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Investor-State Arbitration as Governance: Fair and Equitable Treatment, Proportionality and the Emerging Global Administrative Law

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**Investor-State Arbitration as Governance:
Fair and Equitable Treatment, Proportionality and the
Emerging Global Administrative Law**

Benedict Kingsbury and Stephan Schill***

Abstract

Investor-State arbitration is not only a mechanism to settle disputes between an investor and a State arising out of an investment, it is also a form of global governance that involves the exercise of power by arbitral tribunals in the global administrative space. In setting standards for State conduct vis-à-vis foreign investors, for example in defining what is improper administration or a violation of due process under fair and equitable treatment, tribunals set standards which may influence future conduct by the respondent State and other States, and will very likely influence the decision-making of tribunals in other cases. In settling disputes between investors and States, the tribunals also act as pre-agreed review agencies of a State's specific actions, in some cases applying proportionality analysis or other tools of public law review when confronted with difficult balances between investor protection and the State's environmental or economic policy choices in the wider public interest. In these respects, investor-State arbitration forms part of a governance structure, and helps constitute and shape the emerging body of global administrative law. At the same time, this regulatory activity of arbitral tribunals attracts significant criticism, not only of specific decisions but with regard to the legitimacy of the decision-making powers of these tribunals as such. This paper argues that these concerns can be addressed, at least in part, by application of principles of the emerging global administrative law to, and by, these tribunals.

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TABLE OF CONTENTS	Page
I. Introduction: Investor-State Arbitration and the Emerging Administrative Law of Global Governance.....	01
II. Investment Arbitration as Regulation of State Action: “Fair and Equitable Treatment” Jurisprudence.....	08
III. Proportionality in International Investment Treaty Arbitrations: Arbitral Tribunals as Review Agencies of the Host State’s Exercise of Regulatory Powers.....	21
IV. Addressing Demands for Legitimacy in the Investor-State Arbitration System: Roles of Global Administrative Law.....	40
V. Conclusion: Problems in Operationalizing the Normative Justifications of the Public-Regarding and Governance-Regarding Dimensions of the Investor-State Arbitration System.....	50

Investor-State Arbitration as Governance: Fair and Equitable Treatment, Proportionality and the Emerging Global Administrative Law

I. INTRODUCTION: INVESTOR-STATE ARBITRATION AND THE EMERGING ADMINISTRATIVE LAW OF GLOBAL GOVERNANCE

Investor-State arbitration, and in particular arbitration based on international investment treaties, is not simply dispute resolution.¹ It is also a structure of global governance. Through publicly available and widely studied awards, investor-State arbitral tribunals are helping to define specific principles of global administrative law and set standards for States in their internal administrative processes.² Similarly, investor-State arbitration functions as a review mechanism to assess the balance a government has struck in a particular situation between investor protection and other important public purposes, for example by using proportionality analysis. In addition, decisions made *ex post* by tribunals with regard to such balances may influence what later tribunals will do, and may influence *ex ante* the behavior of States and investors.

Most arbitrators understandably write their awards and their other public remarks within the framework of the primary and immediate function of these arbitrations as being to settle specific

1. This Paper is concerned primarily with treaty-based investor-State arbitration, arising under one or other of more than 2,500 bilateral, regional and sectoral investment treaties, including the North American Free Trade Agreement (NAFTA) and the Energy Charter Treaty (ECT). For general accounts of investment treaties and related instruments of investment protection see, for example, Rudolf DOLZER and Margrete STEVENS, *Bilateral Investment Treaties* (1995); Giorgio SACERDOTI, *Bilateral Treaties and Multilateral Instruments on Investment Protection*, 269 *Recueil des Cours* (1997) 251; M. SORNARAJAH, *The International Law of Foreign Investment*, 2nd edn. (2004) pp. 204-314; Campbell MCLACHLAN, Laurence SHORE and Matthew WEINIGER, *International Investment Arbitration – Substantive Principles* (2007); Andreas LOWENFELD, *International Economic Law*, 2nd edn., (2008) pp. 467-591; Rudolf DOLZER and Christoph SCHREUER, *Principles of International Investment Law* (2008); Peter MUCHLINSKI, Federico ORTINO and Christoph SCHREUER, eds., *The Oxford Handbook of International Investment Law* (2008). This type of arbitration differs from purely contract-based arbitration, in which the governing law, the host State's consent to arbitration, and the rules of the arbitration are dependent on an investor-State contract, not on an international treaty. Although the focus in this Paper is on investment treaty arbitration, many of the observations made may apply, subject to modifications, to contract-based investor-State arbitration that is entirely independent of the application of an international treaty. Whether and how the observations made also apply to purely investor-State contract arbitration is not dealt with in this Paper. However, the existence of an applicable investor-State contract may have a modifying effect on the treaty analysis and institutional analysis in the Paper. Thus, questions of how investor-State tribunals should deal with the public law implications of investment treaty arbitration, such as proportionality analysis or implications of fair and equitable treatment, may potentially be considered differently to the extent that a contractual relationship between host State and investor is involved. For example, investor-State contracts often contain more precise and elaborate rules on the parties' mutual rights and obligations, and applicable contracts may have implications for the specific application of treaty rules and of customary international law. No comment is made on these matters in this Paper.

2. New York University School of Law Institute for International Law and Justice's (IILJ) research project on global administrative law includes a website with a substantial series of working papers and extensive bibliographies as well as links to papers from other scholars around the world <www.iilj.org/GAL>. Among the first sets of papers from this project were three journal symposia: Benedict KINGSBURY, Nico KRISCH, Richard STEWART and Jonathan WIENER, eds., *The Emergence of Global Administrative Law*, 68 *Law and Contemporary Problems* (Summer-Autumn 2005, nos. 3-4), pp. 1-385; Nico KRISCH and Benedict KINGSBURY, eds., *Global Governance and Global Administrative Law in the International Legal Order*, 17 *Eur. J. Int'l L.* (2006) pp. 1-278; and the Global Administrative Law symposium in 37 *NYU Journal of International Law and Politics* (2005, no. 4). Subsequent publications include sets of papers from conferences convened by the IILJ with partner institutions: San Andres University in Buenos Aires, *Res Publica Argentina* (2007-3), 7-141; University of Cape Town, *Acta Juridica* (2009); the Centre for Policy Research in New Delhi (forthcoming); Tsinghua Law School in Beijing (forthcoming); and the University of Geneva, *International Organizations Law Review* (forthcoming).

individual disputes between investors and States arising out of foreign investment activities. But investor-State arbitral awards have important effects going beyond those who appear before them in individual disputes. Investor-State arbitral tribunals implement broadly phrased international standards set out in very similar terms in many investment treaties, and concretize and expand or restrict their meaning and reach through interpretation, so that they increasingly define for the majority of States of the world standards of good governance and of the rule of law that are enforceable against them by foreign investors.³ And they review State action in ways that can have implications for much wider public interests and public policies, and for the legitimacy and methodological justifiability of the tribunals themselves.

The standards thus reinforced or created by arbitral tribunals reflect general principles for the exercise of public power that are applicable not only to State conduct, but likely will be applied over time, *mutatis mutandis*, to the activities of arbitral tribunals themselves. Investor-State arbitration is thus developing into a form of global governance. These tribunals exercise power in the global administrative space. Individual tribunals exercise power directly through the substantive awards they make in favor of investors or States, as well as through their findings of fact and through their decisions on matters such as amicus briefs, the awarding of costs and interest, or decisions as to timing, the suspension of proceedings to allow for settlement negotiations, etc. More fundamentally, the tribunals as an aggregate exercise power through influencing the development of a body of global administrative law that guides State behavior, through influencing both customary international law and approaches taken in other sub-fields such as trade law or human rights, and through their approaches to balancing different investor and public interests, in ways that affect public policy and the future conduct of States and investors alike. Any significant exercise of power in the public or administrative sphere raises demands that the exercise of power be legitimate. This applies not only to what is done (or not done) by individual tribunals and arbitrators, and by individual appointing authorities and annulment committees, but also to the system of investor-State arbitration as a whole. The application of global administrative law to, and by, the investor-State arbitration system may be a key future element in helping to address these legitimacy concerns.

Investor-State arbitration, particularly under the more than 2,500 bilateral investment treaties (BITs) and several important regional treaties, including NAFTA and the ASEAN investment treaty, is a burgeoning field, with more than 300 investment treaty-based disputes publicly known and many new arbitrations being initiated each year.⁴ At the same time, investor-State arbitration may also be a brittle field. Some States are becoming increasingly wary with respect to investment treaty arbitration and investment treaty protection. The cases related to the Argentine economic emergency,⁵ and the stance taken by several other Latin American governments,⁶ highlight obvious concerns about the suitability and indeed the legitimacy of the

3. See David SCHNEIDERMAN, *Constitutionalizing Economic Globalization* (2008).

4. See UNCTAD, *Latest Developments in Investor-State Dispute Settlement, Dispute Settlement* (2008) pp. 1-2, available at <www.unctad.org/en/docs/iteiia20083_en.pdf> (recording 290 investment-treaty-based arbitrations by the end of 2007).

5. Argentina's Minister of Justice Rosatti, for example, was quoted after Argentina lost its first case relating to the emergency measures it took in reaction to the 2001/2002 economic crises (*CMS Gas v. Argentina*, 2005): "We have been insisting that this tribunal is out of its depth here, that it is not prepared to handle such a quantity of cases involving a single country, that it has a pro-business bias, and that it is not qualified to judge a country's economic policy." (See BBC Monitoring Latin America – Political, supplied by BBC Worldwide Monitoring, 17 May 2005).

6. On 30 April 2008, Venezuela communicated to the Netherlands its intention to terminate the Dutch-Venezuelan Bilateral Investment Treaty as of 1 November 2008. Luke Eric PETERSON, ed., *Investment Arbitration Reporter* (16 May 2008), available online at <www.iareporter.com/Archive/IAR-05-16-08.pdf> (reporting that Venezuela had chosen to end the treaty citing reasons of "national policy"). Bolivia withdrew from the ICSID Convention as of 3

existing system for dealing with certain situations.⁷ But also traditional capital-exporting countries, like the United States, are becoming increasingly concerned about restrictions investment treaties and investment treaty arbitration impose on their regulatory powers. The United States' experience with NAFTA Chapter 11, for example, has had a direct influence on the attitudes of the United States attitudes in more recent free trade agreement and BIT negotiations, and led to modifications to the US model BIT.⁸

Criticism of the system of investor-State arbitration may grow further, as traditional capital-exporting States increasingly see prospects that they will become respondents in investment treaty cases. It is conceivable that in special situations some companies may begin to structure their investments in sensitive sectors of Western economies so as to come under BITs, in the same way as they already take account of trade rules in siting factories, and of tax rules in structuring their transnational operations. Using BITs skillfully and drawing on some expansive interpretations tribunals have given of what is covered as an investment by particular BITs,⁹ it would be possible to structure many assets in Western economies through offshore companies in ways that would bring them under BIT protection and thus enable investors to challenge measures taken by traditionally capital-exporting countries. BIT protection and investor-State

November 2007. See "Bolivia Denounces ICSID Convention", 46 ILM (2007) p. 973. On June 12, 2009, Ecuador's Congress voted to withdraw from the ICSID Convention. Discussion of withdrawal from the ICSID Convention has also been reported with respect to Nicaragua, Venezuela, and Cuba. See Marco E. SCHNABL and Julie BÉDARD, "The Wrong Kind of 'Interesting'", Nat'l L. J. (30 July 2007).

7. Numerous works in the field argue that there is, or may soon develop, a "legitimacy crisis" in investor-State arbitration, variously referring to problems such as the design of the dispute settlement mechanism based on ad hoc arbitration with the ensuing risk of inconsistent decisions, the vagueness and ambiguity of many of the core rights conferred on investors, and the perceived blindness of arbitral tribunals to matters which they do not see as related to investment. See Charles N. BROWER, "A Crisis of Legitimacy", Nat'l L. J. (7 Oct 2002); Charles H. BROWER II, "Structure, Legitimacy, and NAFTA's Investment Chapter", 36 Vand. J. Transnat'l L. (2003) p. 37; Charles N. BROWER, Charles H. BROWER II and Jeremy K. SHARPE, "The Coming Crisis in the Global Adjudication System", 19 Arb. Int'l (2003) p. 415; Ari AFILALO, "Towards a Common Law of International Investment: How NAFTA Chapter 11 Panels Should Solve Their Legitimacy Crisis", 17 Georgetown Int'l Env't'l L. Rev. (2004) p. 51; Ari AFILALO, "Meaning, Ambiguity and Legitimacy: Judicial (Re-)construction of NAFTA Chapter 11", 25 Nw. J. Int'l L. & Bus. (2005) p. 279 at p. 282; M. SORNARAJAH, "A Coming Crisis: Expansionary Trends in Investment Treaty Arbitration" in Karl P. SAUVANT, ed., *Appeals Mechanism in International Investment Disputes* (2008) pp. 39-45; Gus VAN HARTEN, *Investment Treaty Arbitration and Public Law* (Oxford 2007); Olivia CHUNG, "The Lopsided International Investment Law Regime and Its Effect on the Future of Investor-State Arbitration", 47 Va. J. Int'l L. (2007) p. 953 (arguing that existing bilateral investment treaties strongly favor investors and that these inequalities will eventually lead to greater difficulties in enforcement of such treaties); Naveen GURUDEVAN, "An Evaluation of Current Legitimacy-based Objections to NAFTA's Chapter 11 Investment Dispute Resolution Process", 6 San Diego Int'l L. J. (2005) p. 399.

8. See Kenneth VANDEVELDE, "A Comparison of the 2004 and 1994 U.S. Model BITs: Rebalancing Investor and Host Country Interests" in Karl P. SAUVANT, ed., 1 Yearbook on International Investment Law and Policy 2008/2009 p. 283; Gilbert GAGNÉ and Jean-Frédéric MORIN, "The Evolving American Policy on Investment Protection: Evidence from Recent FTAs and the 2004 Model BIT", 9 J Intl Econ L (2006) p. 357 at p. 363; Mark KANTOR, "The New Draft Model U.S. BIT: Noteworthy Developments", 21 J. Int'l Arb. (2004) p. 383 at p. 385; Stephen SCHWEBEL, "The United States 2004 Model Bilateral Investment Treaty: An Exercise in the Regressive Development of International Law", 3 TDM (April 2006). See generally Guillermo AGUILAR ALVAREZ and William W. PARK, "The New Face of Investment Arbitration: NAFTA Chapter 11", 28 Yale J Intl L (2003) p. 365 (discussing the phenomenon of developed countries as respondents in investment treaty arbitration).

9. Cf. also Anthony SINCLAIR, "The Substance of Nationality Requirements in Investment Treaty Arbitration", ICSID Rev. – For. Inv. L. J. (2005) p. 357; Markus BURGSTALLER, "Nationality of Corporate Investors and International Claims against the Investor's Own State", 7 J. World Inv. & Trade (2006) p. 857. Consider, for example, the holding in *Aguas del Tunari, S.A. v. Republic of Bolivia* (ICSID Case No. ARB/02/3), Decision on Respondent's Objections to Jurisdiction of 21 October 2005, para. 206 et seq., where the tribunal accepted that the device of holding the water assets in Cochabamba through a company incorporated in the Netherlands was enough to trigger the operation of the Netherlands-Bolivia BIT, even though there were no material connections to the Netherlands apart from the incorporation of an investment vehicle. See generally also Stephan SCHILL, *The Multilateralization of International Investment Law*, Chapter V (Cambridge University Press, forthcoming 2009).

arbitration could thus become increasingly attractive for private economic actors as a valuable safeguard against possible policy choices by Western governments. A further consideration is the dynamic in which some traditional capital-importing States, like China, are now also major sources of outward investments, including investments in Western States, some of which could be detrimentally affected by some flux in the national politics of traditional capital-exporting countries. Actions taken by Western governments in response to the 2008-2009 financial crisis, for instance, have prompted more serious consideration of investment treaty issues.

Furthermore, although the case law is developing in sophisticated ways, there is a painful unevenness in the quality of reasoning in some awards and decisions, and in any event individual tribunals cannot easily have regard to system-level concerns given their mandate and primary responsibilities to solving an individual dispute submitted by the disputing parties in any single case. Inconsistent and conflicting decisions have resulted from various arbitrations, a factor which is precipitated by the ad hoc nature of arbitral panels and the lack of an appellate or other supervisory body that could ensure more consistency in the jurisprudence and hence increase predictability in investment treaty arbitration.¹⁰ Finally, the architecture of the institutional system, with a myriad of bilateral treaties linked by most-favored-nation clauses, and unanimity required to alter most of the key multilateral conventions, does not make it easy for other actors to reform it either. In any event, the political conditions enabling that to happen are not yet present.¹¹

Within the severe constraints imposed by the existing architecture of the investor-State arbitration system, several doctrinal approaches for improvement have considerable currency. These include the comprehensive application of general international law methods or treaty interpretation as instantiated in the Vienna Convention or the Law of Treaties (VCLT), deeper analysis and use of the customary international law which underpins or complements central investment treaty provisions, greater reference to ‘general principles of law’ distilled through robust methodologies, and the use of principles of systemic integration and techniques of defragmentation identified by the United Nations International Law Commission and others concerned with the ‘fragmentation’ of international law.

This Paper does not seek to reprise the substantial literature on these approaches. Rather, it addresses the complementary but neglected idea that the brittleness of the investor-State arbitration system reflects not only the lack of ‘system’ in the design and planning of its development, but also the failure to embed it in theories of governance which take States and public interests seriously. As the theory and practice of the exercise of public power and expression of public interests have moved along, critics of the investor-State arbitration system regard it as more and more out of step. This Paper argues that the theory and practice of the global administrative space, in which global administrative law and ideas of publicness in law play an important part, offers a potentially far-reaching way to conceptualize what investor-State arbitration can be and to bring it more into harmony with current needs and future directions, while not abruptly attempting a complete paradigm change for the currently existing system.

10. See on inconsistencies in investment treaty arbitration and their institutional and procedural reasons Stephan SCHILL, *ibid.*, p. 281 et seq. See also Susan D. FRANCK, “The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law through Inconsistent Decisions”, 73 *Fordham L. Rev.* (2005) p. 1521 at p. 1523.

11. Thus a proposal for change presented by the ICSID Secretariat got very little traction. See ICSID Secretariat, *Possible Improvements of the Framework for ICSID Arbitration*, para. 20 et seq., available at <www.worldbank.org/icsid/highlights/improve-arb.pdf>. See also Christian TAMS, “An Appealing Option? The Debate about an ICSID Appellate Mechanism”, 57 *Beiträge zum Transnationalen Wirtschaftsrecht* (2006).

Whatever its merits, any attempt to radically change the existing paradigm is bound to confront major politico-economic difficulties unless precipitated by a widely shared sense of crisis.¹²

The concept of global administrative law assumes that much of global governance can usefully be analyzed as administration. Instead of neatly separated levels of regulation (private, local, national, inter-State), a congeries of different actors and different layers together form a variegated “global administrative space” that includes international institutions and transnational networks, as well as domestic administrative bodies that operate within international regimes or cause transboundary regulatory effects.¹³ The idea of a “global administrative space” differs from those orthodox understandings of international law in which the international is largely inter-governmental, and there is a reasonably sharp separation of the domestic and the international. In the practice of global governance, transnational networks of rule-generators, interpreters and appliers cause such strict barriers to break down.

This global administrative space is increasingly occupied by transnational private regulators, hybrid bodies such as public-private partnerships involving States or inter-State organizations, national public regulators whose actions have external effects but may not be controlled by the central executive authority, informal inter-State bodies with no treaty basis (including “coalitions of the willing”), and formal inter-State institutions (such as those of the United Nations) affecting third parties through administrative-type actions. A lot of the administration of global governance is highly decentralized and not very systematic. Some entities are given roles in global regulatory governance which they may not wish for or be particularly designed or prepared for: some arbitrators in investor-State tribunals may well place these tribunals in this category.

Global administrative law is emerging as the evolving regulatory structures are each confronted with demands for transparency, consultation, participation, reasoned decisions and review mechanisms to promote accountability. These demands, and responses to them, are increasingly framed in terms that have a common normative character, specifically an administrative law character. The sense that there is some unity of proper principles and practices across these issue areas is of growing importance to the strengthening, or eroding, of legitimacy and effectiveness in these different governance regimes. Endeavoring to take account of these phenomena, one approach understands global administrative law as the legal mechanisms, principles and practices, along with supporting social understandings, that promote or otherwise affect the accountability of global administrative bodies, in particular by ensuring that these bodies meet adequate standards of transparency, consultation, participation, rationality and legality, and by providing effective review of the rules and decisions these bodies make.¹⁴

Global administrative law is concerned with the exercise of public authority by bodies outside the State, and by States in ways that reach beyond the State and its law.¹⁵ It thus imports, at least as an ideal, an aspiration to publicness.¹⁶ Publicness is a necessary element in the concept of law under modern democratic conditions. The claim is that the quality of publicness, and the related

12.Cf. also VAN HARTEN, *supra* fn. 7; Gus VAN HARTEN, “The Public-Private Distinction in the International Arbitration of Individual Claims Against the State”, 56 *Int’l & Comp. L. Q.* (2007) p. 371.

13.Benedict KINGSBURY, et al., “Foreword: Global Governance as Administration”, 68 *Law & Contemp. Probs.* (2005, nos. 3-4) p. 1.

14.Benedict KINGSBURY, Nico KRISCH and Richard STEWART, “The Emergence of Global Administrative Law”, 68 *Law & Contemp. Probs.* 15 (2005, nos. 3-4).

15.Armin von BOGDANDY, “General Principles of International Public Authority: Sketching a Research Field”, 9 *German L. J.* (2008) p. 1909.

16.Benedict KINGSBURY, “The Concept of ‘Law’ in Global Administrative Law”, 20 *Eur. J. Int’l L.* (2009) p. 23. This paragraph and the three preceding paragraphs draw from the article cited here.

quality of generality, are necessary to the concept of law in an era of democratic jurisprudence.¹⁷ Publicness, in this context, refers to the claim that law must be wrought by the whole society, by the public, and the connected claim that law addresses matters of concern to the society as such. It is described as “global” rather than “international” to avoid implying that this is part of the recognized *lex lata* or indeed *lex ferenda*, and to include more diverse legal sources than those encompassed within standard conceptions of “international law”.

