights. There is no doubt that this field of international economic law is concerned with the protection of foreign investment from host state political and regulatory risk. However, throughout this thesis I have demonstrated that this is only part of the story. The main users of investment arbitration, i.e. foreign investors, demand a mechanism for protection against host state measures in order to maintain the control over resources that is necessary for carrying out their projects. Multinational corporations have no interest in protection as an abstract goal or as a means of ensuring international fairness. The main interest of foreign investors is to guarantee a measure of control that will enable them to fulfil their business expectations. My main argument in this thesis has been that if we concentrate on international investment law only as a mechanism for protecting foreign investment, the extent of foreign investors' control is not adequately contemplated in the analysis. This can lead us into a formalist trap. The dominant focus on foreign investment protection tends to be on host state abusive or arbitrary behaviour, paying insufficient attention to the struggle for foreign investors' rights.

This partial view of the IIR undermines institutional and academic efforts to evaluate and improve this regime. Arguably, most knowledge about international investment law has been built on the idea that host states can behave in an arbitrarily and abusive way, whilst less attention has been focused on the substantiation of foreign investors' control over resources, i.e. their rights. I have shown that a debate about how we define this measure of control is highly relevant. After all, investment arbitrators *enforce* these *rights* against host states. In this respect, it is not possible to disconnect the substance of foreign investors' rights from any allegation of abusive behaviour. Protecting foreign investors from host state political risk requires a way of distinguishing abusive from regular behaviour. The content of the rights is the starting point for making this distinction. Furthermore, concentrating only on host state behaviour conceals the socio-relational implications of foreign investors' proprietary rights. Investment disputes do not deal with foreign investors and host states only; the implications for local populations need to be recognised. Thus, I argue that the ontological assumption that the IIR serves to protect the investment – overlooking the effects of this regime on foreign investors' rights – has a distorting effect on the construction of knowledge about this regime: the epistemology of the IIR.[1]

I began my investigation about foreign investors' rights by providing a theoretical understanding of the content of property rights. I mainly explored the domain of ownership. I concentrated on different approaches to ownership, distinguishing between a view that focuses on the individual ability to set the overall agenda for resources and an economic view that concentrates on particular uses of resources. The study of ownership clarifies that the relationship between foreign investors and host states is not a competition to define the use of the resources but a tension between the activities pursued by the foreign investor and the authority of the state to prohibit, limit or regulate these activities. In addition, I explained that legal orders do not provide a clear enumeration of the uses that an owner enjoys over his resources, highlighting the *incomplete* character of ownership. The law cannot include all the potential uses of property, nor does it grant individuals rights regarding all the uses they can pursue. In this regard, I distinguished between the notions of legal and mere uses: individuals have a right to legal uses but not to mere uses. The legislation rarely makes this distinction explicit and, when it does, it is often vague, ambiguous and therefore subject to judicial interpretation. In particular, I stressed that the substantiation of ownership has an important *local* component that depends on the concrete time and place.

I concluded the analysis about ownership showing that, in the end, the individual's control over the resources is a variable of both the substantiation and enforcement of their rights ("as much rights as remedy"). The legal order operates within a level of incompleteness that leaves adjudicators with the task of interpretation whenever there is a dispute. I noted that this uncertainty can pose an obstacle to some long-term economic projects. In this respect, I underlined that most legal orders provide mechanisms for specifically granting individuals certain uses over the resources: contractual commitments and vested rights.

As I began looking into foreign investors' rights, the first element I stressed was that foreign investors' rights over resources have always played an essential role in both the diplomatic protection model and the IIR. These rights are the *object* of protection. I showed that most of the rights that foreign investors ask investment

[1] See Alexy, Robert, "The Nature of Legal Philosophy," 17:2 *Ratio Juris* (2004), pp. 157-158.

tribunals to enforce are essentially of a *proprietary* character. These rights can represent resources that are specific to the location, such as a mine, and resources that the foreign investor brought from abroad, such as intellectual property. In addition, foreign investors may have contractual commitments and vested rights clarifying their ownership of the resources. An important characteristic of these patrimonial rights is that states are necessarily involved in their creation, and only states through sovereign acts can deprive foreign investors of their proprietary rights (including contractual commitments or vested rights).

