How Do Host States Respond to Investment Treaty Law?: Some Empirical Observations

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Abstract

The proliferation of international investment treaty practice and the subsequent boom of investor-state arbitration have prompted an explosion of scholarly contributions analysing various aspects of this steadily expanding field of international law. Existing scholarship offers a rich seam of doctrinal, normative and theoretical critique of the evolving international investment law regime. However, with the exception of some recent studies, there have been relatively limited efforts to analyse international investment law empirically and in particular from a developing country perspective. This paper aims to contribute by filling the gap and offering some insights into the currently underexplored issue of how international investment law influences host state behaviour. In particular, the aim of this study is to test existing claims about the transformative impact of international investment law on national governance in developing states. The analysis is carried out through a small-scale empirical case-study which focuses on how international investment law is perceived by government officials in developing countries whilst also elucidating how governments responded to investment treaty disciplines after experiencing the regime's bite.

Keywords: investment arbitration, investor-state dispute settlement, investment treaties, good governance, developing countries

1. Introduction

The proliferation of international investment treaty practice and the subsequent boom of investor-state arbitration have prompted an explosion of scholarly contributions analysing various aspects of this steadily expanding field of international law. Existing scholarship offers a rich seam of doctrinal, normative and theoretical critique of the evolving international investment law regime. However, with the exception of some notable contributions recently, there have been relatively limited efforts to analyse international investment law empirically and particularly from a developing country perspective.[1] This paper aims to contribute to the existing literature by offering some insights into the currently underexplored issue of how international investment law influences host state behaviour. In particular, the aim of this study is to test existing claims about the transformative impact of international investment law on national governance in developing states. The analysis is carried out through a small-scale empirical case-study which focuses on how international investment law is perceived by government officials in developing countries whilst also elucidating how governments responded to investment treaty disciplines after experiencing the regime's bite.

The paper seeks to examine assumptions that underpin one particular argument recurring in the existing literature which posits that investment treaty law has a positive impact on governance in host states. As the past two decades witnessed a rise in the number of investment arbitrations against host states, including against less-developed economies, with tribunals granting investors significant sums in damages awards, it has been argued that investment arbitration 'must fulfil *some* useful societal function'[2] – something beyond just allowing investors to recover their losses. As if to provide an additional justification for the regime (and to deflect criticisms targeting the regime's effectiveness and legitimacy), a growing number of scholars have claimed that are necessary and desirable not just to ensure effective protection of foreign investors but also to promote host state compliance with the rule of law and good governance precepts. It has been argued that '...investment treaties aim at binding States into a legal framework that gives them an

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[1] Some of the notable recent studies adopting an empirical lens include Lauge N. Skovgaard Poulsen and Emma Aisbett, 'When the Claims Hit: Bilateral Investment Treaties and Bounded Rational Learning,' (2013) 65 World Politics 273-313; Lauge N. Skovgaard Poulsen, *Bounded Rationality and Economic Diplomacy: The Politics of Investment Treaties in Developing Countries* (Cambridge University Press 2015); Jonathan Bonnitcha, *Substantive Protection under Investment Treaties: A Legal and Economic Analysis* (Cambridge University Press 2014); Christine Côté, *A chilling effect? The impact of international investment agreements on national regulatory autonomy in the areas of health, safety and the environment.* PhD thesis, The London School of Economics and Political Science (LSE, 2014); Jason Webb Yackee, 'Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence' Va J Intl L 51 (2010-2011) 397; Susan D. Franck, 'Development and Outcomes of Investment Treaty Arbitration'" (2009) 50 Harv J Intl L 435; KP Sauvant and LE Sachs *(eds) The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows*' (OUP, 2009).

[2] Thomas Schultz and Cedric G. Dupont, 'Investment Arbitration: Promoting the Rule of Law or Over-Empowering Investors? A Quantitative Empirical Study', available at http://ssrn.com/abstract=2399179, 2.

incentive and a yardstick for transforming their legal systems into ones that are conducive to market-based investment activities and provide the institutions necessary for the functioning of such markets.'[3] Even though designed to benefit foreign investors, international investment protection standards arguably may create a "spill over" effect that benefits national citizens and residents as the host country gradually develops better administrative practices to comply with international investment best practices.[4] Thus, because good governance norms enshrined in investment treaty standards have 'intrinsic worth' that would 'justify the existence of BITs, even if BITs are unsuccessful in achieving their instrumental, economic objectives.'[5]

The claim of improved domestic governance is undergirded by a set of assumptions relating to how states should respond to investment treaty disciplines. It presupposes a deterrent effect of investment treaty law on future government behaviour: in addition to being deterred from mistreating foreign investors host states would also be induced into taking positive steps to change their legal and bureaucratic practices. For a deterrent effect to exist, however, government actors in host states would need to be aware of the existence of investment treaties (and concerned about the possibility of the being required to compensate foreign investors).[6] If host states are to be encouraged to adjust their legal orders and to ensure compliance with good governance standards prescribed by investment treaties, government officials ought to understand the scope and meaning of investment protection guarantees under existing bilateral and multilateral agreements. The question is: to what extent are government officials actually aware of and influenced by investment treaty disciplines in making their decisions?

While a comprehensive answer to this question necessitates a large- scale empirical investigation across a large number of states signatories to investment treaties, this paper suggests that insights from small-scale case-studies can be illuminating and useful in testing the existing assumptions about the objectives and effects of investment treaty law. The selected countries (Turkey, Uzbekistan and Nigeria) (1) have a number of investment

[3] Stephan Schill, *The Multilateralization of International Investment Law* (CUP 2009), 377.

[4] Roberto Echandi, "What Do Developing Countries Expect from the International Investment Regime?" in *The Evolving International Investment Regime: Expectations, Realities, Options,* ed. Jose E. Alvarez et al. (Oxford: Oxford University Press, 2011), 13.

[5] See Bonnitcha (n 1) 43.

