



UvA-DARE (Digital Academic Repository)

In Defense of International Investment Law

Schill, S.W.B.

Published in:

European Yearbook of International Economic Law 2016

DOI:

[10.1007/978-3-319-29215-1_13](https://doi.org/10.1007/978-3-319-29215-1_13)

[Link to publication](#)

Citation for published version (APA):

Schill, S. W. (2016). In Defense of International Investment Law. In M. Bungenberg, C. Herrmann, M. Krajewski, & J. P. Terhechte (Eds.), *European Yearbook of International Economic Law 2016* (pp. 309-341). (European Yearbook of International Economic Law; No. 7). Cham: Springer. https://doi.org/10.1007/978-3-319-29215-1_13

General rights

It is not permitted to download or to forward/distribute the text or part of it without the consent of the author(s) and/or copyright holder(s), other than for strictly personal, individual use, unless the work is under an open content license (like Creative Commons).

Disclaimer/Complaints regulations

If you believe that digital publication of certain material infringes any of your rights or (privacy) interests, please let the Library know, stating your reasons. In case of a legitimate complaint, the Library will make the material inaccessible and/or remove it from the website. Please Ask the Library: <http://uba.uva.nl/en/contact>, or a letter to: Library of the University of Amsterdam, Secretariat, Singel 425, 1012 WP Amsterdam, The Netherlands. You will be contacted as soon as possible.

1. Introduction

Not even a decade ago, international investment law and investor-state dispute settlement (ISDS) were considered to be “exotic and highly specialized knowledges.”¹ It was the ambit of a relatively small group of *conoscenti* who, with the exception of the handful of academics in public international law involved, had their principal background in the practice of international commercial arbitration in large transnational law firms in Paris, London, Stockholm, New York, or Washington D.C. By now, investment law has moved mainstream. It has boomed in academia (scholarship and teaching) and international dispute resolution,² and has become a subject of general public debate, chiefly in connection with the negotiation of mega-regionals, such as the Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP).³

From a democratic perspective, this is a positive development given that international investment agreements (IIAs) do not only deal with technical issues,⁴ but are relevant for society at large. It is cases, such as Vattenfall challenging Germany’s nuclear power phase-out under the Energy Charter Treaty,⁵ Philip Morris challenging plain-packaging of cigarettes in Australia under the Hong Kong-Australia bilateral investment treaty (BIT),⁶ and Lone Pine Resources tackling a ban on fracking in Quebec under the North American Free Trade Agreement (NAFTA),⁷ that show how investment law can touch on general public interests and affect core aspects of domestic law-and-policy-making. Consequently, IIAs should be developed in transparent and democratic procedures, strike a fair balance between investment and non-investment concerns, leave states sufficient policy space to pursue public policies, and ensure that the resolution of

¹ Koskenniemi M (2006) Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law. Report of the Study Group of the International Law Commission, International Law Commission, UN Doc A/CN.4/L.682, http://legal.un.org/ilc/documentation/english/a_cn4_l682.pdf (last accessed 28 September 2015). para. 8.

² For the mainstreaming of investment law in academia and dispute resolution see Schill (2011b); Schill and Tvede (2015).

³ This is most emblematically reflected in the online public consultation on investment on investment protection and investor-to-state dispute settlement (ISDS) in the Transatlantic Trade and Investment Partnership Agreement (TTIP) the European Commission conducted from 27 March to 13 July 2014, which elicited close to 150,000 replies, many of which were however submitted collectively through online platforms of opponents of ISDS that contained pre-defined answers. See Report of the European Commission, Commission Staff Working Document, SWD (2015) 3 final, 13 January 2015, http://trade.ec.europa.eu/doclib/docs/2015/january/tradoc_153044.pdf (last accessed 28 July 2015).

⁴ This is how IIAs were often regarded by governments negotiating and parliaments ratifying the treaties. In fact, under-politicisation of the content and effect of investment treaties is a recurring theme in the study conducted by Poulsen L (2011) *Sacrificing Sovereignty by Chance: Investment Treaties, Developing Countries, and Bounded Rationality*. PhD Thesis, London School of Economics, http://etheses.lse.ac.uk/141/1/Poulsen_Sacrificing_sovereignty_by_chance.pdf (last accessed 29 September 2015).

⁵ *Vattenfall AB and others v. Federal Republic of Germany*, ICSID Case No. ARB/12/12 (registered 31 May 2012).

⁶ *Philip Morris Asia Limited (Hong Kong) v. The Commonwealth of Australia*, UNCITRAL, Notice of Arbitration (21 November 2011).

⁷ *Lone Pine Resources Inc. v. The Government of Canada*, UNCITRAL, Notice of Arbitration (6 September 2013).

investment disputes conforms to accepted standards of the rule of law. At the same time, it must be recognised that the protection of investors is not only a private, but equally a public interest.⁸

The burgeoning public debate notwithstanding, the long-lasting niche-existence of the field and little public knowledge about the principal actors in investment dispute settlement has created an aura of obscurity and suspicion. It is therefore hardly surprising that criticism of IIAs and ISDS is vocal and seemingly dominant in the public discourse. Critics are found in political parties from across the democratic spectrum, non-governmental organisations, civil society networks, and academia. Relying on the backlash in state practice, including the retreat of some countries from the existing system and the wide-spread recalibration of investment disciplines,⁹ they have characterised investment law as facing a deep “legitimacy crisis”.¹⁰ Only more recently have supporters of international investment law undertaken more extensive steps in trying to rebalance the public debate and reclaiming argumentative grounds in defense of the system.¹¹

As Kate Miles’ article shows, there are plenty critical points, including the lack of transparency, problems with the independence of arbitrators, the existence of inconsistent and incoherent decision-making, and the concern whether IIAs leave states sufficient policy space for regulating in the public interest. Miles correctly summarises these concerns and pulls them together as arising from the tension between a private law-inspired dispute settlement mechanism and its public interest implications.¹² At the same time, Miles also acknowledges that many concerns are already being addressed on an incremental basis.¹³ Thus, modern, ‘recalibrated’ IIAs take pains to clarify treaty standards and introduce appropriate exceptions in order to ensure policy space to protect public interests; arbitration rules are being reformed in order to ensure transparent proceedings and allow participation of affected third parties; and a number of reform initiatives, at the regional and multilateral level, are under way that aim at building a system that better meets the requirements for fair and democratic dispute settlement under the rule of law. Moreover, there may even be renewed interest in a more institutionalised investment dispute settlement system, with the possible creation of an appeals mechanism or even a permanent investment court, as recently suggested by the European Commission.¹⁴ Overall, these are welcome developments

⁸ Thus, states protect and promote foreign investment in order to further their own policy goals, including the transfer of technology, the creation of employment, economic growth, and other development interests through instruments under domestic and international law. For an overview see UNCTAD (2012) *World Investment Report 2012: Towards a New Generation of Investment Policies*.

http://unctad.org/en/PublicationsLibrary/wir2012_embargoed_en.pdf, (last accessed 15 October 2015), p. 97 ff.

⁹ See Michael Waibel et al. (2010).

¹⁰ Brower and Schill (2009), p. 473 (with further references).

¹¹ See, for example, Brower and Blanchard (2014); Brower et al. (2013), p. 3; Schwebel (2015).

¹² Miles (2016), section 1. In my own explanation of the criticism, I go a step further and read it as stemming from a clash between domestic constitutional values –democracy, the rule of law, and human or fundamental rights- and the basic institutional structures of ISDS. This framing helps not only to see better why investment law is facing such strong headwind, but also allows to draw parallels to the legitimacy debates, and possible solutions to it, that surround other forms of global governance rather than debates about the legitimacy of international commercial arbitration. See Schill (2015a) and Schill (2011a).

¹³ Miles (2016), sections 3.1 and 3.2. For further analysis of the changes IIAs and ISDS are undergoing see the contributions in Hindelang and Krajewski (2016).

¹⁴ See European Commission, Press Release: Commission Proposes new Investment Court System for TTIP and Other EU Trade and Investment Negotiations, 16 September 2015, http://europa.eu/rapid/press-release_IP-15-

as the lack of transparency and the dismissive attitude of large parts of the arbitration community towards critical voices have understandably raised doubt as to whether arbitration is a suitable mechanism to settle what are, in essence, public and not private law disputes.¹⁵

The current reform efforts notwithstanding, Kate Miles remains critical of international investment law and ISDS. She castigates the hegemonic nature and pedigree of investment law in imperialism and in the post-imperialist contractions of decolonisation and goes on record as a critic of “recent attempts to frame investor-state arbitration as a mode of global administrative law, an instrument of good governance, and a purveyor of the rule of law.”¹⁶ Unfortunately, she does not elaborate in depth on any of these intriguing points. What she concentrates on instead as being the core of her continued criticism are two issues. First, there is the option for investors, even under reformed IIAs, to bring “public welfare-related claims” that “encroach in some form on government policy space.”¹⁷ This concerns the justification of investor access to ISDS regardless of the results of individual disputes. Second, Miles casts doubts on whether arbitration, due to the socialisation and composition of the arbitration bar, is well-placed to resolve investment disputes and to further develop investment law in a manner consonant with the public interest.¹⁸

While I agree with Miles’ identification of the legitimacy concerns investment law is facing as a system of global governance,¹⁹ I differ with her on a number of points. First, and most importantly, investment law, and particularly individual access to ISDS, fulfils an important function in subjecting international investment relations to the rule of law, to the benefit of investors, states, and their populations (Part II). Second, my assessment of the power the ‘arbitration community’ has in the present system is fundamentally different. Rather than being able to shape investment law at will, arbitrators are subject to various mechanisms of state control; this ensures that arbitral jurisprudence can develop, and in fact develops, in ways that are intended by states (Part III). In addition, rather than having given short thrift to non-economic public interests, arbitrators regularly make use of interpretative techniques that are sovereignty-friendly and respectful of public interests (Part IV). Finally, I disagree with Miles that the cases she portrays as particularly problematic (*Vattenfall*, *Philip Morris*, and *Bilcon*), are pathologies of the system. Rather than representing illegitimate encroachments on policy space, I consider them as involving legitimate disputes about the relationship between private rights and governmental powers in a global economy that are appropriate for being resolved in an international forum (Part V). All of this leads me to a generally positive assessment of the basic structures of IIAs and ISDS that should be defended against criticism, but that nonetheless can benefit from further reform for which the criticism can serve as a catalyst (Part VI).

[5651_en.htm](#) (last accessed 15 October 2015). For a succinct overview over the most recent reform debates and options more generally see UNCTAD (2015) World Investment Report 2015: Reforming International Investment Governance. http://unctad.org/en/PublicationsLibrary/wir2015_en.pdf (last accessed 28 September 2015), p. 119 ff. See further, inter alia, the contributions in Kalicki and Joubin-Bret (2015).

¹⁵ On the public nature of investment law see Schill (2010), p. 10 ff.

¹⁶ Miles (2016), section 1.

¹⁷ Miles (2016), section 1.

¹⁸ Miles (2016), section 1.

¹⁹ See Schill (2011a, 2015a).

