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# Inter-Relationships between the Investment Law and Other International Legal Regimes

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E15 Task Force on Investment Policy

**Think Piece**

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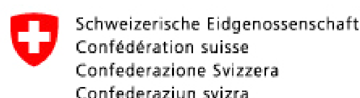

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# ABSTRACT

International investment law coexists with a wide range of other substantive regimes of international law, including human rights law, humanitarian law, environmental law, intellectual property law, and various regional legal orders. The interactions between investment law and these other regimes have come to be seen as increasingly problematic, with stakeholders questioning the legitimacy of international investment law and even the purposes of the international legal order more generally. As international investment tribunals have, in the eyes of many observers, failed to adequately take into account these other substantive norms of international law, concerns have arisen that international investment law privileges the treaty-based rights of investors over the rights of states and, particularly, the values embodied in other areas of international law, such as human rights and environmental protection. Such concerns about the interaction of investment law with other substantive areas of international law are particularly acute today given the ongoing negotiation of "mega-regional" investment agreements (often embedded in trade deals), that have sparked considerable backlash. The negotiation of the Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP), both of which are expected to include investment provisions, has generated significant political acrimony.

While reforms are needed to ensure that investment law fully engages with other substantive fields of international law, scrapping the present investment law system or undertaking significant alterations to the substance of that system would be unnecessary overreactions to manageable challenges. A new generation of investment treaties provides far more treaty-based guidance accepted by states to balance investment protections and other substantive norms of international law. This new generation of treaties offers the prospect of a more balanced, better integrated, and more effective international investment law regime. In the meantime, jurisprudential innovation that pushes arbitrators to engage with and balance competing legal rules is necessary. More radical changes to the system, such as allowing states or non-state actors to bring claims against investors are likely to be counterproductive and might even undermine the viability and purposes of the investment law system itself. However, the potential inclusion of a broad, but carefully tailored, clean hands defence for manifest breaches of critical provisions of domestic and international law by investors is worthy of further consideration.

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# LIST OF ABBREVIATIONS

| | |
|---|---|
| BIT | bilateral investment treaty |
| CETA | Comprehensive Economic and Trade Agreement |
| EU | European Union |
| ICSID | International Centre for Settlement of Investment Disputes |
| GATT | General Agreement on Tariffs and Trade |
| NGO | nongovernmental organization |
| SADC | South African Development Community |
| TPP | Trans-Pacific Partnership |
| TRIPS | Trade-Related Aspects of Intellectual Property Rights |
| TTIP | Transatlantic Trade and Investment Partnership |
| US | Unites States |
| VCLT | Vienna Convention on the Law of Treaties |
| WTO | World Trade Organization |

# INTRODUCTION

International investment law coexists with a wide range of other substantive regimes of international law, including human rights law, humanitarian law, environmental law, intellectual property law, and various regional legal orders. The interactions between investment law and these other regimes have come to be seen as increasingly problematic, with stakeholders questioning the legitimacy of international investment law and even the purposes of the international legal order more generally (see Baetens 2013). As international investment tribunals have, in the eyes of many observers, failed to adequately take into account these other substantive norms of international law, concerns have arisen that international investment law privileges the treaty-based rights of investors over the rights of states and, particularly, the values embodied in other areas of international law, such as human rights and environmental protection.

Such concerns about the interaction of investment law with other substantive areas of international law are particularly acute today given the ongoing negotiation of "mega-regional" investment agreements (often embedded in trade deals), that have sparked considerable backlash.[1] The negotiation of the Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP), both of which are expected to include investment provisions, has generated significant political acrimony. Simultaneously, the ongoing negotiation of the Unites States (US)-China bilateral investment treaty (BIT) could bring the world's two largest economies within the ambit of investment law. On both sides of the Atlantic, the fundamental concerns, in the words of US Senator Elizabeth Warren, are that investment law "tilt[s] the playing field… further in favour of big multinational corporations [and] undermine[s] [state] sovereignty".[2]

While these concerns are real and politically challenging for the creation of new investment protection agreements, the problem may be as much—if not more—political (or public relations) than legal. International law already provides solutions to resolve such conflicts. While these solutions may prove to be limited, they do offer an important starting point for analysis. Moreover, a new generation of BITs is emerging that often provides far more explicit balancing between investment law and other areas of international law. Hence, while limited jurisprudential and textual reforms of the investment law may be needed to address these concerns, a more radical re-visioning of the system is unnecessary.

Yet, three critical questions remain. First, particularly as old-style investment agreements continue in force, how can we ensure that the tribunals arbitrating disputes adequately take into account other substantive fields of international law? Second, in the drafting of new investment agreements, particularly the mega-regionals, how should states incorporate other substantive areas of international law and what treaty-based guidance should they provide to arbitrators who have to balance these competing regimes? Third, should investment law be transformed from its current unidirectional model, whereby generally only investors can sue states based on breaches of the investment agreement, to some multidirectional form, whereby states could potentially sue investors for breaches that might include other substantive areas of international law as well?

Ultimately, there are concrete steps arbitrators and states can and should take to address the first two questions. The third question may prove more controversial and, perhaps, more dangerous. While the expansion of the investment law system to include claims by states against investors based on other subfields of international law may appeal to fairness and legitimacy values, it would likely undermine the effectiveness of international investment law and, quite probably, kill the system itself. However, a somewhat more limited reform that allows states to assert counterclaims based on other substantive areas of international law and that utilizes the clean hands doctrine as a bar to new claims would enhance both the legitimacy of investment law and the unity of the international legal system.

# PROBLEM/OPPORTUNITY

From its inception, international investment law has offered host states and foreign investors a bargain that is at once legal and economic (Salacuse and Sullivan 2005). The legal rules of the regime are largely lopsided, providing significant protections and legal recourse for investors, without offering equivalent protections or recourse to states. This lopsided legal bargain is counterbalanced by an economic bargain. In exchange for granting investors legal protections, host states were expected to benefit significantly from increased FDI flows (Elkins et al. 2006). In many ways, the problems of the interaction between investment law and other areas of law flow from the lopsided legal bargain. Investment law—particularly when interpreted in isolation or as a *lex*

1 See Jude Kirton-Darling, "People's Concerns Over TTIP Must Be Heard," *New Statesman*, 29 May 2015, http://www.newstatesman.com/politics/2015/05/peoples-concerns-over-ttip-must-be-heard.

