

Proportionality in Investment Dispute Resolution

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Keyword: investment, proportionality principle, fair and equitable treatment.

Abstract: Investment dispute resolution mechanism is an enhancing broadly recently. The concern in this field is appear from the existing of a new model of dispute resolution that was introduced by the European Union which known as the Investment Court System. The question to this new mechanism is whether it apply the same mechanism as the investor state dispute settlement or it made a new resolution by its new system. There are several system that can be apply for resolve investment matter, they are the state to state dispute resolution, the investor state dispute resolution, the international commercial arbitration, and the domestic court mechanism. However, all those system need to apply a principle in order to gain justice, that is the proportionality principle. This article will analyze the proportionality principle in the investment arbitration dispute resolution.

1 INTRODUCTION

Investor- State Dispute Settlement (ISDS) is one of the mechanisms for resolving direct investment (FDI). In this dispute resolution mechanism, the investor who feels that he has been harmed by the host State can sue Host State in question into arbitration. Since the end of 1990, the use of ISDS began to bloom and continue to increase significantly (Jeswald W. Salacuse, 2013). However, this mechanism turned out to contain problems that made Host State become increasingly reluctant with this dispute resolution mechanism.

Firstly, The shortcomings that exist in ISDS have caused a loss of public trust and therefore, an alternative to a more credible dispute resolution mechanism is needed. The problem contained in ISDS show that this dispute resolution mechanism cannot achieve the desired justice and neutrality.

There are some problems within the investor state mechanism. Firstly, the appeal Mechanism. In the existing ISDS mechanism, there are no institutions that have the authority to correct jurisdictional errors and ensure the consistency of the resolution of these disputes, as benefits an appeal institution against judicial decisions. The absence of an appeal process is seen as a harassment of the values of justice and an effective legal system so that this can be seen as setback in the spirit of democracy. The ISDS system currently only has very limited examination of the

decision of ISDS, whose function is only to cancel the decision in question based on limited basics as stated in Article 52 of the ICSID Convention.

Secondly, the Inconsistency of Arbitration Decisions (Inconsistency in Arbitral Decisions). ISDS decisions are considered to have no consistency due to the lack of attachment to rule of precedence, and the adoption of an ad hoc tribunal system that creates separateness between each dispute resolution process. This causes a decision decisions in ISDS are unpredictable and threaten the value of the rule of law. Therefore, the position of the State as Host State which is also a container of public interest is threatened.

Thirdly, Lack of Transparency. The existing ISDS is also considered to have failed in realizing the principle of transparency and openness. Not all ISDS arbitration documents including their decisions can be accessed by the public. This is due to ISDS who is bound by ICSID regulations requiring the consent of both parties to the dispute for the publication of ISDS decisions. However, secrecy is beneficial for the parties to the dispute and because of this, the disputing party's agreement tends to be difficult to obtain so that the ISDS decision can be published.

Those problems raise an issue in international investment dispute settlement on the fundamental principle which have to be implemented during the adjudication process. International rule of law assume

to used in the dispute mechanism, since it will need to consider the gap of the jurisdictions of the parties.

2 INTERNATIONAL INVESTMENT AGREEMENT TO PROTECT

International Investment Agreements (IIAs) has no longer viewed merely as a private or commercial device to protect legitimate expectations of foreign investors. The emergence of rule of law in investment law needs a multi-dimensional and non compartmentalized approach on international investment law. IIA involves the promulgation of public interests issues such as sustainable development, environment, human rights, health, etc, thus it must be viewed as a 'system of governance' instead of merely economic instrument. This also means that the establishment of IIA must be met with the principle of distributive and procedural justice, including the principle of rule of law. The need to protect public interests and the right of state to regulate has become the major key concern of the reconceptualization of IIAs. In fact, the emergence of eco social justice and the revival of calvo doctrine promoting state sovereignty over natural resources has shifted the neo liberalism to protectionism and nationalism paradigm. IIAs are not only about to protect the economic interest of the private parties, but it is also a matter of the state's responsibility to protect the public interest of the local communities. This has led to the legitimacy crisis and global backlash against the existing IIAs.

