
The Justification of Privilege in International Investment Law: Preferential Treatment of Foreign Investors as a Problem of Legitimacy

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Abstract

A fundamental feature of international investment law is that it only applies to foreign investment. This has historical reasons and is connected to deep-rooted principles of international law. It has also been a historical cause of controversy because it requires states to treat foreign investors better than they treat their own nationals. This article shows how the international minimum standard for treatment of foreigners nevertheless developed in a dialogue with such a concern for equality. The article argues that the way in which international investment law has developed in recent years into an effective remedial mechanism that can be invoked by individual foreign investors against host states ignores this historical lesson and now poses a particular challenge to its legitimacy. It privileges foreign investors as a select group worthy of more effective legal protection than ordinarily provided under municipal law, challenging the ideal of equality before the law as a basic constitutional value. The article discusses possible justifications of such privilege, arguing that only a more traditional international minimum standard rationale provides a convincing justification of special treatment of foreign investment. This has important implications for the reform of the current investment regime, suggesting that it should be redesigned to adopt a more supplementary role and deferential attitude to domestic law and courts – for example, through a requirement to exhaust local remedies.

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1 Introduction

The international law protecting foreign investment, and its arbitral mechanism for investor-state dispute settlement (ISDS), has been controversial almost since its inception, and its fundamental legitimacy is persistently debated. In recent years, there has been talk of a legitimacy crisis and a ‘backlash’.¹ Even moderately defensive voices admit the need for reform,² and various reformist initiatives are pending at several levels, including a current work on ‘investor-state dispute settlement reform’ under the United Nations Commission on International Trade Law.³

This article discusses a fundamental, but arguably still underestimated, challenge against the legitimacy of investor-state arbitration. We may call it the problem of foreign privilege: the essential characteristic and premise of the law that it only protects foreign investors.⁴ Historically, this was one of the fundamental criticisms against international investment law, often associated with the so-called Calvo Doctrine of the 19th century.⁵ It is still a critique that is sometimes raised and an occasional government concern, but mostly it is directed against the content of substantive standards⁶ or launched as an assault on the very existence of the system.⁷ In contrast, the focus of this article is the legitimacy challenge it poses to certain key remedial characteristics of investor-state arbitration, specifically its intended function as a substitute for domestic courts and law.

The premise of this challenge is the basic notion of equality before the law. Being a cornerstone of the rule of law, this is an embedded constitutional principle in the law

¹ Franck, ‘The Legitimacy Crisis in Investment Arbitration: Privatizing Public International Law through Inconsistent Decisions’, 73(4) *Fordham Law Review* (2005) 1521; see generally M. Waibel *et al.* (ed.), *The Backlash against Investment Arbitration* (2010).

² See, e.g., Schill, ‘In Defense of International Investment Law’, in M. Bungenberg *et al.* (eds), *European Yearbook of International Economic Law* (2016), vol. 7, at 309; Shill and Djanic, ‘Wherefore Art Thou? Towards a Public Interest-Based Justification of International Investment Law’, 33 *ICSID Review* (2018) 29.

³ Schill, ‘Investor-State Dispute Settlement Reform at UNCITRAL: A Looming Constitutional Moment?’, 19 *Journal of World Investment and Trade (JWIT)* (2018) 1; see also the United Nations Commission on International Trade Law (UNCITRAL) webpage, available at https://uncitral.un.org/en/working_groups/3/investor-state.

⁴ See generally R. Dolzer and C. Schreuer, *Principles of International Investment Law* (2nd edn, 2012), at 44; J. Crawford, *Brownlie’s Principles of Public International Law* (8th edn, 2012), at 611.

⁵ The doctrine has usually been associated with the jurist and diplomat Carlos (or Charles) Calvo (1824–1906) and his work, *Le droit international théorique et pratique* (5th edn 1896). See S. Montt, *State Liability in Investment Treaty Arbitration* (2009), at 41; D.R. Shea, *The Calvo Clause: A Problem of Inter-American and International Law and Diplomacy* (1955), at 9. Such concerns were also part of the later movement for a New International Economic Order in the 1960s and 1970s. See K. Miles, *The Origins of International Investment Law: Empire, Environment and the Safeguarding of Capital* (2013), at 93–99.

⁶ See, e.g., Montt, *supra* note 5, at 22–23; J. Bonnitcha, L.N. Skovgaard Poulsen and M. Waibel, *The Political Economy of the Investment Treaty Regime* (2017), at 13; J. Alvarez, *The Public International Law Regime Governing Foreign Investment* (2011), at 166–167.

⁷ Stieglitz, ‘Regulating Multinational Corporations: Towards Principles of Cross-Border Legal Framework in a Globalized World Balancing Rights with Responsibilities’, 23 *American University International Law Review* (2007) 451; Kumm, ‘An Empire of Capital? Transatlantic Investment Protection as the Institutionalization of Unjustified Privilege’, 4 *European Society of International Law Reflections* (2015) 3.

of most countries.⁸ This article does not argue that the protection of foreign investment is illegitimate *per se*. However, it shows how the law of diplomatic protection and the minimum standard for the treatment of foreigners, which is still part of customary international law, emerged in a significant way in a dialogue with this concern for equality. It was, and is, reflected particularly in a lenient standard that provides a measure of deference to municipal law and a requirement to exhaust local remedies. We see much of the same in the law developed in a human rights context – for example, under the European Convention of Human Rights (ECHR). Together, these elements function to place domestic law and courts in the forefront as the primary recourse for nationals and foreigners alike. In contrast, the current investment arbitration regime is intended to function as a substitute for domestic courts, providing an effective legal privilege to foreign investors over local investors and other subjects of the host state law. In this article, I discuss possible justifications for such privilege. The thrust of the argument I make is that the only convincing justification for a system of foreign investment protection is the one provided by the international minimum standard and that this requires the investment treaty regime to adopt a more supplementary role and deferential attitude to domestic law and courts.

The argument is further developed in the following way. In Part 2, I discuss the nature of the problem involved and the implications of domestic constitutional law, before I examine and discuss in Part 3 the historical rationale of granting foreigners special rights under the international minimum standard. Subsequently, in Part 4, I discuss the conventional, as well as other alternative, justifications for the current regime, arguing that they are unable to justify the protection of foreign investment beyond what we may designate as ‘a common level of protection’ under domestic laws. I then discuss in Part 5 the more concrete implications of this for reform initiatives, before I conclude in Part 6.

2 The Problem of Foreign Privilege

A *Equality before the Law as a Constitutional Value*

Equality before the law is an indispensable element of the rule of law and, as such, an embedded ‘constitutional’ value of most legal systems. It entails not only that persons in equal circumstances should be treated equally but also that persons in unequal circumstances may, and sometimes also ought to, be treated differently.⁹ An essential element of law is precisely to make distinctions between categories of people according to what they legitimately require and deserve. It is therefore not illegitimate or problematic as such that a particular group is singled out as deserving of special rights denied to others, as long as it can be rationally justified.

⁸ B.Z. Tamanaha, *On the Rule of Law* (2004), at 64–67, 94.

⁹ R. Alexy, *A Theory of Constitutional Rights*, translated by J. Rivers (2002), at 260.

However, creating something resembling a legal privilege for select groups nevertheless evokes suspicion. If it was proposed in a certain country to set up a special, more efficient court, with an extended mandate to protect only certain capital interests against the state – say, some old venerated families constituting its traditional economic aristocracy – but leaving out all others, one might expect to find an arsenal of arguments against the arrangement in modern constitutional law. In many countries and constitutions, the principle of equality before the law is made into an express constitutional principle.¹⁰ But most countries will also recognize it as a genuine ‘constitutional’ value, informing the interpretation of other constitutional provisions and fundamental legal principles as a crucial component of the basic notion of the rule of law.¹¹ Many constitutions, for instance, will have a provision about the courts or the supreme court, which is likely to be interpreted as a more fundamental protection of the judicial authority, integrity and independence of the domestic courts and, by extension, to embody rule-of-law ideals relating to the equality of access to the courts.¹² It is not unlikely that the creation of a special, more effective court for the protection of certain capital interests, in this light, might be seen to create an unjustified privilege and to violate the unity and integrity of the rule of law, informed, *inter alia*, by an underlying concern for equality.

