

## *Foreword*

The international investment regime has changed dramatically in recent decades. Emerging economies throughout the world are attracting foreign direct investment (FDI) that goes beyond the traditional concentration on natural resources and agricultural products. Infrastructure projects and manufacturing for export and for the domestic market account for an important share of FDI. Furthermore, a growing share involves contracts or joint ventures between multinational corporations (MNCs) and domestic firms, rather than the state. Although the global economic slowdown has had an important negative impact on emerging economies worldwide, a key role for foreign capital and, in particular, for FDI will remain. In the face of overall declines in investment spending, competition for the remaining private funds will be intense.

Multi-national investors can no longer view emerging economies as passive recipients of whatever benefits investors wish to bestow or as dominated by corruptible leaders willing to make deals for personal gain. Of course, corruption and self-dealing remain in some quarters and are facilitated by long-standing MNC business practices. However, the strengthening of democratic regimes worldwide acts as a check on unfettered deal-making and has introduced demands for political accountability into the international investment environment. These demands, however, are rising to prominence just as more and more investment projects are essentially private arrangements that require state acquiescence but no direct state financial participation. The state may give tax breaks, low-interest loans, and regulatory exemptions, but it does not have an ownership stake. Even when the FDI is part of a counter-part investment surrounding a military contract, it nominally may be a private deal. Even when the state has an ownership stake, it may be unable to control management decisions.

The tension between rising democratic demands and growing private FDI comes into focus in Santiago Montt's major study of Bilateral Investment Treaties (BITs). Montt argues that the rise of BITs to over 2500 worldwide represents a major shift in investor-state relations in developing and emerging economies worldwide.

BITs and the investment chapters of free trade agreements govern the relationships between investors from wealthy countries and host states. They are most commonly signed between wealthy countries and developing or emerging economies where investors believe that the host countries' legal regimes lack key protections. Many low income countries have

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also signed BITs with each other, but they account only for a small share of world FDI volume. Although firms' contractual relations are increasingly with private firms, BITs frame that relationship by imposing obligations on host states that limit their ability to interfere with investors' expectations. A key aspect of most BITs is the ability of private firms to trigger their enforcement by bringing cases before the World Bank's arbitration facility, the International Center for the Settlement of International Disputes (ICSID). Hence, private firms can initiate actions to enforce these treaties even if the MNCs' home countries are not supportive. This feature provides extra benefits to MNCs and can encourage them to invest in otherwise risky environments, but it also can challenge the political independence of host countries struggling to create modern, democratic states. For a state that is both an emerging economy and an emerging democracy conflicts may arise between investors' interest in preserving a favorable status quo and popular demands for more effective regulation; better, increased tax-financed infrastructure and social services; and investments that generate and preserve jobs.

Montt's ambitious and wide-ranging study of Bilateral Investment Treaties takes on these fundamental issues and recommends a balanced resolution. He links important issues in international investment law with the domestic political legitimacy of an accountable administrative law system. Montt asks whether international treaties, especially Bilateral Investment Treaties (BITs), limit the ability of emerging democracies to make domestic policy that may impose costs on international investors. He makes empirical claims about the way in which the BIT's regime operates, in practice, and develops his own normative arguments about how the BIT's regime ought to develop in order to balance concerns for state sovereignty and regulatory reform against the encouragement of international investment. Montt draws on a deep and extensive knowledge of the way the BIT's regime operates and the way disputes are resolved through arbitration.

Montt claims that the growing BIT's regime is creating bandwagon or network effects. As experience with BITs grows, a specialized bar has arisen to deal with disputes. These lawyers, acting as both advocates and arbitrators, are playing a key role in interpreting poorly defined terms that recur in many treaties, most of which originate in model treaties drafted by countries whose firms are prominent source of FDI. Over time, this developing expertise encourages more and more countries to sign BITs and enhances their value by removing a source of uncertainty. At the same time, the increasing coverage of BITs means that a country that signs a treaty does not stand out as an especially attractive locale for investment because all if its competitors also have signed BITs. True, those outside the regime are disadvantaged, but those in the regime are in an increasingly competitive situation. Nevertheless, if Montt is correct that learning over

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time lowers costs for investors, the regime has the character of a focal point that will be stable even in the face of serious problems with the way it operates in practice.

In this regard, Montt worries that ICSID arbitral tribunals will interpret the treaties in a way that is too close to the rules of private contract law. The arbitrator may not take account of the character of BITs as treaties between sovereign states that ought to be accountable to their citizens over time. He argues that international investors should not be protected against broad-based domestic policy shifts. His standard is the operation of takings law in wealthy, developed countries; in his view, international investors should have no greater protections abroad than they have at home. This seems an eminently sensible position, but one that would require arbitral tribunals to move beyond a focus on international law jurisprudence to examine domestic constitutional texts. Perhaps it is also a call for broadening the personnel of such tribunals to include some who specialize in constitutional law, especially with respect to the protection of property rights and role of the state as regulator and taxing authority. States with constitutionally mandated takings clauses, which require compensation for the expropriation of private property, nevertheless, both regulate and tax. Laws limit discharges of pollutants, control workplace health and safety, and affect the risk of products. The law requires businesses to comply without obtaining compensation for lost profits. There is no constitutional right to impose risks and other costs on society. Similarly, taxes are constitutionally permitted that reduce profits and raise prices. In Montt's view arbitrators' interpretations of BITs needs to recognize and accept constitutionally-permitted policymaking and use the more well-developed jurisprudence of MNCs home countries as a guideline or benchmark. This observation is particularly important once one recognizes that emerging democracies often must engage in massive amounts of law reform to bring their systems up to date. Thus FDI will often occur in a very dynamic environment, and investors would be naïve to suppose that the current inherited pattern of laws will remain frozen in place. They will likely benefit from some legal reforms that improve the operation of courts and bureaucracies and that clarify the rules, but they can also expect other reforms to impose costs. Investors should not be able to use BITs to pick and choose—benefiting from some reforms and gaining exemption from others.

