Rule of Law, Economic Development and Investment Arbitration under Bilateral Investment Treaties (BITS)

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Abstract

This paper examines the connection between the rule of law, Bilateral Investment Treaties (BITS), and the effect of implementing these on a host state's economic development. The paper demonstrates that BITS and the concept of the rule of law share common tenets. The author proffers an argument that proper implementation of the core principles under BITS goes a long way in demonstrating a host-state's adherence to the rule of law. The author further argues that this leads to consistency and predictability of investor treatment, boosting a host state's foreign investments and thereby boosting its economic development. As to the extent of a host state's benefit under the BITS, this is a discussion for another day. This paper will however briefly examine arguments against investment arbitration under BITS.

This discourse is premised on the fact that despite many Sub-Saharan countries, including Kenya, implementing in the recent years aggressive business-climate reforms to attract international capital, Sub-Saharan Africa is still considered one of the uncertain regions to do business. It is suggested that a key reason for this perception is that Sub-Saharan Africa countries are inconsistent in their actions when it comes to reforming the BITS.

This paper briefly examines a relevant recent (March, 2015) award by an arbitral tribunal in an international case. In this case, Canada lost to an American investor upon being found to have breached its obligations under the BITS principles. This demonstrates that aside from losing out on potential investments, non-compliance with existing BITS obligations leads to financial liability of a host state.

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1.0 Introduction

Do Bilateral Investment Treaties (BITS)[1] enhance or impede the excellence of domestic rule of law? Does this have an impact on economic development of a host state? It is arguable that such influence depends heavily on the specific legal, political, and social contexts of individual countries.[2] Rule of law is debatably one of the most contested concepts in legal discourse.[3]

2.0 General Nature of BITS

A BIT in its very nature generally affords a qualifying investor certain protections and rights in respect of its investment in a state with which its own state of nationality or domicile has concluded a BIT. Some of the basic protections under BITS for investors are: compensation for expropriation; national and 'most favoured nation' treatment; freedom from arbitrary, unreasonable or discriminatory measures impairing their investment; fair and equitable treatment; the sovereign's commitment to honour and uphold its obligations under the treaty and free capital repatriation. The rights include that of a foreign investor to claim against the host state in the event of breach of BITs. Majority of these BITS contain alternative dispute resolution clauses, especially arbitration provisions,

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[1] A BIT is an agreement between two countries that sets up "rules of the road" for foreign investment in each other's countries. See US China Business Council, 'Bilateral Investment Treaties: What They Are and Why They Matter,' June 2014. Available at h*ttps://www.uschina.org/sites/default/files/2014%20USCBC%20BITs%20-%20What%20They%20Are%20and%20Why%20They%20Matter_0.pdf* access date February, 2016; See also Juillard, P., 'Bilateral Investment Treaties In The Context Of Investment Law,' OECD Investment Compact Regional Roundtable on Bilateral Investment Treaties for the Protection and Promotion of Foreign Investment in South East Europe 28-29
May 2001, Dubrovnik, Croatia. Available at *http://www.oecd.org/investment/internationalinvestmentagreements/1894794.pdf* access date February, 2016.

[2] Benjamin K. Guthrie, *Beyond Investment Protection: An Examination of the Potential Influence of Investment Treaties on Domestic Rule of Law*, Vol. 45:1151, International Law and Politics, pp.1152-1200, p.1153.

[3] See David Collier, et al, 'Essentially contested concepts: Debates and applications,' *Journal of Political Ideologies*, Vol. 11, No.3, 211–246, October, 2006; Richard H. Fallon, Jr, "The Rule of Law" as a Concept in Constitutional Discourse,' *Columbia Law Review*, Vol. 97, No. 1 (Jan., 1997), pp. 1-56.

allowing investors to bring claims against states for treaty violations, often referred to as investor-state arbitration (ISA).[4]

3.0 The Effect of Rule of Law, Bits and Economic Development in Kenya

While many Sub-Saharan countries, including Kenya, are in the recent years implementing aggressive business-climate reforms to mobilize domestic investment and attract international capital, Sub-Saharan Africa is still considered one of the uncertain regions to do business.[5] It is suggested that a key reason for this perception is that Sub-Saharan Africa countries are inconsistent in their actions when it comes to performing their BITs dispute settlement mechanism and inconsistent decisions by the arbitral tribunals.[6] National investment laws and international treaties make it possible for private investors to initiate arbitration proceedings against host states even when there is no contractual agreement between an investor and a host state. This paper demonstrates that in the absence of the rule of law, it would be almost impossible to find a proper implementation of BITS. This is demonstrated through the sharing of core tenets between the two. Host states that breach their obligations under their respective BITS suffer not only from a lack of investor confidence, but are also subjected to settling of hefty arbitral awards.