Although qualified not by being old but, rather, by being foreign, the protection of investments under international law undeniably does have a resemblance to such privilege. An essential question that needs to be confronted accordingly is whether this presents a constitutional challenge to our present system of foreign investment protection, and, if not, why. After having passed unnoticed under the radar of constitutional scrutiny for many years, ISDS is indeed increasingly becoming a subject of constitutional controversy.¹³ This is not an entirely new phenomenon. Norway, for instance, has not entered into investment treaties since the mid-1990s, due to constitutional concerns over ISDS interfering with the competence of the Norwegian courts.¹⁴ Constitutional concerns have also played a part in the withdrawal or abstention from the bilateral investment treaty (BIT) system of Latin American countries such as Ecuador and Brazil.¹⁵ In other countries, constitutional concerns have been

¹⁰ Cf., e.g., Charter of Fundamental Rights of the European Union, OJ 2012 C 326/02, Art. 20.

¹¹ Tamanaha, *supra* note 8; Alexy, *supra* note 9, at 261–262.

¹² Such concerns have been relied on in the interpretation of the Norwegian Constitution, s. 88, which stipulates that ‘the Supreme Court judges in the final instance’. See the decision of the Norwegian Supreme Court in Rt. 1980, at 52 (Haaas); see also, e.g., about the US Constitution in P.B. Rutledge, *Arbitration and the Constitution* (2013), at 15–54.

¹³ See, e.g., Schill, ‘Reforming Investor–State Dispute Settlement: A (Comparative and International) Constitutional Law Framework’, 20 *Journal of International Economic Law* (2017) 649, at 652ff.

¹⁴ Alvik, ‘Investor-stat tvisteløsning (ISDS) i internasjonale investeringstraktater’, 54 *Lov og Rett* (2015) 581; Bekkedal, ‘Investeringstraktater med investor-stat tvisteløsning (ISDS) – i strid med Grunnloven?’, 55 *Lov og Rett* (2016) 331.

¹⁵ Vidigal and Stevens, ‘Brazil’s New Model of Dispute Settlement for Investment: Return to the Past or Alternative for the Future?’, 19 *JWIT* (2018) 475, at 486; El Herfi and Guzmán Pérez, ‘Constitutional Court of Ecuador Decision on the Constitutionality of the BIT Ecuador: France’, 3 *Transnational Dispute Management* (2012), available at www.transnational-dispute-management.com.

raised and dismissed.¹⁶ The most serious challenge to the constitutionality of ISDS today comes from the legal order of the European Union (EU), where the Court of Justice of the European Union, in *Slovak Republic v. Achmea*, considered the broad arbitration provision in the Netherlands-Czech/Slovak BIT to violate its own exclusive competence to determine EU law.¹⁷ Equality concerns have played some part in constitutional challenges of BITs, but hardly the most central part.¹⁸ Clearly, however, this is not due to a lack of recognition of the principle of equality as such but, rather, because differential treatment of foreigners generally is, or has been, considered justified.¹⁹

The objective here is accordingly not to argue that ISDS is unconstitutional for discriminating against national investors. Equality before the law remains a rather abstract concept and, as a legal principle, primarily requires a plausible reason for differentiating.²⁰ Democratically elected legislators and political authorities presumably enjoy a wide measure of discretion to decide upon such matters. From the viewpoint of domestic constitutional law, justification is provided already by the fact that the protection of foreign investment is required by international law. The operationalization of it through ISDS is a long-established arrangement in international law. And precisely for this reason, its inner justification is difficult to second-guess from the perspective of domestic constitutional law – acceptance under international law provides the justification. While it is consequently unlikely that ISDS may be deemed to violate constitutionally embedded principles of legal equality under domestic law, this very lack of an inquisitive justification may nonetheless be the reason why such acquittal fails to dispel a certain uneasiness about how the system measures up to these ideals.

But international law in its turn does not either provide any real basis for conceptualizing the relationship between a state and its own citizens as a ‘constitutional’ problem. The exception is the historically speaking quite novel sphere of human rights, but, also from this perspective, it is difficult to question the rationale of the established principles forming the core of international investment law. This is aptly illustrated by how the European Court of Human Rights (ECtHR), in the *James* and

¹⁶ See, e.g., *Council of Canadians, CUPW and the Charter Committee on Poverty Issues v. Attorney General of Canada*, decision by the Court of Appeal for Ontario, 30 November 2006, available at www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/cupw.aspx?lang=eng; Rutledge, *supra* note 12.

¹⁷ Case C-284/16, *Slovak Republic v. Achmea B.V.* (EU:C:2018:158); Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic 1991, 2242 UNTS 205. In its more recent Opinion 1/17, *Compatibility of CETA with EU Law* (EU:C:2019:341), the Court did find, however, that the arbitration provision in the Comprehensive Economic and Trade Agreement between Canada and the EU is compatible with European Union (EU) law. See EU–Canada Comprehensive Economic and Trade Agreement (CETA) (signed 30 October 2016, not yet in force), available at http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf.

¹⁸ Schill, *supra* note 13, at 656.

¹⁹ See, e.g., the Court of Justice of the European Union’s opinion on the compatibility of CETA with EU law (Opinion 1/17, *supra* note 17, paras 179–188) and also the prior opinion of Advocate General Bot in the same case (paras 194–213).

²⁰ Alexy, *supra* note 9, at 265.

Lithgow cases, was called upon to resolve whether stricter property protection for foreigners under international law violated the human rights of domestic investors to equal treatment. The Court found that such different treatment had an ‘objective and reasonable justification’ since there might be justifiable reasons for giving special rights to foreigners, including that they might be more vulnerable to, and less bound to solidarity with, the social and political process in the host state.²¹ Irrespective of how convincing one finds these reasons for differentiating, it is arguable that the ECtHR had little choice in the matter. Accepting that a stricter protection against expropriation under international law was illegitimate discrimination would either have meant that the member states would be compelled to give the same treatment to their own nationals – in effect, raising the level of protection under municipal public law to the stricter standard required by international law – or that their human rights obligations should require them to violate principles of international law, which are far older than the ECHR.

Accordingly, while equality before the law may be a deep-rooted principle of domestic constitutional law, the mere fact of the already established existence of ISDS under international law goes far to justify its constitutionality, while international law in its turn lacks a constitutional awareness for the equality of nationals. As a result, broader normative concerns about the legitimacy of a system that exclusively protects foreign investors remain unanswered, creating a mounting problem of legitimacy. To get a grasp of the implications and significance of this problem, we can inquire nowhere else than into the fundamentals and rationale of the current system of foreign investment protection itself. Before we do this, however, it is useful to look more closely into exactly how the current system privileges foreign investors and why this may be a problem.

B *Investment Arbitration as a Substitute for Domestic Law and Courts*

It is undeniable that the system of ISDS, as it functions today, constitutes a significant legal benefit for foreign investors. Much of this has to do with its remedial character. While foreign investment protection in the past relied principally on diplomatic and military intervention from powerful home states,²² the international investment regime today allows foreign investors to obtain an arbitral award that is enforceable against the host state in the national courts of almost any country where the state has assets, just as a commercial arbitral award rendered in a dispute between private

²¹ *James and Others v. United Kingdom*, Appl. no. 8763/79, Judgment of 21 February 1986, para. 63; *Lithgow and Others v. United Kingdom*, Appl. nos 9006/80, 9262/81, 9263/81/, 9265/81, 9266/81, 9313/81, 9405/81, Judgment of 8 July 1986. All ECtHR decisions are available at <http://hudoc.echr.coe.int/>.

²² See generally C. Lipson, *Standing Guard: Protecting Foreign Capital in the Nineteenth and Twentieth Centuries* (1985), at 147ff; Miles, *supra* note 5, at 47ff.

parties.²³ This is a much more effective legal remedy than traditional diplomatic protection, exacerbated by how the arbitral regime is modelled on international commercial arbitration as essentially a substitute for municipal courts, where agreement on arbitration entails at the same time a waiver of access to domestic courts. While diplomatic protection required the prior exhaustion of local remedies,²⁴ this is not a requirement under most investment treaties or generally under the ICSID Convention.²⁵ Some treaties even exclude access to arbitration for claims litigated before domestic courts.²⁶ While states usually opt in to the system through BITs, the system itself functions largely as a multilateral regime with common substantive standards and a uniform arbitral process.²⁷ The result is a parallel legal regime, designed to function as a more effective substitute for domestic courts.