This Paper explores three legal implications of understanding investor-State arbitration as being embedded in the emerging global administrative law and its ideas of publicness (Parts II-IV). Part II of the Paper makes the case that arbitral tribunals in investor-State cases are rapidly crafting a set of general standards, and illustrative applications of these standards, for the conduct of States when exercising administrative powers in ways that affect foreign investors. Tribunals are thereby helping to define standards of good administration by States. This is an important development. This Paper responds to two particular concerns about it. First, where do the tribunals get these more detailed standards from? In so far as they are interpreting broad treaty standards (such as fair and equitable treatment), ordinary principles of treaty interpretation and legal analysis may call for, and should be buttressed by, the use of comparative administrative law, and systematic study of how States can and should conduct good administration. Instead, many awards fill the gap with references to other awards (which may themselves be thinly reasoned) and loose subjective views and experiences of the arbitrators. This leads to a second concern, that the standards are being crafted (or invented) in the limited context of investor claims, without adequate engagement with other bodies or material on what good administration by States could and should realistically be in different contexts, and in particular without any coordination with standards of good administration imposed on States by the World Trade Organization (WTO) for trade-related governmental actions, or by international human rights tribunals, or by international financial and aid institutions in loan conditions or in their technical advice to developing countries.

Part III of the Paper addresses the challenges that arise as investor-State arbitration proceedings and awards increasingly have to address, and face criticism concerning their lack of responsiveness to, environmental considerations, labour and social standards, and governmental management of economic crises or other fundamental issues for entire populations. Argentina’s emergency suspension of tariff increases and of peso convertibility, Bolivia’s cancellation of the Bechtel water contract after riots, Ontario’s refusal to proceed with a scheme to dump Toronto’s refuse into a lake, or Costa Rica’s prohibition of development on a foreign-owned ranch because of its proclamation of a nature reserve, are among numerous examples of conflicts between investment protection and competing public concerns. Bailouts, subsidies and other emergency measures taken in response to the global financial crisis that developed in 2008-2009 raise similar issues. In such situations investor-State arbitral tribunals are called upon to weigh a measure taken by a State in exercise of its regulatory power, against the damage done to a foreign investor by that measure. Yet, the methods used by investment tribunals in dealing with such issues are often very different from, and less sophisticated than, methods used in various international and national courts. While many international human rights courts, and indeed many national courts, often conduct a proportionality analysis in order to balance rights and rights-limiting policy choices, in investor-State arbitration only a few tribunals have taken such

17.Jeremy WALDRON, “Can There Be a Democratic Jurisprudence?”, NYU School of Law, Public Law Research Paper 08-35 (2008) available at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1280923&rec=1&srcabs=1299017>.

an approach. Instead, the complexity and polyvalent nature of the issues involved is analyzed and weighed only weakly in a range of cases where a stronger methodology seems called for, including some cases dealing with legislative measures of general application that affect existing foreign investors along with domestic actors, and others dealing with discretionary functions assigned to administrative agencies under local law, but exercised in ways that impose regulatory constraints and thus result in particular harm to foreign investors. Part III examines approaches taken in different dispute settlement bodies to such conflicts of rights and principles. It assesses the recourse made by a few investment tribunals to proportionality analysis when faced with cases of conflict between the protection of investments and the furtherance of a non-investment interest, and argues that this may be a permitted and even necessary element of international law treaty interpretation and application in certain cases. It suggests that arbitral tribunals may indeed have little choice but to adopt approaches that are similar to those adopted by domestic courts and other international courts and tribunals when faced with comparable conflicts between important interests that must all be weighed in the legal appraisal. While use of a proportionality approach may have significant problems – in particular because it risks reposing more governance powers in such tribunals and making more demands on them than may be sustainable – in the long run, the application of proportionality analysis is also congruent with an emerging set of public law principles for global regulatory governance.

Part IV of the Paper responds to the observation that, as a form of global governance, investor-State arbitration is increasingly subject to criticism as regards its legitimacy and to demands to meet normative standards of the emerging global administrative law. In similar ways as other institutions that exercise power in global governance, investor-State arbitration is facing demands for accountability on such matters as design of institutions and appointment and recusal of arbitrators, transparency in making materials publicly available, receiving submissions from groups affected by a possible decision, holding public hearings, giving reasons for decisions, becoming amenable to effective review proceedings, and so forth. The first section of Part IV of the Paper argues that the normative considerations and legal principles applicable to various transnational governance structures, even though each institution is different, overlap. All of these involve the exercise of public power beyond the State, and most are potentially generators of and subjects of global administrative law. Many are connected also through the unities of a public international legal order.¹⁸ Consequently, it is a mistake to debate these issues in the investor-State arbitration field as if they were wholly isolated from norms and practices of other areas of global governance. Adherence to these wider norms, particularly customary international law and the norms of treaty interpretation along with the norms of the emerging global administrative law and related norms of international public authority, is highly relevant to addressing concerns about legitimacy in investor-State arbitration. The second section of Part IV of the Paper takes up one element of this broad agenda, making the specific argument that investor-State arbitration tribunals can themselves help to meet such legitimacy demands, even without any fundamental change in the current system, by improving the quality of their reasoning and their engagement with prior decisions.

The conclusion of this Paper (Part V) links the discussion to the fundamental question of what the possible normative justifications of an investor-State arbitration system might be, beyond

18.Cf. Armin von BOGDANDY, Philipp DANN, Matthias GOLDMANN, “Developing the Publicness of Public International Law: Towards a Legal Framework for Global Governance Activities”, 9 *German L. J.* (2008) p. 1375; and Benedict KINGSBURY, “The International Legal Order” in P. CANE and M. TUSHNET, eds., *The Oxford Handbook of Legal Studies* (2003) p. 271.

standard but insufficient (and contestable) arguments that it promotes optimal investment and efficient use of resources. Among such deeper justifications might be the promotion of democratic accountability and participation, the promotion of good and orderly State administration, and the protection of rights and other deserving interests. The currently existing system of investor-State arbitration is undoubtedly limited in its ability to fully vindicate any of the normative justifications of the public-regarding and governance-regarding dimensions of investor-State arbitration. Vindication of these values is a public good that for structural reasons is likely to be under-supplied. Major reform may well be needed. But even incremental reforms may be valuable, and some such reforms are already under way. The emerging global administrative law provides important normative and practical guidance in this respect.

II. INVESTMENT ARBITRATION AS REGULATION OF STATE ACTION: “FAIR AND EQUITABLE TREATMENT” JURISPRUDENCE

The obligation of States to provide “fair and equitable treatment” to foreign investors is a standard provision in modern BITs and multilateral treaties concerning investment, as well as in some friendship, commerce and navigation treaties.¹⁹ As such, it has become the textual basis for a rapidly growing body of interpretive pronouncements and decisions by arbitral tribunals. In many respects this jurisprudence draws upon, or continues deep seams of, customary international law materials and analysis going back many decades. Thus, contemporary controversies over the alleged separation between treaty standards and customary international law, particularly in relation to Art. 1105(1) of the North American Free Trade Agreement (NAFTA), should not obscure the fundamental connections between the treaty standards and mechanisms and the customary international law standards and mechanisms.²⁰

However, the traditional structures of State responsibility and diplomatic protection, and the long-established customary international law standards on matters such as denial of justice and due process, are probably not currently effective enough or fine-grained enough for many of the specific questions arising in relation to foreign investment issues in the modern regulatory practice of States. Instead, customary international law, State treaty practice, and the burgeoning interpretive jurisprudence of investor-State arbitral tribunals, together elaborate an important set of criteria for State conduct, including in the context of purely national administration which in some way affects foreign investors. These standards are inevitably linked to good administrative governance for States more generally, as especially in open economies much administrative practice is applied to everyone and is not special to foreign investors. The jurisprudence of fair and equitable treatment is thus in part a jurisprudence of modern public administration.

Yet, some of the more sweeping dicta about what “fair and equitable treatment” means, misleadingly suggest that it establishes a uniform global standard for State administration that is fully equivalent to the administrative law (or in some respects the constitutional law) of

19. See on the history of the fair and equitable treatment standard Stephen VASCIANNIE, “The Fair and Equitable Treatment Standard in International Investment Law and Practice”, 70 *Brit. Yb. Int’l Law* (1999) p. 99.

20. On the debate about the relationship between fair and equitable treatment and the international minimum standard under customary international law see Rudolf DOLZER and Christoph SCHREUER, *Principles of International Investment Law* (2008) pp. 124-128; Andrew NEWCOMBE and Lluís PARADELL, *Law and Practice of Investment Treaties: Standards of Treatment* (2009) pp. 263-275; Campbell MCLACHLAN, “Investment Treaties and General International Law”, 57 *Int’l & Comp. L. Q.* (2008) p. 361.

developed countries without regard to specificities of the emerging global economy or national interests and circumstances. There are, of course, longstanding and evolving customary international law standards that are broadly conducive to achieve the object and purpose of investment treaties, in particular to promote foreign investment flows, and to contribute to furnishing a legal framework for the functioning of a global economy. Egregious cases, including flagrant State interferences for opportunistic or corrupt reasons with a foreign investor's assets or operation, clearly violate such a global standard. Many such cases are classic denial of justice or denial of due process situations, and can be addressed without elaborate interpretative structures or underlying governance analysis.

Yet, abstract principles of international investment law, such as "fair and equitable treatment", can under ordinary principles of treaty interpretation be interpreted as going beyond a uniform (but modest) traditional minimum, so that they encompass more demanding standards. At the same time, such demanding standards may need to take into account the context and the specific situation of the host State in question, as well as the circumstances of the investor and the arrangements made in respect of the investment. In this respect, investment treaty tribunals are part of and share the challenge that is being faced by global administrative law generally, i.e., to develop effective techniques of comparative and principled analysis that generate both a robust set of sources for giving content to very general principles, and a methodology for applying them to specific local contexts in line with the requirement of the emerging global society. This makes it possible to deal with situations where a very demanding standard of what is fair and equitable would simply fail to recognize enduring capacity and resource problems in a particular developing country's administration and which should not have surprised a sophisticated investor. A starting point in such situations might be a crude distinction between cases in which a State actively interferes with foreign investments, and cases that concern certain kinds of failures to act, or inadequate responsiveness by the host State's administrative apparatus to a request by the investor.

Interpreting and applying the abstract fair and equitable treatment standard involves a particular hermeneutics grounded in the international law of treaty interpretation expressed in the Vienna Convention on the Law of Treaties, including reference to other applicable rules of international law. This hermeneutics is necessarily customized to the institutions, actors and issues involved. It may – at least as regards less egregious cases and the development of more fine-tuned standards of good governance and good administration – call for the use of a comparative method that attempts to extract general principles from domestic legal systems and from other international legal regimes that prescribe standards for the exercise of governmental or other public powers in administrative processes, in judicial proceedings, and in legislation. Part III of the Paper will examine the use of proportionality analysis and related methods of application of such principles. This Part, in contrast, seeks to provide a sketch of elements of "fair and equitable treatment" that find support in general principles of national law, in emerging practices of global administrative bodies in non-investment fields, and above all in the practice of investment tribunals. The aim is to sketch some specific elements of the fair and equitable treatment requirement that have particular applicability to State administration, but also have implications for the further concretization of global administrative law principles.

Five clusters of normative principles recur in the more detailed specification by arbitral tribunals of elements of fair and equitable treatment.²¹ These principles are (1) the requirement of stability, predictability and consistency of the legal framework, (2) the protection of legitimate expectations, (3) the requirement to grant procedural and administrative due process and the prohibition of denial of justice, (4) the requirement of transparency, and (5) the requirement of reasonableness and proportionality. These principles also figure prominently as sub-elements or expressions of the broader concept of the rule of law in many domestic legal systems. They may be connected also to, and may come further to influence, cognate principles enunciated by other international bodies for the exercise of public power within and beyond the State. Such connections are drawn in some analyses of customary international law, and in some important decisions of international courts and mixed claims commissions. However, the wider comparative and normative bases for these principles have not yet been explored fully in modern investor-State arbitration. The following sections discuss some of the modern awards on each of the five clusters of principles in order to indicate ways in which this gap might be filled.

1. *Stability, Predictability, Consistency*

International investment treaty tribunals have repeatedly associated fair and equitable treatment with stability, predictability and consistency of the host State's legal framework. The tribunal in *CMS v. Argentina*, for example, stated that "there can be no doubt ... that a stable legal and business environment is an essential element of fair and equitable treatment".²² Predictability of the legal framework governing the activity of foreign investors has received comparable emphasis. The tribunal in *Metalclad v. Mexico*, for example, based its finding of a violation of Art. 1105(1) NAFTA, inter alia, on the argument that Mexico "failed to ensure a ... predictable framework for Metalclad's business planning and investment".²³ Similarly, the tribunal in *Tecmed v. Mexico* explicated that the foreign investor needs to "know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices and directives, to be able to plan its investment and comply with such regulations".²⁴ Some tribunals have added that a lack of clarity of the legal framework or excessively vague rules can violate fair and equitable treatment.²⁵ Equally, consistency in the government's conduct has received strong emphasis in the jurisprudence. Thus, the tribunal in *Tecmed* emphasized the need for consistency in the decision-making of a national agency in order to conform to fair and equitable treatment.²⁶ Likewise, in *MTD v. Chile*, the tribunal found

21. What follows draws on Stephan SCHILL, "Fair and Equitable Treatment under Investment Treaties as an Embodiment of the Rule of Law", IILJ Working Paper 2006/6 (Global Administrative Law Series), available at <www.iilj.org/publications/2006-6Schill.asp>.

22. *CMS Gas Transmission Company v. The Republic of Argentina* (ICSID Case No. ARB/01/8), Award of 12 May 2005, para. 274. Similarly, *Occidental Exploration and Production Company (OPEC) v. The Republic of Ecuador* (UNCITRAL, LCIA Case No. UN3467), Final Award of 1 July 2004, para. 183.

23. See *Metalclad Corporation v. The United Mexican States* (ICSID Case No. ARB(AF)/97/1 (NAFTA)), Award of 30 August 2000, para. 99.

24. *Tecnicas Medioambientales Tecmed S.A. v. The United Mexican States* (ICSID CASE No. ARB (AF)/00/2), Award of 29 May 2003, para. 154.

25. See for example *OPEC v. Ecuador*, supra fn. 22, para. 184 (criticizing the vagueness of a change in the domestic tax law that did not "provid[e] any clarity about its meaning and extent").

26. *Tecmed v. Mexico*, supra fn. 24, paras. 154, 162 et seq. See also, *OPEC v. Ecuador*, supra fn. 22, para. 184. Similarly, *Ronald S. Lauder v. Czech Republic*, Final Award of 3 September 2001, para. 292 et seq.

a violation of fair and equitable treatment due to “the inconsistency of action between two arms of the same Government vis-à-vis the same investor”.²⁷

Taken together, these dicta embody several elements of the basic requirements for law as adumbrated in Lon Fuller’s “inner morality of law”.²⁸ Many national legal systems place similar emphasis on legal certainty and legal security, perhaps most firmly instantiated in the German *Rechtssicherheit*.²⁹ This core aspect of normativity of law allows individuals and entities to adapt their behavior to the requirements of the legal order and form stable social and economic relationships. It is an aspiration of most legal systems, certainly under democratic conditions of advanced capitalism. International law and the legal institutions of global governance may well be directed toward promoting and helping realize this aspiration.

Yet, stability and predictability cannot and should not mean that the legal framework will never be able to change, nor do they in themselves provide a business guarantee to investment projects.³⁰ Similarly, domestic regulatory frameworks are seldom completely free of inconsistencies.³¹ In addition, the degree of stability in each legal order will vary with the circumstances the State is facing, and the nature of inconsistencies may vary. Likewise, a serious crisis or even an emergency situation may call for different reactions than the deployment of public power in the normal course of things.³² Stability, predictability and consistency will thus have to be implemented in view of the circumstances of the case at hand.

2. *The Protection of Confidence and Legitimate Expectations*

The tribunal in *Saluka v. Czech Republic* referred to the concept of legitimate expectations as “the dominant element of that [fair and equitable treatment] standard”.³³ The concept is found, in different forms, in many national legal systems³⁴ and perhaps in general international law.³⁵ Its

27. *MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile* (ICSID Case No. Arb/01/7), Award of 25 May 2004, para. 163.

28. Lon FULLER, *The Morality of Law* (1969). See KINGSBURY, supra fn. 16, p. 23.

29. This aspect of the rule of law is recognized, mostly as a constitutional standard, in many domestic legal systems. See for its implementation in the German Constitution Helmut SCHULZE-FIELITZ in: Horst DREIER, ed., *Grundgesetz – Kommentar*, Vol. II (1998) Art. 20, para. 117 et seq.; see Richard H. FALLON, “‘The Rule of Law’ as a Concept in Constitutional Discourse”, 97 *Columb. L. Rev.* (1997, no. 1) p. 14 et seq. with references to US constitutional practice; more generally, see also Joseph RAZ, “The Rule of Law and its Virtue”, 93 *L. Quart. Rev.* (1977) p. 195, at p. 198.

30. See *Emilio Agustín Maffezini v. The Kingdom of Spain* (ICSID Case No. ARB/97/7), Award of 13 November 2000, para. 64 (“emphasiz[ing] that Bilateral Investment Treaties are not insurance policies against bad business judgments”); *Marvin Roy Feldman Karpa v. The United Mexican States* (ICSID Case No. ARB(AF)/99/1), Award of 16 December 2002, para. 112 (noting “that not every business problem experienced by a foreign investor is an indirect or creeping expropriation under Article 1110, or a denial of due process or fair and equitable treatment under Article 1110(1)(c)”).

31. Cf. FRANCK, supra fn. 10, p. 675 at p. 678.

32. See, for example, *Elettronica Sicula SpA (ELSI) Case (United States of America v. Italy)*, Judgment of 20 July 1989, I.C.J. Reports 1989, p. 15, para. 74: “Clearly the right [to control and manage a company] cannot be interpreted as a sort of warranty that the normal exercise of control and management shall never be disturbed. Every system of law must provide, for example, for interferences with the normal exercise of rights during public emergencies and the like.”

33. *Saluka Investments BV v. The Czech Republic* (UNCITRAL), Partial Award of 17 March 2006, para. 302. See also Elizabeth SNODGRASS, “Protecting Investors’ Legitimate Expectations”, 21 *ICSID Rev. – For. Inv. L. J.* 1 (2006, no. 1) pp. 1-58.

34. See David DYZENHAUS, “The Rule of (Administrative) Law in International Law”, 68 *Law & Contemp. Probs.* (2005) p. 127 at p. 133 et seq. with reference to case law in Australia and the United Kingdom; SCHULZE-FIELITZ (supra fn. 29), Art. 20 para. 134 et seq. concerning German Constitutional Law; Søren SCHØNBERG, *Legitimate Expectations in Administrative Law* (2000) on English, French and EC/EU law; Bruce DYER, “Legitimate Expectations in Procedural Fairness after *Lam*” in Matthew GROVES, ed., *Law and Government in Australia* (2005)

main thrust is the protection of confidence against some kinds of administrative and legislative conduct. Thus, the tribunal in *Tecmed v. Mexico* held that fair and equitable treatment requires “provid[ing] to international investments treatment that does not affect the basic expectations that were taken into account by the foreign investors to make the investment”.³⁶ Similarly, the tribunal in *International Thunderbird Gaming Corporation v. Mexico* explained that “the concept of ‘legitimate expectations’ relates ... to a situation where a Contracting Party’s conduct creates reasonable and justifiable expectations on the part of an investor (or investment) to act in reliance on said conduct, such that a failure by the NAFTA Party to honour those expectations could cause the investor (or investment) to suffer damages”.³⁷

Various limitations in the scope and applicability of this doctrine require further honing. Ordinarily, such expectations can arise only through explicit or implicit representations made by the host State (potentially including agency, ratification and other structures of connection to the State, but subject then also to limiting rules).³⁸ Moreover the investor’s expectations about the State’s future conduct in ordinary circumstances can not necessarily be transposed into a ‘legitimate expectation’ about State action in extraordinary circumstances, and expectations ought in many cases to encompass the possibility that the State may take some regulatory actions. States are regulators with public responsibilities. Some such views may be reflected in the suggestion by the tribunal in *Eureko v. Poland* that a breach of basic expectations may not be a violation of fair and equitable treatment if good reasons existed why the expectations of the investor could not be met.³⁹ Similarly, the tribunal in *Saluka v. Czech Republic* specifically warned of the danger of taking the idea of the investor’s expectation too literally since this would “impose upon host States’ [sic] obligations which would be inappropriate and unrealistic”.⁴⁰ Instead, the tribunal considered departing from legitimate expectations of an investor as possible and legitimate to the extent such departures are proportional as “[t]he determination of a breach of [fair and equitable treatment] requires a weighing of the Claimant’s legitimate and reasonable expectations on the one hand and the Respondent’s legitimate regulatory interests on the other”.⁴¹ Against this background, the concept of legitimate expectations requires careful comparative law analysis, and a sophisticated methodology of application. Although the jurisprudential process towards these ends has begun, much further work is required.

p. 184 et seq. on Australian law; see also Jean-Marie WOEHLING, “Le Principe de Confiance Légitime dans la Jurisprudence des Tribunaux” in John W. BRIDGE, ed., *Comparative Law Facing the 21st Century* (1998) p. 815 et seq. summarizing a comparative study by the XVth International Congress of Comparative Law, Bristol/UK in 1998.

35. See Jörg P. MÜLLER, *Vertrauensschutz im Völkerrecht* (1971). See more specifically in the context of the law of expropriation of aliens Rudolf DOLZER, “New Foundations of the Law of Expropriation of Alien Property”, 75 A.J.I.L. (1981) p. 553, at p. 579 et seq..

36. *Tecmed v. Mexico*, supra fn. 24, para. 154. The tribunal’s approach was also taken up in a number of other cases. See *ADF v. United States*, Award of 9 January 2003, para. 189; *MTD v. Chile*, supra fn. 27, para. 114 et seq.; *OEPC v. Ecuador*, supra fn. 22, para. 185; *CMS v. Argentina*, supra fn. 22, para. 279; *Eureko B.V. v. Republic of Poland*, Partial Award of 19 August 2005, paras. 235, 241.

37. *International Thunderbird Gaming Corporation v. The United Mexican States* (UNCITRAL/NAFTA), Award of 26 Jan. 2006, para. 147 (internal citation omitted).

38. See on the connection between the expectations and government conduct *ADF v. United States*, supra fn. 36, para. 189, where the tribunal declined to find a violation of Art. 1105(1) NAFTA in a case where the claimant argued that existing case law suggested that an agency would have to grant a waiver from a statutory local content requirement, noting that “any expectations that the Investor had with respect to the relevancy or applicability of the case law it cited were not created by any misleading representations made by authorized officials of the U.S. Federal Government but rather, it appears probable, by legal advice received by the Investor from private U.S. counsel”.

39. See *Eureko v. Poland*, supra fn. 36, paras. 232 et seq.

40. *Saluka v. Czech Republic*, supra fn. 33, para. 304.

41. *Saluka v. Czech Republic*, supra fn. 33, para. 306.