2. International Investment Law and Investor-State Dispute Settlement and the Rule of Law

In her account of international investment law and ISDS, Kate Miles remains silent on the consequences of the criticism she formulates. She deconstructs and points to biases and blind spots, but leaves us without a hint on how a better world of investor-state relations and investment dispute settlement would look like. Would she suggest to get rid of the current system? To reform it, and, if so, along which path? Should we return to state-to-state dispute settlement? Or domestic courts? It is unfortunate that she leaves these questions unanswered, as evaluating alternatives to the present system is important for a considered assessment of the pros and cons of the status quo. Doing so explains why IIAs and ISDS have developed in the first place and why the system carries structural benefits that are worth preserving. These benefits relate to the function of IIAs and ISDS to subject international investment relations to the rule of law.

Under a rule of law focus, individual access to ISDS should not be seen as an encroachment on government policy space, as Miles suggests, but as a form of judicial review that enables investors to have the legality of government action under international law controlled by independent and impartial institutions. As such, ISDS responds to the fundamental rule of law postulate found in international human rights law and many domestic constitutions²⁰ that government action must be reviewable as to its legality by independent and impartial adjudicatory institutions. In this perspective, ISDS is a form of granting access to justice,²¹ which helps to ensure compliance of states with principles contained in IIAs. These principles, in turn, are not overly onerous. They either parallel restrictions governments regularly face under their own constitutional laws or are necessary for integrating national economies into a global economic space. They include the obligation not to discriminate against foreign investors in comparison to nationals or third-party nationals, not to treat them unfairly and inequitably, not to expropriate them without compensation, and to protect them against other government interference that is contrary to the rule of law. In addition, IIAs require free transfer of capital in respect of the investment and, more recently, also provide, albeit subject to a considerable number of exceptions, for market access and investment liberalisation.

What a rule of law perspective considers as a matter of accountability under legal standards can also be looked at in economic terms.²² From this perspective, the availability of access to ISDS transforms IIAs from political declarations into readily enforceable promises. ISDS, in other words, makes government promises to foreign investors in IIAs credible.²³ This reduces the

²⁰ See, for example, *Golder v. United Kingdom*, Judgment (21 February 1975), ECHR Series A No. 18, paras. 28–36 (interpreting Article 6(1) of the European Convention on Human Rights to grant a right to access to justice); Basic Law of the Federal Republic of Germany, Article 19(4); Constitution of the Italian Republic, Article 24; Spanish Constitution, Section 24(1); Political Constitution of the Republic of Chile, Article 20. On access to justice under international law see also the contributions in Francioni (2007).

²¹ Cf. *Lithgow and Others v United Kingdom*, ECtHR (Application No 9006/80, Series A102), Decision (8 July 1986) para. 201 (where the European Court of Human Rights held that Member States could comply with their obligation under Article 6(1) ECHR to provide access to justice by submitting disputes to an arbitral tribunal provided that the principles of fair trial and due process are guaranteed).

²² The following discussion draws on Schill (2015c), pp. 628–633.

²³ Cf. Schwartz and Scott (2003), pp. 556–562.

political risk of foreign investment, lowers the risk premium connected to it, and makes foreign investment projects more cost-efficient to the benefit of investors, host states, and, as products and services offered become cheaper, their populations.²⁴ Certainly, the credibility of commitments of the host state is not only a matter of the availability of dispute settlement mechanisms. Reputation, community pressure, the moral obligation to keep promises, or host states' self-interest to be seen as reliable, may also contribute to states living up to promises made in IIAs.²⁵ Yet, such mechanisms sometimes work imperfectly because states can benefit by reneging on promises made after an investor has made its investment, for example, by imposing additional obligations or even expropriating the investment without compensation.²⁶ For host states to make credible commitments, a mechanism to uphold their original promises, such as independent third-party dispute settlement in courts or arbitration, is necessary.²⁷

Mechanisms to settle disputes between foreign investors and host states that fulfil the rule of law requirement of access to justice can be set up at the domestic and/or the international level. However, host state courts are often not well-positioned to enforce governments' promises vis-à-vis foreign investors. Often these courts are not, or are not perceived to be, sufficiently neutral in resolving disputes with their own governments. Sometimes, independent courts that administer justice efficiently are missing altogether. Sometimes, corruption and lengthy court proceedings may frustrate efforts to hold host states accountable in domestic courts.²⁸ While such problems are often encountered in the domestic courts of developing and transitioning countries, well-developed legal systems are not exempt from similar concerns.²⁹ In respect of Germany, to take my home jurisdiction as an example, the European Court of Human Rights (ECtHR) has handed down various judgments deciding that the length of court proceedings was contrary to the 'reasonable time'-requirement in Article 6(1) of the European Convention on Human Rights

²⁴ See Jandhyala and Weiner (2014) (showing that IIAs reduce the premium for political risk that would make foreign investment projects more costly). It is less clear, however, whether investment treaties on the whole are able to attract additional foreign investment. There is an increasing amount of studies on this topic, with diverging results. Contrast only Tobin and Rose-Ackerman (2009) (finding a positive correlation between investment agreements and investment flows) with Aisbett (2009) (negating a correlation between investment agreements and investment flows). In more recent and refined studies, however, evidence is becoming more robust that there is a positive correlation between investment agreements and the inflow of foreign investment. See, for example, Berger et al. (2012); Bütthe and Milner (2014) (with further references).

²⁵ Particularly on reputation as a mechanism to induce States' compliance with their obligations under international law see Guzman (2008), pp. 71-117.

²⁶ The underlying change in the incentive structure after one party has started performing or placed an asset under the control of the other party is also described as a hold-up problem. See Williamson (1985), p. 52 ff. See also Guzman (1998), p. 658 ff.; for a game-theoretic reconstruction see Cooter and Ulen (2004), p. 195 ff.

²⁷ Cf. Elkins et al. (2006), pp. 823-824.

²⁸ On corruption in the judiciary see Buscaglia and Dakolias (1999); Dakolias and Thachuk (2000). For the length of some court proceedings in the Member States of the Council of Europe see European Commission for the Efficiency of Justice, Length of Court Proceedings in the Member States of the Council of Europe Based on the Case Law of the of the European Court of Human Rights, December 2006, <http://siteresources.worldbank.org/INTLAWJUSTINST/Resources/CEPEJCourtDelayEnglishUPDATED.doc> (last accessed 17 October 2013).

²⁹ For a commonly cited example of a court in a developed legal system engaging in biased and discriminatory conduct vis-à-vis a foreign investor see *Loewen Group, Inc. and Raymond L. Loewen v. United States of America*, IC-SID Case No. ARB(AF)/98/3, Award (26 June 2003).

(ECHR).³⁰ The Court even determined that overly long court proceedings and the inexistence of a domestic remedy at the time constituted a “systemic problem” in the German legal system.³¹

Yet, domestic courts may not only in fact fail to provide efficient access to justice. Sometimes, there are legal barriers, such as access restrictions for foreigners. In Germany, to stay with my example, domestic law contains significant restrictions for foreigners concerning access to justice. While access to general courts is unrestricted, Germany’s Basic Law (i.e., the German Constitution) excludes foreign juridical persons from the enjoyment of fundamental rights and hence excludes their access to the German Constitutional Court.³² In other countries, certain government measures may be completely exempt from domestic judicial review, such as those that constitute ‘political questions’ under the jurisprudence of the US Supreme Court, including in matters touching upon foreign economic policy.³³ In again other countries, such as Australia, obligations arising under international law, including those granted in an IIA, may not be enforceable in domestic courts due to their inapplicability within the domestic legal order.³⁴ In all of these cases, not providing for access to an international forum would effectively frustrate the enforcement of standards granted in IIAs against non-compliant governments and therefore fall short of the rule of law requirement to access to justice.

Another option for the enforcement of IIA disciplines, and granting access to justice, would be international courts and tribunals. In existing international courts, however, investors face limitations as regards standing. Instead of being able to pursue claims independently, only their respective home state is able to espouse a claim through diplomatic protection.³⁵ Apart from the potential to cause rifts in inter-state relations, this has a number of significant drawbacks for efficient access to justice: First, the exercise of diplomatic protection is at the discretion of home states – they can, but do not have to, take up their national’s claim; second, home states exercise exclusive control over the rights of their nationals on the international level³⁶ and can settle, waive or modify them;³⁷ third, the entitlement to receive compensation for the violation of international law is not vested in the alien, but in the home state – home state can, but does not have

³⁰ See, amongst others, *Süremeli v Germany*, ECtHR (Application No 75529/01), Decision (8 June 2006), para. 134; *Kressin v Germany*, ECtHR (Application No 21061/06), Decision (22 December 2009), para. 26; *Spaeth v Germany*, ECtHR (Application No 854/07), Decision (29 September 2011), para. 42.

³¹ *Rumpf v Germany*, ECtHR (Application No 46344/06), Decision (2 September 2010), paras. 64 ff.

³² Under Article 19(3) of the German Basic Law, foreign corporations cannot rely on fundamental rights granted in the Constitution. There is an exception, however, for juridical persons from other Member States of the European Union (EU) who can invoke their rights of non-discrimination under EU law to claim equal treatment with German juridical persons, and hence access to the Constitutional Court. See BVerfGE 129, 78, 97ff (German Constitutional Court, 19 July 2011).

³³ For an overview over the jurisprudence of the US Supreme Court and lower federal courts in the US see. Cole J (2014) The Political Question Doctrine: Justiciability and the Separation of Powers, Congressional Research Service Report No. R43834, <https://www.fas.org/sgp/crs/misc/R43834.pdf> (last accessed 28 July 2015), pp. 10-12, 15-19.

³⁴ See French (2015), pp. 159–161.

³⁵ See *The Mavrommatis Palestine Concessions (Greece v. Britain)*, Judgment (30 August 1924), PCIJ Series A, No. 2 (1924), 12. See generally on diplomatic protection Amerasinghe (2008).

³⁶ See *Barcelona Traction, Light and Power Company, Limited (Belgium v. Spain)*, Judgment (5 February 1970), ICJ Reports 1970, 42, para. 70.

³⁷ In practice, this has led to the settlement of international claims concerning the violation of the rights of foreigners by lump-sum agreements. See Lillich and Weston (1975); Weston et al. (1999).

to pass on the compensation to those who have actually suffered harm;³⁸ and, finally, diplomatic protection is subject to the exhaustion of local remedies.³⁹ While the latter requirement affords host states an opportunity to review and remedy their conduct, it brings the shortcomings of domestic courts back into the picture. Existing international courts dealing with investment disputes at an inter-state level are therefore hardly a viable option for the effective enforcement of IIA standards and granting access to justice to affected investors. Conversely, a return to inter-state enforcement of IIAs may also bring power-relations between states that are reminiscent of gun-boat diplomacy, and therefore contravene the idea of the rule of law, back into international investment relations.⁴⁰

Contractual solutions for dispute resolution, including alternative means for settling disputes, such as conciliation or mediation, that some suggest as an alternative,⁴¹ also have considerable drawbacks in respect of access to justice under the concept of the rule of law. Above all, they are only available to investors with sufficient negotiating power. While large-scale investment contracts have always contained arbitration, choice of law, stabilisation, or internationalisation clauses, small- or medium-sized investors, who play an important part in foreign investment relations, often lack the necessary bargaining power to negotiate such protections. Moreover, contractual solutions are unavailable to investors that make their investments based on a country's general investment legislation. For them, reaching agreement with the host state on non-domestic dispute settlement will be difficult once a dispute has arisen. In such cases, treaty-based arbitration clauses are the only fall-back option to hold host states efficiently accountable and therefore fulfilling rule of law ideals for investor-state relations.