[6] ibid 118, see also S Frank, 'The Legitimacy Crisis in Investment Treaty Arbitration: Privatising Public International Law Through Inconsistent Decisions' (2005) 73 Fordham L Rev 1521,1592.

treaties; and (2) have been exposed to investment arbitration on a number of occasions. According to the UNCTAD IIAs database, Turkey currently has 69 BITs in force, of which 14 were ratified after first high-profile arbitration claims were brought against the country by *PSEG Global* and *Libananco Holdings* respectively.[7] In *PSEG Global*, Turkey was required to pay the claimant investor compensation in the amount of USD 9,061,479.34. The total cost of the arbitration was USD 20,851,636.62, with Turkey held responsible for the payment of 65 percent of the sum.[8] In *Libananco*, Turkey's expenses amounted to USD 35,702,417.76, with the tribunal ordering the claimant investor to pay USD 602,500, as well as a proportion of the Turkeys legal fees and out of pocket expenses in the sum of USD 15,000,000. Between 2004 and 2014, the government of Turkey was involved in 8 ICSID arbitrations.[9] Uzbekistan has 46 BITs in force, of which 4 were signed and ratified after first investment claims against the country had been initiated in *Newmont* and *Romak* cases.[10] Between 2006 and 2014, the country was involved in 8 investment arbitration disputes. Although no damages awards have so far been issued against Uzbekistan, in defending its interests in *Metal-Tech*, the government incurred arbitration costs in the amount of USD 7,985,954.95,[11] and its share of costs in Romak totalled EUR 293,462.27.[12] Nigeria is currently a signatory to 28 Bilateral Investment Treaties (BITs) of which, 13 are in force.[13] Nigeria is also signed up to 9 Other Investment Agreements (IIAs) of which 7 are currently in force, and 21 Investment Related Instruments (IRAs).[14] With regards to exposure to investment arbitration, Nigeria has been

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[7] *PSEG Global Inc and Konya Ilgin Elektrik Üretim ve Ticaret Ltd Širketi v Turkey*, Award and Annex, 19 January 2007 (Case No ARB/02/5); *Libananco Holdings Co. Limited v. Republic of Turkey*, Award, 2 September 2011 (ICSID Case No. ARB/06/8).

[8] UNCTAD, *Best Practices in Investment for Development. How to prevent and manage investor-State disputes: Lessons from Peru*, Investment Advisory Series, Series B, number 10 (United Nations 2011) 8

[9] The statistics is available from the ICSID at <<https://icsid.worldbank.org/apps/ICSIDWEB/cases/Pages/AdvancedSearch.aspx?rntly=ST152>>.

[10] See *Newmont USA Limited and Newmont (Uzbekistan) Limited v. Republic of Uzbekistan* (ICSID Case No. ARB/06/20) (settlement agreed between the parties on 25 July 2007); *Romak S.A (Switzerland) v Republic of Uzbekistan*, Decision 26 November 2009 (PCA Case No. AA280).

[11] *Metal-Tech Ltd. v. Republic of Uzbekistan,* Award, 4 October 2013 (ICSID Case No. ARB/10/3) para 414

[12] *Romak* (n10) para 252

[13] The statistics is available from the ICSID at:< http://investmentpolicyhub.unctad.org/IIA/CountryBits/153> accessed 15 April 2015. For a comprehensive break down of the composition of investment protection clauses in Nigeria's BITs, see generally Global Arbitration Review (12 November 2014), available at: <http://globalarbitrationreview.com/know-how/topics/66/jurisdictions/18/nigeria/ accessed 16 April 2015.

[14] Ibid.

party to three investment claims brought before the ICSID arbitration.[15] In Shell Nigeria Ultra Deep Limited v Federal Republic of Nigeria, the sums an investor sought to recover reportedly exceeded USD 5.2 billion.[16] *In Interocean Oil Development Company and Interocean Oil Exploration Company v. Federal Republic of Nigeria*, the investment claim against Nigeria (if successful) could potentially be in the range of USD 650,000,000. While its exposure to investor claims has been comparatively limited, Nigeria is likely to have incurred considerable financial costs to engage external counsel to defend its position before arbitration panels.[17]

The case studies comprised semi-structured qualitative interviews (28 respondents in total) which were conducted among government officials working in the ministries and agencies that have had involvement in investment treaty making and dispute settlement, as well as government officers who interact with foreign investors outside the context of investment treaty law and dispute settlement, i.e. in making, implementing and otherwise applying national laws in domestic, not international, settings. The interviews were conducted during the period 2013-2015, using a snowball sampling method whereby some of the initially approached respondents referred us onto other respondents. Despite its limitations, this strategy allowed accessing government officials to whom the authors would have otherwise been unable to reach out. In designing this study, the authors have been conscious of the need to disentangle two distinct but interrelated issues: (1) the extent of awareness of investment treaty law and (2) the ways in which investment treaty law is internalised leading to changes in government behaviour. Hence, the findings relating to each of these questions will be presented and discussed separately.

2. The extent of awareness of investment treaty law among government officials

[15] Guadalupe Gas Products Corporation v Nigeria (ICSID Case No. ARB/78/1) was discontinued on 22 July 1980 with settlement agreed by parties; Shell Nigeria Ultra Deep Limited v Federal Republic of Nigeria (ICSID Case No. ARB/07/18) was discontinued on 1 August 2011; Interocean Oil Development Company and Interocean Oil Exploration Company v. Federal Republic of Nigeria (ICSID Case No. ARB/13/20) is currently ongoing.

[16] See Innocent Anaba and Ikechukwu Nnochiri 'Court voids two arbitration awards worth N840bn against NNPC' Vangaurd Newspapers available at: <http://www.vanguardngr.com/2012/04/court-voids-two-arbitration-awards-worth-n840bn-against-nnpc/#sthash.84SqQflw.dpuf> accessed 25 April 2015, and Paul Idornigie, Investment Treaty Arbitration and Emerging Markets: Issues, prospects and challenges (Abuja: Nigerian Institute of Advanced Legal Studies, 2011) 15.

