



## UvA-DARE (Digital Academic Repository)

### From Dispute Settlement to Judicial Review? The Deference Debate in International Investment Law

Fahner, J.H.

**Publication date**

2016

**Document Version**

Final published version

**Published in**

Evolution in Dispute Resolution

[Link to publication](#)

**Citation for published version (APA):**

Fahner, J. H. (2016). From Dispute Settlement to Judicial Review? The Deference Debate in International Investment Law. In M. Duchateau, S. Fikkers, L. Lane, & E. van Schagen (Eds.), *Evolution in Dispute Resolution: From Adjudication to ADR?* (pp. 61-85). (Governance & Recht; Vol. 13). Eleven International Publishing.

**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: <https://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.

## FROM DISPUTE SETTLEMENT TO JUDICIAL REVIEW? THE DEFERENCE DEBATE IN INTERNATIONAL INVESTMENT LAW

Johannes Hendrik Fahner\*

### 3.1 INTRODUCTION

In the field of international investment law, foreign investors are commonly granted a right to initiate international arbitration in the case of a dispute with host state authorities. As a consequence, foreign investors can often choose where to lodge a complaint concerning host state action: either in the domestic courts of the host state or before an international arbitral tribunal.<sup>1</sup> When the investor chooses to pursue claims at the international level, an arbitral *ad hoc* tribunal will evaluate the lawfulness of the host state's conduct against treaty standards, such as the fair and equitable treatment standard and the prohibition of expropriation without compensation. It has been noted that, in such circumstances, the tribunal is called upon to fulfil a task similar to that of the administrative or constitutional courts of the host state.<sup>2</sup>

In many municipal legal systems, the judicial review of government conduct is subject to considerations of deference. They are based on the idea that judges do not possess the expertise nor the democratic authorisation to substitute their judgment for that of other governmental authorities. A topical question in the field of international investment law is whether investor-state arbitral tribunals should exercise similar restraint

---

\* Many thanks to Başak Bağlayan Ceyhan and Relja Radović for their valuable comments on earlier drafts of this chapter. Many thanks also to Alexander Panayotov for numerous constructive discussions on the topic.

1. The investor's freedom of choice is of course limited by the applicable treaty provisions on waiting periods and fork-in-the-road provisions. See Anne van Aken, 'Primary and Secondary Remedies in International Investment Law and National State Liability. A Functional and Comparative View' in Stephan W Schill (ed), *International Investment Law and Comparative Public Law* (OUP 2010) 739-743. Moreover, the extent to which investors are required to make some effort to obtain local remedies remains controversial. See e.g. George K Foster, 'Striking a Balance between Investor Protections and National Sovereignty: The Relevance of Local Remedies in Investment Treaty Arbitration' (2011) 49 *Columbia Journal of Transnational Law* 2, 201-267; Ursula Kriebaum, 'Local Remedies and the Standards for the Protection of Foreign Investment' in Christina Binder, Ursula Kriebaum, August Reinisch and Stephan Wित्तich (eds), *International Investment Law for the 21st Century. Essays in Honour of Christoph Schreuer* (OUP 2009) 417-462.
2. Stephan W Schill, 'International Investment Law and Comparative Public Law. An Introduction' in Schill 2010, *supra* note 1, 4; Gus van Harten, *Investment Treaty Arbitration and Public Law* (OUP 2007) 71.

when evaluating the conduct of states. Respondent states have often advocated such an approach, arguing that arbitral tribunals should adopt a non-intrusive standard of review when evaluating government conduct against treaty standards.<sup>3</sup>

Academic calls for deference in investor-state arbitration have been raised in response to growing criticism of the current system.<sup>4</sup> The core of this criticism is that investor-state arbitration subjects government conduct to review by private arbitrators who operate within in a system that favours investor interests over competing public interests. According to a 'Statement of Concern' drafted by a group of scholars in response to the public consultation on the proposed inclusion of investor-state arbitration in the Transatlantic Trade and Investment Partnership (TTIP), investment arbitration 'involves a shift in sovereign priorities toward the interests of foreign owners of major assets and away from those of other actors whose direct representation and participation is limited to democratic processes and judicial institutions'.<sup>5</sup> It has been argued that this type of concern could be resolved by recourse to deferential standards of review. William Burke-White and Andreas von Staden propose that 'the development of new standards of review grounded in comparative public law' can imbue investment treaty arbitration 'with enhanced legitimacy and result in procedures and outcomes broadly acceptable to all stakeholders'.<sup>6</sup> This proposition is not uncontested, however, as various authors have argued that deference is inconsistent with the very purpose of investor-state arbitration.<sup>7</sup>

---

3. E.g. *Glamis Gold, Ltd. v. United States* [2009] UNCITRAL, Award <[www.italaw.com/sites/default/files/case-documents/ita0378.pdf](http://www.italaw.com/sites/default/files/case-documents/ita0378.pdf)> accessed 29 June 2015 [594-595].

4. William Burke-White and Andreas von Staden, 'Private Litigation in a Public Law Sphere: the Standards of Review in Investor-State Arbitrations' (2010) 35 *Yale Journal of International Law* 2, 283-346; William Burke-White and Andreas von Staden, 'The Need for Public Law Standards of Review in Investor-State Arbitrations' in Schill 2010, *supra* note 1, 689-720. See also Erlend M Leonhardsen, 'Treaty Change, Arbitral Practice and the Search for a Balance. Standards of Review and the Margin of Appreciation in International Investment Law' in Lukasz Gruszczynski and Wouter Werner (eds), *Deference in International Courts and Tribunals. Standard of Review and Margin of Appreciation* (OUP 2014) 135-151; Joshua Paine, 'The Project of System-Internal Reform in International Investment Law: An Appraisal' (2015) 6 *Journal of International Dispute Settlement* 2, 345: 'A common diagnosis is that employment of inappropriately strict standards of review has resulted in one fundamental aspect of investment law's legitimacy crisis, namely the impression that tribunals illegitimately intrude into public policy determinations which are properly the responsibility of host state organs'.

5. Peter Muchlinski, Horatia Muir Watt, Gus van Harten, Harm Schepel *et al*, 'Statement of Concern about Planned Provisions on Investment Protection and Investor-State Dispute Settlement (ISDS) in the Transatlantic Trade and Investment Partnership (TTIP)' <[www.kent.ac.uk/law/isds\\_treaty\\_consultation.html](http://www.kent.ac.uk/law/isds_treaty_consultation.html)> accessed 29 June 2015. See also José Alvarez, *The Public International Law Regime Governing International Investment* (Hague Academy of International Law 2011) 75-93; Muthucumaraswamy Sornarajah, 'The Case against a Regime on International Investment Law' in Leon E Trakman and Nicola W Ranieri (eds), *Regionalism in International Investment Law* (OUP 2013) 475-498.

6. Burke-White and Von Staden 2010, *supra* note 4, 344-345.

7. Sarah Vasani, 'Bowling to the Queen: Rejecting the Margin of Appreciation Doctrine in International Investment Arbitration' in Ian A Laird and Todd J Weiler (eds), *Investment Treaty Arbitration and*

The current chapter investigates the deference debate in international investment law, outlining the main arguments in favour and against the adoption of deference in investor-state arbitration. It is found that the arguments on both sides depend on broader perspectives on the function of investor-state arbitration and in particular on whether investment protection belongs to the field of public or private law. Once international investment law is understood from a public law perspective and the role of investment tribunals is equated to that of domestic administrative and constitutional courts, the adoption of deference is comprehensible. If, however, international investment law is seen from a private law paradigm and the differences between international arbitration and public law judicial review are emphasised, the adoption of deference becomes more problematic. The current chapter discusses both paradigms in some detail. It is then concluded that different characteristics of the current investment protection regime point in different directions as to its public or private law nature, and that a univocal definition of the 'nature' of international investment law is more normative than empirical. It is also concluded, however, that one of the main assertions of the public law paradigm is misleading, namely that arbitral review should be equalled to the review exercised by domestic administrative and constitutional courts. It is argued here that, unlike domestic judicial review, investment arbitration does not serve to control the exercise of public power within the legal parameters of a constitutional framework. It has a more narrow function, primarily to provide investors with a speedy and international remedy to obtain redress for unforeseen government conduct. Within this context, the logic of deference does not apply in the same manner, because the domestic balance of power between various branches of government is not at risk.

### 3.2 THE CONCEPT OF DEFERENCE IN DOMESTIC ADJUDICATION

In numerous municipal legal systems, courts accord deference to other branches of government when they review their decisions.<sup>8</sup> It entails a form of respect with regard to the prerogatives and competences of other institutions. More specifically,

---

*International Law* (Vol 3, JurisNet 2010) 137-169; Kassi D Tallent, 'The Tractor in the Jungle: Why Investment Arbitration Tribunals Should Reject a Margin of Appreciation Doctrine' in Laird and Weiler, *Investment Treaty Arbitration and International Law* (Vol 3, JurisNet 2010), pp. 111-135. Both authors focus on 'the margin of appreciation', which I understand as an expression of deference. See Jeanrique Fahner, 'The Margin of Appreciation in Investor-State Arbitration: The Prevalence and Desirability of Discretion and Deference' in Nicos Lavranos, Ruth Kok *et al* (eds), *26 Hague Yearbook of International Law 2013* (2014) 422-495.