The problem that this system raises is more complicated than one of outright discrimination. Domestic entities may not necessarily experience the protection of foreign investors under international law as discriminatory. In practice, it is primarily small, local businesses without the resources or capacity to incorporate foreign subsidiaries that are potentially disadvantaged.²⁸ And these, being individuals or small firms – the local business person, store owner or farmer – will usually not experience being in equal circumstances to a multinational enterprise making a multibillion dollar investment in an oil field, mining enterprise or energy facility. Local business might even favour legal privileges being given to foreign capital in order to attract investments and create business opportunities. The usually strong support of the business lobby in developed countries for investment treaties being entered into with other countries shows that domestic capital interests do not generally consider such favours being given to foreign capital as particularly problematic. Or at least they prefer the advantage of themselves having such privilege in foreign countries to strict legal equality on the home front.

Accordingly, the problem confronting us may not necessarily be that foreign investors are given a direct advantage over national competitors as much as that the system more generally favours foreign investment over local economic activity and neglects legal conditions for domestic business and entrepreneurial spirit; the ‘grass-roots’, so to speak, of the national economy.²⁹ The problem is not even necessarily an

²³ At the time of writing, 159 and 153 states are parties to, respectively, the New York and ICSID Conventions. Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) 1965, 575 UNTS 159; Convention on Recognition and Enforcement of Foreign Arbitral Awards (New York Convention) 1958, 330 UNTS 38. For more information, see www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention_status.html; <https://icsid.worldbank.org/en/Documents/icsiddocs/List%20of%20Contracting%20States%20and%20Other%20Signatories%20of%20the%20Convention%20-%20Latest.pdf>.

²⁴ C.F. Amerasinghe, *Diplomatic Protection* (2008), at 142ff.

²⁵ ICSID Convention, *supra* note 23, Art. 26.

²⁶ Schreuer, ‘Travelling the BIT Route: Of Waiting Periods, Umbrella Clauses and Forks in the Road’, 5 *JWIT* (2004) 231.

²⁷ S.W. Schill, *The Multilateralization of International Investment Law* (2009).

²⁸ Stieglitz, *supra* note 7, at 549–550.

²⁹ See also Lester, ‘Rethinking the International Investment Law System’, 49(2) *Journal of World Trade* (2015) 211, at 217.

entirely economic one or one of mere comparison between foreign and domestic investors. The question may be asked more broadly why a particular type of economic actor – in practice, multinational corporations – should enjoy a legal privilege not generally open to nationals and other subjects of domestic law. Liberal economic theory, which somewhat paradoxically is often held out as being among the main justifications of the current regime,³⁰ in fact provides its own convincing explanation of why this is problematic.³¹ The notion of equality before the law is central to theoretical liberalism. In his *Constitution of Liberty*, Friedrich A. Hayek states that '[t]he great aim of the struggle for liberty has been equality before the law',³² and the Greek concept of *isonomia*, meaning 'equality of laws to all manners of persons', is crucial in his theory of law.³³ According to a liberal, Hayekian understanding of society as a complex, spontaneous process of interaction between individuals pursuing their different purposes, no central authority can have sufficient knowledge to make informed decisions or plans on how best to develop the economy – instead, this is the role of free markets. The role of law in this perspective is not to prioritize some interests or purposes before others but, rather, to represent a neutral and predictable framework within which economic development can take place.³⁴ From this perspective, preferential treatment of foreign investors becomes merely a crude form of central planning, seeking to promote foreign investment and multinational corporations to the detriment of local impulses as the preferred means of economic development.

Criticism of foreign investment protection as unjustified privilege also has a side to the more common criticism that foreign investment protection constrains political and regulatory freedom. David Schneiderman depicts the foreign investment regime as a parallel, constitution-like regime, impervious to local law and politics, and accentuates how the investment regime lacks the organic relationship and sensitivity to national politics and interests that generally characterize national constitutional law.³⁵ Arguably, the way in which the regime functions as a parallel and substitute rule of law for foreign investors only strengthens its inclinations in this direction. It will be predisposed towards the appropriate legal conditions for foreign investment, not the appropriate legal conditions for the well functioning of the national (or global) economy and society as a whole. With Martti Koskenniemi, we may see this as an implicit 'structural bias' of a legal regime protecting only foreign investment.³⁶ A more private law-oriented critique to the same effect is that international investment law, as

³⁰ M. Sornarajah, *Resistance and Change in the International Law on Foreign Investment* (2015), at 9; Koskenniemi, 'It's Not the Cases, It's the System', 18(2) *JWIT* (2017) 343.

³¹ See also for this point, with further references, Bonnitich, Skovgaard Poulsen and Waibel, *supra* note 6, at 13.

³² F.A. Hayek, *The Constitution of Liberty* (2006), at 75.

³³ *Ibid.*, at 144.

³⁴ This is further developed in F.A. Hayek, *Law, Legislation and Liberty* (2013), at 267ff.

³⁵ D. Schneiderman, *Constitutionalizing Economic Globalization* (2008), at 4–8.

³⁶ M. Koskenniemi, *From Apology to Utopia: the Structure of International Legal Argument: Reissue with a New Epilogue* (2005), at 607; see also Koskenniemi, *supra* note 30.

interpreted by arbitral tribunals, fails to respect the inner rationale of domestic private law in protecting, for example, property rights, contracts and shareholder rights.³⁷ A single-minded concern to provide efficient protection of foreign investment overrides the more complex balancing of conflicting concerns that are elemental in shaping domestic property law, contract law and corporate law. Seen from the perspective adopted here, this is but the natural result of a perception of investment arbitration as an extraordinary right for foreign investors, being independent of the normal operation of domestic law.

The thrust of these criticisms is that the way in which the current arbitral system is designed to function as a substitute, parallel rule of law for foreign investors tends to displace or obscure the normal operation of domestic law in relation to foreign investors. This again exacerbates its character as privilege. As argued, for example, by critics such as Schneiderman and Julian Arato, investment arbitration, in contrast to domestic courts, is vested with a relative singularity of purpose, which will tend to obscure other concerns that courts have to grapple with when domestic law is applied and shaped.³⁸ Ultimately, however, this criticism assumes, but does not prove, that providing foreign investors with such an extraordinary remedy is unjustified. It is accordingly to this question that we shall now turn.

3 Justifying Privilege under the International Minimum Standard

A Introduction

International law has for a very long time recognized, at least in a rudimentary form, a minimum standard of treatment in regard to foreign citizens. The origin of the standard goes back to the ancient practice of granting rights of reprisals to private citizens, which was succeeded by the modern practice of diplomatic protection at the end of the 18th century.³⁹ As this practice matured during the 19th century, one of the controversial issues concerned the standard of treatment that a foreigner could expect compared with the state's own nationals. The current of opinion that came to be identified with the Calvo Doctrine maintained that a foreigner could not claim to be treated according to other standards than the host state's municipal law.⁴⁰ Western countries, in contrast, argued for, and used the means of power at their disposal to project, an absolute minimum standard that would apply independently of how nationals were treated.⁴¹ While it was the latter view that prevailed,

³⁷ Arato, 'The Private Law Critique of International Investment Law', 113 *American Journal of International Law* (2019) 1.

³⁸ *Ibid.*; Schneiderman, *supra* note 35.

³⁹ M. Paparinskis, *The International Minimum Standard and Fair and Equitable Treatment* (2013), at 11; Amerasinghe, *supra* note 24, at 8–9; Crawford, *supra* note 4, at 610–611.

⁴⁰ See note 6 above.

⁴¹ Lipson, *supra* note 22, at 147; Miles, *supra* note 5, at 47.

the minimum standard developed in confrontation with, and as a response to, the challenge from the Calvo Doctrine and the economic and political interests underlying it.⁴² This had implications both in respect of what came to be accepted as the rationale and content of the minimum standard as well as in respect of the procedural requirements for invoking it.

The argument I make in the following part is that there is a legacy of largely forgotten (or ignored) implications here for the current system of international investment law. In many ways, it was the practices, opinions and theories underlying the international minimum standard that constituted the origins of modern international investment law, but, as we shall see, the latter has since progressed quite far from its origins.