2 See Elizabeth Warren, "Kill the Dispute Settlement Language in the Trans-Pacific Partnership," *Washington Post*, 25 Feb. 2015, http://www.washingtonpost.com/opinions/kill-the-dispute-settlement-language-in-the-trans-pacific-partnership/2015/02/25/ec7705a2-bd1e-11e4-b274-e5209a3bc9a9_story.html.

*specialis*—purposefully gives preference to the protection of foreign investors over other potentially conflicting international legal rules.

In the light of this lopsided bargain, three key trends over the past two decades have made the relationship between international investment law and other legal orders more problematic. First, as the substance of both investment law and other legal regimes has expanded in scope and increased in depth, the possibility for overlap, including conflict, among legal regimes has increased. Second, investment law was designed to be relatively more enforceable than other areas of the international legal system. Hence, foreign investors are often able to enforce their investment protection rights, whereas other international legal norms may be unenforceable. Third, as the body of jurisprudence in investment law has matured, arbitral tribunals have proved relatively ineffective at reconciling conflicting legal regimes in a way that is politically acceptable to most audiences.

High profile awards have highlighted the ways in which the investment law system makes it more difficult, or at least more costly, for states to advance the values embodied in some other areas of international law (Schill 2011; Burke-White and von Staden 2010). The result has been a crisis in confidence in the international investment system, exemplified most starkly by the present debates in the US and the European Union (EU) over whether the TTIP and the TPP should include investment protections and, particularly, investor-state dispute settlement provisions. The resolution of this crisis turns on whether investment law can be squared with states' broader international legal obligations toward their citizens and toward other states.

In approaching this question, it is necessary to recognize that investment law is neither uniform nor static. The rules applicable in a given dispute will turn on the particular investment treaty being invoked. Even where basic BIT provisions are similar, subtle drafting differences may yield significant interpretative differences. Moreover, successive generations of BITs have come to include far more detailed provisions with respect to the interaction of investment law with other areas of international law. The challenges presented by the interaction of investment law and other substantive areas of international law will differ, depending on the era in which the BIT was drafted and are likely to change over time. While the majority of BITs in force today come from earlier eras, with less detailed provisions, the substantive law underlying arbitrations will begin to change as new mega-regional agreements are concluded and come into force.

## INTERACTION OF SUBSTANTIVE NORMS

In almost every investment dispute, multiple legal rules, often from different subfields of international law, may be applicable. The outcome of an arbitration will often depend on which rules of law a tribunal applies and how such a tribunal resolves conflicts and interactions among those rules. Before considering possible solutions to the problems of interaction between investment law and other fields of law, the range of those interactions must be explored to determine where problematic relationships may in fact exist (see Pauwelyn 2010; Michaels and Pauwelyn 2012).

From a jurisprudential perspective, the interaction of substantive norms takes place through two related mechanisms. The first mechanism is the applicable law applied to the dispute. The investment agreement in question provides one set of substantive applicable law. Other applicable rules of international law may provide a separate set of legal rules. The second mechanism is one of interpretation by the tribunal and turns on how the tribunal interprets the applicable law in the light of other coexisting substantive norms. Both mechanisms can lead to conflicts of substantive norms.

Investment law and other subfields of international law can be understood to coexist in a number of different relationships:

- **Simple coexistence:** States face a wide range of legal obligations separately and simultaneously. Where states face an obligation under international investment law that coexists with another international legal obligation, but does not conflict with that other obligation or even speak to the same set of issues, coexistence is complementary. Complementary coexistence is frequent in the international legal system and does not create either legal or political problems for the investment law regime.

- **Potential cross-influence:** Potential cross-influence exists where investment law and some other legal regime appear to speak to the same set of facts or issues. In this circumstance, the question arises as to whether other coexistent legal regimes should be taken into account in the interpretation and application of investment law obligations and, similarly, whether investment law obligations should inform the interpretation and application of these other coexistent obligations. An example of potential cross-influence is whether notions of due process in international human rights law inform the interpretation of fair and equitable treatment in international investment law (see Simma 2011; Simma and Kill 2009). Given the above noted comparative enforceability of investment law versus other areas of international law, it will most often be investment tribunals that must determine when and whether to take into account these coexistent legal norms.

3 At times, tribunals have found such simple coexistence, even where in the eyes of the host state a more direct conflict might exist. See *Suez and Vivendi v. Argentina,* ICSID Case No. ARB/03/19, Decision on Liability, 30 July 2010, para. 262 (arguing that Argentina could have respected both its human rights and treaty obligations, because these obligations are not inconsistent, contradictory, or mutually exclusive).

- **Permissive conflict:** Permissive conflict occurs when investment law prohibits particular conduct that is expressly permitted by a coexistent legal regime. The most common example of permissive conflict arises in the relationship between international humanitarian law and international investment law. If, for example, international investment law requires full protection and security for a foreign investor, but international humanitarian law authorizes the targeting of that investor, does the targeting still constitute an internationally wrongful act?[4] Resolving circumstances of permissive conflict requires a determination of whether one legal regime affirmatively trumps the other or whether the permission granted by a separate legal regime can alleviate responsibility under international investment law.

- **Direct conflict:** Direct conflict occurs when international investment law requires that a state take particular action that is affirmatively prohibited under the coexistent legal regime or vice-versa. For example, if international investment law requires that a state refrain from indirect expropriation, but the state is affirmatively required to, for example, reduce carbon emissions under international environmental law, can the state effectively expropriate the factory by imposing severe environmental protection requirements that deprive the investor of the economic benefit of the investment? Examples of direct conflict are, in fact, relatively rare, precisely because investment law is often more procedural than substantive, such that it is often possible for a state to meet the requirements of both legal regimes, though it is more costly to do so. Such examples are better characterized as indirect/policy conflict, below.