8. See for a comparative account, Susana Galera (ed), *Judicial Review. A Comparative Analysis inside the European Legal System* (Council of Europe Publishing 2010). Of course, states adhere to different versions and degrees of deference. The distinction between the common law and civil law traditions seems to be of relevance in this regard. See A Stone Sweet and J Matthews, 'Proportionality, Judicial Review, and Global Constitutionalism' in G Bongiovanni, G Sartor and C Valentini (eds), *Reasonableness and Law* (Springer 2009) 203.

deference implies that the reviewing institution allocates additional weight to the arguments of the institution under review, on grounds unrelated to the merits of the case.<sup>9</sup> It implies a certain limitation of the court's intensity of review.<sup>10</sup> Dependent on the legal issue at stake, this might mean that the court presumes the accuracy of a factual assessment made by a government agency or the fairness of a certain policy adopted by a representative body. The amount of deference granted by the court review increases the likelihood that the conduct under review will be considered lawful.

In legal vocabulary, deference can take various forms. It can be expressed in the form of a relative intensity of scrutiny, such as 'lenient scrutiny' or 'intermediate scrutiny'. Alternatively, deference can be translated into a lenient standard of review, such as reasonableness. The Supreme Court of Canada described this standard in the following way:

A court conducting a review for reasonableness inquires into the qualities that make a decision reasonable. Reasonableness is concerned mostly with the existence of justification, transparency and intelligibility within the decision-making process and with whether the decision falls within a range of possible, acceptable outcomes which are defensible in respect of the facts and the law. It is a deferential standard which requires respect for the legislative choices to leave some matters in the hands of administrative decision makers.<sup>11</sup>

In the Supreme Court's approach, 'reasonableness' functions as a normative benchmark against which the contested government conduct is being evaluated. Alternative benchmarks pose a negative criterion, such as the standard of 'arbitrary and capricious' found in United States administrative law.<sup>12</sup> It implies that the reviewing court restricts its evaluation to a verification of whether the contested measure was not arbitrary or capricious; once this condition is fulfilled, no further evaluation by the court is required.<sup>13</sup>

---

9. Comp Andrew Legg, *The Margin of Appreciation in International Human Rights Law. Deference and Proportionality* (OUP 2012) 21.

10. Paul Barker, 'Investor-State Arbitration as International Public Law: Deference, Proportionality and the Standard of Review' in Ian A Laird *et al* (eds), *Investment Treaty Arbitration and International Law* (Vol 8, Juris Publishing 2015) 254.

11. *David Dunsmuir v. New Brunswick* [2008] Supreme Court of Canada <<http://scc-csc.lexum.com/scc-csc/scc-csc/en/item/2408/index.do>> accessed 29 June 2015. See Paul Daly, *A Theory of Deference in Administrative Law: Basis, Application and Scope* (CUP 2012) 15-17.

12. Anna T Katselas, 'Do Investment Treaties Prescribe a Deferential Standard of Review? A Comparative Analysis of the U.S. Administrative Procedure Act's Arbitrary and Capricious Standard of Review and the Fair and Equitable Treatment and Arbitrary or Discriminatory Measures Treaty Standards' (2012) 34 *Michigan Journal of International Law* 1, 87-150.

13. See for a detailed analysis of different forms of deference in investor-state arbitration Esmé Shirlow, 'Deference and Indirect Expropriation Analysis in International Investment Law: Observations on Current Approaches and Frameworks for Future Analysis' (2014) 29 *ICSID Review* 3, 595-626.

Several arguments justify the adoption of deference in domestic public law adjudication. A primary justification is derived from the notion of the separation of powers, which aims to distribute public power among different branches of government in order to prevent an accumulation of power. If courts would engage in an extensive, comprehensive evaluation of decisions made by other governmental institutions, they would effectively substitute their own view for that of the institutions under review. Deference prevents courts from encroaching upon the powers of other branches of government in such a way.

A related argument in favour of deference points out that judicial institutions cannot rely on a direct democratic mandate. It is often argued that the opinion of a small number of unelected judges should not be prioritised over the decisions adopted by institutions that can rely on direct democratic support. This argument depends on how one understands the proper role of judicial review in democratic states. While opponents of judicial review argue that unelected judges should never be empowered to overrule the democratic will, proponents of judicial review argue that democracy is not synonymous with majority rule and that courts have the duty to protect minorities against majorities. Deference allows courts to navigate between these two positions.<sup>14</sup>

In practice, the amount of deference granted by courts will differ depending on the type of decision and institution that is under review.<sup>15</sup> Institutions that rely on a direct democratic mandate may be given more deference than institutions, which lack such legitimation. Likewise, courts may be inclined to adopt a more lenient approach to factual, technical or scientific assessments than to more legal determinations. Given the fact that judges generally do not have expertise in these matters, it is often considered that they should defer to the findings of other, possibly specialised agencies.<sup>16</sup> Another factor that is commonly taken into consideration is the stage of the judicial proceedings. While a first instance court may grant a certain degree of deference to

---

14. See Benedikt Pirker, *Proportionality Analysis and Models of Judicial Review* (Europa Law Publishing 2013) 73-80.

15. Comp *RosInvestCo UK Ltd v. Russia* [2010] SCC V (079/2005) <[www.italaw.com/sites/default/files/case-documents/ita0720.pdf](http://www.italaw.com/sites/default/files/case-documents/ita0720.pdf)> accessed 29 June 2015 [274]: 'one will have to take into account the different functions held by administrative organs and judicial organs of a state and the resulting differences in their discretion when applying the law and in the appeals available against their decisions'.

16. This form of deference has been labelled 'empirical deference', in contrast to 'normative deference' which is granted because of the reasons mentioned earlier. See Caroline Henckels, 'The Role of the Standard of Review and the Importance of Deference in Investor-State Arbitration' in Gruszczynski and Werner (eds) 2014, *supra* note 4, 115-116. See also Lukasz Gruszczynski and Valentina Vadi, 'Standard of Review and Scientific Evidence in WTO Law and International Investment Arbitration. Converging Parallels?' in Gruszczynski and Werner (eds) 2014, *supra* note 4, 152-172; Caroline E Foster, 'Adjudication, Arbitration and the Turn to Public Law 'Standards of Review': Putting the Precautionary Principle in the Crucible' (2012) 3 *Journal of International Dispute Settlement* 3, 525-558; Yuka Fukunaga, 'Standard of Review and "Scientific Truths" in the WTO Dispute Settlement System and Investment Arbitration' (2012) 3 *Journal of International Dispute Settlement* 3, 559-576.

another branch of government, an appeals court normally also attaches weight to the first instance judgment. Arguably, this results in a double degree of deference at the appeals level.<sup>17</sup> Finally, and most importantly, the degree of deference depends on the applicable legal norm against which the contested government act is being reviewed. Courts may consider it relevant to what extent the legal norm is precise and specific and to what extent it leaves discretionary space to the relevant authorities. Whenever courts review compliance with a discretionary norm, they may consider its normative flexibility an additional reason for deference.

### 3.3 ARGUMENTS IN FAVOUR OF DEFERENCE IN INVESTOR-STATE ARBITRATION

Some of the arguments underpinning deference in domestic public law adjudication have been applied in the context of investment arbitration as well. Stephan Schill has argued that since investment tribunals have the same function as domestic courts in public law disputes, tribunals have a sound reason for following their example: 'The domestic court parallel (...) suggests that deference in investment treaty arbitration is justified because domestic courts, when reviewing government conduct, regularly apply a certain degree of deference to implement the idea of the separation of powers'.<sup>18</sup> Similarly, Caroline Henckels has noted that investment arbitration claims 'often involve legal issues that would ordinarily be considered to be constitutional or administrative in nature, and raise the issue of the horizontal dimension of the standard of review in terms of the balance of power between different branches of government'.<sup>19</sup> In addition to the separation of powers, the argument of democratic legitimacy has also been raised in the context of investment arbitration. Henckels notes that 'the adversarial process cannot effectively substitute democratic or other localised decision-making processes'.<sup>20</sup> Similarly, Barnali Choudhury asks: 'if democratically elected governments enact public interest regulations in response to public concerns or to address democratic ideals, how can investment arbitrators make decisions affecting such regulations without public input?'.<sup>21</sup>

---

17. Comp Lukasz Gruszczynski and Wouter Werner, 'Introduction' in Gruszczynski and Werner (eds) 2014, *supra* note 4, 1. See also Dean Spielmann, 'Allowing the Right Margin: The European Court of Human Rights and the National Margin of Appreciation Doctrine: Waiver or Subsidiarity of European Review?' in C Barnard and M Gehring (eds), *Cambridge Yearbook of European Legal Studies* (Vol 14, 2011-2012 Hart 2012) 412-415.