The importance of foreign investors' rights contrasts with their secondary role in international investment law literature. The focus there is on foreign investment protection, overlooking the proprietary rights. I suggested that this shortcoming engenders the need to study the IIR through a framework capable of considering both foreign investors' rights and remedies. I therefore proposed examining the IIR through the lens of constitutional property regimes. Foreign investors' rights describe a measure of control that foreign investors enjoy over resources, and that they can enforce against other individuals and the host state. The IIR, however, covers only part of this relational scope as foreign investors employ investment arbitration to enforce their rights against host states only. This is an important characteristic of foreign investors' rights from the perspective of the IIR. This regime does not deal with relations between foreign investors and other private individuals in the host country. This is exactly the scope of application of every constitutional property regime. Constitutional property clauses are ways of coping with political risk, i.e. the risk that governments and legislative majorities will utilise the state apparatus to deprive individuals of their rights. I explained that the IIR follows exactly the same rationale. This regime represents an institutional development aimed at solving the problem of the lack of trust in democracy, limiting the scope of measures that states can pass in relation to private property rights. In addition, like every constitutional property regime, the IIR delegates the judgment of any potential deprivation of foreign investors' rights in anti-majoritarian bodies. I stressed that investment arbitration has a more difficult task because it needs to shield foreign investors not only from political majorities but also from domestic interests in a more general way.

I continued to pursue my interest in foreign investors' rights by exploring constitutional property clauses and investment treaties. These texts concentrate on the same problem and provide the same solution. The problem is defined as the risk that states will deprive individuals of their proprietary rights. The actual texts can differ but the issue is always expropriation and the deprivation of patrimonial rights by state actions. The solution that constitutions and the IIR provide for this problem is that states need to pay compensation to the individual. The practice of paying compensation for state deprivations of proprietary rights constitutes an important similarity between constitutional property regimes and the IIR. In practice, neither regime obliges states to annul the inconsistent measure or to restore the previous situation. The characterisation of the IIR as a constitutional property regime, however, provides no answer – in either the constitutional or the investment treaty texts – regarding the content of proprietary or foreign investors' rights.

Traditionally, the position has been that the content of proprietary rights arises not from the constitutions but from other sources of the legal order such as civil codes, legislation, and common law. This approach, however, has an inherent shortfall: it overlooks the incomplete character of ownership, and the important role that adjudicators play in substantiating property rights in the event of a constitutional dispute. The premise that the legislation contains well-defined private property rights is quite formalistic. This is the exception, not the rule. I explained that this conclusion is fully applicable to the IIR as investment treaties do not clarify foreign investors' rights, except their right to transfer funds. Quite often, therefore, investment arbitrations need to substantiate foreign investors' rights to resolve an investment dispute. Thus, interpretation is key.

However, the legal basis for this interpretation is often unclear in investment awards because arbitrators have not been very precise regarding the law applicable to investment disputes. In private international law, the position is that property rights are governed by territorial laws. Yet, investment law scholarship and awards give international law a leading role in investment disputes. Some authors have addressed this contradiction. Douglas, in particular, stresses that domestic law is very important in relation to foreign investors' rights. He explains that this law governs the possibility of acquiring property rights over resources and the title over these rights. Douglas seems to suggest that domestic laws also govern the content of foreign investors' rights. However, his approach disregards the incomplete character of ownership. When ownership is incomplete – and this most commonly the case – Douglas agrees with most of the literature that investment arbitrators should rely on the doctrine of legitimate expectations in accordance with investment treaties and international law.

The issue of foreign investors' legitimate expectations has attracted some attention in legal scholarship on investment, although much less than host state behaviour. The approach to the study of these expectations has been essentially doctrinal. Tribunals have focused on the question of when foreign investors have legitimate expectations, and the scholarship has followed a similar line of inquiry. However, I argued that this doctrinal analysis is not the key to understanding what lies behind the interpretation and substantiation of foreign investors' proprietary rights. Property scholars such as Michelman, Rose, Alexander, Singer, Waldron and Ackerman all claim that the central point is the normativity that guides judges. In particular, Waldron and Rose demonstrate the correlation between the dominant justifications for private property rights and the substantiation of these rights.

Following this line of argument, in the second part of my thesis, I concentrated on the way that investment arbitrators substantiate foreign investors' rights. I began by analysing the main justifications for the IIR, showing that this regime has been justified on contractualist and neo-utilitarian premises. The influence of contractualism is illustrated by the widespread recognition of the OBM and commitment models as leading justifications for the IIR. Foreign investors work and devote their resources to carrying out business activities in host states. However, the OBM warns us that after establishment they run the risk that host states will breach the conditions of the foreign investment. The premise of these contractual models is that the foreign investor and the host state have struck a bargain that governs every detail of the investment. However, this proposition does not represent social reality because these two actors often do not sign any contract, or the signed agreement may not cover all the issues. Thus, I submitted that the description provided by the OBM resembles a Lockean contractualist account of the origin of property rights, where the individual participates through his labour in the creation of property rights, and, later, this presumed peaceful and fair process is threatened by the authority of the state to change the law. This authority, on the contrary, is described as potentially abusive and arbitrary.

