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Introduction

Arbitration based on investment treaties is undergoing a crisis, with many states pulling out of such arbitration.[1] Some are leaving out investor–state dispute settlement from their treaties.[2] Others are seeking to change the terms of the investment treaties, the bases of investment arbitration, so that investment protection is no longer the sole object of such treaties. The new treaties seek to preserve some regulatory space over foreign investment so as to enable them to control investments in the public interest. Other states have suspended making such treaties. Investment arbitration has seen a dramatic increase in recent years. The extent of the disenchantment caused by awards in the area, which many states feel go beyond the consent they had given the tribunals, must be explained. The resistance that has resulted is not confined to states, but extends to non-governmental organizations (NGOs), such as environmental and human rights groups. These groups believe that exclusive investment protection works to the detriment of other interests, such as the protection of human rights, the environment, cultural interests and indigenous tribal interests. This book seeks to offer an explanation of the changes that have resulted from such resistance, the reasons for such resistance and their outcomes. It examines what the future course of the law in the area should be.

A feature of investment arbitration in the last two and a half decades has been the dramatic increase in the number of arbitral awards under

[1] Many Latin American states have pulled out of such arbitration. Venezuela, Ecuador and Bolivia have terminated their links with the International Centre for the Settlement of Investment Disputes. Many have announced that they will not conclude any more investment treaties, including South Africa, India and Indonesia.

[2] Australia announced such a policy, but has since recanted after the change of government. Leon Trakman, 'Investor–State Arbitration: Evaluating Australia's Evolving Position', (2014) 15(1) *Journal of World Trade Law* 152. The Philippines–Japan investment treaty does not contain an investor–state dispute settlement provision. In Japan, there has been much discussion as to whether such dispute resolution should be permitted, particularly in relation to the projected Trans Pacific Pact that is being negotiated.

investment treaties.[3] The specific year in which this explosion in treaty-based investment arbitration began can be identified as 1990. It was the year in which *Asian Agricultural Products Ltd (AAPL)* v. *Sri Lanka*[4] was decided. In that award, jurisdiction was invoked for the first time on the basis of the investor–state dispute settlement provision in an investment treaty. Since then, the majority of awards have been based on this manner of invocation of jurisdiction to settle claims of violation of the standards of protection of investment in the treaties. The impact of this development has been such that texts written on investment arbitration virtually ignore the existence of contract-based arbitration of foreign investment disputes, the older and still extant variety of investment arbitration.[5] The specialist arbitral institution for investment disputes, the International Centre for the Settlement of Investment Disputes (ICSID), set up in 1965, was designed with contract-based arbitration in mind.[6] But its workload is now largely confined to disputes arising from the violation of

[3] An investment treaty was usually made between a capital-exporting developed state and a capital-importing developing state, assuring protection on the basis of defined standards to foreign direct investment made by nationals and payment of compensation in the event of nationalizations. The recent treaties contain a commitment to provide unilateral recourse to arbitration to the investor in the event of a dispute. Increasingly, treaties, usually regional treaties, contain developed state partners grouped with developing states. The law is moving away from its North–South axis. Developed states often become respondents in such arbitrations, a relatively new phenomenon.

[4] (1990) 4 ICSID Rep. 245.

[5] Campbell McLachlan, Laurence Shore and Mathew Weininger, *International Investment Arbitration: Substantive Principles* (Oxford University Press, 2008). Texts on international investment law concentrate almost exclusively on investor–state arbitration as a distinct phenomenon (Christoph Schreuer and Rudolf Dolzer, *International Investment Law*, 2nd edn (Oxford University Press, 2012)). There is a spate of literature on aspects of investment treaty arbitration. For a survey of this literature, see Stephan Schill, 'Whither Fragmentation? On the Literature and Sociology of International Investment Law', (2011) 22 *European Journal of International Law* 888. A text by the present author, however, sees the law as a part of general international law and as involving other considerations besides investment protection. Muthucumaraswamy Sornarajah, *International Law on Foreign Investment* (Cambridge University Press, 1992) (its later editions are 2nd edn 2004, 3rd edn 2010).