B *Rationale and Content: A Lenient Standard*

Developing in dialogue with the concerns underlying, for example, the Calvo Doctrine, the rationale that came to be accepted for an international minimum standard took the premise that nationals and foreigners should be treated equally as its starting point. General opinion at the time emphasized the ‘limited reach of the international standard’ and its core element of non-discrimination.⁴³ The accepted reason for requiring that foreigners were treated according to a certain minimum standard was not considered to be special entitlement as such. Rather, the standard was deemed to reflect what any private citizen should be able to expect from a ‘civilized’ government, irrespective of nationality.⁴⁴ The reason why the minimum standard nevertheless only applied to foreigners was simply that home states were considered to have a protective interest in respect of their nationals abroad⁴⁵ and that none other than the host state had such an interest in respect of its own nationals.⁴⁶ Nationals, therefore, were part of the host states’ reserved domain, while foreigners could appeal to their home states for protection. This is still a general principle of some bearing under international law. States’ protective function and interests outside their territory are limited to their own nationals, meaning that a state has no legitimate right to complain against another

⁴² Crawford, *supra* note 4, at 613–614.

⁴³ Paparinskis, *supra* note 39, at 43.

⁴⁴ See, e.g., the much cited statement from Root, ‘The Basis of Protection to Citizens Residing Abroad’, 4 *Proceedings of the American Society of International Law at Its Annual Meeting* (1910) 16, at 20–21: ‘There is a standard of justice, very simple, very fundamental, and of such general acceptance by all civilized countries as to form a part of the international law of the world. The condition upon which any country is entitled to measure the justice due from it to an alien by the justice which it accords to its own citizens is that its system of law and administration shall conform to this general standard. If any country’s system of law and administration does not conform to that standard, although the people of the country may be content or compelled to live under it, no other country can be compelled to accept it as furnishing a satisfactory measure of treatment to its citizens.’

⁴⁵ This was based on the so-called ‘Vattelien fiction’ that an injury to its national indirectly offended also its home state. See K. Parlett, *The Individual in the International Legal System* (2011), at 49–50.

⁴⁶ Crawford, *supra* note 4, at 607.

state's treatment of its own nationals within its territory, save for the possible exception of certain fundamental human rights.⁴⁷

An important implication of this rationale is the benchmark it entails for what is required under the minimum standard. It is a minimum standard, requiring no more nor less than the common level of protection recognized under the municipal law of most countries.⁴⁸ As noted by Edwin Borchard, '[l]ong before article 38 of the Statute of the Permanent Court of International Justice made the "general principles of law recognized by civilized states" a source of common international law, foreign offices and arbitral tribunals had relied on such general principles to work out a loose minimum which they applied constantly in interstate practice'.⁴⁹ While criticized for being too vague to provide a meaningful standard of treatment,⁵⁰ this critique is of less concern here because what is more important is the limited reach of the justification it provides for protecting foreign interests under international law. Crucially, it cannot justify a level of protection generally exceeding that which is commonly accepted by all or most municipal laws.⁵¹

This reasoning provides a strong argument for perceiving international investment law as belonging most appropriately within a public law 'paradigm', to use the terminology of Anthea Roberts, because it necessarily frames the relationship between state and investor according to the common perspective adopted by domestic legal systems to legal restrictions on government authority – that is, administrative and constitutional law.⁵² While not usually making the connection explicit, recent proposals to reconceive international investment law as a form of global public law, drawing on domestic traditions, in fact have a close resemblance to the rationale of the international minimum standard, such as it was perceived, for example, by Elihu Root and Borchard. Santiago Montt has proposed an 'updated Calvo doctrine', which reconceives international investment protection as a distillation of municipal constitutional and administrative law traditions.⁵³ Others have similarly argued that international investment law ought to be recognized as a kind of global constitutional and

⁴⁷ See the *Barcelona Traction, Light and Power Company, Limited (Belgium v. Spain)* (Second Phase), 5 February 1970, ICJ Reports (1970) 3, at 33–34, para. 91; International Law Commission (ILC), Draft Articles on Diplomatic Protection, Doc. A/61/10 (2006), reprinted in 2(2) *ILC Yearbook* (2006), Art. 3; see also the (somewhat controversial) ruling of the International Court of Justice in *South West Africa (Liberia v. South Africa)* (Second Phase), 20 May 1961, ICJ Reports (1966) 6.

⁴⁸ Root, *supra* note 44.

⁴⁹ Borchard, 'The Minimum Standard of the Treatment of Aliens', 38 *Michigan Law Review* (1940) 445, at 449.

⁵⁰ Paparinskis, *supra* note 39, at 43.

⁵¹ Cf. Montt, *supra* note 5, at 21, claiming that 'the objective of international investment law should not be the super-protection of investments and property rights'.

⁵² Roberts, 'Clash of Paradigms: Actors and Analogies Shaping the Investment Treaty System', 107 *American Journal of International Law* (2013) 45, at 63. The argument for a 'public law' approach is made, for example, by Schill, *supra* note 13, and, generally, in S.W. Schill (ed.), *International Investment Law and Comparative Public Law* (2010); see also Montt, *supra* note 5; Schneiderman, *supra* note 35; G. Van Harten, *Investment Arbitration and Public Law* (2007). It is, however, also disputed by others, see, e.g., J.E. Alvarez, 'Is Investor-State Arbitration "Public"?', 7 *Journal of International Dispute Settlement* (2016) 534.

⁵³ Montt, *supra* note 5, at 22–23.

administrative law,⁵⁴ relying more on comparative analysis of domestic constitutional and administrative law traditions.⁵⁵

Such a comparative approach is still criticized for not providing a workable basis of international rules.⁵⁶ More than a recipe for determining the exact content of the applicable rules, a more important implication of the public law approach, however, may be that it suggests an attitude of ‘judicial restraint’ or ‘modesty’ that requires ‘deference and respect’ towards the nature and function of government, and, by extension, the role and function of domestic courts.⁵⁷ One may see this reflected in the quite lenient demands of the international minimum standard as generally understood pursuant to the *Neer* case.⁵⁸ Such an approach, however, is not necessarily averse to ‘a reasonable evolutionary interpretation’ more suitable for modern-day relationships between states and investors.⁵⁹ After all, domestic administrative and constitutional law has developed considerably over the last hundred years, and the *Neer* formula may no longer be the best expression of the level of protection generally recognized under all or most domestic laws.

If one accepts this rationale, it is clearly problematic, on the other hand, to interpret investment treaty standards in the manner ‘most conducive to fulfill the objective of the BIT to protect investments and create conditions favorable to investments’.⁶⁰ Despite this, there seems to be a clear tendency in practice, and a widely held understanding, that this is indeed an appropriate aim of international investment law. Indeed, as observed by James Crawford, the ubiquitous fair and equitable treatment standard sometimes seems to have been interpreted so strictly that ‘many governments would fail to meet this utopian standard most of the time’.⁶¹ Such dynamic interpretations clearly cannot be justified by a minimum standard rationale.

C Exhaustion of Remedies

But a possibly even more problematic aspect of the current arbitral regime in this light is how it dispenses with the local remedies requirement ordinarily affiliated with

⁵⁴ See, e.g., Schneidemann, *supra* note 35; Van Harten and Loughlin, ‘Investment Treaty Arbitration as a Species of Global Administrative Law’, 17 *European Journal of International Law* (2006) 121.

⁵⁵ See especially Schill, *supra* note 13; Schill, *supra* note 52.

⁵⁶ See, e.g., the convincing criticism of such an approach by Alvarez, *supra* note 52, at 563–569.

⁵⁷ The formulations are those of US Supreme Court Justice Stephen Breyer as quoted by Montt, *supra* note 5, at 22.

⁵⁸ *LFH Neer and Pauline Neer (USA) v. United Mexican States* (US-Mexican General Claims Commission), 1926, reprinted in UNRIAA, vol. 4, at 60. The commission held that, in order for a breach to have occurred, it would have to amount to ‘an outrage, to bad faith, to wilful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognise its insufficiency’.

⁵⁹ *ICSID, Mondev International Ltd. v. United States of America*, ICSID Case no. ARB(AF)/99/2, reprinted in 6 *ICSID Reports* 192, para. 123.

⁶⁰ *ICSID, MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile – Award*, 25 May 2004, ICSID Case no. ARB/01/7, para. 104.