It is therefore necessary for Kenya to enter into BITS and to honour its BITS obligations by adhering to the rule of law.

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[4] Franck, supra note 4, at 53-54. These investor-state dispute mechanisms grant private investors, corporations, or individuals the right to sue a sovereign state in an international tribunal and receive binding awards of compensation from the state. Isabelle Van Damme, Eighth Annual WTO Conference: An Overview, 12 J. INT'L ECON. L. 175, 176 (2009).

[5] Source: World Bank, 2010 Doing Business Indicators, cited at Benjamin Leo, *Where are the BITs? How U.S. Bilateral Investment Treaties with Africa Can Promote Development*, centre for global development essay, August 2010, accessible at *www.cgdev.org/content/publications/detail/1424333*.

[6] Uche Ewelukwa Ofodile, *Africa and the System of Investor-State Dispute Settlement: To Reject or Not to Reject? (*12 October, 2014).

4.0 **Definition of the Rule of Law and its place in BITs from a Domestic Perspective**[7]

> *Rule of law refers to a principle of governance in which all persons, institutions and entities, public and private, including the state itself, are accountable to laws that are publicly promulgated, equally enforced and independently adjudicated, and which are consistent with international human rights norms and standards. It requires, as well, measures to ensure adherence to the principles of supremacy of law, equality before the law, accountability to the law, fairness in the application of the law, separation of powers, participation in decision-making, legal certainty, avoidance of arbitrariness and procedural and legal transparency."*

The core purpose of BITs is to protect investments made by nationals of one signatory state in the territory of the other signatory state.[8] BITs typically require that investments be treated on a non-discriminatory basis.[9] This is assessed both by reference to domestic investors (national treatment) and investors from other countries (most-favoured nation)[10], joined by several absolute standards, most notable is the requirement of "fair and equitable treatment." The precise content of the "fair and equitable treatment obligation is a hotly contested issue, in its various permutations, fair and equitable treatment demands that states act in a predictable and non-arbitrary fashion, in good faith, transparently, and/or in keeping with due process of law. [11]

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[7] The United Nations definition of the Rule of Law as stated in a Presentation at ICCA 2016 Congress Roadshow Johannesburg, 28 July 2015, by Claire de Tassigny Schuetze, Legal Counsel and Permanent Court of Arbitration Representative in Mauritius: Investor-State Arbitration and the Rule of Law. *http://www.arbitration-icca.org/media/3/14388535080960/investment_arbitration_from_a_rule_of_law_perspective_de_tassigny_schuetze.pdf* access date February, 2016.

[8] Benjamin K. Guthrie, *Beyond Investment Protection: An Examination of the Potential Influence of Investment Treaties on Domestic Rule of Law*, Vol. 45:1151, International Law and Politics, pp.1152-1200, p.1154.

[9] DiMascio, Nicholas, & Joost Pauwelyn, "Non-discrimination in Trade and Investment Treaties: Worlds Apart or Two Sides of the Same Coin?" *The American Journal of International Law* Vol. 102, No. 1 (Jan., 2008), pp. 48-89.

[10] Ibid.

[11] Benjamin K. Guthrie, *Beyond Investment Protection: An Examination of the Potential Influence of Investment Treaties on Domestic Rule of Law*, Vol. 45:1151, International Law and Politics, pp.1152-1200, p.1155.

5.0 International Perspective on Enforcement of BITS within the Rule of Law[12]

The decision by the arbitral tribunal in the case of Claytons and Bilcon of Delaware Inc.-vs- the Government of Canada (2015) examined three principles under BITS which have a common thread with the concept of the rule of law as discussed in this paper: national treatment, most-favoured nation treatment and minimum standard of treatment. [13] The arbitration pertains to the alleged governmental conduct that relates to the management and operation of the Claimant's investment and the administration and implementation of the EA.