18. Stephan W Schill, 'Deference in Investment Treaty Arbitration: Re-conceptualizing the Standard of Review' (2012) 3 *Journal of International Dispute Settlement* 3, 588.

19. Henckels 2014, *supra* note 16, 121.

20. Caroline Henckels, 'Balancing Investment Protection and the Public Interest: The Role of the Standard of Review and the Importance of Deference in Investor-State Arbitration' (2013) 4 *Journal of International Dispute Settlement* 1, 197-215.

21. Barnali Choudhury, 'Recapturing Public Power: Is Investment Arbitration's Engagement of the Public Interest Contributing to the Democratic Deficit?' (2008) 41 *Vanderbilt Journal of Transnational Law* 3, 779. See also, generally, Andreas von Staden, 'Democratic Legitimacy of Judicial Review beyond the State:

The reasons for granting deference on constitutional and democratic grounds may become more pressing when the issue at stake requires arbitrators to make value judgments on controversial policy questions. Tribunals often insist that they are not requested to review the quality of government decisions in the abstract. The CMS tribunal, for example, dealing with claims concerning Argentina's response to the financial crisis of the early 2000s, ruled that its task was not 'to pass judgment on the economic policies adopted by Argentina'.<sup>22</sup> However, when a tribunal is requested to review government conduct against evaluative norms such as the fair and equitable treatment standard, this inevitably involves a degree of value judgment. In such circumstances, it could be argued that arbitral tribunals should defer to the policy choices made by domestic institutions. Indeed, the tribunal in *S.D. Myers v. Canada*, reviewing a Canadian import ban on toxic waste, held that an investment arbitration tribunal:

does 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.<sup>23</sup>

The difficulties involved with reviewing legislation against investment treaty standards have been explicitly addressed by the tribunal in *Paushok v. Mongolia*. The tribunal held that 'actions by legislative assemblies are not beyond the reach of bilateral investment treaties. A State is not immune from claims by foreign investors in connection with legislation passed by its legislative body'.<sup>24</sup> Nonetheless, the tribunal also ruled that 'the fact that a democratically elected legislature has passed legislation that may be considered as ill-conceived, counter-productive and excessively burdensome does not automatically allow to conclude that a breach of an investment treaty has occurred'.<sup>25</sup> This position arguably implies a degree of deference granted to the institutions under review.<sup>26</sup>

---

Normative Subsidiarity and Judicial Standards of Review' (2012) 10 *International Journal of Constitutional Law* 4, 1023-1049.

22. *CMS Gas Transmission Company v. Argentina* [2005] ICSID Case No ARB/01/8 <[www.italaw.com/sites/default/files/case-documents/ita0184.pdf](http://www.italaw.com/sites/default/files/case-documents/ita0184.pdf)> accessed 1 June 2014 [159].

23. *SD Myers, Inc v. Canada* [2000] UNCITRAL Merits Award <[www.italaw.com/sites/default/files/case-documents/ita0747.pdf](http://www.italaw.com/sites/default/files/case-documents/ita0747.pdf)> accessed 1 June 2014 [261].

24. *Sergei Paushok, CJSC Golden East Company and CJSC Vostokneftegaz Company v. Mongolia* [2011] UNCITRAL, Award on Jurisdiction and Liability <[www.italaw.com/sites/default/files/case-documents/ita0622.pdf](http://www.italaw.com/sites/default/files/case-documents/ita0622.pdf)> accessed 1 June 2014 [298].

25. *Ibid* [299].

26. Jonathan Bonnitcha, *Substantive Protection under Investment Treaties. A Legal and Economic Analysis* (CUP 2014) 213-214: 'The tribunal's view that "ill-conceived, counter-productive and excessively

The *Paushok* tribunal also expressed some sympathy toward the difficult tasks often faced by legislative institutions. The tribunal acknowledged that 'legislative assemblies around the world spend a good part of their time amending substantive portions of existing laws in order to adjust them to changing times or to correct serious mistakes that were made at the time of their adoption'.<sup>27</sup> From this statement, one could deduct another reason for deference, namely that governmental institutions are often required to make difficult decisions in circumstances that are complex but nonetheless demand swift action. Several tribunals have held that arbitrators should not be too critical of such decisions, especially when they could themselves benefit from the benefit of hindsight. For instance, the Annulment Committee reviewing the *Enron v. Argentina* award concerning the Argentine economic crisis wondered whether an assessment of necessity should entail a degree of deference. It questioned whether the credibility of the necessity claim should be determined 'at the date of its award, when the Tribunal may have the benefit of knowledge and hindsight that was not available to the State at the time that it adopted the measure in question'.<sup>28</sup> The Committee appeared to be of the opinion that the tribunal's evaluation should be made 'on the basis of information reasonably available at the time that the measure was adopted' and with regard to the 'margin of appreciation' of the state.<sup>29</sup> In a similar vein, the *Continental Casualty* tribunal accorded a 'significant margin of appreciation' to the respondent state: 'a time of grave crisis is not the time for nice judgments, particularly when examined by others with the disadvantage of hindsight'.<sup>30</sup>

Various authors have argued that while deference is appropriate in the municipal context, it is all the more so in the context of international arbitral review. It has been pointed out that domestic judges are held accountable to the public in various ways, for example through a legislative override. In investment-arbitration, however, there are no comparable accountability mechanisms that tie arbitrators to the public of the host state.<sup>31</sup> On the contrary, it has been argued that arbitrators often lack linkages with the host state's social, political and legal environment. Tribunals are comprised

---

burdensome" legislation would not breach the FET standard clearly precludes substantive review under the FET standard'.

27. *Paushok v. Mongolia*, *supra* note 24 [299].

28. *Enron Creditors Recovery Corp v. Argentina* [2010] ICSID Case No ARB/01/3, Decision on the Application for Annulment <[www.italaw.com/sites/default/files/case-documents/ita0299.pdf](http://www.italaw.com/sites/default/files/case-documents/ita0299.pdf)> accessed 1 June 2014 [372].

29. *Ibid.*

30. *Continental Casualty Co v. Argentina* [2008] ICSID Case No ARB/03/9, Award <[www.italaw.com/sites/default/files/case-documents/ita0228.pdf](http://www.italaw.com/sites/default/files/case-documents/ita0228.pdf)> accessed 3 June 2014 [181]. See also *Gemplus SA et al and Talsud SA v. Mexico* [2010] ICSID Case No ARB (AF)/04/3 and ARB (AF)/04/4, Award <[www.italaw.com/sites/default/files/case-documents/ita0357.pdf](http://www.italaw.com/sites/default/files/case-documents/ita0357.pdf)> accessed 1 June 2014 [6-26]. The tribunal accorded to the respondent 'a generous margin of appreciation, applied without the benefit of hindsight'.

31. Choudhury 2008, *supra* note 21, 818-819.

of 'non-tenured arbitrators who are not necessarily sufficiently embedded in the social, economic and legal background of a case to undertake an informed balancing exercise'.<sup>32</sup> William Burke-White and Andreas von Staden have argued that, for this reason, arbitrators should defer to assessments made by national authorities: 'lack of embeddedness suggests the need for greater deference to decisions made by institutions that are more culturally, legally, and politically embedded'.<sup>33</sup>

Moreover, it has been argued that international tribunals should be inclined to accord deference to respondent states on grounds of their sovereignty. Although the assumption of obligations under international law is arguably a sovereign act itself that cannot be circumvented on grounds of sovereignty, it could be argued that states are entitled to deference with regard to the interpretation and application of treaty norms. As the masters of the treaty, respondent States can be considered to have the final authority on the interpretation of treaty provisions. Also the idea that State are sovereign as concerns their domestic affairs has been used to defend the desirability of deference. The *S.D. Myers* tribunal famously held that arbitral tribunals should acknowledge 'the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders', at least when applying the minimum standard of treatment codified in Article 1105 NAFTA.<sup>34</sup>

Some observers have argued that the concept of deference has become widely accepted by courts and tribunals in diverse fields of international law.<sup>35</sup> Along these lines, the *Continental Casualty* tribunal, referring to the approach of the European Court of Human Rights, held that 'a certain deference' with regard to the application of general standards 'may well be by now a general feature of international law also in respect of the protection of foreign investors under BITs'.<sup>36</sup> This allegedly widespread adoption of deference has been explained with reference to the awareness of courts and tribunals of their limited powers *vis-à-vis* respondent states.<sup>37</sup>

---

32. Pirker 2013, *supra* note 14, 348.

33. Burke-White and Von Staden 2010, *supra* note 6, 332-333.

34. *Myers v. Canada*, *supra* note 23 [263].