⁶¹ Crawford, *supra* note 4, at 615, commenting on *ICSID, Técnicas Medioambientales Tecmed, S.A. v. United Mexican States – Award*, 29 May 2003, ICSID Case no. ARB (AF)/00/2.

the minimum standard under customary international law.⁶² Arguably, this requirement, which the International Court of Justice has considered ‘well established’⁶³ and ‘an important principle of customary international law’,⁶⁴ is not merely premised on ‘practical’ concerns.⁶⁵ It should be seen as interwoven with the broader rationale of the international minimum standard as a compromise between the different rights and interests of home states, host states and individual nationals and foreigners.⁶⁶ Traditionally seen as an expression of a respect for the sovereignty of the host state, and its assumed interest in being able to resolve matters concerning individual aliens before its own courts and legal procedures,⁶⁷ a significant part of the rationale of a local remedies requirement is also that the interest of the home state in such matters is indirect or representative – that is, it is not itself directly injured. We see this clearly in the limitation of the requirement to exhaust local remedies to situations where a claim is brought ‘preponderantly on the basis of an injury to a national’.⁶⁸ This can be seen to reflect a more general concern for subsidiarity where the legal position of individuals is concerned.⁶⁹ It reflects the fact that the legal position of individuals is, and primarily ought to be, a matter of internal sovereignty and municipal law. It also reflects a concern for equality, as it assumes foreigners have to be treated on equal terms with nationals. It generally assumes that ‘[i]nternational individual rights are and should be primarily enforced through domestic institutions’.⁷⁰ This concern underlies, for example, the requirement to exhaust local remedies in the ECHR, where it must be seen in combination with the right to an effective remedy under Article 13. As held by Anne Peters, this right to a domestic remedy may be seen as a ‘correlate’ of the local remedies rule in cases of ‘international individual rights’.⁷¹ As such, it would undeniably have a role in a protective regime that was really aimed at strengthening international rights for foreign investors under domestic law.

Today, such concerns are hardly reflected at all in the current regime for protection of foreign investment. The way it dispenses with the local remedies rule clearly reflects that it is designed to function not as a supplement but, rather, as a stricter and more efficient substitute for the domestic rule of law. This right to sidestep national court

⁶² See ILC, Articles on Responsibility of States for Internationally Wrongful Acts, UN Doc A/56/83, 3 August 2001, reprinted in 2(2) *ILC Yearbook*, Art. 44(b); ILC Draft Articles on Diplomatic Protection, *supra* note 47, Art. 14; see generally C.F. Amerasinghe, *Local Remedies in International Law* (2nd edn, 2004); Amerasinghe, *supra* note 24, at 142–190.

⁶³ *Interhandel (Switzerland v. United States of America)*, Preliminary Objections, Judgment, 21 March 1959, ICJ Reports (1959) 6, at 27.

⁶⁴ *Elettronica Sicula S.p.A. (ELSI) (United States of America v. Italy)*, Judgment, 20 July 1989, ICJ Reports (1989) 15, at 42.

⁶⁵ As formulated by Crawford, *supra* note 4, at 711.

⁶⁶ Amerasinghe, *supra* note 62, at 43.

⁶⁷ Amerasinghe, *supra* note 24, at 142–143.

⁶⁸ Cf. ILC Draft Articles on Diplomatic Protection, *supra* note 47, Art. 14.3.

⁶⁹ See generally, e.g., Jachtenfuchs and Krisch, ‘Subsidiarity in Global Governance’, 79 *Law and Contemporary Problems* (2016) 1.

⁷⁰ A. Peters, *Beyond Human Rights* (2016), at 480.

⁷¹ *Ibid.*

proceedings is often heralded as one of the key attributes of investment arbitration.⁷² It is said that the host state's courts will usually be 'lacking the objectivity that the investor desires' and may be 'bound to apply domestic law even if that law falls short of the standards provided by international law'.⁷³ From this perspective, the local courts merely represent unnecessary noise, delay and additional costs on the road to justice.

Of course, it is undeniable that having the option to sidestep local courts may be a considerable advantage for the foreign investor. But this is precisely also the reason why it is problematic in view of equality concerns and a concern for the integrity of municipal law. It begs the question why foreign investors should enjoy this particular advantage, which they do not have under their home state law and which no local investor or other subjects of the host state law can benefit from. It clearly cannot be justified on the basis of a minimum standard rationale.

4 Alternative Justifications of Extended Protection

A Introduction

The examination above shows that a minimum standard rationale cannot justify the current design of international investment law and its arbitral regime. Of course, this does not exclude the possibility that the current system could be justified by some alternative objective.⁷⁴ Thus, before we criticize the current system, it is necessary to first examine possible alternative justifications. Defenders of the system sometimes argue that it is justified for being based on treaties freely entered into in accordance with domestic constitutional processes.⁷⁵ This defence, however, does not suffice to normatively justify the system's continued existence in the face of claims that it should be reformed, renegotiated or outright discarded. What has been created by treaty can also be reformed or discarded by treaty. Moreover, it has been convincingly shown that many countries, in fact, did not understand the implications of the treaties they signed, especially in the 1980s and 1990s, and that the treaties were often concluded by mid-level civil servants without much political attention.⁷⁶ Another often cited justification of ISDS is that it serves to depoliticize investment disputes.⁷⁷ However, this

⁷² See, e.g., Schreuer, 'Calvo's Grandchildren: The Return of Local Remedies in Investment Arbitration', 4 *Law and Practice of International Courts and Tribunals* (2005) 1; Kriebaum, 'Local Remedies and the Standards for the Protection of Foreign Investment', in U. Kriebaum *et al.* (eds), *International Investment Law for the 21st Century: Essays in Honour of Christoph Schreuer* (2009) 417; Foster, 'Striking a Balance between Investor Protections and National Sovereignty: The Relevance of Local Remedies in Investment Treaty Arbitration', 49 *Columbia Journal of Transnational Law* (2010–2011) 201.

⁷³ Schreuer, *supra* note 72, at 1.

⁷⁴ See also in this regard Van Harten, 'Five Justifications for Investment Treaties: A Critical Discussion', 2 *Trade, Law and Development* (2010) 19.

⁷⁵ *Ibid.*, at 41, 54.

⁷⁶ Bonnitcha, Skovgaard Poulsen and Waibel, *supra* note 6, at 223; L.N. Skovgaard Poulsen, *Bounded Rationality and Economic Diplomacy: The Politics of Investment Treaties in Developing Countries* (2015).

⁷⁷ Ibrahim F.I. Shihata, 'Towards a Greater Depoliticization of Investment Disputes: The Roles of ICSID and MIGA', 1 *ICSID Review* (1986) 1; Bonnitcha, Skovgaard Poulsen and Waibel, *supra* note 6, at 193–199.

is not an argument for privilege; it merely suggests that foreign investors should have individual standing to enforce their rights whatever they may be.

Prima facie and in light of conventional, often emphasized considerations, it is however possible to envisage at least three alternative normative justifications that merit serious attention: first, that the current system serves as a means to facilitate economic development; second, that it protects capital originating outside the host state; and, third, that foreign investment represents a kind of contract between individual investors and home states. I argue, however, that none of these justifications provide a convincing rationale for privileging foreign investors beyond a minimum standard rationale.

B Improved Rule of Law and Economic Development

The most common justification of the current system of foreign investment protection is the idea that it facilitates economic development by creating legal certainty for foreign investment. There is good evidence that this has been a prime motivation for capital-importing states having concluded investment treaties with ISDS.⁷⁸ *Prima facie*, it does not seem unreasonable to assume that the availability of a neutral and effective legal remedy may work to ensure that foreign capital is not deterred by a lack of legal certainty, especially in countries lacking a strong and reliable domestic rule of law. However, upon scrutiny, it is questionable whether this objective can justify the current system.

In economic theory, it is quite generally recognized that a country's economic development is deeply connected with a developed rule of law and legal institutions.⁷⁹ A problem lies, however, as already noted, in the way in which the current regime actually fulfils this function. Representing an original 'grand bargain' struck between developed and developing countries, where the developed countries promise capital and the developing countries make 'a promise of protection of capital in return for the prospect of more capital in the future', investment treaties are designed not to improve domestic rule of law in the developing countries but, rather, to provide a substitute for it.⁸⁰ If the intent was to influence and improve the internal working of the host state's legal system,⁸¹ then the most appropriate way, as already mentioned, would be to design a system to interact with the host state's law, such as we find, for example, in

⁷⁸ Bonnitich, Skovgaard Poulsen and Waibel, *supra* note 6, at 207–211.