In this arbitral reference, the claimant, Claytons and Bilcon of Delaware Inc., (Bilcon) were U.S. investors who own and control shares in a Canadian subsidiary named Bilcon of Nova Scotia to operate the Whites Point project, the purpose of which was to provide a reliable supply of aggregate for Bilcon of Delaware and the Clayton Group of Companies. Bilcon entered into a partnership with a Nova Scotia company, Nova Stone Exporters, to develop a quarry and marine terminal at Whites Point Quarry. The partnership was acquired entirely by Bilcon in 2004.

The Claimants alleged that the Environmental Assessment (EA) that was undertaken by the Government of Canada and the Government of Nova Scotia for the Whites Point project, along with the administration and conduct of the EA, were arbitrary, discriminatory and unfair. The Claimants did not dispute the fact that EAs were required before construction and operating of industrial projects was to begin, although they allege that Canada's environmental regulatory regime was applied to the project in an arbitrary, unfair and discriminatory manner.

The governments of Canada and Nova Scotia jointly conducted the EA for the Whites Point project from 2003 to 2007. As the governments jointly determined

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[12] This summary on the arbitral tribunal's decision in the case of Claytons and Bilcon of Delaware Inc.-vs-. The Government of Canada (2015) accessed on *http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/clayton.aspx?lang=eng* access date February, 2016.

[13] This case is being governed by the arbitral rules of the United Nations Commission on International Trade Law (UNCITRAL Arbitral Rules). Kenya has heavily adopted the UNCITRAL Arbitral Rules in her arbitration rules.

that the project engaged widespread public concern and the possibility of significant adverse environmental effects, the EA was referred to a Joint Review Panel (JRP), which was comprised of three professors from Dalhousie University.

The JRP gathered information on the environmental effects of the Whites Point project, held public hearings, and issued a recommendation to government decision-makers that the Whites Point project should not be permitted to proceed because it would have a significant and adverse environmental effect on the "community core values" of the Digby Neck. "Community core values" were defined by the JRP as shared beliefs by individuals in a group that constitute defining features of the community. Nova Scotia and the federal government rejected the project in late 2007. The Government of Canada specifically concluded, under the former Canadian Environmental Assessment Act, that the project was likely to cause significant and adverse environmental effects that were not justified.

5.1 Award on Jurisdiction and Liability

In its March 17, 2015 Award on Jurisdiction and Liability, the Arbitral Tribunal found Canada liable for having breached its obligations under Articles 1105 and 1102 of the North American Free Trade Agreement (NAFTA)[14]. A majority of the Tribunal found Canada liable for having breached its minimum standard of treatment obligation under Article 1105(1) of the NAFTA. This provision requires that investors of NAFTA Parties be treated "in accordance with international law, including fair and equitable treatment and full protection and security" and prescribes the customary international law minimum standard of treatment of aliens as the applicable standard. The majority's findings were based on the fact that the JRP's recommendation relied on the application of a standard, "core community values," that was not found in Canadian law and therefore that there was a lack of due process because the proponents were not given an opportunity to make a case based on this criterion.

The majority also found Canada liable for having breached its National Treatment obligation under Article 1102. This provision requires Canada to accord NAFTA investors treatment no less favourable than that which it accords, in like

[14] North American Free Trade Agreement, 32 I.L.M. 289 and 605 (1993).

circumstances, to domestic investors. The majority's finding was based on the fact that the standard applied by the JRP had not been applied in other environmental assessments and the government had not shown any legitimate non-discriminatory reason for such difference in treatment.

As at present, following the issuance of the Award on Jurisdiction and Liability, the arbitration has moved into a damages phase, where the parties will submit evidence and argument to the Tribunal concerning the quantum of a compensation award. On June 16, 2015, Canada filed a notice of application in the Federal Court of Canada for the setting aside of the Tribunal's award of March 17, 2015. In the setting aside proceedings, Canada was arguing that the Award on Jurisdiction and Liability contains decisions on matters beyond the scope of the submission to arbitration, contrary to Article 34(2) (a) (iii) of the Commercial Arbitration Code as enacted and set out in the Schedule to the Commercial Arbitration Act and is in conflict with the public policy of Canada contrary to Article 34(2) (b) (ii) of the Commercial Arbitration Code.

