1 Introduction

Investment treaties grant a range of generous rights to foreign investors. These include both substantive rights, such as the right to ‘fair and equitable’ treatment (FET) and the right to be compensated for the expropriation of their investments, and procedural rights – notably, the right to bring a claim that these substantive rights have been breached to investor-state arbitration. Since the late 1990s, there has been a rapid growth in the number of investors bringing claims under investment treaties to investor-state arbitration. Relying on the substantive rights conferred by investment treaties, investors have challenged a range of regulatory measures taken by host states, including measures to regulate the use of pesticides, the discharge of pollutants, the sale of tobacco products and the (non-)grant of medical patents. Investors have also challenged the decisions of national courts and the allocation of financial risks and returns in investment projects. Claims regularly run into the billions of dollars and involve tens of millions of dollars in legal costs. Not all these claims have been successful. Some have succeeded, some have failed and some result in settlement agreements involving concessions by one or both parties. But the amount of money at stake and the fact that foreign investors are able to frame viable claims against such a broad range of government conduct has raised questions about whether investment treaties grant overly expansive rights.

At the same time, investment treaties promise to spur the economic development of the states that are party to them and, perhaps more ambitiously, to stimulate the spread of ‘good governance’. If the grant of robust substantive rights to foreign investors were necessary to realise these benefits, any associated costs might be justified. In any case, it is impossible to reach an informed view about whether the substantive
protections commonly found in investment treaties are justified without examining the benefits of conferring such rights on foreign investors.

This book provides a systematic analysis of the costs and benefits of the substantive protections that investment treaties provide to foreign investors. The purpose of this inquiry is to determine whether investment treaties should provide more or less protection than they currently do. I take the arguments of both supporters and critics seriously and seek to test whether they are coherent and borne out by evidence. The book concludes with a range of recommendations for reform of the investment treaty system.

1.1 A brief history of investment treaties
While international law has long been concerned with the protection of foreign-owned property,1 the proliferation of treaties placing obligations on host states with respect to foreign investment is a more recent phenomenon. The modern era of investment treaties is often dated from the signing of the first bilateral investment treaty (BIT) between Germany and Pakistan in 1959.2 Yet it was not until 1969, with the BIT between Italy and Chad, that investment treaties began to grant foreign investors the right to bring disputes with the host state directly to investor-state arbitration.3 The grant of this unprecedented procedural right to foreign investors laid the basis for the transformation of the field of international investment law by making treaties directly enforceable.4 However, it was only after the first investor-state arbitration, more than two decades later, that the full implications of the BIT movement began to become clear.5 In the meantime, the negotiation and ratification of BITs accelerated through the 1980s and 1990s, before continuing at a slower pace during the early twenty-first century.

There are now more than 2800 BITs, with nearly every state having signed at least one.6 Roughly three-quarters of these BITs have entered

1.1 A BRIEF HISTORY OF INVESTMENT TREATIES

into force.\textsuperscript{7} While most early BITs were signed between a developed and a developing country,\textsuperscript{8} BITs between developing countries are increasingly common.\textsuperscript{9} Notwithstanding the number of BITs and the array of states involved, there is considerable uniformity in their structure and wording. Two features common to the majority of BITs are particularly important to the present inquiry. The first is that they provide a common set of substantive legal protections to foreign investment. Each signatory state is typically required to provide foreign investment from the other signatory state with Fair and Equitable Treatment (FET), national treatment and compensation in the event of expropriation of the investment.\textsuperscript{10} The second feature, as already noted, is that they allow foreign investors to bring claims that the host state has breached these protections directly to investor-state arbitration.\textsuperscript{11} If an arbitral tribunal determines that a host state has breached the applicable BIT, it will invariably award the investor-claimant compensation for the loss it suffered as a result of the breach. Such awards are readily enforceable.\textsuperscript{12}

Whereas all the early investment treaties were bilateral, the 1990s saw the beginnings of a shift towards the negotiation of investment treaties with a broader regional or sectoral scope. Examples of regional investment treaties include the Association of South East Asian Nations (ASEAN) Comprehensive Investment Agreement, the Common Market for Eastern and Southern Africa (COMESA) Investment Agreement and the Japan-China-Korea Trilateral Investment Treaty.\textsuperscript{13} Similarly, the Energy Charter Treaty


\textsuperscript{9} UNCTAD, South–South Cooperation in International Investment Agreements (2007), p. 6.