The establishment of IIA involves the sovereign economic and political power of the states to set a basic legal framework in investment sector. As part of economic governance system, IIA provisions must ensure justice and rule of law for all stakeholders involved in foreign investment regime. The negation of rule of law principle may lead to asymmetric focus on extensive protection of investor's substantive rights at the expense of the protection of public interests. If it is observed from the existing IIAs, there is no explicit provisions as regard to investor's liability. The pro investor bias and open ended standard protection under the existing IIA have led to many investment disputes involving social issues implicated by investment. The expansive protection of foreign investor under the IIA will certainly restrict the regulatory flexibility of the host states. This situation is more compounded by the domination of dispute settlement mechanism through Investor State

Arbitration (ISA). Under the principle of 'arbitration without privity', ISDS (Investor State Dispute Settlement) has been increasingly used to challenge the regulatory systems and policy choices of the host states. Therefore, the reconceptualisation of IIAs is urgently required in order to strike a proportional protection between the investor's legitimate expectation and the host state's right to regulate as regard to the protection of public interests

Firstly, this article will analyse a basic concept of the principle of rule of law and how this principle is approached in international investment law. The divergence conceptions of national and international level of rule of law needs an adoption of transnational rule of law. Secondly, substantive and procedural justice in the establishment of the IIA as the basic attributes of the rule of law will be examined. At the substantive level, the principle of rule of law needs a proportional allocation of rights and liability between the contracting parties in the IIAs. At the procedural level, to what extent the principle of rule of law has been adopted by the arbitral tribunal in conducting arbitral proceedings and the interpretation of investment treaties will be discussed. Based on the principle of rule of law, investment agreements must be viewed as good governance instrument that require the implementation of administrative and constitutional law standards such as proportionality, legal predictability, and transparency.

The principles of justice, fairness, reasonableness, accountability and morality as the basic elements of the rule of law have not been properly approached in the establishment of the very existing IIAs. At a certain point, it is true that investment treaty is urgently required to protect economic interests of foreign investors in the host states in order to restraint abuse of power of the host government. However, this is not merely the case. This view rests on compartmentalized approach to investment law. In this context, investment law is isolated from constitutional justice issues as the basic element of the rule of law. To date, the very existing investment treaties had been considered merely as an economic instrument to boost FDI (Foreign Direct Investment) despite the fact that there is still a debatable issue whether FDI can boost economic welfare of the host states. Investment liberalization has become the major underlying basis of the establishment of investment treaties. Accordingly, investment treaty mostly depends on the protection of foreign investment. This has resulted in the imbalance protection of the interests of investors and the host states leading to the negation of the protection of public interests of the host states.

The principle of justice as the basic attribute of 'rule of law' entails responsibilities and duties with regard to the protection of public interests for the local society. This needs a more transparent proportionality balancing of competing rights and obligations in multilevel judicial protection of fundamental rights across frontiers. According to Sornarajah, both investors and the host states have obligations relating to human rights, environmental norms and the promotion of economic development of the host states. The recognition of the obligation of investors i.e. multinational corporations towards host states and the local communities in which these corporations operate need to be expressly incorporated in the investment treaties. These obligations include: (1) obligation not to interfere in the domestic politics; (2) obligations relating to human rights; (3) liability for violations of environmental norms; (4) the liability to promote economic development. Competing public and private interests in investment treaty can be reconciled and integrated through proportionality principle focusing on 'trade off' of economic and constitutional rights. As regard to the obligation of investors to promote economic development of the host state can be examined from the case of *Joseph C Lemire v Ukraine*¹⁵ in which case the tribunal claimed that economic development should benefit all stakeholders affected by the investment. This demonstrates the rejection of one-sided interpretation in favor of foreign investors by emphasizing that the treaty objectives of promoting economic development by utilizing investor protection as a tool to achieve national objectives. This emergence of explicit exceptions reserving state rights to protect non-economic public interests asserts the urgent for a balanced interpretation by taking into account both state sovereignty and the necessity to protect foreign investment. There must be a balanced between the preferential treatment for the investors and the right of state to regulate for the protection of public interests. This involves the balancing process between the objective of foreign investors and other legitimate public interests. This principle will serve the purpose to determine whether substantive rights provisions under the IIAs can be objectively and reasonably justified and proportional.