- **Indirect/policy conflict:** Indirect or policy conflict could be said to arise where a state faces competing legal obligations under different legal regimes that, while not directly in conflict, may require the state to make policy choices that privilege one legal regime over another or impose significant burdens that become untenable in the face of the second set of legal obligations. If, for example, a state is party to the Framework Convention on Tobacco Control and the state makes the policy choice to limit tobacco companies' advertising rights in a way that impairs their foreign investment, is the state's policy choice somehow justified by the coexistent legal regime, even if investors are harmed as a consequence? (see Vadi 2013).

## JURISDICTIONAL RELATIONSHIPS

Beyond the interaction of legal rules as such, there are a range of jurisdictional relationships among different areas of law that can arise in investment disputes. In each of these relationships, the other substantive fields of international law play a different role in the arbitration. As new investment agreements—particularly mega-regional agreements—are drafted, they will need to take into account these different jurisdictional relationships. To the degree these new agreements can make clear how these relationships should be resolved, many of the current challenges associated with the interaction of substantive legal norms can be addressed.

- **Substantive defences:** Substantive rules of international law from other fields, such as environmental or human rights law, might be able to serve as an affirmative defence for a violation of investment law. If, for example, a state is under an affirmative obligation from an environmental law agreement to reduce carbon emissions, does requiring a foreign investor to reduce emissions violate fair and equitable treatment given the state's environmental law obligations? And, if it does, can the state invoke the international environmental law to avoid responsibility under international investment law?

- **Clean hands defences:** Clean hands defences would allow a state to invoke the investor's lack of clean hands, even with respect to other substantive legal regimes, as a defence or jurisdictional bar to an investor's claim under investment law rules. For example, if the investor has engaged in violations of international human rights law, the clean hands defence would bar the investor from making a claim against, say, violations of fair and equitable treatment.

- **Counterclaims:** In the relatively limited cases in which states bring counterclaims against investors, can those counterclaims be based on other substantive norms of international law? Should the jurisdiction of investment tribunals be broadened to include more counterclaims based on norms outside the investment treaty itself?

- **Reciprocal jurisdiction:** Reciprocal jurisdiction would represent a far more radical restructuring of the international investment law system and would allow for states to bring original claims against investors before investment tribunals for breaches outside of purely international law. This would essentially transform the lopsided bargain of international investment law into a more reciprocal relationship in which both sets of actors could bring claims before tribunals.

# RESPONSES

While criticism of investor-state arbitration has grown, whether the relationships and interactions noted above are

4 See, for example, *Asian Agricultural Products Ltd. v. Sri Lanka*, Award, 27 June 1990, 4 ICSID Reports 246.

viewed as a problem often turns on the observer's normative perspective. Admittedly, investment law tends to privilege the rights of investors and the norms of investment law with its highly effective enforcement structure. That is only a concern if one's normative perspective is that the substantive norms of investment protection should be on equal footing with other substantive rules of international law and the existing mechanisms of international law do not result in such parity.

This paper accepts the assumption that investment law is one of several subfields of international law that coexist in a unified system. States may (and do) choose to privilege particular rights in certain enforcement settings. Nevertheless, those enforcement mechanisms must treat international law as a coherent, unified system. Hence, the normative judgment point for the responses discussed in this paper are: (1) is there a viable political process through which states and domestic polities knowingly choose to privilege particular rules of international law; and (2) are there legal mechanisms through which tribunals are able to engage across and balance competing legal obligations? While legal and jurisprudential mechanisms to achieve these goals already exist, they are far from perfect and additional efforts—in treaty drafting and interpretation—are needed.

## EXISTING RESPONSES

Notwithstanding the political concerns that have been raised over the failure of international investment law to adequately engage other substantive areas of international law, the existing international legal system provides legal mechanisms to address several of the forms of interaction detailed above. While these mechanisms are imperfect, they offer a key starting point for addressing many forms of interaction between investment law and other substantive legal regimes.

First, international law provides tools for the resolution of conflicts-of-law. The rules of *lex posterior* (the later-in-time rule prevails) and *lex specialis* (the more specific rule prevails) can and do resolve many potential conflicts (see Akehurst 1976; Pauwelyn 2003 Lowenfeld 2003). Yet, these conflict-of-law provisions are thin and their application is often far from clear. Is, for example, investment law *lex specialis* such that it alone applies in an investment dispute independent of other substantive areas of law? Moreover, even if investment law is *lex specialis,* when should a dispute be framed as a matter of investment law, such that investment treaty rules would apply independently? In many cases, it is unclear which regime is more specific or the determination of specificity turns on the perspective a party or tribunal brings to the analysis (Franck 2005). Hence, while these conflict-of-law rules offer a starting point for addressing direct and permissive conflicts, they often do not provide a suitable resolution.

The primary mechanism to guide interaction among substantive rules of international law is the inherent unity of international law itself. Generally speaking, international legal rules cannot and should not be interpreted and applied in isolation. Article 31(3)(c) of the Vienna Convention on the Law of Treaties (VCLT) requires "any relevant rules of international law applicable in the relations between the parties" be taken into account in the interpretation of a treaty provision.[5] This provision clearly opens the door for tribunals interpreting and applying investment law to consider other rules of international law and, potentially, interpret investment law in a way that avoids conflict (Sands 1998).[6] This unity of the legal system and the interpretative rules of VCLT Article 31 may well be adequate to address the aforementioned relationships of coexistence and cross-influence.

Collectively, the conflict-of-law provisions and the interpretative rules of Article 31(3)(c) provide arbitrators with considerable room—if they choose to use it—to avoid or resolve an even wider range of potential conflicts between investment law and other substantive fields of international law. The political backlash seen today, however, arises in large part because tribunals have failed to, or at least chosen not to, do so. In the early years of investment arbitration, investment tribunals prioritized investment law, often finding that it alone applied as *lex specialis* or not considering other applicable rules of international law in their interpretations of investment law provisions (see Koskenniemi 2009).

A second existing means of addressing conflicts is rooted in secondary norms of international law. Secondary norms—including circumstances precluding wrongfulness—may provide a means to avoid the effects of two conflicting rules of law applying simultaneously to a state's conduct. For example, necessity and distress may allow states to take certain actions that advance the norms of a conflicting legal regime while breaching an international investment agreement without bearing legal responsibility for those actions (Schill 2007).