35. Yuval Shany, 'Towards a General Margin of Appreciation Doctrine in International Law?' (2006) 16 *European Journal of International Law* 5, 907-940. Valentina Vadi and Lukasz Gruszczynski argue that investment tribunals should follow the example of WTO dispute settlement bodies concerning deference. Valentina Vadi and Lukasz Gruszczynski, 'Standards of Review in International Investment Law and Arbitration: Multilevel Governance and the Commonwealth' (2013) 16 *Journal of International Economic Law* 3, 613-633.

36. *Continental Casualty v. Argentina*, *supra* note 30 [footnote 270].

37. Leonhardsen 2014, *supra* note 4, 139: deference is 'a rational response to the problem of institutional weakness that characterises international courts and tribunals in times when (...) States and those who influence States voice strong criticism'.

With regard to deference in the context of factual and scientific determinations, it has been noted that arbitral tribunals normally lack the expertise to second-guess determinations made by domestic agencies. Unlike domestic institutions, tribunals are not supported by bureaucracies or specialised agencies that can compete with those of respondent states. For this reason, national authorities arguably deserve a degree of deference. As noted by Stephan Schill, the expertise of domestic authorities may 'speak in favour of respecting factual determinations made by domestic institutions, rather than supporting full-blown review by investment treaty tribunals' and of 'respecting science-based determinations made by domestic agencies'.<sup>38</sup> In the case of *Glamis Gold v. United States*, the respondent state raised exactly this argument: 'a high measure of deference to the facts and factual conclusions seems the only way to prevent investment tribunals from becoming science courts'.<sup>39</sup>

A circumstantial argument for deference applies once the contested government act has already been reviewed by domestic courts. If an investor brings an investment treaty claim after domestic remedies have been pursued, this usually means that the tribunal has to rule on the same matter as domestic courts before it.<sup>40</sup> In this situation, the tribunal may consider that the contested government act has already been reviewed by a presumably independent judicial institution before the treaty claim was brought, which arguably implies a ground for deference. However, investors may also complain that the manner in which domestic courts applied domestic law constituted a violation of treaty rights in itself, for example under the fair and equitable treatment standard or under a claim for denial of justice. This requires the tribunal to review the domestic courts' application of domestic law. As tribunals have often acknowledged, however, they are not meant to operate as courts of appeal, while domestic courts may be presumed to know the domestic law of their legal system, at least more so than international arbitral tribunals. This presumption is arguably a strong ground for deference whenever tribunals are required to review the domestic courts' application of municipal law.

### 3.4 ARGUMENTS AGAINST DEFERENCE IN INVESTOR-STATE ARBITRATION

In response to the various argument raised by academic observers and respondent states in favour of deference, opponents have brought up various reasons that militate against the adoption of deference. On a general level, it has been emphasised that by

---

38. Schill 2012, *supra* note 18, 602.

39. *Glamis Gold v. United States*, *supra* note 3 [594].

40. Treaty standards often provide similar protection as municipal standards: 'the protective provisions in international investment agreements (IIAs) cover grounds similar to that covered by administrative law or state liability law in municipal orders'. Van Aken 2010, *supra* note 1, 721.

adopting arbitration clauses in investment treaties, states have themselves empowered arbitral tribunals to interpret and apply treaty norms. As noted by the *Renta 4* tribunal, 'when agreeing to the jurisdiction of international tribunals, states perforce accept that those jurisdictions will exercise their judgment'.<sup>41</sup> In a similar vein, the *Enron* tribunal held:

Judicial determination of the compliance with the requirements of international law in this matter should not be understood as if arbitral tribunals might be wishing to substitute for the functions of the sovereign State, but simply responds to the duty that in applying international law they cannot fail to give effect to legal commitments that are binding on the parties and interpret the rules accordingly.<sup>42</sup>

Admittedly, the mandate given to tribunals to settle disputes between states and investors does not yet tell them how to exercise their review. It could be argued, however, that deference constitutes a constraint of this mandate, which should be explicitly ordered by the relevant treaty.<sup>43</sup>

More specific objections against deference relate to the reasons which compelled states to grant foreign investors access to international arbitration. It should be noted that investment arbitration provides investors with a unique remedy to challenge host state conduct as an alternative to domestic courts. The ICSID Convention itself acknowledges that investment disputes are normally capable of being settled through domestic proceedings.<sup>44</sup> This raises the question of why states offer international arbitration as an alternative to domestic court litigation.<sup>45</sup> A common answer to this question points to the vulnerable position of the foreign investor in the environment of the host state. As noted by Thomas Wälde in his Separate Opinion to the *Thunderbird*

41. *Quasar de Valores SICAV SA, Orgor de Valores SICAV SA, GBI 9000 SICAV SA, ALOS 34 SL (Renta 4) v. Russia* [2012] SCC V (024/2007) Award <[www.italaw.com/sites/default/files/case-documents/ita1075.pdf](http://www.italaw.com/sites/default/files/case-documents/ita1075.pdf)> accessed 1 June 2014 [179]. The award is commonly named after the first original claimant that was denied standing by the tribunal in preliminary award.

42. *Enron Corp and Ponderosa Assets, LP v. Argentina* [2007] ICSID Case No ARB/01/3 <[www.italaw.com/sites/default/files/case-documents/ita0293.pdf](http://www.italaw.com/sites/default/files/case-documents/ita0293.pdf)> accessed 1 June 2014 [340].

43. James Egerton-Vernon, 'Is Investment Treaty Arbitration a Mechanism to Second-Guess Government's Exercise of Administrative Discretion: Public Law or *Lex Investoria*' in Laird *et al* (eds) 2010, *supra* note 10, 201-233; Paine 2015, *supra* note 4, 346.

44. ICSID Convention Preamble: '(...) Bearing in mind the possibility that from time to time disputes may arise in connection with such investment between Contracting States and nationals of other Contracting States; Recognizing that while such disputes would usually be subject to national legal processes, international methods of settlement may be appropriate in certain cases (...)'.

45. See Leon E Trakman, 'Australia's Rejection of Investor-State Arbitration: A Sign of Global Change' in Leon E Trakman and Nicola W Ranieri (eds), *Regionalism in International Investment Law* (OUP 2013) 356-362; Christoph Schreuer, 'Do We Need Investment Arbitration?' in Jean E Kalicki and Anna Joubin-Bret (eds), *Reshaping the Investor-State Dispute Settlement System. Journeys for the 21st Century* (Brill 2015) 879-889.

Award, this position is frequently one of 'structural weakness', because the investor is subjected to the host state's regulatory, administrative and judicial powers.<sup>46</sup> Admittedly, this hierarchical relationship applies to domestic investors as well, but there are certain aspects of the foreign investor's position that may render his situation worse. Firstly, a foreign investor may fear that domestic institutions are biased against him because of his foreign nationality. Secondly, even when such bias is absent, foreign investor may be at a disadvantage in the municipal legal order, because the legal, social, political and cultural environment of the host state is alien to him.<sup>47</sup> When states adopt arbitration clauses in investment treaties, they seek to rebalance the investor's position by offering him access to an international, neutral forum unrelated to the host state itself.

Individuals or corporations engaging in foreign investment enter the situation of 'structural weakness' described by Wälde of their own free will. When the Australian government renounced the practice of investor-state arbitration, it concluded: 'If Australian businesses are concerned about sovereign risk in Australian trading partner countries, they will need to make their own assessments about whether they want to commit to investing in those countries'.<sup>48</sup> It should be noted, however, that states who provide international investment protection do so because they want to attract foreign investment. When states offer potential investors the right to initiate international arbitration, they intend to enhance their credibility and attractiveness as host state.<sup>49</sup> The right to initiate arbitration is supposed to sooth investor concerns over political risk, because potential arbitration claims might prevent the host state from adopting unlawful measures or at least because the arbitration process might provide the investor with compensation in case the preventive effect would fail.

If understood in this way, the purpose of investor-state arbitration could be considered antagonistic to the concept of deference. Access to international arbitration

---

46. *International Thunderbird Gaming Corporation v. Mexico* [2005] UNCITRAL, Separate Opinion of Thomas Wälde <[www.italaw.com/sites/default/files/case-documents/ita0432.pdf](http://www.italaw.com/sites/default/files/case-documents/ita0432.pdf)> accessed 31 October 2014 [12].

47. Thomas Wälde, 'The Specific Nature of Investment Arbitration' in P Kahn and T Wälde (eds), *New Aspects of International Investment Law* (Martinus Nijhoff 2007) 54-55.

48. Australian Government Department of Foreign Affairs and Trade, 'Gillard Government Trade Policy Statement: Trading our Way to More Jobs and Prosperity' (2011) <[www.acci.asn.au/getattachment/b9d3cfae-fc0c-4c2a-a3df-3f58228daf6d/Gillard-Government-Trade-Policy-Statement.aspx](http://www.acci.asn.au/getattachment/b9d3cfae-fc0c-4c2a-a3df-3f58228daf6d/Gillard-Government-Trade-Policy-Statement.aspx)> accessed 31 October 2014.