3. Administrative Due Process and Denial of Justice

As long-standing customary international law recognizes, and as many tribunals applying investment treaties have decided, fair and equitable treatment embraces elements of due process: specifically, administrative and judicial due process.⁴² Fair and equitable treatment is thus closely connected to the proper administration of civil and criminal justice.⁴³ Thus, the tribunal in *Waste Management v. Mexico* defined a violation of fair and equitable treatment as “involv[ing] a lack of due process leading to an outcome which offends judicial propriety – as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process”.⁴⁴ Similarly, for the tribunal in *S.D. Myers v. Canada* fair and equitable treatment, among other elements, included “the international law requirements of due process”.⁴⁵ The tribunal in *International Thunderbird Gaming v. Mexico* held that the proceedings of a government agency “should be tested against the standards of due process and procedural fairness applicable to administrative officials”.⁴⁶

Issues closely connected to due process are also reflected in the jurisprudence linking fair and equitable treatment to the prohibition of arbitrariness⁴⁷ and of discrimination. The tribunal in *Loewen v. United States*, for example, stated (obiter) that fair and equitable treatment is violated by “[a] decision which is in breach of municipal law and is discriminatory against the foreign litigant”.⁴⁸ Similarly, the tribunal in *Waste Management v. Mexico* suggested that “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”.⁴⁹

42. The national legislator, so far, has not been subjected to any due process notions in investment arbitration. This could, however, be conceivable in the context of legislative expropriations since most BITs explicitly require host States to grant affected investors due process. See Rudolf DOLZER and Margrete STEVENS, *Bilateral Investment Treaties* (1995) p. 106 et seq.

43. See comprehensively on the closely related concept of denial of justice in international law Jan PAULSSON, *Denial of Justice in International Law* (2005). Recently, both an explicit reference to due process and the concept of denial of justice as part of fair and equitable treatment have been included in the treaty practice of the United States. See, for example, Art. 10.5(2)(a) of the Dominican Republic – Central America – United States Free Trade Agreement, which stipulates that “fair and equitable treatment includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world”. The Dominican Republic – Central America – United States Free Trade Agreement, signed 5 August 2004, is available at <www.ustr.gov/Trade_Agreements/Bilateral/CAFTA/Section_Index.html>.

44. *Waste Management v. Mexico* (ICSID Case No. ARB(AF)/00/3), Award of 30 April 2004, para. 98.

45. *S.D. Myers v. Canada* (UNCITRAL/NAFTA), Partial Award of 13 November 2000, para. 134.

46. *International Thunderbird Gaming v. Mexico*, supra fn. 37, para. 200.

47. See, in particular, *Elettronica Sicula S.p.A. (ELSI) (United States v. Italy)*, supra fn. 32, p. 76, para. 128 (stating that “[a]rbitrariness is not so much something opposed to a rule of law, as something opposed to the rule of law. This idea was expressed by the Court in the *Asylum* case, when it spoke of ‘arbitrary action’ being ‘substituted for the rule of law’. It is wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety.” (internal citations omitted)).

48. *Loewen v. United States*, para. 135.

49. *Waste Management v. Mexico*, supra fn. 44, para. 98; similarly *Eureka v. Poland*, para. 233 (finding that the State “acted not for cause but for purely arbitrary reasons linked to the interplay of Polish politics and nationalistic reasons of a discriminatory character” and therefore breached fair and equitable treatment). *S.D. Myers v. Canada*, supra fn. 45, para. 266, also draws a parallel between national treatment and the fair and equitable treatment standard when stating: “Although ... the Tribunal does not rule out the possibility that there could be circumstances in which a denial of the national treatment provisions of the NAFTA would not necessarily offend the minimum standard provisions, a majority of the Tribunal determines that on the facts of this particular case the breach of Article 1102 essentially establishes a breach of Article 1105 as well.”

What is not yet fully defined, however, is how exactly the requirements of due process blend an international law standard with the controlling local law. State violation of local law can be a significant datum, as several cases illustrate. Thus, in *Metalclad v. Mexico*, for instance, the tribunal focused on the apparent misapplication of a construction law by a local municipality as one element for finding a violation of fair and equitable treatment.⁵⁰ Similarly, in *Pope & Talbot v. Canada* the tribunal referred to a lack of competence of a particular agency under national law to initiate administrative proceedings against the investment. Instead of relying “on naked assertions of authority and on threats that the Investment’s allocation could be cancelled, reduced or suspended for failure to accept verification”, the tribunal said, “before seeking to bludgeon the Investment into compliance, the SLD [i.e., the Canadian administrative agency involved] should have resolved any doubts on the issue and should have advised the Investment of the legal basis for its actions”.⁵¹ Similarly, the tribunal in *GAMI Investments, Inc. v. Mexico* deduced from fair and equitable treatment an obligation not only to abide by, but also to enforce existing provisions of national law.⁵² In *Tecmed v. Mexico* the tribunal underscored that host States have to make use of “the legal instruments that govern the actions of the investor or the investment in conformity with the function usually assigned to such instruments”.⁵³

Conversely, the conformity of a State administrative measure with the relevant domestic legal rules has in some cases been referred to by tribunals as indicative that there has not been a violation of the fair and equitable treatment standard. In *Noble Ventures v. Romania*, for example, the tribunal observed that certain bankruptcy proceedings “were initiated and conducted according to the law and not against it”⁵⁴ and accordingly denied a violation of fair and equitable treatment. Similarly, in *Lauder v. Czech Republic* the tribunal emphasized that a violation of fair and equitable treatment was usually excluded in case of a “regulatory body taking the necessary actions to enforce the law”.⁵⁵ This set of cases broadly aligns with the democratic requirement that public power derive its authority from a legal basis and be exercised along the lines of pre-established procedural and substantive rules. As such, the violation of domestic law can translate into a violation of the fair and equitable treatment standard; but the international law standard of fair and equitable treatment is not, of course, simply a mirror of whatever the national law provides.

4. Transparency

Traditional customary international law on treatment of foreigners and of foreign investments is quite underdeveloped with regard to transparency of governmental information and decision processes. In international law more broadly, the crafting and application of international legal standards for national governmental transparency has been an important direction of legal development. However, it remains a challenging branch of international legal practice, whether in the WTO, the international environmental law-inspired Aarhus Convention model, or international human rights jurisprudence. Many countries, particularly transitional and

50. *Metalclad v. Mexico*, supra fn. 23, para. 93.

51. *Pope & Talbot, Inc. v. The Government of Canada* (UNCITRAL/NAFTA), Award on the Merits of Phase 2 of 10 April 2001, para. 174 et seq.

52. *GAMI Investments, Inc. v. The Government of the United Mexican States* (UNCITRAL/NAFTA), Final Award of 15 November 2004, para. 91: “It is in this sense that a government’s failure to implement or abide by its own law in a manner adversely affecting a foreign investor may but will not necessarily lead to a violation of Article 1105.”

53. *Tecmed v. Mexico*, supra fn. 24, para. 154.

54. *Noble Ventures v. Romania*, Award of 12 October 2005, para. 178.

55. *Lauder v. Czech Republic*, supra fn. 26, para. 297.

developing countries, struggle to meet their existing obligation in this respect, and some have adopted constitutional amendments (as in Chile) or legislation to try to hasten both the change of bureaucratic culture and the practical processes of making information available. Furthermore, defining the proper limits on transparency requirements, such as the protection of privacy interests, of commercial confidentiality, or of national security, is complex.

Accordingly, for investment tribunals to pursue such an intricate agenda through the very underspecified fair and equitable treatment standard is far from easy, even though several tribunals have done so. Thus, the tribunal in *Metalclad v. Mexico* concluded that Mexico breached Art. 1105 NAFTA because “Mexico failed to ensure a *transparent* and predictable framework for Metalclad’s business planning and investment”.⁵⁶ The reference in this holding to a transparency requirement was set aside by the Supreme Court of British Columbia exercising jurisdiction under the British Columbia International Arbitration Act.⁵⁷ While the British Columbia decision can be contested in some respects, it does indeed seem justified to cast doubt on the breadth for the arbitral tribunal’s statements “that all relevant legal requirements for the purpose of initiating, completing and successfully operating investments ... should be capable of being readily known to all affected investors” and that the host State is required “to ensure that the correct position is promptly determined and clearly stated so that investors can proceed with all appropriate expedition in the confident belief that they are acting in accordance with all relevant laws”.⁵⁸ Statements of such breadth indeed could result in redefining the position and function of administrative agencies by obliging them to reorient their priorities and national missions so as to act as authoritative consultative units and even as de facto insurers in the implementation of foreign investment projects.⁵⁹

Similar concerns could be expressed about the dictum in *Tecmed v. Mexico* that connected the element of legitimate expectations to the requirement of transparency in reasoning:

“The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations.”⁶⁰

Yet, a more restrictive reading of a transparency requirement under the “fair and equitable treatment” standard seems possible and more readily defensible. In the *Tecmed* case, in fact, transparency was mainly applied to procedural aspects of administrative law, such as the requirement to give sufficient reasons⁶¹ and the obligation to act in a comprehensible and predictable way.⁶² These framings buttress the reasonable procedural position of foreign

56. *Metalclad v. Mexico*, supra fn. 23, para. 99 (emphasis added).

57. See Supreme Court of British Columbia, *The United Mexican States v. Metalclad Corporation*, 2001 BCSC 644.

58. *Metalclad v. Mexico*, supra fn. 23, para. 76 (for both citations).

59. Stephan SCHILL, “Revisiting a Landmark: Indirect Expropriation and Fair and Equitable Treatment in the ICSID Case *Tecmed*”, 3 TDM (April 2006) p. 15.

60. *Tecmed v. Mexico*, supra fn. 24, para. 154; similarly *Maffezini v. Spain*, para. 83.

61. See *Tecmed v. Mexico*, supra fn. 24, para. 123 (stating that “administrative decisions must be duly grounded in order to have, among other things, the transparency required so that persons that disagree with such decisions may challenge them through all the available legal remedies”). Similarly, *Tecmed v. Mexico*, para. 164.

62. See *Tecmed v. Mexico*, supra fn. 24, para. 160 (stating that

“[t]he incidental Statements as to the Landfill’s relocation in the correspondence exchanged between INE and Cytrar or Tecmed ... cannot be considered to be a clear and unequivocal expression of the will of the Mexican

investors in administrative proceedings. Transparency can thus be important even if it is not yet a well-developed additional substantive requirement. Furthermore, it has significant specific functions, such as in assisting procedurally to resolve uncertainty in the domestic law, in which connection it interacts closely with the burden of proof. Comparative law methodology, and the sophisticated analysis and use of normative standards from other areas of international law, potentially has much to contribute in this area.

5. *Reasonableness and Proportionality*

Finally, investment arbitration tribunals link fair and equitable treatment to the concepts of reasonableness and proportionality. Like proportionality, but with much less methodological precision, reasonableness can be used to control the extent to which interferences of host States with foreign investments are permitted. Thus the tribunal in *Pope & Talbot v. Canada* repeatedly referred to the reasonableness of the conduct of an administrative agency in declining to find a violation of fair and equitable treatment.⁶³ The element of reasonableness can also be incorporated into a proportionality test, as in *Tecmed v. Mexico*'s dictum that "[t]here must be a reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realized by any expropriatory measure".⁶⁴

6. *Implications of the "Fair and Equitable Treatment" Requirement for National Law and Administration*

The five dimensions of fair and equitable treatment mentioned above relate to the exercise of public power by governmental agencies, as well as by national courts and legislatures. They are used as a standard of evaluation of national governmental action (a classic administrative law function), but conducted not by national tribunals, but by tribunals established under international treaties. "Fair and equitable treatment" is not itself a legal standard of direct application in the administrative or constitutional law of most countries, although the five dimensions outlined above have counterparts in much national law. Nevertheless, different processes of diffusion or influence may lead this international standard, with its specific components, to have effects over time on specific laws and administrative practices within states.

This happens where other international institutions (such as the World Bank, or the United Nations Conference on Trade and Development (UNCTAD)) refer to investment treaty standards and jurisprudence, in giving advice to particular countries about legal and institutional reform. Likewise, government agencies in States that have lost arbitral cases may seek to influence the structure and process of administrative decision-making. These processes, and a general normative seepage as more people become familiar with developments in arbitral jurisprudence

authorities to change their position as to the extension of the Permit so long as Cytrar's business was not relocated, nor can it be considered an explicit, transparent and clear warning addressed to Cytrar from the Mexican authorities that rejected conditioning the revocation of the Permit to the relocation of Cytrar's operations at the Landfill to another place").

63. See *Pope & Talbot v. Canada*, supra fn. 51, paras. 123, 125, 128, 155; see also *MTD v. Chile*, supra fn. 27, para. 109 with a reference to an expert opinion by Schwebel.

64. *Tecmed v. Mexico*, supra fn. 24, para. 122. It is possible that an independent jurisprudence of reasonableness can be established and given detailed content. See Olivier CORTEN, *L'utilisation du raisonnable par le juge international: discours juridique, raison et contradictions* (1997). The focus in this Paper, however, will be on proportionality, which is discussed extensively in Part III.

and in other areas of international law on similar topics, may have effects for the future on the procedural rights and consideration accorded to foreign investors or indeed to others under national law, and even on the exercise and review of administrative discretion.

With respect to administrative procedure, in particular concerning the granting, renunciation or renewal of operating licenses, fair and equitable treatment typically requires national administrations to grant foreign investors a fair opportunity to put forward their case, conduct proceedings in a rational and comprehensible fashion, and give reasons for their decisions. A right to a fair hearing and a right to participation in administrative proceedings, for example, played a role in the NAFTA case *Metalclad v. Mexico* where the tribunal found a breach of fair and equitable treatment because the investor was not properly involved. According to the tribunal the investor should have been given the chance to participate in a meeting of a local town council that discussed whether a construction permit was to be given for the investor's waste landfill.⁶⁵ Similarly, the tribunal in *Tecmed v. Mexico* emphasized fairness in hearings as part of fair and equitable treatment in the context of an administrative proceeding that concerned the non-prolongation of an operating license for a waste landfill. It also stated that the standard required the national administration to take decisions about the requests of a foreign investor.⁶⁶

Fair and equitable treatment requirements may prompt national administrative agencies to give reasons for their decisions and to base these decisions on sufficient factual evidence. This is a potential effect in the NAFTA context of decisions such as *Metalclad v. Mexico*, in which the tribunal determined that Mexico had breached the fair and equitable treatment standard because the decision of a town council to deny the construction permit was not grounded in considerations concerning "construction aspects or flaws of the physical facility",⁶⁷ but was mainly motivated by the opposition of the local population to the landfill in question. In the tribunal's view, the decision was therefore not supported by evidence pertaining to legitimate criteria under the municipal construction law. The requirement to supply sufficient evidence also results in a duty to conduct fact-finding and to verify evidence before a final decision is taken. Furthermore, the requirement to give reasons aims at facilitating the legal review of an administrative decision.⁶⁸

Exercises of discretionary powers may also be tempered by requirements of fair and equitable treatment. If, for example, the national administration has consistently tolerated a specific unlawful conduct, fair and equitable treatment may impose restrictions on it intervening only against a foreign investor who engaged in the same conduct.⁶⁹ Similarly, legitimate expectations of the investor can set bounds to the administration's discretionary power. Acting contrary to representations made by government officials, for instance, can in certain circumstances constitute a breach of fair and equitable treatment.⁷⁰

Some of these requirements also have implications for national judicial practice. In *Mondev v. United States* the tribunal, for example, entertained the possibility that "the conferral of a general

65.The tribunal particularly pointed out that "the permit was denied at a meeting of the Municipal Town Council of which Metalclad received no notice, to which it received no invitation, and at which it was given no opportunity to appear"; see *Metalclad v. Mexico*, supra fn. 23, para. 91.

66.See *Tecmed v. Mexico*, supra fn. 24, para. 161 et seq. More specifically on the elements of a fair hearing required under fair and equitable treatment Todd G. WEILER, "NAFTA Article 1105 and the Principles of International Economic Law", 42 Columbia J. Transnat'l L. (2003) p. 35 at p. 79 et seq.

67.*Metalclad v. Mexico*, supra fn. 23, para. 93.

68.See *Tecmed v. Mexico*, supra fn. 24, para. 123.

69.Cf. Steffen HINDELANG, "No Equals in Wrong?" The Issue of Equality in a State of Illegality – Some Thoughts to Encourage Discussion", 7 J. World Inv. & Trade (2006) p. 883.

70.See *International Thunderbird Gaming v. Mexico*, supra fn. 37, para. 137 et seq.; *Metalclad v. Mexico*, para. 85 et seq.

immunity from suit for conduct of a public authority affecting a NAFTA investment could amount to a breach of Article 1105(1) of NAFTA”.⁷¹ In *Azinian v. Mexico* the tribunal pointed out that “a denial of justice could be pleaded if the relevant courts refused to entertain a suit, if they subject it to undue delay, or if they administer justice in a seriously inadequate way”.⁷² Access to domestic courts for foreign investors may also be required, providing an opening for wider global and national arguments about obligations to ensure access to justice. Courts must generally entertain suits in a timely fashion, give a fair hearing to the foreign investor on all essential questions, and base decisions on legal grounds explained by reasons.⁷³ The standards for judicial proceedings are broadly comparable to those already set under human rights instruments, such as Art. 6 of the European Convention on Human Rights.⁷⁴ The distinctive impact on administrative proceedings, however, may be greater.

Overall, fair and equitable treatment requires that domestic administrative proceedings, like judicial proceedings, conform to standards that are derived from a process-oriented understanding of legality and good governance.⁷⁵ What is almost completely unknown at present, is how far this developing investment treaty jurisprudence, and the set of global administrative norms that are developing contemporaneously with it, are in fact having an impact prospectively on national practices. It is obvious, however, that the “fair and equitable treatment” standard now included in so many treaties, as interpreted by tribunals in recent years, ought (from a standpoint of government lawyers’ advice) to influence the ways in which a State goes about considering any changes to their regulatory frameworks after an investment was made,⁷⁶ and more broadly ought to prompt States to adapt their domestic legal orders to standards that are internationally accepted as conforming to the concept of the rule of law.

Although as regards good administration and treatment of foreign investors, some expert guidance and nudging to reform is supplied by the World Bank and comparable bodies in relations with poor or transitional States, there is less of an organized international institutional push for *ex ante* reform in this area than comes from human rights bodies, the EU for accession countries, or the WTO. The risk of *ex post* arbitration losses seems not readily to seep back into *ex ante* administrative reform.⁷⁷ There are of course some obvious exceptions. Chinese scholars point to the implications of episodes in which foreign investors might have considered bringing cases against China, as having had salutary reform effects.⁷⁸ A Namibian court referred to the Germany-Namibia BIT in ruling unlawful, on grounds of inadequate consultation and other

71. See *Mondev v. United States* (ICSID Case No. ARB(AF)/99/2 (NAFTA)), Award of 11 October 2002, para. 151 (concluding, however, that the immunity granted to a municipal authority in the case at hand was not a violation of fair and equitable treatment).

72. *Robert Azinian, Kenneth Davitian, & Ellen Baca v. The United Mexican States* (ICSID Case No. ARB (AF)/97/2 (NAFTA)), Award of 1 November 1999, para. 102.

73. See *Azinian, ibid.*, para. 102.

74. European Convention for the Protection of Human Rights and Fundamental Freedoms and its protocols, 4 November 1950, 213 U.N.T.S. 222. For this analogy see *Mondev v. United States*, supra fn. 71, para. 144. See also Andrea BJORKLUND, “Reconciling State Sovereignty and Investor Protection in Denial of Justice Claims”, 45 Va. J. Int’l L. (2005) p. 809.

75. See for parallel developments of transnational administrative law in the context of administrative proceedings in the EU/EC and similar developments under WTO law Giacinto DELLA CANANEA, “Beyond the State: the Europeanization and Globalization of Procedural Administrative Law”, 9 Eur. Publ. L. (2003) p. 563.

76. In this sense Rudolf DOLZER, “Fair and Equitable Treatment: A Key Standard in Investment Treaties”, 39 Int’l Law (2005) p. 87 at p. 100 et seq.

77. Cf. Tom GINSBURG, “International Substitutes for Domestic Institutions”, 25 Int’l Rev. L. & Econ. (2005) p. 107; Susan D. FRANCK, “Foreign Direct Investment, Investment Treaty Arbitration and the Rule of Law”, 19 McGeorge Global Bus. & Dev. L. J. (2007) p. 337.

78. Xiuli HAN, “The Application of the Principle of Proportionality in *Tecmed v. Mexico*”, 6 Chinese J. Int’l L. (2007) p. 635, provides such indications, mainly with regard to indirect expropriation.

procedural grounds, the expropriation of absentee German-owned farms in the way the government had proposed to do it. Systematic research on this issue is needed, and is likely to affect practice and policy. In any event, the public and widely analyzed jurisprudence of arbitral tribunals can have effects on future governance; and this reality imposes a responsibility on those constructing this jurisprudence to base it on a sophisticated understanding of the issues and fine-grained analysis of specific problems.

8. *Reforming the Methodology for Applying the Fair and Equitable Treatment Standard*

The vagueness of the fair and equitable treatment standard has contributed to significant problems in its interpretation and construction by arbitral tribunals. The arbitral jurisprudence meanders without any very thought-out conceptual vision of the principle's function in relation to State administrative conduct. The reasoning in arbitral awards is therefore often weak, at times even unconvincing, in its legal analysis. Often arbitral tribunals restrict themselves to invoking equally weakly reasoned precedent or referring in an inconclusive manner to the object and purpose of BITs without any deeper justification of how the specific construction is grounded in a sophisticated international law approach to treaty interpretation. Ultimately, these shortcomings endanger the suitability of fair and equitable treatment as a concept against which the conduct of host States can be measured in a predictable way.

Furthermore, the jurisprudence has produced some results and dicta that are not generally accepted (and almost certainly are not embraced for prospective internal application) by aggrieved States, and some of the awards not only endorse but perhaps even celebrate a broad *ex post facto* "I will know it when I see it"-control of host State conduct.⁷⁹ Predictability in its application is, however, essential for host States and foreign investors alike who need to know beforehand what kind of measures entail the international responsibility of the State and, accordingly, against which kind of political and administrative risk the fair and equitable treatment standard protects (and, conversely, what risks the investor takes or should separately insure against).

Specifying what "fair and equitable treatment" actually requires of State administrative agencies necessitates an approach to interpretation and application of "fair and equitable treatment" clauses that is much more ambitious than arbitral tribunals have typically undertaken. Instead of relying on a string of abstract quotations from prior arbitral decisions (an approach that is of little help, especially when disputes concern novel circumstances), or positing the content of fair and equitable treatment in an abstract way without sufficient justification, tribunals should use, as part of the hermeneutics of international law treaty interpretation and legal decision-making, a comparative method that draws on domestic and international law regarding good administration. Arbitral tribunals should therefore engage in a comparative analysis of the major domestic legal systems, and of major approaches in international law and institutions, in order to grasp common features those legal systems establish for the exercise of public power.