Mont argues that international investment law can and should have an impact on the domestic legal and political systems in host countries. He is optimistic about the 'halo effect' of international investment law insofar as it can equalize the position of foreign and domestic investors by improving the status of the latter. International investment law should help emerging economies develop their own regulatory takings jurisprudence without imposing rigid rules that could prevent policy innovation in such

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countries. It should aim to improve the position of domestic investors consistent with democratic values, not undermine local initiative and local democracy.

Montt's study is a comprehensive and thoughtful contribution to the ongoing debates over foreign direct investment and bilateral investment treaties in particular. Practitioners in the field will add to their knowledge of the area and find many issues to debate. In addition, Montt has opened up a new area of study and concern for those interested in the development of constitutional and administrative law in emerging democracies worldwide. Henceforth, comparative constitutional and administrative law will need to take account of the way the international investment regime interacts with domestic political and policy imperatives.

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## Acknowledgements

This book is a revised and updated version of the JSD dissertation that I wrote at Yale Law School between 2004 and 2006. I came to Yale in 2003, to pursue a Masters' and Doctorate in administrative law and regulation. Prior to this, I had practised law in Chile, where my work primarily involved defending domestic and foreign companies against government measures, particularly in the fishing industry, which was one of the most heavily regulated industries in the country.

During my first semester as an LLM, I stumbled across the *Metalclad* award.<sup>1</sup> Being completely ignorant at that time on the subject of investment treaties and their system of investor–state arbitration, I was stunned. My immediate reaction was to realise that several of the disputes that I previously handled in Chilean courts—and, of course, many similar ones—would now be litigated before arbitral tribunals pursuant to investment treaty standards.

In addition, the administrative legal scholar in me reacted with deep shock at the reasoning and tone of the award. Although I did not disagree with the outcome itself, many of the arguments adopted by the Tribunal would not have been remotely possible for plaintiffs suing government under any Western public law tradition. Moreover, the Tribunal tended to disregard domestic law, effectively downplaying the importance it deserved in this case. More importantly, in the award, I could not find the deferential and modest attitude normally displayed by public law judges who review decisions made by the political branches of government.

I am neither 'pro-state' nor 'pro-investor'. Instead, I would like to describe myself as 'pro-appropriate equilibrium'. In fact, in terms of my background if anything I would be more on 'pro-investor' side: just before beginning my graduate studies at Yale, I wrote a book on administrative law, galvanised by the consistently poor treatment that a foreign investor, in whose defence I participated, received at the hands of a public entity. This book was designed with the purpose of clarifying and resolving several inadequacies that I found in the Chilean legal system.<sup>2</sup>

The important point is that I had the impression, while reading the *Metalclad* award and later confirmed from other decisions, that international investment law was failing to seriously take into account the

<sup>1</sup> *Metalclad Corporation v Mexico*, ICSID Case No ARB(AF)/97/1 (Lauterpacht, Civiletti, Siqueiros), Award (30 August 2000).

<sup>2</sup> Santiago Montt, *El Dominio Público. Estudio de su Régimen Especial de Protección y Utilización* (Santiago de Chile, Conosur-Lexis, 2002).

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enormous reservoir of human experience that had accumulated over many decades, at the domestic level. This struck me as a significant oversight, since domestic public law generally possesses a much more refined conceptual framework than international law for dealing with the problems that typically arise in the confrontation between private interests and the public good.

I decided, then, to embark upon a project that would examine investment treaty arbitration against the more well-established background of domestic constitutional and administrative law. My ultimate purpose—which I hope the reader may appreciate throughout the present book—was and continues to be to contribute to the development of an investment treaty jurisprudence characterised by moderation and deference, in which the interests and expectations of foreign investors will be properly balanced against the regulatory state's exercise of its powers.

Given this agenda, it should come as no surprise that this book does not follow what has become the canon in international investment law. A brief scanning of the table of contents will undoubtedly reveal that the book provides an alternative, multidisciplinary approach to the subject, incorporating historical, economic and legal analysis that places a strong emphasis on issues of constitutional law and expropriations, and of administrative law and arbitrariness.

I had the privilege of working on this project at three of the most intellectually stimulating and vibrant places that a legal scholar can possibly find: Yale Law School, Columbia Law School, and the Woodrow Wilson School of Public and International Affairs at Princeton University. I would like to generally thank all of the people who work at these three institutions, and in particular, their librarians and library personnel.

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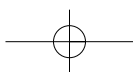
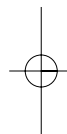
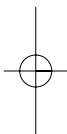
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Writing any book in the midst of other work and study is a selfish act. Without the support of my wife Alejandra, and the inspiration of my daughters Violeta and Matilde, this would have been impossible. If there is any specific *expropriation* which they have come to know while I worked on this project, it is that their husband and dad has been *taken* to the library. In return—though this constitutes far from *prompt*, *adequate*, and *effective compensation*—I dedicate this book to them, with love.

Of course, in the midst of all this tremendous help and support, all faults and errors are exclusively mine.

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