49. See Jeswald W Salacuse and Nicholas P Sullivan, 'Do BITs Really Work? An Evaluation of Bilateral Investment Treaties and Their Grand Bargain' (2005) 46 *Harvard International Law Journal* 1, 67-130, describing the conclusion of investment treaties between capital-exporting and capital-importing states as a 'grand bargain: a *promise* of protection of capital in return for the *prospect* of more capital in the future'. Some authors have described the development of the BIT network in more critical terms. See e.g. Kate Miles, *The Origins of International Investment Law: Empire, Environment and the Safeguarding of Capital* (CUP 2013).

enables investors to bring complaints in a dispute settlement forum that is unrelated to the host state. As noted by Kassi Tallent, 'the assurance that the investor may have his or her case decided by an impartial, international tribunal is probably the most important promise offered by the state in exchange for the expected benefit of foreign investment'.<sup>50</sup> The logic of deference does not fit with this rationale behind investor-state arbitration. Deference implies that the power to interpret treaty requirements is being shifted back to the host state authorities. By granting deference to the respondent state, tribunals weaken the independent nature of their review. For the same reasons, the alleged lack of embeddedness in the social, economic and cultural background of the host state which distinguishes arbitrators from domestic judges and which has been lamented by Burke-White and von Staden cannot be considered problematic. On the contrary, the lack of ties to the host state is precisely the reason why arbitrators are chosen to review a dispute.

Investment arbitration does not only aspire to be independent, but it also assumes that the parties involved are equal before the tribunal. Sarah Vasani argues that 'a fundamental principle of the investment arbitration system irrespective of the fact that sovereign States are involved is that both parties are to be treated equally'.<sup>51</sup> Deference, however, accords extra weight to the views of one of the parties, namely the host state. By adopting considerations of deference like those common in domestic courts, investment tribunals would reintroduce the inequality between the parties that was a main reason for establishing the arbitration system in the first place.<sup>52</sup>

Arguments related to the normative openness of investment treaty standards have been raised on both sides of the debate. On the one hand, it has been argued that respondent states are entitled to deference, because common investment treaty standards are open-ended and leave a wide discretionary space to host state authorities.<sup>53</sup> On the other hand, it has been observed that since treaty standards pose only minimum obligations for host states, the review exercised by tribunals is already of a very limited nature, which reduces the need for further deference. This is the approach

---

50. Tallent, 'The Tractor in the Jungle', *supra* note 7, 130. See also *Gas Natural SDG v. Argentina* [2005] ICSID Case No ARB/03/10 [29]: 'assurance of independent international arbitration is an important – perhaps the most important – element in investor protection'.

51. Vasani 2010, *supra* note 7, 164.

52. Moreover, it has been argued that in practice the state always enjoys advantages over the investor. For instance, the state has various ways of interfering with arbitration cases that the investor lacks. Charles N Brower, 'W(h)ither International Commercial Arbitration. The Goff Lecture 2007' (2008) 24 *Arbitration International: The Journal of LCIA Worldwide Arbitration* 2, 189-190. This argument renders deference even more undesirable. See also Thomas W. Wälde, 'Procedural Challenges in Investment Arbitration under the Shadow of the Dual Role of the State: Asymmetries and Tribunals' Duty to Ensure, Pro-actively, the Equality of Arms' (2010) 26 *Arbitration International* 1, 3-42.

53. See Anne van Aken, 'International Investment Law between Commitment and Flexibility: A Contract Theory Analysis' (2009) 12 *Journal of International Economic Law* 2, 527-531.

taken by the *Glamis Gold* tribunal. It disagreed with the respondent 'that domestic deference in national court systems is necessarily applicable to international tribunals'.<sup>54</sup> The tribunal found 'the standard of deference to already be present in the standard as stated, rather than being additive to that standard', because a breach of Article 1105 NAFTA required 'something greater than mere arbitrariness, something that is surprising, shocking, or exhibits a manifest lack of reasoning'.<sup>55</sup> The reasoning of the *Glamis Gold* tribunal shows the complexities of the relationship between deference and the flexibility of the applicable norm. While some observers argue that a flexible norm is a reason for granting deference, the *Glamis Gold* approach implies that since the applicable norm is already lenient, there is no need for 'additional' deference.<sup>56</sup>

Specific arguments have been raised against deference on grounds of the separation of powers and the democratic legitimacy of host state measures. It has been pointed out that in various host states, democratic modes of decision-making are absent and administrative agencies lack expertise or suffer from corruption. In those circumstances, the logic of the separation of powers becomes problematic. Moreover, even when domestic decision-making procedures reflect the popular will, this may have less relevance in the context of international investment law than in the domestic constitutional scheme. Investment treaty protection may actually be offered precisely to protect foreign investors from the popular will in certain circumstances, since foreign investments are common targets of domestic discontent, especially in times of economic crisis.<sup>57</sup>

Furthermore, it has been emphasised that foreign investors do not participate in domestic decision-making processes. Domestic public law courts grant deference to other branches of government in order to respect the democratic will and also because discontented citizens have other means to advance their cause, such as their vote. Foreign investors do not have the same position. As noted by Kassi Tallent, 'the investor is an outsider to the democratic processes influencing the development and application of state regulatory measures'.<sup>58</sup> The *Tecmed* tribunal, reviewing the closing of an industrial waste landfill, expressed the same rationale:

the foreign investor has a reduced or nil participation in the taking of the decisions that affect it, partly because the investors are not entitled to exercise political rights reserved to the

---

54. *Glamis Gold v. United States*, *supra* note 3 [617].

55. *Ibid.*

56. See for the same argument Rahim Moloo and Justin M Jacinto, 'Standards of Review and Reviewing Standards: Public Interest Regulation in International Investment Law' in Karl P Sauvart (ed), *Yearbook on International Investment Law and Policy 2011-2012* (OUP 2013) 539-567.

57. Anthea Roberts, 'Clash of Paradigms: Actors and Analogies Shaping the Investment Treaty System' (2013) 107 *American Journal of International Law* 1, 68; Vasani 2010, *supra* note 7, 167. M Sornarajah, *The International Law on Foreign Investment* (3rd edn, CUP 2010) 71-72.

58. Tallent, 'The Tractor in the Jungle', *supra* note 7, 130.

nationals of the State, such as voting for the authorities that will issue the decisions that affect such investors.<sup>59</sup>

The investor's exclusion from domestic politics arguably militates against the adoption of domestic concepts such as the separation of powers within the context of investment law. Within the domestic scheme, judicial deference expresses respect towards the decisions taken by other institutions with democratic involvement. Because foreign investors are not similarly involved in domestic decision-making procedures, the logic of deference cannot be applied in the same way in investor-state arbitration.

Various tribunals have rejected the argument that deference has become a general feature of international adjudication. When the respondent in *Siemens v. Argentina* invoked the case law of the European Court of Human Rights, the tribunal held that this Court applied a 'margin of appreciation not found in customary international law'.<sup>60</sup> The *Renta 4* tribunal also objected to the idea that the concept of the 'margin of appreciation' should be applied in the context of investment law. Comparing the protection offered by a BIT to the protection offered by human rights treaties, the tribunal held:

Human rights conventions establish minimum standards to which all individuals are entitled irrespective of any act of volition on their part, whereas investment-protection treaties contain undertakings which are explicitly designed to induce foreigners to make investments in reliance upon them. It therefore makes sense that the reliability of an instrument of the latter kind should not be diluted by precisely the same notions of 'margins of appreciation' that apply to the former.<sup>61</sup>

According to the tribunal, the purpose of human rights protection on the one hand and investment protection on the other hand is too different to allow a cross-regime application of the margin of appreciation.

In general, it appears that tribunals are reluctant to accord deference to the determinations made by respondent states. On the basis of an investigation of 243 investment arbitration awards, Gus van Harten has concluded that arbitrators are more likely to engage in unrestrained review than domestic courts. According to van Harten, tribunals 'assumed far-reaching authority to oversee states intensively in relation to legislative and executive decision-making and in spite of the overlapping role of other

---

59. *Técnicas Medioambientales Tecmed SA v. Mexico* (2003) ICSID Case No ARB (AF)/00/2 <[www.italaw.com/sites/default/files/case-documents/ita0854.pdf](http://www.italaw.com/sites/default/files/case-documents/ita0854.pdf)> accessed 15 September 2015 [122].

60. *Siemens AG v. Argentina* (2007) ICSID Case No ARB/02/8 <[www.italaw.com/sites/default/files/case-documents/ita0790.pdf](http://www.italaw.com/sites/default/files/case-documents/ita0790.pdf)> accessed 15 September 2015 [354].