\textsuperscript{12} Arbitral awards are enforceable in the courts of states that have signed the Convention on the Settlement of Investment Disputes between States and Nationals of other States (18 March 1965; hereafter, ICSID Convention), art. 54, if the tribunal is convened under the ICSID Convention or the courts of the states that have signed the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (10 Jan 1958; hereafter, New York Convention), art. III, if the tribunal is convened under any other set of procedural rules, such as the United Nations Commission on International Trade Law (UNCITRAL) rules or the rules of the International Center for the Settlement of Investment Disputes (ICSID) Additional Facility.

\textsuperscript{13} ASEAN Comprehensive Investment Agreement (26 February 2009; hereafter, ASEAN Comprehensive Investment Agreement); Common Market for Eastern and Southern
(ECT), the most important sectoral investment treaty, confers legal protection on investments made by investors of a signatory state in the energy sector of any of the other fifty-one signatory states. Increasingly, bilateral and regional free trade agreements (FTAs) also contain investment chapters modelled on BITs. The most well known of these treaties is the North American Free Trade Agreement (NAFTA), but there are many others. At the time of going to press, it was envisaged that all three ‘mega-regional’ FTAs under negotiation – the TransPacific Partnership (TPP), the Regional Comprehensive Economic Partnership (RCEP) and the TransAtlantic Trade and Investment Partnership (TTIP) – would include investment chapters.

This book concerns the full set of treaties that place substantive obligations on host states relating to the protection of foreign investment and provide for compulsory investor-state arbitration of claims that those protections have been breached. For convenience, the term ‘investment treaty’ is used throughout to refer to such treaties, but it is important to be clear that the analysis applies equally to the investment protection provisions contained in FTAs. Consistent with this terminology, the term ‘investment treaty protections’ is used to refer to the substantive obligations relating to the protection of foreign investment whether found in BITs, regional or sectoral investment treaties or FTAs.

1.2 The scope of the inquiry

This is a book about investment treaties, but it does not attempt to answer all the policy and legal questions raised by these agreements. It does not chart the history of investment treaties in detail, nor does it seek to determine whether states fully understood the implications of the treaties that they signed. It does not ask whether investor-state arbitration is an appropriate way of resolving disputes arising from the exercise of governmental authority (although the findings may have implications for this question). Instead, the inquiry seeks to determine the level of protection that investment treaties should provide to foreign investment. As well as being of academic interest, this question confronts policymakers every time they negotiate an investment treaty. The contribution


14 The Energy Charter Treaty (17 December 1994; hereafter, ECT), art. 13(1).
of this book is both that it provides a rigorous and systematic methodology for answering this question and that, through the application of this methodology, it offers a set of answers to this question.

The methodology proposed in this book involves a comparison between the costs and benefits of adopting different levels of investment protection. In other words, the methodology is consequentialist. In Chapter 3, I develop a framework for conceptualising, identifying and evaluating the consequences of providing differing levels of protection in investment treaties. This framework is then applied to some of the most contentious issues in debate about investment treaties – questions about the level of protection that should be provided through FET and expropriation provisions. Chapters 4 and 5 review existing arbitral jurisprudence on the interpretation of the FET and indirect expropriation provisions of investment treaties. These chapters identify several different understandings of the extent of protection provided to foreign investment, which are then sketched as levels of protection that might, in future, be adopted and applied consistently. Chapter 6 uses the framework to evaluate each of these levels of protection.

The following paragraphs explain the scope of the inquiry more precisely. As will become clear, the task of evaluating variations in the drafting of every investment treaty protection (not to mention the omission of existing protections and their replacement with entirely new provisions) would require a work several times the length of this volume. Through a detailed engagement with the FET and expropriation provisions of investment treaties, I demonstrate how the framework developed in Chapter 3 could be applied to evaluate a much broader range of options.

1.2.1 The evaluation of levels of protection derived from existing arbitral jurisprudence

In this book, I evaluate a range of levels of protection derived from arbitral jurisprudence interpreting the FET and indirect expropriation provisions of existing investment treaties. These levels of protection constitute a set of options that states, in the drafting of future treaties or by the amendment of existing ones, might adopt. The primary justification for evaluating options derived from existing jurisprudence is that the options to be evaluated must themselves be defined with some degree of precision. Existing investment treaty protections are drafted in unusually vague terms, and their meaning has primarily been fleshed out through
the process of interpretation and application by arbitral tribunals.\textsuperscript{17} The question of whether investment treaties should contain provisions requiring ‘fair and equitable treatment’ cannot sensibly be answered without first providing a more precise articulation of the extent of protection that such provisions provide.