[6] The ICSID was created in 1965 by the Convention for the Settlement of Disputes between States and Nationals of Other States (1965). The meagre caseload of the Centre from its inception to 1990 until treaty-based arbitration commenced, was based on contracts. This caseload was low. For a history of the Convention, see Antonio Parra, *The History of ICSID* (Oxford University Press, 2012). As Parra pointed out, the possibility of treaty-based consent to future arbitration was discussed during the drafting conferences on the Convention. By the end of 2013, the investment cases had reached over 568. UNCTAD, *World Investment Report* (Geneva, 2014), p. 124.

investment treaties. The award in *AAPL* v. *Sri Lanka*,[7] made in 1990, identified the possibility of appropriately worded dispute settlement clauses in investment treaties as constituting indefinite offers by the host state to foreign investors of the treaty partner.[8] Such wording in investment treaties has now become commonplace. These offers could be converted into binding commitments to arbitrate. A request for arbitration would be regarded as an acceptance of the offer to arbitrate by the foreign investor. Such acceptance would create jurisdiction in the arbitration tribunal.[9] The technique triggered off a spate of investment treaty arbitrations in the succeeding years. Initially, the treaties made reference only to the ICSID, but later treaties made reference of disputes to ad hoc tribunals using UNCITRAL Rules, and to other arbitral tribunals.[10] ICSID, however, being a specialist centre dealing with disputes between foreign investors and states, has continued to attract the larger number of cases.[11]

[7] (1990) 4 ICSID Rep. 245. The final award was made on 27 June 1990. The view that offers of arbitration could be made to potential investors through domestic investment laws and that jurisdiction in arbitral tribunals could be created through the acceptance of these offers was stated in *Southern Pacific Properties Ltd (SPP)* v. *Egypt*, ICSID, Case No. ARB/84/3(30 May 1992). Yet none of the commentators on the British treaties made around the time identified that investment treaties had made such a momentous change, enabling an individual or a corporation to bring a state to arbitration. Two commentators participated in the negotiation of the British treaties. Eileen Denza and Shelagh Brooks, 'Investment Protection Treaties: The United Kingdom Experience', (1987) 36 *International & Comparative Law Quarterly* 908. Francis Mann, a distinguished international lawyer, wrote another. Francis Mann, 'British Treaties for the Promotion and Protection of Foreign Investments', (1981) 52 *British Yearbook of International Law* 241. Neither commentary refers to the momentous change, if a change was in fact intended. The *travaux preparatoires* of the UK–Indonesia treaty, which was made public recently under the thirty-year rule of releasing public documents previously kept secret, does not indicate that such a result was intended.

[8] The silence was not confined to British authors. Though treaties containing similar articles on dispute resolution had existed in US treaties for some time, no writer or arbitral award had suggested that such a course of securing jurisdiction purely on the basis of the treaty statement was a possibility. Some identify the first treaty containing investor–state arbitration as the investment treaty between Indonesia and the Netherlands made in 1968. By the 1980s they had become commonplace. Yet the interpretation that they would support a unilateral recourse to arbitration by the foreign investor had to await *AAPL* v. *Sri Lanka* (1990) 4 ICSID Rep. 245, which did not contain a reasoned analysis of the position. It is difficult to explain this time lapse as to why unilateral recourse to arbitration, which if it did exist as suggested, was not resorted to until 1990.

[9] For a fuller consideration of this technique, see Chapter 3.

[10] An UNCTAD study indicated that fifty-eight arbitrations were brought in 2012, the highest per year so far. In 2013, fifty-six cases were initiated. *World Investment Report* (Geneva, 2014), p. 124

[11] See at: https://icsid.worldbank.org.