Such a comparative analysis of national law may influence tribunal jurisprudence in at least two respects. First, it may enable investment tribunals to positively deduce institutional and procedural requirements from the domestic rule of law standards for a context-specific

79.Cf. in the context of defining the concept of indirect expropriation Yves FORTIER and Stephen L. DRYMER, "Indirect Expropriation in the Law of International Investment: I Know It When I See It, or Caveat Investor", 19 ICSID Rev. – For. Inv. L. J. (2004) p. 293.

interpretation of fair and equitable treatment. A comparative analysis of domestic legal systems and their understanding of the rule of law may, for example, be used to justify the standards administrative proceedings affecting foreign investors have to live up to.⁸⁰ Second, a comparative analysis of the implications of the rule of law under domestic law may be used to justify the conduct of a State vis-à-vis a foreign investor under the fair and equitable treatment standard. If similar conduct, for instance the State-ordered modification of foreclosure provisions in private mortgage contracts in an emergency situation, is generally accepted by domestic legal systems as being in conformity with their understanding of the (national) rule of law, investment tribunals can transpose such findings to the level of international investment treaties as an expression of a general principle of law.

The analysis should not, however, be limited to national legal systems. Cross-regime comparison with other international law regimes is also proving increasingly fruitful. The example of European Court of Human Rights (ECHR) jurisprudence concerning Art. 6 of the European Convention on Human Rights has already been mentioned, and the emerging principles of European administrative law are now also the subject of considerable academic and policy work.⁸¹ The jurisprudence of the WTO Appellate Body is also an important source concerning requirements with respect to the exercise of public power. For example, in its first decision in the *Shrimp-Turtle* case, the Appellate Body held that shrimp from India, Thailand and other countries had been improperly excluded from US markets. The administrative procedures followed by the United States, in applying its turtle-protecting legislation, constituted “arbitrary and unjustifiable discrimination between Members”, and hence the United States was precluded from defending its turtle-protecting measures under the GATT Art. XX exceptions. The Appellate Body pointed out that the US procedure for certifying the shrimp industries of particular States as meeting turtle-protecting standards provided:

- “– no formal opportunity for an applicant country to be heard, or to respond to any arguments that may be made against it...
- no formal written, reasoned decision, whether of acceptance or rejection...
- no notification of such decisions, and
- no procedure for review of, or appeal from, a denial”.

Comparison involves recognizing differences as well as similarities. International investment treaties have distinct substantive features, and the institutional features and roles of arbitral tribunals under treaties are also distinctive. The mechanisms for the protection and promotion of foreign investment are, however, not an end in themselves. They are rather closely related to the goals of economic growth and development, in particular in developing countries. This was explicitly mentioned as an objective of the ICSID Convention that recognized “the need for international cooperation for economic development, and the role of private international investment therein”.⁸² The link between the inflow of foreign investment and economic

80. See also della CANANEA, *supra* fn. 75, p. 563 at p. 575 (explaining that the WTO Appellate Body in the *Shrimp-Turtle* Case has “subsumed from national legal orders some general or ‘global’ principles of administrative law” in order to impose procedural rule of law elements on the exercise of public power by WTO Member States).

81. See, for example, Paul CRAIG, *EU Administrative Law* (2006); Carol HARLOW, *Accountability in the European Union* (2003); Francesca BIGNAMI and Sabino CASSESE, eds., “The Administrative Law of the European Union”, 68, *Law & Contemp. Probs.* (2004) p. 1; Sabino CASSESE, ed., *Trattato di Diritto Amministrativo*, 2nd edn. (2003); Jürgen SCHWARZE, *Europäisches Verwaltungsrecht*, 2nd edn. (2005).

82. See the preamble of the ICSID Convention.

development is further reinforced by the character of the World Bank as a development institution.⁸³ The implementation of an investor-State dispute settlement mechanism under the ICSID Convention aimed at reducing the political risk connected with investing in a developing country with weaker domestic institutions and a less stable legal and political infrastructure in the interest of growth and development.⁸⁴ Whether these objectives have in fact been met by the system as it currently operates, and whether new and more complex goals and limitations may now be part of the purpose of individual treaties and of the system as a whole, are also considerations of central importance. Constructing a jurisprudence that takes adequate account of the full set of relevant considerations is an enterprise that must be connected, at least at the level of ideals, with the underlying normative justifications for the system of investor-State investment arbitration. These underlying normative justifications will be discussed in Part V of this Paper. The Paper turns now to issues concerning the actual conduct by tribunals of their governance task of review of State action, and in particular to comparative study of established governance techniques for courts and tribunals exercising such review functions, such as proportionality analysis.

III. PROPORTIONALITY IN INTERNATIONAL INVESTMENT TREATY ARBITRATIONS: ARBITRAL TRIBUNALS AS REVIEW AGENCIES OF THE HOST STATE'S EXERCISE OF REGULATORY POWERS

Challenges to the legitimacy of investment tribunals exercising power over States also frequently involve some critique of the open-ended language of the investors' rights provisions and concerns that these empower tribunals to abridge the role of States as regulators to protect the public interest, whether for environmental protection, human rights, or to meet emergencies, in the sole interest of protecting property rights and economic interests. This is particularly the case as regards the State's function as a regulator by means of abstract and general regulation. This Part therefore responds to the observation that investment treaty tribunals considering such situations increasingly feel the need to deploy a proportionality analysis where investment treaties frame the duties of the States in relation to investors and investments without establishing clear textual criteria for permitted departures from or limits to these duties for public regulatory purposes to protect other important interests.

Proportionality analysis is a method of legal interpretation and decision-making in situations of collisions or conflicts of different principles and legitimate public objectives. It is characteristic of this approach to distinguish principles on the basis that they do not work in an "all-or-nothing fashion", but allow for a "more or less".⁸⁵ Rules "contain fixed points in the field

83.Aron BROCHES, *The Convention on the Settlement of Investment Disputes between States and Nationals of Other States*, 136 Recueil des Cours (1972-II) p. 331 at p. 342 et seq.; Burkhard SCHÖBENER and Lars MARKERT, "Das International Centre for Settlement of Investment Disputes (ICSID)", 105 ZVglRWiss (2006) p. 65 at p. 67.

84.For debate on the link between institutions and economic growth, see: Edgardo BUSCAGLIA, William RATCLIFF and Robert COOTER, *The Law and Economics of Development* (1997); Jean-Philippe PLATTEAU, *Institutions, Social Norms, and Economic Development* (2000); Dani RODRIK, Arvind SUBRAMANIAN and Francesco TREBBI, "Institutions Rule: The Primacy of Institutions Over Geography and Integration in Economic Development", 9 J. Econ. Growth (2004) p. 131; Daron ACEMOGLU, Simon JOHNSON and James ROBINSON, "Institutions as the Fundamental Cause of Long-Run Growth" in Philippe AGHION and Stephen DURLAUF, eds., *Handbook of Economic Growth* (2005). For a sceptical view on causality between political institutions and economic growth see Edward L. GLAESER, Rafael LA PORTA, Florencio LOPEZ-DE-SILANES and Andrei SHLEIFER, "Do Institutions Cause Growth?", 9 J. Econ. Growth (2004) p. 271.

85.Ronald DWORKIN, *Takings Rights Seriously* (1978) p. 24.

of the factually and legally possible”, that is, a rule is a norm that is either “fulfilled or not”.⁸⁶ Principles, by contrast, operate differently in that they aim at “commanding that something be realized to the highest degree that is actually and legally possible”.⁸⁷ As one of the great German exponents of proportionality commented: “Conflicts of rules are played out at the level of validity,” whereas “competitions between principles are played out in the dimension of weight.”⁸⁸ There is, by contrast, tempered enthusiasm for proportionality analysis among US judges,⁸⁹ and historically also in systems influenced by English law, although the process of European integration is having its effects on approaches in the United Kingdom.

There are significant problems, however, in such an enterprise, but also good reasons for it. Proportionality analysis facilitates application of standard concepts of investment protection, and can be accommodated to a certain extent within the concepts of indirect expropriation and fair and equitable treatment, whenever the restriction of the State’s regulatory leeway is at play.⁹⁰ It thus operationalizes balancing between interests of foreign investors, or more generally property rights, and conflicting public interests. While proportionality analysis no doubt can be susceptible to use as a means to justify particular judicial preferences, when deployed by sophisticated courts and tribunals in national and international jurisprudence to deal with open-ended concepts and difficult balancing, it has proven to be methodologically workable and more coherent and generalizable than the kinds of reasoning applied by many tribunals to “fair and equitable treatment” clauses or the concept of indirect expropriation. The diversity of existing uses of proportionality analysis means that it is possible to undertake wide-ranging and instructive comparative law research and analysis as to what is considered as proportional in various national legal systems and transnational or international tribunals.

In addition, the principle of proportionality may in some respects provide a stricter framework for decisions in investor-State disputes than does the current jurisprudence. It requires arbitrators to engage in a method of assessing the competing legal claims, weighing them, considering alternatives, etc. and provides rational arguments for their decisions. Certainly, proportionality analysis can be criticized as legitimating judicial law-making and as generating a *gouvernement des juges*. But it is more robust than some of the alternative methods for dealing with these difficult assessments currently employed in international investment law. Without the proportionality analysis the concept of indirect expropriation, for example, risks degrading to an

86. Robert ALEXY, *A Theory of Constitutional Rights* (1986; transl. Julian Rivers, OUP 2002) pp. 47-48.

87. Robert ALEXY, *On the Structure of Legal Principles*, 13 *Ratio Juris* (2000) p. 294 at p. 295. See also ALEXY, *supra* fn. 86, p. 47, stating that principles are norms that “require that something be realized to the greatest extent possible given the legal and factual possibilities”.

88. ALEXY, *ibid.*, p. 50.

89. Concerning the scope of the proportionality requirement in US constitutional law in particular concerning criminal law in the context of the Eighth Amendment see Alice RISTROPH, “Proportionality as a Principle of Limited Government”, 55 *Duke L. J.* (2005) p. 263 with further references; see also on the hesitance in US constitutional law to accept proportionality as a general principle Vicki C. JACKSON, “Ambivalent Resistance and Comparative Constitutionalism: Opening up the Conversation on ‘Proportionality’, Rights And Federalism”, 1 *U. Pa. J. Const. L.* (1999) p. 583.

90. This limits the scope or application of proportionality analysis as a legal instrument. Thus, cases where the State acts as a party to an investor-State contract will usually not be covered. But see on limitations to the power of States in their capacity as a party to a contract Stephan SCHILL, “Enabling Private Ordering – Function, Scope and Effect of Umbrella Clauses in International Investment Treaties”, 18 *Minn. J. Int’l L.* (2009) p. 1. Furthermore, situations in which decisive controlling rules of priority between property interests and competing non-property interests are already clearly established, are usually not subject to the proposed proportionality reasoning and analysis. Proportionality analysis rather finds application in cases where the State itself redistributes or interferes with property rights in the interest of protecting some non-economic interest by means of general legislation or administrative regulation.

analysis without rationalization: “I know it when I see it.”⁹¹ Similarly, some subsets of the standard of fair and equitable treatment would, instead of following a structured analysis about the relationship between the investor’s expectations of favorable treatment and competing public interests in the application of rule of law standards and the balance between the two, become open to subjective assessments of arbitrators about what they consider fair and equitable – a standard of equity, not a legal standard that has normative content. Proportionality, in this respect, may provide more predictability than the lack of any intelligible standard of weighing and balancing, in particular if the procedural aspect or version of proportionality analysis is emphasized, instead of the more substantive versions undertaken under this heading by some domestic courts.

Fundamental to the application of proportionality analysis (and comparable techniques of balancing) in investment treaty arbitration is the question of the relationship of proportionality analysis to the applicable law, and in particular to the applicable international law.⁹² The starting point is the good faith interpretation of the applicable treaty. A particular feature of most investment treaties is that they make provisions for investor rights without addressing in a comprehensive fashion the relationship of these to continuing powers of State regulation. It is likely that States parties typically did not intend a severe occlusion of these regulatory powers, and a good faith reading of the text of the applicable treaty in context and in light of the object and purpose of the treaty may well indicate that interpretation calls for a balance to be struck between investor protection and State regulatory powers. In interpreting the text of the treaty in order to be able to apply it to a specific dispute, the interpreter may well have recourse to other relevant rules of international law applicable between the treaty parties (VCLT Art 31(3) (c)), potentially including general principles of law. In this way, application of the principle of proportionality can be consistent with, and a form of, the interpretation and application of the substantive provisions of investment treaties.

Investment treaty tribunals also engage, at least tacitly, in interpretation and application of the institutional provisions of treaties: the provisions under which the tribunals are established and operate. These provisions cover not only the institutional design of the tribunals and the scope of their work, they also provide the foundation for the governance functions which, as shown in Parts I and II of this Paper, are inescapable dimensions of their work. The texts of these treaty provisions are typically sparse in relation to the tribunals’ governance roles, and their interpretation also calls for consideration of their context, their object and purpose, and other relevant materials. General principles of law concerning the roles and functions of such juridical decision-making institutions may become relevant. Global administrative law principles on the proper conduct of tribunal processes have obvious relevance, but legal principles of broader ambit, such as proportionality, may also help to give substance to the proper roles and functions of these tribunals in their assessment of State conduct, based on their constitutive treaties. The relationship between hermeneutic functions (i.e., interpretation of texts) and governance functions for any particular tribunal involves complex questions that are not examined in detail in this Paper. The essential point is that conflicts between investment protection and other legitimate public interests may have to be fully and fairly weighed in tribunal processes, given that the State parties did not necessarily subordinate all of these other public interests by entering

91. FORTIER and DRYMER, *supra* fn. 79, p. 293.

92. Where a tribunal analyzes or applies national law, the use of proportionality analysis or other balancing techniques in a particular area of national law may of course be directly relevant, but that is not the focus of the discussion here.

into a particular international investment treaty. Proportionality analysis, in turn, provides a rational process for weighing and balancing that can itself be grounded in the proper interpretation of investment treaties.⁹³ Against this background, this section introduces in brief outline the development and diffusion of proportionality analysis in national and international adjudication and dispute settlement, analyzes its methodological structure, and examines the use of such reasoning by arbitral tribunals in some specific investor-State disputes.

1. *The Development and Diffusion of Proportionality Analysis*

This section provides basic illustrations of national and international juridical institutions applying proportionality analysis to State action impinging on other rights. The aim is simply to show that the emergence of a general principle may be involved. It is fundamental to emphasize that there are essential differences between the institutional settings, and between the underlying texts, so the precise analysis and background assumptions can not be transposed even from one international treaty body to another.

At its origin in the domestic law context, proportionality entails a method of defining the relationship between the State and its citizens. It helps resolve conflicts between, on the one hand, the rights of individuals and the interest of the State and, on the other, between conflicting rights of individuals. Proportionality “sets material limits to the interference of public authorities into the private sphere of the citizen”⁹⁴ and “provide[s] a tool to define and restrain the regulatory freedom of governments”.⁹⁵ It helps to define and to balance the public, represented by the interference and its underlying interest of the State or the community concerned, and the private, represented by the interests of the individuals affected.

Proportionality balancing is a concept stemming from German administrative and constitutional law and has migrated from these roots as a mode of balancing between competing rights and interests to numerous jurisdictions in South America, Central and Eastern Europe, as well as various common law jurisdictions.⁹⁶ At the outset, the German Constitutional Court (*Bundesverfassungsgericht*) formulated the test of proportionality for the first time in its seminal *Apothekenurteil*, a case concerning the interference with the freedom of profession of pharmacists by a licensing system that limited the number of pharmacy licenses in order to secure the supply of the population with pharmaceuticals. In solving the underlying conflict of rights, the German Constitutional Court stated that the individual right and the public purpose of the law had to be balanced:

“The [purpose of] the constitutional right should be to protect the freedom of the individual [while the purpose of] the regulation should be to ensure sufficient protection of societal interests. The individual’s claim to freedom will have a stronger effect ... the more his right to free choice of a profession is put into question; the protection of the public will become more urgent, the greater the disadvantages that arise from the free practicing of professions.

93. See *MTD v. Chile*, supra fn. 27, para. 113; *Saluka v. Czech Republic*, supra fn. 33, para. 297.

94. Jürgen SCHWARZE, “The Principle of Proportionality and the Principle of Impartiality in European Administrative Law”, 1 *Rivista Trimestrale di Diritto Pubblico* (2003) p. 53.

95. Mads ANDENAS and Stefan ZLEPTNIG, “Proportionality: WTO Law in Comparative Perspective”, 42 *Tex. Int’l L. J.* (2007) p. 371 at p. 383.

96. See on this and the following Alec STONE SWEET and Jud MATHEWS, *Proportionality Balancing and Global Constitutionalism*, Yale Law School Faculty Scholarship Series No. 14 (2008). This paper is also published in 47 *Columbia J. Transnat’l L.* (2008) p. 72, but page references in this article are to the Yale version.

When one seeks to maximize both ... demands in the most effective way, then the solution can only lie in a careful balancing [*Abwägung*] of the meaning of the two opposed and perhaps conflicting interests.”⁹⁷

The Supreme Court of Canada applies a very similar proportionality test since *Regina v. Oakes*, a case that concerned the question whether a provision of the Narcotics Act was in conformity with Canada’s Charter of Rights and Freedoms in establishing a rebuttable presumption that a person found to be in possession of drugs was trafficking drugs and thus criminally liable. The Court struck down this provision as violating the presumption of innocence enshrined in the Charter and based its analysis on a three-step “proportionality test”:

“First, the measures adopted must be carefully designed to achieve the objective in question. They must not be arbitrary, unfair or based on irrational considerations. In short, they must be rationally connected to the objective. Second, the means, even if rationally connected to the objective in this first sense, should impair ‘as little as possible’ the right or freedom in question. Third, there must be a proportionality between the effects of the measures which are responsible for limiting the Charter right or freedom, and the objective which has been identified as of ‘sufficient importance’.”⁹⁸

To give one further example, the Constitutional Court of South Africa also applies a test of proportionality in balancing individual rights and government purposes. In *State v. Makwanyane*, the Court was faced with a challenge against the death penalty as violating the constitutional right against cruel, inhuman and degrading punishments. The Court, through its leading opinion by President Chaskalson, decided to solve the conflict based on a proportionality analysis: “The limitation of constitutional rights for a purpose that is reasonable and necessary in a democratic society involves the weighing up of competing values, and ultimately an assessment based on proportionality.”⁹⁹ The Court considered that the following factors would need to be taken into account:

“In the balancing process, the relevant considerations will include the nature of the right that is limited, and its importance to an open and democratic society based on freedom and equality; the purpose for which the right is limited and the importance of that purpose to such a society; the extent of the limitation, its efficacy, and particularly where the limitation has to be necessary, whether the desired ends could reasonably be achieved through other means less damaging to the right in question.”¹⁰⁰

Proportionality has also been routinely applied in the context of international legal regimes as a technique for delineating and balancing the conflicting interests of the international legal order and domestic public policy. In the context of the EC/EU, for example, the concept of proportionality has been used by the European Court of Justice (ECJ) to balance the Community’s fundamental freedoms – the free movement of goods, services, labour and capital

97.BVerfGE 7, 377, 404-405.

98.*R. v. Oakes*, [1986] 1 S.C.R. 103, 139.

99.*State v Makwanyane & Another*, 1995 (3) SA 391, 436 (CC).

100.*Ibid.*

– with conflicting legitimate interests of the Member States.¹⁰¹ For example, in the *Cassis de Dijon* case the ECJ decided that the free movement of goods, guaranteed in Art. 28 EC, could be violated not only by discriminatory regulations of a Member State, but also through non-discriminatory regulations that limited intra-Community trade. At the same time, however, and as a corollary to this broad understanding of the fundamental freedom, the Court recognized that Member States could limit the free movement of goods in the public interest if this interest constituted a so-called “mandatory requirement”. The Court held that

“[o]bstacles to movement within the community resulting from disparities between the national laws relating to the marketing of the products in question must be accepted in so far as those provisions may be recognized as being necessary in order to satisfy mandatory requirements relating in particular to the effectiveness of fiscal supervision, the protection of public health, the fairness of commercial transactions and the defence of the consumer”.¹⁰²

Even though this test is formulated as a necessity test focusing on less restrictive alternatives, the Court applies it very similarly to the proportionality tests described earlier on with respect to the domestic courts.

Similarly, the ECJ and the Court of First Instance require that measures of the Community vis-à-vis Member States, and those affecting individuals subject to the Community legal order, are to be evaluated against the standard of proportionality. The Court of First Instance, for example, explained in a case concerning the review of a Community act that

“the principle of proportionality, which is one of the general principles of Community law, requires that measures adopted by Community institutions should not exceed the limits of what is appropriate and necessary in order to attain the legitimate objectives pursued by the legislation in question, and where there is a choice between several appropriate measures, recourse must be had to the least onerous, and the disadvantages caused must not be disproportionate to the aims pursued”.¹⁰³

In the jurisprudence of the ECJ, proportionality is thus used to “manag[e] tensions and conflicts between rights and freedoms, on the one hand, and the power of the EC/EU and of Member States, on the other”.¹⁰⁴ It therefore not only constitutes a method for delimiting individual rights and the Member State’s right to limit such rights, but also “a mechanism of coordination between the supranational legal order and national legal orders”.¹⁰⁵

In other areas of public international law proportionality plays a similar role in resolving conflicts in the relationships between equal sovereigns. In the law of countermeasures, proportionality is used to limit the reaction against a State breach of international law by another

101. See also Evelyn ELLIS, ed., *The Principle of Proportionality in the Laws of Europe* (1999); on proportionality as a principle in EU/EC law Nicholas EMILIOU, *The Principle of Proportionality in European Law: A Comparative Study* (1996) p. 23 et seq.; Georg NOLTE, “General Principles of German and European Administrative Law – A Comparison in Historic Perspective”, 191 *Mod. L. Rev.* (1994) p. 191; see also T. Jeremy GUNN, “Deconstructing Proportionality in Limitations Analysis”, 19 *Emory Int’l L. Rev.* (2005) p. 465.

102. *Cassis de Dijon*, ECJ 120/78, Judgment of 20 Feb., 1979 – see [1979] ECR 649, para. 8.

103. Case T-13/99, Judgment of 23 November 2002 – *Pfizer Animal Health SA v. Commission*, [2002] ECR II-3305, para. 411 (citing [1990] ECR I-4023, para. 13).

104. STONE SWEET and MATHEWS, *supra* fn. 96, p. 48.

105. *Ibid.*

State.¹⁰⁶ Here, proportionality limits both the means and scope of the countermeasures applied.¹⁰⁷ In particular, the countermeasure must not be tailored so as to permanently deprive the State in breach of its fair shares of benefits. As the International Court of Justice (ICJ) stated in the *Gabcikovo-Nagymaros Case*: “the effects of a countermeasure must be commensurate with the injury suffered, taking account of the rights in question”.¹⁰⁸ Likewise, proportionality is an element of the legality of the use of force in the context of the right to self-defence. Even though not appearing explicitly in Art. 51 of the UN Charter, it has been held by the ICJ to constitute part of customary international law according to which “self-defence would warrant only measures which are proportional to the armed attack and necessary to respond to it”.¹⁰⁹

Under WTO law, proportionality analysis also plays an increasing role in balancing the objectives of the international trade regime, notably trade liberalization, non-discrimination in the trade context and the limitation and careful assessment of non-tariff barriers to trade, with conflicting and legitimate government purposes such as the protection of public health, public morals or the environment, many but not all of which are enumerated in Art. XX GATT. Even though WTO scholars maintain that no uniform proportionality analysis has developed in the jurisprudence of the Dispute Settlement Body to balance trade and non-trade interests,¹¹⁰ the various balancing tests applied in this context can nevertheless be framed, on an abstract level, as a type of proportionality analysis.