The proportionality principle involves 'a trade-off' mechanism which resolves conflicting norms, principles and values. The most basic function of this principle is intended to control and limit the discretionary authority of the host state as a sovereign state. It needs to define the limit of host state's authority to regulate as to what necessary in the public

interest through the exception clauses. The principle of proportionality is also directed to balance the rights and obligations of investors and host states through reasonableness test. This test requires that the protected right or interest must be suitable, necessary and proportionate. The proportionality principle involves three assessment steps. Firstly, it must be determined whether the domestic regulatory measure can be justified in accordance with the public policy exception. Secondly, the relationship between the aim pursued and the measure adopted will be assessed. The measure needs to be 'necessary' to protect a specific public policy objective. This also means that the protection of the interest is not excessive. Thirdly, it has to be assessed whether the effects of a measure are not excessive in relation to the interest affected. The application of the rule of law and the principle of proportionality in the establishment of an international investment agreement is also reflected in an attempt to provide a standard of judicial and legal restrictions on the scope of legal norms contained in clauses in the investment agreement. This is reflected through the efforts to clarify substantive treaty provisions, reaffirm public interests through exceptions/exclusion and the establishment of binding interpretation of the content of the investment agreement. The word 'necessary' illustrates that, the protection of public interest must be construed narrowly.

The following section provides a brief overview of the proliferation of new model reform of international investment agreements. This relates, in particular, to the issue of clarifying the concept of the FET (Fair and Equitable Treatment) and FPS (Full Protection Security), specific provision of the 'right state to regulate' and the idea of establishing a reform on ISDS mechanism, reaffirming public interests through the establishment of general exceptions clause based on the principle of rule of law and proportionality.

2.1 General Exceptions

The open-ended standard protection under the very existing IIAs had restricted the regulatory flexibility of the host states to pursue public interest objectives. The expansion of the protection of legitimate expectations of investors through IIAs has created imbalance that may be detrimental to sustainable development and human rights. As a result, the host states have defended many claims and challenged many awards before the International Centre for Settlement of Investment Dispute (ICSID) annulment committees.²³ The main reason for the disregard by

Investor State Arbitration of the customary law requirement of settling investment disputes in conformity with principles of constitutional justice is the lack of adequate judicial remedies and unequal allocation of rights and duties. An expansive, open ended and one-sided protection in favor of investors in IIAs is an example of the self-interests of host states government in limiting their legal and judicial accountability for the economic welfare of the local communities.

The new modern of IIAs, in particular BIT, provide for a list of general exceptions from the BIT obligations. The adoption of 'general exceptions' in some BITs amongst the developing states is in conformity with economic evolution from traditional capital importing states to capital exporters.²⁴ The host states which want to justify their national policies as BIT consistent and invoke public policy exceptions in one of the BIT provisions. Accordingly, not all of government measures or regulatory takings can be considered as the violation of the legitimate expectation of the investors under the BIT. Any domestic measure, in order to qualify as lawful exceptions under the BIT, needs to comply with the conditions laid down in this provision. In order to justify public policy exception, it has to be measured the relationship/connection between the aim pursued and the measures adopted.

The proportionality principle requires that a regulatory measure must be 'necessary to' protect a specific public policy objective such as public morals, human rights, environment, and public health. The equal protection of public and private interests in IIA reflects the increasing recognition of local communities as legal subjects and democratic owners of international law. The incorporation of public policy exception will justify judicial clarification of indeterminate and open-ended BIT standards of protection in conformity with governmental obligation to protect individual rights. The 'constitutional democracy calls for legal and judicial protection of the constitutional rights of investors, and the legitimate rights of locals or nationals.' This multilevel regulation of investments demonstrates the need for multilevel constitutional safeguards of public interests against abuses of public and private powers at national and international levels. By incorporating public policy exception in the IIAs can contribute to the clarification and strengthening of the legitimacy of constitutional rights and provide a more focus on discretionary government powers with adequate legal and judicial remedies for citizen. It should be bear in mind that the reconciliation of public and private interests must remain consistent

with the principle of rule of law i.e. justice and fairness. Under the proportionality principle, objective justification of public policy exception is not without limit and it is applied narrowly. In other words, the measure applied must confirm to the demand must be legal. This has also been adopted in Article 17 of the A Comprehensive Investment Agreement (ACIA) provides that any measures and policies taken by the host state which are 'necessary to' protect public moral, public order, human and health cannot be considered as the violation of the BIT. This provision is similar to Article 8.9 of the Canada-EU Comprehensive Economic and Trade Agreement (CETA) on investment and regulatory measures. It explicitly preserves the right to regulate and to protect legitimate policy objectives such as public health, safety, environment, public morals, social or consumer protection and the promotion and protection of cultural values. Despite the fact that this provision attempts to preserve the right of state to regulate in foreign investment regime, it also refers to a restrictive interpretation of the exceptions in order to provide a proportional protection. This can be noted from the wording of paragraph (1) of Article 17 which states that: "Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between Member States or their investors where like conditions prevail, or a disguised restriction on investors of any other Member State and their investments". In addition, this narrow approach is also exemplified from the word 'necessary' which shows the elements of the principle of proportionality. This means that only if there were no alternative measures consistent with the investment agreement or less consistent with it, which the host state could reasonably be expected to employ to achieve public policy objective. From these two points, a measure's legality is not only necessary, but it also must be applied equally. In this context, the wording of 'general exceptions' also provides specific guarantee that the regulatory takings/measures will not be taken in an arbitrary or unjustifiable discrimination. Other exceptions in Article 17 of ACIA are subject to the condition that the measure is 'related to' a legitimate public policy objective such as conservation of exhaustible natural resources. Compared to the word 'necessary to', the term 'related to' demonstrates a looser degree connection between the measure and the aim than the stricter necessity test. This term is considered more flexible compared to 'necessary requirement'. In other words, it can either be interpreted extensively or restrictively.³² However, arbitral tribunal tends to