In addition, in the case of the IIR, I stressed that an important justification for this regime is the allegedly weak position of foreign investors vis-à-vis domestic investors because they cannot participate in the political life of the host country. I explained that some scholars and decisions have relied on this reason to claim that foreign investors may need to collaborate less in the achievement of local social goals. Presently, however, the view of an important part of the scholarship is that foreign investors are responsible to a global community in relation to development, the environment and public health.

Arguably, the most significant justification for the IIR is based on the positive development effects of foreign investment and investment protection. The assumption is that foreign investment promotes development, and investment treaty protection increases foreign investment or at least decreases political risk. This neo-utilitarian perspective coincides with a neoclassical, and law and economics view in which the main justification for a property system is the maximisation of wealth. The premise of these intellectual schools is that individuals, and arguably foreign investors in particular, are the most efficient at maximising wealth. For this reason, the private property system needs to be aligned with the use that these individuals make of the resources.

The argument that emerges from this analysis is that investment arbitrators substantiate foreign investors' rights according to contractualist and neo-utilitarian rationales. This is a guarantee as well as a transnational-oriented interpretation. Against this normative background, I proceeded to examine the substantive doctrine of legitimate expectations in the IIR. I began by comparing the doctrine of acquired rights with the doctrine of legitimate expectations. I highlighted that the doctrine of legitimate expectations is connected to the host states' regulatory threat, and that foreign investors' legitimate expectations are *investment-backed* expectations. The substitution of the concept of investment for the notion of property supports my argument. The concept of investment is an essential part of the puzzle for understanding the way investment arbitrators substantiate foreign investors' legitimate expectations. As opposed to property, the concept of investment refers to individual actions directed towards wealth maximisation. The same applies to the historical account of the incorporation of the concept of investment in treaties and the interpretation of this concept for jurisdictional purposes. Most jurisdictional awards concerning the concept of investment stress the characteristics of the actions taken by the foreign investor (i.e. duration and risk) and their objective (i.e. to make profit through wealth maximisation).

I relied on the concept of investment to explain how contractualism and neo-utilitarianism substantiate foreign investors' rights. I argued that *investment* is to the IIR what *labour* is to a Lockean theory of property. Investment awards confirm the contractualisation of foreign investor-host state relations. The time of establishment is essential to the substantiation of foreign investors' legitimate expectations. The premise behind this approach is precisely what follows from the OBM and the contractual commitment models: the idea of a bargain or contractual commitment. However, I underlined that the scholarship and the awards are not referring to contracts when they talk about legitimate expectations. They concentrate instead on foreign investors' reliance on government declarations and the general legislation to plan their investments. The protection of the conditions existing at the moment of establishment is justified on the basis that they may have become essential for the foreign investment. The idea behind this approach is that the IIR needs to strengthen certainty and predictability for foreign investors. I explained that this view can lead either to a stabilisation of the legal order or to the claim that changes need to be consistent with foreign investors' expectations.

Although the first approach may have dominated investment awards for a short period, the dominant position in investment arbitration and scholarship recognises some level of host state authority to pass regulatory measures. Scholars such as Schill, Montt, Schreuer and Dolzer embrace notions such as global administrative law, a substantive rule of law and good governance. These views indicate that host states have some authority to issue changes in relation to the foreign investment. However, these changes need to be *compatible* with the expectations of the foreign investor. The message behind these positions is that a level of certainty and predictability is required to facilitate wealth maximisation through foreign investment.

In this respect, I claimed that wealth maximisation through foreign investment constitutes the purpose or core value of the IIR. This purpose permits investment arbitrators to facilitate foreign investors' expectations, whilst recognising at the same time some host state authority to pass measures. In this context, two questions emerge as central to determining the content of these expectations. The first is when can a foreign investor rely on government declarations or the legal order of host states to claim a legitimate expectation? The second is under what circumstances can a foreign investor reasonably expect and tolerate changes in the host state legal order?