⁷⁹ See, e.g., Rodrik, Subramanian and Trebbi, 'Institutions Rule: The Primacy of Institutions over Geography and Integration in Economic Development', 9 *Journal of Economic Growth* (2004) 131; Haggard, MacIntyre and Tiede, 'The Rule of Law and Economic Development', 11 *Annual Review of Political Science* (2008) 205.

⁸⁰ Salacuse and Sullivan, 'Do BITs Really Work? An Evaluation of Bilateral Investment Treaties and Their Grand Bargain', 46 *Harvard International Law Journal* (2005) 67, at 77; see also K.J. Vandevelde, *Bilateral Investment Treaties: History, Policy and Interpretation* (2010), at 57.

⁸¹ Alvarez, *supra* note 6, at 137, citing Thomas Wälde, suggests this has been part of the motivation of domestic elites in least developed countries for entering into investment treaties. See also Schill and Djanic, *supra* note 2, at 36, arguing this ought to be considered one of the prime objectives of international investment law.

EU and human rights law, where the primary responsibility for enforcement lies with national courts. Whether ISDS in its current form may also contribute to improve the domestic rule of law is ultimately an empirical question.⁸² But the way the system is currently structured makes it implausible that this is one of its prime objectives. Some empirical studies do in fact also suggest that the way investment arbitration functions as a substitute for domestic rule of law may actually weaken national courts and institutions.⁸³

If ISDS is designed to facilitate economic development, it must therefore be as a somewhat extraordinary means of attracting foreign investment in its own right. As already mentioned, this has probably been a primary motivation for developing countries entering into BITs. But, at the same time, a number of empirical studies in recent years have shown that it is at best unclear how BITs actually contribute to increasing inward foreign investment to developing countries.⁸⁴ Moreover, in view of empirical research, it is questionable whether they actually do much to attract investment in the so-called least developed countries (LDCs), where, according to their rationale, they would be most needed and provide the most useful function. Several studies to the contrary show that where BITs do work to attract foreign investment, they do so primarily by supplementing and strengthening the signal effect of an already functioning, domestic rule of law.⁸⁵ However, perhaps the strongest point to make here is that, even if BITs actually may contribute in some cases to attracting investments that would otherwise have been deterred by the lack of legal certainty, which is not at all an unreasonable assumption, **there is little evidence that this requires overprotecting investments beyond what follows from the rationale of the minimum standard.**

The doubt cast by empirical evidence on the investment treaty regime's ability to increase foreign investment may reflect quite complex underlying economic realities. A reasonable inference nevertheless seems to be that what is probably most important for a country in terms of law, both for creating economic development and attracting foreign investment, is the quality and reputation of its domestic legal system. Investment arbitration faces at least two challenges in this regard. It is not designed to interact with and improve domestic law. And it also seems increasingly outdated in its insistence that what is needed to attract foreign investors in developing countries is

⁸² Bonniticha, Skovgaard Poulsen and Waibel, *supra* note 6, at 168.

⁸³ Ginsburg, 'International Substitutes for Domestic Institutions. Bilateral Investment Treaties and Governance', 25 *International Review of Law and Economics* (2005) 107; see also Stieglitz, *supra* note 7, at 550. And see generally Bonniticha, Skovgaard Poulsen and Waibel, *supra* note 6, at 167–172; Pohl, 'Societal Benefits and Costs of International Investment Agreements: A Critical Review of Aspects and Available Empirical Evidence', OECD Working Papers on International Investment no. 2018/1 (2018), at 67–69.

⁸⁴ See generally Bonniticha, Skovgaard Poulsen and Waibel, *supra* note 6, at 155–166. A valuable compilation of studies (most of which originally are published elsewhere) is K.P. Sauvant and L.E. Sachs (eds), *The Effect of Treaties on Foreign Direct Investment* (2009).

⁸⁵ Rose-Ackerman, 'The Global BITs Regime and the Domestic Environment for Investment', in Sauvant and Sachs, *supra* note 84, 311; Hallward-Driemeier, 'Do Bilateral Investment Treaties Attract FDI? Only a Bit ... and They Could Bite', in Sauvant and Sachs, *supra* note 84, 349, at 374.

a substitute for domestic courts.⁸⁶ To quote Peter Muchlinski, investment arbitration increasingly appears as ‘something of an anachronism ... designed to deal with a mid-20th century developing host country with a post-colonial, possibly authoritarian, unaccountable and corrupt government that cannot be relied upon to act predictably and transparently towards an investor in a major resource extraction or infrastructure project that requires major costs to function’.⁸⁷

C Foreign Origins and Home State Interests

If economic reasons cannot justify special and more extensive protection of foreign investors, this does not rule out that reasons of international justice might require it. Historically, this would indeed seem to be the accepted justification for the protection of foreign property rights, as these were considered an extended part of the home state economy. A related notion is that foreign investors lack prior attachment to the host state and have their origins in a different society. Thus, **two conceivable justifications for differential treatment may be that foreign investors have other moral claims and expectations than nationals and that they are really representatives of their home states’ interests.**

1 Different Standard of Justice?

In the two cases of *James* and *Lithgow*,⁸⁸ the ECtHR relied on the first of these justifications to refute the claim that the reference to ‘international law’ in Article 1 of Protocol no. 1 to the ECHR extended the benefit of the international law rule requiring prompt, adequate and effective compensation in case of expropriation also to nationals.⁸⁹ The claimants had argued that differentiating between foreigners and nationals would violate the principle of non-discrimination in Article 14 of the ECHR. The Court found, however, that there were, conceivably, justifiable reasons for giving foreigners special rights under international law. **It referred both to ‘non-nationals [being] more vulnerable to domestic legislation’, and to their lack of allegiance to the host state, suggesting that nationals sometimes have to carry ‘a greater burden in the public interest’.**⁹⁰

As a justification of the current investment treaty regime, this is not convincing. If nationals may owe greater allegiance to their nation than what may be demanded

⁸⁶ See, e.g., the 2016 Rule of Law Index of the World Justice Project, available at <http://worldjusticeproject.org/rule-of-law-index>, presenting a more nuanced picture with a traditionally developed country such as Italy in the 35th place, below Romania, the United Arab Emirates and Georgia. The USA is placed in 18th place, just below the Czech Republic and above South Korea.

⁸⁷ Muchlinski, ‘Corporations and the Uses of Law: International Investment Arbitration as “Multilateral Legal Order”’, 1 *Onati Socio-Legal Series* (2011) 5.

⁸⁸ *James*, *supra* note 21; *Lithgow*, *supra* note 21.

⁸⁹ The relevant provision is the second sentence: ‘No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.’ Protocol no. 1 to the Convention for the Protection of Human Rights and Fundamental Freedoms 1952, ETS 9.

⁹⁰ *James*, *supra* note 21, para. 63; *Lithgow*, *supra* note 21, para. 116.

from foreigners in certain circumstances, this can hardly justify the way in which investor-state arbitration today functions as a substitute for domestic courts, and this was not of course what the Court had in mind. Moreover, the argument that foreign investors as a group are more vulnerable to the domestic political and legal process because they lack the right, or the ability, to participate has little connection to reality.⁹¹ The typical foreign investor is not an individual outsider thrown into an alien political and social environment but, rather, a multinational corporation likely to wield substantial influence in the host state by virtue of both its organizational capacity and its economic resources.

An alternative version of this justification is provided by Thomas Franck, who maintains that the fundamental problem and primary justification of differential treatment is that foreign investment invariably involves a conflict of separate normative cultures or backgrounds: '[U]nexpected changes which frustrate reasonable entrepreneurial expectations may emanate not from the political system within which the entrepreneur participates, but in another system whose mores, values, and expectations may contrast sharply with those of the investor and in which the investor may have little legitimate role.'⁹² The problem with this argument, nevertheless, is that it assumes we are dealing primarily with different national, social and political cultures, suggesting that a compromise needs to be found under the neutral arbiter of international law and justice. But what we are dealing with in the current ISDS system is rather a clash of cultures of a different kind. Foreign investors represent a global elite world of international finance and business, confronting on a broad scale the more complex, social and political realities of different host state legal systems. Thus, international investment law, in reality, aims to deal with the clash of cultures between globalism, on the one hand, and the local and national, on the other. And the way it does this is mainly by extricating itself from the latter and taking refuge in the cool, clean atmosphere of the former. Thus, while there may be some force in the argument that the existence of an international law dealing with foreign investment is justified by different normative cultures, it can hardly justify the idea that international law generally should give foreign investors better rights than a common level of protection accepted under domestic law, nor that they should be allowed to sidestep domestic courts altogether. It can at most justify international investment law according to a minimum standard rationale, which aims to provide for a more common and uniform standard of protection under domestic laws.