[17] Unlike Turkey and Uzbekistan, there are no publicly available figures to indicate the financial costs incurred by Nigeria in defending itself before arbitration panels. However, the average cost for legal representation according to statistics from Allen and Overy may total approximately USD 4,559,000.00. See <http://www.allenovery.com/publications/en-gb/Pages/Investment-Treaty-Arbitration-How-much-does-it-cost-How-long-does-it-take-.aspx> accessed 27 April 2015.

Even before the emergence of empirical scholarship on international investment law and policymaking, it was argued that decision-makers—particularly those in administrative agencies of developing states—who do not have direct or regular dealings with foreign investors are unlikely to be aware of international investment agreements and their prescriptions.[18] As a consequence, such decision-makers are unlikely 'to internalise the constraints of investment treaty protections'[19] not only when evaluating the adoption of new governmental measures but also in exercising their day-to-day decision-making powers vis-à-vis foreign investors. This argument is partially corroborated by our case-studies. The interviews showed that the first exposure to investment arbitration claims entailed a spike in the level of awareness of investment treaty law among government officials who were directly involved in regulating and implementing foreign investment projects (e.g. ministries of energy, economic development, justice and foreign affairs). In Turkey, 5 out of 10 respondents linked their awareness of investment treaty law with the first large scale and well-publicised arbitration claim made against the country. Of these respondents, 4 have been directly or indirectly involved in the process of defending the government in that particular investment arbitration. In the Nigerian case-study, only 1 of the 7 respondents interviewed was aware of any investment treaties and investor-state arbitration. This awareness can be explained by the fact that *Shell Nigeria Ultra Deep Limited v Federal Republic of Nigeria* led to a parallel dispute in the Nigerian courts, instigated by the agency where the respondent worked.

At the same time, the case-studies show a lack of awareness of investment treaty law among officials in lower tiers of government and among the judiciary. The case-studies suggest that, even after the respective governments became exposed to a number of investment treaty arbitrations, many government officials in the executive and judicial organs have remained unaware of both the very existence of investment treaty law and of the fact that their acts or omissions affecting foreign investors may lead to investment arbitration claims. This finding is interesting because the interviewees had dealings with foreign investors in an executive, legislative or judicial capacity. For example, in one of the countries

[18] J Coe and N Rubins, 'Regulatory Expropriation and the *Tecmed* Case: Context and Contributions' in T Weiler, (ed) *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law* (Cameron May 2005) 599.

[19] Bonnitcha (n 5) 122.

under examination, 4 out of 5 respondents from the judiciary (regional and Supreme Court judges) were surprised to learn that a foreign investor's dispute with a government body may lead to investor-state arbitration under investment treaties. This was despite the fact that all of the respondents had an extensive experience of adjudicating claims involving a foreign investor, either in the form of a joint venture or a foreign-owned enterprise. Likewise, in a study conducted in the second country, 3 respondents from executive agencies (dealing with energy and capital markets) showed no prior knowledge of investment treaties. The majority of the respondents concurred in a belief that the lack of awareness about investment treaties and their implications could be explained by the fact that national law is the law routinely invoked and applied in their daily activities, and international law is very rarely if at all invoked before national government agencies. One respondent revealed that investment treaties and the arbitration mechanism would usually be regarded as a last resort; hence their limited relevance (and limited awareness about their existence) to government officials who deal with foreign investors.

These findings offer interesting insights. First, they resonate with recent empirical investigations into patterns of investment treaty-making in a number of developing countries which revealed that all surveyed officials, including stakeholders, 'had been unaware of the far-reaching scope and implications of BITs during the 1990s, when the treaties proliferated.'[20] Furthermore, even despite the information about investment treaties and their liability implications being available, decision makers in many developing countries tended to ignore the experience of other countries and neglected to take investment treaties seriously until their first exposure to an investment arbitration claim in a respondent capacity. Our case-study confirms that some learning did indeed take place after the respective countries were first hit by investment treaty claims. However, it also shows that learning has occurred predominantly among those who were involved, directly or indirectly, in the process of responding to investment treaty claims. Officials in other tiers of the government showed very limited or no awareness of investment treaties even after the respective countries had to defend itself in investment arbitration on more than one occasion. Recent statistical analyses of ICSID caseload show that the majority of government decisions that lead to investor-state arbitrations are associated with actions taken by the executive branch and that, beyond ministries, it was conduct of subnational actors such as provincial, state and municipal

[20] Poulsen and Aisbett (n 1) 281-2.

authorities and agencies that eventually led to investment disputes.[21] If government officials involved in making executive and judicial decisions vis-à-vis investors are unaware of investment treaty law and its prescriptions even after the country has had to defend itself in a number of investment arbitration cases, it becomes very difficult to agree with the argument that such arbitration would lead to changes in governance practices and culture within these agencies.

3.1. How are investment treaty prescriptions internalised?

In order for investment treaty law to bring about change of a positive nature (improved governance) or a negative one (a regulatory chill) , government officials in host states should be not only aware of investment treaty prescriptions and the implications of non-compliance but also prepared to take measures to avoid sanctions that non-compliance may entail. Both those who claim the investment treaty regime to have a transformative impact on national governance and those who are concerned about the regime's capacity to discourage national regulators from pursuing various public policy objectives assume that host state would respond to investment treaties in a certain way. With the exception of some recent contributions, these narratives are not borne out by empirical evidence. Our case-studies suggest that investment treaty law can be internalised by government officials but not necessarily in the way predicted by the proponents of the good governance narrative or those predicting a chilling effect of treaties on national regulatory activities. First, in some cases, despite the previous exposure of the host state to investment treaty arbitration claims, government officials chose to ignore the risk of a new claim which their action could entail. One interviewee, for instance, referred to an incident where a high-ranking official disregarded legal advice about the potential risk of investment arbitration on the ground that governmental action at issue was "economically significant" and thus more important. Another interviewee mentioned changes being made to the duration of tax holidays (the so-called pioneer status) provided to foreign investors. He stated that many investors had been incorrectly given a 5 year tax holiday when the law actually provided for a 3 year first term

[21] Jeremy Caddel and Nathan M. Jensen, 'Which host country government actors are most involved in disputes with foreign investors?' Columbia FDI Perspectives No. 120 April 28, 2014, available at <<http://ccsi.columbia.edu/files/2013/10/No-120-Caddel-and-Jensen-FINAL-WEBSITE-version.pdf>>.

renewable to a maximum of 5 years in total. He stated that due to austerity measures brought about by dwindling revenue from crude oil, the government is looking to review these pioneer status terms irrespective of the fact that a change in the application of the policy may lead to investor-state disputes. In the respondent's view, the government is ready to disregard any potential fallout because the economic significance of the change to the policy outweighs the potential risk of investment arbitration.