In sum, ISDS compensates for a number of limitations that may exist for foreign investors under domestic law, other instruments of international law, and contracts as regards access to justice as a requirement of the concept of the rule of law. In many cases, domestic courts in developing and developed countries will not be able, for the reasons discussed above, to ensure the comprehensive and neutral enforcement of IIA disciplines.⁴² Existing international courts would not be sufficient either. As a consequence, proposals to limit access to ISDS by foreign investors should be analysed critically and assessed in light of the question of whether alternatives are able to serve not only the interests of host states in preserving policy space, but also the interest in holding states accountable for compliance with obligations contained in IIAs under the concept of the rule of law.

³⁸ Borchard (1915), pp. 356-359, 383-388; Hagelberg (2006), p. 51. Home states are therefore under no obligation to pass the compensation on to those investors that have actually suffered the harm.

³⁹ See Amerasinghe (2005); Cancado Trindade (1983).

⁴⁰ See Johnson and Gimblett (2012).

⁴¹ Public Statement on the International Investment Regime, 31 August 2010, <http://www.osgoode.yorku.ca/public-statement-international-investment-regime-31-august-2010/> (last accessed 28 July 2015), para. 10; see also Yackee (2008).

⁴² Certainly, the situation of investors behaving opportunistically and attempting to renege on their original promises also exists. However, the host state as a sovereign actor does not depend on dispute settlement mechanisms to make investors comply with his or her obligations, but can typically react to such conduct by unilaterally imposing sanctions. The states' ability to impose and enforce decisions unilaterally is also the deeper justification for having a unilateral right of recourse for foreign investors. It is a corollary and no more than a modest limitation on host state sovereignty.

Certainly, a newly created international court in which investors have direct access to enforce IIA disciplines would be an alternative, but such a court, while recently discussed in various quarters⁴³ does not yet exist, and it is highly uncertain whether it will ever come into existence. For the moment, investor-state arbitration is therefore the only viable option to grant access to justice to foreign investors and to allow enforcement of IIA disciplines in a neutral forum. This notwithstanding, ISDS is not immune from criticism. On the contrary, viewing it as an instrument furthering the rule of law requires that investor-state arbitration itself, and those serving as arbitrators, have to be faithful to the requirements of the rule of law. However, unlike critics, I have faith that arbitrators are able to live up to high rule of law standards and fulfil the expectations commonly vested in adjudicatory institutions that administer justice and control the exercise of public authority. This requires that arbitrators orient their decision-making towards administering justice in accordance with the idea of the rule of law and with sufficient respect for competing public interests. That they can, and in many cases already do so, is what the next section will address.

3. Mechanisms of State Control of Arbitration

Kate Miles' criticism of the international investment regime not only stems from its institutional structure involving a right of action of foreign investors against government conduct at the international level; it is closely connected to her assessment of the sociological consequences choosing arbitration to settle investor-state disputes has on how public interests are dealt with. In her view, the sociological composition of the arbitration bar is responsible for interpretations of IIA standards, conduct of hearings, and drafting of awards that show an "apparent reluctance to address adequately non-investment issues within awards and a lack of appreciation of the distinct character of ISDS from that of international commercial arbitration."⁴⁴ It is the cultural context that arbitration brings with it in the resolution of investor-state disputes that Miles views as a fundamental problem for the protection of public interests in the international investment regime. Echoing other critical voices in the field, she suggests that ISDS is subject to capture by a small group of particularly influential arbitrators that have preponderant influence on how the law is applied and further developed.⁴⁵

The point I take issue with here is not that many of those who regularly sit as arbitrator have a commercial arbitration mind-set. I have criticised this myself and advocated that more attention should be paid to both public international and comparative public law in order to make the in-

⁴³ See the European Commission's proposal for a permanent TTIP Tribunal, European Commission, Press Release: Commission Proposes New Investment Court System for TTIP and Other EU Trade and Investment Negotiations, 16 September 2015, http://europa.eu/rapid/press-release_IP-15-5651_en.htm (last accessed 15 October 2015). See further UNCTAD (2015) World Investment Report 2015: Reforming International Investment Governance. http://unctad.org/en/PublicationsLibrary/wir2015_en.pdf, (last accessed 28 September 2015), p. 152.

⁴⁴ Miles (2016), section 1.

⁴⁵ See the discussion of the community of investment arbitrators in Miles (2016), section 2.2. For other particularly critical views of how a small group of arbitrators allegedly captured the investment field see Eberhardt P, Olivert C (2012) Profiting from Injustice: How Law Firms, Arbitrators and Financiers Are Fuelling an Investment Arbitration Boom, Corporate Europe Observatory and the Transnational Institute, <http://www.tni.org/profitfrominjustice.pdf> (last accessed 29 July 2015), pp. 35-55; Sornarajah (2015), pp. 27-28.

ternational investment regime more legitimate, produce better and fairer results, provide more convincingly reasoned decisions, and ensure regard for competing non-investment concerns and public policies.⁴⁶ I also do not cast into doubt that the investment arbitration community has developed its own epistemic, or interpretive culture,⁴⁷ and that that community's core of repeatedly appointed arbitrators is particularly influential in further developing international investment law.⁴⁸ What I take issue with in Kate Miles' account is the suggestion that a certain commercial mind-set of arbitrators is a given and cannot be changed, that states have little possibilities for changing it, and that in consequence arbitrators, rather than states dominate the system. What Miles disregards, in my view, are the control mechanisms states have at their disposal to ensure that arbitrators stay within their mandate and develop the law in line with states' expectations.

First, it is important to see that investment treaty arbitrators are not self-entitled, neither individually nor as a group, nor is the legal basis upon which the resolution of investor-state disputes rests removed from state control. On the contrary, arbitrators derive their power to adjudicate and decide individual disputes from the choice of the parties to IIAs. It is states that chose to provide for the possibility to settle investment disputes by means of arbitration between foreign investors and host states; it is states that provided for the choice of arbitrators by investors and states as disputing parties. Furthermore, in their appointment decisions disputing parties are not limited to certain individuals or members of a specific group, but are free to choose anybody as arbitrator who meets the necessary standards of independence and impartiality. Thus, the decisions arbitral tribunals produce, the way they interpret IIA standards, and the attention they give to non-investment concerns, is not an unavoidable consequence of a specific *esprit des corps* of the arbitration community, but results from the choices of contracting parties to IIAs. It is states who tailor the contours of investment dispute settlement, not arbitrators. For example, arbitral rules can be tailored, as is actually the case with the most-used rules in investor-state disputes, namely the rules applicable pursuant to the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (ICSID Convention),⁴⁹ to ensure that the majority of arbitrators on individual tribunals can trace their appointments either directly to the respondent state's consent, or are indirectly legitimised through the consent given by contracting states of the ICSID Convention to the appointing authority, which is the Chairman of ICSID's Administrative Council, and to the individuals nominated by states as members of ICSID's List of Arbitrators.⁵⁰ Similarly, it is states, not arbitrators, who crafted the applicable law under IIAs. States,

⁴⁶ See Schill (2010).

⁴⁷ On the influence of epistemic communities on interpretation see Karton (2013); see further Waibel (2015).

⁴⁸ The structure of the community of investment arbitrators and their influence on how investment disputes are decided is the subject of a number of recent empirical sociological studies. See Franck et al. (2015); Pauwelyn J (2015) WTO Panelists Are from Mars, ICSID Arbitrators Are from Venus – Why? And Does It Matter?

<http://dx.doi.org/10.2139/ssrn.2549050> (last accessed 29 July 2015); Puig (2014). Earlier studies include Kapeliuk (2010); Fontoura Costa (2011); Waibel M, Wu Y (2011) Are Arbitrators Political? Working Paper, <http://www.wipol.uni-bonn.de/lehrrveranstaltungen-1/lawecon-workshop/archive/dateien/waibelwinter11-12> (last accessed 29 September 2015).

⁴⁹ Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (adopted 18 March 1965, entered into force 14 October 1966) 575 UNTS 159.

⁵⁰ Pursuant to Article 37(2) ICSID Convention the respondent state has to agree to a sole arbitrator deciding the dispute (lit a) or, in addition to appointing one arbitrator at will, agree to the president of the Tribunal (lit b). Failing such agreement, the Chairman of the Administrative Council shall appoint the presiding arbitrator after consulting

in other words, are the actors responsible for creating international investment law and ISDS and controlling its further development.

Second, it is crucial to note that the power of arbitral tribunals is limited to an individual case. This one-off nature of arbitration increases the influence of states over the dispute settlement process as compared to a permanent international court, concomitantly reducing the power of arbitrators. Although arbitral tribunals, through the use of precedent, contribute to the further development of international investment law, there is no institutional rationale for them to do so that is comparable to that of a permanent international court, which would strive for interpretive hegemony. Santiago Montt designates the underlying logic of the investment arbitration system as a “BIT lottery”,⁵¹ arguing that states had no interest in creating a permanent investment court because that would have increased the risk of such a court going in the wrong direction in interpreting vague IIA standards. Instead, states deliberately risked incoherence by opting for arbitration in order to reduce systemic effects of individual decisions. If, for example, the decision in *Bilcon v. Canada*, as Miles argues,⁵² is incorrect, it is less likely to perpetuate itself in a system of one-off arbitration as compared to a system that is subject to the jurisdiction of a permanent international court or appellate body.

Furthermore, the state’s influence in the appointment of arbitral tribunals arguably brings arbitrators closer to domestic democratic processes than judges in permanent international courts who are appointed for a term of several years, are empowered to hear an indeterminate number of cases, and are subject to complex inter-governmental bargains about positions in international organisations.⁵³ Likewise, the ratio of party-appointed *ad hoc* judges to permanent members is smaller (for example, 1 to 15 or 16 in the International Court of Justice) than in a three-member tribunal where one out of three members has been directly appointed by the state and the presiding arbitrator may also have its consent. This is a democratic advantage of international arbitration over permanent international courts that is often disregarded.

Third, the appointment system in investor-state arbitration also ensures on the long-term that arbitrators have an interest in settling investment disputes and further developing investment law in ways that are consistent with the expectations of states parties to IIAs. Unlike critics who argue that arbitrators as a group, independently of whether they are usually investor- or state-

both parties (Article 38 ICSID Convention). In making appointment choices, the Chairman is limited to individuals that Member States have nominated to be included in the List of Arbitrators (see Article 40(1) ICSID Convention. Other arbitration rules frequently applied in investment treaty arbitrations, such as the United Nations Conference on International Trade Law (UNCITRAL) Arbitration Rules (the revised version of 2010, and the latest version of 2013 incorporating the UNCITRAL Rules on Transparency for Treaty-Based Investor-State Arbitration are available at http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/2010Arbitration_rules.html (last accessed 29 July 2015) or the Rules Governing the Additional Facility for the Administration of Proceedings by the Secretariat of the International Centre for Investment Disputes (ICSID Additional Facility Rules) (latest version effective as of 10 April 2006) reprinted in ICSID Additional Facility Rules, Document ICSID/11, April 2006, https://icsid.worldbank.org/apps/ICSIDWEB/icsiddocs/Documents/AFR_English-final.pdf (last accessed 30 July 2015) are slightly more complicated, but they can be applied so as to ensure that states face a majority on the arbitral tribunal that they are comfortable with or that is legitimised through appointment by a truly neutral appointment authority in a process in which the state party participates.

⁵¹ Montt (2009), p. 157.