In *Korea Beef*, for example, a case concerning the labeling and sale of beef depending on its origins as Korean or non-Korean beef in order to protect public health, the Appellate Body explained that

“[t]he more vital or important ... common interests or values are, the easier it would be to accept as ‘necessary’ a measure designed as an enforcement instrument. There are other aspects of the enforcement measure to be considered in evaluating that measure as ‘necessary’. One is the extent to which the measure contributes to the realization of the end pursued, the securing of compliance with the law or regulation at issue. The greater the contribution, the more easily a measure might be considered to be ‘necessary’.... [The] [d]etermination of whether a measure, which is not ‘indispensable’, may nevertheless be ‘necessary’ within the contemplation of Article XX(d), involves in every case a process of weighing and balancing a series of factors which prominently include the contribution made by the compliance measure to the enforcement of the law or regulation at issue, the importance of the common interests or values protected by that law or regulation, and the accompanying impact of the law or regulation on imports or exports.”¹¹¹

106.Thomas M. FRANCK, “On Proportionality of Countermeasures in International Law”, 102 A.J.I.L. (2008) p. 715.

107.Enzo CANNIZZARO, “The Role of Proportionality in the Law of International Countermeasures”, 12 Eur. J. Int’l L. (2001) p. 889, at p. 897.

108.*Gabcikovo-Nagymaros Project (Hungary/Slovakia)*, Judgment of 25 September 1997, I.C.J. Reports 1997, p. 7, para. 85.

109.*Military and Paramilitary Activities in and against Nicaragua*, Judgment of 27 June 1986, I.C.J. Reports 1986, p. 14, paras. 176, 194; see also *Legality of the Threat or Use of Nuclear Weapons*, Advisory Opinion of 8 July 1996, I.C.J. Reports 1996, p. 226, paras. 41-42 (stating more generally that “the exercise of the right of self-defence to the conditions of *necessity* and *proportionality* is a rule of customary international law”).

110.See Axel DESMEDT, “Proportionality in WTO Law”, 4 J. Int’l Econ. L. (2001) p. 441.

111.Appellate Body Report, *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, para. 164, WT/DS161/AB/R (11 December 2000).

Finally, proportionality plays a crucial role in the jurisprudence of the ECHR in its application of the European Convention on Human Rights and Fundamental Freedoms, notably as regards the resolution of conflicts between individual rights granted under the Convention and public policy of the Member States. Even though the Convention requires, for example, with respect to restrictions of the freedom of expression that a State measure be “necessary in a democratic society”, the Court developed this into a proportionality analysis that is similar to the one found in German constitutional law. In its leading case of *Handyside v. the United Kingdom*, a case involving censorship of a book based on violations of public morals, the Court stated that “the adjective ‘necessary’, within the meaning of Article 10 para. 2 is not synonymous with ‘indispensable’ [and] neither has it the flexibility of such expressions as ... ‘admissible’, ... ‘useful’, ‘reasonable’, or ‘desirable’”.¹¹² Later on, in *Dudgeon v. the United Kingdom*, the Court declared a State measure that criminalized certain homosexual conducts to be “disproportionate” in interfering with the right to privacy.¹¹³ Meanwhile, the Court has engaged in proportionality-style balancing with respect to almost every right enshrined in the Convention.¹¹⁴

At the same time, however, the Court grants, as stated in the *Handyside* case, a margin of appreciation to the Member States in “mak[ing] the initial assessment of the pressing social need implied by the notion of ‘necessity’ in this context”.¹¹⁵ It is for them to determine in the first place what they consider necessary for a democratic society and it is this choice that the ECHR subjects to scrutiny. The margin varies depending on the right involved, the government purpose pursued and the degree of interference. Similar to the function of proportionality in the EC/EU-context, proportionality analysis by the Strasbourg Court has to be seen not only in balancing individual rights and public interests, but also as “a basic mechanism of coordinating between the ECHR and national legal systems, and among diverse national systems”.¹¹⁶

2. *The Structure of Proportionality Analysis*

Proportionality implies a means-ends relationship between the aims pursued by a specific government action and the means employed to achieve this end.¹¹⁷ Certainly, major differences exist between various versions and methodologies of proportionality analysis, including differences between full-fledged proportionality that involves a substantive review by the adjudicator of the balance struck by the political decision under scrutiny and a more procedural type of review, such as less- or least-restrictive-measure tests.¹¹⁸ The balancing between conflicting rights and interests will be dependent upon the cultural socializations and values connected to a specific institution, its hermeneutics, and the core legal texts, other legal materials, and the purposes of the specific legal regime. Notwithstanding such variance, as a general matter proportionality analysis provides a guiding structure for decision-makers that requires them to address certain issues and to determine whether measures taken by a State have sufficiently taken into account the rights or interests they interfere with. As developed in the jurisprudence of various domestic and international courts, proportionality analysis can be

112. *Handyside v. United Kingdom*, App. No. 5493/72 (Eur. Ct. H.R. December 7, 1976), para. 48.

113. *Dudgeon v. United Kingdom*, App. No. 7525/76 (Eur. Ct. H.R. 22 October 1981).

114. Julian RIVERS, “Proportionality and Variable Intensity of Review”, 65 Cambridge L. J. (2006) p. 174, at p. 182. It particularly engaged in a heavy critique of the more lenient reasonableness standards initially applied by the courts in the United Kingdom, see STONE SWEET and MATHEWS, supra fn. 96, pp. 51-53.

115. *Ibid.*

116. STONE SWEET and MATHEWS, supra fn. 96, p. 53.

117. See EMILIOU, supra fn. 101, pp. 23-24.

118. ANDENAS and ZLEPTNIG, supra fn. 95, p. 388.

described as comprising three sub-elements: (1) the principle of suitability, (2) the principle of necessity and (3) the principle of proportionality *stricto sensu*.

a. Suitability for a legitimate government purpose

The first step in proportionality reasoning is the analysis of whether the measure adopted by the State or government agency serves a legitimate government purpose and is generally suitable to achieve this purpose. The task the decision-maker has to achieve is thus two-fold, but both elements of this first step set a relatively undemanding standard for the State measure to meet, certainly in the context of investor-State arbitration. The first element of the task is to ascertain whether the measure adopted purports to aim at a legitimate purpose. Consequently, illegitimate purposes can be filtered out at this early stage. They constitute *per definitionem* a disproportionate interference with the right or interest protected.

In investor-State arbitration, most ordinary public purposes of State action will be legitimate purposes, and only in marginal cases will it be necessary to assess the legitimacy of the purpose based on a comparative approach or from its recognition in international treaties. A State action that is manifestly corrupt for the purely private benefit of a crony, or that is a manifest jus cogens violation such as crimes against humanity is obviously not for a legitimate purpose. Overall, however, very few State measures will fail to aim at a legitimate government purpose.

After establishing the legitimacy of the purpose pursued, the decision-maker will have to determine, in the second element of its task, whether the measure taken is suitable to achieve the stated aim. This requires establishing “a causal relationship between the measure and its object”.¹¹⁹ The decision-maker will thus have to determine whether the measure taken furthers the stated purpose in any way. Again, only very few measures will not pass the suitability test, as good faith actions by governments will usually not involve the use of means that are wholly ineffective in pursuing the stated purpose.

b. Necessity

In a second step, proportionality analysis involves a test of necessity. This covers the question of whether there are other, less intrusive means with regard to the right or interest affected that are equally able to achieve the stated goal (without infringing other protected interests). Necessity requires that there is no less restrictive measure that is equally effective.¹²⁰ This step requires answering two questions: first, is there a less restrictive measure, and secondly, is this measure equally effective (and reasonably feasible)? The background to this test can again be seen in the optimization the decision-maker has to achieve when balancing conflicting principles.¹²¹ If the right affected is protected in principle, there is no justification for the State to be allowed to infringe upon such rights more than necessary, since there are other equally effective alternatives to achieve the same aim.

c. Proportionality Stricto Sensu

In a final step, proportionality analysis involves a balancing between the effects of the State measure on the affected right or interests and the importance of the government purpose. Proportionality *stricto sensu* requires that the measure is not excessive with regard to the

119. Jan H. JANS, “Proportionality Revisited”, 27 *Legal Issues of Econ. Integration* (2000) p. 239 at p. 240.

120. *Ibid.*

121. Cf. Robert ALEXY, *A Theory of Constitutional Rights*, p. 399.

objective pursued and that relative weight is given to each principle.¹²² “The greater the degree of non-satisfaction of, or detriment to, one principle, the greater must be the importance of satisfying the other.”¹²³ Proportionality *stricto sensu* requires taking into account all available factors such as cost-benefit analysis, the importance of the right affected, the importance of the right or interest protected, the degree of interference (minor v. major interference), the length of interference (permanent v. temporary), the availability of alternative measures that might be less effective, but also proportionally less restrictive for the right affected, and so on.

This third step is apposite because an analysis that stops at the necessity-stage would allow restricting a right severely in order to protect a negligible public interest.¹²⁴ In addition, the major advantage of this type of reasoning compared to more deferential standards is that the judge or decision-maker is required to go through an exercise in creative problem-solving that attempts to relate the purpose pursued and the importance of the rights affected. It requires the adjudicator to actively consider alternative policies which could have resulted in a better optimization of the two conflicting rights or interests involved, instead of just assessing their reasonableness, a standard that would necessarily be more deferential to government policy-making, but also accord less protection to the rights protected.

This does not mean, however, that the adjudicator should substitute its own preferences for those of the government, but merely that it should consider whether the reasoning and policy objectives of the State or Government stay within a framework that is based on the recognition of various, eventually conflicting rights or interests which the State tries to generally protect and thus minimize interferences. Depending on the interpretive issues and legal norms involved, all the adjudicator might be allowed to do, for example, is verify whether the State has stayed within an outer framework that is spanned by the recognition of property and investment protection on the one hand and the legitimate public interest on the other.

3. *Applying Proportionality Analysis in Investor-State Arbitration*

Investment tribunals are beginning to adopt (albeit not frequently yet) proportionality analysis when faced with the question whether a regulatory measure stays within the framework set up by the requirement under investment treaties to respect the interests of foreign investors through the concepts of fair and equitable treatment and indirect expropriation. This is particularly evident in two sets of cases which will be discussed in this section. One concerns the question of how to delineate between indirect expropriations that require compensation (depending on the applicable treaty or customary international law) and non-compensable regulation. Another concerns the issue, dealt with in the context of the fair and equitable treatment standard, of the extent to which the investor’s legitimate expectations can constitute a bar to regulations that further a non-investment related interest and adversely affect the expectations an investor had when making its investments.

a. *Proportionality analysis and the concept of indirect expropriation*

122.ALEXY, supra fn. 87, 13 Ratio Juris p. 294, at p. 298,

123.ALEXY, supra fn. 86, p. 102.

124.Rupperecht von KRAUSS, *Der Grundsatz der Verhältnismäßigkeit in seiner Bedeutung für die Notwendigkeit des Mittels im Verwaltungsrecht* (1955) p. 15 (stating that “if the measure [of legality] is only necessity” (i.e., the least restrictive means test), then “a quite negligible public interest could lead to a severe right infringement, without being unlawful”).

International takings law is one field where the tension between investment protection and conflicting rights and interests crystallizes. Virtually all investment treaties contain prohibition on expropriations without compensation. A typical provision is contained, for example, in the BIT between Germany and China that provides:

“Investments by investors of either Contracting Party shall 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 Party (hereinafter referred to as expropriation) except for the public benefit and against compensation.”¹²⁵

Expropriation is not necessarily confined to direct expropriations or nationalizations that involve the transfer of title from the foreign investor to the State or a third-party. Depending on the treaty provision or other controlling standard (such as customary international law) it may also cover so-called indirect, creeping or de facto expropriations, involving State measures that do not interfere with the owner’s title, but negatively affect the property’s substance or void the owner’s control over it.¹²⁶ Thus one NAFTA tribunal opined that the concept of expropriation

“includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State”.¹²⁷

Classical customary international law and treaty jurisprudence typically holds that covered direct and indirect expropriations are only lawful under international investment treaties if they fulfill a public purpose, are implemented in a non-discriminatory manner and observe due process of law. Finally and most importantly, both direct and indirect expropriations regularly require compensation.¹²⁸

125. Art. 4(2) of the China-Germany BIT.

126. See on the concept of indirect expropriation George C. CHRISTIE, “What Constitutes a Taking of Property Under International Law?”, 38 Brit. Yb. Int’l L. (1962) p. 307; Burns H. WESTON, “‘Constructive Takings’ under International Law: A Modest Foray into the Problem of ‘Creeping Expropriation’”, 16 Va. J. Int’l L. (1975) p. 103; Rosalyn HIGGINS, *The Taking of Property by the State: Recent Developments in International Law*, 176 Recueil des Cours (1982) p. 259 at p. 322 et seq.; Rudolf DOLZER, “Indirect Expropriation of Alien Property”, 1 ICSID Rev. – For. Inv. L. J. (1986) p. 41; Thomas W. WÄLDE and Abba KOLO, “Environmental Regulation, Investment Protection and ‘Regulatory Taking’ in International Law”, 50 Int’l & Comp. L. Q. (2001) p. 811; Catherine YANNACA-SMALL, “‘Indirect Expropriation’ and the ‘Right to Regulate’ in International Investment Law”, OECD Working Paper on International Investment, No. 2004/4, available at <www.oecd.org/dataoecd/22/54/33776546.pdf>; Jan PAULSSON and Zachary DOUGLAS, “Indirect Expropriation in Investment Treaty Arbitrations” in Norbert HORN and Stefan KRÖLL, eds., *Arbitrating Foreign Investment Disputes* (2004) pp. 145-158; FORTIER and DRYMER, supra fn. 79, p. 293; Andrew NEWCOMBE, “The Boundaries of Regulatory Expropriation”, 20 ICSID Rev. – For. Inv. L. J. (2005) p. 1; Bjørn KUNOY, “Developments in Indirect Expropriation Case Law in ICSID Transnational Arbitration”, 6 J. World Inv. & Trade. (2005) p. 467; Charles LEBEN, “*La liberté normative de l’etat et la question de l’expropriation indirecte*” in Charles LEBEN, ed., *Le contentieux arbitral transnational relatif a l’investissement international: nouveaux développements* (2006) p. 163.

127. *Metalclad v. Mexico*, supra fn. 23, para. 103.

128. For the question of whether the level of compensation differs for indirect expropriation see Yves NOUVEL, “*L’indemnisation d’une expropriation indirecte*”, 5 Int’l L. FORUM du droit int. (2003) p. 198; Thomas W. MERRILL, “Incomplete Compensation for Takings”, 11 N.Y.U. Env’t L. J. (2002-2003) p. 110. Cf. also W.

Indirect expropriation can also occur based on regulatory acts of the host State. In arbitral jurisprudence, tribunals vary in basic approaches to the issue of how to distinguish between compensable expropriation and non-compensable regulation of property.¹²⁹ Some tribunals solely look at the effects the host State's measure has, thus finding a compensable indirect expropriation either because the impact of the measure reaches a certain intensity, owing either to the permanent interference with fundamental components of the right to property,¹³⁰ or to the substantial diminution in or destruction of the value of the property in question.¹³¹ The majority of the tribunals, however, take into account the purpose of a State's measure and adopt the so-called police power doctrine in deciding whether a general measure entitles an investor to compensation under the concept of indirect expropriation.¹³² The police powers doctrine recognizes that a State has the power to restrict private property rights without compensation in pursuance of a legitimate purpose. Under this approach, it is not sufficient to determine the effect of a State measure; instead, the measure's effect has to be balanced in relation to the object and purpose of the interference.

Even though most investment treaties do not explicitly contain such exceptions to the protection of property,¹³³ tribunals acknowledge that host States have the power to restrict private property rights without compensation in pursuance of a legitimate purpose, so long as this purpose is reasonably balanced in relation to the regulation's effect on the investment. Thus, the tribunal in *Tecmed v. Mexico* held that a police power exception formed part of the

Michael REISMAN and Robert D. SLOANE, "Indirect Expropriation and Its Valuation in the BIT Generation", 74 *Brit. Yb. Int'l L.* (2003) p. 115.

129. See Rudolf DOLZER, *Eigentum, Enteignung und Entschädigung im geltenden Völkerrecht* (1985) p. 186 et seq.; Rudolf DOLZER, "Indirect Expropriation: New Developments?", 11 *N.Y.U. Env't'l L. J.* (2002-2003) p. 64 with further references.

130. See *Starrett Housing Corp. v. Iran*, AWD ITL 32-24-1, 19 December 1983, 4 *Iran-U.S. Claims Tribunal Reports* 122, 154; *Tippetts, Abbott, McCarthy, Stratton v. TAMS-AFFA et al.*, AWD 141-7-2, 22 June 1984, 6 *Iran-U.S. Claims Tribunal Reports*, 219, 225 et seq.; on the jurisprudence of the Iran-United States Claims Tribunal on expropriations see George ALDRICH, "What Constitutes a Compensable Taking of Property? The Decisions of the Iran-United States Claims Tribunal", 88 *A.J.I.L.* (1994) p. 585.

131. *Phelps Dodge Corp. v. Iran*, AWD 217-99-2, 19 March 1986, 10 *Iran-U.S. Claims Tribunal Reports* 121, 130; see also SWANSON, "Iran-U.S. Claims Tribunal: A Policy Analysis of the Expropriation Cases", 18 *Case W. Res. J. Int'l L.* (1986) p. 307 at p. 325 et seq.; WESTON, *supra* fn. 126, p. 103 at p. 119 et seq.

132. Maurizio BRUNETTI, "Indirect Expropriation in International Law", 5 *Int'l L. FORUM du droit int.* (2003) p. 150; DOLZER, "Indirect Expropriation: New Developments?", *supra* fn. 129, p. 64 at p. 79 et seq. (2002-2003); Rudolf DOLZER and Felix BLOCH, "Indirect Expropriation: Conceptual Realignment?", 5 *Int'l L. FORUM du droit int.* (2003) p. 155 at p. 158 et seq.; Allen S. WEINER, "Indirect Expropriation: The Need for a Taxonomy of 'Legitimate' Regulatory Purposes", 5 *Int'l L. FORUM du droit int.* (2003) p. 166; *Sea-Land Service Inc. v. Iran*, AWD 135-33-1, 22 June 1984, 6 *Iran-U.S. Claims Tribunal Reports* 149, 165; *Sedco Inc. v. NIOC and Iran*, AWD ITL 55-129-3, 24 October 1985, 9 *Iran-U.S. Claims Tribunal Reports* 248, 275 et seq.; *Too v. Greater Modesto Insurance Associates and The United States of America*, AWD 460-880-2, 29 December 1989, 23 *Iran-U.S. Claims Tribunal Reports* 378, 387 et seq.

133. Security exceptions or similar non-precluded measures provisions, such as those often included in U.S. bilateral investment treaties, raise special issues and are not addressed in this Paper. See, for example, Art. 10(1) of the Treaty Between the United States of America and the Arab Republic of Egypt Concerning the Reciprocal Encouragement and Protection of Investments, signed 11 March 1986, entry into force 27 June 1992 (stating that "[t]his Treaty shall not preclude the application by either Party or any subdivision thereof of any and all measures necessary for the maintenance of public order and morals, the fulfillment of its existing international obligations, the protection of its own security interests, or such measures deemed appropriate by the Parties to fulfill future international obligations"). For one view of these clauses, see José E. ALVAREZ and Kathryn KHAMSI, "The Argentine Crisis and Foreign Investors: A Glimpse into the Heart of the Investment Regime" in Karl P. SAUVANT, ed., 1 *Yearbook on International Investment Law and Policy 2008/2009* p. 379. For a different view see William BURKE-WHITE and Andreas von STADEN, "Investment Protection in Extraordinary Times: The Interpretation and Application of Non-Precluded Measures Provisions in Bilateral Investment Treaties", 48 *Va. J. Int'l L.* (2008) p. 307.

international law of expropriation: “[t]he principle that the State’s exercise of its sovereign powers within the framework of its police power may cause economic damage to those subject to its powers as administrator without entitling them to any compensation whatsoever is undisputable”.¹³⁴ Similarly, the tribunal in *Methanex v. United States* stressed that

“as a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, inter alios, a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation”.¹³⁵

How the balancing itself is to be done, however, is not always explained in depth by arbitral tribunals. Yet, the approach of the tribunal in *Tecmed v. Mexico* illustrates well the use of a proportionality analysis to manage tensions between investment protection and competing public policies. In the case at hand, Mexican authorities had not renewed the temporary operating license for a waste landfill that was essential to the business of the Mexican subsidiary of a Spanish investor. For the tribunal this constituted a compensable indirect expropriation. In its argumentation concerning the distinction between indirect expropriation and regulation, the tribunal drew on the jurisprudence on Art. 1 of the First Additional Protocol to the European Convention on Human Rights, and weighed the conflicting interests using a proportionality test familiar from the European Court of Human Rights jurisprudence.

While the agency had justified non-renewal of the landfill license on the basis of the operator’s lack of reliability, inter alia owing to its having processed biological and other toxic waste in violation of the operating license and having exceeded the landfill’s capacity,¹³⁶ the tribunal concluded that political considerations had been decisive.¹³⁷ It pointed out that only after massive protests by the local population had occurred in late 1997, did the agency intend to accelerate the relocation of the landfill by refusing to renew the license.¹³⁸ Although the investor had already agreed to relocate the landfill, its request to renew the operating license for another five months until the relocation could take place was refused. Moreover, the agency ordered the investor to cease its activities immediately.¹³⁹

In applying the concept of indirect expropriation to the facts at hand, the tribunal followed a two-step analysis. In a first step, it determined whether the State’s measure itself was sufficiently intense in order for a non-compensable regulation to turn into a compensable indirect expropriation. This, the tribunal considered, depended on two factors: a temporal and a substantive one. First, the interference with the property interest in question must not be of a transitional nature only; second, the interference must lead to a complete destruction of the property’s value. Since the landfill facility could not be used for a different purpose, and could

134. *Tecmed v. Mexico*, supra fn. 24, para. 119.

135. *Methanex Corporation v. United States of America* (UNCITRAL/NAFTA) Final Award of 3 August 2005, Part IV - Chapt. D - para. 7. Similarly, *International Thunderbird Gaming v. Mexico* (UNCITRAL/NAFTA), supra fn. 37, para. 127; *Saluka v. Czech Republic*, supra fn. 33, paras. 254-262; *LG&E Energy Corp., LG&E Capital Corp., LG&E International Inc. v. Argentine Republic* (ICSID Case No. ARB/02/1), Decision on Liability of 3 October 2006, paras. 194-197; *Feldman v. Mexico*, supra fn. 30, paras. 103-106.