2 Home State Interests

What then can be said about the, again, alternative justification that foreign investors do not only represent themselves but also the material, economic interests of their home states? This was an important historical rationale of rules protecting foreign private property under international law.⁹³ In his *Law of Nations* (1758), Emer de Vattel

⁹¹ See, e.g., Pohl, *supra* note 83, at 41, with further references.

⁹² T. Franck, *Fairness in International Law and Institutions* (1995), at 440.

⁹³ Alvik, 'Protection of Property in the Early Law of Nations', 20 *Journal of the History of International Law* (2018) 1; see also Miles, *supra* note 5, at 33.

justified diplomatic protection by reference to the home state's protective function over its nationals abroad,⁹⁴ but he also reasoned that the state, in the special case where the private property of its citizens was concerned, had a more direct and material interest: such property 'in some sort really belongs to her from the right she has over the property of her citizens, because it constitutes a part of the sum total of her riches, and augments her power'.⁹⁵ In addition, in a more contemporary setting, such concerns are part of the accepted rationale and justification of protection of foreign investment under international law.⁹⁶ Historically, home states have engaged in the protection of their investors abroad not only out of mere idealistic concerns but also because of a perceived material interest in promoting the investment of capital with some attachment to their own economy in other countries.⁹⁷ This still seems true today.⁹⁸

Whether the contemporary international law protecting foreign investment really reflects any such notion of direct home state interests is nevertheless debatable. The majority of the Court in *Barcelona Traction* held that the right to protect capital invested abroad through corporate entities does not reflect the underlying capital interest as such but, rather, relies on a formal link of nationality, albeit possibly subject to a substantial link.⁹⁹ Although some do, most investment treaties do not include any requirement of a substantial link and, instead, extend protection based on nationality purely as a formal criterion, determined by where a company is incorporated.¹⁰⁰ Arbitral practice has consistently refused to interpret such provisions restrictively,¹⁰¹ even allowing claims from companies owned exclusively or primarily by nationals of the host state.¹⁰² In most cases, foreign origin is consequently not a necessary, operative requirement of the existence of an international right under international investment law.¹⁰³

More than a reduced emphasis on home state economic interests, this may reflect a changed perception of the nature of capital. As noted by Simon Lester, 'the notion of "foreign" and "domestic" companies looks increasingly outdated in today's globalized

⁹⁴ E. de Vattel, *The Law of Nations*, edited by B. Kapossy and R. Whatmore (2008), at 298: 'Whoever uses a citizen ill, indirectly offends the state, which is bound to protect this citizen; and the sovereign of the latter should avenge his wrongs, punish the aggressor, and, if possible, oblige him to make full reparation; since otherwise the citizen would not obtain the great end of the civil association, which is safety.' See also Parlett, *supra* note 45, at 49–50.

⁹⁵ Vattel, *supra* note 94, at 302.

⁹⁶ See, e.g., the separate opinions of Justices Jessup and Gros in the *Barcelona Traction*, *supra* note 47, at 196 (Separate Opinion of Jessup J) and 269 (Separate Opinion of Gros J). See also I. Seidl-Hohenveldern, *International Economic Law* (1999), at 27.

⁹⁷ Miles, *supra* note 5, at 33ff.

⁹⁸ Alvarez, *supra* note 6, at 146.

⁹⁹ *Barcelona Traction*, *supra* note 47, at 46, paras 86–88; see also ILC Draft Articles on Diplomatic Protection, *supra* note 47, Art. 9.

¹⁰⁰ Dolzer and Schreuer, *supra* note 4, at 48.

¹⁰¹ *Ibid.*

¹⁰² ICSID, *Tokios Tokelés v. Ukraine – Decision on Jurisdiction*, 29 April 2004, ICSID Case no. ARB/02/18; ICSID, *Rompetrol Group N.V. v. Romania – Decision on Jurisdiction*, 18 April 2008, ICSID Case no. ARB/06/3.

¹⁰³ Schreuer, 'Nationality of Investors: Legitimate Restrictions vs. Business Interests', 24 *ICSID Review* (2009) 521, at 523.

world'.¹⁰⁴ Capital has become a fluid commodity that moves unrestrained between countries, knowing no borders and having no allegiance to particular countries. It is consequently doubtful whether it can any longer plausibly be maintained, as Vattel did, that foreign private, property rights 'really belong' to their home state as 'a part of the sum total of her riches'.¹⁰⁵ Moreover, even if states do perceive a material interest in protecting capital abroad, the legal interest recognized by the law is clearly in the nature of a representative or indirect interest.¹⁰⁶

3 Summing Up: Foreign Origins Does Not Justify More Extensive Protection Than under the Minimum Standard

It follows that neither foreign origins nor home state interests provide a convincing justification for protection beyond a minimum standard rationale. Of course, this does not preclude that states between themselves do agree on more extensive protection based on an appreciation of their interests. The point, however, is that as long as the rules are meant to function reciprocally, it is difficult to see why states should perceive this to be in their interest. An explanation, of course, is that the rules are not meant to function reciprocally. But this is not a justification, although it may be a cause, of the persistent legitimacy crisis confronting the investment treaty regime.

D Foreign Investment as a Contract

Accepting that capital in our contemporary world in some sense is 'homeless' may suggest an alternative perspective on foreign investment as a transactional relationship between individual investors and host states. The investor makes a voluntary decision to invest in the host state, which has an interest in attracting the investment, suggesting an implicit bargain between the host state and the investor. The host state, in order to attract investments, offers stability and predictability, which the investor accepts when an investment is made. Investment treaty arbitration in this perspective provides a means for the host state to credibly commit to predictability and stability. It responds to the so-called 'obsolescing bargain', which is seen to characterize investor–state relationships, where the balance of interests and power changes radically after an investment has been made.¹⁰⁷

We see a clear reflection of this perspective in how the contractual instrument of arbitration merged into a remedy for the protection of foreign investment – for example, through the theory of 'internationalization' and the adoption of the ICSID Convention in 1965 and later as a conceptual model for investment treaty arbitration.¹⁰⁸ In

¹⁰⁴ Lester, *supra* note 29, at 214.

¹⁰⁵ Vattel, *supra* note 94, at 302.

¹⁰⁶ As encapsulated under general international law in 'the right of the State to have its nationals enjoy a certain treatment guaranteed by general international law'. Cf. *Barcelona Traction*, *supra* note 47, para. 87.

¹⁰⁷ R. Vernon, *Sovereignty at Bay: The Multinational Spread of U.S. Enterprises* (1971), at 46.

¹⁰⁸ I. Alvik, *Contracting with Sovereignty* (2011), especially at 24, 47ff; Van Harten, *supra* note 52, at 10–11; Dolzer and Schreuer, *supra* note 4, at 257–259.

addition, interpretations of substantive investment treaty standards sometimes reveal such an implicit contractual perspective.¹⁰⁹ A lack of deference to the discretion of municipal authorities may be seen to reflect an implicit contractual perspective, being focused on clarifying reasonable expectations more than the proper limits of government power.¹¹⁰ The same goes for progressive interpretations of, for example, the fair and equitable treatment standard as a strict requirement of respect for legitimate expectations.¹¹¹ Moreover, it is reflected in the interpretation of so-called umbrella clauses – that is, treaty provisions committing host states to ‘observe any obligation ... assumed with regard to specific investments’¹¹² – as commitments ‘transforming municipal law obligations into obligations directly cognizable in international law’¹¹³ or as ‘assimilating breaches of contract to breaches of treaty’.¹¹⁴ This is by no means an obvious interpretation. It could just as easily have been argued that a reasonable interpretation would be that the clause is meant to deal with the ‘substantial impairment’ of established contractual rights through the exercise of public power, assuming an implicit competence to regulate in so far as ‘reasonable and necessary to serve an important public purpose’ or to ‘secure the health, safety, good order, comfort, or general welfare of the community’.¹¹⁵

The contractual or bargain perspective is not without some appeal. It reflects the need for a remedy that ensures the credible commitment of host states, combined with the increasing internationalization of capital: its lack of any substantial bond of allegiance to particular nation-states and the observation that host states compete in the global business and financial markets to attract international capital. To ensure a well-functioning market for capital, host states should be expected to act rationally and predictably. However, in itself, this does not give a justifiable basis for a protection disconnected from domestic law or for protecting foreign investment according to other and stricter standards than those that apply to local investors and other actors. It does not explain why a company, once turned global, ought to expect more efficient

¹⁰⁹ See also Arato, *supra* note 37, at 16–29.

