

**THE IMPACT OF INVESTMENT TREATIES
ON DOMESTIC ADMINISTRATIVE LAW**

– Short version –

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1. Foreign investment treaties are based on the presumption that the domestic legal system of the host country may be, or turn out to be, insufficient for the special purpose intended by these treaties, being the creation of an investment-friendly climate which attracts foreign investment as desired by the host state. These treaties are inherently indifferent to the issue of the legal system as it relates to the nationals of the host state, and they will often result in reverse discrimination to the detriment of the nationals. Whether or not the legal system is changed by the host state so as to avoid such a discrepancy is a matter for the host state alone to decide.
2. The scope of foreign investment treaties *rationae materiae* applies essentially to all economic activities of foreign investors; this results from the broad definitions of investment which practically all of the treaties contain. As a result, nearly every aspect of the host state's legal system is affected and may be subjected to international review in accordance with the treaty's system of dispute settlement.
3. Inasmuch as foreign investment treaties promote the perspective of the foreign investor, it is consistent with the purpose of the treaties that they all depart from classical international law and allow that not just the states parties to the treaties, but the investor directly to bring a claim before an international tribunal. Also, a number of the treaties are drafted to insure that contracts concluded by the host state and the foreign investor under the laws of the host state are also subject to the international guarantees provided by the treaty, including the dispute settlement mechanism. Thus, by way of placing the guarantees contained in the treaty outside of the realm of diplomatic negotiations on the state-to-state level, the laws of the host state are subject to international review in accordance with the will of the foreign investor.

4. Most of the 2300 bilateral investment treaties have been negotiated at the request of traditional capital-exporting countries. However, more and more such treaties are concluded among developing states. Also, within NAFTA, the United States and Canada as well as Mexico have been willing to accept international review of their actions toward foreign investors from the other two countries. Contrary to the existing situation under bilateral treaties, the United States and Canada already found themselves as defendants before international NAFTA tribunals. While the United States has never been ordered to pay for any damage, concern has been expressed by different groups within the United States that the effect of foreign investment treaties on the domestic legal system may be so severe as to be unacceptable.

5. In the current Ministerial Round of the WTO an effort was made to negotiate a multilateral investment treaty. For the time being, this effort failed, after developing countries such as Brazil, India and Malaysia, but also China spoke out against this effort and indicated that the domestic regulatory space desirable for developing countries might be significantly reduced by such a treaty and that future studies would be necessary to examine the impact on the domestic regulatory system.

It is not clear at the moment whether and under what circumstances the effort to create a multilateral investment system will be revived inside or outside the WTO.

6. The various substantive rules contained in investment treaties which bear upon domestic legal systems of the host countries emanate from different sources of international law. In part, they are based on autonomous treaty law specifically negotiated among the state parties. Other parts re-state customary international law which would be applicable even in the absence of a treaty. Both types of substantive

rules are subject, in all of these treaties, to interpretation and application by international tribunals at the request of foreign investors and thus are subject to a more rule-oriented institutionalised system of compliance than under classical international law. The power to identify, apply and enforce the rules has been shifted away from the free will of states.

7. In practice, two clauses contained in investment treaties have the most severe impact on domestic legal systems. All treaties contain clauses providing for rules on indirect expropriation and for fair and equitable treatment of foreign investors. The interpretation and application of these two clauses will require special examination from the point of view of the reduction of the sovereign rights of the host country to determine its domestic regulatory system.
8. As to indirect expropriation, investment treaties use different formulae to define the concept. Some treaties refer to measures equivalent to expropriation, others to measures having the same effect, the NAFTA rules, for instance, additionally refer to measures tantamount to expropriation.

While there has not been much discussion on this point, it has been assumed that at least some of these clauses are meant to represent the same standard as the parallel rule of customary international law. However, similar to the jurisprudence in domestic legal orders on this point, the long-standing jurisprudence on the content of customary law has not led to a clear-cut line which would provide for a hard and fast rule.

A similar degree of uncertainty characterises the jurisprudence of international investment tribunal on indirect expropriation. Some tribunals have used the test of the

expected benefit of the use and enjoyment of the property. Others have focused in a similar way on the effect of the measure as the sole criterion. In contrast, it seems that yet another group of decisions have been based more on a balancing approach which takes into account the context of a measure. Remarkably, the 2004 US draft of a model treaty also points to the context as one factor to be considered.

The Metalclad decision, for instance, has spelled out that the absence of a timely and orderly process of governmental decision-making which affects the foreign investor may lead to the conclusion that an indirect expropriation has occurred. As to the sole effect doctrine, the Santa Elena Case has strictly focused on the effect without placing any emphasis on the environmental context of the measure.

However the individual case may be assessed, it would in my view not be appropriate to characterise the existing jurisprudence as being out of step with the earlier jurisprudence and with the literature on customary international law regarding indirect expropriation.

