Hard Reset Vs. Soft Reset: Recalibration Of Investment Disciplines Under Free Trade Agreements

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When mapping the present trajectory of investment treaties, common themes include the "rebalancing" or "recalibration" of substantive disciplines, concepts that signal a retreat from the high-water mark of investor protection and a reorientation towards the preservation of regulatory space for host states. Generally, this phenomenon takes two forms: preparation of new model treaties (the prospective approach) and the denunciation of treaties in force (the retrospective approach). Assuming the desirability of change, the prospective and retrospective approaches provide effective tools for the adjustment of substantive disciplines imposed by bilateral investment treaties (BITs). As explained below, however, they may prove less effective in securing the readjustment of substantive disciplines established by investment chapters housed in free trade agreements. Consequently, one must also consider the mechanisms for achieving reorientation of substantive norms within the confines of existing regimes.

When it comes to bilateral investment treaties, recalibration involves a comparatively simple task, which one may compare to the options for managing the decline of an aging sedan: one may cast the unwanted object aside (full stop), replace it immediately, or draft a list of the features desired for future models. By contrast, when it comes to free trade agreements, recalibration of investment chapters involves a more complex task, which one may compare to the options for managing the infirmities of an aging heart or other vital organ: one cannot abandon the object (full stop); immediate replacements may not be available; and the long-term quest for alternatives carries a material risk of failure, including the possibility of rejection by the intended beneficiary.

To illustrate the points just made, one need only refer to the NAFTA's investment chapter. Despite perceived flaws, states parties cannot renounce their investment disciplines without sacrificing interlocking compromises on trade in goods, trade in services, intellectual property, government procurement, and technical standards. Likewise, states parties cannot revisit the scope of investment disciplines without also reopening negotiations on all topics addressed by the NAFTA's twenty-two chapters, the corresponding annexes, and the exceptions negotiated by states parties in 1993—an unappealing venture fraught with the risk of failure. Given the strong disincentives to initiating change that might trigger such cascading effects, the NAFTA's investment chapter has remained stable, and states parties will likely remain unreceptive to "rebalancing" or "recalibration" in the form of denunciation or renegotiation.

However, just as organs may benefit from non-invasive therapies, the NAFTA's investment chapter may profit from mechanisms designed to facilitate course correction without risky intervention by states parties. In this regard, one may observe that the decentralized character and inconsistent

results of arbitration by a series of unrelated tribunals (often cited as flaws) supply the flexibility required to make u-turns from undesirable trends.

For example, after the pro-investor triad of Metalclad, S.D. Myers, and Pope & Talbot, which threw the NAFTA parties into a near state of panic, a different trinity emerged. First, in 2003, the Loewen tribunal admonished arbitrators not to display "too great a readiness to step from outside into the domestic arena" and not to impose liability even for serious "local error[s]." Later, in 2005, the Methanex tribunal operationalized the principle by declaring that non-discriminatory regulations enacted for public purposes in accordance with due process fall outside the scope of expropriation. Most recently, in 2009, the Glamis award transported the international minimum standard of treatment eight decades into the past, holding that NAFTA Article 1105 only prohibits the sort "egregious," "outrageous" or "shocking" government acts condemned by the Neer tribunal in 1926. Together, Loewen, Methanex, and Glamis represent a decisive shift in emphasis towards the preservation of regulatory space for host states. They also track many of the recalibrations adopted by Canadian and U.S. model investment treaties.

Although the new trinity clearly signals the development of a trend, it remains to be seen whether its momentum will build or will dissipate in the face of resistance. For example, although the Loewen award might reflect the prevailing mood of states parties, it drew criticism from many observers, who viewed the decision as a retrograde step in the protection of investment and a second denial of justice for the particular investor. Similarly, while the Methanex award may reflect the current disposition of states parties, it too has drawn criticism from observers, who have viewed the decision as: (1) exaggerating the clarity of the dividing line between regulations and expropriations under international law, (2) conflicting with or extending the decisions of tribunals in previous awards, and (3) exceeding the scope of regulatory space preserved by recent model treaties.

Likewise, the Glamis award may coincide with the desire of states parties to discourage the creative tendencies of tribunals by shifting their mandate from treaty interpretation towards the rigorous factual inquiry demanded by assessment of state practice under customary international law. However, the Glamis award remains open to criticism for declining to recognize any evolution in the minimum standard of treatment since 1928, despite the fundamental transformations of international law in the post-war era. These include the proliferation of investment treaties (which signal a universal commitment to robust protection of foreign investment even if they do not signal agreement on the precise definition of standards). The transformations also include the specific phrasing of NAFTA Article 1105 and similar treaties, which recognize that the international minimum standard positively guarantees "fair and equitable treatment" and, thus, represents an improvement over the prohibition against "egregious," "outrageous," and "shocking government" conduct.

The Glamis award may also conform to the preference of states parties to set obligations at the lowest common denominator by defining "fair and equitable treatment" in terms of a uniform international minimum, or "absolute bottom," that does not vary with the character or capacities of host states. However, this view arguably conflicts with international jurisprudence recognizing that other minimum standards (such as the prohibition against cruel, inhuman, or degrading treatment and punishment) often vary with factual context, including the personal characteristics of relevant actors. Thus, one need not apply minimum standards as rigid and uniform rules that exhaust the creative functions of international tribunals. To the contrary, they may preserve the flexibility required for adaptation to the circumstances of particular disputes.

Given the criticisms leveled at recent awards, it seems possible that the tide could turn against Loewen, Methanex, and Glamis. However, that is the point: while adjudicative recalibration by single-instance tribunals remains a tool for course correction even under free trade agreements, that only establishes the possibility for a soft reset. Because a hard reset remains beyond reach, the continuation or reversal of trends depends on the views of arbitrators in subsequent cases. Under these circumstances, disputing parties have even more incentives to exercise care in the selection of arbitrators for disputes under free trade agreements.

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