A third existing means to reconcile investment law and other substantive fields of international law is found in the provisions of investment treaties themselves. Such treaties can and do provide textual guidance as to how potential conflicts should be resolved, when investment protections should trump other obligations, and when other obligations should prevail. Over time, newly drafted treaties have become more explicit in the reconciliation of investment law with other obligations. While early treaties might, at most, have included a war clause and, perhaps, a non-precluded measures provision, more recent treaties, such as the 2012 US Model BIT, directly address investment law and environmental obligations (Article 12) and investment law and labour obligations (Article 13).[7]

5 Vienna Convention on the Law of Treaties, Art. 31(3)(c).

6 There is some debate as to whether this interpretative provision allows reference to legal rules from other subject areas or is confined to a same subject matter analysis.

7 2012 US Model Bilateral Investment Treaty.

The new Canada-China BIT similarly has a detailed "general exceptions" article that provides a tribunal guidance on the interaction of the investment protections contained in the BIT and other obligations including those related to the environment, human health, and so on.[8] Even more extensive carve-outs are found in the new Indian model BIT and the proposed SADC (Southern African Development Community) BIT.[9] These exceptions clauses give arbitrators clear guidance as to whether and when to prioritize investment law over other substantive legal rules and how to resolve conflicts where they arise.

Detailed treaty provisions that allow states parties to an investment treaty to balance competing obligations ex ante offer the most promising means of resolving potential conflicts between investment law and other areas of law. By drafting such explicit provisions, states can internalize the political costs and benefits of different balancing arrangements and provide interpreters as clear a set of resolution principles as they may need.

However, international investment adjudication is, to a large degree, backward looking. The treaties underlying the majority of today's arbitrations were drafted a decade or more ago. These early treaties were generally far less detailed instruments than their newer equivalents and provided little specific guidance to arbitrators on how to balance competing legal regimes. Over time, as these newer, more detailed agreements come to replace their more terse predecessors, it is likely that investment law itself will provide the framework for a more effective interaction between investment law and other substantive areas of the law. In the meantime, however, jurisprudential solutions to the challenges faced by the interaction between investment law and other areas of international law will be needed. These jurisprudential solutions can, likewise, inform states' drafting choices as they craft new investment agreements.

## NEW JURISPRUDENTIAL RESPONSES: TOWARD AN INTERPRETATIVE DIALOGUE

Particularly as old-style investment agreements without explicit provisions on conflicts between substantive norms of international law continue to be the most frequently adjudicated investment treaties, new jurisprudential mechanisms are needed to ensure that investment arbitrators adequately take into account states' competing legal obligations. The approach of many—though by no means all—arbitral tribunals to date has been to privilege investment law over other substantive legal rules. In fact, the *lex specialis* and *lex posterior* conflicts rules tend to point to such a result. More often than not, the relevant rule of investment law will be the more recent rule, precisely because most investment treaties are comparatively new. Similarly, by far the easiest way to address a potential conflict is for a tribunal to rule investment law as the applicable *lex specialis*, thereby avoiding the need to engage in any kind of reconciliatory effort of balancing. While this approach has been relatively easy for tribunals to implement, it appears not to conform with the intent of states parties and has been the source of much of the aforementioned backlash. Hence, a more effective jurisprudential balancing mechanism must be developed.

What is needed, in these circumstances, is for tribunals to move toward an interpretative dialogue. Collectively, the conflict-of-law provisions and Article 31 of the Vienna Convention provide tribunals a great deal of jurisprudential freedom to address and resolve tensions between different substantive areas of international law. To do so effectively, however, tribunals interpreting international investment law must move from what often appears to be a myopic vision of the international legal system that foregrounds investment obligations over potentially competing obligations toward a form of interpretive dialogue, in which investment law is understood to be in dialogue with other substantive legal regimes.[10] Such an interpretative dialogue has been launched quite successfully in the World Trade Organization (WTO) context, using the exceptions clause of the General Agreement on Tariffs and Trade (GATT) Article XX as a starting point. More specifically, WTO jurisprudence has used the principle of "mutual supportiveness" among competing legal regimes, particularly trade and environmental rules, to find common ground by "fostering harmonization and complementarity (Pavoni 2010)."

Adopting an interpretative dialogue would engage a tribunal in a deep investigation of the competing (or potentially competing) substantive legal regimes at play, seeking to find points of overlap and means of reconciliation.[11] In other words, the tribunal could—through interpretation—import norms from one regime into the other, thereby avoiding conflict, increasing harmonization, and promoting the unity of international law. At the very least, tribunals would be forced to give reasons for their prioritization of particular norms, driving a public dialogue across tribunals that ultimately enhances systemic legitimacy (Helfer and Slaughter 1997).

8 See Bilateral Investment Treaty between Canada and the People's Republic of China (2012).

9 See Indian Model Text of Bilateral Investment Promotion and Protection Agreement (2015), http://finmin.nic.in/the_ministry/dept_eco_affairs/icsection/Indian%20Model%20Text%20BIPA.asp; Southern African Development Community, Model Bilateral Investment Treaty, http://www.iisd.org/itn/wp-content/uploads/2012/10/sadc-model-bit-template-final.pdf.

10 Some investment tribunals have begun to move in this direction. See for example, *Mondev International v. USA*, ICSID Case No. ARB (AF)/99/2, Award, 1 Oct. 2002, para. 1.

11 Some tribunals have demonstrated at least a partial willingness to do so. See *Unglaube and Unglaube v. Costa Rica,* ICSID Case Nos. ARB/08/1 and ARB/09/20, Award, 16 May 2012 (showing sensitivity toward the host state's regulatory freedom to effectuate sustainable development objectives).

Even where the text of the treaty that gives rise to the dispute is fixed, there are at least three ways to move tribunals toward such an interpretative dialogue. First, it is possible for states and investors to change who is doing the interpretation and application of the treaty by altering appointments to investment tribunals. Engaging in an interpretative dialogue among substantive legal regimes requires that the arbitrators themselves are well grounded in the substantive norms of coexisting regimes. Choosing an arbitrator who self-defines as a human rights lawyer or an international environmental lawyer, may well change the discussion within the tribunal itself, its interpretation and application of investment law, and, perhaps, the outcome itself (Franck 2009).