⁵² Miles (2016), section 4.

⁵³ For this argument see Schill (2015b), p. 4.

appointed, have an interest in rendering investor-friendly decisions because only investors can bring future claims that may result in reappointments.⁵⁴ I see the reappointment system as functioning in the reverse fashion. Assuming (with critics) that all arbitrators have an interest in being reappointed, and therefore assuming that they have an incentive to align their decision-making and interpretative methods, including the extent of policy space they grant, with the interests of those actors that keep the system running, it is states, and not investors, that are relevant for ensuring the long-term viability of international investment law. It is states, and not investors, that can make, and in fact have made, use of their treaty-making powers, their powers to terminate investment treaties, and their powers of interpretation, to bring change to the system. What is more, they could, if they choose to do so, even bring down the system altogether. It is therefore states, not investors, upon whom the long-term viability of the system depends.

Given that states have crafted ISDS as a mechanism for the neutral resolution of investment disputes, arbitrators not only have an incentive to be independent and impartial, but also to adapt their decision-making to changing expectations, including the increasing respect for what states parties to IIAs consider as part of their public interests. What these interests are can be brought to the attention of arbitral tribunals through the submission of respondent states and of the non-disputing state party.⁵⁵ The reappointment process for arbitrators can therefore function as a mechanism by means of which states can implement changes among the group of decision-makers and their prevalent thinking. Accordingly, what some perceive as a fundamental flaw in system-design, namely dispute settlement by one-off arbitral tribunals, could be viewed as a gateway for change and adaptation to outside criticism, rather than a threat to the legitimacy of ISDS. In the end, it is the parties themselves, in particular states, who are not only responsible for the jurisprudence arbitral tribunals produce and the sociological composition of the core group of investment arbitrators that are particularly influential in further developing investment law, but are also in a position to use their appointment powers to change the sociological composition of those who serve as arbitrators, as well as their treaty-making powers to adapt the legal bases for resolving investor-state disputes.

Finally, ISDS does not take place in a void, but is embedded in a functioning system of separation of powers between arbitrators as adjudicators and contracting states as legislators. States are not at the mercy of arbitral interpretations of IIA standards, but retain influence over the way tribunals further develop international investment law. Apart from their powers to terminate, modify, and amend IIAs, they can influence arbitral jurisprudence, and correct arbitral interpretations they disagree with, through joint interpretations, which are binding on tribunals pursuant to Art. 31(3)(c) of the Vienna Convention on the Law of Treaties.⁵⁶ Such interpretations have at times occurred in the investment treaty context and been generally respected by arbitral tribunals. Binding interpretations by the Free Trade Commission (FTC) under NAFTA, a treaty organ

⁵⁴ For this argument see Van Harten (2007), p. 167 ff.; Van Harten (2010).

⁵⁵ Some IIAs provide expressly for the possibility of non-disputing party submissions; see eg Article 10.20.2 of the Dominican Republic–Central America–United States Free Trade Agreement (CAFTA-DR), <https://ustr.gov/trade-agreements/free-trade-agreements/cafta-dr-dominican-republic-central-america-fta/final-text> (last accessed 15 October 2015). Yet, even in the absence of such an explicit provision, tribunals are generally able to suggest such submissions, and in practice have done so (see eg *Aguas del Tunari, S.A. v. Republic of Bolivia*, ICSID Case No. ARB/02/3, Decision on Respondent’s Objections to Jurisdiction (21 October 2005), paras. 45–49).

⁵⁶ See further on the impact of states’ interpretations of IIAs, Roberts (2010).

mandated *inter alia* for this purpose, are probably the prime example for how arbitral tribunals can be embedded into a functioning separation of powers framework.⁵⁷ Another example of a joint interpretation⁵⁸ are the diplomatic notes Argentina and Panama exchanged after the jurisdictional decision in *Siemens v. Argentina*⁵⁹ in order to clarify that the most-favoured-nation clause in their BIT would not apply to more favourable access conditions granted under the host state's third-country BITs along the lines first set out in *Maffezini v. Spain*.⁶⁰

All in all, through the appointment and reappointment of arbitrators, the parties to individual disputes, and amongst them predominantly states, exercise control over arbitral tribunals and are able to influence the future direction of arbitral jurisprudence. Similarly, states' powers to terminate and renegotiate IIAs, as well as to issue joint interpretations allow states to limit the systemic effects of arbitral decisions they disagree with. All of this shows that states retain power to ensure a fair balance between investment and non-investment concerns within the existing system and are not at the mercy of arbitral discretion. Instead, states in investment treaty arbitration receive what they have bargained for and are able to continuously monitor, and react to imbalances of that bargain.

4. Arbitral Tribunals and Their View of Public Interests

Turning away from the institutional relations between states and arbitral tribunals, it is also difficult to see how a commercial mind-set prevails in the practice of investment treaty arbitration and operates to the detriment of public interests. Not only does Miles not mention actual examples of cases that she considers have incorrectly cut short non-investment concerns or reduced host states' regulatory power to protect them; she also gives short thrift to the long string of cases in which arbitral tribunals expressly have recourse to what I call public law thinking and public law rationales in order to interpret IIA standards in ways that are respectful of non-investment concerns, thus granting states considerable leeway to pursue what they consider to be in their public interests. The existence of these cases casts doubt on the argument that the commercial-mindedness of the arbitral community has undue impact on the interpretation of IIAs to the detriment of public interests.

One example of an argumentative technique that has its root in public law thinking which arbitral tribunals frequently use in order to take account of non-investment concerns in the inter-

⁵⁷ The FTC has issued an Interpretive Note through which the interpretation of fair and equitable treatment under NAFTA was tied to customary international law and that infused transparency into the decision-making of arbitral tribunals. See NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions, 31 July 2001, http://www.sice.oas.org/tpd/nafta/Commission/CH11understanding_e.asp (last accessed 30 July 2015). Arbitral tribunals have, with some initial quarrels as to whether interpretations should affect ongoing proceedings, accepted and followed that interpretation. Most recently see *Clayton and others and Bilcon of Delaware, Inc. v. Government of Canada*, UNCITRAL (NAFTA), Award on Jurisdiction and Liability (17 March 2015), paras. 432–433.

⁵⁸ This incident is reported in *National Grid plc v. The Argentine Republic*, UNCITRAL, Decision on Jurisdiction (20 June 2006), para. 85.

⁵⁹ See *Siemens AG v. The Argentine Republic*, ICSID Case No. ARB/02/8, Decision on Jurisdiction (3 August 2004), paras. 82–110.

⁶⁰ *Emilio Agustín Maffezini v. The Kingdom of Spain*, ICSID Case No. ARB/97/7, Decision of the Tribunal on Objections to Jurisdiction (25 January 2000), paras. 38–64.

pretation of investment treaty standards, thereby safeguarding host states' policy space is recourse to proportionality balancing.⁶¹ Already early on, the Tribunal in *Tecmed v. Mexico* was strongly influenced by the jurisprudence of the ECtHR on the First Optional Protocol to the ECHR when adopting the Court's proportionality test in order to determine when state measures turn from a regulation not requiring compensation into a compensatory indirect expropriation.⁶² The Tribunal's point of departure was 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."⁶³ Only measures that interfered with foreign investment to achieve a public purpose in a disproportionate manner would require compensation.⁶⁴ Alternatively, discriminatory action or the existence of specific commitments given to the foreign investor that the government would refrain from such regulation could also trigger compensation.⁶⁵ Applied in this way, proportionality reasoning helps to achieve a balance between the interest of the affected investor and the public interest that is to be protected by the host state's measure in question.

Yet, proportionality analysis is not limited to the expropriation context. It is increasingly also used by arbitral tribunals when applying the concept of fair and equitable treatment. For example, far from constituting an absolute and fixed threshold that government conduct cannot pass without incurring liability, the Tribunal in *Saluka v. Czech Republic* considered that "[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."⁶⁶ Under this reasoning, fair and equitable treatment does not prohibit changes to the regulatory framework in place; it only requires that host states give due consideration to the position of investors and weigh the importance of the continuation of a specific regulatory framework against the benefits and need for change. All in all, as this interpretation shows,

⁶¹ For more in-depth discussion of the principle of proportionality in investment treaty arbitration see Bücheler (2015); Kingsbury and Schill (2010); Stone Sweet (2010); Leonhardsen (2012); Henckels (2012).

⁶² See *Tecnicas Medioambientales Tecmed S.A. v. United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award (29 May 2003), paras. 113-122.

⁶³ *Tecnicas Medioambientales Tecmed S.A. v. United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award (29 May 2003), para. 119.

⁶⁴ *Tecnicas Medioambientales Tecmed S.A. v. United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award (29 May 2003), para. 122 (stating that one needed to "consider, in order to determine if [the interferences] are to be characterised 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").

⁶⁵ See *Methanex Corporation v. United States of America*, UNCITRAL (NAFTA), Final Award of the Tribunal on Jurisdiction and Merits (3 August 2005) Part IV, ch D, para. 7 ("In the Tribunal's view, Methanex is correct that an intentionally discriminatory regulation against a foreign investor fulfils a key requirement for establishing expropriation. But 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.").

⁶⁶ *Saluka Investments B.V. v. Czech Republic*, UNCITRAL, Partial Award (17 March 2006), para. 306.

fair and equitable treatment does not immunise investors from regulatory changes unless host states have made specific promises to the contrary.⁶⁷

Most recently, the Tribunal in *Occidental v. Ecuador* applied the principle of proportionality to determine the legality of a revocation of an operating license by the host state and expressly placed it into a comparative public law context:

The application of the principle of proportionality may be observed in a variety of international law settings, including cases in which the proportionality of countermeasures taken in trade disputes is challenged before a WTO Panel under the General Agreement on Tariffs and Trade (“GATT”).

On the application of proportionality generally in the context of administrative action, the most developed body of jurisprudence is in Europe. It is very well-established law in a number of European countries that there is a principle of proportionality which requires that administrative measures must not be any more drastic than is necessary for achieving the desired end. The principle has been adopted and applied countless times by the European Court of Justice in Luxembourg, and by the European Court of Human Rights in Strasbourg.

Against that background, the Tribunal observes that there is a growing body of arbitral law, particularly in the context of ICSID arbitrations, which holds that the principle of proportionality is applicable to potential breaches of bilateral investment treaty obligations.⁶⁸

These decisions are not exceptions. Rather there is a more general trend to use proportionality balancing as a method to bring public interest considerations into the interpretation of IIA standards.⁶⁹ While proportionality analysis itself raises concerns as to its legal basis and the power it confers on arbitral tribunals, what is important for present purposes is that in practice arbitral tribunals by no means one-sidedly decide disputes in favour of foreign investors, nor disregard competing non-investment concerns.

⁶⁷ For another example that fair and equitable treatment does not suppress the host state’s power to legislate in the public interest see *Parkerings-Compagniet AS v. Republic of Lithuania*, ICSID Case No. ARB/05/8, Award (11 September 2007), para. 332 (stating that “[i]t is each State’s undeniable right and privilege to exercise its sovereign legislative power. A State has the right to enact, modify or cancel a law at its own discretion. Save for the existence of an agreement, in the form of a *stabilisation* clause or otherwise, there is nothing objectionable about the amendment brought to the regulatory framework existing at the time an investor made its investment. As a matter of fact, any businessman or investor knows that laws will evolve over time. What is prohibited however is for a State to act unfairly, unreasonably or inequitably in the exercise of its legislative power.”).