It appears that even though, as some scholars have suggested, the country may scale back its investment treaty policy after experiencing their bite[22], the existence of investment treaties may not necessarily influence government decision-making vis-a-vis a concrete foreign investment project even after the country had been exposed to investment arbitration. Secondly, two interviewees from one of the countries under examination pointed to a lack of coordination as a factor that may shape considerably the way in which host states respond to investment treaty disciplines. They recounted a situation where the government proceeded with a ratification of an investment treaty without a proper legal screening, despite having been earlier exposed to a number of high-profile investment arbitration claims which in turn offered an opportunity to reflect on the content of investment treaties. This suggests that, due to various factors, the awareness of investment treaties and of their implications does not necessarily lead to internalisation in the sense of a more coordinated and risk-averse government behaviour.

In another case, two respondents recounted an informal guidance issued by a ministerial body instructing government officials to prevent the inclusion of arbitration clauses in agreements involving foreign investors (although it was not clear whether the guidance concerned investment contracts or investment treaties). An analysis of applicable national laws of Uzbekistan, also reveals the government's attempt to retrospectively limit the scope of certain legal guarantees extended to foreign investors after it became clear how those provisions could be deployed in international arbitration against the government. One such attempt was made in 2006 when following a number of claims brought against the state by foreign investors[23] the central ministerial body initiated proceedings in a constitutional court

[22] Poulsen and Aisbett (n 1) 282.

[23] The decision of the Constitutional Court does not specify which foreign investor claims prompted a request for the interpretation of the relevant provisions in national law. The existing data on investment arbitration claims brought against Uzbekistan suggests that the request for interpretation might have been the consequence of arbitral proceedings initiated in PCA Case No. AA280 between Romak S.A. (Switzerland) Claimant and the Republic of Uzbekistan Newmont USA Limited And Newmont (Uzbekistan) Limited v. Republic of Uzbekistan

requesting an interpretation of a dispute settlement provision in the law which provided for investors access to arbitration.[24] The contentious provision was a replica of a dispute settlement clause contained in many traditional investment treaties. It stipulated that a dispute, directly or indirectly relating to foreign investment, shall be settled through consultation; should the parties fail to reach settlement, such a dispute should be resolved by a competent court *or* through arbitration in accordance with rules and procedures of international agreements on settlement of investment disputes. The constitutional court held that certain investors "mistakenly construed" provisions contained in Article 10, in particular the provision concerning the settlement of an investment dispute by means of arbitration in accordance with rules and procedures of international agreements (treaties and conventions) on the settlement of such disputes, as an expression of state consent to refer the dispute to the ICSID in line with the Washington Convention. Having acknowledged that generally recognised principles of international law take precedence over national laws, the constitutional court stressed the supremacy of the national constitution and pointed to a provision therein which vested the competent state courts with jurisdiction over the adjudication of disputes between business actors and state administration organs. It concluded that the contentious provision only listed the options of resolving investment disputes available to investors and did not as such contain the state's express consent to either of the stipulated options. Thus, the provision could not be relied upon as an expression of consent to ICSID arbitration and express and written consent to arbitration ought to be obtained in each individual case.[25] Despite having resorted to constitutional review in an attempt to restrain the existing avenues through which claimants could initiate investor-state arbitration, the government did not amend the relevant provisions in either the national statutes or its subsequent investment treaties. In 2013, the Ministry of Justice announced that amendments would be made to the said law to clarify that it did not offer a free-standing consent to arbitration.[26] However, although a number of amendments were made in the law in question in 2014, the provisions on dispute settlement remained intact.

(ICSID Case No. ARB/06/20).

[24] Decision of the Constitutional Court of the Republic of Uzbekistan "On interpretation of part 1 of Article 10 of the Law of the Republic of Uzbekistan on Guarantees and Measures of Protection of Foreign Investor Rights", translated by the author; a version in Russian is available at << http://www.lex.uz/pages/getpage.aspx?lact_id=1267669>>.

[25] Ibid

[26] Tatiana Minaeva, 'Uzbekistan: Planned Reforms to Foreign Investment Law', Global Arbitration Review, 20 July 2013, http://www.shlegal.com/Asp/uploadedFiles/File/Newsletters/2013_newsletters/06_13/07_13_Global_Arbitration_Review.pdf

A similar incidence of the government contesting the meaning of guarantees contained in its national legislation can be found in Interocean Oil Development Company and Interocean Oil Exploration Company v. Federal Republic of Nigeria.[27] Nigeria filed a preliminary objection arguing that the provision of s. 26 of the NIPC Act (its principal national legislation on investment protection) does not provide a basis for finding consent to ICSID arbitration on the part of Nigeria, as it merely provides that disputes should be conducted in accordance with the ICSID Rules (see para 19 of Panel Decision). The arbitral tribunal disagreed with this interpretation. It held that the relevant provisions in Sections 26(2) and 26(3) of the NIPC Act clearly made a standing written offer to arbitrate to anyone with a claim under the Act.[28] However, in contrast with Uzbekistan, no clear attempt was made by Nigerian government to amend the relevant provisions of national legislation. Although the data obtained through this case study is limited, the interviews and statutory analysis reveal no concrete plans to translate the learning into concrete domestic governance reforms. So far, Nigerian government and the judiciary appear to have resisted the application of investment treaties, including through contesting the existence of prior state consent to arbitration before investment tribunals and invoking exclusive jurisdiction of national courts over disputed matters.[29]

The case-studies above tends to suggest that, even if a host state learns about investment treaty law and its implications after having to defend itself in investor-state arbitration, its response may not necessarily conform to what is predicted by the proponents of the good governance and those debating the possibility of a regulatory chill. Rather than pointing to a positive, transformative effect on national governance or a chilling effect of investment treaty law on national regulatory activities, the interviews show the respective government's ambivalence about investment arbitration. They also suggest that in some cases the governments ignore and act contrary to legal advice on the implications of investment treaty law, which in turn belies an assumption that the exposure to investment treaty disciplines would make states more risk-averse. Despite having accumulated a certain learning experience, a host state may continue to neglect the possible repercussions of its actions under investment treaty law.