There is a second justification for evaluating options derived from existing jurisprudence, one that relates to the practicalities of treaty revision. Insofar as this book is addressed to policy-makers, existing state practice suggests a preference for the revision and clarification of existing standards, rather than the replacement of existing standards by new standards with no basis in current treaty practice.\textsuperscript{18} Of course, it remains open to states to include whatever provisions on which they agree in future investment treaties. And I do not intend to foreclose the possibility, or desirability, of more radical changes to investment treaties. My claim is simply that the broad disagreement about the level of protection that is provided by existing provisions offers a useful entry point to the wider debate about how much protection investment treaties should provide. The evaluation of options derived from existing jurisprudence also means that the analysis is relevant to arbitrators and lawyers tasked with the interpretation of treaties as they are currently drafted.

1.2.2 The prospective evaluation of legal rules

Chapters 4 and 5 show that decisions interpreting provisions of existing investment treaties do not define a level of protection that is applied consistently in all disputes. The review of existing decisions identifies several different understandings of the level of protection provided by existing treaties, each of which defines a level of protection that could be adopted and applied consistently in the future. Thus, the inquiry in this book has two important characteristics. The first is that it concerns the evaluation of a set of prospective options, each of which would entail a degree of certainty about the level of protection provided to foreign investment. The second is that it concerns the evaluation of different


possible legal rules,¹⁹ as opposed to an analysis of whether particular past disputes should have been resolved in favour of the host state or the investor.

These two characteristics of the options under consideration have implications for the range of costs and benefits that must be taken into account. The inquiry must consider the implications of the proposed rule for the full range of situations covered by the rule, including its impact on the behaviour of actors in situations that do not ultimately result in legal disputes. For example, the inquiry must consider whether adopting a high level of protection for foreign investors would encourage greater foreign investment and whether it would increase ‘regulatory chill’.

1.2.3 Exceptions to substantive protections
Two additional parameters should be acknowledged, both of which relate to the extent of substantive protection provided by investment treaties. I do not consider the role that general exceptions in investment treaties play in qualifying states’ obligations or the role that the public international law doctrine of necessity plays in precluding wrongfulness of breaches of investment treaties that occur in emergency situations. I have excluded general exceptions on the grounds that only a handful of investment treaties contain such provisions.²⁰ I have excluded the doctrine of necessity on the basis that this doctrine is applicable only in a narrow set of emergency situations.²¹ Nevertheless, it would be relatively straightforward to use the framework developed in Chapter 3 to evaluate the costs and benefits of including exceptions to various levels of substantive protection.

¹⁹ Some commentators have distinguished ‘legal rules’ from ‘legal standards’, arguing that ‘rules’ are defined with a greater precision than ‘standards’, e.g., Ortino, ‘Refining the Content and Role of Investment “Rules” and “Standards”: A New Approach to International Investment Treaty Making’ (2013) 28 ICSID Review, p. 153. In this book, I do not adopt this distinction. Variation in the precision with which a rule/standard is drafted is a matter of degree. In the context of debate about investment treaty protections, there is little value in attempting to determine the point at which an increasingly imprecise ‘rule’ could be said to become a ‘standard’. For this reason, I use the term ‘legal rules’ on the understanding that such rules may be drafted with varying degrees of precision.


²¹ International Law Commission, Draft Articles of the International Law Commission art. 25.
1.2.4 Evaluation from a general, impartial perspective

Chapter 6 evaluates each of the levels of protection identified in Chapters 4 and 5 from a general, impartial perspective. By ‘general’, I mean that different levels of protection are evaluated on the basis that they would be included in a range of investment treaties involving many differently situated states. This general perspective contrasts with the perspective one would adopt when determining the level of protection that should be provided by one particular investment treaty, considered in isolation. In such an exercise, the specific characteristics of the state parties to the treaty under consideration would assume greater importance. By ‘impartial’, I mean that all the costs and benefits associated with a given level of protection are considered. This impartial perspective differs from the self-interested perspective of a given actor (for example, a particular state), where the focus would be limited to the costs and benefits that affect the actor in question.

