RULE OF LAW IN THE EMERGING DEVELOPMENT AGENDA: ON FINDING THE OPTIMAL ROLE FOR INVESTMENT TREATIES

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My sincere thanks to Isabella Bunn for arranging such an interesting topic and format, and to my fellow panelists for bringing it to life. As stated in the Symposium's program for this A.B.A. Special Event, the proposition before us is that the rule of law is a goal in and of itself, "a key principle in the achievement of other development objectives, and as an over-arching theme in the creation of an enabling environment for sustainable development."[1] I want to focus on the aspect of the proposition that looks to rule of law in creating an "enabling environment for sustainable development" via the encouragement of foreign direct investment.

We must begin with the term *rule of law*. It is a term we are all familiar with and, speaking for myself when I use it, I have a general sense of what it means; however, at the same time, I would be hard

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1. *Law, Justice and Development Week 2014: Financing and Implementing the Post-2015 Development Agenda*, World Bank Group (A.B.A. Section of Int'l Law, Washington, DC), Oct. 20-24, 2014.

pressed to give you a precise definition. Let me begin, then, by offering a definition of this term to enable us to have a common framework for thinking about the issue at hand.

The World Justice Project defines "rule of law" as a system in which the following four universal principles are upheld:

> 1) The government and its officials and agents as well as individuals and private entities are accountable under the law.
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> 2) The laws are clear, publicized, stable, and just; are applied evenly; and protect fundamental rights, including the security of persons and property.
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> 3) The process by which the laws are enacted, administered, and enforced is accessible, fair, and efficient.
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> 4) Justice is delivered timely by competent, ethical, and independent representatives and neutrals who are of sufficient number, have adequate resources, and reflect the makeup of the communities they serve.[2]

I am going to come to the proposition at hand: That the rule of law creates an enabling environment for sustainable development with this definition in mind, and with a particular focus on certain legal underpinnings that encourage—or purport to encourage—foreign direct investment, often a key source of investment and sustainable development for developing nations. This is particularly the case for fragile states that have recently emerged from, or are trying to emerge from, conflict, with the added advantage (or often curse) of being natural-resource rich.

With respect to encouraging foreign direct investment, emerging states are often urged by international organizations, sovereign friends, non-governmental organizations, and international law firms to commit wholesale to the investor-state dispute settlement system (ISDS). In my experience, this urging is made regardless of the state of the domestic rule of law in a developing country; indeed, it is offered as a way of plugging the gap—providing a system of law that will encourage foreign investment without having to wait for the development of adequate domestic laws and legal capacity. For this reason, the invitation to the ISDS can be very attractive to developing countries as a turnkey system that seems to require no real effort or investment on the part of the state, while at the same time offering the critical benefit of attracting needed investment.

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2. *What is the Rule of Law?*, WORLD JUST. PROJECT, http://worldjusticeproject.org/what-rule-law (last visited Mar. 31, 2015).

The ISDS may broadly be defined as an international law-based system that is founded mostly on thousands of bilateral investment treaties (BITs) and some multilateral investment-related treaties that protect, on a reciprocal basis, the investors of each state when they make investments in other states. To a lesser extent, ISDS can and does include contracts and domestic laws.

At the heart of the investment treaty regime is a commitment on the part of the state-parties to consent to arbitrate disputes that may arise out of these investments. By this system, sovereigns agree to *privatize* the dispute resolution process for covered investments. In this way, foreign investors are protected against the traditional *home field advantage* that sovereigns may enjoy via their national court systems: Disputes are presented in a neutral forum, before independent arbitrators appointed by the parties themselves, and pursuant to the law designated by both parties. Importantly, the ISDS has the additional benefit of de-politicizing investment disputes between states.