⁶⁸ *Occidental Petroleum Corporation and Occidental Exploration and Production Company v. The Republic of Ecuador*, ICSID Case No. ARB/06/11, Award (5 October 2012), paras. 402–404.

⁶⁹ See *MTD Equity SDN BHD and MTD Chile S.A. v. Republic of Chile*, Award (25 May 2004), para. 109; *Azurix Corp. v. The Argentine Republic*, ICSID Case No. ARB/01/12, Award (14 July 2006), para. 311; *Fireman’s Fund Insurance Company v. The United Mexican States*, ICSID Case No. ARB(AF)/02/01, Award (17 July 2006), para. 176(j); *LG&E Energy Corp, LG&E Capital Corp, LG&E International Inc. v. Argentine Republic*, ICSID Case No. ARB/02/1, Decision on Liability (3 October 2006), para. 194; *BG Group Plc. v. Republic of Argentina*, UNCITRAL, Final Award (24 December 2007), para. 298; *National Grid P.L.C. v. Argentine Republic*, UNCITRAL, Award (3 November 2008), para. 175; *Joseph C. Lemire v. Ukraine*, ICSID Case No. ARB/06/18, Decision on Jurisdiction and Liability (14 January 2010), para. 285; *Total S.A. v. The Argentine Republic*, ICSID Case No. ARB/04/1, Decision on Liability (27 December 2010), paras. 123 and 197; *El Paso Energy International Company v. The Argentine Republic*, ICSID Case No. ARB/03/15, Award (31 October 2011), paras. 241–243 and 373; *Deutsche Bank AG v. Democratic Socialist Republic of Sri Lanka*, ICSID Case No. ARB/09/2, Award (31 October 2012), para. 522; cf. also *Antoine Goetz & Consorts et S.A. Affinage des Metaux v. Republique du Burundi*, ICSID Case No. ARB/01/2, Sentence (21 June 2012), para. 258.

Moreover, as an argumentative technique proportionality reasoning is typical for public law thinking; its use therefore illustrates a clear break with commercial law thinking that has long prevailed in investment arbitration. Through this and similar public law argumentation, tribunals ensure policy space for host states to determine and implement what they determine to be in their public interest. In addition, proportionality analysis also serves as a tool to coordinate and reconcile IIA disciplines with obligations under other international treaties, whether for the protection of the environment, human rights, or rights of indigenous people.⁷⁰

In addition to recourse to proportionality reasoning, tribunals also secure that states have sufficient policy space to pursue public interests through various doctrines of deference, that is, restrictions in the depth of review of government conduct.⁷¹ The Tribunal in *S.D. Myers v. Canada* perhaps most clearly caught the different dimensions of deference when it stated that investment treaty tribunals:

d[o] not have an open-ended mandate to second-guess government decision-making. Governments have to make many potentially controversial choices. In doing so, they may appear to have made mistakes, to have misjudged the facts, proceeded on the basis of a misguided economic or sociological theory, placed too much emphasis on some social values over others and adopted solutions that are ultimately ineffective or counterproductive. The ordinary remedy, if there were one, for errors in modern governments is through internal political and legal processes, including elections.⁷²

Likewise, the Tribunal in *Tecmed v. Mexico* observed that, in determining whether a regulatory act constituted an indirect expropriation,

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 ... whether such measures are reasonable with respect to their goals, the deprivation of economic rights and the legitimate expectations of who suffered such deprivation.⁷³

While there is not yet a uniform line of reasoning, nor a uniform standard of deference applied by arbitral tribunals, tailoring the standard of review is a wide-spread technique arbitral tribunals use to ensure that states dispose of sufficient room for manoeuvre in implementing public policies to protect non-investment concerns. What is more, just as proportionality reasoning, recourse to deference and similar concepts indicating a reduced standard of review reflects public law and public international law thinking, thus constituting a clear break with commercial law-inspired techniques of interpretation and dispute resolution.⁷⁴

Finally, there is a notable move in investment treaty arbitration more generally to interpret IIA standards against the benchmark of comparative public law. While this development is only

⁷⁰ See van Aaken (2009), pp. 502–506; Schill (2012a).

⁷¹ For more in depth discussion see Schill (2012b); Burke-White and von Staden (2010a); Burke-White and von Staden (2010b); Henckels (2012). For a different reading of arbitral decisions as not showing sufficient restraint see Van Harten (2013).

⁷² *SD Myers, Inc v Canada*, UNCITRAL (NAFTA), Partial Award, 13 November 2000), para. 261.

⁷³ *Tecnicas Medioambientales Tecmed S.A. v. United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award (29 May 2003), para. 122.

⁷⁴ For an in-depth discussion of the conceptual foundations of deference in public and public international law see Schill (2012b), pp. 585-594.

starting to take hold of investment treaty arbitration more broadly, it shows that the hitherto prevailing commercial law spirit is subsiding. For example, the Tribunal in *Total v. Argentina* observed in relation to the fair and equitable treatment standard:

In determining the scope of a right or obligation, Tribunals have often looked as a benchmark to international or comparative standards. Indeed, as is often the case for general standards applicable in any legal system (such as “due process”), a comparative analysis of what is considered generally fair or unfair conduct by domestic public authorities in respect of private firms and investors in domestic law may also be relevant to identify the legal standards under BITs. Such an approach is justified because, factually, the situations and conduct to be evaluated under a BIT occur within the legal system and social, economic and business environment of the host State.⁷⁵

Similarly, the Tribunal in *Toto v. Lebanon* stated that “[t]he fair and equitable treatment standard of international law does not depend on the perception of the frustrated investor, but should use public international law and comparative domestic public law as a benchmark.”⁷⁶ And finally, the Tribunal in *Gold Reserve v. Venezuela* gave an extensive overview over the parallels that existed between the concept of legitimate expectations in IIAs and parallel doctrines of domestic public law:

With particular regard to the legal sources of one of the standards for respect of the fair and equitable treatment principle, *i.e.* the protection of ‘legitimate expectations’, these sources are to be found in the comparative analysis of many domestic legal systems. ... Based on converging considerations of good faith and legal security, the concept of legitimate expectations is found in different legal traditions according to which some expectations may be reasonably or legitimately created for a private person by the constant behavior and/or promises of its legal partner, in particular when this partner is the public administration on which this private person is dependent. In particular, in German law, protection of legitimate expectations is connected with the principle of *Vertrauensschutz* [sic] (protection of trust) a notion which deeply influenced the development of European Union Law, pointing to precise and specific assurances given by the administration. The same notion finds equivalents in other European countries such as France in the concept of *confiance légitime*. The substantive (as opposed to procedural) protection of legitimate expectations is now also to be found in English law, although it was not recognized until the last decade. This protection is also found in Latin American countries, including in Argentina ... and exists equally in Venezuelan administrative law.....⁷⁷

As these decisions show, Miles’ critique conveys a one-sided picture of the sociological and legal implications the choice for arbitration entails in ISDS. Her view suggests that power in the existing system resides in the hands of arbitrators, either individually or as a group. Yet, the community of investment arbitrators is far from the ‘old boys club’ Miles depicts, which controls the fate of individual disputes and the future of the entire field to the detriment of public interests. For once, states have it in their hands to diversify the group of investment arbitrators by appointing people with a different mind-set and different characteristics – and indeed, a diversification in terms of gender, age, nationality, professional background and pedigree of investment arbitrators is already taking place in recent years. At the same time, investment tribunals are

⁷⁵ *Total S.A. v. The Argentine Republic*, ICSID Case No. ARB/04/1, Decision on Liability (27 December 2010), para. 111 (internal citations omitted).

⁷⁶ *Toto Costruzioni Generali S.p.A. v. Republic of Lebanon*, ICSID Case No. ARB/07/12, Award (7 July 2012), para. 166.

⁷⁷ *Gold Reserve Inc. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/09/1, Award (22 September 2014), para. 576 (internal citations omitted).

themselves increasingly breaking with the mind-set of international commercial arbitration by making use of argumentative techniques known from (national and international) public law, such as proportionality balancing, doctrines of deference, and comparative public law reasoning. These developments illustrate that arbitrators, already in the existing system, dispose of the tools to interpret IIA disciplines in a way that respects the policy space states need to regulate in the public interest. What remains in Miles' account of ISDS are then no more than half a handful of 'problematic' cases that I will turn to next.

5. Vattenfall, Philip Morris, Bilcon: Pathologies of the System?

When considering the effect of IIAs on regulatory powers of states, decisions by arbitral tribunals have always been the focal point of criticism – and rightly so as a dispute settlement system should not only be assessed in respect of its structural features, including who has access, who decides, under which procedures, and at what cost, but also in terms of its outcomes. Over time, however, there has been a curious shift in how investor-state cases have been used to criticize ISDS' impact on regulatory space. When the first ISDS cases were handed down in the late 1990s and early 2000s, critics castigated the outcome of certain decisions as paying insufficient respect to public interests and unduly restricting a government's policy space, for example to protect the environment.⁷⁸ Yet, soon such arguments became difficult to sustain because few, if any, cases were convincing examples of undue restrictions of government policy space to protect public interests.⁷⁹ Consequently, criticism shifted to the potential 'regulatory chill' that interpretations of IIA standards by arbitral tribunals, and governments' fear for incurring liability for breach of IIAs, could cause.⁸⁰ However, since actual examples showing such a chill by arbitral interpretations are equally rare, the regulatory chill-argument was largely devoid of legal bite and hence equally weak.⁸¹

⁷⁸ Reactions to *Metalclad Corporation v. The United Mexican States*, ICSID Case No. ARB(AF)/97/1 (NAFTA), Award (30 August 2000), were such an example, as the case was criticised for expanding the concept of indirect expropriation in IIAs so as to encompass a particularly broad version of regulatory taking that required compensation for any general measure that aimed at the protection of the environment and was harmful to the profits of foreign investors. What often went unnoticed, however, was that the case concerned not a 'regulatory taking' at all, but involved the frustration of an assurance that the central Mexican government had given to the investor in question that all permits to operate the envisioned waste landfill had been granted and that construction could start.

⁷⁹ On the contrary, a host of decisions recognised, not much differently from the restrictions domestic constitutional standards imposed, that general regulation was usually exempt from compensation, unless there was discrimination, unnecessary and disproportionate negative impact, or specific assurances to refrain from the measure in question. See *Methanex Corporation v. United States of America*, UNCITRAL (NAFTA), Final Award of the Tribunal on Jurisdiction and Merits (3 August 2005). See also *Saluka Investments BV v Czech Republic*, UNCITRAL, Partial Award (17 March 2006) para. 255 ("It is now established in international law that States are not liable to pay compensation to a foreign investor when, in the normal exercise of their regulatory powers, they adopt in a non-discriminatory manner bona fide regulations that are aimed at the general welfare.").

⁸⁰ See, for example, Tienhaara (2011).