136. *Tecmed*, supra fn. 24, paras. 99 et seq.

137. *Tecmed*, *ibid.*, paras. 127 et seq.

138. *Tecmed*, *ibid.*, paras. 106 et seq.

139. See *Tecmed*, *ibid.*, paras. 45, 110 et seq.

not be sold because of the existing contamination,¹⁴⁰ the effect of the non-renewal of the license potentially amounted to an expropriation.

The tribunal, however, did not conclude the analysis there. Instead, in a second step, it considered the effects of the non-renewal of the operating license only as one factor among others in distinguishing between regulation and indirect expropriation. The reason for this approach, according to the tribunal, is that “[t]he principle that the State’s exercise of its sovereign powers within the framework of its police power may cause economic damage to those subject to its powers as administrator without entitling them to any compensation whatsoever is undisputable”.¹⁴¹ In this way, the tribunal accepted that bilateral investment treaties in principle do not exclude a State’s regulatory power, even if the treaty text did not explicitly provide for the continuous existence of such power. Consequently, the tribunal posited that the BIT requires only that the effects of a specific State measure on private property have to be proportional to the exercise of the State’s police power. In essence, the tribunal therefore considered property to be inherently bound and restricted by the police power of the State even if the wording of the Treaty does not explicitly mention a police power exception.

Following the doctrinal structure of fundamental rights reasoning, the tribunal then engaged in a comprehensive proportionality test that weighed and balanced the competing interests in order to determine when legitimate regulation flips over into indirect expropriation. In doing so, the tribunal essentially aimed at achieving “*Konkordanz*” of the various rights and interests affected.¹⁴² From this perspective, a compensable indirect expropriation occurs only when State measures lead to disproportional restrictions of the right to property. Thus, the tribunal stated:

“[T]he Arbitral Tribunal will consider, in order to determine if they are to be characterized as expropriatory, whether such actions or measures are proportional to the public interest presumably protected thereby and to the protection legally granted to investments, taking into account that the significance of such impact has a key role upon deciding the proportionality. Although the analysis starts at the due deference owing to the State when defining the issues that affect its public policy or the interests of society as a whole, as well as the actions that will be implemented to protect such values, such situation does not prevent the Arbitral Tribunal, without thereby questioning such due deference, from examining the actions of the State in light of Article 5(1) of the Agreement to determine whether measures are reasonable with respect to their goals, the deprivation of economic rights and the legitimate expectations of who suffered such deprivation. There must be a reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realized by any expropriatory measure. To value

140. *Tecmed, ibid.*, para. 117.

141. *Tecmed, ibid.*, paras. 118 et seq.

142. The term “*Konkordanz*” or “*praktische Konkordanz*” was coined by the German constitutional law scholar Konrad Hesse and refers to a concept or method of reconciliation and balance of competing fundamental rights. In case two fundamental rights collide, “*Konkordanz*” requires that both rights be reconciled without giving up either one of them. What this concept primarily excludes is perceiving one of the fundamental rights as superior to any other such right. Instead both rights have to be reconciled in a differentiated manner, a task that is achieved in the fundamental rights context by balancing the different rights and interests on proportionality grounds while aiming at a solution that gives both rights effective protection to the best possible extent. See Konrad HESSE, *Grundzüge des Verfassungsrechts der Bundesrepublik Deutschland*, no. 72, 20th edn. (1995). The concept has been recognized as a governing principle by the German Constitutional Court, see BVerfGE 41, 29; BVerfGE 77, 240; BVerfGE 81, 298; BVerfGE 83, 130; BVerfGE 108, 282. The concept can also be found in the constitutional jurisprudence of the French *Conseil Constitutionnel*, CC *décision* no. 94-352 DC, 18 Jan. 1995, available at <www.conseil-constitutionnel.fr/decision/1994/94352dc.htm>.

such charge or weight, it is very important to measure the size of the ownership deprivation caused by the actions of the State and whether such deprivation was compensated or not.”¹⁴³

The concrete aspects the tribunal considered in its balancing approach were the legitimate expectations of the investor, the importance of the regulatory interest pursued by the host State, the weight and the effect of the restriction, and other circumstances concerning the investor’s position (such as the prior violations of the terms of the operating license by the operating company).¹⁴⁴ Apart from that, the tribunal, in assessing proportionality, also accorded importance to the question whether an investor has been especially and unequally affected by the adoption of a measure.¹⁴⁵ In conclusion, the tribunal held that the non-renewal of the license restricted the Claimant’s property rights disproportionately and therefore constituted an indirect expropriation. The tribunal placed particular emphasis on the fact that the degree of the operating company’s breaches were marginal and that they could not be invoked to justify the refusal to renew the license as a consequence.

In addition, the tribunal also fleshed out its general approach to proportionality reasoning by enumerating certain restrictions on the right to property that it considered proportional, such as police measures taken to eliminate threats to public safety, that is, measures addressed either to the person directly threatening public safety or, in case of an emergency, even against a third party that does not itself constitute a threat to public safety.¹⁴⁶ Interferences with the right to property which are aimed at the prevention of danger are therefore in conformity with international law and do not necessarily give rise to a claim for compensation.

A similar proportionality analysis was also adopted by the tribunal in *LG&E v. Argentina*, a case that concerned the emergency measures Argentina passed in the context of its economic crisis in 2001/2002. These included the pesification of dollar-denominated debts and claims and affected tariff guarantees that were given to foreign investors in the gas and electricity sectors. LG&E brought a claim under the United States-Argentina BIT and argued that the effect of these measures significantly affected the value of its shareholding in an Argentine subsidiary that operated in the gas sector and thus constituted an indirect expropriation.¹⁴⁷

However, the tribunal denied a finding of indirect expropriation partly because it required a high threshold for interferences with investments in order for them to constitute indirect expropriations. In the tribunal’s view, indirect expropriation in the case of shareholder claims presupposed that “governmental measures have ‘effectively neutralize[d] the benefit of property of the foreign owner’. Ownership or enjoyment can be said to be ‘neutralized’ where a party no longer is in control of the investment, or where it cannot direct the day-to-day operations of the

143. *Tecmed*, supra fn. 24, para. 122.

144. *Tecmed*, *ibid.*, paras. 149 et seq.

145. *Tecmed*, *ibid.*, para. 122. This idea is conveyed in an important strain of takings jurisprudence in Germany that relies on whether property owners had to suffer a special sacrifice to the benefit of the general public (“*Sonderopfer*”). See on this WÄLDE and KOLO, supra fn. 126, p. 811 at p. 845 et seq.

146. *Tecmed*, supra fn. 24, para. 136.

147. See *LG&E v. Argentina*, supra fn. 135, para. 177. See on the decision, also in comparison to the earlier *CMS v. Argentina* Award, Stephan SCHILL, “International Investment Law and the Host State’s Power to Handle Economic Crises”, 24 J. Int’l Arb. (2007) p. 265.

investment.”¹⁴⁸ In addition, the tribunal emphasized that interferences that amount to indirect expropriation ordinarily are akin to permanent measures.¹⁴⁹

In addition, the tribunal endorsed the approach taken by the tribunal in *Tecmed v. Mexico* and incorporated that tribunal’s reasoning on a proportionality or balancing test for distinguishing between legitimate non-compensable regulation and compensable indirect expropriation. The tribunal in *LG&E* noted:

“The question remains as to whether one should only take into account the effects produced by the measure or if one should consider also the context within which a measure was adopted and the host State’s purpose. It is this Tribunal’s opinion 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. It is important not to confound the State’s right to adopt policies with its power to take an expropriatory measure. ‘This determination is important because it is one of the main elements to distinguish, from the perspective of an international tribunal between a regulatory measure, which is an ordinary expression of the exercise of the State’s police power that entails a decrease in assets or rights, and a *de facto* expropriation that deprives those assets and rights of any real substance.’”¹⁵⁰

The tribunal in *LG&E* thus suggested that international investment treaties ordinarily do not exclude a host State’s power to regulate in the public interest. Instead, it emphasizes that the “State has the right to adopt measures having a social or general welfare purpose”.¹⁵¹ This position is in line with the view of several international courts and tribunals, i.e., that a State is, in general, not internationally liable for bona-fide regulation.¹⁵² Yet, at the same time, the tribunal in *LG&E* suggests that in exceptional cases even generally applicable regulation in the public interest requires compensation if the measure are “obviously disproportionate”.¹⁵³

An approach like this is also reflected in recent State treaty practice, such as recent US agreements which include an interpretation of the concept of indirect expropriation that states: “[e]xcept in rare circumstances, nondiscriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations”.¹⁵⁴ This essentially

148. *LG&E v. Argentina*, supra fn. 135, para. 188 (citing *CME Czech Republic B.V. v. The Czech Republic* (UNCITRAL), Partial Award of 13 September 2001, para. 604 and *Pope & Talbot, Inc. v. The Government of Canada* (UNCITRAL), Interim Award of 26 June 2000, para. 100).

149. *LG&E v. Argentina*, supra fn. 135, para. 193. See also *LG&E v. Argentina*, para. 191 (citing *Pope & Talbot*, supra fn. 148, paras. 101 et seq.) (stating that “[i]nterference with the investment’s ability to carry on its business is not satisfied where the investment continues to operate, even if profits are diminished. The impact must be substantial in order that compensation may be claimed for the expropriation.”).

150. *LG&E v. Argentina*, supra fn. 135, para. 194 (quoting from *Tecmed v. Mexico*, supra fn. 24, para. 115).

151. *LG&E v. Argentina*, supra fn. 135, para. 195.

152. *LG&E*, *ibid.*, para. 196 (citing American Law Institute, *Restatement (Third) of the Foreign Relations Law of the United States*, Vol. I (1987) Sect. 712, Commentary g, *Too v. Greater Modesto Insurance Associates and The United States of America*, supra fn. 132, 23 Iran-U.S. Claims Tribunal Reports 378, 387 et seq. and *The Oscar Chinn Case (United Kingdom v. Belgium)*, Judgment No. 23 of 12 December 1934, PCIJ Series A/B, Case No. 63, 1934). Similarly, *Sea-Land Service Inc. v. Iran*, supra fn. 132, 6 Iran-U.S. Claims Tribunal Reports 149, 165; *Sedco Inc. v. NIOC and Iran*, supra fn. 132, 9 Iran-U.S. Claims Tribunal Reports 248, 275 et seq.; *Methanex v. United States*, supra fn. 135, Part IV Chap. D, para. 7; *International Thunderbird Gaming v. Mexico*, supra fn. 37, para. 123 et seq.; *Saluka v. Czech Republic*, supra fn. 33, paras. 253 et seq.

153. *LG&E v. Argentina*, supra fn. 135, para. 195 (citing *Tecmed v. Mexico*, supra fn. 24, para. 122).

154. See, for example, Art. 15.6 of the United States – Singapore Free Trade Agreement, signed 15 Jan. 2003, entry into force 1 January 2004, in connection with an exchange of letters on the scope of the concept of indirect

incorporates a proportionality test into the application of the concept of indirect expropriation and thereby helps in balancing investment protection and competing public policy purposes.

b. Proportionality analysis and fair and equitable treatment clauses

Proportionality analysis can also apply in some contexts and with regard to some sub-elements of the fair and equitable treatment standard. As shown in Part II of this Paper, the “fair and equitable treatment” standard has been interpreted by different tribunals as encompassing stability and predictability of the legal framework, consistency in the host State’s decision-making, the protection of investor confidence or “legitimate expectations”, procedural due process and the prohibition of denial of justice, the requirement of transparency, and the concepts of reasonableness and proportionality.¹⁵⁵ Actually applying many of these general propositions often entails weighing competing interests, as well as establishing a standard of review, burdens of proof, and whatever degrees of deference may be appropriate.

For example, the protection of the investor’s legitimate expectations does not make the domestic legal framework unchangeable or subject every change to a compensation requirement. Rather a balancing test is sometimes needed in order actually to apply this, and potentially other, aspects of fair and equitable treatment.¹⁵⁶ Thus, the tribunal in *Saluka v. Czech Republic* specifically warned of the danger of taking the idea of the investor’s expectation too literally since this would “impose upon host States’ [sic] obligations which would be inappropriate and unrealistic”.¹⁵⁷ Instead, the tribunal set out to balance the investor’s legitimate expectations and the host State’s interests within a broader proportionality test. It reasoned:

“No investor may reasonably expect that the circumstances prevailing at the time the investment is made remain totally unchanged. In order to determine whether frustration of the foreign investor’s expectations was justified and reasonable, the host State’s legitimate right subsequently to regulate domestic matters in the public interest must be taken into consideration as well. [...]

The determination of a breach of Article 3.1 by the Czech Republic therefore requires a weighing of the Claimant’s legitimate and reasonable expectations on the one hand and the Respondent’s legitimate regulatory interests on the other.

A foreign investor protected by the Treaty may in any case properly expect that the Czech Republic implements its policies *bona fide* by conduct that is, as far as it affects the investors’ investment, reasonably justifiable by public policies and that such conduct does not manifestly violate the requirements of consistency, transparency, even-handedness and non-discrimination. In particular, any differential treatment of a foreign investor must not be based on unreasonable distinctions and demands, and must be justified by showing that

expropriation, available at <www.ustr.gov/Trade_Agreements/Bilateral/Singapore_FTA/Final_Texts/Section_Index.html>.

155. See supra Sects. II.1.-5.

156. The main difference between the concept of indirect expropriation and the protection of legitimate expectations under fair and equitable treatment is that indirect expropriation requires interference with a property interest or entitlement, whereas the protection of legitimate expectations under fair and equitable treatment is broader and can encompass the expectation in the continuous existence and operation of a certain regulatory or legislative framework. Balancing tests of different sorts are also beginning to be used in the jurisprudence of investment tribunals on other issues, including in the interpretation of umbrella clauses.

157. *Saluka v. Czech Republic*, supra fn. 33, para. 304.

it bears a reasonable relationship to rational policies not motivated by a preference for other investments over the foreign-owned investment.”¹⁵⁸

The general approach of the tribunal in *Saluka* has also been endorsed by various other tribunals.¹⁵⁹ More broadly, however, 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. The assessment by the tribunal in *Pope & Talbot v. Canada* of the reasonableness of the conduct of an administrative agency,¹⁶⁰ and the comments by the tribunal in *Eureko v. Poland* concerning the adequacy of the reasons why the expectations of the investor could not be met, can be seen as importing a general concept of reasonableness into specific interpretations and applications of the fair and equitable treatment standard.¹⁶¹

Proportionality-related analysis likewise can potentially play a role when arbitral tribunals scrutinize whether the exercise of administrative discretion conforms to the standard of fair and equitable treatment. The case in *Middle East Cement Shipping and Handling Co S.A. v. Egypt*¹⁶² involved the seizure and auctioning of the Claimant’s vessel in order to recover debts the investor had incurred in relation to a State entity. A key question was whether the procedural implementation of the auction was valid, in particular whether sufficient notice of the seizure was given.¹⁶³ Arguably in conformity with Egyptian law, the notice was given by attaching a copy of a distraint report to the vessel, because the Claimant could not be found onboard the ship. The tribunal, however, considered that the authority had wrongly exercised its discretion by using this *in absentia* notification instead of notifying the Claimant directly at his local address. Relying on the principle of fair and equitable treatment in interpreting the due process requirement in the expropriation provision of the Greek-Egyptian BIT, the tribunal reasoned that “a matter as important as the seizure and auctioning of a ship of the Claimant should have been notified by a direct communication ... irrespective of whether there was a legal duty or practice to do so by registered mail with return receipt”.¹⁶⁴

158. *Saluka, ibid.*, paras. 305 et seq.

159. See e.g. *BG Group Plc. v. The Republic of Argentina* (UNCITRAL), Final Award of 24 December 2007, para. 298:

“The duties of the host State must be examined in the light of the legal and business framework as represented to the investor at the time that it decides to invest. This does not imply a freezing of the legal system, as suggested by Argentina. Rather, in order to adapt to changing economic, political and legal circumstances the State’s regulatory power still remains in place. As previously held by tribunals addressing similar considerations, ‘... the host State’s legitimate right subsequently to regulate domestic matters in the public interest must be taken into consideration as well’.”

(citing *Saluka v. Czech Republic*, supra fn. 33, para. 304). See also *Feldman v. Mexico*, supra fn. 30, para. 112 (stating that “[g]overnments, in their exercise of regulatory power, frequently change their laws and regulations in response to changing economic circumstances or changing political, economic or social considerations. Those changes may well make certain activities less profitable or even uneconomic to continue.”).

160. See *Pope & Talbot v. Canada*, supra fn. 51, paras. 123, 125, 128, 155, see also *MTD v. Chile*, supra fn. 27, para. 109 with a reference to an expert opinion by Schwebel.

161. See *Eureko v. Poland*, supra fn. 36, paras. 232 et seq. See also discussion at supra fn. 39 and accompanying text.

162. *Middle East Cement Shipping and Handling Co S.A. v. Arab Republic of Egypt* (ICSID Case No. ARB/99/6), Award of 12 April 2002.

163. The issue turned on the question whether the seizure breached the requirement of due process in the provision prohibiting direct and indirect expropriations without compensation in the Egyptian-Greek BIT, and the principle of fair and equitable treatment.

164. *Middle East Cement Shipping v. Egypt*, supra fn. 162, para. 143.

This reasoning implies, without formulating it explicitly, a proportionality-type analysis, weighing the importance of investment protection, the legitimate government interest pursued, and the fact that less restrictive but equally effective ways were available to put the claimant on notice of the impending seizure of his ship.

4. *Proportionality Analysis and Reasoning in Investment Arbitration*

Proportionality analysis is increasingly applied by investment tribunals, in ways that are similar to those in many domestic legal orders and other international dispute settlement systems, including the EC/EU, the ECHR or the WTO dispute settlement system. This concerns, above all, the determination of whether a host State's measures constitutes an indirect expropriation or a violation of some aspects of fair and equitable treatment. Proportionality analysis, however, is open to the criticisms that it confers power on judges to take policy-driven decisions about the proper balance between conflicting rights and interests, and that it encourages a focus on principles above rules.

This criticism may be less problematic in the domestic context as the legislature there has power to reverse court decisions on administrative and legislative standards, at least with regard to future cases. Yet, in the investment treaty context, the revision of BITs is a slow and slow-acting process requiring consent of both contracting State parties. Furthermore, most investment treaties do not provide for an institutional procedure that can be triggered in order to adapt the treaty in response to interpretations by investment tribunals, for example along the lines of the NAFTA Free Trade Commission, an organ through which the State parties can jointly issue authoritative interpretations of the rules and standards applicable to investor-State disputes.¹⁶⁵ While the application of proportionality analysis to constitutional rights has some parallels with its application in the context of interpreting investor rights under investment treaties, national constitutional courts and international treaty-based courts, such as the ECJ and the ECHR, may well be in a better institutional position to bear this weight than are ad hoc and evanescent investment treaty tribunals.

Yet, as shown in this Paper, investment treaty tribunals are already exercising governance functions and applying very open-textured standards, in situations where important public interests are involved. Given that reality, and the possibilities of at least a loose structure of control through institutional supervision and checking by other tribunals, as well as critical scrutiny by the academic community, think-tanks and NGOs, the adoption of a proportionality methodology at a minimum establishes criteria and a framework to ensure that tribunals consider the relevant interests under the applicable principles, and weigh or balance them under an established framework. This may produce better and more convincing reasoning, and enable clearer assessment, critique and accountability of tribunals, because each decision must be rationalized under the proportionality framework and methodology. A proportionality analysis certainly seems preferable as a rational process for balancing investment protection and competing interests, by comparison with approaches in which an extensive summary of the facts

165. See Art. 1131(2) NAFTA. For such an interpretation, see, for example, NAFTA Free Trade Commission, *Notes of Interpretation of Certain Chapter 11 Provisions*, 31 July 2001, available at <www.international.gc.ca/trade-agreements-accords-commerciaux/disp-diff/NAFTA-Interpr.aspx?lang=en>. Likewise, the new US Model BIT provides for a similar treaty-based body. See Art. 30(3) US Model BIT 2004: "A joint declaration of the Parties, each acting through its representative designated for purposes of this Article declaring their interpretation of a provision of this Treaty shall be binding on a tribunal, and any decision or award issued by a tribunal must be consistent with that joint decision."

of the case at hand is followed by the abrupt determination with little intelligible legal reasoning that a State's measure does or does not violate fair and equitable treatment or constitutes a measure tantamount to expropriation based on "I-know-it-when-I-see-it"-type of reasoning.

Proportionality analysis also has the advantage that it is open towards different strands of political theory and different substantive preferences on investment protection.¹⁶⁶ It is potentially attractive both to those stressing that tribunals should more broadly take into account non-investment related interests of non-represented parties that are affected by the outcome of a tribunal's decision, and to those seeking to tighten the legal framework of State interferences with foreign investment. Furthermore, the methodological structure of proportionality analysis may have the effect that arbitrators become more accountable since they also have to justify their decisions in a detailed fashion. Proportionality analysis thus has the potential to become a tool to enhance accountability and justification for governmental action and the activity of arbitral tribunals alike.

In summary, while reasons for hesitation must be acknowledged, the principle of proportionality has the potential to help structure both the relationships between States and foreign investors and between States and investment tribunals. Proportionality analysis potentially enhances the legitimacy of rule-governed legal institutions that undertake it. As a study of the adoption of proportionality analysis by more and more national and international courts concludes: "In adopting the proportionality framework, constitutional judges acquire a coherent, practical means of responding to these basic legitimacy questions."¹⁶⁷ Intense concerns about legitimacy in the system of international investment treaty law should drive a rapid adoption of proportionality analysis as a standard technique. This is one step toward investment treaty tribunals recognizing and meeting the demands that their place in global regulatory governance now requires of them.

IV. ADDRESSING DEMANDS FOR LEGITIMACY IN THE INVESTOR-STATE ARBITRATION SYSTEM: ROLES OF GLOBAL ADMINISTRATIVE LAW

Arbitral tribunals exercise significant power in formulating standards for host State conduct vis-à-vis foreign investors and in reviewing State conduct against these standards. As shown in Parts II and III of this Paper, this power is magnified by being part of a system of governance. Numerous scholars and practitioners have pointed to concerns about the legitimacy of these exercises of power, with some asserting that there is or soon will be a veritable "legitimacy crisis".¹⁶⁸ This Part focuses in Section 1 on the connection between demands for increased legitimacy and what has been described above as the governance function of investor-State arbitration, and suggests reforms largely capable of implementation by the decision-makers themselves, which will enhance legitimacy through bringing the practices of tribunals and other agencies more into line with applicable principles of the emerging global administrative law. Section 2 argues that one particularly important element in doing this is for tribunals and appointing and supervisory agencies to ensure the quality and depth of the tribunals' legal interpretation, analysis and reasoning.