There are several significant factors that took place in the relatively short period of a decade in the 1990s, which was a period of intense activity in this field. First, the number of investment treaties rose from around 500 in 1990 to 2,700 by 2000. The number of bilateral investment treaties is currently over 3,236.[12] Secondly, the number of investment arbitrations, particularly arbitrations under investment treaties, rose dramatically during the decade and the trend continues. Thirdly, three distinct efforts at multilateral agreements on investments were made during this period.[13] All of them failed, but the fact is that there was a general belief in the possible success of the outcome such that efforts were attempted in quick succession within a span of ten years. The prevalent view was that a climate favourable to the making of multilateral rules on investment protection existed. Fourthly, the large number of arbitral awards under the treaties was regarded as having generated sufficient 'law' on principles of investment protection through treaties, so much so that books could be written on the basis of such 'law' as if a regime of investment protection had come into existence.[14] The different awards sought to expand significantly the scope of the treaties well beyond the intention of the states parties to the treaties. Some regard these awards as creating law through precedent. They speak in terms of constancy in arbitral jurisprudence.[15] Others question the legitimacy of the generation of law through means of precedent in investment arbitration.[16] Such questioning, however, occurred much later. During the 1990s, there was

[12] These figures are given in UNCTAD, *World Investment Report* (Geneva, 2014), p. 124. Forty-four treaties were terminated in 2014.

[13] First, the World Bank discussed such a code, but settled on guiding principles. Secondly, the OECD produced a draft of the Multilateral Agreement on Investment. Effort on the draft was abandoned due to states withdrawing from discussions in 1998. Thirdly, an instrument on investment under WTO was attempted, but these efforts were abandoned by 2000.

[14] Jeswald Salacuse, *The Law of Investment Treaties* (Oxford University Press, 2010); Jeswald Salacuse, 'The Emerging Global Regime for Investment', (2010) 51 *Harvard International Law Journal* 463; Jose Alvarez, *The Public International Law Regime Governing International Investment* (The Hague: Hague Academy of International Law, 2011); Karl Sauvant and Frederico Ortino, *Improving the International Law Policy Regime* (Helsinki: Ministry of Foreign Affairs, 2014).

[15] Christoph Schreuer and Mathew Weininger, 'A Doctrine of Precedent?' in Peter Muchlinski *et al.* (eds.), *Oxford Handbook of International Investment Law* (Oxford University Press, 2008), p. 1188.

[16] It is unlikely that there could be a constancy in jurisprudence simply because the treaty formulations are different. In *AES Corp.* v. *Argentina*, ICSID, Case No. ARB/02/17 (26 April 2005), the tribunal, following the Law of the Sea Tribunal, held that even the same provisions in different treaties need not produce the same interpretation, as the

almost a free rein for the expansion of treaty-based investment arbitration. There were efforts to expand both the bases of jurisdiction under the treaties as well as the substantive law under the treaties through interpretation of their terms. The expansion of jurisdiction, as well as the expansion of the scope of the substantive principles in the treaties, necessarily caused discomfort to states. They had not anticipated such a course. Fifthly, over the course of time, but well after the end 1990s, disenchantment resulted with the system that had been created, resulting in a diversity of reactions from states, with some pulling out of investment arbitration altogether.[17] Often, there has been resistance to the rules that had been made in arbitral awards both by states, by arbitrators disinclined towards expansionary interpretations and by other interest groups, which stressed the importance of factors extraneous to the treaty, such as human rights, environmental protection and sustainable development. The nature of the investment treaties began to change. The newer treaties purport to be balanced treaties, seeking to reflect a resolution of the conflict between the interest of investment protection and the interest of the host state in regulating in the public interest. Some states

treaty balances differ. This is a strong argument against the treaties generating customary international law. Irene Ten Cate, 'The Costs of Consistency: Precedent in Investment Treaty Arbitration', (2013) 51 *Columbia Journal of Transnational Law* 418.

