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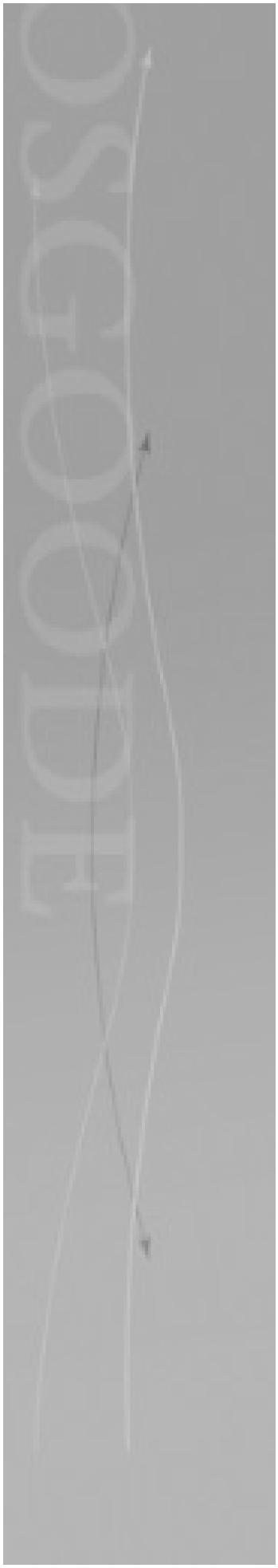
INVESTMENT RULES AND THE DENIAL OF CHANGE

Gus Van Harten



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Abstract: The article reviews Constitutionalizing Economic Globalization by David Schneiderman. In the book, Schneiderman examines the relationships between international investment rules and constitutional principles of liberal democracy and identifies how arbitrators have interpreted investment treaties in ways that take constitutionalist notions of limited government beyond their domestic trajectories and that promote versions of the 'rule of law' with a distinctly neo-liberal bent. Ironically, this portrayal of investment arbitration as an institutional hammer of neo-liberalism that is just now hitting its nails coincides with a resurgent Keynesianism and renewed regulation at the domestic level, making the investment-rules regime's claims to detachment from politics and government look all the more disingenuous or naïve. My main criticism of the book is that its claim of 'constitutionalization' is open to doubt given that (1) the treaties can be abrogated, (2) the treaties lack the normative power of domestic constitutions, and (3) investment arbitration lacks integral components of a liberal constitutional structure including institutional safeguards of judicial independence. Nevertheless, Schneiderman offers powerful insights on the capacity for alternative visions and resistance. It is also refreshing, in an age of too much talk about globalization, to see Schneiderman focus on national governments and their power to undo that which has been done.

Keywords: investment law, international arbitration, constitutionalization, neoliberalism, self-determination

JEL Classification: K30, K33

A review of David Schneiderman, *Constitutionalizing Economic Globalization: Investment Rules and Democracy's Promise* (Cambridge: Cambridge University Press, 2008). Draft review article forthcoming in *University of Toronto Law Journal* (2010).

Gus Van Harten,
Osgoode Hall Law School, York University, Toronto,
gvanharten@osgoode.yorku.ca

Investment Rules and Denial of Change

Gus Van Harten*

The rules regime established by investment treaties is complex and opaque. Yet it has generated controversy across countries and continents. People have protested and sometimes died, not only to resist harm they foresee to their lives and communities from foreign investment but also to respond to the arcane processes of investment treaties themselves. Many local organizations have focused their sights on investment arbitration because of its role as a key forum in which decisions of great importance to their constituencies are made. Arbitration has supplanted other decision makers in matters of high public policy and has, in turn, found itself mired in the politics of conflicts involving communities, governments, and international business. The politics of this environment for decision making, in turn, appear to be deeply mistrusted, even derided, by many arbitrators and advocates of investment arbitration.

David Schneiderman's *Constitutionalizing Economic Globalization* draws on constitutional theory to survey this field of controversy. Schneiderman's orientation emphasizes both the political importance and the practical benefits of democratic pluralism. The book is rich in its study of the relationships between international investment rules and the constitutional principles of liberal democracy. A central theme is that those who manage the investment-rules system, especially the arbitrators and their surrounding 'band of elites' (160), have taken investment treaties well beyond conventional notions of limited government in the interests of a rather stark, neo-liberal vision of society and markets. Schneiderman explores how the neo-liberal program, in turn, has re-entered the domestic sphere through the real or imagined power of investment law. Although the impact of this re-entry may not be determinative of policy decisions in the wider context of domestic politics, Schneiderman argues that investment treaties have, nonetheless, removed important options for pluralist self-government. He expresses a highly aspirational yet constructive aim: 'Rather than instituting a transnational system for uniform economic governance, any transnational regime should encourage innovation, experimentation, and the capacity to imagine alternative futures for managing the relationship between politics and markets' (8).

The potency of the investment-rules regime compared to other international adjudicative systems stems from the ability of investors (usually transnational firms) to sue governments and from the corresponding power of arbitrators to award investors public compensation for the negative consequences of regulatory activity. Investor claims are decided by tripartite

* Gus Van Harten, Osgoode Hall Law School, York University, Toronto, gvanharten@osgoode.yorku.ca

arbitration tribunals, one member of which is appointed by the investor, another by the respondent state, and the third, a presiding arbitrator, by agreement of the parties (or party-appointed arbitrators) or by a default appointing authority such as the president of the World Bank. Arbitrators adjudicate claims based on broad standards that regulate states by prohibiting 'expropriation' or 'deprivation' of investor assets, by prescribing 'fair and equitable treatment' or 'full protection and security' for investors, and by obligating 'no less favourable' state treatment of foreign business relative to its domestic counterparts. If a tribunal interprets and applies these standards so as to find a breach of the treaty, it may order the state to pay damages to the investor. The award can then be enforced against the state's assets in other countries, although states have generally paid awards without obliging investors to pursue enforcement abroad.