It is noteworthy that Uzbekistan did not change its stance on investment arbitration, despite

[27] ICSID Case No. ARB/13/20
[28] Ibid, para 147
[29] Innocent Anaba and Ikechukwu Nnochiri 'Court voids two arbitration awards worth N840bn against NNPC' Vangaurd Newspapers available at: <http://www.vanguardngr.com/2012/04/court-voids-two-arbitration-awards-worth-n840bn-against-nnpc/#sthash.84SqQflw.dpuf> accessed 25 April 2015.

expressing an intention to remove the relevant provisions from the national law. In fact, the recently amended text of another statute, the Law on Investments, no longer refers disputes to national courts but instead mandates that they be resolved in accordance with existing legislation, thus making a step towards affirming the guarantee of access to international arbitration which is contained in both national law and investment treaties.[30] Neither has

Turkey made any significant steps towards scaling-back its commitments to investment treaty protection and investment arbitration; this is partly evidenced by the number of treaties it signed and ratified following its first significant experience of defending itself in investment disputes. Nigeria has recently expressed a desire to make sweeping changes to its investment treaty protection regime, but it remains to be seen if this would translate to any actual change to the relevant national laws and bilateral investment arrangements.

Our hypothesis is that the absence of a dramatic backlash against investment treaty law, such as that witnessed among some Latin American states, can be explained by the overall positive experience Turkey, Uzbekistan and Nigeria had in investment arbitration. Two respondents from Turkey pointed to the fact that a number of unmeritorious claims against the country were dismissed, thus leaving the government with an impression that the investment arbitration regime is overall balanced, and hence it would be in Turkey's interests to remain committed to its investment protection promises. One interview also referred to the use of investment arbitration by Turkish investors abroad, which the respondent believed to contribute to the perception of the regime as being useful for Turkey. Although the interviews conducted in Uzbekistan and Nigeria did not produce similar responses, it can be inferred that the fact that no damages or arbitration costs award has so far been rendered against it may have influenced the government's disinclination to change its stance on investment arbitration (even despite its past intentions to do so).

3.2. Internalisation: incorporation of investment treaty prescriptions into national legal framework

[30] Law N 719-I On Investment Activity, 24 December 1998, amended 09 December 2014 , the Russian and Uzbek language versions are available at << http://www.lex.uz/>>.

For investment treaty law to induce host states into embracing good governance standards of investment treaty law, such standards should be internalised – be either directly applicable or incorporated into national statutory material. An overwhelming number of respondents explained the low levels of awareness about investment treaty law by reference to the fact that it is national law that is routinely applied by government agencies with whom foreign investors interact. Although the constitutions of Turkey and Uzbekistan proclaimed supremacy of international law over national law, the interviews suggest that international law is rarely invoked in daily practices of government agencies, particularly at regional and local levels. International investment law was relevant only for government agencies involved in international investment disputes, and as such investment treaty norms were resorted to and invoked after an investment claim had been brought against the state. A number of respondents opined that, although investment treaty rules are not directly applied by many governmental bodies, incorporating investment treaty norms into national laws was not necessary because, as one interviewee put it: 'national laws are good, we just have problems with enforcing them and generally with a legal culture.' This view was shared by a number of interviewees, and raises the question that has long been discussed in law and development literature: to what extent can the incorporation of international good governance standards into national legal frameworks effectively transform national legal cultures?[31] The good governance narratives of investment treaty law do not elaborate on how investment treaty norms are expected to become effectively embedded so as to penetrate the fabric of legal culture in a host state.

In Nigeria, the interviews also indicate that international law is rarely invoked in daily practices of government agencies. However, in the Nigerian case study this is the result of the country operatinga dualist system for implementing international law whereby international and domestic legal commitments exist on entirely separate planes. In accordance with s 12 of the 1999 Constitution, international treaties do not have domestic legal effect until they are incorporated into national law. [32] The Nigerian respondents confirmed that they do not have any engagement with international law, including international investment treaties, unless it is already transposed into national law. They also shared the view expressed by Turkish and

[31] See eg John Hewko, Foreign Direct Investment: Does the Rule of Law Matter? Carnegie Endowment for International Peace Rule of Law Series, Democracy and Rule of Law Project, Working Paper No 26, April 2012, 2.

[32] C23 LFN 2004. The section provides inter alia: 'No treaty between the Federation and any other country shall have the force of law to the extent to which any such treaty has been enacted into law by the National Assembly…' and any such domesticated treaty '…shall not be enacted unless it is ratified by a majority of all the Houses of Assembly in the Federation.'

Uzbek respondents regarding the importance of enforcement of national legal rules (as opposed to the mere existence of relevant rules in the national legislation). In particular, the belief shared by majority of the respondents interviewed so far has been that contractual clauses are the most effective way to regulate investor-state relationships.

3.3. Internalisation: the creation of agencies for monitoring and preventing investment disputes

Another important aspect of internalization of investment treaty prescriptions by host states concerns the legal and institutional frameworks that need to be in place to prevent governmental behavior which may result in investment claims. In theory, holding a host state liable for an investment treaty breach should compel the state to create a governmental agency responsible for detecting, identifying, and controlling risk-increasing activities in which its government agencies and officials may engage.[33] The capacity of the investment treaty regime to induce government officials to respond to investment treaty rules in a certain way will hinge on the targeted government's "monitoring ability".[34] Thus, in order for investment treaty law to have a deterrent and incentivizing effect on national governance practices in a host State, an internal loss-allocation regime should be in place to ensure that monetary losses incurred as a result of damages awards are shifted to a governmental agency which has managerial, supervisory, and budgetary authority and political power over bureaucrats whose activities lead to state liability.[35] For such a mechanism to have not only a preventative but also a transformative effect, two principal and interrelated preconditions are: it should operate (1) to discourage government officials from acting in breach of investment treaty rules; and (2) to embed governance prescriptions of investment treaty law into daily practices of relevant government agencies.