9. The requirement of fair and equitable treatment of foreign investment has long been a standard feature in all modern investment treaties. The relevant clause appears in two different versions. Whereas countries such as Germany, Switzerland and Sweden draft the rule so as to create an autonomous, treaty-based standard, a second group including the US, France and the UK prefer to require “fair and equitable treatment in accordance with international law”, thus indicating that they require such a standard of treatment which corresponds to the rules of customary international law.

10. As to the content of customary law, an intense debate has evolved in the past years as to whether the relevant rules will only be violated if the conduct of the host state is outrageous and shocks the legal conscience, or whether it is sufficient for a violation that the conduct must be characterised as grossly unjust.

Whereas a difference between the two positions certainly exists as a matter of abstractly defining the standard, it seems open whether in practice the difference is as significant as the fierce debate seems to suggest. In my view, it is possible that tribunals will not be inclined to differentiate according to any abstract difference which may be, or may not be, inherent in the two positions. Instead, they may reach their judgment based on their sense of what is under the circumstances still acceptable or not from the point of view of a proper treatment acceptable from a contemporary point of view.

Identifying the content of fair and equitable treatment may be more complex when it comes to interpreting a version of the clause which is strictly treaty-based. Efforts to spell out the content by way of a shorthand formula as a way to elaborate the ordinary meaning of the clause will not be very promising, given that dictionaries are not very helpful in this context and in fact often refer to equitable when explaining fair and also refer to fair when discussing the meaning of equitable. What seems more beneficial is to discuss, in a casuistic way, certain types of conduct as being acceptable or unacceptable. Indeed, the more recent jurisprudence seems to move in this direction.

11. Along these lines of a casuistic approach to determine the meaning of fair and equitable treatment, tribunals have recently emphasized themes such as consistency and transparency of administrative conduct. Also, a duty was found to follow the goals

of the policies and practices underlying the applicable rules. All of this is meant to provide for legal stability, to let the investor know what to expect before planning and launching the business activities.

A few decisions have added the requirement of due process, without explaining its content in this context, and a recent decision has set forth the requirement of candor.

As to the judicial process, one tribunal reviewed the workings of the jury system in Mississippi and found that the trial in question could not be countenanced, in fact was a disgrace.

12. One facet of recent decisions which underlines the theme of both legal stability and national sovereignty relates to the chronological focus of the tribunals on the law at the time at which it stands when the investment is made. According to this vantage point, the legitimate expectations of the investor are based on this state of the law, but they are also limited thereby. Thus, tribunals have been inclined, in general, to point out that laws that may be unwise or deficient cannot form the basis of a claim as long as they were in place and known to the investor at the time of the investment.
13. In conclusion, it will not be overlooked that the jurisprudence of investment tribunals as a whole may be seen to contain the ingredients of an international system of administrative law developed on the basis of very generally-worded clauses in virtual all areas of administrative law ranging from tax law to bankruptcy issues, from the law of governmental immunity to the export rules, and in particular to the requirements of a permit process. The appropriate time for filing an appeal, the process of determining

a relevant fact, and the judicial administration of justice in general have been subject to review by this growing jurisprudence.

14. The future evolution of this jurisprudence will mainly depend upon the methodology by which tribunals apply the relevant rules of investment law. One approach is to underline the host state's margin of appreciation in handling its legal system and to find in favour of state sovereignty in the case of doubt. A different method will emphasize the object and purpose of an investment treaty as set forth in the relevant preambles of the treaty and will conclude that the creation of an investment-friendly climate will typically require to underline the legal interests of the investor. To some extent, it may be possible to evade these two positions and to simply base a decision on the language of a treaty and its ordinary meaning.

Currently, variations of all these three approaches can be found in the decisions of tribunals, and this will continue to be so as long as no institutional changes are introduced to provide for coherence in the system of investment arbitration.

15. So far, states seem to have accepted, albeit sometimes grudgingly, not just the standard rules of investment treaties, but also their interpretation and application by tribunals in the direction of an emerging body of international rules of administrative law. A certain ambivalence must be diagnosed when more and more developing states are willing to sign investment treaties among themselves, such as most recently China and India, and when these countries nevertheless object to a corresponding multilateral treaty in view of the undesirable reduction of regulatory space and the unknown effects of such treaties.

16. On the bilateral level, states have accepted that the willingness to conclude investment treaties is today recognized as the entrance card to the global market on which states compete for foreign investment. Whereas this recognition is accompanied in part by a lament on the loss of national sovereignty, these investment treaties are at the same time seen by reformers in developing countries as powerful tools to modernise the domestic administrative legal system, providing effective external checks on deficiencies and shortcomings which are difficult to control on the internal level.