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CAPITAL INVESTMENTS AND THE SOVEREIGN PREROGATIVE: A DEFENSE OF INVESTOR-STATE ARBITRATION AGREEMENTS IN INTERNATIONAL COMMERCE

Since the establishment of a more globalized capital market in the late Nineteenth and early Twentieth Centuries, opportunities for private investment in developing nations have spurred a number of successful partnerships between foreign investors and host states seeking capital improvements. A challenge emerges at international law, however, in adjudicating the interests of foreign investors who have witnessed the expropriation of their investments by host states which either lack longstanding protections for private property rights or, alternatively, the political will to enforce existing investment guarantees. In light of the absence of an effective international legal regime designed to ensure that the claims of foreign investors have the chance to be fairly considered in an impartial setting, this article advocates for the expansion of the investor-state arbitration process as the most suitable means for settling disputes between private investors and the host governments which have allegedly expropriated their investments.

Key Words: *Bilateral Investment Treaty. — Arbitration. — Expropriation. — NAFTA. — Developing Nation. — Neocolonialism.*

1. INTRODUCTION

On a humid summer day in 1619, the Kingdoms of Bantam and Jacatra declared war on a small settlement on the western coast of Java.[1]

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[1] J. Crawfurd, *History of the Indian Archipelago (Vol. II)*, George Ramsay & Co., Edinburgh 1820, 515

Seeking deliverance from this fearsome attack, the settlement quickly sent word of its distress to Jan Pieterszoon Coen who arrived shortly thereafter with a fleet of sixteen battleships and 1,200 soldiers.[2] Within forty-eight hours of their arrival, Coen's forces had inflicted such a devastating defeat on the settlement's attackers that, after razing the enemy capital of Jacatra to the ground, he wrote "[i]n this manner, we have become foot and master in the territory of Java. The foundation of the long-wished-for rendezvous is laid."[3]

While the story of Coen's victory against the armies of Java would hardly stand out in the annals of military lore, his conquest is notable for one particularly unique reason. Unlike the vast majority of armed conflicts which have taken place throughout recorded history, Coen's forces did not fight under the flag of a sovereign nation such as France, The Netherlands, or Spain, but rather under the red, white, and blue banner of the Dutch East India Company—a privately owned corporation then headquartered in Amsterdam.[4] Organized to take advantage of the newly discovered Asiatic trading routes, this enterprise had the power to declare war, erect fortresses, coin money, and to appoint administrators and judicial officials to maintain order inside its territories.[5] At the height of its power and glory, it ruled all of modern Indonesia, parts of southern Africa, and numerous other provinces scattered throughout the Far East.[6]

It goes without saying that, unlike the Dutch East India Company, it would be the rare commercial enterprise today that would have the political strength and financial clout to challenge the authority of a sovereign nation—much less the ability to defeat one militarily. With the rise of the State as the principal actor in international relations, multinational commercial organizations have, to a substantial extent, become subordinated to the policies, passions, and dictates of the national governments under which they operate.[7] Whether this state of affairs is the most efficient—or even the most desirable—arrangement for facilitating transna-

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[2] P. J. Blok, *History of the People of the Netherlands*, G.P. Putnam's Sons, New York 1900, 492.

[3] *Ibid.*

[4] The company was initially established with a capital investment of approximately $2.5 million and was managed by a Governor-General—the aforementioned Coen serving in this capacity—and a council comprised of representatives "chosen indirectly from a list selected by the chief stockholders of each city." W.C. Webster, *A General History of Commerce*, Athenæum Press, Boston 1918, 155.

[5] *Ibid.*

[6] *Ibid.*, 156.

[7] M. Alagappa, T. Inoguchi, *International Security Management and the United Nations*, United Nations University Press, New York 1999, 80 (noting from a review of Twentieth Century trends that "it is clear that the nation-state is also set to underwrite the structure and define the operation of the international system beyond this century.").

tional commerce is a question best left to other minds; it is enough for one to appreciate that this is the world of international business as it currently exists.[8]

Given the primacy of the nation-state in the current geopolitical order, how is one to react when a dispute arises between a private economic concern and the host state in which it operates? Shall a company which has seen its assets expropriated without warning petition the courts of the offending government for an effective redress? What chance of recovery can an enterprise expect when the courts of its own nation dismiss its claim against the foreign government on grounds of sovereign immunity? Short of sending a fleet of sixteen battleships and 1,200 soldiers to burn the offending government's capital, what recourse does an investing party have against a host state which chooses to rewrite the rules in the middle of the game?

In light of the challenges and diplomatic headaches these disputes have the potential to create, it is the position of this article that the answer to such a dilemma can be found through agreements to submit certain disputes to binding arbitration and that, with respect to most international business transactions involving private concerns and sovereign entities, such agreements should be the preferred means of international dispute settlement. In support of this position, Part I of this article will address the historical balance of power between foreign investors and their host states, Part II will consider the rise of bilateral and multilateral investment treaties with particular regard to the North American Free Trade Agreement, Part III will respond to certain criticisms which have been leveled against arbitration as a means of international dispute settlement, and Part IV will offer concluding remarks about the state of commercial arbitration and why it is a superior alternative to litigation in national courts.

2. TIERRA, LIBERTAD, AND THE AFTERMATH OF WESTERN COLONIALISM

Since the days of Andrew Jackson, the phrase "to the victor belong the spoils" has been a popular political expression.[9] While the United States' seventh President may be credited with articulating the statement, however, the sentiment itself reflects a much older and more pervasive principle. Seen through the lens of the Global South's collective experience with foreign powers and their instrumentalities, an understanding of this principle's economic consequences and the social ramifications stemming therefrom

[8] *Ibid.*

[9] W.G. Sumner, *Andrew Jackson*, The Riverside Press, Cambridge 1899, viii.

has the potential to go a long way toward explaining much of the controversy surrounding investor-state arbitration agreements.

Using the colonization of Central and South America as archetypes for the historical experiences encountered by many of the world's developing nations, it is clear that, to a large extent, modern opposition to investor-state arbitration agreements bears a strong correlation with a much older set of political experiences lodged in the developing world's collective conscience. Consequently, before one can begin to make an accurate defense of investor-state arbitration agreements, one must first consider the history of Western influence as it has been felt by the influenced parties or, phrased differently, the history of colonialism as it has been seen through the eyes of the colonized.

While any number of notable examples such as the destruction of Tenochtitlan[10] or the conquest of Peru[11] could be considered in reviewing the history of Western colonial ventures, an illustration from the expedition of Gonzalo Ximenes de Quesada provides a particularly telling synopsis of the early relationship between the European powers and the aboriginal populations they encountered.[12] After entering the region of Cundinamarca in present-day Colombia in 1537, Quesada's forces learned of a great city named Bogota where, they were told, "emeralds and gold . . . were abundant."[13] As recorded by Hawthorne:

> A battle with the Bogota people ensued; they were defeated; but in their scattering flight they took their gold and emeralds with them. Where the treasure was hidden the Spaniards could not discover. But at length a rival chief directed them to the stronghold of the Tunja tribe, and Quesada surprised the principal Tunja chiefs in their council-house; a fight followed, and the Tunjas got the worst of it. And here, at last, was treasure in plenty: so big a pile of gold and gems that a man on horseback could be hidden behind it. Probably as much as was obtained had been carried off or concealed; but about a million dollars' worth of gold, and nearly two thousand emeralds, were collected.[14]

Although the exact monetary value of Quesada's conquest is impossible to establish with any level of precision—particularly if Hawthorne's valuation is inaccurate—a crude estimation of the value of the

[10] A.H. Noll, *From Empire to Republic*, A.C. McClurg & Co., Chicago 1903, 1.