Since investor-state disputes originate in problems which investors encounter in their dealings with host government organs, a monitoring and response mechanism should target

[33] David Cohen, "Regulating Regulators: The Legal Environment of the State," *University of Toronto Law Journal* 40 (1990): 245.

[34] Eric A. Posner and Alan O. Sykes, *Economic Foundations of International Law* (Cambridge, Mass.: Harvard University Press, 2013), 115.

[35] Cohen, *Regulating Regulators*, 213.

all stages of government decision-making.[36] It is essential that 'all levels of government and agencies that interact with foreign investors understand the scope and consequence of the commitments under IIAs and the practical implications for their day-to-day activities.'[37] As observed in the UNCTAD report, 'disputes that reach the stage of arbitration can originate with measures taken by agencies or entities that at times do not have full understanding or knowledge of the commitments undertaken by central governments in IIAs.'[38] Our case-studies support this finding – the awareness of investment treaty law and the standards of governance it imposes on host states are particularly low among government officials in local and regional executive bodies and the judiciary.[39] The first wave of investment disputes did generate the concerns relating to the costs of liability and of defending against investor claims. For instance, in *PSEG Global v Turkey*, the cost of the arbitration, including costs and fees, totalled USD 20,851,636.62, of which Turkey was ordered to pay 65 percent, in addition to USD 9,061,479.34 it had to pay in compensation to the claimant investor.[40] Some countries have realized that no domestic institutional frameworks were in place to detect and solve disputes with investors at early stages, resulting in the general lack of preparedness for investment arbitration.[41] To address these concerns, a number of countries have been reported to be 'proactively implementing policies aimed at preventing international investor-State arbitration, where possible.'[42]

Our case-studies point to a more varied picture. It has emerged from a number of interviews and from analysis of the national legislation of Uzbekistan that, despite its initial encounters with investment treaty law in a respondent capacity, no concrete institutional changes were made in the sense of establishing an internal mechanism of prevention and management of investment disputes. The Ministry of Justice remains responsible for representation of the government interests in investment arbitration, and no special unit or department has been created to prevent and manage investment disputes. Neither have there been any changes to the existing legal framework on the payment of awards and judgments rendered against government organs and/or their officials.[43] As mentioned earlier, analysis of the

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[36] UNCTAD, *Best Practices in Investment for Development. How to prevent and manage investor-State disputes: Lessons from Peru*, Investment Advisory Series, Series B, number 10 (United Nations 2011) 10
[37] Ibid 11
[38] Ibid 12
[39] See above
[40] See above
[41] UNCTAD
[42] UNCTAD, *Best Practices in Investment for Development. How to prevent and manage investor-State disputes: Lessons from Peru*, Investment Advisory Series, Series B, number 10 (United Nations 2011)10.

[43] The Russian language version of the rules governing the payment of judgments and awards of compensation

national statutory material reveals an attempt to change the interpretation of the provisions granting foreign investors access to international arbitration; despite the fact that the government representatives expressed an intention to remove the state consent to arbitration from the law, the subsequent amendments left the relevant provision intact.

In Turkey, in the aftermath of the first wave of investment claims against the government an executive decree No 659 regulating the provision of legal services for government departments put the legal department of Prime Minister's office in charge of defending Turkey's interests in international disputes, including investment arbitration cases.[44] The department may handle the claim by itself or coordinate actions of the government authorities involved in the dispute. The decree does not expressly mention dispute prevention or accountability of government agencies in cases where their actions result in Turkey's international responsibility.

In Nigeria, the principal national legislation relating to investment promotion and protection - the NIPC Act - was introduced in 1995. The legislation outlines the internal response mechanism for dealing with investor-state disputes. The Federal Ministry of Justice is a designated government entity to which arbitration notices against Nigeria ought to be addressed. The Federal Ministry of Justice also manages all international investment arbitration claims against Nigeria. However, the ministry may outsource the defense of its claims to external counsel. Although the national legislation of Nigeria provides for various institutionalised internal dispute resolution and prevention mechanisms within concrete government agencies, there is no single internal loss-allocation and dispute prevention body which would ensure that lessons learnt from Nigeria's involvement in investment arbitration cases are translated into concrete changes in daily practices of relevant government organs and officials.

The interviews, however, revealed a very interesting form of response by Nigerian authorities to its early exposure to investment claims. For example, one of the respondents recounted a situation whereby in signing a concession agreement between a foreign investor and a Nigerian government agency, the federal government insisted that, as a condition for providing a sovereign guarantee for the contract, the government agency concerned should set up a fund which could be used to reimburse the federal authorities in a case if the foreign

for damages caused by government bodies and officials is available at <<www.lex.uz>>.

[44] Law No 659 of 29 September 2011 (the Turkish language version is available at << http://mevzuat.basbakanlik.gov.tr/Metin1.Aspx?MevzuatKod=4.5.659&MevzuatIliski=0&sourceXmlSearch=&Tur=4&Tertip=5&No=659>>.

investor claims to draw on the sovereign guarantee. Although the example refers to what is essentially a commercial transaction between two government agencies, the respondent perceived it is as a form of claw back arrangement aimed at ensuring that the agency signing the investment contract bears the financial costs of any failure to perform under the contract and other financial consequences arising from its dealing with a foreign investor. By making the responsible agency to shoulder fully the monetary consequences of its behavior, the federal government's strategy was seen as an incentive for the relevant government agency to fulfil its obligations under the contract with a foreign investor and to prevent possible investor-state disputes.