[17] In April 2007, at the 5th Summit Meeting of the Bolivarian Alliance for the Americas (ALBA), Nicaragua, Bolivia and Venezuela announced that they would withdraw from ICSID 'in order to guarantee the sovereign right of states to regulate foreign investment on their territories'. Ecuador joined ALBA and denounced ICSID. South Africa has announced that it will not renew investment treaties that have lapsed and has suspended its treaty programme. India is drafting a new model treaty that will reduce the nature of protection to foreign investment considerably. This follows the award in *White Industries* v. *India*, UNCITRAL (30 November 2011) (Brower, Rowley, Lau) where the delays in Indian courts formed the focal points of the award. Since then, there have been new disputes submitted to arbitration on the basis of the decisions of the Indian Supreme Court. Courts in South Korea and Brazil have discussed the constitutionality of the treaties. The Philippines has not signed treaties with investor–state arbitrations in the recent past. Its FTA with Japan left out the section on investor–state dispute settlement. Thailand seems to have formed negative views of investment treaties after the award in *Walter Bau* v. *Thailand*, UNCITRAL, Award (1 July 2009) (Barker, Lalonde, Bunnag). Norway has not been able to get its model treaty accepted as its balanced approach did not please all stakeholders. Norway has discontinued negotiating new treaties. In South Korea, an arbitration involving the insurance company, Lone Star, in which the general public have small investments, has caused considerable public disquiet. Yet new treaties are still being negotiated. China has made a treaty with Canada and is negotiating one with the United States. The Trans Pacific Pact, a treaty between several Pacific states, including the United States, Canada and Australia, is also being negotiated with an investment chapter.

also showed a disinclination to accept arbitral awards. They have contested them through available annulment procedures.[18] Argentina has resisted enforcement of awards on various legal grounds. Attempts to seize Argentinian property for enforcement purposes have failed largely on the ground of sovereign immunity.[19] One of the Argentine awards was not enforced by the US Court of Appeal for not fulfilling the waiting period of eighteen months prior to arbitration as required by the treaty.[20] But the Supreme Court overruled the decision by a narrow majority. Argentina continues to resist enforcement despite pressure.

UNCTAD stated its displeasure with the system of investment arbitration as follows:[21]

> the public discourse about the usefulness, legitimacy and deficiencies of the investor–state dispute settlement mechanism is gaining momentum, especially given that the ISDS (Investor–State Dispute Settlement) mechanism is on the agenda in numerous bilateral and regional IIA (International Investment Agreement) negotiations. While reform options abound, their systematic assessment, including with respect to their feasibility, expected effectiveness and implementation method (e.g., at the level of international investment agreements, arbitral rules, institutions) remains wanting.

Commenting on the Bolivian withdrawal from ICSID arbitration in 2008, a leading scholar remarked that 'the future of investment arbitration is by no means certain'.[22] Since then, events have made this future even more shaky.

[18] Argentina has sought annulment of all awards made against it.

[19] The Law of the Sea Tribunal ordered that an Argentinian naval training ship seized in Ghana for the purposes of enforcing an arbitral award be released on the ground of sovereign immunity. *The Hindu*, 16 December 2012. The United States excluded Argentina in 2012 from the list of countries given trade preferences as a measure against non-enforcement.

[20] Argentina also resisted the enforcement of the award in the *BG Group* Award before the US courts. See *Argentina* v. *BG Group plc*, US Ct. App. DC Cir. (18 January 2012) (setting aside a US$185 million UNCITRAL award, which allowed the investor to commence arbitration without recourse to domestic courts in Argentina for eighteen months). The court said that arbitrators did not have power to decide whether investors could ignore the requirement. The Supreme Court overruled the decision by a narrow majority. Interestingly, in *ICS Inspection and Control Services Ltd* v. *Argentina*, UNCITRAL Ad hoc Arbitration (10 February 2012), the Tribunal rejected jurisdiction on the ground of non-satisfaction of the negotiation period.

[21] UNCTAD, IIA Issue Note, No. 1 (May 2013), p. 26.

[22] Christoph Schreuer in his introduction to August Reinish and Christina Knahr (eds.), *International Investment Law in Context* (Oxford University Press, 2008).