I began to consider these two questions by stressing that to understand the way investment arbitrators substantiate foreign investors' rights we need to pay attention not only to the answers but also to the normative framework that gives rise to these two questions. I explained that the first question is based on a contractual approach grounded in the reliance theory. This contractual theory moves the focus of the legal reasoning away from the promisor and his intention. Instead, the emphasis is on the *promisee* and his *expectations*. In the context of the reliance theory, the existence of a bargain is less important because the rationale is that protecting reliance facilitates wealth maximisation. I showed that investment tribunals follow the reliance theory when substantiating foreign investors' legitimate expectations. Although some tribunals have begun to pay more attention to the specificity of host state declarations, I explained that they still ground their decisions in the reliance theory. In addition, I showed that investment arbitrators follow a substantive rule of law to consider the question of foreign investors' expectations in relation to change. The core of this approach is that changes in the legal order need to be consistent with foreign investors' expectations. Again, the application of a substantive rule of law is justified on the basis that increasing individual certainty and predictability facilitates wealth maximisation.

Overall, I claimed that this approach goes too far in favour of wealth maximisation through foreign investment. I relied on property theory insights to develop this argument. Thinking about the IIR as a constitutional property regime allows us to reflect on the entire set of relations that converge into the resources that are part of the foreign investment. Thus, the first thing that comes to our attention is the *socio-relational* character of foreign investors' rights. The question concerning the control of the resources affects foreign investors, host state and local populations. This perspective also stresses the *plural* character of property as a social institution. The normative questions involved in the substantiation of foreign investors' rights show that investment disputes are not only about allegations of abusive host state behaviour but also about the values that shape the substance of these rights. This analysis leads to the conclusion that the substantiation of foreign investors' rights affects host populations and their social practices. The record in investment arbitration includes issues such as waste disposal, mining, nuclear energy, smoking, financial crisis and historical reparation. In this regard, I submitted that a view of the IIR that only concentrates on foreign investment protection overlooks the fact that the reliance theory and a substantive rule of law focus excessively on wealth maximisation, putting pressure on any attempts of the host country to achieve a decent order where individuals, nationals and foreigners alike can flourish.

In particular, I described two ways in which the IIR can affect the establishment of a decent order. A consequence of substantiating foreign investors' rights through the reliance theory and a substantive rule of law is that important questions can be decided through opaque methods, e.g. a business meeting, reducing the possibility for local populations to deliberate and participate in the creation of foreign investors' legitimate expectations. I explained that entire countries may realise the substance of foreign investors' rights when they want to apply a change. However, by then the threat of an investment arbitration is imminent. This argument does not derive from the idea that host states and populations have an unrestricted right to change their laws. On the contrary, the thrust of my criticism is that the law should promote the participation of the people in decisions that can modify their social practices, and that later can only be modified by paying compensation. Thus, I argued that the substantiation of foreign investors' rights focuses excessively on the position of foreign investors, affecting a procedural rule of law and democratic principles. Local populations are turned into witnesses in the enduring struggle for the content of the proprietary rights.

In addition, I claimed that the way investment arbitrators substantiate foreign investors' rights further empowers multinational corporations. The traditional justification for the IIR is that host states can abuse the rights of foreign investors after establishment. The argument has never been that multinational corporations require stronger rights. However, I showed that investment arbitration is not calibrated just to enforce protection. The effects on the substance of foreign investors' rights improve the position of foreign investors. In particular, I claimed that the reliance theory is dangerous for developing and least-developed countries. I explained that the governments of these countries find themselves making declarations about the investor friendly character of their legal orders. Even if these countries do not grant contractual commitments or vested rights, the premise of the doctrine of legitimate expectations is that these declarations can enlarge foreign investors' rights. As a result, the prism of the IIR makes weak countries and populations even weaker. From the point of view of fairness, I claim that this outcome is difficult to justify.[2]

I concluded this thesis by showing that neoformalist public law tools, such as proportionality, cannot *balance* the excesses in favour of wealth maximisation through foreign investment. Public law tools give adjudication a mediating feature that does not offset the previous excessive substantiation of foreign investors' rights. This is because foreign investors' legitimate expectations will always constitute one of the terms of the means-ends test. In addition, I showed that investment arbitrators perceive the circumstances that surround the disputes from a scientific and technocratic standpoint, downplaying democratic decisions taken as a result of the preferences of local populations. I finished by emphasising that even if proportionality is applied only after investment arbitrators have found the existence of a breach of legitimate expectations, this way of reasoning is not able to balance the excesses of the IIR. I argued that this is because the purpose of this regime remains focused on the maximisation of wealth through foreign investment.