[11] W.H. Prescott, *History of the Conquest of Peru*, Phillips, Sampson & Co., Boston 1858, 319.

[12] While recognizing that not all European nations conducted colonization efforts with the same level of zeal and punitive cruelty which many aboriginal groups experienced in Central and South America, this section is meant to highlight the overall political relationship which typically existed between the colonizers and the colonized rather than on the relative means employed by one colonizing power over another.

[13] J. Hawthorne, *Spanish America*, Peter Fenelon Collier, New York 1899, 221.

[14] *Ibid.*

gold taken from the slain Tunjan chiefs comes to more than forty-six million dollars.[15] Factoring in the loss of the emeralds and other priceless relics taken from the local populace, the amount of economic harm caused by Quesada's forces is even greater.

In view of Quesada's defeat of the Bogotan natives and the subsequent plundering of the Tunjan people, one may very well ask by what right these actions occurred. By what authority did Quesada have the power to demand the wealth of a city and, when it was not forthcoming, to destroy its inhabitants for their failure to surrender it? What justification could be provided for the massacre of a group of tribal chiefs who merely sought to protect that which was rightfully theirs? To steal from a man in Castile subjected a highway robber to an instant death sentence,[16] and yet to steal from an entire tribe in Cundinamarca warranted a Conquistador the honor of founding a new Spanish city.[17] Whatever justification Quesada's forces might have offered, the fact remained that the wealth of the native population had been taken by force and many of its guardians had been destroyed in the process—a theme which would become tragically repetitive.

Three hundred years later, the military might of the Conquistadors had been replaced by the economic power of the Dons. As described by M. Palacio Faxar in his account to the Royal Institution of Great Britain, "[t]he plantations of cocoa-trees, sugar canes, Indian corn, Jatropha manioc, banana-trees, and various sorts of peas, scarcely require the hand of man to cultivate them, for they produce almost spontaneously the most delicious fruits in abundance."[18] As for the "stronghold of the Tunja tribe" conquered by Quesada, Faxar noted that "[t]he province of Tunja contains a population of two hundred thousand persons . . . Tunja is the [provincial] capital, and still displays the pride of its founder, in the heavy magnificence of its buildings."[19] As for the owners of the plantations, it was observed that "the planters themselves, who being too proud to take the management of their plantations into their own hands, generally commit

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15 Taking the price of gold per ounce as it stood at the end of the Nineteenth Century ($20.68, *see* R.P. Falkner, *Annals of the American Academy of Political and Social Science (Vol. VII)*, Philadelphia Jan.-June 1896, 37) divided by $1,000,000 approximated from Hawthorne's analysis, one arrives at an estimated 48,356 ounces of gold. Multiplied by the price per ounce of gold quoted for contracts entered on March 23, 2009 ($952.10, *see http://finance.yahoo.com/q?s=GCH09.CMX*), this produces the sum of $46,039,747.60. This assumes, of course, that Hawthorne's figures were reasonably close to being accurate.

16 J.M. White, *A New Collection of Laws, Charters and Local Ordinances of the Governments of Great Britain, France and Spain*, T. & J.W. Johnson, Law Booksellers, Philadelphia 1839, 254.

17 Hawthorne, *supra* note 13.

18 *The Journal of Science and the Arts (No. V, Vol. III)*, James Eastburn & Co., New York 1818, 338.

19 *Ibid.*

them to overseers; residing in towns, and living above their income, they seldom visit their plantations above once a-year."[20] Lest any absentee owner be burdened with the costs of running such a large-scale operation, however, it was noted that "the agriculturalist in this country has an excellent method of availing himself of the services of his slaves, almost free of any expense."[21]

With the independence movements that swept through the Western hemisphere in the late Eighteenth and early Nineteenth Centuries, a redistribution of power began to occur. In South America, Simón Bolívar—El Libertador—decreed "the confiscation of all Spanish property, and [ordered] the division of 'national property' amongst the republican army."[22] In North America, a similar confiscation was attempted some forty years earlier when, on March 1, 1778, the colonial government of Georgia "issued an act of attainder to bolster depreciating state notes by obtaining hard cash. This act set up a complex mechanism whereby the state could obtain collateral through confiscation of real and personal property of 117 [loyalists]" charged with high treason.[23] Upon taking an inventory of the confiscated assets, "the commissioners were to sell the property; all money accrued would go to the government."[24]

With the signing of the Treaty of Paris in 1783, the American Revolution came to an official end and a new period of diplomatic exchange began.[25] Even though the guns had stopped firing, however, all was not settled between the two sides. After eleven years of an uneasy peace, the United States dispatched John Jay to London to avert a second war which threatened to break out over unresolved border issues and debt settlements.[26] The Loyalists had not forgotten the indignities they had suffered when their properties had been expropriated, and now, with the full support of the British Crown, they were prepared to obtain redress.[27]

[20] J. Bell, *A System of Geography, Popular and Scientific, or A Physical, Political, and Statistical Account of the World and its Various Divisions (Vol. VI)*, Archibald Fullarton & Co., Glasgow 1832, 50.

[21] *Ibid.*

[22] F.L. Petre, *Simon Bolivar "El Libertador"*, John Lane Co., New York 1910, 194.

[23] L. Hall, *Land & Allegiance in Revolutionary Georgia*, University of Georgia Press 2001, 69. Georgia was hardly alone in passing expropriation measures against loyalist property, however. *Ibid.*, 71.

[24] *Ibid.*, 70.

[25] Interestingly enough, as recently as November 1, 2007, the U.S. Department of State still acknowledged Article 1 of the Treaty of Paris (recognizing the independence of the thirteen former colonies) as a "Treaty in Force" between the United States and the United Kingdom. *http://www.state.gov/documents/treaties/83046.pdf*.

[26] A.W. Young, *The American Statesman*, J.C. Derby, New York 1855, 137.

[27] Quoting the sixth article of the Treaty, "it is alledged [sic] by divers British merchants and others his Majesty's subjects, that debts . . . still remain owing to them by citi-

In drafting what would become known as the Jay Treaty, the parties did not establish that one or the other nation's courts would be tasked with determining the value of the Loyalists' claims, but instead chose to include a somewhat unique provision for the ascertainment of loss:

> five commissioners shall be appointed, and authorized to meet and act in the manner following, viz. Two of them shall be appointed by his Majesty, two of them by the President of the United States . . . and the fifth by the unanimous voice of the other four; and if they should not agree in such choice, then the commissioners named by the two parties shall respectively propose one person, and of the two names so proposed, one shall be drawn by lot, in the presence of the four original commissioners. . . . Three of the said commissioners shall constitute a board, and shall have power to do any act appertaining to the said commission, provided that one of the commissioners named on each side, and the fifth commissioner shall be present, and all decisions shall be made by the majority of the voices of the commissioners then present.[28]

As a final rebuke to the state legislatures, the Treaty also affirmed that no assets should "ever in any event of war or national differences be sequestered or confiscated, it being unjust and impolitic that debts and engagements contracted and made by individuals, having confidence in each other and in their respective governments, should ever be destroyed or impaired by national authority on account of national differences and discontents."[29]

Unjust and impolitic though it might have been from the perspective of the foreign party, the following years nevertheless saw a widespread increase in the number of expropriations conducted by newly-empowered populist governments. In revolutionary France, the National Convention—shortly after executing Louis XVI—passed a law "sweep-

zens or inhabitants of the United States . . . [which] the British creditors cannot now obtain, and actually have and receive full and adequate compensation for the losses and damages which they have thereby sustained." Treaty of Amity, Commerce and Navigation, Between His Britannic Majesty and the United States of America, Nov. 19, 1794, 8 Stat. 116.