6.0 Arguments against Investment Arbitration under BITS

A key challenge to investment arbitration under BITS is inconsistent decisions by the arbitral tribunals. Critics of investment arbitration under BITS in developing countries argue that investment arbitration undermines local governance because its unpredictability and inconsistency expose developed countries to unknown potential litigation risk every time they attempt to exercise their sovereign legislative and regulatory powers.[15] They argue that investment arbitration under BITS diverts government funds from the public to cover administrative fees, legal fees, and provide for typically large monetary compensations that can and have

[15] See Joshua Boone, footnote 50: *'…Grant Kesler, Metalclad's former CEO, said that 'the arbitration process is too…indeterminate'.* '*…This was said after the same arbitration awarded his company over 16.5 million in compensation. Metalclad Corporation v. United Mexican States, ICSID Case No. ARB (AF)/97/1, Award, ¶ 131 (Aug. 30, 2000); Jack J. Coe,Jr., Toward a Complementary Use of Conciliation in Investor-State Disputes: A Preliminary Sketch, 12 U.C. DAVIS J. INT'L L. & POL'Y 7, 9-10 (2005)'*; cf. Trakman, Leon, *Investor State Arbitration or Local Courts: Will Australia Set a New Trend?* (January 26, 2012). *Journal of World Trade*, Vol. 46, No. 1, 2012, pp. 83-120; UNSW Law Research Paper No. 2012-1; See also Paulsson, Jan. "Avoiding unintended consequences." *Appeals Mechanism in International Investment Disputes* 241 (2008), 244.

been awarded to investors by the arbitration tribunals.[16] The opportunity costs of losing a claim are much higher for developing rather than developed nations.[17]

Arguably, past decisions by arbitration tribunals regarding violations of investment treaties have been vastly inconsistent.[18] Such inconsistencies inhibit the developing host state from making informed decisions about regulations and legislations that effect investment treaty provisions because there is no consistent, predictable interpretation regarding the scope or application of the BITs provisions.[19]

This unpredictability and inconsistency stems from the fact that these arbitration proceedings have been highly secretive, and therefore, one tribunal would not have any idea what another tribunal's decision was or the reasoning behind it.[20] This

[16] Joshua Boone, How Developing Countries can Adapt Current Bilateral Investment Treaties to Provide Benefits to Their Domestic Economies, 1 Global Bus. L. Rev. 187 (2010-2011), p.192; See Pia Eberhardt & Cecilia Olivet, 'Profiting from injustice: How law firms, arbitrators and financiers are fuelling an investment arbitration boom,' (Corporate Europe Observatory and the Transnational Institute, November, 2012).

[17] Kevin P. Gallagher and Elen Shrestha, Global Development And Environment Institute Working Paper No. 11-01: Investment Treaty Arbitration and Developing Countries: A Re-Appraisal (May 2011), p.9.

[18] Joshua Boone, (How Developing Countries can Adapt Current Bilateral Investment Treaties to Provide Benefits to Their Domestic Economies, 1 Global Bus. L. Rev. 187 (2010-2011), pp190- 191 at footnote 51: *'...For example, Mr. Lauder, a U.S. Citizen, brought a claim against the Czech Republic under the U.S./Czech Republic BIT, but he has his investment restructured under a Dutch Investment group. Upon the alleged violation of theCzech Republic Mr. Lauder and the Dutch firm each brought a separate claims under the applicable BIT. These identical claims resulted in different conclusion on all but one point. Id at 60-61.'*; See also Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions*, 73 Fordham L. Rev. 1521 (2005).

[19] See Joshua Boone, footnote 52: *'...For example, the terms "investment" and "investor" are not properly defined and have often been understood to have broad definitions thereby allowing for a vast array of potential claims to be brought against a sovereign'*; See also Susan D. Franck, 'The Nature And Enforcement Of Investor Rights Under Investment Treaties: Do Investment Treaties Have A Bright Future,' *University of California, Davis*, Vol. 12, No. 47, 2005, 47-99.

[20] See Joshua Boone, footnote 53; See also Steffen Hindelang, 'Study of Investor-State Dispute Settlement ('ISDS') and Alternatives of Dispute Resolution in International Investment Law,' available at *https://publixphere.net/i/salon/page/STUDY_ON_INVESTORSTATE_DISPUTE_SETTLEMENT_ISDS_AND_ALTERNATIVES_OF_DISPUTE_RESOLUTION_IN_INTERNATION*

prevents any legal precedent to form and forces an already *ad hoc* tribunal to make ad hoc decisions without any guidance.[21] Furthermore, ISA forces developing countries to divert funds from use for public benefit to payment of administrative fees, legal fees, and dispute settlement awards.[22]