interpret the term 'related to' inconsistently. It refers to either expansive or restrictive interpretation. The term 'essential security interests' is defined by reference to the concept of state necessity under the customary international law. Under the customary international law, security exceptions more likely refer to a minimum standard of protection. Thus, it refers to a restrictive interpretation of the exception. However, this is not always the case. In the absence of express exceptions, it may allow tribunals to consider an unlimited list of legitimate government measures. In order to avoid 'vagueness', ambiguity and inconsistent interpretation of the exception at the first stage, it needs to be clarified and defined in the IIA. This may limit the authoritative power of the tribunal to interpret those terms. The absence of specific definition of the words 'necessary to' or 'related to' may lead to legal uncertainty. Other formulation of IIAs more likely prefers to use the word 'good faith' which basically also refers to a more restrictive interpretation of exceptions. This elaborates that the substantive protection found in treaties must be provided in a manner that is consistent with the rule of law i.e. the principle of proportionality and reasonableness.

This provision is more likely intended to provide greater regulatory flexibility to host states in pursuing the specific legitimate objectives established in the exceptions. The absence of the term 'necessary to' in this provision suggest that the intention of the parties in including an express intention is to provide more regulatory space to the host state to regulate than in the provisions of ACIA. However, the term 'legitimate' in this provision may also refer to restrictive interpretation of policy concern. The scope and application of this provision is crucial for the investors and the host states. Due to the lack of certainty, the interpretation of general exceptions in IIAs raises many interpretative issues. In fact, in the absence of precise definition of the general exceptions, the arbitral tribunal tends to interpret the provision by referring to the excuse necessity under customary international law. From this point of view, it remains questionable and uncertain whether exceptions provision would ensure the protection of public interest of the host state. Restrictive and expansive approaches can be adopted by the tribunal with regard to the interpretation of general exceptions in IIAs.

3 CONCLUSION

The Proportionality in investment dispute resolution is an important aspect to proceed within the investment dispute resolution settlement mechanism. However, the implementation of this principle can be implemented with an exception. Accordingly, 'general exceptions' does not always lead to greater regulatory flexibility of host states in pursuing the specific legitimate objective established in the exceptions. A narrow approach to the general exceptions may provide less policy space to host states. In this case, the tribunal tends to interpret this vague rule in favor of the protection of covered investment as the main objective of BIT. Therefore, it is argued that the public policy exception and the right state to regulate must be incorporated both in the preamble and the body text of the IIA. The interpretation of a treaty comprises both its preamble and the text. This can be noted from Article 31 (2) of the Vienna Convention on the Law of Treaties (VCLT). In addition to this, a joint binding interpretation as regard to the general exception should also clearly incorporated in the agreement, thus it is not solely based on the discretionary power of the arbitral tribunal.

The general exception clause should be framed within the concept of the rule of law. Based on the principle of the rule of law, general exceptions clause must be based on the creation of substantive and procedural justice and fairness. In terms of substantive fairness, the wording of general exceptions shall be formulated narrowly and devoted to the protection of the public interest or public morals which is fundamental and based on the legitimate regulatory framework or policy, not because of political interests. In other words, there must be an exhaustive list of general exceptions. The word 'necessary' in the wording of general exceptions refers to a more restrictive and exhaustive interpretation. By borrowing the method that has been applied by the Appellate body of the WTO, the interpretation of the word 'necessary' requires a process of weighing and balance a series of elements including the essential contribution made by the measure to the policy objective, the fundamental of the public interest protected by the measure and the of the measure to the policy objective, the essential contribution made by the environmental measure to the policy objective and the implication of the measure on international investment.

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