[28] *Ibid.* Arbitrators chosen to serve on this panel had to swear the following oath: "I will honestly, diligently, impartially, and carefully examine, and to the best of my judgment, according to justice and equity, decide all such complaints, as under the said article shall be preferred to the said commissioners: and that I will forbear to act as a commissioner, in any case in which I may be personally interested." *Ibid.*

[29] *Ibid.* at art. X. As noted by Brower, this quasi-diplomatic settlement regime was not a true arbitration tribunal as understood in the modern sense, and, "[a]fter the claims proved much larger than expected by the United States . . . doctrinal and interpersonal quarrels broke out among the commissioners, causing the American members to withdraw, thereby bringing a halt to the proceedings in July 1799." C. Brower, II, "The Functions and Limits of Arbitration and Judicial Settlement under Private and Public International Law", *Duke Journal of Comparative. & International Law* 18/2008 259, 268. Ultimately, the United States settled the remaining British claims for $2,664,000. For all of its failings, however, "[v]irtually all writers trace the modern history of international tribunals" back to it. *Ibid.*, 266.

ing away without compensation the whole feudal system, including many money dues which had been purchased, and as it was believed secured, by the most legitimate contracts."[30] Not to be outdone, the government of Prussia in turn issued an edict in 1811 "order[ing] the attachment and confiscation of all colonial, and other merchandize, which have been considered English,"[31] while the government of Egypt went even further by decreeing that "the State can expropriate non-Moslem proprietors by ordering their transfer without their consent."[32]

As the Nineteenth Century gave way to the Twentieth, the amount of commercial expropriations continued to rise. Under the rallying cry of "tierra y libertad"[33] Carranza's *revolución liberal* in Mexico nationalized the railways in 1914—exiling many of the "pernicious foreigners"[34] at the same time—while in proletarian Russia the Constituent Assembly quickly moved to "nationalize the banks and to annul the debts of the nation" while also "adopt[ing] a number of resolutions . . . abolishing 'forever . . . the right to privately own land,' [and] placing all land, mines, forests, and waters" under the control of the State in order to thwart the imperialist ambitions of foreign capitalists.[35] The ability to expropriate increasingly began to be seen as the sovereign prerogative of the State[36] and was even granted the imprimatur of the Permanent Court of International Jus-

[30] W.E.H. Lecky, H.E. Bourne, *The French Revolution*, D. Appleton & Co. 1904, 100. In addition to seizing substantial quantities of what would now be considered commercial paper, the Convention also burned castles "in order to destroy the muniment rooms and the title deeds they contained," in order to frustrate the claims of those who might claim an interest in the properties.

[31] W. Cobbett, *Cobbett's Political Register (Vol. XIX, Apr. 24, 1811)*, G. Houston, London 1811, 991. Under Articles I and II of the edict, "[a]ny ship or ships wherever built, and to whatever nation belonging, the cargo of which consists of what has been considered the produce of England, either by growth or manufacture, must in pursuance of the Continental System, be seized the moment it reaches our harbours . . . The penalty of confiscation follows such seizure without the necessity of any further legal formality . . . ." *Ibid.*, 992.

[32] Y. Bey, *The Right of Landed Property in Egypt*, Wyman & Sons, London 1885, 17. In fairness to Egypt, however, the government did "not admit that the powers that be or authorities have a right to expropriate save in the single case where the expropriation is profitable to the public interest." *Id.* Even concerning "non-Moslems," expropriation could "be ordered only for two well-defined reasons, namely: 1st. If the non-Moslems to be transferred have not themselves sufficient strength to defend themselves against the aggressions of enemies inhabiting adjacent countries. [Or] 2nd. If the Moslem State have reason to fear the treason of these non-Moslems." *Ibid.*, 18.

[33] M. Bonilla, *Diez Años de Guerra*, Imprenta Avendaño, S.A., Mazatlan 1922, 237.

[34] W. Thompson, *Trading with Mexico*, Dodd, Mead & Co., New York 1921, 63.

[35] N. Lenin, L. Trotzky, *The Proletarian Revolution in Russia*, The Communist Press 1918, 305–07.

[36] C.D. Wallace, *The Multinational Enterprise and Legal Control*, Martinus Nijhoff Publishers 2002, 976.

tice in the *Factory at Chorzów* case.[37] Against the backdrop of international state practice, the ability of national governments—often the recent victors in revolutionary struggles—to claim the spoils of foreign entities operating inside their territories began to gain an almost unquestioned, if not respectable, amount of political legitimacy.[38]

3. REDEFINING THE STATUS QUO

Recognizing the unpleasant truth that "[i]nternational law offered foreign investors little effective protection"[39] against uncompensated expropriations, capital-exporting regimes soon began to adopt measures to protect their economic nationals from the harms being inflicted by contumacious host states. In 1959, the governments of West Germany and Pakistan signed the first bilateral investment treaty and by 1989 more than 300 similar accords had been negotiated—a figure which, as of 2009, has risen to include some 2,500 treaties.[40] As described by Professor Salacuse, "the nations of the world fashioned an instrument of public international law to create rules for private foreign investments, an area that, despite western nations' claim to the contrary, has few generally accepted principles of customary international law."[41]

Central to these new instruments of public international law were provisions to submit investment disputes which could not be resolved by negotiation or consultation with the host state to independent arbitration panels for final resolution. While recognizing that host states could expropriate foreign investments as long as the expropriation was for a public purpose and was conducted in a non-discriminatory manner in accordance with due process of law—with prompt, adequate, and effective com-

[37] "After determining in 1926 that Poland's expropriation of a German-owned nitrate concern violated the terms of the convention on Upper Silesia, the PCIJ in 1928 [held that . . .] Under general international law, the measure of damages in cases of expropriation would have been based on the book value of the property at the time of its dispossession, plus interest . . . [but] while this standard might be appropriate to a legal expropriation, it did not adequately remedy an illegal one." N. Jasentuliyana, *Perspectives on International Law*, Martinus Nijhoff Publishers 1995, 25.

[38] *Ibid.* This is not to suggest that domestic concerns were never expropriated, but merely that foreign entities, particularly in capital-intensive industries, usually made for more convenient political targets. *See supra* note 34.

[39] J.W. Salacuse, "BIT by BIT: The Growth of Bilateral Investment Treaties and their Impact on Foreign Investment in Developing Countries", *International Lawyer* 24/1990, 655, 659.

[40] *Ibid.*, 655. *See also* U.N. Conference on Trade and Development, World Investment Report 2006—FDI from Developing and Transition Economies: Implications for Development xix (2006).

[41] *Ibid.*

pensation to be made to the aggrieved party—the negotiating states also recognized that questions would inevitably arise as to whether a particular state party had satisfied its obligations.[42]

With respect to this last point, judicial experience had demonstrated that investing parties could routinely be frustrated in their attempts to obtain redress if left to the mercy of domestic legal institutions. As the U.S. Supreme Court declared in *Oetjen v. Central Leather Co.*:

> The principle that the conduct of one independent government cannot be successfully questioned in the courts of another . . . rests at last upon the highest considerations of international comity and expediency. To permit the validity of the acts of one sovereign state to be reexamined and perhaps condemned by the courts of another would very certainly 'imperil the amicable relations between governments and vex the peace of nations.'[43]

Lest a lawsuit brought against the expropriating state "imperil the amicable relations between governments," the Court ruled that "[i]t is not necessary to consider . . . the validity of the [act of the foreign government] *since the subject is not open to re-examination by this or any other American court*. The remedy . . . must be found in the courts of [the expropriating state] or through diplomatic agencies of the political department of our government."[44] Consequently, injured parties would have to sue in the courts of the expropriating nation in order to obtain redress since the Act of State doctrine prevented such a recovery in a domestic forum.