61. *Renta 4 v. Russia*, *supra* note 41 [22].

adjudicators'.<sup>62</sup> He concludes that the current tendency among arbitrators is 'to assert explicitly or implicitly an expansive role for themselves to decide whether the choices and conduct of another decision-maker were correct'.<sup>63</sup>

### 3.5 THE FUNCTION OF INVESTOR-STATE ARBITRATION: PRIVATE LAW DISPUTE SETTLEMENT OR PUBLIC LAW JUDICIAL REVIEW?

The ultimate answer to the question of whether investment tribunals should defer to domestic authorities seems to be related to broader perspectives on the nature or character of investor-state arbitration. In particular, it appears that the concept of deference is more widely appreciated by observers who emphasise the public law characteristics of investor-state arbitration, while observers familiar with a private law perspective are more critical of its adoption.<sup>64</sup>

It has often been pointed out that investor-state arbitration is modelled after commercial arbitration.<sup>65</sup> International commercial arbitration, developed in order to provide parties in cross-border business disputes with a speedy and presumably neutral adjudication mechanism, has several features which states consider useful for the settlement of investment disputes as well. Compared with court adjudication, arbitration is hailed for its speediness, neutrality and the possible confidentiality of the proceedings. States endorse commercial arbitration out of respect for 'the autonomous decisions of commercial actors to displace the courts' competence and replace it with a mutually constructed alternative'.<sup>66</sup>

Investor-state arbitration shares many of the procedural characteristics of commercial arbitration.<sup>67</sup> In both types of proceedings, disputing parties agree to bring their dispute before an *ad hoc* tribunal, of which all or some of the members are chosen by the

---

62. Gus van Harten, *Sovereign Choices and Sovereign Constraints: Judicial Restraint in Investment Treaty Arbitration* (OUP 2013) 17. See also Gus van Harten, 'Judicial Restraint in Investment Treaty Arbitration: Restraint Based on Relative Suitability' (2014) 5 *Journal of International Dispute Settlement* 1, 5-39.

63. *Ibid* 162. This does of course not necessarily mean that the state is found in breach. See Susan D Franck, 'Empirically Evaluating Claims about Investment Treaty Arbitration', 86 *North Carolina Law Review* 1 (2007) 84, finding 'reasonably equivalent investor and state win rates'.

64. Anthea Roberts, 'The Next Battleground: Standards of Review in Investment Treaty Arbitration' (2011) *International Council for Commercial Arbitration Congress Series No 16* (2011) 170-180; Julian Arato, 'The Margin of Appreciation in International Investment Law' (2014) 54 *Virginia Journal of International Law* 3, 555; Egerton-Vernon 2010, *supra* note 43, 201-233.

65. Barton Legum, 'Investment Treaty Arbitration's Contribution to International Commercial Arbitration – The Effects of Investment Treaty Arbitration on International Commercial Arbitration, and their Significance' (2005) 60 *Dispute Resolution Journal* 3, 70-75.

66. Van Harten 2007, *supra* note 2, 61.

67. For some differences, see Karl-Heinz Böckstiegel, 'Commercial and Investment Arbitration: How Different Are They Today? The Lalive Lecture 2012' (2012) 28 *Arbitration International* 4, 577-590.

parties. The tribunal is empowered to rule on its own jurisdiction and the outcome of the proceedings is a damage award that is binding on the parties. The isolation from court review that characterises commercial arbitration occurs in investor-state arbitration as well, since investor-state awards cannot be set aside by domestic courts, except in cases of serious procedural shortcomings.<sup>68</sup>

The private law origins of investor-state arbitration are widely acknowledged. Moreover, some authors argue that the type of obligations at stake in international investment law are of a private nature. Moshe Hirsch, for example, contends that 'international investment law emphasises the private law aspects of the relations between host governments and foreign investors'.<sup>69</sup> According to Hirsch, the primary inquiry undertaken in the context of investment arbitration focuses on obligations deriving from promises made by state authorities and from the regulatory framework as it existed when the investment was negotiated and entered into. For this reason, Hirsch argues, international investment law 'largely aims to protect various private law undertakings that are made between the host state and the foreign investor'.<sup>70</sup> From this perspective, investment arbitration does not serve to evaluate the lawfulness of government in the abstract, but only to verify whether the assurances relied on by the investor were complied with.

In spite of the private law roots of international arbitration, observers have started to stress the public law characteristics of international investment law.<sup>71</sup> A first element that has been emphasised in this regard is the source of the consent to arbitration on the side of the state. Historically, most arbitrations between a state and a foreign investor depended on arbitration clauses provided in investment contracts.<sup>72</sup> The main innovation of the current international investment law regime was the codification of general consent to arbitration in investment protection treaties.<sup>73</sup> As a result of this general consent, any party who fell within the definitions of the treaty became

---

68. Lars Markert and Helene Bubrowski, 'National Setting Aside Proceedings in Investment Arbitration' in Marc Bungenberg *et al* (eds), *International Investment Law. A Handbook* (Hart 2015) 1460-1481.

69. Moshe Hirsch, 'Investment Tribunals and Human Rights: Divergent Paths' in Pierre-Marie Dupuy, Ernst-Ulrich Petersmann and Francesco Francioni, *Human Rights in International Investment Law and Arbitration* (OUP 2009) 114.

70. *Ibid* 109.

71. Gus van Harten and Martin Loughlin, 'Investment Treaty Arbitration as a Species of Global Administrative Law' (2006) 17 *European Journal of International Law* 1, 121-150; Santiago Montt, *State Liability in Investment Treaty Arbitration* (Hart 2009); Stephan W Schill, 'Enhancing International Investment Law's Legitimacy: Conceptual and Methodological Foundations of a New Public Law Approach' (2011) 52 *Virginia Journal of International Law* 1 (2011) 57-102. See also Barry Leon and John Terry, 'Special Considerations When a State is a Party to International Arbitration. Why Arbitrating against a State is Different: 12 Key Reasons' (2006) 61 *Dispute Resolution Journal* 1, 68-76.

72. Van Harten 2007, *supra* note 2, 63.

73. See Surya P Subedi, *International Investment Law. Reconciling Policy and Principle* (Hart 2008) 32-33, speaking about a 'silent revolution in foreign investment law'.

entitled to initiate an arbitration claim. According to van Harten, this innovation transformed 'international arbitration from a form of reciprocally consensual adjudication into a governing arrangement'.<sup>74</sup> General consent to arbitration has created a new layer of arbitral control of government conduct.

A second characteristic of the current international investment law regime, which is emphasised in the public law paradigm is the subject matter of common investment disputes. It has been argued that these disputes are not limited to contractual disputes concerning the state's private conduct, but instead involve its exercise of public power and potentially affect entire populations.<sup>75</sup> As noted by Stephan Schill, investment arbitration disputes often concern domestic policy-making, as is evident from cases concerning water concessions, affirmative action programs, environmental protection measures, public health programs and economic reforms.<sup>76</sup> In a similar vein, Burke-White and von Staden note that investment arbitration is not restricted to 'merely technical questions', but 'frequently implicates the scope of the regulatory powers of the respondent state'.<sup>77</sup> Consequently, investment arbitration engages with contested policy choices, with the balancing of private and public interests and with the state's general definition of the public good. These issues are commonly considered to fall within the scope of public law. A related argument concerns the relationship between the different parties involved. Investment treaties are signed between equal, sovereign states and disputing parties are considered equal before arbitral tribunals. In their everyday relationship, however, the relationship between the disputing parties is one between sovereign and subordinate. The law that governs this sort of relationship is typically considered public law.

A third characteristic of international investment law that allegedly demonstrates its public law nature is the contribution of investment arbitration awards to the development of international law. Stephan Schill has argued that international investment law is not only concerned with 'backing up private ordering between foreign investors and host states', but instead with 'providing a legal framework for a public international economic order'.<sup>78</sup> While investment arbitration awards do not formally have the value of precedent, in reality awards are often quoted and discussed by subsequent tribunals ruling on similar matters. This is not surprising given the fact that different cases often concern similarly phrased treaty provisions or standards of customary international law. Consequently, although no formal rule of precedent exists

---

74. Van Harten 2007, *supra* note 2, 64.

75. Barker 2015, *supra* note 10, 238: 'The central premise of this paper is that investor-state arbitration can directly affect the lives of entire populations who are not parties to, and are far removed from, any particular case'.