166.Cf. ANDENAS and ZLEPTNIG, *supra* fn. 95, p. 371 at p. 387, drawing on the work of Paul Craig on judicial review of agency decisions in the United Kingdom.

167.STONE SWEET and MATHEWS, *supra* fn. 96, p. 5.

168.See the literature cited *supra* fn. 7.

1. *Investor-State Tribunals as Regulators Beyond the State: Distinguishing the Different Problems of Legitimacy*

People in democratic societies are accustomed to the idea that exercises of power on public issues, particularly power exercised by public bodies or by bodies authorized by the State to act on public issues, should be legitimate. This applies to investor-State arbitration tribunals which exercise power in the public sphere: they review past actions of States, they in effect help set limits to States' future actions and they take positions on matters affecting entire populations and the way these populations are governed. The tribunals operate and exercise power in the global administrative space, which is created in large part by States through their agreements, including investment treaties and the ICSID and 1958 New York Conventions. The demands for public legitimacy and justification in relation to these investor-State tribunals are thus different, often dramatically different, from those applying to commercial arbitration. Ordinary transnational commercial arbitration between corporations is a different form of dispute resolution in terms of the legitimacy demands it faces. Whereas investment treaty arbitration faces legitimacy demands stemming from the fact that investment tribunals exercise control over the host State's conduct which operates in a public rather than a private sphere, commercial arbitration cases ordinarily are significant only for the disputing parties and their stakeholders, although on occasion these cases can have some precedential and even systemic implications.¹⁶⁹

Legitimacy can be approached and understood in Weberian terms, or in democratic terms through the use of democratic electoral processes or plausible substitutes for such processes. These two different approaches to legitimacy will be briefly addressed in turn. Max Weber analyzed the legitimacy (and hence the claim to authority outside the power to coerce obedience) of laws and institutions as coming from one or more of three sources: tradition (i.e., a long-accepted way of conducting matters), charismatic leadership or bureaucratic rationality.¹⁷⁰ Investor-State tribunals are hardly traditional from the standpoint of the lay public, and they seldom rely on the public persona and charisma of their individual members. So, in Weberian terms, investor-State arbitration depends, at least in part, on the legality and rationality of its design, its processes, and the technical quality and persuasiveness of the reasons tribunals give in explaining and justifying their decisions. This theme will be discussed in Section 2 below.

169. On the differences between investment arbitration and regular commercial arbitration see Gus VAN HARTEN and Martin LOUGHLIN, "Investment Treaty Arbitration as a Species of Global Administrative Law", 17 *Eur. J. Int'l L.* (2006) p. 121 at p. 139 et seq.; Stephan SCHILL, "Arbitration Risk and Effective Compliance: Cost-Shifting in Investment Treaty Arbitration", 7 *J. World Inv. & Trade* (2006) p. 653, at pp. 676-679. Experience with commercial arbitration has systemic effects in shaping the judgment of economic actors about whether to include arbitration clauses in future contracts and about which arbitral institutions and rules to use. Loukas MISTELIS, Crina BALTAG, Stavros BREKOULAKIS, *Corporate Attitudes and Practice: Recognition and Enforcement of Foreign Awards* (2008); Loukas MISTELIS, "International Arbitration: Corporate Attitudes and Practices", 15 *Am. Rev. Int'l Arb.* (2004) p. 525; Theodore EISENBERG, Geoffrey MILLER and Emily SHERWIN, "Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts", 41 *U. Mich. J. L. Ref.* (2008) p. 871. With regards to investor-State arbitration based on contracts, or in which a contract is central to the substantive issues, the public legitimacy issues for tribunals are often much the same as where an investment treaty provides the whole basis for the claim. See José ALVAREZ, "Book review", 102 *AJIL* (2008) p. 909, at pp. 911-2.

170. Max WEBER, *Economy and Society: An Outline of Interpretive Sociology* (Guenther Roth and Claus Wittich eds., 1968).

Electoral democracy provides a different and more elaborate means of legitimation.¹⁷¹ A particular feature of democratic elections by secret ballot is that they allow for the special democratic freedom of the voters to engage in political expression by allowing them to act arbitrarily. Voters are not required to give reasons for their choice. They are free to throw out the current government because they simply are tired of it.¹⁷² The basic legitimacy of democratic forms of government thus comes through their election by arbitrary voters. Elected leaders, in turn, may also bring legitimacy to the international institutions they establish, control or support, as founders and funders, and to institutions over which they themselves can exercise what might be arbitrary political authority, for example by removing a cabinet minister or the head of a government agency. Extending this democratic legitimation to formal transnational institutions, however, is very difficult, especially for relatively weak States whose influence on these institutions is necessarily limited.¹⁷³

Accordingly, the direct democratic legitimation of investor-State tribunals is tenuous. They are, of course, based on the consent of the relevant States, either in a measured inter-public way through consent to a BIT or regional agreement or to the ICSID Convention, or, more privately and raising special issues, in a State agency's contract with the investor. However, this delegation of decision-making power to arbitral tribunals, without more, is often too thin to provide much democratic legitimation. The treaty commitments last a long time, they are not supervised through institutions with regular processes of democratic political participation, and the electoral processes which give the basic legitimation to governmental institutions in democratic States can seldom come into play when an investor's arbitral claim is actually made and an arbitral tribunal comes into operation. Furthermore, the host State itself usually only determines the appointment of one of the three arbitrators without needing to compromise with the investor-claimant.

What then are the non-electoral mechanisms of legitimation of transnational institutions that exercise public power, including investor-State arbitral tribunals? This question of non-electoral legitimation is fundamental in all kinds of transnational institutions, especially where they have real powers of governance affecting the rights and responsibilities of individuals, corporations, States and other groups. In fact, concerns about legitimacy, effectiveness and acting justly, combined with political pressure and protests, have led many transnational institutions to change their practices and their views as to what the applicable norms conferring legitimacy are and indeed what their roles are as regulative institutions and public actors in relation to public issues. For example, the Basle Committee of central bankers now publishes drafts on the internet and invites comments before it adopts new policies on the supervision of commercial banks;¹⁷⁴ the World Bank follows a similar consultation procedure in setting its social safeguards policies, and has an Inspection Panel to which individuals claiming to be victims of a breach of the Bank's own policies can complain;¹⁷⁵ the ICSID Convention now contemplates transparency of

171. See John FERREJOHN, "Accountability in a Global Context", IILJ Working Paper 2007/5 (Global Administrative Law Series) available at <<http://iilj.org/publications/documents/2007-5.GAL.Ferrejohn.web.pdf>>.

172. See *ibid.*, p. 20 et seq. (discussing the ancient Greek story of a peasant voting to ostracize Aristides the Just, simply because the peasant had enough of him being called "the Just").

173. Grainne de BURCA, "Developing Democracy Beyond the State", 46 *Columbia J. Transnat'l L.* (2008) p. 221.

174. Michael BARR and Geoffrey MILLER, "Global Administrative Law: The View from Base", 17 *Eur. J. Int'l L.* (2006) p. 15.

175. Benedict KINGSBURY, "Operational Policies of International Institutions as Part of the Law-Making Process: The World Bank and Indigenous Peoples" in Guy S. GOODWIN-GILL and Stefan TALMON, eds., *The Reality of International Law* (1999) p. 323; David SZABLOWSKI, *Transnational Law and Local Struggles: Mining Communities and the World Bank* (2007).

documents and hearings during investment arbitrations that would have been unimaginable just a few years ago.¹⁷⁶

Moreover, these developments, while not universal, are not simply isolated reforms. They are part of the general if uneven emergence of norms of global administrative law, dealing with matters such as participation, transparency, due process, reason-giving, the existence of review mechanisms, accountability and respect for basic public law values including the rule of law.¹⁷⁷ These norms of global administrative law may be applicable as positive law in specific instances. Often, however, they will be influential in determining what weight another decision-making body, such as a national court, will give to the rule or decision issued by the transnational body in question. More generally, they are markers in the framing of debates about the legitimacy of the exercise of power by transnational bodies that affect the lives and well-being of human beings.

In investor-State arbitration, participation by the defending State, and its public, in the actual arbitral proceedings can help somewhat with democratic legitimation, as the elected government engages in appointing a member of the arbitral tribunal it consented to establish, and argues its case. This, however, is hardly enough in cases where tribunals are interpreting provisions, such as the “fair and equitable treatment” standard or the concept of indirect expropriation, that are not precise and thus inescapably confer on tribunals a wide margin in their decision-making. This is compounded because a tribunal’s decision on how to interpret and apply one of these open-ended provisions can have implications for non-participants, including dozens of other States and innumerable specific investments around the world, because identical or similar standards are obligatory in virtually every investment treaty relationship. The interpretation of such a provision by arbitral tribunals potentially shapes the future behavior of States and their legislatures and agencies, as well as the expectations and choices of investors and perhaps of other actors affected by investment-related issues. In other words, the effects of public decisions of investment tribunals are not limited to the investment treaty governing the dispute at hand. This can be seen in particular through examination of the importance of precedent, and the

176. See the amended ICSID Rules: Rule 48(4) (concerning the publication of the legal reasoning of the tribunals); Rule 37(2) (providing for third-party participation as *amicus curiae*); Rule 32(2) (providing for the possibility to hold public hearings). See on the recent changes to the ICSID Rules Aurélie ANTONIETTI, “The 2006 Amendments of the ICSID Rules and Regulations and the Additional Facility Rules”, 21 *ICSID Rev. – For. Inv. L. J.* (2007) p. 427. See further on issues of transparency and third-party participation in investor-State arbitration Jack J. COE, “Transparency in the Resolution of Investor-State Disputes – Adoption, Adaptation, and NAFTA Leadership”, 54 *U. Kan. L. Rev.* (2006) p. 1339; Carl-Sebastian ZOELLNER, “Third-Party Participation (NGO’s and Private Persons) and Transparency in ICSID Proceedings” in Rainer HOFMANN and Christian J. TAMS, eds., *The International Convention for the Settlement of Investment Disputes (ICSID) – Taking Stock After 40 Years* (2007) p. 179; Christian J. TAMS and Carl-Sebastian ZOELLNER, “*Amici Curiae im internationalen Investitionsschutzrecht*”, 45 *Archiv des Völkerrechts* (2007) p. 217; Christina KNAHR, “Transparency, Third Party Participation and Access to Documents in International Investment Arbitration”, 23 *Arb. Int’l* (2007) p. 327. It is notable, however, that UNCITRAL Rules have been much slower to change, and some prospective parties to arbitrations may strongly prefer fora which have not moved toward ‘publicness’ in these ways.

177. For substantive discussion of specific principles of global administrative law, see the materials cited *supra* fn. 2 and 12-16, as well as works of Jean-Bernard AUBY, Armin von BOGDANDY, Sabino CASSESE, Richard STEWART, and other leading scholars in this field. An extensive bibliography is available at <www.ijl.org/GAL>. See also the valuable analysis of Robert HOWSE, “Adjudicative Legitimacy and Treaty Interpretation in International Trade Law: The Early Years of WTO Jurisprudence” in Joseph WEILER, ed., *The EU, The WTO and the NAFTA: Towards a Common Law of International Trade* (2000) p. 35, focusing on fair procedures, coherence and integrity in legal interpretation, and sensitivity to other relevant international legal regimes (e.g., international environmental law and institutions), as elements used by the WTO Appellate Body in building its legitimacy.

prevalence of references to precedent, in investment treaty arbitrations and indeed in the phrasing of treaties.¹⁷⁸

Adherence by tribunals to global administrative law principles (where these principles are applicable to the work of such tribunals) can play a role in generating and/or enhancing the legitimacy of investment treaty arbitration. Conversely, ignoring these principles provides grounds for serious criticism of the work of tribunals. Part II of this Paper examined what the jurisprudence of tribunals has contributed in defining for States a framework based on standards of good governance and the rule of law, mainly through interpretation of the obligation to accord foreign investors fair and equitable treatment. The examination of some of the requirements of good administrative conduct that tribunals derive from fair and equitable treatment, and use as a yardstick for measuring the appropriateness of State conduct, provides a gentle reminder that arbitral tribunals themselves on occasion do not meet the requirements of transparency, predictability, reason-giving and participation of affected interests that they consider fair and equitable treatment entails for States. The tribunals are, of course, not States and are not formally bound to the same standards under the treaties they apply. However, as global administrative law develops, the kinds of requirements investment treaty tribunals apply to States will more and more become an indicator of the legal measure applicable also to their own operations.

Key global administrative law principles for investor-State tribunals obviously include good process, legality and freedom from bias or arbitrariness in the decision-making process. More difficult to attain, because they introduce delay and higher costs, but probably inevitable in the future, are provisions for adequate review of the work of tribunals by a trusted independent mechanism. Independent reasoned review of decisions by arbitrators or by an appointing authority seems essential, and already exists to some extent, where the appointment of an arbitrator is challenged on proper grounds, or where it is alleged that an arbitrator has a direct conflict of interest. Of independent significance for legitimacy, but also relevant if there is substantive review of tribunal awards, is the requirement that arbitral tribunals address the issues and give reasons for their decisions and awards. Courts in democratic States are expected to give convincing legal reasons for their decisions partly because courts are not themselves directly accountable to the public. Certainly, arbitrations can rest on trust – if people trust the third party enough, they may be willing to hand over the decision-making power to the third party even without specifying many rules to be applied nor requiring much reasoning. But this is rare in situations where investor-State relations have deteriorated to the point where arbitration is sought. Where there is little such trust or more concern about legitimacy, the applicable legal rules will usually be more tightly specified through the political process, and reason-giving by the dispute settlement body takes on greater significance as the justification of the body's actions in accordance with the pre-specified law. The next section of this Paper examines the norms and practices of reason-giving, and of consideration of awards by other investor-State tribunals, in recent investment arbitration jurisprudence.

2. Adequate Reasoning and Consideration of Other Awards as Elements of Systemic Legitimacy

Reason-giving is important as a response to the arguments made, and facts asserted, by the disputants. Reason-giving is also important for the State as a potential repeat defendant, and for non-litigants more generally, as it is the part of the arbitral award which guides future conduct

178. See *infra* fns. 183 and accompanying text.

and shapes the normative expectations of a wider audience as tribunals increasingly follow common-law type rationalities and apply structures of reasoning that heavily use and rely on investment arbitration precedent. It is this prospective effect or shaping impact that lies at the heart of the view of investment arbitration tribunals as regulators.

The reasoning of arbitral awards is thus of considerable importance both for the non-electoral legitimacy of the tribunals, and with regard to its regulatory impact on future State administrative and regulatory behavior. Art. 48(3) ICSID Convention does of course provide that an award “shall State the reasons upon which it is based”.¹⁷⁹ It does not, however, really explain the purpose of the reason-giving requirement. Furthermore, recent annulment committee decisions, in setting a rather modest standard for the quality or cogency of the reason-giving needed to avoid annulment, do not put the reason-giving requirement into a wider context of public reason, deliberative democracy, and legitimacy. Instead, they focus primarily on the question whether the reasoning is intelligible to the parties, not necessarily whether the reasons given are adequate for the wider audience of the tribunal, including the legislatures, courts and publics of affected States and of unrelated States potentially affected by investment awards, and also unrelated investors, insurers and other stakeholders.¹⁸⁰

An implication of the global administrative law approach to global governance, as noted in the opening section of this Paper, is that the reasoning of awards and indeed of judicial decisions in investment arbitration disputes should reflect a quality of publicness in law – it should speak not only to the parties to enable them to understand the *ratio decidendi* of the award, but also to the interests and engagements of non-represented and non-participating stakeholders. In particular, to the extent that it affects general principles of international investment law and arbitration, the reasoning should engage with these wider and systemic issues. This does not mean that affirmative statements necessarily must be made on each such issue – prudence, circumspection and minimalism can all be highly desirable arbitral and judicial virtues. Yet, the reasoning should nonetheless be transparent and accessible not only from the point of view of the parties to the proceeding, but to the tribunals’ wider audience, including non-participating States, the investment community at large and those groups that may be impacted by specific decisions in the context of foreign investment activities. This is particularly true because of the precedential effect investment awards have in practice.

It is sometimes asserted that because investment tribunals typically do not have precedential authority – that is, they only decide the case before them and each case is a new case – they do not need to worry about having *ex ante* regulative effects on future behavior of the defendant State, let alone other States.¹⁸¹ Whatever the merits of this as a jurisprudential position, and

179. A failure to state reasons also constitutes one of the grounds for the annulment of an ICSID award under Art. 52(1)(e) ICSID Convention. Similarly, other arbitration rules specify that awards have to be reasoned, see, for example, Art. 32(3) UNCITRAL Arbitration Rules (providing, however, that the parties can agree that no reasons shall be required).

180. While providing reasons does not mean that there are no lacunae, the reasoning has to enable “the reader to follow the reasoning”; see *CMS Gas Transmission Company v. Argentine Republic* (ICSID Case No. ARB/01/8), Decision of the Ad Hoc Committee on the Application for Annulment of the Argentine Republic of 25 September 2007, para. 97; see also *Wena Hotels Ltd. v. Arab Republic of Egypt* (ICSID Case No. ARB/98/4), Decision on the Application by the Arab Republic of Egypt for Annulment of the Arbitral Award of 28 January 2002, para. 81.

181. This strategy was, for example, chosen by the tribunal in *RosInvestCo v. Russia* in regard of its non-acceptance of earlier precedent with respect to the issue of whether most-favored-nation (MFN) clauses can import the broader jurisdictional consent host States have given under investment treaties with third countries. See *RosInvestCo UK Ltd. v. The Russian Federation* (SCC Case No. V 079/2005), Award on Jurisdiction, October 2007, para. 137 (observing in a case of open dissent with regard to the interpretation of MFN clauses:

indeed as a theoretical mechanism for reducing the reach and impact of the decision of each tribunal and hence assuaging the legitimacy problems, it is not the current practice. States, and their legal advisors, would be rash not to consider the arbitral jurisprudence on a specific issue in deciding how to deal with a particular foreign investment. Regard to investment treaty awards is evident also in changes in State practice as States come to draft new investment treaties or revise existing ones. For example, broad interpretations of fair and equitable treatment and the concept of indirect expropriation have led the United States to introduce more restrictive wording in some recently concluded BITs and Free Trade Agreements.¹⁸² In a certain sense, prior jurisprudence thus has been treated by States as de facto regulative.

References to ICSID decisions can be found in nearly all of the more recent ICSID and NAFTA decisions on jurisdiction and awards on the merits. A recent quantitative study of citations investment tribunals make to prior decisions¹⁸³ confirms the strong qualitative impression derived by reading recent awards in investment treaty cases, namely that “citations to supposedly subsidiary sources, such as judicial decisions, including arbitral awards, predominate”.¹⁸⁴ That the citation of earlier awards carries weight and that earlier awards have an impact on subsequent awards, is also suggested by statements that some investment tribunals have made with regard to the value of earlier arbitral decisions. Although they emphasize the lack of *de iure stare decisis*, they nevertheless have an irresistible urge to turn to earlier decisions for guidance.¹⁸⁵ The tribunal in *El Paso v. Argentina*, for example, stated that it would “follow the same line [as earlier awards], especially since both parties, in their written pleadings and oral arguments, have heavily relied on precedent”.¹⁸⁶ The way the parties to the disputes rely on

“After having examined them [i.e. decision of arbitral tribunals regarding MFN-clauses and arbitration submissions in other treaties], the Tribunal feels there is no need to enter into a detailed discussion of these decisions. The Tribunal agrees with the Parties that different conclusions can indeed be drawn from them depending on how one evaluates their various wordings both of the arbitration clause and the MFN-clauses and their similarities in allowing generalisations. However, since it is the primary function of this Tribunal to decide the case before it rather than developing further the general discussion on the applicability of MFN clauses to dispute-settlement-provisions, the Tribunal notes that the combined wording in [the MFN clause] and [the arbitration clause] of the [applicable] BIT is not identical to that in any of such other treaties considered in these other decisions.”)

182.Art. 10.5(2)(a) of the Dominican Republic – Central America – United States Free Trade Agreement, available at <www.ustr.gov/Trade_Agreements/Bilateral/CAFTA/Section_Index.html>, for instance, stipulates – in departing from the more general treaty language in earlier treaties – that “fair and equitable treatment includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world”. See further Art. 15.6 of the United States – Singapore Free Trade Agreement, signed 15 January 2003, entered into force 1 January 2004, in connection with an exchange of letters on the scope of the concept of indirect expropriation which clarifies that bona fide general regulation do not regularly constitute a compensable indirect expropriation. More generally on the interaction between investment arbitration and investment treaty practice see UNCTAD, *Investor-State Dispute Settlement and Impact on Investment Rulemaking* (2007) pp. 71-89.

183.Jeffrey P. COMMISSION, “Precedent in Investment Treaty Arbitration – A Citation Analysis of a Developing Jurisprudence”, 24 J. Int’l Arb. (2007) p. 129 at pp. 142-154.

184.*Ibid.*, at p. 148. In particular, his results show a “marked increase of citation to ICSID decisions by ICSID tribunals” (*ibid.*, at p. 149). While ICSID tribunals between 1990 and 2001 cited on average approximately two earlier ICSID decisions and awards, this number increased to an average of more than seven within the period between 2002 and 2006. ICSID decisions on jurisdiction even cited to an average of nine earlier ICSID decisions or awards. Similar trends are also present with regard to decisions under the ICSID Additional Facility and non-ICSID investment treaty awards (see Tables 3-5, at *ibid.*, at pp. 149-150).

185.See also Gabriele KAUFMANN-KOHLER, “Arbitral Precedent: Dream, Necessity or Excuse?”, 23 Arb. Int’l (2007) p. 357.

186.*El Paso Energy International Company v. The Argentine Republic* (ICSID Case No. ARB/03/15), Decision on Jurisdiction of 27 April 2006, para. 39. See also *AES Corporation v. The Argentine Republic* (ICSID Case No. ARB/02/17), Decision on Jurisdiction of 26 April 2005, para. 18 (observing that the investor relied on earlier

precedent therefore suggests the emergence of expectations that tribunals will decide cases not by abstractly interpreting the governing BIT, but by embedding it into the pre-existing structure and content of the discourse among investment treaty awards.¹⁸⁷

The significance of precedent is particularly evident in the NAFTA award in *Waste Management v. Mexico*, which having itself purported to aggregate and synthesize NAFTA precedents, has now become a *locus classicus* not only on NAFTA's fair and equitable treatment standard but on the parallel standards in BITs. Similar in style to a system of *stare decisis*, the tribunal defined the standard of fair and equitable treatment by referring to earlier NAFTA decisions and stated:

“Taken together, the *S.D. Myers*, *Mondev*, *ADF* and *Loewen* cases suggest 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 – as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candour in an administrative process.”¹⁸⁸

The tribunal thus derived the meaning of fair and equitable treatment primarily from earlier decisions and defined it accordingly, not from its own interpretation of the text of NAFTA. Consequently, the tribunal in *Waste Management* itself focused more on applying the standard thus derived to the facts of the specific case.¹⁸⁹

Once it is accepted that the legal interpretation and reasoning of tribunals is important as a practical matter for future tribunals, for States, and for the legitimacy of awards among parties and non-parties, some problematic practices of reasoning can be discerned. One problematic

investment awards “more or less as if they were precedent [tending] to say that Argentina’s objections to the jurisdiction of this Tribunal are moot if not even useless since these tribunals have already determined the answer to be given to identical or similar objections to jurisdiction”).