There are several justifications for the ‘general’ perspective adopted in this book. The first concerns the practicalities of the negotiation and application of investment treaties. Most existing state practice is driven by model investment treaties – template negotiating positions devised by a state and then offered to several other states. This practice is unsurprising. Tailoring the level of protection provided by each individual investment treaty to the particular characteristics of the partner state(s) in question would complicate efforts to negotiate and comply with investment treaties enormously. As such, views about the level of protection that should be provided across treaties involving many differently situated states drive existing treaty practice.

The second justification is that at the time a state negotiates an investment treaty, it cannot predict with certainty the types of investments that will qualify for protection under the treaty during the period it remains in force or the range of regulatory actions that the state may wish to adopt during this period. This is not to say that states are unable to make any predictions about the future of a given investment relationship. When negotiating with the Democratic Republic of Congo, the United States may be able to predict that it is likely to remain a net capital exporter over the coming decades. My point is that it would be unwise to evaluate the terms of any prospective investment treaty solely through the lens of

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the investment relationship between the states at the time the treaty is signed. If a state is to bind itself with respect to an uncertain range of regulatory actions that may affect an uncertain set of future investments, it makes sense to reflect in more general terms on the merits of offering investment protection.

Two more justifications flow from the structure of investment treaties themselves. Many investment treaties contain most favoured nation (MFN) clauses. An MFN clause allows foreign investors covered by one investment treaty to rely on higher levels of protection conferred by another treaty. For this reason, states will need to consider the possibility that an unusually high level of protection offered in any given investment treaty may become generalised by being made available to foreign investment covered by another investment treaty. Moreover, several investment treaties have been interpreted as providing protection to investors of the corporate nationality of the home state. For this reason, states will need to consider the possibility that the level of protection offered under any given investment treaty will become generalised by being made available to investors that structure investments through corporate intermediaries in the ‘home’ state.

A final justification is of a different character, as it concerns the relationship of this book to existing academic debate. The vast majority of academic writing treats the existing network of investment treaties as a single field of academic inquiry. More than one commentator has described this network as constituting a ‘regime’; another has argued that, in many respects, these treaties ‘function analogously to a truly multilateral system’. Without going so far as to endorse these claims, it is clear that the academic literature regards the set of existing investment treaties as raising common legal and policy issues. I share this premise.

The justifications for the ‘impartial’ perspective adopted in this book are less numerous but equally compelling. The primary justification is

23 Schill, The Multilateralization of International Investment Law, p. 140.
25 CME v. Czech Republic, Partial Award, para. 6; Tokios Tokeles v. Ukraine, Decision on Jurisdiction, para. 38.
26 Schill, The Multilateralization of International Investment Law, p. 199.
27 E.g., Dolzer and Schreuer, Principles of International Investment Law (2nd edn); Salacuse, The Law of Investment Treaties, p. 5.
29 Schill, The Multilateralization of International Investment Law, p. 15.
normative: legal rules should not be evaluated solely on the extent to which they benefit one actor; all costs and benefits should be considered. These premises are foundational in scholarship concerned with the normative evaluation of legal rules. The majority of existing scholarship on investment treaties also appears to take these premises as given – for example, they underpin scholarship arguing that investment treaties should balance competing interests.

There are also important pragmatic justifications for adopting an impartial perspective. An impartial perspective approximates the shared perspective of the states that are party to any investment treaty. For this reason, consensual negotiations between well-informed state parties should converge towards mutually beneficial levels of protection that maximise net benefits overall. Moreover, arbitral tribunals are obliged to interpret investment treaties in light of the shared purpose of the treaty parties, as embodied in the treaty. Thus, the impartial perspective adopted in this book is practically relevant to both the negotiation and interpretation of investment treaties.

A further justification concerns the perspective of states that are both sources and recipients of foreign investment. Even when negotiating a single BIT, the self-interest of such states will tend towards levels of protection that are desirable from an impartial perspective. The current trend towards multilateralism amplifies this effect. From the perspective of any one state, a multilateral investment treaty is more likely to cover relationships with both states with which it is a net capital importer and a net capital exporter. As Alvarez has argued:

More countries than ever before are, like the PRC [People’s Republic of China] and the United States, capital exporters as well as capital importers. The position of such countries in the investment regime might be said to approximate that of the individual in John Rawls’ ‘original position’, that is, someone who is placed behind a veil of ignorance and does not know the social or economic position she occupies within society and is therefore incentivized to articulate principles of justice that are fair to all.

The impartial perspective adopted in this book is akin to that of an ‘original position’ analysis in that it is not addressed to the self-interest of a particular state.

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31 See Section 2.5. 32 See Section 7.3.1.1.