21st Century Investment Agreements: Justice, Governance and the Rule of Law

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Investment treaty law can no longer be managed as if it were merely a system of private ordering setting out the protected rights of capital owners. This philosophy has contributed to the ongoing legitimacy crisis affecting investment law today, including the TPP and TTIP negotiations.\(^1\) In response to a similar legitimacy crisis in the 1990s, the international trade system began a profound paradigm shift, recognizing that trade law was not simply a technical regime for liberalizing economic flows, but a system of treaty-based governance for managing transnational economic resources for the good of society as a whole.\(^2\)

Investment law has today reached the same point, and a similar paradigm shift is the key to successful resolution of the legitimacy crisis facing international investment.\(^3\) The international investment regime certainly involves private actors with valid and important interests, but it is not solely about private actor rights — it is also about state responsibilities to the larger society. International investment agreements (IIAs) are instruments of economic governance, by their nature subject to principles of procedural and distributive justice, as with any system that allocates social resources.

_Investment Law as Governance_

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IIAs are part of a governance system meant to ensure justice and the rule of law for everyone in the allocation of investment capital. International investment law is governance, because through it states use their sovereign powers to set the basic framework in public law for economic activity, in this case for the regulation of foreign investment capital within their jurisdictions. This framework includes a legal mechanism for the settlement of resulting disputes that will also involve the state as a party, and that can effectively overriding host state regulatory decisions. In establishing and deploying this framework, states make a range of political and distributive decisions involving power, rights and resources that are quite familiar to domestic law.

However, as a system of governance, international investment law today is seriously deficient. Structural and normative aspects of IIAs — their asymmetric focus on investor rights and how those rights have been interpreted by arbitral panels — leave large segments of the affected public in host countries, meaning most of us, without effective voice.

These structural deficits have come under increasing scrutiny in part due to a number of high-profile investment disputes involving social issues implicated by investment. These include the many cases arising from the Argentine economic crisis of the early 2000’s (investment and human rights),4 and more recent cases involving developing country host states such as Tanzania (investment and public health),5 newly industrialized host states such as Mexico (investment and environmental protection),6 and developed host states such as Australia


5 Biwater Gauff (United Republic of Tanzania) Ltd. v. United Republic of Tanzania, ICSID Case No. ARB/05/22 (foreign investor initiated arbitration proceedings against the Tanzanian Government after the latter terminated the contract due to the investor’s alleged failure to meet certain performance guarantees (specifically, the investor raised prices while failing to improve the water and sewage system in Dar Es Salaam). Biwater is interesting because although the panel found in favor of the investor on the substantive legal claims, the panel declined to award monetary damages to the investor because at the time of expropriation the company had no value, and each party was responsible for its own legal and arbitration costs, raising the possibility that this was at least in part an equitable adjustment.

6 Técnicas Medioambientales Tecmed, S.A. v. United Mexican States (Case No. ARB(AF)/00/2) (tribunal ruled in favor of the foreign investor despite the host state’s allegations of violations of its environmental laws related to investor’s waste management operations).
(investment and public health)\textsuperscript{7} and Germany (investment and environmental safety).\textsuperscript{8} As was the case with the “trade and ___” disputes in the GATT/WTO system in the 1980’s and 90’s, these linkage conflicts raise one of the most important issues facing investment law today: whether it can consistently and effectively acknowledge and weigh the countervailing social concerns of host states, and the affected human rights and other social values implicated in many investment disputes.

This represents a governance crisis, and an opportunity. Thomas Franck reminds us that in domestic economies, capital operates within political systems wherein the expectations of the capitalists are not usually the sole or last word.\textsuperscript{9} Yet in political terms, the domestic equivalent to the investment treaty system in terms of participation would be the reinstatement of property requirements as a condition of voting rights: only those with capital would have a voice. Such an approach to investment law, in which capital’s needs and interests are privileged in the political process,\textsuperscript{10} is no longer sustainable. Investment touches so many core social issues and responsibilities of host countries that it simply cannot be managed from the perspective of capital alone. To continue doing so would be to ignore the public nature of investment rules and their allocative effects on legal rights and economic resources.

\textit{Investment Law and Justice}

Instead, investment law should be subject to principles of justice (norms of procedural and substantive fairness), as with any framework for the allocation of social resources.\textsuperscript{11} Investment law allocates social resources in at least three ways:

- IIAs allocate rights, privileges and burdens between investors and host countries, on key subjects such as the establishment and operation of a foreign investment, minimum standards of treatment, the right to regulate, and how disputes are settled, to name a few. Such rights and privileges are a valuable social resource in themselves.
- IIAs impact the allocation of rights, privileges and burdens among a range of stakeholders within host countries. They affect the regulatory, economic and

\textsuperscript{7} Philip Morris Asia Limited v. The Commonwealth of Australia, UNCITRAL, PCA Case No. 2012-12.
\textsuperscript{8} Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG v. Federal Republic of Germany, ICSID Case No. ARB/09/6.
\textsuperscript{10} See Nathan M. Jensen, \textit{Nation-States and the Multinational Corporation} 3 (Princeton: Princeton University Press 2006) (noting how MNEs are “privileged” in the political process governing their rights under domestic and international law, leading to outcomes favoring investment-friendly policies).
social balance among government, domestic capital, foreign capital, producers, consumers, and citizens needing economic rights, social welfare, environmental protection, and other public goods.