Given that the courts of the expropriating state would likely be disinclined to rule in the foreign investor's favor as a matter of practice and that courts in the investing party's home state would generally be unable or unwilling to hear the claim for reasons of international comity, the available fora in which to bring a claim—narrow though they might be—contracted even further when one considered that "[n]o supranational courts possess mandatory jurisdiction to decide the appropriate indemnity for nationalized assets."[45] Although the political branches of a government might bring diplomatic resources to bear in dealing with politically significant claims—such as the United States did with the Iran-U.S. Claims Tribunal[46]—one can imagine any number of smaller claims fall-

[42] *See* Article 6 of the United States' 2004 Model Bilateral Investment Treaty, last visited May 1, 2009, *http://www.ustr.gov/assets/Trade_Sectors/Investment/Model_BIT/asset_upload_file847_6897.pdf*.

[43] 246 U.S. 297, 303–04 (1918).

[44] *Ibid.*, 304 (emphasis added).

[45] W.W. Park, *Arbitration of International Business Disputes*, Oxford University Press, Oxford 2006, 327.

[46] C.R. Drahozal, C.S. Gibson, *The Iran-U.S. Claims Tribunal at 25*, Oxford University Press, Oxford 2007, 375.

ing through the diplomatic cracks because the investing party either lacked the clout to raise the issue with its national government or because the amount in controversy was simply too insignificant to fight over.

In response to this generally troublesome state of affairs, arbitration clauses in bilateral investment treaties began to be seen as an effective compromise since they provided a forum "that is more neutral than host country courts, both politically and procedurally" while at the same time managing to avoid the political awkwardness which could come from having to repeatedly present a series of diplomatic inquiries to a foreign state over relatively small claims.[47] Furthermore, the "relative impartiality of international tribunals [would] bolster[] investor confidence and inspire[] greater certainty that the [investment] contract [would] be interpreted in line with the parties' shared *ex ante* expectations."[48] As a result, articles providing for the binding arbitration of disputes between investing parties and their host governments began to be incorporated more frequently in bilateral treaty negotiations—even becoming the default position of the Model Investment Treaties of the United States,[49] Norway,[50] the United Kingdom,[51] China,[52] and Brazil,[53] to name just five specific nations. Although customary international law was less than ideal for capital investors *ab initio*, diplomatic pressures could be brought to bear to force a change in this situation through bilateral treaties.[54] By providing "a way to level the playing field and to reduce the prospect of 'hometown justice,'" arbitration clauses provided an attractive means for businesses to safeguard their assets while still allowing them to operate in states which might lack longstanding legal commitments to property rights.[55]

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47 Park, *supra* note 45, at 327.

48 *Ibid.*

49 *See supra* note 42.

50 *See* Article 15 of the Norwegian Model Treaty, last visited May 1, 2009, *http://www.regjeringen.no/upload/NHD/Vedlegg/hoeringer/Utkast%20til%20modellavtale2.doc*.

51 *See* Article 9 of the Agreement between the U.K. and Moldova for illustration, last visited May 1, 2009 *http://www.fco.gov.uk/resources/en/pdf/pdf21/fco_ref_cm4260_moldovaippa*.

52 *See* Article 7 of the Agreement between the People's Republic of China and the government of Albania, last visited May 1, 2009, *http://www.unctad.org/sections/dite/iia/docs/bits/china_albania.pdf*.

53 *See* Artigo 7 (Article 7) of the Agreement between Brazil and Cuba, last visited May 1, 2009, *http://www.unctad.org/sections/dite/iia/docs/bits/Brazil_cuba_por.pdf*.

54 Given the widespread use these treaties enjoy—with particular regard to the provisions governing (and defining) permissible expropriations—one could argue that customary international law has been redefined on this point. Such an argument goes beyond the scope of this article, however, and will be considered only in passing.

55 Park, *supra* note 45, at 326.

In recent years, the North American Free Trade Agreement—a trilateral treaty between the governments of Canada, Mexico, and the United States—has attracted a substantial amount of attention with respect to its investment chapter and, more specifically, its dispute resolution components. Under Chapter Eleven of the Agreement, private investors have "the right to seek compensation directly from a NAFTA party-government for enacting certain measures that adversely affect their investments in the host country."[56] Since the treaty has been in existence for over fifteen years and its constituent governments form the world's largest trading bloc in terms of GDP,[57] an evaluation of the NAFTA regime as a procedural case study in international investment arbitration is a useful endeavor. Looking to the text of Chapter Eleven itself, Article 1122 of the treaty holds that "[e]ach [State] Party consents to the submission of a claim to arbitration in accordance with the procedures set out in this Agreement."[58] Unless otherwise agreed by the disputing parties, "the Tribunal shall comprise three arbitrators, one arbitrator appointed by each of the disputing parties and the third, who shall be the presiding arbitrator, appointed by agreement of the disputing parties."[59]

While affirming that expropriations could still occur, Article 1110 solidified the position of the United States and other capital-exporting nations by mirroring the language of the model bilateral investment treaties with respect to what constituted a permissible expropriation: "[n]o Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ("expropriation"), except: (a) for a public purpose; (b) on a non-discriminatory basis; (c) in accordance with due process of law and Article 1105(1); and (d) on payment of compensation in accordance with paragraphs 2 through 6."[60] In

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56 C. Tollefson, "Games Without Frontiers: Investor Claims and Citizen Submissions under the NAFTA Regime", *Yale Journal of International Law* 27/2002, 143.

57 H. Siebert, *The World Economy*, Routledge 2007[3], 307.

58 *http://www.nafta-sec-alena.org/en/view.aspx?x=343&mtpiID=142#A1102*, last visited May 1, 2009.

59 *Ibid.* at art. 1123.

60 *Ibid.* at art. 1110. While the language of Article 1110 may not appear all that remarkable at first, it is, as noted by Tali Levy, an important change in Mexico's official position on the subject. "In NAFTA, Mexico has finally accepted what is essentially the 'prompt, adequate and effective' standard of compensation for expropriated foreign properties. Although NAFTA does not specifically mention the words 'prompt,' 'adequate,' or 'effective,' NAFTA's expropriation provision requires compensation on the terms traditionally demanded by the United States. This standard has been asserted by the United States, and refuted by Mexico, since the 1938 exchange of diplomatic notes in response to the Mexican expropriation of U.S.-owned property. The fact that Mexico acceded, some fifty years later, to U.S. terms illustrates changing global economic realities and Mexico's interest in making concessions to attract U.S. investment." T. Levy, "NAFTA's Provision

the event a foreign enterprise believed its rights had been violated in some manner by one of the NAFTA parties, it could, after satisfying the conditions precedent under Article 1121, "submit to arbitration under [Article 1116] a claim that another Party has breached an obligation . . . and that the investor has incurred loss or damage by reason of, or arising out of, that breach."[61]

In the case of *Metalclad Corp. v. United Mexican States*,[62] an American corporation constructing a hazardous waste landfill in the Mexican state of San Luis Potosi put NAFTA's arbitral procedures to the test when it alleged that the Mexican government had unlawfully expropriated its investment.[63] After securing the personal support of the governor of San Luis Potosi and the necessary construction permits from the National Ecological Institute to construct the aforementioned landfill, Metalclad's progress was thwarted when the municipality of Guadalcazar denied it a local construction permit.[64] Choosing to rely "on the apparent acquiescence of government officials," however, Metalclad "continued with the construction of the landfill for five months until Guadalcazar issued a stop-work order, claiming that Metalclad did not have the necessary municipal building permit."[65] Since "federal officials . . . had assured it, prior to the order, that no such municipal construction permit was necessary," Metalclad believed it had the right to proceed with the landfill's construction, but "was ultimately obstructed by state and local officials, as well as demonstrators."[66]

"After attempting to resolve the issue through negotiation, Metalclad filed a claim under NAFTA, alleging that the Mexican government

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for Compensation in the Event of Expropriation: A Reassessment of the 'Prompt, Adequate and Effective' Standard", *Stanford Journal International Law* 31/1995, 424.