The way in which Turkey, Uzbekistan and Nigeria responded to their first encounters with investment arbitration differs from what happened in other developing countries. Of interest here is the response model adopted by Kazakhstan, Uzbekistan's immediate neighbor and the country with which it shares many characteristics, including a similar history of transition and the overhaul of the national legal system following the disintegration of the USSR. In Kazakhstan, the initial exposure to investment arbitration has led to the creation of a department vested with the task of dealing with investor claims. Representing and protecting Kazakhstan's interests in investment disputes are not the only functions of the department; its other objective is to prevent investment disputes. What is interesting is how the notion of prevention is described in the agency's mandate: it comprises legal expertise of investment contracts and international agreements as well as analysis of the matters relating to harmonisation and implementation of international norms into national legislation.[45] This provides a useful example of the impact of international investment law on domestic governance. Beyond the references to dispute prevention and implementation of international norms in the national sphere, there is no evidence of how learning from its involvement in investment arbitration is to be translated into concrete positive change in the legal and bureaucratic environment the shortcomings of which continue to be cited among impediments to doing business in Kazakhstan. At the same time, analysis of developments in the national legislation reveals some evidence of a change towards the improvement of an investment climate. For instance, the most recent amendment to the Law on Investments has created an

[45] The outline of the department's mandate in Russian language is available on the website of the Ministry of Justice of the Republic of Kazakhstan at << http://kapital.kz/details/27535/ne-tolko-zacshicshatsya-no-i-vnimatelnee-chitat-kontrakty.html>>. See also <<http://tengrinews.kz/kazakhstan_news/kazahstan-otstoyal-iski-3-milliarda-dollarov-mejdunarodnyih-arbitrajah-2013-godu-250785/>>

investment ombudsman.[46] One of the principal functions of the ombudsman is to provide a rapid response system for difficulties which foreign investors may encounter in their dealings with various government agencies in Kazakhstan. To perform its coordination task, the ombudsman will bring together officials from the General Prosecutor's office, the Ministries of Oil and Gas, Interior Affairs, Justice, Finance, Economy and Budget Planning, Labour and Social Protection, Emergency Situations and Environmental Protection, the Agency for Countering Economic and Corruption Crime, the National Security Commission, and the Supreme Court. Some of its key responsibilities include (1) solving issues related to rights and interests of foreign investments during implementation of investment projects, (2) mediating settlement of disputes between investors and state authorities, (3) offering support in legal proceedings, (4) where problems cannot be solved under the existing legislation, designing and recommending proposals on the improvement of the legislation to the competent legislative organs of the Republic of Kazakhstan.[47] It is not clear from the official statements accompanying this legal development whether the creation of the ombudsman was linked to concerns emanating from Kazakhstan's experience of acting as a respondent in a number of investment treaty arbitrations. The media briefs suggest that the ombudsman was modelled on the South Korean experience, where the eponymous institution played a central part in the state's investment promotion strategy (as opposed to being designed to prevent investment disputes).[48]

Another noteworthy model of response to investment arbitration is that which Peru adopted after having faced first investment claims and realising that 'the institutional framework required to optimally defend the State in ISDS cases was not in place.'[49] To address this shortcoming, in 2006 Peru adopted Law No 28933, followed by a number of regulatory decrees in 2008 and 2009 that created the International Investment Disputes State Coordination and Response System (hereinafter the Response System).[50] The Response System has brought together the different state agencies that are involved in creating the

[46] See <<http://www.invest.gov.kz/?option=news&itemid=136>>.

[47] See Article 12-1 of the Law № 373-II On Investments, 8 January 2003, as amended 12 June 2014.

[48] See eg << http://trevianinternational.com/kazakhstan-investors-monitor-july-16-2013/>>.

[49] UNCTAD, *Best Practices in Investment for Development. How to prevent and manage investor-State disputes: Lessons from Peru*, Investment Advisory Series, Series B, number 10 (United Nations 2011) 19

[50] ibid 20

international investment legal framework.[51] The three crucial pillars of the system are (1) a direct link enabling investors to register their concerns or investment problems so that they can be addressed before escalating into an investment arbitration dispute;[52] (2) government agencies' obligation to promptly report to the Response System Coordinator any investment disagreement or dispute that may result in an investment arbitration case;[53] (3) the allocation of responsibility for financial costs of Peru's involvement in an investment dispute on the agency that took measures which triggered the dispute.[54] The framework also incorporates a training component to ensure that government agencies at all levels and tiers are aware of Peru's investment obligations and their consequences.

While creating a direct gateway through which investors can register their concerns is designed to 'allow more time to resolve a problem, prepare a case…or facilitate an amicable settlement, or at least… provide the State with more time to prepare a strong and complete case for arbitration',[55] the imposition of ultimate responsibility on the agency involved in the dispute aims to render government bodies accountable for taking measures in violation of Peru's investment treaty commitments.[56] Peru's Response System empowers the coordinator to require the agency whose action resulted in the dispute to bear the costs of the process and of any award against the government. An overarching aim of the policy is to 'serve as a deterrent of measures not compatible with IIAs, and encourage agencies to reach out to the central investment contact point to consult on measures before they are taken or when problems do arise, thereby promoting early detection.'[57]

Peru's model of the response system is notable in that it goes beyond the immediate concerns relating to optimal defense of the state interests in investment arbitration and acknowledges the importance of raising the awareness among, and ensuring accountability of, public officials in different tiers and branches of government. As mentioned earlier, 'one of the challenges of an investor-State dispute prevention and management system is the fact that IIA provisions and commitments apply to all levels of government.'[58]

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[51] UNCTAD, *Best Practices in Investment for Development. How to prevent and manage investor-State disputes: Lessons from Peru*, Investment Advisory Series, Series B, number 10 (United Nations 2011) 22

[52] ibid 25.
[53] ibid 30.

[54] ibid 31.
[55] ibid 30.
[56] ibid 31.
[57] ibid 46.
[58] ibid 11.