⁸¹ See, for example, the conclusion of a study for the Minister for Foreign Trade and Development Cooperation, Ministry of Foreign Affairs, The Netherlands by Tietje C, Baetens F (2014) *The Impact of Investor-State-Dispute Settlement (ISDS) in the Transatlantic Trade and Investment Partnership*, Ref. MINBUZA-2014.78850, <http://www.rijksoverheid.nl/bestanden/documenten-en-publicaties/rapporten/2014/06/24/the-impact-of-investor-state-dispute-settlement-ids-in-the-ttip/the-impact-of-investor-state-dispute-settlement-ids-in-the-ttip.pdf> (last

With little problematic outcomes to point to, critics have now resorted, as does Kate Miles in her discussion of *Vattenfall*, *Philip Morris*, and *Bilcon*, to taking the very fact that certain claims are even brought as an “inappropriate encroachment into domestic policy and regulatory space”.⁸² Viewing claims as a problem for a dispute settlement system says much about the critic’s view of the concept of the rule of law and the idea of access to justice – it propagates that the better alternative to government control through adjudicatory mechanisms is no effective government control at all. I have refuted the value of such an argument already in Part 2 above. Yet, even when taking a closer look at *Vattenfall*, *Philip Morris*, and *Bilcon*, we see that Miles’ assessment of these cases as pathologies of the system is little convincing. Instead, a more detailed assessment of these cases shows that they have ended up in ISDS for entirely legitimate reasons. In both, *Vattenfall* and *Philip Morris*, legitimate controversies existed as to whether the government’s concrete conduct, not the underlying policies themselves, which nobody doubted were legitimate, were in line with the applicable investment disciplines. The same holds true with respect to the *Bilcon* case. Not the legitimacy of a government policy to protect the environment was at stake here, but the concrete implementation of that policy and its compliance with NAFTA’s investment chapter.

First, let me turn to the two *Vattenfall* cases.⁸³ These cases are entirely separate from each other and not part of a “two-step story”.⁸⁴ *Vattenfall I* concerned the legality of environmental conditions attached to an operating license issued by the City of Hamburg under existing environmental laws for a coal-fired power plant. *Vattenfall II* concerned a legislative change to the federal law governing nuclear power plants. While *Vattenfall I* thus involved a question tied to administrative law; *Vattenfall II* involved restrictions of the legislator and hence a constitutional matter. There was no other connection between these two cases except for the fact that the same energy company operated the plants in question and that the basis for the claims were the investment provisions in the Energy Charter Treaty. More importantly, however, both *Vattenfall* cases are not presented in full by Kate Miles, but in a selective fashion that has the effect of suggesting conclusions that both cases simply do not support, namely that *Vattenfall* was and is using ISDS to circumvent uncontested and flawless public interest regulation. Rather, a full reading of the facts of both cases shows that legitimate disputes about the appropriateness of the government measures under international law are at issue and that these disputes are apt for an international adjudicatory system, such as investor-state arbitration, to decide.

Turning to *Vattenfall I*, this is not a case where a settlement of the parties of the ICSID proceeding resulted in the City of Hamburg (not Germany) “agreeing to slacken the environmental

accessed 31 July 2015), p. 9 (“We recognize that regulatory chill is difficult to prove or disprove, but a close examination of case law from NAFTA and CAFTA does not support this theory. Most investment claims do not challenge the government’s ability to legislate or regulate as such, but are administrative in character, challenging a government’s treatment of an individual investor in the context of a particular license, permit, or promise extended by government officials. So far under NAFTA, direct challenges to the government’s legislative or regulatory rights have never succeeded.”); see further at pp. 39-48.

⁸² Miles (2016), section 2.1.

⁸³ These are *Vattenfall AB*, *Vattenfall Europe AG*, *Vattenfall Europe Generation AG v. Federal Republic of Germany*, ICSID Case No. ARB/09/6, Award (11 March 2011) (*Vattenfall I*) and *Vattenfall AB and others v. Federal Republic of Germany*, ICSID Case No. ARB/12/12 (registered 31 May 2012) (*Vattenfall II*).

⁸⁴ Miles (2016), section 2.1.1.

standards and issue a significantly less exacting permit.”⁸⁵ What Miles does not mention is that Vattenfall had challenged the environmental conditions in Hamburg’s administrative courts and that it was in these domestic court proceedings that a settlement was reached, as permitted under German administrative law, regarding certain conditions of a water permit that was necessary for the operation of the plant. The settlement of the ICSID proceedings, which is publicly available,⁸⁶ only procedurally implemented the parties’ earlier settlement in domestic courts and has no independent regulatory content. It is of course possible that the ICSID proceeding exercised pressure on the City to settle the domestic court case, but such an argument has not been put forward.

In addition, Miles also does not tell us the full background of *Vattenfall I*. Importantly, this was not a case where an investor used ISDS to reach an exemption from environmental standards required under domestic law. Instead, the case was concerned with a situation in which the ministry in charge changed policy after local election, even though the investor had already been promised by the Hamburg City Government, then under the sole control of the Christian Democrats, that an operating license with certain environmental parameters was going to be issued and on that basis had been granted permission to start the construction of the power plant. However, before all final licenses were issued, the Green Party joined the City Government after the elections alongside the Christian Democrats, took over the ministry in charge and issued a license that the investor claimed made the operation of the plant economically unviable because it imposed environmental conditions that were harsher than originally promised. The full background of *Vattenfall I* should make clear that this is not a straightforward situation of a government agreeing to slacken environmental regulations facing an ISDS claim. On the contrary, it concerns a legitimate dispute about whether a government that indicates that it would exercise administrative discretion in issuing a license in a certain way and thereby induces a specific investment, can simply renege on that promise without standing in for the damage caused. The modus of implementation of environmental policies was thus the true problem, not the environmental policy as such.

Likewise, *Vattenfall II* is not so much about the legitimacy of phasing out nuclear power *per se*, but about the procedure of doing so. Above all, the case cannot be limited to the law phasing out nuclear power that was ultimately passed, but needs to be seen against the background of consecutive governments engaging in roller coaster ride-type politics in respect of nuclear energy.⁸⁷ Thus, after nuclear power was first made into one of the corner stones of Germany’s strategy to secure an autarkic energy supply, the coalition government between the Social Democrats and the Green Party under Chancellor Schröder decided in 2002, in agreement with the energy industry, a long-term plan to phase-out nuclear power by 2032. In October 2010, however, the newly elected federal government under Chancellor Merkel consisting of a coalition between Christian Democrats and the Liberal Party, essentially undid the earlier phase-out of nuclear power, again in consultation with the nuclear industry. This deal, however, came at a price, so that the government would also benefit from the additional income. In return for the extension of

⁸⁵ Miles (2016), section 2.1.1.

⁸⁶ *Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG v. Federal Republic of Germany*, ICSID Case No. ARB/09/6, Award (11 March 2011)

⁸⁷ For a short discussion of the factual background with further references see Wikipedia, *Atomausstieg* <https://de.wikipedia.org/wiki/Atomausstieg> (last accessed 31 July 2015).

operating capacity for nuclear plants, power producers were required to invest in their plants and pay a new tax on nuclear fuel that would benefit the public purse.

Only a few months later, in March 2011, the Fukushima incident happened, and because of impending elections in Germany's South-Western State of Baden-Württemberg, which Chancellor Merkel's Christian Democrats risked losing *inter alia* due to having undone the original nuclear phase-out, an immediate moratorium on producing nuclear power was declared by executive order on the basis of existing legislation. In August of the same year the permanent phase-out was then decided by federal law. The end date of that second phase-out was 2022 -ten years earlier than the phase-out decided under the Schröder government in 2002; at the same time, the tax on nuclear however was not repealed. This additional background gives *Vattenfall II* a very different flavour and moves it far from an "illegitimate encroachment on regulatory space". It is the back-and-forth of law and policy-making in an area requiring significant investments and long-term planning that is brought to ISDS here, not the phase-out of nuclear power as such.

That legal action against the nuclear power phase-out itself is not an encroachment of regulatory space can also be seen from the domestic court cases that are pending in the matter. The highest German administrative court, the Bundesverwaltungsgericht, has already held that the temporary moratorium declared immediately following the Fukushima incident was contrary to the governing statutory law, thus requiring the government to pay damages to affected power producers.⁸⁸ Other aspects of the nuclear power phase-out are still pending in domestic courts, such as the question whether maintaining the nuclear fuel tax was legal, even though the rest of the 'phase-out deal' was undone.⁸⁹ Similarly, Vattenfall and some of its German competitors have brought constitutional challenges against the nuclear power phase-out in the German Constitutional Court.⁹⁰ If the ICSID proceeding in *Vattenfall II* encroach on regulatory space, the same would hold true of the domestic proceedings in the matter.

Certainly, one may argue that domestic proceedings control government conduct sufficiently. Yet, Vattenfall faces additional hurdles that ISDS remedies help to smoothen. Thus, none of the domestic proceedings is likely going to address the legality of the measures under the Energy Charter Treaty. Moreover, with Vattenfall being in essence a foreign state-owned company, it is unclear whether the company can invoke fundamental rights under the German Constitution. And finally, the case illustrates the possible lack of neutrality, from the perspective of foreign investors, of domestic courts. After all, one could ask how the German Constitutional Court can deliver a strictly neutral and apolitical decision when each judge on the court is likely to have a

⁸⁸ See German Federal Administrative Court (Bundesverwaltungsgericht – BVerwG), Decision of 20 December 2013 (7 B 18/13) [2014] Deutsches Verwaltungsblatt 303. See also the pointed analysis of the moratorium by Re-bentisch (2011). On the liability of the state under domestic law see Schmitt and Wohlrab (2015).

⁸⁹ See German Federal Constitutional Court (Bundesverfassungsgericht), 2 BvL 6/13 (pending) following an order for reference by the Hamburg Fiscal Court, Decision of 29 January 2013 (4 K 270/11). The Federal Fiscal Court (Bundesfinanzhof – BFH) declined the application of interim measures until the Bundesverfassungsgericht renders its judgment, thereby annulling prior decisions by the FG Hamburg and the FG Munich that granted repayment claims put forward by power plant operators, see BFH, Decision of 9 March 2012 (VII B 171/11) and Decision of 25 November 2014 (VII B 65/14).

⁹⁰ See constitutional complaints submitted by E.ON Kraftwerke GmbH (1 BvR 2821/11), RWE Power AG (1 BvR 321/12), Kernkraftwerk Krümmel GmbH & Co OHG and Vattenfall Europe Nuclear Energy (1 BvR 1456/12) (all pending).

political view on the issue at stake. After all, apart from German reunification, nuclear power has been perhaps the most political of all topics in Germany in the past decades. For all of these reasons, it is entirely legitimate that the dispute between Vattenfall and the German government about the legality of the measures at stake under the Energy Charter Treaty is pending in an international, and not only in a national forum. What is highly problematic, however, is the confidentiality with which the *Vattenfall II* case is handled. So far, little is known about the case itself and the parties' arguments except for minor details that were leaked from unknown sources. This aspect, in my view, is the true problem with *Vattenfall II*, because it is contrary to the principle of openness and transparency that govern dispute settlement between private and public actors in democratic societies, not the fact as such that the case is brought.

Second, turning to *Philip Morris*, in my view this is also not a good example of an illegitimate claim *per se* that reflects badly on the entire investment treaty system. Independently of the low likelihood many observers attribute to Philip Morris' chances of winning,⁹¹ and independently of how the implementation of plain packaging in Australia should be decided, the very fact that this dispute is brought in ISDS is not part of an illegitimate encroachment of Australia's policy space, but responds, entirely legitimately, to a shortcoming the Australian legal system has with the domestic enforcement of international treaties, including IIAs. After all, under Australian law, IIAs are not enforceable within the domestic legal order and before Australia's courts. As Australia's Chief Justice recently stated: "[t]he capacity of international treaties to confer rights on non-state actors has long been accepted. But such rights are not enforceable under the domestic law of dualist states, unless those states are constitutionally empowered to give effect to them and have done so."⁹² Australia, being a dualist state, faces exactly this limitation with respect to IIA disciplines: they cannot be invoked in domestic courts. Where then, other than in an international forum, should an investor bring claims for non-compliance with the Australia-Hong Kong BIT? Under the circumstances at hand, ISDS is the only available forum in which access to justice to review Australia's conduct under the BIT in question is granted.