- By collectively setting the terms under which investment capital is regulated, IIAs influence the allocation of investment capital, a socially produced resource.

Such allocative effects render investment law a matter of justice. This is not new—similar allocative effects subject many other areas of law such as taxation, banking regulation and international trade law to principles of justice—but it is under-acknowledged in investment law. Recognizing such allocative effects makes it clear that investment law does not operate outside the bounds of justice. Rather, managing capital for the good of capital owners and the larger society is inherently about justice, for all affected stakeholders and not exclusively for investors alone.12

Reforming Investment Law

Recognizing that investment law is a matter of justice is a paradigm shift with profound implications for investment law and policy. Essentially, it means we have to examine the investment law regime in terms of the kinds of fairness norms we would apply to any system of governance allocating economic rights and resources across a range of settings.13 Ensuring a secure return on investment is fair, but this consideration does not necessarily exhaust what fairness requires of us in investment law. Discovering what fairness means in investment law is really what contemporary policy debates and treaty negotiations are about.

This can be seen clearly in the controversy surrounding investor-state dispute resolution (ISDS). Commentators from all points on the spectrum note serious shortcomings in ISDS from a governance perspective. Even prominent advocates of the current ISDS system acknowledge structural deficits in the coherence and predictability of arbitral outcomes, two key values of procedural justice.14 Granting for the sake of argument that ISDS strengthens the rule of law for one class of stakeholders (investors), this is still no substitute for the larger systemic evaluation of ISDS in terms of the rule of law for all stakeholders, not just favored investors.15

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12 Rudolf Dolzer, although he speaks of the BIT system in terms of justice, confines this to “outcomes generally considered by the investment community to be just...” “Fair and equitable treatment: today’s contours”, Santa Clara Journal of International Law, vol. 12, (2014) p.33 (emphasis added).

13 See, e.g., Franck, supra note 9; Frank J. Garcia, “Justice, the Bretton Woods Institutions, and the Problem of Inequality” in The Future of International Law (Davey & Jackson eds. 2008).

14 See e.g., Dolzer, supra note 12.

15 See Gus Van Harten, INVESTMENT TREATY ARBITRATION AND PUBLIC LAW (2008) (Investment arbitration undermines the rule of law because the fact that claims can be brought by only one class of parties provides arbitrators with an incentive to favor claimants, since arbitrators are appointed on a case-by-case basis).
Properly understood, many current investment reform proposals — such as appellate review mechanisms of the sort recently agreed by Canada and the EU,\(^\text{16}\) enhanced transparency provisions, and balanced social clauses that effectively (not aspirationally) protect the right to regulate — cannot be superficially rejected as unwelcome “intrusions” into a private ordering system. Instead, they are more accurately seen as efforts to make investment law more just by ensuring it embodies essential civil and political values, such as procedural fairness, equality before the law, the rule of law, and the right to political voice for all affected parties.\(^\text{17}\)

**Conclusion**

The expansion of BITs and dominant trends in ISDS have contributed to a significant, but potentially transformative, legitimacy crisis in the regulation of investment. When the trading system faced its own earlier legitimacy crisis, it was understood that preserving the viability of the trading system depended on a strong and visible response to that crisis. This meant recognizing that trade law had grown into a system of treaty-based economic governance, and therefore had be brought within the best practices of contemporary global governance and justice norms.\(^\text{18}\)

The same is true for investment law today. Based on the trading system’s experience, the investment regime can emerge from its own crisis as a stronger system with enhanced legitimacy, but only if it recognizes its own success and takes appropriate action.

\(^{16}\) The recent announcement by the EU and Canada of their decision to create a permanent investment Court and an Appellate Tribunal in the investment chapter of the CETA (also an EU proposal for the TTIP) represents a breakthrough in ISDS. “CETA: EU and Canada agree on new approach on investment in trade agreement,” [http://europa.eu/rapid/press-release_IP-16-399_en.htm](http://europa.eu/rapid/press-release_IP-16-399_en.htm), (29 February 2016). If ratified, CETA will set a new standard for the rule of law in investment treaties.


\(^{18}\) The IMF and World Bank have also been undergoing similar challenges (as with trade and investment, a result of their success as global governance institutions as much as of their failures in terms of specific policy interventions), with varying degrees of progress, suggesting we are in an evolutionary period of institutional reform and innovation as international economic law becomes global economic governance.