61 *See supra* note 58. Claims are prohibited, however, "if more than three years have elapsed from the date on which the investor first acquired, or should have first acquired, knowledge of the alleged breach . . . or damage." *Ibid.*

62 *ICSID Rev.-Foreign Investment Law Journal* 16/2001, 179.

63 B. Olsen, "International Local Government Law: The Effect of NAFTA Chapter 11 on Local Land Use Planning", *Brigham Young University International Law & Management Review* 4/2007, 65. As noted by Olsen, "[t]he *Metalclad* case came under the jurisdiction of NAFTA because COTERIN [a Mexican corporation responsible for actually managing the project] was a subsidiary of Metalclad, a U.S. corporation." *Ibid.*

64 *Ibid.*, 65.

65 *Ibid.*, 66.

66 *Ibid.* While the casual observer might argue that Metalclad's business posture and its decision to continue with the landfill's construction could appear to have been unjustified in light of the municipality of Guadalcazar's opposition and repeated denials of the "necessary" paperwork, Metalclad's position does not appear to have been entirely without support since "[t]he [federal] officials dismissed the order of the municipality and reassured Metalclad that it had all the necessary permits to go forward on its landfill project." *Ibid.*

had unlawfully expropriated its investment."[67] At the heart of its argument was the assertion that, by prohibiting it from completing the landfill and thereby depriving it of the benefit of its operation, the Mexican government had "taken a measure tantamount to expropriation," so that compensation was due under Article 1110.[68] After hearing the contentions presented by both sides, the arbitral tribunal agreed with Metalclad's position and "opined that expropriation under Article 1110 includes not only an 'outright seizure' of property, but also 'covert or incidental interference with the use of property.'"[69] In a significant decision for capital investors, Metalclad—a private economic entity—was awarded an enforceable judgment against a sovereign nation which was obtained without having to resort to endless litigation in either the Mexican courts or those of the United States.[70]

Although *Metalclad* is but one of the many cases which could be cited for the principle that states have some implicit duty to compensate foreign investors when an expropriation has occurred,[71] its true significance comes from the recognition that multilateral investment treaties can offer an effective mechanism for dispute resolution which would ordinarily be unavailable to private parties.[72] With the political fortunes of capital-importing states shifting during the decolonization era to a position of relative national strength vis-à-vis foreign investors—as opposed to their positions of relative weakness and exploitation under the colonial system—the potential for legitimate foreign investments to be harmed through populist redistributions took on a risk which was historically less likely to have occurred. Rather than being entirely at the mercy of the expropriating nation, however, investor-state arbitration proceedings offered investors a viable way to ensure that their claims had a fair chance of being equitably considered.

67 *Ibid.*

68 *Ibid.* Under American law, this action would have been appropriately categorized as a regulatory taking. *Ibid.*, 65.

69 *Ibid.*, 66. This is an admittedly simplified account of the *Metalclad* decision, but it is the form of the resolution rather than its particular factual substance that is of greatest interest in the immediate instance.

70 It should be noted that "[t]he *Metalclad* tribunal's decision was partially set aside by the British Columbia Supreme Court in Canada, which has jurisdiction to review arbitration decisions when the legal seat of arbitration is in British Columbia. The court rules that the tribunal had improperly imposed a requirement of 'transparency' into Chapter 11 of NAFTA . . . [but] the court did not set aside the tribunal's separate finding that the Ecological Decree was an expropriation." *International Investment Law, Understanding Concepts and Tracking Innovation*, OECD Publishing 2008, 155.

71 Keeping in mind, however, that "[t[here are few if any issues in international law today on which opinion seems to be so divided as the limitations on the state's power to expropriate the property of aliens." Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398, 428 (1964).

72 *See supra* note 45.

4. CRITICS, CRITICISMS, AND REPONSES THERETO

In light of the sweeping changes investment treaty arbitration clauses have made to the relational status of capital investors vis-à-vis their sovereign hosts, it is unsurprising that various interest groups and affected parties would protest what they might regard as an unfavorable shift in the socioeconomic winds. While one may readily concede that investor-state arbitration agreements do not offer the perfect solution to every problem and that—like any traditional form of dispute resolution—the process is not entirely free of error, it is the opinion of this author that, in view of the unique challenges investor-state arbitration provisions were originally designed to solve, it is still the best method for resolving disputes between foreign investors and their host states. As such, this section will address many of the common criticisms which have been leveled against arbitration as a means of international dispute settlement so that one might better understand the controversy surrounding its use and why it is nevertheless the superior means of conflict resolution in the investment context.

Before delving into the specific objections critics have voiced against the investor-state arbitration process, it is important to recognize that all criticisms are not created equal. While some commentators have offered substantive policy recommendations designed to provide practical solutions to investment arbitration's perceived inadequacies,[73] others have resorted to the use of half-truths, factually-unsupported assertions, and politically-charged innuendo to attack a process which they do not view as being legitimate without offering any alternative—let alone superior—solutions. Although this section will examine to an extent the diatribes and misinformation circulated by the latter, it will focus primarily on responding to the substantive policy critiques and commentary offered by the former.

It should also be noted as another analytical caveat that since the earliest days of the industrial era, capital investments have generally been seen as either one of the greatest engines of social progress,[74] or alternatively, as one of the greatest tools of popular oppression.[75] While much can be said about the relative merits of either position, it cannot be denied

[73] For a particularly articulate and well-reasoned examination of the many ways in which investor-state arbitration tribunals could be improved, see Susan D. Franck's "The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions", *Fordham Law Review* 73/2005, 1521.

[74] E.T. Devine, *Economics*, The Macmillan Co., New York 1902, 360 ("The accumulation of capital is essential to social progress").

[75] *Public Opinion and the Steel Strike*, Harcourt, Brace & Co., New York 1921, 290 ("Capital, through oppression, exploitation and high cost of living, is pressing harder than ever upon the rights of men.").

that these political and economic overtones still exist in some form or fashion today.[76] Thus, any critique of the criticisms made against investor-state arbitration agreements or, more abstractly, the juxtaposition of the so-called "moneyed interests" versus "the people,"[77] cannot be divorced from the historical connotations these parties necessarily bring to the table. When combined with the occasional undercurrent of popular xenophobia, such an analysis becomes even more challenging.[78]

While conceding, as mentioned before, that some criticism of investor-state arbitration agreements is entirely well-founded and deserved, a substantial portion of the commentary currently circulating in both academic circles and the popular media consists of nothing more than worst-case scenarios predicated on the irrational and the absurd. In an essay written by Guillermo Aguilar Alvarez and William W. Park, it was noted that a publication sponsored by Ralph Nader's "Public Citizen's Global Trade Watch":

> referred to [a] possible extension of a NAFTA provision permitting "foreign corporations to sue the federal government in secret tribunals, demanding our tax dollars as payment for complying with U.S. health, safety, and pollution laws." The advertisement continued that foreign manufacturers of toxic chemicals could use "private courts" (i.e. arbitration) "to sue U.S. taxpayers . . . if zoning rules kept them from building a chemical plant near a school."[79]

Even though one may shudder to think of the conversations occurring in smoke-filled boardrooms across the world as the directors of foreign corporations plot devious ways to loot the national treasury after they have finished exposing local school children to carcinogenic toxins, the fact remains that under the current formulation of NAFTA's Chapter 11 provisions and similar chapters in most bilateral investment treaties, the aforementioned scenario would likely never happen. Looking to Article 1114:

> (1) Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.