Non-governmental organizations, interested in the impact of foreign investment on human rights, the environment and other areas, have shown concern over the impediments imposed by investment treaties on states to regulate harmful activity of foreign investors. Public anxiety has been caused as a result of huge damages awarded against states by investment tribunals.[23] Substantial disquiet exists as to the utility of investment treaty arbitration. There is an evident clash of distinct forces arraigned on different sides. One force, consisting of large multinational corporations, the law firms that advise them, their home states, large financial institutions providing investment funds, third-party funders of investment arbitration whose new business depends on investment arbitration and arbitrators inclined towards a policy of investment protection pulled the law towards inflexible investment protection on the ground that it catered to the interests of all concerned, including the developing host states, as foreign investment generally promoted economic development. The other force, supported by states affected by expansionary interpretation in arbitral awards, NGOs, arbitrators not inclined towards interpretations based solely on the policy of investment protection, and international lawyers opposing fragmentation of their discipline pulled it towards the recognition of competing regulatory interests of protection of the environment, human rights and other public interests such as health and welfare. Disputes arose which evidenced these clashes. Absolute investment protection clashed with the right to water,[24] the protection of health being affected by smoking,[25] the protection of cultural sites,[26] the protection of the rights of indigenous people,[27] the right to medicine[28] and global rights recognized by public international

[23] The award in *Occidental* v. *Ecuador* was for US$1.9 billion. Vulture funds which bought the awards against Argentina have refused to settle, raising the possibility of another bankruptcy in Argentina. *The Guardian*, 24 June 2014.

[24] *Aguas del Tunari SA* v. *Republic of Bolivia*, ICSID Case No. ARB/02/3 (21 October 2005); *Suez* v. *Argentina*, ICSID Case No. ARB/03/19 (30 July 2010); *Vivendi Universal* v. *Argentina*, ICSID, Case No. ARB/97/3 (20 August 2007); *Biwater Gauff* v. *Tanzania*, ICSID, Case No. ARB/05/22 (29 September 2006).

[25] *Philip Morris Brands Sarl* v. *Uruguay*, ICSID, Case No. ARB/10/7, Decision on Jurisdiction (2 July, 2013) (Bernadini, Born, Crawford); *Philip Morris* v. *Australia*, UNCITRAL PCA, Case No. 2012-12 (2012).

[26] *Parkerings-Compagniet AS* v. *Lithuania*, ICSID, Case No. ARB/05/8, Award (11 September 2007) (Levy, Lew, Lalonde).

[27] *Chevron* v. *Ecuador*, UNCITRAL PCA, Award (31 August 2011) (Bockstiegel, Brower, Van den Berg).

[28] *Apotex Inc.* v. *United States*, UNCITRAL (NAFTA), Jurisdiction (2013) (Landau, Smith, Davidson).

law. Each of these rights were espoused by different NGOs and people's pressure groups while the arbitrations were ongoing. The emergence of NGOs as actors in the field of investment law brought a countervailing power to that of multinational corporations into the field. There was also a strong pressure from within public international law to end the fragmentation of the subject by accommodating within it other principles of international law beside inflexible investment protection. These principles were increasingly concerned with issues relating to the environment, human rights and related interests. They militated against developing investment law through insulation from general principles of international law in such a manner as to accentuate a preferred objective of investment protection without heeding other international interests. In the face of such resistance, changes had to occur. These developments and the changes they provoked, which took place in a relatively short period, need an explanation.

One purpose of this book is to examine the course of developments that took place in a relatively short span of around twenty-five years, and to give explanations for the changes that took place in a rapidly evolving area of international law. It seeks an explanation in terms of the context in which the law operated, the economic and philosophical underpinnings of the important movements within the law, and the principal interests that clashed within the law. In the process, it also attempts to identify the manner in which changes take place in international law. The international law on foreign investment has hitherto been developed in a fragmented fashion, probably because of the fact that it served the specific purpose of investment protection. The strategy was to isolate it from its moorings in international law so that the focus could be on investment protection, and not on the other areas of international law that also affected the foreign investment process. To achieve the purpose of inflexible investment protection, it was necessary to keep the area insulated from other areas of international law so that the purpose of investment protection could not be diluted by other considerations. This study seeks to end the fragmented approach and to argue that the subject of investment protection under investment treaties is subject to international law principles. The solutions reached under it must always be accommodated within the general discipline of international law.