Second, it is possible to alter the political and social context in which such interpretation and application occurs (Ortino 2013). Arbitrators—like judges—do not operate in isolation. They are aware of, and responsive to, the political and social context of their actions (see Bickel 1986). Where arbitrators adjudicate within a political and social context framed exclusively around investment protection, it is not surprising that they prioritize investment rules over other substantive norms. Over the past few years, the political and social context of investment law has changed dramatically. States have begun to balance investment provisions with other legal norms in their investment agreements. Social groups, academics, and politicians have called for broad systemic reform. These shifts are likely to change the context in which investment arbitration occurs even further. As arbitrators undertake their work, they are likely to be conscious of, and perhaps even influenced by, these shifts in a way that brings other substantive norms into their interpretative process. Ultimately, a normative choice must be made as to whether a tribunal's analysis should be limited to the text in front of it or framed by these changing background social norms. The legitimacy of the system itself may well be enhanced through an interpretation that does, in fact, change with shifts in the background social context (Venzke 2012). For those who favour these contextual elements entering into a tribunal's interpretative process, the easiest means to push tribunals toward more adept balancing may well be to continue to alter this background social and political context through statements by governments themselves, social activism, and political advocacy.

Third, it is possible for both states and investors[12] to frame their claims, defences, and counterclaims in ways that force tribunals to engage in an interpretative dialogue. Party litigants have the power to frame the dispute. When states invoke secondary norms of international law, such as the circumstances precluding wrongfulness of necessity, distress, and force majeure, tribunals must consider how these secondary norms may impact or relieve primary obligations under international investment law. For example, denying an investor fair and equitable treatment might not be wrongful if it were the only available means to protect an essential state interest. Similarly, denying an investor full protection and security may not be wrongful if it was necessary to save lives entrusted to the state's care (by, for example, deploying police forces elsewhere).

Perhaps more boldly, states could also raise competing obligations in their pleadings as defences, even if they are not as a matter of *lex lata* formal legal defences.[13] For example, in a time of armed conflict, a state could and should raise the permissibility of a target under international humanitarian law in its response to a claim of violation of full protection and security in investment law. Such a framing of the claim would force the tribunal to consider so-called permissive conflicts as a possible defence and to engage in balancing competing legal regimes. Even where such a framing of the pleadings does not immediately resolve the conflict or lead to a change in the law, it will push tribunals in the direction of greater engagement and balancing across legal regimes.

Finally, in some cases, states may have the legal ability to bring counterclaims against investors. By framing such counterclaims (within the tribunal's jurisdictional limits) in part based on other substantive areas of the law, the state may push the tribunal to more directly grapple with the interplay of substantive norms. This may be easier in arbitrations where consent is found in a contract (and therefore likely bilateral) (see also Crawford 2008),[14] but there is precedent for doing so, even where consent rests only in the treaty itself and privity may be lacking (see also Veenstra-Kjos 2007).[15] Efforts to frame such counterclaims broadly would again force tribunals to grapple with and integrate a variety of substantive international legal norms. Many BITs may, however, limit the scope of such counterclaims to breaches of the BIT itself. As a result, in order for such counterclaims to be a more regular occurrence within the investment law system, treaty-drafting changes (such as those discussed below) may be needed.

## TREATY DRAFTING: POLITICAL DEBATE AND TREATY-BASED BALANCING

While the solutions discussed thus far are intended to work within existing treaties with fixed language and provisions, the most promising means of addressing and resolving conflicts among legal regimes involve changes to language of future investment treaties. As noted above, early BITs were extremely thin and provided little, if any, guidance on how to

12 In *Grand River Enterprises et al. v. United States*, the native peoples were the claimant and invoked other substantive protections owed to them outside investment law in the framing of their claim.

13 States have tended to be reluctant to do so. Even in the few cases where tribunals have engaged in a cross-regime balancing, they have often done so either *sua sponte* or at the urging of third parties. See for example, *Glamis Gold Ltd. v. United States*.

14 See for example, *Maritime International Nominees Establishment v. Guinea* (ICSID Case No. ARB/84/4).

15 *Alex Genin, Eastern Credit Limited, Inc. and A. S. Baltoil v. Estonia,* ICSID Case No. ARB/99/2, (considering a state-initiated counterclaim). But, compare *Spyridon Roussalis v. Romania,* ICSID Case No. ARB/06/1, (finding no jurisdiction over a state-initiated counterclaim).

reconcile competing legal obligations. At least some aspects of the current problem may resolve themselves over time if new generations of investment treaties include more explicit means of reconciling competing obligations or provide carve-outs for certain types of state actions taken in furtherance of coexisting legal obligations. The new US, Canadian, and Indian model BITs move in this direction, providing more detailed exceptions, limitations, and conflicts guidance.

A prime benefit of states parties incorporating guidance on the reconciliation of competing legal obligations in investment treaties themselves is that it returns the question of prioritization of legal regimes to the political space. Choices between the scope of investment protection and other objectives, such as human rights protection, labour rights, or environmental rights are, at their core, political. States must decide which ends they and their people value most. Treaty-drafting and ratification processes allow those debates to play out through political, rather than adjudicatory, processes (see Alvarez 1989). States then must internalize the relative political costs of those choices for different actors in the system. The trends of the past few years, during which many new investment agreements have provided more room for states to advance the objectives of other substantive areas of international law, suggest a political rebalancing in favour of somewhat more limited investment protections.

Yet, even while this process is ongoing, there are several concrete steps treaty-drafters can and should take to ensure a more balanced interaction between investment law and other areas of international law going forward. First, newly drafted treaties should include clear exceptions clauses, non-precluded measures provisions, and war clauses. The scope of such exceptions and, hence, the relative protection of investments is ultimately a matter for states parties themselves to agree upon. But ensuring that such provisions are included in newly drafted treaties forces states parties to consider such exceptions and makes clear to interpreting tribunals that the states parties have engaged in that consideration and offers interpretative guidance. At a minimum, treaties should address the interaction between investment law and environmental, labour, and human rights law.