Finally, turning to *Bilcon*, I cannot see how this case "embodies an approach that is reminiscent of the earliest investor-state disputes involving environmental matters", as Kate Miles argues.⁹³ To start with, *Bilcon* is a pending dispute, which makes it a bad example to argue a general point about the dangers of arbitral discretion. The Tribunal has only ruled on liability, but left damages open. It is therefore too early to assess the impact of the decision and the consequences of the breach of NAFTA that the Tribunal found. Possibly, the damages attached to the breach found by the Tribunal will remain very low, given that the project at issue was not a going concern. Furthermore, there are remedies in case the decision was wrong before the Canadian courts that exercise supervisory jurisdiction at the seat of the arbitration, which have been used by the respondent.⁹⁴ Only upon completion of that process will one be able to assess whether the current ISDS system does not dispose of the necessary powers of self-correction, if they were

⁹¹ See, for example, Voon and Mitchell (2011). Meanwhile, Philip Morris' claim has reportedly been dismissed, albeit on jurisdictional grounds. See 'Australia Prevails in Arbitration with Philip Morris over Tobacco Plain Packaging Dispute' IAReporter (17 December 2015), <http://tinyurl.com/jd7qwlf> (last accessed 27 February 2016).

⁹² See French (2015), p. 159.

⁹³ Miles (2016), section 4.

⁹⁴ *Attorney General of Canada v. William Ralph Clayton and others*, Notice of Application (16 June 2015), Court File No. T-1000-15, <http://italaw.com> (last accessed 31 July 2015).

needed. *Bilcon* may be correctly or incorrectly decided, it may be good or bad from an environmentalist's perspective, but I do not think it is a good example to illustrate the dangers of arbitral interpretations.

Certainly, it is problematic if an arbitral tribunal steps entirely into the shoes of a domestic administrative court reviewing the measures in question, and engages in an exercise of second-guessing the application of national law by a national institution. Yet, this is not what the majority in *Bilcon* did. It set out the deferential and well-accepted NAFTA standard of fair and equitable treatment, as developed by the tribunal in *Waste Management v. Mexico*⁹⁵ as the basis of its holding, emphasising “that there is a high threshold for the conduct of a host state to rise to the level of a NAFTA Article 1105 breach.”⁹⁶ Already this statement should counter the argument about *Bilcon* rolling back the deferential character of arbitral review under NAFTA. The majority in *Bilcon* did also not review the measure in question under the standards of Canadian law, saying that the treatment of the foreign investor was simply illegal under that law. The majority went further than that and held that the way the environmental assessment was conducted in the case at hand was arbitrary and contrary to how Canadian companies were treated in comparable circumstances.⁹⁷ The Tribunal therefore applied a lenient standard and held that the administrative process carried out in the case at hand fell blatantly short of the international minimum standard.

A finding of arbitrariness, which requires a high threshold, should not be taken as an illustration of unpredictable arbitral discretion, but rather throws a critical light on the administrative process in the case in Canada. Keeping in mind that we are here in an international, transborder, not a purely inner-Canadian context, is important because what may seem arbitrary for lawyers from outside Canada, such as the Tribunal's President, a German, and the investor's nominee, an American, may be just perfectly fine for a Canadian, such as the dissenter, and vice versa. Importantly, the transborder context has to be taken into account when considering whether certain government conduct withstands scrutiny under basic notions of fairness and the rule of law not only within a domestic legal and cultural context, but also under the eyes of lawyers that have been socialised elsewhere and that may take issue with conduct found perfectly agreeable in the host state. After all, differing legal culture is one of the obstacles that international law tries to overcome by providing legal standards that are independent of national law and compliance with which is determined by independent and neutral legal institutions.

That conduct that is legal under domestic law, suddenly becomes illegal under international law is the most normal of consequences the acceptance of, and submission to, international law by states can have. This holds true in international law generally, and international investment

⁹⁵ *Clayton and others and Bilcon of Delaware, Inc. v. Government of Canada*, UNCITRAL (NAFTA), Award on Jurisdiction and Liability (17 March 2015), paras. 427-446.

⁹⁶ *Clayton and others and Bilcon of Delaware, Inc. v. Government of Canada*, UNCITRAL (NAFTA), Award on Jurisdiction and Liability (17 March 2015), para. 444.

⁹⁷ *Clayton and others and Bilcon of Delaware, Inc. v. Government of Canada*, UNCITRAL (NAFTA), Award on Jurisdiction and Liability (17 March 2015), para. 591 (concluding that “that the conduct of the joint review was arbitrary. The JRP [i.e. Joint Review Panel] effectively created, without legal authority or fair notice to Bilcon, a new standard of assessment rather than fully carrying out the mandate defined by the applicable law, including the requirement under the CEAA [i.e. the applicable legal framework] to carry out a thorough ‘likely significant adverse effects after mitigation’ analysis.”).

law in particular. Likewise, falling short of international standards in individual cases, and losing an arbitration here or there, should be appreciated as a normal consequence of engaging in international adjudicatory institutions. Rather than casting the adjudicatory institutions dealing with such disputes into doubt, losing a case should inspire states to aim at further perfecting the way they exercise public authority in transborder relations. What one should rather wonder about is why only cases against developed countries, such as Germany, Canada, and Australia, are depicted as pathologies of international investment law and ISDS? Developed countries are in no way exempt from the need of occasional and well-balanced control by international courts and tribunals that smoothen the unavoidable edges of less-than-ideal law- and policy-making, which, at times, affects foreigners more than nationals.

6. Conclusion: Pathways for Future Reform

The current international investment regime is certainly not perfect – no system of adjudication is. It suffers from a number of shortcomings, which Kate Miles has rightly mentioned. I agree that a fundamental problem with ISDS is the unfortunate blending between a model for the resolution of private (commercial) disputes with public law issues. I agree that these disputes should not be conducted behind closed doors, but should be fully transparent, that public participation should be ensured to reflect the fundamental democratic principle that those affected by a decision should be heard and involved in their making. I also agree that legitimate public welfare regulation should not be prevented or even chilled by international investment protection, but that host states need policy space to regulate in the public interest. At the same time, I consider it important that foreign investors –in fact any investor, independent of nationality– benefit from sufficient protection against arbitrary, discriminatory or otherwise illegitimate government conduct and have recourse to a neutral and efficient forum to settle disputes with governments. This is called for not only in the interest of investors, but is – as a postulate of the rule of law – itself in the public interest.

What we are looking for in the end, is a balance between protecting investors against illegitimate government interference, while ensuring sufficient policy space to pursue legitimate regulation in the public interest. Yet, what is legitimate in the eyes of one side (whether investors, states, third parties, or outside observers), may not be so in the eyes of the other. It is for this reason that somebody neutral and independent needs to decide on where the boundaries of legitimate government and investor conduct lie, and do so not on the basis of political preference, but based on legal principle. Arbitration is an appropriate instrument to achieve such ends and is capable, in both principle and fact, to distinguish illegitimate opportunistic government behaviour from legitimate regulation in the public interest. What is more, looking at past performance of investment treaty arbitration, there is little concern about systemic pro-investor and anti-public interest biases. On the contrary, arbitrators have fared well in resolving the often complex investor-state disputes without disregarding competing non-investment concerns. This does not mean that arbitration is necessarily the best possible alternative, but it is at present the only workable one we have to enforce IIA disciplines effectively and neutrally.

As I have argued above in discussing and refuting the criticism of IIAs and ISDS, my own assessment of the present system is much more positive than the one depicted by Kate Miles. This notwithstanding, the criticism investment treaty arbitration has been and continues to be subject

to is an important source of dynamism and change without which the investment regime would be much worse off than at present. The criticism of the investment regime and particularly ISDS is to be credited for making governments, the general public, as well as specialists, aware of potential biases and shortcomings. It has functioned as a wake-up call for governments to watch arbitral decision-making and to assess whether the system stays within its intended mandate. The criticism has also contributed to governments starting to remedy certain shortcomings through the introduction of more transparency and third-party participation, clarifications to IIA standards, and tighter control mechanisms vis-à-vis arbitral decision-making. And the criticism has led to an improvement in how arbitrators conduct arbitral proceedings, reason awards and decisions, deal with competing public interests, and how the arbitration community is starting to self-regulate in order to ensure the benefits of the system.

Finally, the criticism continues to fuel much of the current debates about the reform of the investment treaty regime, in particular the debates about renewed efforts at multilateralism, the thinking about international investment law as part of policies of sustainable development, and possibly the creation of new and more permanent institutions for ISDS, such as an appellate mechanism or a permanent investment court.⁹⁸ Thus, instead of continuing to argue that the existing international investment regime is fundamentally flawed, it is these reform efforts that critics should direct their attention to and actively engage with in order to tweak the system to better live up to the ideals of democracy, the protection of human rights, and the rule of law they aspire to. After all, it is not the basic structure of the system, in particular recourse to an international forum in order to review government action as to their compliance with certain basic rule of law principles enshrined in international treaties, which are rotten. It is rather some excrescent rank growth that needs trimming. Critics of the investment regime could do a lot on this end by turning from deconstruction to constructive engagement and help build a better system of international investment law.

References

- Aisbett E (2009) Bilateral investment treaties and foreign direct investment: correlation and causation. In: Sauvant K, Sachs L (eds) *The effect of treaties on foreign direct investment: bilateral investment treaties, double taxation treaties, and investment flows*. Oxford University Press, Oxford, p 395–435. doi:10.1093/acprof:oso/9780195388534.003.0015
- Amerasinghe C (2005) *Local remedies in international law*, 2nd edn. Cambridge University Press, Cambridge
- Amerasinghe C (2008) *Diplomatic protection*. Oxford University Press, Oxford. doi: 10.1093/acprof:oso/9780199212385.001.0001
- Berger A, Busse M, Nunnenkamp P, Roy M (2012) Do trade and investment agreements lead to more FDI? accounting for key provisions inside the black box. *Int Econ & Econ Policy* 10(2):247-275. doi: 10.1007/s10368-012-0207-6
- Borchard E (1915) *The diplomatic protection of citizens abroad*. Banks Law Publishing Company, New York

⁹⁸ See European Commission, Press Release: Commission Proposes New Investment Court System for TTIP and Other EU Trade and Investment Negotiations, 16 September 2015, http://europa.eu/rapid/press-release_IP-15-5651_en.htm (last accessed 15 October 2015). For a succinct overview over the most recent reform debates and options more generally see UNCTAD (2015) *World Investment Report 2015: Reforming International Investment Governance*. http://unctad.org/en/PublicationsLibrary/wir2015_en.pdf (last accessed 28 September 2015), p. 119 ff. See further, inter alia, the contributions in Kalicki and Joubin-Bret (2015).

