# More Modesty and Honesty in International Investment Law!

Marino Baldi

*Das internationale Investitionsrecht ist im Zuge der beschleunigten Globalisierung nach dem Ende des Kalten Krieges stürmisch gewachsen. Es ist heute echten Zerreissproben ausgesetzt. Das Rechtsgebiet – vielfach Richterrecht – basiert zu grossen Teilen auf unbestimmten Grundsätzen des Völkergewohnheitsrechts, zusammen mit Normen nicht immer glücklich formulierter bilateraler Verträge. Durch Streitparteien und Schiedsrichter werden in internationalen Verfahren Ansprüche an die Disziplin gestellt, die diese oft nur ungenügend zu erfüllen vermag. Mehr Bescheidenheit, mehr reflektierendes Grundsatzdenken, aber auch mehr Bodenhaftung – Eigenschaften wie sie Yvo Hangartner verkörperte – sind vonnöten.*

*Le droit international en matière d'investissements a connu une croissance fulgurante après la fin de la guerre froide, en raison de l'accélération de la globalisation. Aujourd'hui, il est soumis à rude épreuve. Ce domaine juridique – en grande partie du droit jurisprudentiel – est largement fondé sur des principes indéterminés du droit international coutumier, et sur des normes d'accords bilatéraux, qui ne sont pas toujours formulées de manière optimale. Les parties en litige et les arbitres ont, dans les procédures internationales, des attentes relatives à la discipline qui ne sont pas toujours satisfaites. Plus de simplicité, plus de réflexions fondamentales, mais aussi une attitude plus terre-à-terre, des traits caractéristiques d'Yvo Hangartner, sont nécessaires.*

List of contents



## 1. Preliminary Remarks

Yvo Hangartner combined outstanding legal competence with modesty, realism and social conscience. The thing that was particularly impressive about his work was his constant striving to probe even markedly practical legal issues from a broad theoretical perspective, bearing in mind the basic principles of our legal and social order such as respect for human dignity, equal treatment, the guarantee of basic freedoms, etc. Nor was high-flying theoretical discourse for him an end in itself, but was rather put to the service of practical, grass-roots insights.

Today, International Investment Law (IIL) is being pushed to its limits. This legal sphere – in many instances, one of case law – is extensively based on general principles of International Customary Law, along with not always artfully worded bilateral treaties. Parties at dispute and arbitrators often make claims on the discipline which the latter is scarcely able to cope with. More modesty, more reflective thinking on fundamentals, as well as more of a down-to-earth approach – the very characteristics that Yvo Hangartner incarnated – are called for.

## 2. General Developments in IIL

Developments over the past twenty years in IIL have been astounding. The field has rapidly been expanding within a landscape that has changed dramatically[1]. We have seen a continually increasing network of bilateral investment treaties (BITs) with investor-state dispute settlement – and, more recently, a rising number of free trade agreements (FTAs) containing investment chapters. Litigation on investment issues has become frequent and a number of important awards have been rendered. At the same time, doubts have been expressed in regard to the lack of coherence and harmonization of the present system. Is there a need to revisit the fundamental concepts, to rebalance the rights of home and host countries, in addition to the rights of the investors, for a new generation of investment agreements? What might «better» investment treaties look like? Are there even new opportunities for multilateral approaches?

Literature has become abundant on these issues, and views diverge. For some, the present system is sound and, at the most, needs some marginal improvements. Others see rather fundamental problems, but do not necessarily agree on possible remedies.

Marino Baldi, Dr. oec. HSG, a. Botschafter, Senior Counsel, Prager Dreifuss Rechtsanwälte, Zürich/Bern/Brüssel.
Der vorliegende Beitrag basiert auf einer Vorlesung zum Thema *«Less may be More – The Need for Moderation in International Investment Law»*, gehalten am 15.11.2012 an der *Lomonossov Moscow State University* im Rahmen der *Tunkin Readings 2012*.

[1] See OECD, International Investment Law: A Changing Landscape, Paris 2005.