The normative criticism I have made of the way investment arbitrators substantiate foreign investors' rights could lead me to suggest that the problem is investment arbitration. However, the issues I have identified would not be automatically resolved by creating a permanent tribunal, an appeal body, a multilateral investment agreement, or by returning to diplomatic protection.[3] The challenges of substantiating foreign investors' rights will remain, provided that the international legal order allows foreign investors or home states to assert private proprietary rights against host states. These alternatives for reform do imply some changes. The establishment of a permanent investment court would have implications for the substantiation of foreign investors' rights. Similarly, a different

[2] See Dworkin, Ronald, "A New Philosophy for International Law," 41:1 *Philosophy & Public Affairs* (2013), pp. 14-17, 22, 28-29.

[3] See Sauvant, Karl and Federico Ortino, "The need for an international investment consensus-building process," 101 *Columbia FDI Perspectives* (2013); UNCTAD, "Reform of Investor-State Dispute Settlement: In Search of a Roadmap," 3 IIA Issues Note (2003); Åslund, Anders, "The World Needs a Multilateral Investment Agreement," Peterson Institute for International Economics PB 13-01 (2013).

wording for the treaties, substituting the concept of investment or consolidating host state authority, would shape the reasoning of investment arbitrators. Nevertheless, in my view none of these alternatives will reduce the significance of interpretation for the substantiation of foreign investors' rights. I claim that the only way to completely resolve these issues at the international level is not to pose the question at all, forcing foreign investors to look for redress domestically. This option may not only be illusory in the present global scenario, but also unwise as nobody wants to return to gunboat diplomacy or political intervention as a means of solving investment disputes.

Assuming that international arbitral tribunals (or a future appeal or permanent tribunal) continue deciding investment disputes, an important challenge is to address the struggle that lies in the substantiation of foreign investors' rights. First of all, I think that neo-utilitarian arguments for foreign investors' rights are neither flawed nor improper. My view is that the IIR has gone too far with wealth maximisation, and not that utilitarianism should have no role in the content of foreign investors' rights. Multinational corporations that create global business will probably resist the local particularities of their rights. Foreign investors favour the IIR because of the assurance that international arbitrators with a global profile will scrutinise host state actions. This position is reasonable. However, I have claimed that the issue at stake is not only political risk, but also the content and socio-relational implications of foreign investors' rights. The application of the reliance theory and a substantive rule of law gives local populations important reasons to discuss and complain about the IIR. The IIR explicitly or implicitly stands between the global and local tensions in foreign investors' use of the resources of different countries, and it favours a global position.

I consider that a legitimate approach to this tension should start by advancing a purpose for the IIR that is more pluralistic than wealth maximisation through foreign investment.[4] I have claimed that there is a need to accommodate the preferences of host states and populations to establish a decent order where national and foreign individuals can flourish. Autonomy is fundamental for everybody. I acknowledge that the reality is probably more complicated because state behaviour can have two types of goals: wealth maximisation through

[4] The need to modernise the purpose of the IIR has been acknowledged by Sauvant and Ortino. See Sauvant, Karl and Federico Ortino, "The need for an international investment consensus-building process," p. 2.

domestic and public investment or the improvement of social conditions. In this context, the key to balance the IIR is to identify a core value that recognises the role that foreign investment can play to establish a decent order. This purpose would serve to enforce foreign investors' rights against any attempt to improve the private and public domestic sectors at the expense of foreign investors. Such an approach would lead to a more intense use of standards to assure fair and equitable *political* treatment (i.e. discrimination standards).[5]

In addition, an important principle that follows from a more pluralistic purpose for the IIR is that when a foreign investor enters a country he has to accept his social responsibility towards the local population. This includes the recognition of the local particularities of his property rights, and his obligation to collaborate with non-excessive and non-discriminatory contributions to any attempt of the host country to improve social conditions.[6]

Thus, balancing the IIR requires reducing the influence of contractualism and returning to the premise that property rights – not the investment – constitute the object of protection. A return to the basis of property law would move the focus back to vernacular expectations. The source of foreign investors' rights should be the formal and informal property rules of the domestic legal order. The name of this approach could be "acquired rights" or "vernacular legitimate expectations." But the label is a less important question; what matters is that "[a]n expectation remedy makes sense if the promisee actually has acquired an existing right to the promised performance at the time of the breach."[7] As multinational corporations are economically powerful and politically influential, they can negotiate contractual commitments and vested rights when they require greater certainty and predictability to carry out their investments. The basis of the model I propose is that host states need to pay compensation if they deprive foreign investors of their proprietary rights, substantiated and enforced in a proprietary manner. In particular, I argue that a fair regime for investment protection should assure