¹¹⁰ See generally Montt, *supra* note 5, at xi–xii; see also Uruena, ‘Subsidiarity and the Public-Private Distinction in Investment Treaty Arbitration’, 79 *Law and Contemporary Problems* (2016) 99; Alvarez, *supra* note 52, at 434.

¹¹¹ Alvik, *supra* note 108, at 203.

¹¹² Cf. Agreement between the Republic of the Philippines and the Swiss Confederation on the Promotion and Reciprocal Protection of Investments, 23 April 1999, Art. X: ‘Each Contracting Party shall observe any obligation it has assumed with regard to specific investments in its territory by investors of the other Contracting Party.’

¹¹³ ICSID, *Noble Ventures, Inc. v. Romania* – Award, 12 October 2005, ICSID Case No. ARB/01/11, para. 53.

¹¹⁴ See generally Dolzer and Schreuer, *supra* note 4, at 166ff, noting that there are essentially two approaches to umbrella clauses, one of ‘effective application’ assimilating breaches of contract to breaches of treaty, and one restrictive, requiring something more than a mere breach of contract for a breach of treaty to have occurred.

¹¹⁵ The citations are from the US Supreme Court interpreting the contracts clause of the US Constitution, Art. I, s. 10, the relevant parts of which read: ‘No state shall ... pass any ... law impairing the Obligation of Contracts.’ Respectively, *General Motors Corp. v. Romein*, 503 US 181 (1992); *United States Trust Co. v. New Jersey*, 431 US 1 (1977); *Atlantic Coast Line R. Co. v. City of Goldsboro*, 232 US 548 (1914). See Alvik, *supra* note 108, at 240ff.

protection than it may expect at home. If capital, in its nature, is global, after all, it makes no sense to distinguish between national and foreign investors.¹¹⁶

While the bargain perspective may strengthen an appreciation of the value of host states being held to their commitments, express or implicit, this is not the only relevant concern, nor does it only apply to foreign investors. Domestic legal systems also generally appreciate commitment and predictability as concerns, recognized through the principles of legitimate expectations in constitutional and administrative law, which, however, must be balanced against other competing concerns. This may suggest an evolutionary interpretation of the international minimum standard to take account of such concerns in a contemporary context.¹¹⁷ However, it hardly justifies an autonomous contractual standard for foreign investment. And it clearly does not in itself justify that foreign investors should be able to invoke arbitration without prior recourse to the domestic courts, unless specifically agreed with the individual investor.

5 Implications for Reform

If one accepts that the only convincing and justifiable rationale for international legal protection of foreign investment is the one provided by the international minimum standard – namely, securing a common level of protection reflected under most domestic laws or enjoying the ‘general acceptance by all civilized countries’,¹¹⁸ this has obvious implications for the current investment treaty regime. We can allow ourselves here to ignore the practical challenge involved in finding and giving shape to such common principles because the point is merely its negative implication: there is no justifiable reason why foreign investors in principle should enjoy stronger and more effective protection than nationals. As noted by Christoph Schreuer, an obvious response might be to stop distinguishing between national and foreign investment altogether and the institution of a protective regime for investment more akin to, for example, the ECHR. But, as Schreuer notes, ‘we are still a long distance from that’, and introducing such a system would raise a whole lot of other difficult concerns.¹¹⁹

A more important implication is that appreciating the limited reach of a minimum standard rationale provides a strong argument for perceiving international investment law in accordance with a public law ‘paradigm’¹²⁰ and for substantive reform that draws more on domestic constitutional and administrative law traditions and generally incorporates a more deferential attitude to domestic law and authorities.¹²¹ This is not the place for discussing the more concrete implications of such an approach,

¹¹⁶ This point is also made by Lester, *supra* note 29, at 214.

¹¹⁷ See, e.g., ICSID, *Waste Management Inc. v. United Mexican States II – Final Award*, 30 April 2004, ICSID Case no. ARB(AF)/00/3, para. 98: ‘In applying this standard it is relevant that the treatment is in breach of representations made by the host State which were reasonably relied on by the claimant.’

¹¹⁸ Root, *supra* note 44.

¹¹⁹ Cf. Schreuer, *supra* note 103, at 527.

¹²⁰ Roberts, *supra* note 52, at 63.

¹²¹ See part 3.B.

but it may be noted that the kind of deference required by international law and international tribunals in their relation to national law and national courts is of another kind than the deference required by a national court towards a democratically elected parliament or government. Thus, the most appropriate analogy for the judicial review to be undertaken by investment tribunals may not necessarily be municipal constitutional and administrative law but, rather, the judicial review performed by certain other international tribunals such as the ECtHR.¹²² A future permanent investment court would clearly have greater ability and legitimacy to develop its own perspective in this regard than ad hoc arbitral tribunals, and might thus be a step in the right direction.

Crucially, the creation of a permanent court however will not by itself satisfy the legitimacy challenge posed by the present procedural architecture of the investment regime, whereby it functions as a substitute for domestic courts and a parallel legal regime with reserved access for foreign investors. Not only will this continue to raise equality concerns, it is also unlikely to provide the desired 'halo-effect' that might have alleviated such concerns by contributing to improve domestic rule of law in a manner that is beneficial to general economic development.¹²³ There is arguably something inconsistent in considering that the substantive law should be cast in the form of a deferential public law, while simultaneously holding on to a system of dispute settlement based on the private law model of international commercial arbitration. In view of the fundamental concerns underlying the local remedies rule, and the way these are closely interwoven with the rationale of an international minimum standard, it is difficult to escape the conclusion that some form of local remedies rule is indispensable for the global investment regime to improve its legitimacy.

This is also not the place to work out the more concrete implications of this argument, but, in response to the possible objection that it would sacrifice remedial efficiency on the altar of abstract legitimacy, it should be recalled that the rule would not necessarily have to be an absolute one. It might be subject to exceptions that could be further developed in treaty drafting and by investment tribunals, such as the idea that recourse to the local courts provides 'no reasonable possibility' of obtaining justice or that 'there is undue delay' or 'the injured person is manifestly precluded from pursuing local remedies'.¹²⁴ It would still be open to waiver in contracts with individual investors.¹²⁵ What this would essentially do is make the need for direct recourse into a criterion of admissibility and place the burden of ascertaining it on the foreign investor rather than just making it a premise of the system.

¹²² A margin of appreciation doctrine in the context of investment treaty standards may have to be developed in light of somewhat different concerns and policy considerations than those that have been relied on, for example, by the European Court of Human Rights. For discussion of the latter, see Benvenuti, 'The Margin of Appreciation, Subsidiarity and Global Challenges to Democracy', 9 *Journal of International Dispute Settlement* (2018) 240, arguing for a less extensive margin of appreciation where non-nationals are concerned in favour of a concept of subsidiarity.

¹²³ Contrast Montt, *supra* note 5, at 154–155.

¹²⁴ ILC Draft Articles on Diplomatic Protection, *supra* note 47, Art. 15(a), (b) and (d).

¹²⁵ *Ibid.*, Art. 15(e).

6 Conclusion

International investment law as it exists today has grown in bits and pieces mainly through bilateral arrangements, without any superior purpose or design. It is unquestionably also the product of a certain constellation of interests and power between countries, which may explain, but not normatively justify, the way it aims to provide a better and more effective legal protection for foreign investors than generally available under domestic law. The main argument of this article is that unless the concerns that this article raises are addressed and convincingly implemented into the design, framework and structure of the current investment regime, they will continue to challenge its legitimacy.