While subject to potentially competing understandings and interpretations, whatever their agreed-upon scope, exceptions clauses limit the applicability of the treaty with respect to certain predefined issue areas, such as environmental protection or labour protection. Exceptions clauses avoid or resolve conflict by taking certain issue areas outside the substantive remit of investment law. Non-precluded measures provisions limit the scope of applicability of investment law when a state takes actions in furtherance of particular objectives. While similar in effect, exceptions clauses are more general limits to the treaty, whereas non-precluded measures clauses only apply when a state's actions are necessary for the furtherance of an enumerated policy goal., While such clauses do not resolve the deeper tensions between investment law and other areas of the law, they can offer a means for states to balance multiple regimes. Given that these clauses are drafted by the states entering into investment agreements, if carefully constructed they can prioritize some coexistent regimes over others, removing actions in furtherance of or mandated by other legal regimes from the scope of investment protection.

The negotiating text of the Canada-EU Comprehensive Economic and Trade Agreement (CETA) provides a useful illustration. For example, the CETA text provides clear guidance with respect to the interaction of investment law with intellectual property law (Trade-Related Aspects of Intellectual Property Rights or TRIPS). Similarly, a joint declaration brings human rights protection within the scope of the treaty's national security exception.[16]

Second, new investment agreements should provide greater guidance as to the resolution of conflicts among legal regimes, even outside areas covered by exceptions and non-precluded measures clauses. If one thing has become clear from the experience of international investment law over the past few decades, it is that states have a difficult time anticipating the trajectory of the regime and the types of conflicts between legal rules and policy goals that can occur in the future. The recent changes seen in investment agreements are, in fact, a response to the problems that have arisen to date and may not adequately address the yet-to-be-seen problems and conflicts of the future. Hence, even while it is critical to include exceptions clauses in new investment agreements, it is also imperative to provide more general conflicts guidance to investment tribunals.

As states continue to draft new generations of BITs, such treaties can incorporate clearer guidance as to conflicts of law, the incorporation of norms from coexistent regimes, the relations between permissive and restrictive legal norms, and the parties' views on the overall unity or intentional fragmentation of the international legal regime as a whole. States parties could include treaty language providing, for example, "the investment protections contained in this treaty should not be understood as exclusive *lex specialis* and must be interpreted in the light of the parties' other international legal obligations." Different formulations could, of course, prioritize in various ways investment protection or other substantive norms. While such language would not guarantee a particular outcome, it would force tribunals applying international investment law to consider a state's competing legal obligations and to recognize the broader unity of the international legal system.

## THE OPPORTUNITY OF MEGA-REGIONALS

To date, investment law has been a largely bilateral enterprise. Early efforts for a multilateral investment agreement failed,

16 Draft Text of the Comprehensive Economic and Trade Agreement (EU-Canada) of 26 Sept. 2014.

and the current regime has emerged through the development of thousands of similar, though not identical, bilateral agreements. While this model has allowed for considerable experimentation, it has also driven differential interpretation and lack of uniformity. Present efforts to include investment protection in so called mega-regional trade deals offer three critical opportunities that must be exploited.

First, the negotiation of mega-regional agreements provides the first broad political forum in which to consider the right balance between investment law and other substantive norms of international law. Striking the right balance as a political matter is essential to the continued legitimacy of investment law itself. If these new agreements fully grapple with and reconcile competing political interests in the framing of exceptions clauses and conflicts guidance, they can go far toward improved perceptions and systemic legitimacy. However, such treaty negotiations and political dialogue must be understood as a two-level game (see Putnam 1988). Not only must an acceptable political bargain be reached on the global stage among states parties to the regional agreements, so too must an acceptable political bargain be reached domestically within each state party. The current lack of transparency around both the TTIP and the TPP, while perhaps helpful to the multilateral negotiation, may also undermine that much-needed domestic political negotiation. Additional transparency and domestic dialogue before a final text is agreed upon may be essential to the ultimate success of the effort.

Second, by virtue of the fact that mega-regional agreements are multi-subject treaties, by their structure they result an internal balancing of some substantive areas of international law. The mega-regional agreements currently under negotiation include both trade and investment chapters and, in order to ensure internal consistency, must address the interactions among those provisions.[17] While these mega-regionals may only directly address the interaction of trade and investment law, they have the potential to clarify relationships among a broader array of legal regimes and provide conflicts guidance of more general applicability. The inclusion of investment law in treaties with a broader substantive scope also allows for the applicability of additional rules of interpretation. In the context of a single treaty, Articles 31 and 32 of the VCLT require that a tribunal interpreting and applying investment protection rules takes into account other provisions of the same treaty.[18]

Going forward, one could certainly imagine regional agreements that include related substantive areas beyond just trade and investment, such as environmental and labour law. Yet, it remains unlikely that this approach will resolve the interaction of more disparate legal regimes, such as investment law and humanitarian or human rights law. Nevertheless, the broader framing of such treaties may provide a step toward new conflict resolution mechanisms and offer interpretative guidance that resolves conflicts.

Third, mega-regional agreements offer the best prospect for the harmonization of the international legal system. To the degree that mega-regional agreements include consistent exceptions and conflict-resolution guidance, there is the real prospect of convergence. The lack of uniformity among bilateral treaties opens the door for the emergence of a more consistent standard based on terms included in a mega-regional agreement. Even in the drafting of subsequent bilateral agreements, states are likely to draw from the terms included in a broadly accepted (and tested) mega-regional agreement. Hence, it is all the more important to "get it right" in the emerging mega-regionals. Finally, even though a new mega-regional agreement will directly impact the interpretation and application of the terms of existing bilateral investment agreements, these new terms will undoubtedly shape the political and social context in which existing treaties are interpreted. Hence, the inclusion of new exceptions and conflict resolution guidance in mega-regionals may have an impact on how arbitrators treat conflicts even under existing treaties.

## EXPANDING AND CLARIFYING THE CLEAN HANDS DEFENCE

While the solutions discussed thus far comprise relatively limited textual changes, but ones that could have significant impact, two more bold proposals are worthy of consideration. First, investment treaties could be drafted to include a jurisdictional or admissibility bar prohibiting claims by investors whose prior behaviour was in breach of other substantive obligations of domestic or international law, including environmental, labour, or human rights law. In effect, such treaties would include a clean hands provision, prohibiting investors whose own conduct in the host state was in breach of international law from bringing claims against host states.