According to a report by the United Nations Conference on Trade and Development on implication of ISAD to developing countries as well as related literature as discussed by Joshua Boone, administrative fees and legal fees on their own can reach into the millions.[23] For instance, in the situation of Argentina, arguably one of the largest defaults in history, the claims aggregated in the multi-billions.[24] These claims not only direct needed public funds towards non- public interests, but also any potential benefit that a developed country may have received from the additional FDI brought in by the BIT could be easily nullified by one

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AL_INVESTMENT_LAW_BY_PROF_DR_STEFFEN_HINDELANG_LLM_1; See also Susan D. Franck, 'The Legitimacy Crisis In Investment Treaty Arbitration: Privatizing Public International Law through Inconsistent Decisions,' Fordham Law Review, Vol. 73, 2005, 1521-1625, 1611.

[21] See Joshua Boone, footnote 54; See also Susan D. Franck, 'The Legitimacy Crisis In Investment Treaty Arbitration: Privatizing Public International Law through Inconsistent Decisions,' *Fordham Law Review*, Vol. 73, 2005, 1521-1625, 1613.

[22] See Joshua Boone, footnote 55; See also Pia Eberhardt & Cecilia Olivet, 'Profiting from injustice: How law firms, arbitrators and financiers are fuelling an investment arbitration boom,' (Corporate Europe Observatory and the Transnational Institute, November, 2012); See also Claire Provost & Matt Kennard, 'The obscure legal system that lets corporations sue countries,' *The Guardian*,
available at *http://www.theguardian.com/business/2015/jun/10/obscure-legal-system-lets-corportations-sue-states-ttip-icsid*

[23] See Joshua Boone, footnotes 56-60.

[24] See Joshua Boone, footnotes 56-60; See also John Muse-Fisher, 'Starving the Vultures: NML Capital v. Republic of Argentina and Solutions to the Problem of Distressed-Debt Funds,' *California Law Review*, Vol. 102, Iss. 6, 2014, 1671-1726.

large award.[25] This, therefore, makes a BIT essentially prejudicial as opposed to beneficial to developing host states.[26]

7.0 Conclusion

As argued by Professor Schuaer on consistency and precedent, there is a concern to "treat like case alike" and that failure to treat similar cases similarly "is arbitrary, and consequently unjust or unfair."[27] This argument as demonstrated in this paper exemplifies a nexus between the core principles of the rule of law and BITS.

This discussion seems to reach a consensus on the need for consistency and predictability among both proponents and opponents of investment arbitration under BITS. Consistency would likely promote the conception of fairness across the system, while inconsistency may lead to the opposite result. Although those who win specific cases are unlikely to complain about the result, inconsistencies adversely impact others immediately affected by the result as well as future users of the system.[28]

The discussion demonstrates that BITS a proper implementation of BITS in line with the rule of law principles gives a standard of treatment of foreign investors within a host state. This gives a predictability of treatment of foreign investors.

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[25] See generally, Kevin P. Gallagher and Elen Shrestha, 'Investment Treaty Arbitration and Developing Countries: A Re-Appraisal,' *Global Development and Environment Institute Working Paper No. 11-01*, 2011; See also 'Chapter 4: Who guards the guardians? The conflicting interests of investment arbitrators,' (International Trade, 2012), *Corporate Europe Observatory*, available at *http://corporateeurope.org/trade/2012/11/chapter-4-who-guards-guardians-conflicting-interests-investment-arbitrators*

[26] See Joshua Boone, page 194; See also generally, Valentine Nde Fru, *The International Law on Foreign Investments and Host Economies in Sub-Saharan Africa: Cameroon, Nigeria, and Kenya*, (e-book, LIT Verlag Münster, 2011). Available at *https://books.google.co.ke/books?id=Y9uig70i64cC&printsec=frontcover&source=gbs_ge_summary_r&cad=0#v=onepage&q&f=false*

[27] Franck, S.D., at p. 65; See also Aranguri, Cesar. "The Effect of BITs on Regulatory Quality and the Rule of Law in Developing Countries." (2010).

[28] Ibid, at p. 65.

Predictability is a long accepted pillar of the rule of law.[29] Consistency leads to predictability of an outcome and this would facilitate economic development of a host state.

[29] Franck, S.D., The Nature and Enforcement of Investor Rights under Investment Treaties: Do Investment Treaties Have a Bright Future, University of California, Davis [Vol. 12:47], 2005, pp.47-99, at 63. *http://jilp.law.ucdavis.edu/issues/volume-12-1/franck1.19.pdf* accessed on 21/09/10.