It is not possible in this paper to deal extensively with many of the issues I have just alluded to. I shall thus select a few items which seem to me to be of key importance for any future work with a view to improving the *international investment regime.* This selection is based on my experience as a long-standing Swiss Government representative for trade and investment agreements as well as on my functions with international organisations dealing especially with foreign direct investment, including aspects of corporate social responsibility and business ethics.

When dealing with the vast and intricate field of the *international investment regime,* it is advisable to be mindful of three distinct topical areas: rules on investment protection; rules on investment liberalisation (market access rules); and rules aimed at serving the economic and social development dimension (sustainable development) of international investment.

These areas, by and large, can also be related to different stages in the historical development of international investment law:

- Key elements of international investment treaties were shaped from the 1960s through the 1980s, when a relatively small number of OECD countries were the main source of outward investment, and developing countries were almost exclusively at the receiving end. The capital-exporting countries of that time were setting rules that were incorporated into bilateral investment treaties and, as a result, strong and, for the most part, uncontested investment protection – often backed by investor-state arbitration – was predominant.
- The economic environment of investment law dramatically changed after the end of the Cold War and the ensuing acceleration of the globalization process. Investment flows among developing countries gradually expanded, and, more recently, emerging market economies became strong players of outward investments. These profound changes in international investment trends resulted in a new policy debate. In addition to investment *protection* issues, investment *liberalization* and issues concerning the *development dimension* of international investment became important topics on the international policy agenda.

Following these introductory remarks, I should now like to focus on two particular issues that seem to me of crucial importance for the future debate, namely:

- Investor-state arbitration in respect of investment protection; and
- the question of how to approach future work with a view to more coherent and more comprehensive investment rules encompassing, in addition to disciplines on investment liberalisation, rules responding, for instance, also to environmental and social concerns.

## 3. Investor-State Dispute Settlement

Let me start with some critical comments on developments regarding investment protection and investor-state dispute settlement (ISDS). The growing uneasiness of countries worldwide with ISDS on investment treaties (BITs and FTAs) is well documented. The policy statement by the Government of Australia of April 2011 that it will stop including ISDS clauses in its BITs highlights the problem[2]. A number of other countries have also expressed serious concerns with ISDS, lately e.g. India and Canada. While basically being in favour of ISDS, I have some sympathy for these concerns, and do so for the reasons I shall be discussing now.

The degree to which ISDS has in the context of BITs been prioritised over national remedies does not seem to me very rational, and I think that some misunderstandings may have been at the origin of this practice.

The International Centre for Settlement of Investment Disputes (ICSID) – and thus ISDS – was not primarily conceived with a view to settling disputes arising out of BITs. It was essentially created for the purpose of adjudicating *investment contracts* between individual investors and their host-countries and not – at least not in the first place – for solving problems of any framework agreements between *states,* which is what BITs *are*[3]. However, probably without giving much thought to the question of whether BITs and ISDS fit well together, countries, from around the beginning of the 1980s, started to include ISDS clauses in their BITs.

These countries, or their BIT negotiators, presumably had lost sight of the basic rationale for concluding BITs. This rationale was – and largely still is – to prevent countries not having sufficient tradition of applying concepts such as «the rule of law» and «due process of law» from taking *discriminatory or arbitrary measures* vis-à-vis for-

---

2 *Australia* provided the following reasoning for this step: «The Government does not support provisions that would confer greater legal rights on foreign businesses than those available to domestic businesses. Nor will the Government support provisions that would constrain the ability of Australian governments to make their laws on social, environmental and economic matters in circumstances where those laws do not discriminate between domestic and foreign businesses»; see American Society of Intertational Law, available at: http://www.asil.org/insights110802.cfm.

3 See in this context also: PETER MUCHLINSKI, Multinational Enterprises & the Law, 2nd ed., Oxford 2007, p. 719 f.

eigners and their property. Protecting investors and their investments from discriminatory or arbitrary state measures – in other words: from «maladministration» – by the investor's host country is also the essence of relevant *customary international law principles*[4].