A brief comparative assessment of the above models with those of Turkey, Uzbekistan and Nigeria offers some potentially useful insights as well as raising some novel questions. First, contrary to the assumption that an exposure to investment arbitration is likely to lead the host state to set up a mechanism to prevent future disputes, it appears that states can differ significantly in the way they respond to investment treaty disciplines and in particular, to the costs of arbitration and the imposition or threat of monetary liability. Even though Turkey, Uzbekistan and Nigeria incurred significant financial costs in defending themselves in investment arbitration cases,[59] none of the respective countries has translated its 'learning' experience into concrete and meaningful steps towards preventing investment claims and, particularly, towards addressing the causes of investment disputes. One possible explanation for this is that, due to a degree of success with defending their interests, the three countries perceived their experience of investment arbitration to be overall positive and thus did not see any reason to query and address the underlying causes of investment disputes. However, Peru could be said to be in a comparable position with regards to a high proportion of cases where investors failed to succeed in their claims against it; nonetheless, the government of Peru did put in place a mechanism to prevent and manage investment disputes. Other examples of countries which introduced a formal dispute prevention and management system include Colombia which, despite having never faced an investment arbitration claim, nevertheless established a formal legal framework with the aim of reducing the risks of non-compliance with the international commitments it assumed under investment treaties.[60] Thus, the fact that Turkey, Uzbekistan and Nigeria did not create similar dispute prevention mechanisms may not necessarily be attributable to their satisfaction with the outcome of the investment disputes brought against them; a more complex chain of causative events is likely to be in work. One conclusion that can be safely made on the basis of the case-studies is that the imposition and/or threat of monetary sanctions, either in the form of damages awards and/or costs of participation in the arbitral process, do not necessarily entail a positive transformative impact on national governance. Host states do not respond to investment treaty pressures in the same way, and some governments have shown that possible responses may include ambivalence about investment arbitration and a failure to query and the causes of investment disputes and preventing practices that are likely to cause them.

[59] See above fn 8-11 and accompanying text.

[60] USAID/APEC, Investor-State Dispute Prevention Strategies: Selected Case Studies, 2013, available at << http://www.apec.org/Groups/Committee-on-Trade-and-Investment/~/media/Files/Groups/IEG/20130625_IEG-DisputePrevention.pdf >>, 13.

Another possible explanation for the fact that no formal dispute prevention mechanisms were created in Turkey, Uzbekistan and Nigeria may be linked to the role of international organisations, including the providers of technical assistance to developing states. Indeed, a number of interviews in Turkey revealed that an impetus for reform of the national legal environment has originated from the prospect of EU accession. When asked whether investment treaty arbitration is likely to act as a catalyst of domestic reform, the interviewees referred to significant changes that were already being made as part of the process of harmonising Turkish legislation with that of the EU. A brief look at the genesis of the dispute prevention systems adopted in Peru and Colombia also point to external entities such as UNCTAD and the EU.[61] During the first years after the dispute prevention systems were launched, both governments received support from UNCTAD and the EU to organise training of government officials.[62] While is not clear whether the idea for the formal prevention mechanism too came from the external actors, it seems that the availability of capacity-building support frequently plays a decisive role in government decision-making.

The foregoing discussion invites two conclusions. First, the pressure of investment treaty remedies alone is unlikely to act as a sufficient catalyst for the host government to internalize its learning experience into concrete domestic governance reform. Second, the high costs of putting in place dispute prevention and management mechanisms also highlights the fact that the ability of host governments to actively prevent their exposure to international liability by changing domestic governance practices can be severely circumscribed by the very weaknesses in the domestic legal and bureaucratic culture which international investment law allegedly aims to improve. Such weaknesses, including human and institutional capacity as well as financial constraints, may interfere with the host government's ability to create and maintain an effective mechanism for monitoring and prevention of investment disputes. This creates a vicious role in which investment treaty law can play a controversial part: as developing states are held to monetary liability for failing to ensure good governance vis-à-vis foreign investors, financial constraints are unlikely to enable them to pay significant damages awards whilst expending resources on the creation of effective mechanisms for

[61] Ibid 16 (noting the support Colombia received from the EU to implement its dispute prevention strategy); also UNCTAD, *Best Practices in Investment for Development. How to prevent and manage investor-State disputes: Lessons from Peru*, Investment Advisory Series, Series B, number 10 (United Nations 2011) 37.

[62] UNCTAD, *Best Practices in Investment for Development. How to prevent and manage investor-State disputes: Lessons from Peru*, Investment Advisory Series, Series B, number 10 (United Nations 2011) 37-8

prevention and management of investment disputes and thus improving domestic governance.

Conclusion

This paper has attempted to evaluate the causal assumptions about the impact investment treaty law on governance in host states. The intention was to go beyond analysing the formal characteristics of the investment treaty regime and to examine practical experiences of host states and government officials in three developing countries, Turkey, Uzbekistan and Nigeria. Although due to the small scale of the case studies, our findings can be difficult to extrapolate into the broader analysis of investment treaty law's influence on host government behaviour, the aim of this paper was to provide a more nuanced picture of the experiences of developing countries that have been involved in investment treaty-making and investment arbitration. While the findings from the empirical case-studies are used to highlight particular experiences of the host states in which the interviews were undertaken, they expose some of the on-the-ground perceptions and effects that often remain hidden behind purely formal and conceptual analyses.

At the same time, some of the conclusions drawn from our case-studies raise novel questions that may apply to the broader array of states. For instance, the difference in the ways host states have responded to the imposition or threat of international liability under investment treaties and to the financial costs of investment arbitration suggests that the impact of investment treaty law cannot be the same across various regimes, and the deterrent effect of sanctions is likely to be mediated by a variety of endogenous and exogenous factors present in each individual case. One such factor appears to be the host state's capacity to translate its learning from the previous exposure to investment treaty arbitration into concrete changes at a national level. Drawing on the interviews as well as comparative analysis, this paper concludes that financial consequences associated with the host state's involvement in investment arbitration are unlikely to provide a sufficient impetus for embracing a more risk- averse behaviour on the part of government organs and officials; more is needed to embed good governance precepts into the legal culture of the host state. External advisory and financial support appears to have played a significant part in prompting host states to internalise investment treaty prescriptions through training of government officials and the creation of dispute prevention and management mechanisms.