[76] H.J. Walberg, J.L. Bast, *Education and Capitalism*, Hoover Institution Press, Stanford 2003, 128.

[77] J.D. Works, *Man's Duty to Man*, The Neale Publishing Co., New York 1919, 187.

[78] M. Bruno, B. Pleskovic, *Annual World Bank Conference on Development Economics*, World Bank Publications 1996, 278.

[79] G.A. Alvarez, W.W. Park, "The New Face of Investment Arbitration", in *International Commercial Arbitration: Important Contemporary Questions*, Kluwer Law International 2003, 408–09.

> (2) The Parties recognize that it is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures. Accordingly, a Party should not waive or otherwise derogate from . . . such measures as an encouragement for the establishment, acquisition, expansion or retention in its territory of an investment of an investor.[80]

While parents and school children alike may all breathe a collective sigh of relief in the face of NAFTA's Article 1114, this same interest group also released a second report designed to highlight the looming financial threat foreign investors' claims presented to the wallets of North American taxpayers. In *NAFTA Chapter 11 Investor-to-State Cases: Bankrupting Democracy*, it was announced with the utmost solemnity that "[o]f the 15 [arbitration] cases reviewed in this report, the damages claimed by the companies add up to more than U.S. $13 billion."[81] Although this assertion was entirely correct, it should be noted that in a much more subdued follow-up report the actual value of the judgments issued against NAFTA State Parties over the Treaty's fifteen-year history was a humble $69 million—or a grand .53%—of the damages initially sought.[82]

Given that the U.S. Department of Agriculture took a $90 million direct loan write-off for its rural housing insurance fund in the 2006 fiscal year alone,[83] it would appear that fears of runaway arbitration tribunals "bankrupting" democracy "with [their] powers to award an unlimited amount of taxpayer dollars to corporations"[84] are somewhat premature. On the contrary, a review of fifty-nine arbitration claims filed under NAFTA's Chapter 11 through January 2009 revealed that only eighteen cases actually made it to the point of arbitration and, of these, only six resulted in awards against NAFTA parties.[85] Thus, rather than serving as "private courts" designed to funnel copious sums of money to foreign corporations, arbitration tribunals have instead ruled *against* the claims of foreign investors by a margin of two to one.[86]

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[80] *See http://www.nafta-sec-alena.org/en/view.aspx?x=343&mtpiID=142#A1114*, last visited May 1, 2009. As stated in Article 1101(4), "[n]othing in this Chapter shall be construed to prevent a Party from . . . performing a function such as . . . social welfare [and . . .] health" in a manner that is not inconsistent with this Chapter. *Ibid.*

[81] *See http://www.citizen.org/documents/ACF186.PDF* at iii, last visited May 1, 2009.

[82] *See http://www.citizen.org/documents/Ch11CasesChart–2009.pdf*, last visited May 1, 2009.

[83] *See http://www.gpoaccess.gov/USbudget/fy08/pdf/spec.pdf* at 94, last visited May 1, 2009.

[84] *http://www.citizen.org/trade/nafta/CH__11/*, last visited May 1, 2009.

[85] *See supra* note 82.

[86] *Ibid.*

This record of practice also holds true in investor-state arbitration proceedings conducted under the auspices of the International Centre for the Settlement of Investment Disputes (ICSID). In a review of ninety cases concluded under the ICSID since January 2000, forty-five of these disputes were settled or otherwise disposed of by the parties, and, of the remaining forty-five in which an award of some type was rendered, a random sample of twenty of these awards indicates that state parties received favorable judgments in sixty-five percent of the decisions—again, a margin approaching a ratio of two to one.[87] Thus, while many nations, developed or developing, could face "billions and billions' of dollars" of claims which could severely impact their national treasuries[88]—even possibly leading to true fears of bankruptcy—the probability of such an award actually being rendered is comparatively small.[89]

Although the record of investor-state arbitrations suggests that critics' fears of tribunals awarding unlimited judgments to investors on the basis of frivolous claims are unsubstantiated or, at a minimum, in need of a significant probabilistic discount,[90] there are still those who criticize arbitration for its procedural nature in addition to its substantive results. In an article appearing in the Vanderbilt Journal of Transnational Law, Professor Barnali Choudhury decried what she regarded as arbitration's contribution to the "democratic deficit."[91] Arguing that "investment treaties have gradually transformed into weapons with which investors can 'attack' the acts of host states," Choudhury concluded that arbitrators "are not accountable to the public and not independent and may, therefore, be viewed publicly as illegitimate."[92]

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87 *See http://icsid.worldbank.org/ICSID/FrontServlet?requestType=GenCaseDtlsRH&actionVal=ListConcluded.*

88 *See* S.D. Franck, "The Nature and Enforcement of Investor Rights under Investment Treaties: Do Investment Treaties Have a Bright Future", *U.C. Davis Journal of International Law & Policy* 12/2005, 49.

89 While certainly unscientific, a statistical analysis of the aforementioned ICSID decisions suggests that the probability of any claim actually resulting in an award against a sovereign is less than eighteen percent.

90 This is not to diminish the economic severity or harsh political impact certain judgments against sovereign parties have had on their public finances, but rather to point out that the likelihood of such devastating awards being rendered for meritless claims is in fact rather small. Although there may be the occasional decision which draws headlines for the sheer size of its award—notably the $355 million judgment awarded against the Czech Republic in 2003 which was equivalent to half its annual healthcare budget—*see* G. van Harten, *Investment Treaty Arbitration and Public Law*, Oxford University Press 2007, 7, the body of evidence as reflected through NAFTA and ICSID decisions suggests that these awards should be considered to be the exception rather than the rule.

91 B. Choudhury, "Recapturing Public Power: Is Investment Arbitration's Engagement of the Public Interest Contributing to the Democratic Deficit?", *Vanderbilt Journal of Transnational Law* 41/2008, 785.

92 *Ibid.*, 782–819.

Ignoring for the moment that—with respect to NAFTA, at least—investment treaty arbitrations have only been used to successfully "'attack' the acts of host states" in six out of fifty-nine instances,[93] Choudhury's larger point about investor-state arbitration tribunals being undemocratic and therefore illegitimate warrants a thorough response. Looking to the belief that "correcting the democratic deficit that investment arbitration creates . . . involves concepts of legitimacy, which requires the inclusion of core democratic values in the investment arbitration process,"[94] this statement glosses over much of the unpleasant history which gave rise to the need for these agreements in the first place. As Corwin notes in his critique of the early legislatures, absent sufficient due process guarantees, "democratic values" often equated to little more than mob rule:

> [they] were prone, during the early years of our constitutional history . . . to [pass] all sorts of "special legislation" so called; that is, enactments setting aside judgments, suspending the general law for the benefit of individuals, interpreting the law for particular cases, and so on and so forth. So long, of course, as there were [foreigners] to attaint of treason this species of legislative activity had some excuse, but hardly was this necessity past than it came into great disrepute even with some of the best friends of democracy, by whom it was denounced not only as oppressive but as not properly within legislative power at all.[95]

In view of the due process protections which have existed in Western legal theory for much of the last three centuries, it is easy to forget that there are many states which do not have longstanding protections for private property rights and which may, in the absence of negotiated investment treaties, take without compensation any foreign investment the majority of the people wish to seize.[96] Thus, before demanding the inclusion of "core democratic values," it must first be established that these values include sufficient due process protections which respect individual rights and the firm rule of law.[97]

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[93] *See supra* note 82.

[94] Choudhury, *supra* note 91, at 807–08 (emphasis added).

[95] E.S. Corwin, "The Doctrine of Due Process of Law before the Civil War", *Harvard Law Review* 24/1911, 375.