[5] See Dagan, Hanoch, "Reimagining takings law," in Alexander, Gregory and Eduardo Peñalver (Eds.), *Property and Community*, New York: Oxford University Press, 2010, p. 46.
[6] See Gray, Kevin, "There's No Place Like Home!," 11:1 *Journal of South Pacific Law* (2007), p. 82; Michelman, Frank, "Property, Utility, and Fairness: Comments on The Ethical Foundations of 'Just Compensation' Law," 80 *Harvard Law Review* (1966-1967), p. 1277; Rose, Carol "Mahon Reconstructed: Why the Takings Issue is Still a Muddle," 57 *Southern California Law Review* (1984), pp. 583-584, 595.
[7] Gold, Andrew, "A Property Theory of Contract," 103:1 *Northwestern University Law Review* (2009), p. 18.

foreign investors that they will not suffer excessive burdens without receiving adequate compensation.

Arguably, a regime for investment protection that moved away from the recognition of individual legitimate expectations would promote the negotiation and conclusion of contractual commitments and vested rights: reasonable foreign investors would never invest in natural resources or sensitive sectors without a licence or a clear agreement regarding the conditions.[8] This alternative IIR would be *fairer* for two reasons. First, foreign investors' need to acquire contractual commitments and vested rights would facilitate the deliberation and participation of local populations regarding foreign investors' rights. Foreign investors can make legally binding promises regarding job creation or local production requirements. Countries can accept the effects of the foreign investment on their social practices on the basis of the promised benefits of the project. This decision of the host country is perfectly fair and it should be subsequently enforced against host states. Similarly, some populations may not want the project. This position should also be respected. As Rose explains, even the property system in the United States does not show a clear and uniform preference for wealth maximisation.[9]

Second, the premise that only contractual commitments and vested rights can serve to substantiate foreign investors' rights beyond formal and informal property rules will not make multinational corporations even more powerful. In this model, foreign investors know that they need to negotiate a contractual commitment or a vested right to have further assurances. This approach would create certainty, albeit of a different kind, putting pressure on multinational corporations to negotiate these agreements and accept some of the conditions demanded by host countries.

All in all, this study on the substantiation of foreign investors' rights over the resources of different countries has highlighted the significant place that business

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[8] Additionally, reasonable foreign investors would need to consider questions such as "the development planning in the country of investment […] When it comes to investment in an underdeveloped country, the lawyer advising an enterprise is necessarily engaged in questions of public policy and transactions with the host government-all of which go beyond the usual technical legal questions to a wider range of considerations of a political, administrative, and economic character," Meier, Gerald, "Legal-Economic Problems of Private Foreign Investment in Developing Countries," 33:3 *The University of Chicago Law Review* (1966), p. 465.

[9] See Rose, Carol, "'Takings' and the Practices of Property: Property as. Wealth, Property as 'Propriety'," in *Property and Persuasion*, Colorado: Westview Press, 1994, pp. 58-64; Rose, Carol "Mahon Reconstructed: Why the Takings Issue is Still a Muddle," 561-599.

certainty has in the IIR. Indeed, the application of the reliance theory and a substantive rule of law is a means of increasing individual certainty justified by a neo-utilitarian rationale. This is costly in a market economy. I have argued that this cost is paid in socio-relational terms by local populations. The IIR constitutes a risk to their values and social practices. The source of this risk lies in the reduction of their autonomy. The normative basis for my proposal to return to a property framework is precisely to revalorise the *autonomy* of host countries to decide essential questions about their social organisation. We need a legitimate and fair political way of resolving the struggle for resources of different countries. The only counter-argument the proponents of the current IIR can make to this criticism is that it is a means of maximising wealth through foreign investment. The idea that the effort is worthwhile points to a correlation between foreign investment protection, an increase in foreign investment and host state development. However, even those who believe in this justification cannot deny that there is much more to the IIR than foreign investment protection. The socio-relational costs of this regime are tangible and cannot be simply ignored. Otherwise, sometimes explicitly and sometimes in a subtle manner, foreign investors' rights will continue to threaten social life, particularly in the weakest countries.

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