76. Schill 2012, *supra* note 18, 577-578.

77. Burke-White and Von Staden 2010, *supra* note 4, 284.

78. Schill 2010, *supra* note 2, 3.

in international investment law, in reality awards have an impact that goes beyond the specific case at hand.<sup>79</sup>

In conjunction with the adoption of a public law paradigm in international investment law, observers have started to define the function of investment arbitration in terms of 'judicial review'.<sup>80</sup> Federico Ortino, for example, has argued that 'the main object of an investment treaty is the establishment of a system of judicial review reserved for foreign investors'.<sup>81</sup> Similarly, Stephan Schill has proposed that investor-state arbitration should be viewed as 'more akin to administrative or constitutional judicial review than to commercial arbitration'.<sup>82</sup> Arbitration allows the investor, as a subordinate of the state, to challenge government action. Within the domestic scheme, such challenges are normally dealt with by domestic courts who are empowered to engage in administrative or constitutional judicial review. Gus van Harten summarised the point as follows:

In many states, adjudication plays an important and expanding role in regulating relations between individuals and the state. One of the core functions of the judiciary is to constrain the exercise of sovereign authority by executive government and, under many constitutions, by the legislature. When a judge invokes his or her public law competence to resolve a dispute between the state and a person or organization that is subject to regulation by the state, he or she determines matters such as the legality of governmental activity, the degree to which individuals should be protected from regulation, and the appropriate role of the state. The role of arbitrators under investment treaties is essentially the same.<sup>83</sup>

The public law paradigm in international investment law seems to have found wide acceptance in academia. This has clear consequences for the debate on deference. Once investor-state arbitration is understood as a judicial review mechanism in a public law field, the case for deference becomes much stronger, while the arguments against deference are sometimes being rejected as an obsolete insistence on the private law origins of international arbitration.<sup>84</sup>

---

79. *Comp Saipem S.p.A. v. Bangladesh* (2009) ICSID Case No ARB/07/7 <[www.italaw.com/sites/default/files/case-documents/ita0734.pdf](http://www.italaw.com/sites/default/files/case-documents/ita0734.pdf)> accessed 15 September 2015 [90]: 'The Tribunal considers that it is not bound by previous decisions. At the same time, it is of the opinion that it must pay due consideration to earlier decisions of international tribunals. It believes that, subject to compelling contrary grounds, it has a duty to adopt solutions established in a series of consistent cases. It also believes that, subject to the specifics of a given treaty and of the circumstances of the actual case, it has a duty to seek to contribute to the harmonious development of investment law and thereby to meet the legitimate expectations of the community of States and investors towards certainty of the rule of law'.

80. See e.g. *International Thunderbird v. Mexico*, Opinion Thomas Wälde, *supra* note 46 [13].

81. Federico Ortino, 'The Investment Treaty System as Judicial Review' (2013) 24 *American Review of International Arbitration* 3, 443.

82. Schill 2010, *supra* note 2, 4.

83. Van Harten 2007, *supra* note 2, 71.

84. Other issues to which the distinction matters are e.g., transparency, third-party participation and the relevance of norms originating from other fields of international law, such as human rights or

It should be noted, however, that the public law paradigm in international investment law is not without weaknesses. For instance, it leaves unclear why states opted for the mechanism of arbitration in the first place. As noted by Anthea Roberts, 'public law proponents assume that the choice of arbitration was not intended to import private law concepts or approaches into the field, or that, if it were, this was a mistake that should be rectified by the introduction of an international investment court'.<sup>85</sup> Instead, it could be argued that states deliberately chose for international arbitration, because they wanted the international remedy reserved for foreign investors to have a more narrow function than public law adjudication.<sup>86</sup>

In sum, it appears that some characteristics of investor-state arbitration seem to demonstrate its public law nature, while other characteristics fit better in a private law paradigm.<sup>87</sup> Arguably, investment law 'is not a subgenre of an existing discipline. It is dramatically different from anything previously known in the international sphere'.<sup>88</sup> Consequently, discussions on whether the public law or the private law paradigm provide the best conceptual framework for understanding investor-state arbitration cannot be concluded on the basis of empirical arguments alone. Since the system comprises both public and private law characteristics, observers will emphasise the relevance of those elements that fit with their normative assumptions.<sup>89</sup>

Nonetheless, it is concluded here that some of the public law arguments are misleading, notably the idea that investment arbitration is a form of judicial review. In spite of the similarities between investment arbitration and municipal administrative and constitutional adjudication, it appears that the purpose of both types of proceedings is fundamentally different. It seems that while the purpose of domestic court

---

environmental law. Roberts 2013, *supra* note 57, 65. Answers to questions related to consistency and precedent may also depend on the chosen paradigm. See Susan D Franck, 'The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law through Inconsistent Decisions', 73 *Fordham Law Review* 1521 (2004-2005). See also Benedict Kingsbury and Stephan W Schill, 'Public Law Concepts to Balance Investors' Rights with the State Regulatory Actions in the Public Interest – the Concept of Proportionality' in Schill 2010, *supra* note 1, 75-104.

85. Roberts 2013, *supra* note 57, 68.

86. Katselas 2012, *supra* note 12, 147: 'the use of arbitration rather than adjudication is meaningful and suggests that states may have had a dispute-settlement rather than an administrative review function in mind when they signed onto the system'; Egerton-Vernon 2010, *supra* note 43, 231: investor-state arbitration 'was deliberately designed by States to be a hybrid system, a *lex investoria* incorporating a private international arbitration model designed to address disputes that often involve issues of public international law'.

87. Stephan Wittich, 'State Responsibility' in Bungenberg 2015, *supra* note 68, 37, noting the 'hybrid nature of investment law'.

88. Jan Paulsson, 'Arbitration without Privity' (1995), 10 *ICSID Review* 2, 232. Quoted in Roberts 2013, *supra* note 57, 94.

89. See for a general argument against the distinction between public and private international law Alex Mills, *The Confluence of Public and Private International Law. Justice, Pluralism and Subsidiarity in the International Constitutional Ordering of Private Law* (CUP 2009).

adjudication is to ensure the legitimacy of the exercise of public power, the purpose of investment arbitration is only to compensate foreign investors for damages that, if foreseen, would have prevented them from investing.

The narrow purpose of investment arbitration in comparison to domestic court adjudication can be demonstrated with reference to the remedies available in both types of proceedings. As noted by Anne van Aken, it is helpful to distinguish between primary remedies, which have a preventive or restorative function and include declaratory actions and injunctions, and secondary remedies, which are directed at pecuniary damages. Van Aken contends: 'whereas municipal legal orders tend to be reluctant to grant pecuniary damages and require the use of (preventive) primary remedies against the (illegal) act *per se*, international investment law most heavily relies on *ex post* secondary remedies'.<sup>90</sup> A similar point is raised by Andreas Kulick, who argues that in domestic courts the greatest concern of the state is to avoid 'the stigma of unlawfulness'. In investor-state arbitration, on the other hand, the host state is mostly concerned with avoiding liability, according to Kulick.<sup>91</sup> Of course, arbitral tribunals cannot award compensation without the finding of a treaty violation, while plaintiffs in domestic courts often also seek monetary compensation for unlawful government conduct. This does not mean, however, that the primary purpose of both mechanisms is similar. Compensation appears to be the core aim of investment arbitration, while public law adjudication has a broader role in ensuring the legitimacy of public governance. As noted by José Alvarez, the purpose of investor-state dispute settlement is not to force states to correct their mistakes, but 'to secure a compensatory remedy for past harms done'.<sup>92</sup>

In theory, investment tribunals have the formal power to order other remedies than compensation, but in reality this rarely occurs, for several reasons.<sup>93</sup> Firstly, by definition an investor-state arbitration claim is related to an investment, so the ultimate interest of the applicant is probably a monetary interest. Moreover, investment arbitration claims are mostly raised once the investment has already been terminated and the investor's interests have been reduced to obtaining compensation. Secondly, the enforcement of secondary remedies is more feasible than that of primary remedies granted at the international level. A pecuniary award is enforceable through domestic

---

90. Van Aken 2010, *supra* note 1, 723.

91. Andreas Kulick, 'Book Review' of Schill, *supra* note 1 (2011) 22 *European Journal of International Law* 3, 922.

92. Alvarez 2011, *supra* note 5, 52.

93. Pirker 2013, *supra* note 14, 347; Christoph Schreuer, 'Non-Pecuniary Remedies in ICSID Arbitration' (2004) 20 *Arbitration International* 4, 325-332; Berk Demirkol, 'Remedies in Investment Treaty Arbitration' (2015) 6 *Journal of International Dispute Settlement* 2, 403-426. See for an argument in favour of non-pecuniary remedies Gisele Stephens-Chu, 'Is it Always All About the Money? The Appropriateness of Non-Pecuniary Remedies in Investment Treaty Arbitration' (2014) 30 *Arbitration International* 4, 661-686.

courts on grounds of the ICSID Convention or the New York Convention, while a primary remedy requires more readiness to cooperate on the side of the state.<sup>94</sup> Some tribunals have explicitly refused to order other remedies than compensation. The tribunal in *LG&E v. Argentina*, for example, held that it was not empowered to order a 'modification of the current legal situation by annulling or enacting legislative and administrative measures'.<sup>95</sup> This would imply an 'undue interference' with the respondent's sovereignty'.<sup>96</sup> Because tribunals are reluctant to engage in such interference, investment awards have normally no impact on the domestic legitimacy of the contested measure. This distinguishes awards from domestic court judgments, which can result in the nullification or invalidation of legislation or administrative measures.