But does this system help establish, or enhance, the rule of law in developing countries? When singularly comparing the ISDS to the World Justice Project's definition of "rule of law," it often seems the ISDS system—again, standing alone—falls short. In relation to the World Justice Project's first principle (that the government and its officials and agents as well as individuals and private entities are accountable under the law), the ISDS does not purport to hold accountable the legal decision makers—the arbitrators—who must judge the compatibility of government action vis-à-vis foreign investment with that government's treaty commitments. In regards to the fourth principle (that justice is delivered timely by competent, ethical, and independent representatives and neutrals who are of sufficient number, have adequate resources, and reflect the makeup of the communities they serve), a criticism of the ISDS system is that the arbitrator pool is far too small, particularly when it comes to the appointment of a presiding arbitrator.

Indeed, in both developed and developing countries, the ISDS itself has come under some considerable criticism. These include the contention that disputes resolved under investment treaties are anti-democratic insofar as independent non-national arbitrators can decide the legality of a government measure. Another is that ISDS actually frustrates development of the rule of law, in that for every dispute brought outside a national system, an opportunity for law development within the national system is lost. Moreover, domestic judges do not benefit from learning by doing and the gradual development of

judicial expertise. This can be particularly problematic in countries whose income is dominated by a single revenue source, and where foreign investments in that revenue source are covered by investment treaties.

There is also the criticism that investment treaties can frustrate a sovereign's ability to regulate in response to changing information and circumstances. A rather stark example often pointed to is Phillip Morris's 2010 claim against Uruguay under the Uruguay-Switzerland BIT. In this claim, Phillip Morris challenged two pieces of Uruguayan tobacco legislation, including a health-warning requirement.[3]

For all of these reasons, states have begun to rethink the level of their commitment to the ISDS. South Africa, for example, recently took the radical step of unilaterally terminating its BITs with a selection of European states (Germany, Switzerland, Spain, Netherlands, Belgium, and Luxembourg), and is renegotiating its treaties with China and South Korea (these are "first generation" BITs that include generous protections for investors).[4]

Whether these criticisms are valid or not is beside the particular point I intend to make today. The point I want to stress is that while the ISDS system can offer benefits to those countries that enter into them, these benefits sometimes come with an unanticipated price that can include, in addition to the issues just discussed, large damage awards against the sovereign. Indeed, it should be borne in mind that when a government loses an investment treaty arbitration, it often also loses the investment. This can be devastating to developing economies dependent on a small number of investments. ISDS is not the panacea to a rule of law deficit in relation to foreign direct investment.

Governments committed to the robust rule of law on a domestic level are much more able to understand the true costs and benefits of bilateral investment treaties; they can create the kind of legal and regulatory environment that will be consistent with any international obligations undertaken in bilateral or multilateral investment treaties. In other words, where the sovereign government has thought through

3. Philip Morris Brand Sàrl v. Oriental Republic of Uru., ICSID Case No. ARB/10/7, Procedural Order No. 3, ¶ 13 (Feb. 17, 2015), https://icsid.worldbank.org/ICSID/FrontServlet?RuleofrequestType=CasesRH&actionVal=showDoc&docId=DC5532_En&caseId=C1000.

4. Xavier Carim, *Columbia FDI Perspectives No. 109: Lessons from South Africa's BIT Review*, VALE COLUM. CTR. ON SUSTAINABLE INT'L INVESTMENT (Nov. 25, 2013), http://www.vcc.columbia.edu/content/lessons-south-africa-s-bits-review. Generally, "First Generation" BITs include those negotiated up to the early 1990s and are characterized by pro-investor provisions; later generation BITs tend to be more balanced as between the host State and the investor protections.

its domestic laws that relate to investment—its administrative law, its commercial law, its judicial code, and even its criminal code—it is in a better position to properly consider offers of investment treaties made by foreign governments, and indeed better able to seek out those treaties it wishes to conclude.

The international community has a substantial role to play in better assisting developing countries—and in particular fragile states—by advocating a balanced approach that does not make domestic rule of law secondary to international commitments via investment treaties. Emerging states should be advised of the need for careful and strategic consideration of the nature of the commitments they may be entering into. In the meantime, there is no better way to attract foreign investment than by a stable legal framework that is on a steady march to realizing the rule of law principles set forth by the World Justice Project.