The overall purpose of BITs – which are *bilateral* treaties – has never been and cannot be anything other than to provide a framework for protection against so-called political risks, namely measures by states that are considered to be incompatible with concepts such as the «rule of law» and «due process of law». *BITs can never provide the world with refined rules of international economic law as may be desirable in an increasingly globalised economy.* It amounts to inadmissibly stretching the purpose of BITs if investors – in invoking BIT clauses on «fair and equitable treatment» or against «indirect takings» – claim, for instance, large amounts of compensation for damages allegedly caused by measures of general application dealing with public health or environmental concerns – as seen in a series of cases over the past fifteen years.

Tribunals that decided in favour of the claimants in such cases of «regulatory takings» basically argued that the challenged measure had *the same effect* as an expropriation – in that the measure largely devalued an investment – even though it had in no way the characteristics of an expropriation. I think that in these cases the term «indirect taking» has been interpreted in *too mechanical a manner*[5], and yet arbitrators should have known that, e.g. at the OECD, there had been extensive discussions on the subject, particularly in the context of the multilateral agreement on investment (MAI) negotiations, and that these had yielded clear results. No OECD country has ever contested the «right to regulate» in terms of regulatory measures that are non-discriminatory and, according to the concrete circumstances, whose purpose is not that of taking any property, even though, incidentally, the effect may be exactly that.

Let us assume for a moment that a case of the kind in question – I am thinking, for instance, of the *Methanex* facts as a prototype case[6] – came up in a state–state proceeding. Could one imagine a state challenging *de facto* the right of another state to regulate under the aforementioned circumstances (i.e. non-discriminatory regulation adopted according to democratic procedures)? The answer, I think, is obvious. But accepting that countries in their mutual relations would be much more hesitant to challenge the right to regulate, practically amounts to saying that IS arbitral tribunals have often *not been up to their task.* This is also my view with respect to some other types of decisions by IS arbitral tribunals. I am thinking, for instance, of arbitral statements on the interpretation of most-favoured nation (MFN) clauses, or of certain decisions in relation to the Argentine financial crisis.

What is then my overall *assessment* of the situation? Let me make three points:

*First,* the conviction seems to be growing that IS arbitration has in a number of cases exceeded its legitimate role. Arbitration panels have, over time, taken on functions they initially were not meant to have. States will never accept their policy space being substantially narrowed down by judicial action of other *states,* if merely based on «creative interpretation» of relatively vague treaty provisions. It is obviously even less acceptable for them to see their policy space limited in such a way by private sector arbitrators.

*Second,* the question therefore arises whether IS arbitral tribunals will in the future have to step back and accept a *more modest role?* What could this mean in practical terms? Here are a few indications:

International public law provisions may in certain circumstances be «directly applicable» in national legal orders («self-executing» character of treaty provisions). Any such direct application presupposes, *inter alia,* that the rules to be applied are «sufficiently clear and precise». In other words: individuals may invoke international public law rules before national courts only if the rules are sufficiently clear. BIT provisions, however, even if they are anything but sufficiently clear, are often used without any hesitation as a basis for IS arbitral decisions – sometimes in a truly adventurous manner.

---

4 See Marino Baldi, Völkerrechtlicher Schutz für internationale Direktinvestitionen, in: *recht,* Zeitschrift für juristische Ausbildung und Praxis, Heft 1, 1990, p. 5–15; Rudolf Dolzer/Christoph Schreuer, Principles of International Investment Law, Oxford 2008, p. 1–17.

5 One could in this context also speak of a purely textual interpretation, not taking into account the broader context of the provisions, i.e. ignoring elements of teleological and systematic interpretation.

6 The *Methanex* case was about the banning of a fuel additive by the State of California, because of the water contamination risks the additive posed. A Canadian investor producing a component of the banned product – i.e. methanol – challenged the measure under the North American Free Trade Agreement (NAFTA) investment provisions, arguing that it was a «regulatory taking», i.e. a measure tantamount to an expropriation, and claimed compensation of nearly one billion United States (US) dollars. After lengthy proceedings before different arbitral tribunals, the claim was finally dismissed, mainly on procedural grounds specific to the NAFTA. However, in a number of other, very similar, cases – i.e. legislative measures dealing with public health or environmental concerns and, incidentally, devaluating an investment – arbitral tribunals decided in favour of the claimants.