The clean hands doctrine—in a variety of forms, ranging from traditional clean hands[19] to "equity,"[20] to the English *ex turpi causa* defence,[21] has a long history in domestic and international law. In the words of Gerald Fitzmaurice, "a State which is guilty of illegal conduct may be deprived of the necessary *locus standi in judicio* for complaining of

17 A separate paper in this series considers the interactions between trade and investment law.

18 Vienna Convention on the Law of Treaties, Art. 31, 32.

19 See *Precision Instrument Mfg. Co. v. Automotive Co.*, 324 US 806 (1945).

20 See *Diversion of Water from the Meuse (Neth. v. Belg.)*, 1937, Permanent Court of International Justice (ser. A/B) No. 70, p. 25 (28 June) (invoking equity).

21 See *World Duty Free Company Limited v. Republic of Kenya*, ICSID Case No. ARB/00/7, Award (4 Oct. 2006), para. 161 (recognizing the ex turpi causa defence).

corresponding illegalities on the part of other States, especially if these were consequential on or were embarked upon in order to counter its own illegality—in short were provoked by it." [22] Such a rule could apply equally to an investor.

While it is arguable that the clean hands doctrine could be applied by a tribunal as a matter of customary law or general principles of law without a textual basis in the treaty,[23] the recent Yukos Award found that "unclean hands" was not "a general principle of law recognized by civilized nations (see also Llamzon 2015)".[24] If the Yukos award is relied upon by other tribunals, the continued operation of the clean hands doctrine may well require new treaty-based justifications. Some bilateral investment treaties already stipulate that covered investments must be made in accordance with host state law (see Moloo and Khachaturian 2011). In an application of a version of the clean hands doctrine, several arbitral tribunals have relied on such a provision to find that they lacked jurisdiction.[25] Such a clause could be included in the "consent to arbitration article", conditioning the host state's consent to arbitration upon the investor's compliance with selected provisions of domestic or international law. Such a provision could also be included in the "scope of application" or "denial of benefits" article of a treaty such that "a Party may deny the benefits of this treaty to an investor whose conduct on that party's territory is in material breach" of particular provisions of domestic or international law. Ultimately the scope of the clean hands defence and its point of procedural application would depend on the particular formulation chosen by the states parties to the treaty.

Several recent model investment agreements, including the 2005 IISD Model BIT, the 2012 SADC Model BIT, the 2015 Indian Model BIT, and CETA have directly incorporated a clean hands requirement. The 2005 IISD Model BIT, for example, enumerates several obligations of investors, including at Article 13 anti-corruption obligations, and then provides: "Where an investor or its investment has breached Article 13 of this Agreement, neither the investor nor investment shall be entitled to initiate any dispute settlement process established under this Agreement…."[26] Texts such as these, however, struggle with the degree of malfeasance by the investor with respect to different substantive obligations in the agreement and the level of proof necessary to trigger the clean-hands clause.[27] Getting that right may require experimentation over time, but is critical to ensuring the fair and balanced application of the doctrine.

A clean hands defence would offer a number of benefits in addressing legitimacy, fairness, and regime-interaction concerns. First, it would create a strong incentive for foreign investors to comply with key provisions of domestic and/or international law, particularly important in relatively weak host states that might lack the ability to enforce those provisions directly in national courts. Second, it would take a step toward a structural rebalancing of the investor-state system. While not creating true parity between states and investors, it would partially level the playing field, ensuring that poorly behaved investors would not reap the benefits of the system at no cost to themselves. Finally, even if only infrequently invoked, incorporation of the clean hands doctrine could go far toward addressing current political controversies, demonstrating that the investment law system is not a one-way-street favouring investors and could actually be used to improve rule of law compliance by foreign investors.

Notwithstanding these potential benefits, a few risks should be borne in mind. First, such a provision could create an almost insurmountable limit on arbitration, miring any potential claimant in a lengthy and potentially damaging litigation over its own conduct in the host state. This is particularly true if the clean hands defence is framed broadly with a low trigger threshold. Second, unscrupulous host states could use relatively minor regulatory breaches to deny investors the benefits of the investment law regime, thereby undermining the utility of the system itself. Third, allowing such a clean hands defence could complicate the relationships between international investment arbitration and domestic investigation and enforcement mechanisms. Would, for example, investment tribunals defer to a host state's determination that a foreign investor was in breach of the relevant legal rules or engage in a de novo consideration thereof?

With respect to each of these concerns, the framing of the clean hands provision is critical. Almost any investor could be found to be in some breach of domestic or international law. Hence, the critical questions to be considered are (1) how significant a breach of (2) which substantive norms (3) based on what level of evidence would trigger the clean hands defence? Many of the potential problems with such a defence—lengthy jurisdictional litigation and the possibility of pre-textual regulatory violations being used to deny benefits—could be ameliorated if such a defence requires a significant breach by the investor. Additional drafting efforts and interpretative practice may be needed to develop the right formulation—whether the "persistent failure" referred to in the IISD Model, the "material breach" referred to in the

22 Sir Gerald Fitzmaurice, 1957, Recueil des Cours, Vol. 92, p. 119..

23 For an example, see *Palma Consortium Limited v. Republic of Bulgaria,* ICSID Case No. ARB.03/24, Award, (27 Aug. 2008), Part IV(B)(3).

24 *Yukos Universal Limited (Isle of Man) v. The Russian Federation,* UNCITRAL, PCA Case No. AA227, Final Award, 18 July 2014.

25 *Inceysa Vallisoletana, S.L. v. Republic of El Salvador,* ICSID Case No. ARB/03/26, Award (2 Aug. 2006), para 195; Fraport AG Frankfurt Airport Services Worldwide v. Philippines, ICSID Case No. ARB/03/25, Award (16 Aug. 2007).

26 International Institute for Sustainable Development, IISD Model International Agreement on Investment for Sustainable Development (2005), Art. 18.

27 See note 26, noting the different standards applied to corruption (simple breach) and corporate governance (persistent failure).