- Brower C, Blanchard S (2014) What's in a meme? The truth about investor-state arbitration: why it need not, and must not, be repossessed by states. *Columbia J Transl Law* 52(3):689–777
- Brower C, Schill S (2009) Is arbitration a threat or a boon to the legitimacy of international investment law?. *Chicago J Int Law* 9(2):471–498
- Brower C, Pulos M, Rosenberg C (2013) So is there anything really wrong with international arbitration as we know it? In: Rovine A (ed) *Contemporary issues in international arbitration and mediation: the Fordham Papers*. Brill Nijhoff, Leiden, pp 1–13. doi:[10.1163/9789004260207_002](https://doi.org/10.1163/9789004260207_002)
- Bücheler G (2015) *Proportionality in investor-state arbitration*. Oxford University Press, Oxford
- Burke-White W, von Staden A (2010a) The need for public law standards of review in investor-state arbitrations. In: Schill S (ed) *International investment law and comparative public law*. Oxford University Press, Oxford, pp 689–720. doi:10.1093/acprof:oso/9780199589104.003.0022
- Burke-White W, von Staden A (2010b) Private litigation in a public law sphere: the standard of review in investor-state arbitrations. *Yale J Int Law* 35:283–346
- Buscaglia E, Dakolias M (1999) An analysis of the causes of corruption in the judiciary. *Law Policy Int Bus* 30:95–116
- Büthe T, Milner H (2014) Foreign direct investment and institutional diversity in trade agreements: credibility, commitment, and economic flows in the developing world, 1971-2007. *World Pol* 66 (1):88–122. doi:<http://dx.doi.org/10.1017/S0043887113000336>
- Cancado Trindade A (1983) *The application of the rule of exhaustion of local remedies in international law*. Cambridge University Press, Cambridge
- Cooter R and Ulen T (2004) *Law and economics* 4th edn. Addison Wesley, Boston
- Dakolias M, Thachuk K (2000) The problem of eradicating corruption from the judiciary: attacking corruption in the judiciary: a critical process in judicial reform. *Wis Int Law J* 18:353–406
- Elkins Z, Guzman A, Simmons B (2006) Competing for capital: the diffusion of bilateral investment treaties, 1960–2000. *Int Organ* 60(4):811–846. doi:<http://dx.doi.org/10.1017/S0020818306060279>
- Fontoura Costa J (2011) Comparing WTO panelists and ICSID arbitrators: the creation of international legal fields. *Oñati Socio-Legal Series* 1(4), <http://opo.iisj.net/index.php/osls/article/view/63/207>
- Francioni F (ed) (2007) *Access to justice as a human right*. Oxford University Press, Oxford
- Franck S, Freda T, Lavin K, Lehmann T, van Aaken A (2015) The diversity challenge: exploring the “invisible college” of international arbitration. *Columbia J Transl Law* 53:429–506
- French R (2015) ISDS: litigating the judiciary. *Public Law Rev* 26(3):155–165
- Guzman A (1998) Why LDCs sign treaties that hurt them: explaining the popularity of bilateral investment treaties. *Virginia J Int Law* 38:639–688
- Guzman A (2008) *How international law works: a rational choice theory*. Oxford University Press, Oxford
- Hagelberg J (2006) *Die völkerrechtliche Verfügungsbefugnis des Staates über Rechtsansprüche von Privatpersonen*. Nomos, Baden-Baden. doi:[10.5771/9783845225081](https://doi.org/10.5771/9783845225081)
- Henckels C (2012) Indirect expropriation and the right to regulate: revisiting proportionality analysis and the standard of review in investor-state arbitration. *J Int Econ Law* 15(2):223–255. doi: 10.1093/jiel/jgs012
- Hindelang S, Krajewski M (eds) (2016) *Shifting paradigms in international investment law: more balanced, less isolated, increasingly diversified*. Oxford University Press, Oxford
- Jandhyala S, Weiner R (2014) *Institutions sans frontières: international agreements and foreign investment*. *J Int Bus Stud* 45(6):649–669. doi:10.1057/jibs.2013.70
- Johnson O T, Gimblett J (2012) From gunboats to BITs: the evolution of modern international investment law. In: Sauvart K (ed) *Yearbook on international investment law and policy 2010-2011*. Oxford University Press. New York, pp 649–692
- Kalicki J, Joubin-Bret A (eds) (2015) *Reshaping the investor-state dispute settlement system: journeys for the 21st century* Brill Nijhoff, Leiden. doi:[10.1163/9789004291102](https://doi.org/10.1163/9789004291102)

- Kapeliuk D (2010) The repeat appointment factor: exploring decision patterns of elite investment arbitrators. *Cornell Law Rev* 96:47–90
- Karton J (2013) *The culture of international arbitration and the evolution of contract law*. Oxford University Press, Oxford
- Kingsbury B, Schill S (2010) Public law concepts to balance investors' rights with state regulatory actions in the public interest – the concept of proportionality. In: Schill S (ed) *International investment law and comparative public law*. Oxford University Press, Oxford, pp 75–104. doi:10.1093/acprof:oso/9780199589104.003.0003
- Leonhardsen E (2012) Looking for legitimacy: exploring proportionality analysis in investment treaty arbitration. *J Int Disp Settlement* 3(1):95–136. doi: 10.1093/jnlids/idr014
- Lillich R, Weston B (1975) *International claims: their settlement by lump-sum agreements*. University Press of Virginia, Charlottesville
- Miles K (2016) Investor-state dispute settlement: conflict, convergence, and future directions. In: Bungenberg M, Hermann C, Krajewski M, Terchechte JP (eds) *European yearbook of international economic Law*, vol 7. Springer, Heidelberg
- Montt S (2009) *State liability in investment treaty arbitration*. Hart Publishing, Oxford
- Puig S (2014) Social capital in the arbitration market. *Eur J Int Law* 25(2):387–424. doi:10.1093/ejil/chu045
- Rebentisch M (2011) “Kraftwerks-Moratorium” versus Rechtsstaat. *Neue Zeitschrift für Verwaltungsrecht* 30:533–535
- Roberts A (2010) Power and persuasion in investment treaty interpretation: the dual role of states. *Am J Int Law* 104(2):179–225
- Schill S (2010) *International investment law and comparative public law: an introduction*. In: Schill S (ed) *International investment law and comparative public law*. Oxford University Press, Oxford, pp 3–37. doi: 10.1093/acprof:oso/9780199589104.003.0001
- Schill S (2011a) Enhancing international investment law's legitimacy: conceptual and methodological foundations of a new public law approach. *Virginia J Int Law* 52(1):57–102
- Schill S (2011b) W(h)ither fragmentation? On the literature and sociology of international investment law. *Eur J Int Law* 22(3) 875–908 doi: 10.1093/ejil/chr062
- Schill S (2012a) Cross-regime harmonization through proportionality analysis: the case of international investment law, the law of state immunity, and human rights. *ICSID Review-Foreign Investment Law J* 27(1):87–119. doi: <http://dx.doi.org/10.1093/icsidreview/sis002>
- Schill S (2012b) Deference in investment treaty arbitration: re-conceptualizing the standard of review. *J Int Disp Settlement* 3(3)577–607. doi: 10.1093/jnlids/ids010
- Schill S (2015a) Developing a framework for the legitimacy of international arbitration. In: van den Berg A (ed) *Legitimacy: myths, realities, challenges*. ICCA Congress Series, vol. 18, Miami 2014, Wolters Kluwer, Alphen aan den Rijn, pp 789–827
- Schill S (2015b) The overlooked role of arbitration in international adjudicatory theory. *ESIL Reflections* 4(2)
- Schill S (2015c) The sixth path: reforming investment law from within. In: Kalicki J, Joubin-Bret A (eds.) *Reshaping the investor-state dispute settlement system – journeys for the 21st century* Brill Nijhoff, Leiden, pp 621–652
- Schill S, Tvede K (2015) Mainstreaming investment treaty jurisprudence: the contribution of investment treaty tribunals to the consolidation and development of general international law. *Law Pract Int Courts Trib* 14(1)94–129. doi: [10.1163/15718034-12341287](http://dx.doi.org/10.1163/15718034-12341287)
- Schmitt T, Wohlrab S (2015) Haftung des Bundes in der Auftragsverwaltung am Beispiel des so genannten „Moratoriums“ für Kernkraftwerke. *Neue Zeitschrift für Verwaltungsrecht* 34(14):932–937
- Schwartz A, Scott R (2003) Contract theory and the limits of contract law. *Yale Law J* 113:541–619
- Schwebel S (2015) In defense of bilateral investment treaties. In: van den Berg A (ed) *Legitimacy: myths, realities, challenges*. ICCA Congress Series, vol. 18, Miami 2014, Wolters Kluwer, Alphen aan den Rijn, pp 1–11
- Sornarajah M (2015) *Resistance and change in the international law on foreign investment*. Cambridge University Press, Cambridge. doi: <http://dx.doi.org/10.1017/CBO9781316156339>

© Stephan W. Schill

Pre-Publication Draft – do not circulate with permission

to appear in *European Yearbook of International Economic Law* (2016), Markus Krajewski (ed.)

- Stone Sweet A (2010) Investor–state arbitration: proportionality’s new frontier. *Law Ethics Hum Rights* 4(1):48–76. doi: [10.2202/1938-2545.1044](https://doi.org/10.2202/1938-2545.1044)
- Tienhaara K (2011) Regulatory chill and the threat of arbitration: a view from political science. In: Brown C, Miles K (eds) *Evolution in investment treaty law and arbitration*. Cambridge University Press, Cambridge, pp 606–657
- Tobin J, Rose-Ackerman S (2009) When BITs have some bite. In: Rogers C, Alford R (eds) *The future of investment arbitration*. Oxford University Press, New York, pp 131–144
- van Aaken A (2009) Defragmentation of public international law through interpretation: a methodological proposal. *Indiana J Glob Leg Stud* 16(2):483–512
- Van Harten G (2007) *Investment treaty arbitration and public law*. Oxford University Press, New York. DOI:10.1093/acprof:oso/9780199552146.001.0001
- Van Harten G (2010) Investment treaty arbitration, procedural fairness, and the rule of law. In: Schill S (ed) *International investment law and comparative public law*. Oxford University Press, Oxford, pp 627–657. doi:10.1093/acprof:oso/9780199589104.003.0020
- Van Harten G (2013) Sovereign choices and sovereign constraints: judicial restraint in investment treaty arbitration. Oxford University Press, Oxford. doi:10.1093/acprof:oso/9780199678648.001.0001
- Voon T, Mitchell A (2011) Time to quit? Assessing international investment claims against plain tobacco packaging in Australia. *J Int Econ Law* 14(3):515–552. doi: 10.1093/jiel/jgr030
- Waibel M (2015) Interpretive communities in international law. In: Bianchi A, Peat D, Windsor M (eds) *Interpretation in international law*. Oxford University Press, New York, pp 147–164. doi:10.1093/acprof:oso/9780198725749.003.0007
- Waibel M, Kaushal A, Chung, KH, Balchin, C (eds) (2010) *The backlash against investment arbitration*. Kluwer Law International, Alphen aan den Rijn
- Weston B, Bederman D, Lillich R (1999) *International claims: their settlement by lump-sum agreements 1975–1995*. Brill Nijhoff, Leiden
- Williamson O (1985) *The economic institutions of capitalism: firms, markets, and relational contracting*. The Free Press, New York
- Yackee J (2008) Do we really need BITs?’ *Asian J WTO Int Health Law Policy* 3(1):121–146