187.Cf. on the emergence of expectations in the reference to, application of and justified departure from precedent Appellate Body Report, *Japan – Taxes on Alcoholic Beverages* WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 4 October 1996, p. 14 (observing that “[a]dopted panel reports are an important part of the GATT *acquis*. They are often considered by subsequent panels. They create legitimate expectations among WTO Members, and, therefore, should be taken into account where they are relevant to any dispute. However, they are not binding, except with respect to resolving the particular dispute between the parties to that dispute.”). Similarly *Saipem S.p.A. v. The People’s Republic of Bangladesh* (ICSID Case No. ARB/05/07), Decision on Jurisdiction and Recommendation on Provisional Measures of 21 March 2007, para. 67

“The Tribunal considers that it is not bound by previous decisions. At the same time, it is of the opinion that it must pay due consideration to earlier decisions of international tribunals. It believes that, subject to compelling contrary grounds, it has a duty to adopt solutions established in a series of consistent cases. It also believes that, subject to the specifics of a given treaty and of the circumstances of the actual case, it has a duty to seek to contribute to the harmonious development of investment law and thereby to meet the legitimate expectations of the community of States and investors towards certainty of the rule of law.”

See also *International Thunderbird Gaming v. Mexico*, supra fn. 37, Separate Opinion by Thomas Wälde, para. 16 (observing that while arbitral awards by themselves do not as yet constitute binding precedent, a consistent line of reasoning developing a principle and a particular interpretation of specific treaty obligations should be respected; if an authoritative jurisprudence evolves, it will acquire the character of customary international law and must be respected”). See further *ibid.*, paras. 129-130.

188. *Waste Management v. Mexico*, supra fn. 44, para. 98.

189. *Waste Management*, *ibid.*, paras. 99 et seq.

pattern is simply to posit in the abstract the normative content of vague standards of investment protection, such as fair and equitable treatment, perhaps supported by some quotations of equally abstract dicta by prior tribunals without further explanations or justifications, and then to assert that the facts of the case meet or do not meet this standard.¹⁹⁰ While this may meet the minimum requirements of reasoning of the sort set by recent ICSID annulment committees,¹⁹¹ tribunals in this pattern may fail to show how they ground these abstract explications of fair and equitable treatment in a legal fashion capable of assessment and deliberative contestation. They thus also fail to counter the reproach that their content is simply determined based on the subjective standards and preferences of individual arbitrators.

A second problematic pattern consists in a failure to spell out the normative assumptions tribunals are making when interpreting abstract standards, such as fair and equitable treatment, and instead limiting themselves to extensively presenting the facts of a case, with legal issues treated briefly and by assertion more than by legal argumentation and reasoning. One such example is the Partial Award in *Eastern Sugar B.V. v. Czech Republic*, which involved a dispute about breaches of the Netherlands-Czech Republic BIT in view of changes in the domestic law relating to the allocation of sugar quotas.¹⁹² The award extensively recounted the facts relevant to a claim based on a violation of fair and equitable treatment in over 100 paragraphs,¹⁹³ and found a violation of that standard, without, however, clearly identifying the standard's legal meaning and normative content, and without even making reference to arbitral "precedent" and relevant sources for treaty interpretation, including international law scholarship on this point. Instead, the award in question simply set out an extremely broad framework within which the normative content of fair and equitable treatment was situated. Thus, the tribunal considered that a violation of fair and equitable treatment, at one end, "does not only occur through blatant and outrageous interference", and, at the other, "may also not be invoked each time the law is flawed or not fully and properly implemented by a State".¹⁹⁴ Basing a decision on such a broad framework, however, is inadequate in view of the consensus existing today that fair and equitable treatment is a legal standard with independent normative content¹⁹⁵ and in view of the concretization this standard has already received in arbitral jurisprudence and academic writing.¹⁹⁶

The type of reasoning in *Eastern Sugar* might be sufficient in settings where a dispute concerns only the parties to a proceeding. Such reasoning, however, does not satisfy the quality demanded of reasoning of dispute settlement bodies in public governance contexts. Although an argument elegantly reviewing every possible precedent on international law issues raised by the parties is not to be expected, and tribunals are inevitably constrained both by the quality of the legal submissions they receive and by resources and costs, it seems plainly insufficient in this field to posit the content of a certain legal standard of investment protection without any careful inquiry into international law sources and without the use of a convincing interpretative

190. See, for example, *S.D. Myers v. Canada*, supra fn. 45, para. 134.

191. See supra fn. 180.

192. *Eastern Sugar B.V. v. The Czech Republic* (SCC Case No. 88/2004), Partial Award of 27 March 2007.

193. *Eastern Sugar*, *ibid.*, paras. 222-343.

194. *Eastern Sugar*, *ibid.*, para. 272.

195. See only *Oil Platforms (Islamic Republic of Iran v. United States of America)*, Preliminary Objection, Judgment of 12 December 1996, Separate Opinion by Judge Higgins, I.C.J. Reports 1996, 803, 858, para. 39 (noting that fair and equitable treatment constitutes "legal terms of art well known in the field of overseas investment protection" and having a "well-known meaning given to these terms").

196. See Barnali CHOUDHURY, "Evolution or Devolution? – Defining Fair and Equitable Treatment in International Investment Law", 6 J. World Inv. & Trade (2005) p. 297; Christoph SCHREUER, "Fair and Equitable Treatment in Arbitral Practice", 6 J. World Inv. & Trade (2005) p. 357; DOLZER, supra fn. 76, p. 87; SCHILL, supra fn. 21.

methodology. This is an essential responsibility toward the system of arbitration based on international law and to those arguing or arbitrating later investment treaty cases which will properly seek to take account of earlier arbitral awards. More generally, weak reasoning and inadequate assessment of prior jurisprudence fuels concerns that investment tribunals are unaccountable, and apply legal standards that are not only vague and unpredictable, but essentially are made subordinate to the inclinations of investment tribunal members.

Similarly, although investment tribunals are not bound by earlier decisions and can thus diverge without committing an error of law, they nevertheless ought ordinarily to explain why they diverge from the reasoning of well-known prior decisions on the same point.¹⁹⁷ In most cases of “inconsistent decisions” arbitral tribunals do this. The tribunal in *SGS v. Philippines*, for example, extensively engaged in a discussion of the earlier award in *SGS v. Pakistan* that suggested a contrary interpretation and application of umbrella clauses.¹⁹⁸ Likewise, the tribunal in *El Paso Energy v. Argentina* that preferred the solution in *SGS v. Pakistan*, and disapproved of the ruling in *SGS v. Philippines*, engaged in an extensive discussion of why it followed one rather than the other approach.¹⁹⁹ Similarly, decisions on the interpretation of most-favored-nation clauses usually discuss in a well-reasoned way inconsistent decisions by other investment tribunals.²⁰⁰

LG&E v. Argentina and *Enron v. Argentina*, both decisions concerning the lawfulness of Argentina’s emergency legislation under the U.S.-Argentina BIT, may raise concerns in this respect. While the decision in *LG&E* largely followed the earlier award in *CMS v. Argentina* concerning the assessment of Argentina’s conduct under the substantive BIT obligations, it departed from the *CMS* decision with respect to the plea of necessity.²⁰¹ However, while it frequently concurred with the award in the *CMS* case and even cited this award as support for its interpretation of the substantive BIT obligations, including fair and equitable treatment and the concept of indirect expropriation,²⁰² it did not mention that the *CMS* award fundamentally differed concerning the concept of necessity under international law. Instead, the tribunal in *LG&E* delivered its own decision without rebutting the arguments provided in the *CMS* award against the operation of necessity. The tribunal in *Enron*, in turn, invoked the decision in *LG&E* affirmatively as regards the interpretation of substantive standards of treatment,²⁰³ but largely followed the award in *CMS* concerning the plea of necessity, without engaging, or merely noting,

197. See FRANCK, *supra* fn. 10, p. 1521.

198. *SGS Société Générale de Surveillance S.A. v. Republic of the Philippines* (ICSID Case No. ARB/02/6), Decision of the Tribunal on Objections to Jurisdiction of 29 January 2004, paras. 119-126.

199. *El Paso Energy v. Argentina*, *supra* fn. 186, paras. 71-82.

200. See, for example, *Plama Consortium Ltd. v Bulgaria* (ICSID Case No. ARB/03/24), Decision on Jurisdiction of 8 February 2005, paras. 210-226. The same, however, does not hold true as regards the reasoning of the tribunal in *RosInvestCo* (see *supra* fn. 181), even though the result of this decision may be more convincing. See generally Stephan SCHILL, “Most-Favored-Nation Clauses as a Basis of Jurisdiction in Investment Treaty Arbitration: Arbitral Jurisprudence at a Crossroads”, 10 *J. World Inv. & Trade* (2009), p. 189; and Martins PAPANISKIS, “MFN Clauses in Investment Arbitration between Maffezini and Plama – A Third Way?” *ICSID Review – Foreign Investment Law Journal* (forthcoming).

201. *LG&E v. Argentina*, *supra* fn. 135, paras. 226-266. Compare *CMS v. Argentina*, *supra* fn. 22, paras. 323-331, 353-394. See for a more detailed comparison of both decisions SCHILL, *supra* fn. 147, p. 265; see also August REINISCH, “Necessity in International Investment Arbitration – An Unnecessary Split of Opinions in Recent ICSID Cases? Comments on *CMS v. Argentina* and *LG&E v. Argentina*”, 8 *J. World Inv. & Trade* (2007), p. 191; Michael WAIBEL, “Two Worlds of Necessity in ICSID Arbitration: *CMS* and *LG&E*”, 20 *Leiden J. Int’l L.* (2007) p. 637.

202. *LG&E v. Argentina*, *supra* fn. 135, paras. 125, 128, 171.

203. *Enron Corporation and Ponderosa Assets, L.P. v. Argentine Republic* (ICSID Case No. ARB/01/3), Award of 22 May 2007, paras. 260, 262, 263, 274.

that the tribunal in *LG&E* had adopted a conflicting position.²⁰⁴ The best way, however, to arrive at a *jurisprudence constante*, which is accepted by investors and States alike, is for the tribunals to set out clearly the arguments for their approach and refute existing counterarguments in order to reach, in a deliberative fashion, convincing results about the proper interpretation of investment law and international law principles.

V. CONCLUSION: PROBLEMS IN OPERATIONALIZING THE NORMATIVE JUSTIFICATIONS OF THE PUBLIC-REGARDING AND GOVERNANCE-REGARDING DIMENSIONS OF THE INVESTOR-STATE ARBITRATION SYSTEM

This Paper has argued that investor-State arbitration is a form of global governance. The case has been made that these arbitral tribunals help define proper standards for State conduct toward investors, and serve as review agencies to assess balances governments have struck between investor interests and public interests. These tribunals are, of course, constrained by the law under which they operate, including treaties under which they are established, and the terms of national law, contracts and other legal instruments. They are also part of a normative legal framework which includes the wider structure of customary international law, general principles of law, and other treaties and international decisions. All of these inform their work. But these observations do not give an exhaustive account of how these tribunals function, nor of what is normatively relevant in appraising the whole system of investor-State arbitration.

Instead, it is essential to reflect on a topic which receives rather less sustained consideration than it merits: on what basis, if any, can the current system of investor-State arbitration be normatively justified? The common proposition that it is justified because it vindicates State aspirations to promote investment flows, if it does indeed do that, addresses only the ordinary functional conception of the tribunals as enforcing commitments and resolving disputes. It is a tenuous justification at best for the more far-reaching governance functions exercised by tribunals. Rather, the normative justifications for the current investor-State arbitration system, *as a form of governance*, which produces and is subject to global administrative law, are very likely to be aligned with one or another of the basic normative conceptions of the role of global administrative law as a whole. Considerations of regulatory efficacy, social welfare, democracy and justice may all come into this. It may be debated whether global administrative law should or realistically can embody robust commitments to promote overall social welfare, or equity and just treatment of marginalized and disregarded economic and social interests, or should instead be concerned more modestly with promoting orderly administration and accountability. Bracketing these far-reaching issues, three basic normative conceptions can be identified for an administrative law of global governance, with potential relevance also to investor-State arbitration as a form of governance: (1) promotion of democracy, (2) promotion of internal administrative accountability and (3) protection of private rights and the rights of States.²⁰⁵

The first of these normative conceptions, which views the role of global administrative law as promoting democracy, is probably too demanding to be a systematic objective for investor-State arbitration given the realistic limits to the possibilities of this dispute settlement mechanism, but

204. *Enron, ibid.*, paras. 288-345. On these cases see Jürgen KURTZ, “Adjudging the Exceptional at International Law: Security, Public Order and Financial Crisis”, IILJ Working Paper 2008/6 available at <<http://iilj.org/publications/documents/2008-6.Kurtz.pdf>>.

205. On similar normative conceptions behind domestic administrative law, see Eberhard SCHMIDT-ASSMANN, *Das Allgemeine Verwaltungsrecht als Ordnungsidee*, 2nd edn. (2004). The following passages draw from joint work of Benedict Kingsbury and Richard Stewart on global administrative law.

in special cases particular democratic issues may be highly relevant. Clearly, national administrative law in many countries has a democratic component: it ensures the accountability of administrators to parliament by ensuring their compliance with statutes, and to broader economic and social constituencies through public participation in administrative decision-making procedures. The development of a global administrative law, including through the work of investor-State arbitral tribunals, could potentially strengthen representative democracy at the national level by making global regulatory decisions and institutions more visible and subject to effective scrutiny and review within domestic political systems, thereby also promoting more accountability of global regulatory decision-makers through those systems.²⁰⁶ This could involve requiring such administrative transparency and accountability processes within the State as part of the standards of treatment required under investment treaties.

The second of these normative conceptions, internal administrative accountability, focuses on securing the accountability of the subordinate or peripheral components of an administrative regime to the legitimating center (whether legislative or executive), especially through ensuring the legality of administrative action. This conception emphasizes organizational and political functions and regime integrity rather than any specific substantive normativity, making it a potential model for an international order, particularly a pluralist one that lacks a strong consensus on substantive norms. This conception provides a strong basis for arguments that global administrative law should be applicable (where apposite) to the work of the institutions of the investor-State arbitral system.

The third normative conception is liberal and rights-oriented: administrative law protects the rights of individuals and other civil society actors, mainly through their participation in administrative procedures and through the availability of review to ensure the legality of a decision. Protection of foreign investors is one instantiation of this conception. This conception may also be extended to the protection of the rights of States; this idea may help to protect publics and public interests even within powerful States, but it is likely to be especially valuable for many developing countries and other weak states that lack political and economic bargaining power and influence. This conception may also overlap with the notion that global administrative law can promote the rule of law by ensuring the public character of regulatory norms, their reasoned elaboration, and their impartial and predictable application.

These three normative conceptions inform quests for legitimacy and accountability in the work of international institutions. They have a direct bearing on the design and functioning of the system of investor-State arbitral tribunals, and on their legitimacy as they exercise the governance functions which are an ineluctable part of their current mandates.

It is fruitful to consider the possible implications of these normative conceptions as justifying the investor-State arbitration system: in particular, they set specific conditions or require certain features in its institutional design and institutional practices. At the same time, it must be recognized that problems of structure and of institutional design may currently be an insuperable obstacle to making investment treaty arbitration a totally effective and wholly legitimate means of exercising power for the multiple set of functions which these arbitral institutions are now called on to perform. They are regulatory institutions which must at once: (1) arbitrate and settle actual disputes between specific parties (usually *ex post*, though in some cases the positive

206. Systems of global administrative law might also support the development of deliberative democracy at the level of global regulatory regimes, although the elements of such a conception as well as the conditions of its effective realization have yet to be resolved. See Robert HOWSE, "Transatlantic Regulatory Cooperation and the Problem of Democracy" in George A. BERMANN, Matthias HERDEGEN and Peter L. LINDSETH, eds., *Transatlantic Regulatory Cooperation: Legal Problems and Political Prospects* (2000) p. 469.

economic relations between the disputants may be continuing at the time of the arbitration); (2) adjudicate these same disputes in ways that articulate public power to all concerned with this specific political-economic issue, and with the substantive legal standards involved, by embodying the idea of publicness in law; and (3) regulate by interpreting applicable standards in ways that have prospective effects for States and other actors. This leads to proposals for radical reform, such as Gus Van Harten's argument for abandoning the current model of what he regards as privatized governance and instead creating a public institution with tenured judges, a permanent International Investment Court.²⁰⁷ As a practical matter, however, proposals for such an institution, or for an appellate structure, seem unlikely to be realized in the near term. Consequently, it seems both imperative and more feasible for those involved in the current system to try to achieve more legitimacy within it, rather than outside of it. This has been the focus of the analysis and relatively modest set of recommendations made in this Paper.

One fundamental structural problem with the aspiration to public-regarding and governance-regarding institutional design and arbitral reasoning is that the parties, and particularly the investor, may have little interest in making the effort, and especially in paying the costs of providing this public good, i.e., prospective governance of State behavior, and of the sophisticated balancing of public and investor interests, through retrospective arbitration. Not surprisingly, therefore, this public good is under-supplied. Furthermore, there is no tax and no general system of State contributions to finance most of the system. Even the system-level problems of overextension or weak legitimacy in investor-State arbitration that may threaten its viability, are collective action problems that no single investor, and probably few individual defendant States, want to pay to fix.²⁰⁸

Some individual arbitrators or panels of arbitrators may be particularly skilled in this area, and motivated to put extra work into a particular award even without financial recompense. But many arbitrators do not necessarily want to assume large responsibilities without additional compensation, one or both of the parties may indeed be apprehensive about arbitrators who might embed the case into some wider set of considerations, and the appointments process in any case can produce mismatches and idiosyncratic combinations. Institutional support, such as is provided by the ICSID Secretariat or other arbitral institutions, could conceivably help in the supply of reasoning addressed to more expansive concerns, particularly if its officials play a significant role and have a system-level view. Yet, the availability of such support varies greatly with the institution and other factors.

This problem is exacerbated by the uneven range of cases brought to investor-State tribunals. Except in very unusual circumstances, States are the only targets of these cases. Public interest organizations do not bring these cases against States – or not yet, although, if they find means to manage the costs, it is possible to imagine NGOs becoming investors to challenge State action through arbitration in the same way as some of them bring suits against foreign States in national courts, or others have for many years purchased shares in corporations to try to influence the

207. VAN HARTEN, *supra* fn. 7, p. 180 et seq. Similarly questioning the suitability of investor-State arbitration as a mechanism to review sovereign acts of host States, see, for example, Vicki L. BEEN and Joel C. BEAUVAIS, "The Global Fifth Amendment? NAFTA's Investment Protections and the Misguided Quest for an International 'Regulatory Takings' Doctrine", 78 N.Y.U. L. Rev. (2003) p. 30; Marc R. POIRIER, "The NAFTA Chapter 11 Expropriation Debate Through the Eyes of a Property Theorist", 33 *Env't'l L.* (2003) p. 851.

208. One way of financing the bringing of certain kinds of cases having general importance may be to shift costs to the State party to the arbitration in case the investor's claim was brought in good faith. See SCHILL, *supra* fn. 169, p. 653.

corporation's conduct.²⁰⁹ Thus, it is usually only investors with high economic stakes in the outcome who initiate these cases, and they usually do so to receive a direct economic benefit, not to generate jurisprudence on new issues or raise the quality of reasoning. Furthermore, in some cases investors with meritorious and important claims do not bring them at all, often because they may not want to be shut out of the relevant market. Smaller investors, by contrast, may be discouraged from bringing claims because of the significant costs involved in investor-State arbitration.²¹⁰

The institutional design of the investor-State dispute settlement structures and its capacity to generate an international public good thus contrasts sharply with, for example, international human rights tribunals. These set some limits on *locus standi*, and typically require prior exhaustion of reasonably available local remedies, but are open to persons claiming to be victims of substantive human rights violations at relatively modest cost.²¹¹ The Inspection Panels of the World Bank and other international development banks are similar. In the World Trade Organization, the absence of a direct right to litigate for corporations or other private actors limits the range of cases, but within the inter-State process, a structural problem of undersupply of the public good of law development in ad hoc GATT Panels was in part addressed through the establishment of the more precedent-creating standing seven-member Appellate Body in 1994.²¹²

Under the current system the investment arbitration tribunals are a highly decentralized and fragmented regulator. They are usually not well embedded in a unifying institution, although some loose monitoring occurs through multiple appointments of individuals to tribunals. Furthermore, institutions such as the Organisation for Economic Co-operation and Development (OECD), UNCTAD, the World Bank and the WTO Committee on Trade Related Investment Measures all provide some institutional supervision and expert enunciation of foreign investment theories and policies. In addition, some intellectual unity is built by the tribunals themselves in their use of precedents and common methodologies, by inter-governmental institutions distilling and disseminating their work through publications and training in investment law (like UNCTAD, or the OECD), and by unofficial actors such as the arbitration congresses or academic commentators who analyze jurisprudence and existing or proposed treaty clauses. Altogether, however, the tribunals are much less embedded in political institutions capable of helping deliver on governance objectives than are the WTO dispute settlement organs, or even OECD supervisory bodies such as the Bribery Working Group under the OECD's Convention against transnational bribery of government officials. The combination of the strong regulatory effects the investment tribunals have on States, and the lack of political inter-governmental institutions in which the tribunals are effectively embedded, intensifies the premium on high-quality reasoning and knowledgeable shaping of standards for good State administration. The recognition by investor-State tribunals that they are both producers and subjects of global administrative law seems inevitable and is beginning to proceed apace.

209. But see Luke PETERSEN and Nick GALLUS, "International Investment Treaty Protection of Not-for-Profit Organizations", 10 Int'l J. of Not-for-Profit Law (December 2007) p. 47, available at <www.icnl.org/knowledge/ijnl/vol10iss1/ijnl_vol10iss1.pdf> (discussing the protection of investment treaties of NGOs and their activities on foreign territory).

210. Again, cost-shifting techniques may provide a solution to the deterrent effect of high costs. See SCHILL, *supra* fn. 169, p. 653.

211. Usually they pay nothing toward the costs of the institution itself, or the State's defense, and there may be NGOs or public interest lawyers able and keen to represent them *ex gratia*.

212. For an overview see Joel TRACHTMAN, "The Domain of WTO Dispute Resolution", 40 Harv. Int'l L. J. (1999) p. 333.