It has been argued that even when arbitral tribunals order only monetary awards, the sheer amount of compensation may have serious consequences for the host state. A famous example is the case of *CME v. Czech Republic*. According to Van Harten, 'the award of \$353 million placed an enormous strain on the public finances of the Czech Republic', equalling the country's entire health-care budget.<sup>97</sup> Financial burdens of this kind may effectively force the host state to change its policies, for example when there is a risk of further claims by other investors in similar circumstances.<sup>98</sup> In general, however, it seems that tribunals do not often order large amounts of compensation. Investors commonly obtain only a fraction of the amounts claimed, if anything at all. Of a total number of 82 cases analysed by Susan Franck in 2007, only 22 resulted in a damage award and only in 4 cases the tribunals awarded more than \$10 million.<sup>99</sup> On the basis of this analysis, Franck suggests that the average amount of damages awarded by investor-state arbitration tribunals is comparable to those granted by other international adjudicators.<sup>100</sup> Moreover, even when tribunals award damages, host states have various means to resist enforcement and prevent the investor from recovering their money. Consequently, it seems that although awards in theory have the potential to substantially affect host state policies, in reality this may hardly ever happen.

---

94. Van Aken 2010, *supra* note 1, 734. See also Article 54(1) ICSID Convention. Stephan Wittich, 'Investment Arbitration: Remedies' in Bungenberg 2015, *supra* note 68, 1401-1402.

95. *LG&E Energy Corp v. Argentina* [2007] ICSID Case No ARB/02/1, Award <[www.italaw.com/documents/LGEEEnglish.pdf](http://www.italaw.com/documents/LGEEEnglish.pdf)> accessed 1 July 2015 [87]. See, critically, Wittich 2015, *supra* note 94, 1398-1400.

96. *LG&E v. Argentina*, *supra* note 95 [87]. But see Thomas W Walde and Borzu Sabahi, 'Compensation, Damages, and Valuation' in Peter Muchlinski *et al* (eds), *The Oxford Handbook of International Investment Law* (OUP 2008) 1055-1056, pointing out that an order to re-do a procedurally flawed decision may be less intrusive than a large damages award.

97. *CME Czech Republic BV v. Czech Republic* [2003] UNCITRAL, Final Award <[www.italaw.com/sites/default/files/case-documents/ita0180.pdf](http://www.italaw.com/sites/default/files/case-documents/ita0180.pdf)> accessed 15 September 2015; Van Harten 2007, *supra* note 2, 7.

98. Choudhury 2008, *supra* note 21, footnote 319.

99. Franck 2007, *supra* note 63, 55-66.

100. *Ibid* 58.

The review exercised by domestic administrative and constitutional courts forms part of the checks and balances that have been developed within systems of government in order to prevent powerful actors to seize public power at the cost of other actors and to prevent a tyranny of the majority. Together with other branches of governments, the domestic court system plays a specific, balanced role in the legitimisation of the exercise of public power. For this reason, judicial review is embedded in institutional structures that ensure the continuity and consistency of jurisprudence, as well as a due respect for the prerogatives of other branches of government. Arguably, investor-state arbitration does not form part of these constitutional arrangements.<sup>101</sup> Rather, it is an external mechanism provided with the mere purpose of soothing investor concerns over the quality of domestic adjudication. It is an extra-constitutional form of review of government conduct, provided exclusively for the benefit of foreign investors and without repercussions for the domestic legitimacy of governance. For this reason, international investment protection has been compared to a political risk insurance.<sup>102</sup> As noted by Benedikt Pirker, investment arbitration pursues ‘the logic of an insurance policy for investors which offers the determination of a breach and calculation of compensation *ex post*’.<sup>103</sup> Consequently, the main task of tribunals is to provide appropriate compensation, rather than to re-assess ‘the balancing of interests undertaking by a legislator or administrator in order to suggest a “better” balance’.<sup>104</sup>

The limited scope and function of arbitral review distinguishes investment arbitration from public law review, even though both types of proceedings involve the evaluation of government conduct. Whereas judicial review serves to control the legitimate exercise of public power by legislative and executive branches of government within a constitutional framework, investment arbitration entails a mechanism specifically aimed at settling disputes between a host state and an investor concerning the former’s treaty commitments.<sup>105</sup> This difference affects the desirability of deference in

---

101. This seems to distinguish investment arbitration from standing international courts, such as the European Court of Human Rights, the World Trade Organization Dispute Settlement Bodies and the European Court of Justice, which have a more ‘constitutional’ role. See Alec Stone Sweet and Thomas L Brunell, ‘Trustee Courts and the Judicialization of International Regimes. The Politics of Majoritarian Activism in the ECHR, the EU, and the WTO’ (2013) *Yale Law School Faculty Scholarship Series*. Paper 4625 <[http://digitalcommons.law.yale.edu/fss\\_papers/4625](http://digitalcommons.law.yale.edu/fss_papers/4625)> accessed 1 July 2015.

102. Subedi 2008, *supra* note 73, 89. For certain differences, see Kaj Hobér and Joshua Fellenbaum, ‘Political Risk Insurance and Investment Treaty Protection’ in Bungenberg 2015, *supra* note 68, 1517-1551.

103. Pirker 2013, *supra* note 14, 347.

104. *Ibid.* See also Pieter Bekker and Akiko Ogawa, ‘The Impact of Bilateral Investment Treaty (BIT) Proliferation on Demand for Investment Insurance: Reassessing Political Risk Insurance After the “BIT Bang”’ (2013) 28 *ICSID Review* 2, 314-350. Bekker and Ogawa argue that the protection offered by BITs is substantially similar to that offered by political risk insurance, although they did not find a causal link between BIT proliferation and demand for political risk insurance.

105. Katselas 2012, *supra* note 12, 147: ‘the function performed by investment tribunals should not be regarded as equal to the administrative review function, and certainly not to the constitutional-review

international investment law.<sup>106</sup> In the municipal context, deference ensures a legitimate allocation of public power among different branches of government. Investment arbitration, however, does not concern the constitutional legitimacy of government conduct, but only the host state's compliance with treaty standards. Consequently, the major justification for deference in the domestic context, the logic of the separation of powers, does not apply in international investment law. While arbitral tribunals may issue condemning awards that require the host state to pay compensation, this does not affect the domestic balance of powers between the different actors in the constitutional scheme.

### 3.6 CONCLUDING REMARKS

There are few fields of law in which the legitimacy of different forms of dispute resolution is as topical as it is in international investment law today. Within this field, the practice of investor-state arbitration has come under growing criticism for its alleged infringements on national sovereignty and its prioritisation of private over public interests. It has been argued that the legitimacy of the current regime could be reinforced if tribunals would adopt a deferential approach to the review of contested domestic measures. Similar approaches have been developed by domestic administrative and constitutional courts who exercise judicial review.

This chapter has found, however, that the function of investment arbitration is different from that of domestic judicial review. Whereas judicial review serves to ensure the legitimacy of government action within the constitutional framework, investment arbitration has a more narrow function. Its main purpose is to give investors the opportunity to obtain indemnification for losses caused by unforeseeable host state conduct. It is offered in order to sooth investor concerns about regulatory change and other state measures that would hamper the profitability of the investment. Certainly, arbitral review of government conduct involves a certain degree of evaluation, but unlike domestic judicial review, it does not influence the balance of power between different branches of government, which is where the logic of deference originates from.

---

function, performed by national courts. Investment arbitration is an alternative to a host state's courts that foreign investors may choose in the event of a dispute with the state, but it is no substitute for judicial review'. For Katselas, however, the differences between arbitral and judicial review provide a reason for even greater deference in the context of investment arbitration.

106. James Egerton-Vernon argues that deference actually comprises the legitimacy of investor-state arbitration. Egerton-Vernon 2010, *supra* note 43, 204: 'Tribunals must reject the application of inappropriate public law standards of review and instead revert to the strict application of the provisions of the international treaties governing their disputes. Only through thereby returning investment law to its private law roots can it perform the function for which it was created'. Egerton-Vernon argues that it should be left to states to reform the current system as they see fit.

The narrow approach to investor-state arbitration described so far may soothe some of the concerns raised against it in recent times. In response to the fear that investor-state arbitration threatens democratic decision-making, it could be emphasised that the evaluation of state policies undertaken by arbitral tribunals is of a different nature than the one undertaken by administrative and constitutional courts. Moreover, the alleged intrusion into sovereignty could be put into perspective by the fact that an arbitral award does not touch upon the legality of state measures in the domestic legal order, but only results in the indemnification of the investor.

The argument proposed here is different from the public law approach to international investment law. According to the latter perspective, the legitimacy of investor-state arbitration can be enhanced if arbitral tribunals would act more like domestic courts involved in the judicial review of state action. It is argued here, however, that the legitimacy of investor-state arbitration would be better served by a sharper distinction between the functions of arbitral tribunals on the one hand and domestic courts on the other hand. Conceiving investor-state arbitration as the international counterpart of administrative law review may actually threaten the legitimacy of the international investment law regime, because it turns arbitral tribunals into administrators of global governance and, consequently, expands their authority beyond the settlement of investor claims, which was their original mandate.