I am not arguing that the IS arbitration system as such should be abandoned. IS arbitral tribunals should, however, focus on rules where they are on safe ground, such as when the application of BITs fits into the body of principles that is known as «international customary law». Beyond that, the judicial application of BITs, in view of their frequent lack of precision, becomes problematic. In such cases, arbitrators have to show self-restraint, lest the system in the end should collapse. In this context, using as an interpretative principle «in case of doubt, in favour of national sovereignty» might benefit the system, i.e. help to save it.

With a view to future treaty-making, the suggestion has been made to provide – at least in *certain cases* of IS arbitration – for some requirement of «exhaustion of local remedies»[7]. This idea is certainly worth considering.

*Lastly,* it is sometimes argued that the work of IS arbitrators may be an important part of an emerging *international administrative law*[8]. From the above, it should be clear that I see relatively narrow limits to this. With what legitimacy should private sector arbitrators be allowed to take a leading role in the development of international public law, particularly under the aforementioned circumstances?

## 4. Important Issues related to Treaty Design

Let me turn now to the subject of how to approach future work on *more comprehensive investment rules* that would include liberalisation disciplines as well as rules on other important policy issues, such as consideration of social and environmental concerns. In this context of broader investment rules, the possible interaction between investment protection and investment liberalisation plays a key role.

Traditional BITs focus on investment protection, largely along the lines of relevant customary international law. In recent times, however, investment agreements have increasingly been supplemented with investment liberalisation rules, and also with best-efforts clauses, for example, on key personnel, labour rights and sustainable development. Such provisions have notably become part of modern free trade agreements (FTAs). This trend started with the NAFTA, continued with the (unsuccessful) negotiations on an MAI[9], and has in the course of the last ten years increasingly characterised FTAs throughout the world. As to modern FTAs, I should add that the rapid increase in the number of these treaties has, in the investment field, unfortunately been accompanied by a trend towards a lowering of quality. In fact, a good number of these treaties contain such wide-ranging exceptions and vaguely formulated safeguard clauses that their regulatory value is called into question, particularly as such agreements potentially harm the application of core *protection* principles. What is the reason for this?

There can be no question that the world needs more comprehensive investment rules. But an important preliminary question for me is how best to achieve this from the point of view of «treaty design». Is it advisable to have all the elements under discussion in one instrument (which would be the NAFTA approach), or would it be preferable to have separate instruments for different subject-matters (which would be the traditional OECD approach)? I am aware that, from a viewpoint of *negotiating tactics,* the single-treaty approach may have certain advantages. However, experience shows that a *multiple-instruments solution* helps to avoid problems that in a single-treaty approach are extremely difficult to overcome. Based on my experience with the MAI negotiations – and also a number of FTA negotiations with investment chapters – I am convinced that the single-treaty approach – which closely connects investment *liberalisation* and investment *protection* issues – has, in the end, negative effects on both areas. This has to do with the different legal and economic characteristics of the two areas.

Investment *protection* rules have clear characteristics of *property law.* As a matter of principle, provisions of this kind ought to have a broad scope – as basically any kind of asset is worth protecting. Traditional BITs therefore usually feature comprehensive, asset-based definitions of the term «investment». Extensive exceptions to the broad coverage of investments are neither necessary nor desirable. Contrary to the property-oriented provisions on protection, investment *liberalisation rules* have

---

7 See PETER MUCHLINSKI, Towards a Coherent International Investment System: Key Issues in the Reform of International Investment Law, World Trade Forum 2011, Bern.

8 See generally STEPHAN SCHILL (ed.), International Investment Law and Comparitive Public Law, New York, 2010.

9 The MAI negotiations were an attempt to negotiate a comprehensive «Multilateral Agreement on Investment» (MAI), led by the OECD members but encompassing also a number of other countries. The negotiations started in 1995 and were abandoned in 1998, essentially because of too ambitious goals; for the history of the MAI negotiations, see: RAINER GEIGER, Towards a Multilateral Agreement on Investment, 31 Cornell International Law Journal 467 (1998); MARINO BALDI, The MAI Negotiations: Reflections on a Missed Opportunity, UNCTAD Symposium on International Investment Agreements and their Implications for Development, Xiamen/China 1999, Geneva 2000.

a trade-policy character[10] where sector exceptions to the basic rules are a normal feature. Also, from a pure trade-policy perspective, free market access is mainly, if not exclusively, of importance for *direct* investments – and much less for short-term capital movements.