SADC text, or some other formulation.[28] Ultimately, the exact framing of such a clean hands defence should be determined in the political sphere, a key recommendation is that further consideration should be given to the incorporation of a clean hands defence in bilateral investment treaties, where such a defence is triggered only by a significant breach by the investor either at the time of the investment or throughout the life of the investment.

## EXPANDING JURISDICTION TO ALLOW CLAIMS AGAINST INVESTORS

The most radical response would involve a more full rebalancing of the investment law system such that states or even non-state actors—as well as investors—could bring claims before investment tribunals based on a wide range of substantive legal obligations (see Laborde 2010 and Toral and Schultz 2009). The International Centre for Settlement of Investment Disputes (ICSID) Convention itself expressly allows for state-initiated claims where jurisdiction is founded in either treaty or contract. Claims brought by non-state actors might require a broader change in the structure of ICSID or the use of alternative arbitral institutions. Such an expanded jurisdiction presumably based on a wide range of substantive norms would directly engage investment tribunals in the interaction among competing legal regimes, but would, in so doing, quite fundamentally change their nature and purpose.

On first appraisal, such an approach is seductive. Opening the gates for claims against investors would respond to many of the concerns that have been raised about the one-sided nature of the investment law regime. It would create incentives for foreign investors to comply with domestic and international law. It would create a new means for states to hold foreign investors responsible for breaches of domestic and international law. And it would more directly incorporate other subfields of international law into the international investment law system. From a legal and drafting perspective, it would not be difficult to implement such a solution. In newly drafted treaties, certain provisions would need to be altered to allow claims by states as well as investors. Changes to institutional frameworks might be necessary to accommodate claims by third parties. And, of course, foreign investors would need to consent to arbitration in advance, presumably in the investment contract itself.

Yet, transforming international investment law from its current largely unidirectional structure, whereby primarily investors can sue states based on breaches of the investment agreement, to some multidirectional structure, whereby states and other actors could potentially sue investors for breaches of a broader set of substantive norms is likely to be counter-productive for several reasons. First, such an approach could undermine the currently accepted core goals of international investment law—namely protecting and promoting foreign investment. If a prerequisite to receive the benefits of investment law is the foreign investor's consent to potential litigation against it, it is far from certain whether foreign investors would consent at all. Foreign investors already face potential investigation and prosecution by national authorities; consenting to jurisdiction would open them up to a second potential source of liability. To the degree foreign investors choose not to engage in such a modified system, the very purposes of international investment law are undermined. Of course, these goals could be revisited and broadened to include, for example, sustainable development more generally (see Segger et al. 2010). Despite strong advocacy from states and non-governmental organizations (NGOs), there is little evidence to suggest that the goals of the system have moved that far as yet.

Second, from the perspective of rule of law and institutional development, one of the purposes of the investment law system should be to encourage the development of fair and effective national enforcement mechanisms. If national governments are able to turn to investment tribunals to enforce their own laws or even international law against investors, the incentives to improve national enforcement capacity decline. Third, from the perspective of institutional competence, concerns have already been raised about investment tribunals engaging in public law litigation (Burke-White and von Staden 2010). A proposal such as this would move investment tribunals more fully into the public law space, essentially replacing national law enforcement institutions. In the process, investment tribunals would cease to be investment tribunals and, instead, emerge as the enforcement mechanisms for a multitude of international legal rules. At least as currently structured, investment tribunals lack both the legitimacy and competence to play this role (see Eskridge 2013 and Kingsbury et al. 2005). Hence, proposals to raise the jurisdictional bar and allow claims by states against investors should be resisted.

# CONCLUSION

International investment law is facing significant criticism and political backlash. That present political context must be addressed, particularly if the TPP and TTIP negotiations are to succeed and mega-regional investment agreements are to be concluded. While reforms are needed to ensure that investment law fully engages with other substantive

28 See IISD Model International Agreement on Investment for Sustainable Development, Art. 18(c); Southern African Development Community, SADC Model Bilateral Investment Treaty Template (2012), Art. 19 (requiring that the tribunal consider "whether this breach, if proven, is materially relevant to the issues before it").

fields of international law, scrapping the present investment law system or undertaking significant alterations to the substance of that system would be unnecessary overreactions to manageable challenges. A new generation of investment treaties provides far more treaty-based guidance accepted by states to balance investment protections and other substantive norms of international law. Over time, these new treaties will govern more investment disputes; many current concerns may pass of their own accord. While political debate and textual experimentation is still needed to ensure that such new treaties get the political balance right and provide the intended legal guidance to arbitrators, this new generation of treaties offers the prospect of a more balanced, better integrated, and more effective international investment law regime. A key immediate step is to ensure that the mega-regional treaties currently being negotiated contain the necessary exceptions clauses and explicit language requiring tribunals to take into account the full range of a state party's legal obligations. Of course, this relatively optimistic conclusion depends on the interpretation of these new texts by investment tribunals themselves. In a system without appellate review, that interpretative process may be unpredictable or at least require a period of jurisprudential experimentation.

While legislative (treaty-based) responses offer the most promising long-term solutions, they do not, of course, apply retroactively. In the meantime, jurisprudential innovation that pushes arbitrators to engage with and balance competing legal rules is necessary. The existing law provides the framework necessary for them to do so. States and other stakeholders may need to alter the political and social context in which such arbitrations occur, framing their claims in ways that integrate across international legal obligations and criticizing awards that fail to do so (see Burke-White 2008).[29] Such efforts would provide a useful political response to current criticism of the regime, potentially alter the outcomes of arbitrations even under existing treaties, and lay an important jurisprudential foundation for subsequent application of the coming generation of more explicit investment treaties.

More radical changes to the system, such as allowing states or non-state actors to bring claims against investors are likely to be counterproductive and might even undermine the viability and purposes of the investment law system itself. However, the potential inclusion of a broad, but carefully tailored, clean hands defence for manifest breaches of critical provisions of domestic and international law by investors is worthy of further consideration. Such a defence might well move toward a more politically acceptable balance between the rights of states and investors and the better integration of investment law with other substantive norms of international law while still advancing the broadly accepted goals of the international investment law system.

29 The CMS Annulment Award is indicative of how criticism of an earlier award can change the trajectory of rule development.

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