[96] *See* Banco Nacional de Cuba v. Sabbatino, *supra* note 71.

[97] Given that most of the uncompensated expropriations of the Twentieth Century were done by ostensibly democratic societies acting in the name of the people, *see supra* notes 33–38, it may well be argued that "core democratic values" are in fact the cause of, rather than the solution to, investor-state arbitration agreements. Thus, it is questionable that injecting *more* democratic elements into the process will necessarily address the reason for arbitration's use. Rather than automatically deferring to the principle that popular "might makes right" as articulated by some philosophical sources, *see* T. Sorell, L. Foisneau, *Leviathan After 350 Years*, Oxford University Press, Oxford 2004, 68, it could be argued that investor-state arbitration instead seeks to pursue the more Lincolnian approach

As for the arguments that "the international arbitration system enjoys a form of undemocratic supremacy"[98] and has "the potential to create significant problems for citizens' basic and most essential rights,"[99] it must not be forgotten that "[f]oreign investment constitutes the single largest source of external financing for developing countries [and a]ccordingly, *developing countries have sought ways to encourage* this form of financing from foreign investors."[100] Unlike Quesada's raid on the Tunjan chiefs or the days of slave-driven profits being repatriated by absentee plantation owners, it must be recognized that host states today make the conscious choice to enter into bilateral or multilateral investment treaties and that, before the first investor-state arbitration claim can ever be brought, state officials must negotiate the terms of the agreement, debate the merits of its provisions, and then choose to accept whatever terms they ultimately deem to be satisfactory.[101]

Consequently, although the citizens of Guadalcazar might complain that their interests were not properly consulted in deciding whether to arbitrate the *Metalclad* case, their complaint should not go against the investor-state arbitration tribunal, but rather against their federal government which determined after a substantial amount of negotiation and democratic debate that investor-state arbitration agreements were in the national interests of the Mexican people. By arguing that a system using "unelected and unappointed arbitrators is not consistent with basic principles of democracy,"[102] critics who ascribe to this view ignore the reality

of "right makes might." *See* F.D. Tandy, *An Anthology of the Epigrams and Sayings of Abraham Lincoln*, Francis D. Tandy Co., New York 1908, 4.

[98] Choudhury, *supra* note 91, at 789.

[99] *Ibid.*, 803.

[100] *Ibid.*, 779–80 (emphasis added).

[101] "[W]hen NAFTA was being negotiated, . . . [t]he business community's long-standing hesitation toward foreign litigation made it vital to bolster confidence that investors would receive a 'fair shake' in the event of controversy with the host government. . . . For Mexico to accept arbitration of investment disputes within its borders, Canada and the United States had to respect a similar dispute resolution process." Park, *supra* note 45, at 329. Although it may be argued that, rather than being the product of serious bargaining, bilateral investment treaties bear a closer resemblance to "take it or leave it" contracts of adhesion, *see* K.P. Sauvant, *Appeals Mechanism in International Investment Disputes*, Oxford University Press, Oxford 2008, 19, state parties seeking to impose unreasonable terms must be careful, lest their own treaty provisions be used against them. As noted by Alvarez and Park, "[a]s the first Chapter 11 cases were filed *against the United States and Canada*, voices began to be heard saying that investment arbitration infringes national prerogatives," the same national prerogatives, of course, which citizens in developing nations had traditionally asserted as being violated by Western claims. Alvarez & Park, *supra* note 79, at 408.

[102] One wonders what is meant by the use of the phrase "unappointed arbitrators" since, by the very framework of the investor-state arbitration process, the host state gets to appoint an arbitrator of its choosing. *See supra* note 59.

that many democratically-elected governments willfully choose to enter into such settlement regimes.

This premise that investor-state arbitration tribunals are somehow illegitimate because local governments lack the power to pass judgment on the merits of the decision is a recurring theme throughout many critics' opposition. As articulated by Andrew Shapren, "[s]uch a practice greatly undermines local control as not only is the tribunal deciding issues of local concern, but those affected cannot even represent their own interests."[103] This contention ignores, however, the fact that citizens and municipal governments have routinely been denied "local control" in matters affecting national treaty responsibilities. In *Asakura v. City of Seattle*, the U.S. Supreme Court unanimously reversed the Washington Supreme Court's ruling that the City of Seattle could pass an ordinance making it unlawful for noncitizens to operate pawnshops.[104] Finding that the ordinance in question violated the Treaty of Commerce and Navigation between the United States and the Empire of Japan,[105] the Court held:

> A treaty made under the authority of the United States 'shall be the supreme law of the land; and the judges in every state shall be bound thereby,' . . . The treaty was made to strengthen friendly relations between the two nations. . . . The rule of equality established by it cannot be rendered nugatory in any part of the United States by municipal ordinances or state laws. It stands on the same footing of supremacy as do the provisions of the Constitution and laws of the United States.[106]

Thus, to the extent local governments might lose the ability to pass certain regulations because an investment treaty mandates a different result, questions of democratic legitimacy should hardly be implicated since, under Article VI of the U.S. Constitution and, for illustrative purposes, Article 133 of the Mexican Constitution, treaties generally become

[103] A.J. Shapren, "NAFTA Chapter 11: A Step Forward in International Trade Law or a Step Backward for Democracy?", *Temple International & Comparative Law Journal* 17/2003, 348. While the instances of local parties having a chance to directly raise issues impacting their interests to arbitration tribunals are certainly few and far between, the practice of local organizations filing amicus briefs is not entirely without precedent. In the Glamis Gold matter, an arbitration case filed against the United States relating to certain open-pit mining restrictions passed in the state of California, the Quechan Indian Nation, an indigenous population whose sacred sites were near the area affected by the mining operations, was allowed to file a supplemental amicus brief with the tribunal advising it of the impact the decision would have on their tribal interests. Although it is unclear what, if any, impact this submission might have had on the tribunal's deliberative process, the mere fact that it was considered suggests a possible approach local organizations may take in the future. *See http://www.state.gov/documents/organization/75016.pdf*, last visited May 1, 2009.

[104] 265 U.S. 332 (1924).

[105] *See* 37 Stat. 1504 (Apr. 5, 1911).

[106] 265 U.S. at 341.

the supreme law of the land which trump any local government actions taken to the contrary.[107]

As for the more insidious argument that capital investment treaties and, by association, investor-state arbitration agreements, constitute a form of neocolonialist control over the economies of capital-importing nations, generalized statements demonizing investment protocols as tools of imperialist powers are susceptible to challenge on two key points. First, in viewing the neocolonialist regime as a system designed to foster economic under-development "making former dependencies still poorer,"[108] critics who claim that "economic subservience continued after the end of formal colonial rule because foreign companies maintained their domination in alliance with the new indigenous rulers," forget that, in many instances, foreign companies were the first to be dispossessed of their property in the decolonization process. In post-independence Burma, for instance, "all foreign and private national banks were nationalized on 23 February 1963 under the Nationalization of Banking Business Ordinance"[109] while in the former French West African country of Benin, nationalizations "culminat[ed] in the eventual centralization in state hands of much of the economy."[110] Thus, far from dominating local affairs through "alliance[s] with the new indigenous rulers," many foreign enterprises have instead found themselves to be the immediate targets of the new indigenous rulers.[111]

Secondly, even in states in which foreign investors were able to retain their capital investments and bilateral investment treaties were concluded with the former colony's historical parent, there are other explanations beyond the presence of foreign colonial holdouts which account for the underdeveloped state of their economies. As discussed by Godfrey Mwakikagile in his economic analysis on the subject, "[s]ince 1965, the per capita incomes of southeast Asia grew 11 times faster than those of sub-Saharan Africa. The question is why [there is] such a huge gap in economic performance between the two regions, both of which emerged from colonial rule roughly around the same time during the post-World War II era."[112] While acknowledging the existence of a variety of reasons,

[107] Quoting Article 133 of the Mexican Constitution, "treaties . . . shall be the supreme law of the whole Union." *http://www.gob.mx/wb/egobierno/egob_1917_Mexican_Constitution*, last visited May 1, 2009.