If we now have a single instrument combining protection and liberalisation elements and providing for only one set of definitions (which is normally the case), we almost inevitably run into virtually insurmountable problems. Let us take the case of *portfolio investments:* from a protection point of view, it may be desirable to use an asset-based definition of «investment» also covering portfolio investments; from a liberalisation angle you might, however, wish to restrict the definition to direct investment. In practical treaty terms, the most frequently chosen way out of this dilemma is to have a broad investment definition together with some kind of a safeguard clause allowing the host-country to intervene more or less at its own discretion in the free flow of capital. This solution, however, clearly undermines legal security, whereas the main purpose of investment agreements is precisely to enhance such security.

The problem in question is by no means a theoretical one. In the MAI negotiations, we were grappling with it throughout the negotiating process without arriving at a satisfactory solution, as we were never able to decide on an investment definition supported by all sides. I would not say that this was *the* reason for the breakdown of the negotiations. Yet, I do contend that the combination of investment protection elements with liberalisation and other regulatory features in *one* treaty, together with – and this is the decisive point – *strict investor-state dispute settlement* (broad «prior consent»), was the real reason for the failure of the negotiations – and not one or more of the other, rather superficial reasons that are often purported.

Let me finally – and still within the context of my remarks on treaty design – make some comments on the very important issues concerning *investment and development,* which include aspects of sustainability, employment, and human rights, among others. It should be clear from my explanations that these issues are much closer to the liberalisation aspects of investment treaty-making than to protection. Moreover, such policy issues are mainly relevant in the context of «direct investment». This should be kept in mind when talking, from a global economic perspective, of the need to *rebalance investors apostroph rights and the sovereign interests of host states* (there is not much to be rebalanced in the protection field). Still on rebalancing efforts, it seems to me obvious that they should, given their political and, in a way, systemic nature, mainly take place on a *multilateral* level.

## 5. Moderation is of the Essence

Above everything else, I think it is advisable when working towards a more coherent international investment regime, to intellectually and practically separate investment protection issues from the broader policy issues.

On investment protection and IS dispute settlement, let me reiterate that the issue at stake is ultimately *today's system* as such. As pointed out earlier in this paper, arbitrators will have to show *moderation and self-restraint,* should the system in the end not collapse. This includes in particular a good amount of respect for the need of a government to take measures for the advancement of its people, their health and environmental protection, and their economic development.

As to the broader international policy issues under the catchphrase «investment and development», they essentially lie within the realm of multilateralism. This does not mean that another attempt to negotiate a comprehensive international treaty of the MAI type should be envisaged in the near future. Not only is the *single-treaty approach* problematic from a technical point of view (with important consequences as to the substance), negotiating a broad and globally applicable treaty of a somewhat meaningful content would not be politically realistic today. More modest approaches should now be tried, such as the formulation of voluntary guidelines, benchmarks, and the like. The OECD Policy Framework for Investment adopted in 2006[11] was a useful step in this direction. In 2012, UNCTAD followed with an Investment Policy Framework for Sustainable Development[12].

To wind up, let me again stress that politically the time is not ripe today for the «grand design». There is nevertheless a lot of work that could be done with a view to improving the present system. But it is important that any such work be guided by an attitude of *modesty and respect* including the insight that sometimes *less may be more.*

---

[10] *Direct investments* are often substitutes for trade – a way of doing business internationally which has been of increasing importance in recent times, and is truly characteristic of the globalised economy.

[11] Available at: http://www.oecd.org/daf/inv/36671400.pdf.

[12] Available at: http://www.unctad-docs.org/files/UNCTAD_IPFSD_2012.pdf.