It also seeks to provide an explanation as to why the law veered out of course during the period of the last decade of the twentieth century. Explanations for this phenomenon may be sought within the law as most prefer, but the argument pursued in this work is that the explanations

have to be sought outside the law as well. It suggests that the law was driven by the power of ideological changes that came about, particularly as to the structuring of the international and domestic markets. In that sense, the argument is that a set of rules came to be promoted by leading states with the instrumental purpose of ensuring the building of a law that advanced the prescriptions of an ideological preference towards the liberalization of markets, trade and investment. The view has often been taken that the decade in question was dominated politically by a single hegemonic power upholding the ideal of democratic governance as the political model, and advancing the preference for a neoliberal economic structure in which market mechanisms determined outcomes and self-corrected defects.[29] The absence of regulatory controls over market forces was a distinct feature of domestic legal systems of the period, particularly in the major developed states. This preference was transferred to the international sphere through a package of norms that reflected an ideological preference that came to be referred to as neoliberalism. In international law, this instrumental use was reflected in the expansive rule-making through arbitration to serve the ideological preference for inflexible protection of foreign investment. Neoliberalism, it is argued, becomes the central thrust behind the law that was put in place during this period.

As a prelude to the work, the next few sections of this chapter identify the primary factors that affected the law involved in investment arbitration. Section 1.1 explains how the tenets of neoliberalism were transferred into the law in the form of normative prescriptions. These were the basis on which some arbitrators made expansionist interpretations of treaty provisions. Section 1.2 demonstrates that changes that took place in the law depended on external political and economic factors, so that the changes that are taking place can be seen as a continuum of the past. Section 1.3 looks at the factors that have led to change in this area of the law and the phases of the change. Within this section, there is an examination of the clash between the aim of conserving the changes made during the neoliberal phase and the aim of change through resistance to the objectives of neoliberalism. Section 1.5 identifies the objectives to be achieved in the work. They set the background for the rest of the work, which expands on the points made, explains the resulting disenchantment with the system and suggests alternative solutions to

[29] Francis Fukuyama, *After the Neocons: America at the Crossroads* (New York: Profile Books, 2006).

the problems created by the process. Sections 1.6 and 1.7 detail the contents of the chapters that are to follow.

1.1 Neoliberalism as a driving factor

The beginning of the 1990s witnessed the triumph of capitalism over communism after the dissolution of the Soviet Union. The Soviet Union had kept much of Eastern Europe bound to Russia and Russian communism since the end of the Second World War. During the Cold War between the Soviet Union and the United States, the two powers competed for influence in the rest of the world. They sought to spread their ideologies to other states. They created spheres of influence. The Cold War ended with the fall of the Berlin Wall in November 1989.[30] Communism, as a competing ideological force to democracy and the free market, also fell. This was trumpeted as signalling the need to organize the world on the basis of the twin philosophies of political democracy and the market-based organization of economic activity.[31] They were the twin ideologies left standing after the fall of communism. The new thinking manifested itself on international law in many ways. In the political sphere, new doctrines justifying the imposition of democracy, even by military intervention, came to be articulated. Scholarly effort was invested in the study of the influence of the single hegemonic power on the shaping of international law.[32] In the economic sphere, the preference was for the neoliberal philosophy for the ordering of both the domestic and the international economy on the basis that the market will be able to distribute resources and order economic activity more

[30] The Berlin Wall was built in August 1961 to prevent East Germans fleeing from communist rule into West Germany. Its sudden destruction symbolized the fall of communism.

[31] Francis Fukuyama, *The End of History and The Last Man* (London: Penguin, 1992); Michael Mandelbaum, *The Ideas that Conquered the World: Peace, Democracy and the Free Markets in the Twenty-First Century* (New York: Public Affairs, 2002). Fukuyama's book must have had a short shelf life as events transpired. Within six years, with the global economic crisis in 2008, the free-market ideology came to be questioned. Fukuyama was to regret his earlier, triumphant book in 2006 when he wrote *After the Neocons*. Two years later, there was the global economic crisis.

[32] Michael Byers and George Nolte (eds.), *United States Hegemony and the Foundations of International Law* (Cambridge University Press, 2003); Amy Bartholomew (ed.), *Empire's Law: The American Imperial Project and the War to Remake the World* (London: Pluto Press, 2006); Richard Burchill (ed.), *Democracy and International Law* (London: Ashgate, 2006); Shirley Scott, *International Law, US Power: The United States' Quest for Legal Security* (Cambridge University Press, 2013).