[108] P. Burroughs, A.J. Stockwell, *Managing the Business of Empire*, Frank Cass, Portland 1998, 138.

[109] E. Kaynak et al., *Global Business, Asia-Pacific Dimensions*, Routledge 1989, 356.

[110] J. Markakis, M. Waller, *Military Marxist Regimes in Africa*, Routledge 1986, 137.

[111] *Ibid.*

[112] G. Mwakikagile, *Investment Opportunities and Private Sector Growth in Africa*, Godfrey Mwakikagile 2007, 24.

Mwakikagile continued his analysis with a comparative review of the political models and savings rates of the former Asian and African colonies. With respect to the former, it was noted that the East Asian states, "especially the most successful ones, avoided socialism. . . . Through the decades, socialism proved to be a disastrous failure round the globe, and African countries were among those which suffered the most."[113] As to the issue of personal savings, Mwakikagile noted:

> Savings is another factor which has played a vital role in the rapid economic growth of East Asian nations. Savings are needed to finance new [indigenously owned] factories and [to] provide capital for investments that stimulate economic growth. . . . national savings rates have been much higher in Asia, averaging more than 30 percent of the gross domestic product, than in Africa whose savings rate on average is about only 12 percent. . . . [a]nd many Africans are well aware of the problem. As Professor Samuel Ndomba at the University of Kisangani in Congo stated: "Our problem is that we don't save. When people get a bit of money, they just spend it to buy a beer."[114]

In a further comparison of the divergence of economic fortunes between the former East Asian and African colonies, Mwakikagile also recognized the important role a responsible bureaucratic civil service could play in fostering economic growth. Contrasting resource-poor South Korea with the resource-abundant Democratic Republic of the Congo:

> Congo became one of the poorest countries in the world under the kleptocratic regime of Mobutu. Yet it is potentially one of the world's richest even without a national culture of savings. . . . Back in the 1950's, when this country and several others in Africa were at the same income level as South Korea and while blessed with far more natural resources, it might have seemed reasonable that Africa would soon leave Asia in the dust. Now (resource-poor) South Korea has a per capita income of about $10,000 a year (1997 statistics) and (mineral-rich) Congo stands at $150 per person.[115]

Even though one cannot ignore the fact that certain cultural practices and economic connections to the parent state will continue to remain in force after a colony gains its independence—thus providing some evidentiary support for proponents of neocolonialist theory—it cannot be argued that investment treaties by themselves are singularly responsible for perpetuating the economic conditions many developing nations find themselves in. Prior to gaining independence from Britain, the territories of Singapore and Burma were primarily known for producing agricultural products such as spices in the former[116] and teak in

[113] *Ibid.*, 25.

[114] *Ibid.*, 25–26.

[115] *Ibid.*, 26.

[116] H.N. Ridley, J.B. Carruthers, *Agricultural Bulletin of the Straights and Federated Malay States (Vol. V)*, Government Printing Office, Singapore 1906, 93.

the latter.[117] Today, Singapore—which heavily embraced foreign investment treaties after its independence—exports consumer electronics and pharmaceuticals while enjoying one of the highest standards of living in the world.[118] In contrast, Burma, a state which expropriated many of its early foreign investments and which continues to reject calls for economic reforms, is still primarily exporting teak, and, as of 2007, was tied with Somalia for the title of most corrupt regime in the world.[119]

Consequently, while critics might offer anecdotal evidence of bilateral investment treaties being used to perpetuate colonial patterns of economic exploitation, a review of states which have attained their independence within the last sixty years suggests that localized factors such as the rate of savings, the ideological philosophy of the political system, and a history of past corruption on the part of government officials contribute substantially more in determining whether two countries with the same initial level of resources will experience development or underdevelopment. Thus, while some might argue that former colonies are the target of a disproportionate amount of investment treaties which appear to render them poor and oppressed, one must remember the old adage that correlation does not automatically equal causation.

5. CONCLUSION

Although investor-state arbitration agreements may not constitute a perfect means of international dispute settlement, history has demonstrated the need for impartial adjudicatory systems and, with respect to foreign capital investments which face the risk of national expropriation, it is difficult to envision a dispute resolution regime which is superior in both process and results. As the experiences of foreign investors operating at various times in countries as diverse as the United States, France, Mexico, Russia, Prussia, and Egypt can attest, it is an easy thing for a national government to expropriate a foreign investor's property[120] and a much more difficult thing for a private entity to receive an adequate measure of compensation for it.[121]

To the extent critics of investor-state arbitration agreements attack the process for being a shadowy exercise of power by undemocratic, anti-

[117] The London Chamber of Commerce, *The Chamber of Commerce Journal (Vol. XXVI)*, London 1907, 171.

[118] *https://www.cia.gov/library/publications/the-world-factbook/geos/sn.html*, last visited May 1, 2009.

[119] *http://www.irrawaddy.org/article.php?art_id=8738*, last visited May 1, 2009.

[120] *See supra* notes 29–36.

[121] *See supra* note 43.

government "private courts" operating in the service of foreign corporations, the record of actual practice in the matter suggests that arbitration tribunals have a low degree of tolerance for frivolous claims and—in the rare instances foreign investors are actually awarded a judgment against a state party—the value of these judgments is usually rather small and disappointing.[122] Thus, rather than bankrupting democracy with runaway judgments, the record of investor-state arbitration tribunals suggests instead a relatively clear pattern of economic restraint.[123] Furthermore, critics who attack the arbitration process as being illegitimate due to its "undemocratic" nature forget that these agreements are not created in a vacuum but often emerge from a lengthy and contentious series of negotiations and debates orchestrated by state officials and elected national legislatures.[124]

Given the challenges capital investors face in attempting to litigate their claims in either their domestic courts or the courts of their host states, along with the fact that it would be exceedingly rare—and generally undesirable—to find a modern-day Dutch East India Company which would have the power to openly resist a host state's move to expropriate its property, investor-state arbitration agreements serve a useful purpose by providing an adjudicatory forum "more neutral than host country courts" that both parties can trust.[125] As suggested by Terrence Corcoran, investor-state arbitration agreements are valuable tools of international commerce since they can protect capital investors "from arbitrary regulation, abusive bureaucracies, banana-republic laws, and back-room protectionism—all the stuff that passes for good government" in many parts of the developing world.[126]

By forcing investors to forgo the investor-state arbitration process on account of concerns of perceived democratic illegitimacy, neocolonialist ambitions, or other unsavory historical connotations, capital-importing regimes may find themselves needlessly losing valuable investment opportunities which could have enhanced the lives of their citizens and the health of their overall economies. Investor-state arbitration agreements may not be perfect, but given the historical events which produced the need for them, they nevertheless serve a critically-important role in international commerce which should not be derogated on account of ill-conceived majoritarian fears or unsubstantiated economic rumors. Rather than viewing investment treaties as a means of extorting wealth from a

[122] *See supra* note 82.

[123] *Ibid.*

[124] *See supra* note 101.

[125] *See supra* note 47.

[126] T. Corcoran, "Chapter 11: It Works", *National Post*, Apr. 11, 2000, at 1, LEXIS, News Group File.

native population à la Gonzalo Quesada, host states should instead view the process as a means of obtaining a lower overall cost of capital in exchange for providing foreign investors with the assurance that, in the event of a dispute, their claims will be adjudicated by impartial third parties beholden to neither side's exclusive interest.