Much of this may sound benign from a domestic viewpoint, especially one that champions the role of courts in protecting individuals from the state, until one considers the sheer novelty of the investment-law regime, its openness to investors and not to others whose interests are affected by foreign investment and its regulation, and the anomalous delegation to arbitrators (rather than judges) of the power to discipline legislatures, courts, and administrations without serious oversight by a domestic or international court. These novel institutional features of the system are not the thrust of Schneiderman's critique, however. He focuses not on investment arbitration as a system of adjudication but rather on the rules regime as a system of government and, in particular, on its suppression of previously available avenues for democratic choice and regulatory adaptation.

Schneiderman begins by examining the legal and ideological underpinnings of international investment rules. He studies how key concepts under the treaties, especially the concept of expropriation, originate in domestic constitutions, especially that of the United States. In elaborating on this, Schneiderman provides an excellent survey in chapter 2 of US case law on the Fifth Amendment safeguards against takings of property. For instance, he connects expansive readings of 'indirect expropriation' by investment tribunals to US Supreme Court Justice Scalia's move toward the 'sole effect' doctrine in US takings law and away from the predominant alternative 'that considers public interest objectives under the rubric of proportionality analysis' (72). The discussion here is thorough and elucidating. I found that it assisted me to break down clearly the doctrinal fault lines that have opened among investment-treaty awards on the issue of indirect expropriation.

Schneiderman's review of case law focuses on the United States mainly because his review of investment awards focuses on those involving the three NAFTA states and, more broadly, on the implications of NAFTA for Mexico and Canada. On the other hand, Schneiderman shows how other constitutions – such as those of Dicey's Great Britain, Weimar Germany, and twentieth-century Latin American states – adopted different orientations to property rights, inspired, for instance, by Léon Duguit's view of the state and property as institutions justified by

the social function they perform (cited at 165). Schneiderman also makes clear that the investment-rules regime is not simply inspired by US notions of takings but has served as a vehicle for ratcheting up the disciplinary impacts of international review and the corresponding protections and privileges enjoyed by international business.

A richly informative feature of the book is its review in chapters 3 and 4 of case studies examining the impact of investment rules on governments. Schneiderman pursues two angles. The first is a review of cases involving apparent 'regulatory chill'; that is, apparent deterrence of regulation in the face of investor claims or threatened claims. The second is an analysis of how public initiatives may contravene the investment rules. On the first, Schneiderman recalls the theme of US constitutionalism by tracing the language of regulatory chill to US free speech doctrine (70), although the spread of this terminology might simply be a factor of investment arbitration under NAFTA drawing public attention at an earlier stage than has arbitration under other investment treaties. He cautions that reliable conclusions about regulatory chill call for 'a detailed investigation into the workings and practices of one or more of the NAFTA national or sub-national governments in order to determine whether there has been regulatory chill in certain branches of government' (70). Although Schneiderman does not aspire to this level of empirical scrutiny, he establishes a powerful preliminary case in his discussion of the impact of NAFTA threats or claims on Canadian efforts to require plain packaging of cigarettes (120–9) and to ban a gasoline additive on precautionary grounds (129–34), both for well-founded public health reasons. He reviews also, though less extensively, the abandoning of a provincial proposal for public auto insurance in Canada (70–1). These case studies are dealt with at a very good level of detail and with sharp attention to context.

A key message of the book is that the impact of investment treaties on governments depends on the discretionary choices of arbitrators. Schneiderman examines early NAFTA cases in which tribunals opted for highly expansive approaches to various disciplines. His condemnation of *Metalclad*[1] is powerful, focusing on the tribunal's failure even to mention local concerns about dumping of hazardous waste in the relevant region of Mexico and its further strategy of interpreting away the authority of Mexican municipalities to refuse building permits for environmental reasons (82–6). *Metalclad*, and other early NAFTA awards, are critiqued extensively to demonstrate how tribunals have actively exacerbated concerns about regulatory chill while also exciting prospective future claimants and their counsel. That said, Schneiderman does not go further and examine the later wave of NAFTA cases, including, for instance, *Loewen*,[2] *ADF*,[3] and *Methanex*,[4] that adopt a moderated position in the balancing of investor interests against regulatory concerns. He also does not address the apparent irony that the numerous awards that have dismissed claims against the United States have tended to adopt

[1] *Metalclad Corporation v. United Mexican States* (Merits) (30 August 2000), 16 I.C.S.I.D. Rev. 168, 40 I.L.M. 36, 5 I.C.S.I.D. Rep. 212, (2001) 13:1 World Trade and Arb. Mat. 45.

[2] *Loewen Group, Inc. and Raymond L. Loewen v. United States of America* (Merits) (26 June 2003), 42 I.L.M. 811, 7 I.C.S.I.D. Rep. 442, (2003) 15:5 World Trade and Arb. Mat. 97.

[3] *ADF Group Inc. v. United States of America* (Merits) (9 January 2003), 18 I.C.S.I.D. Rev. 195, 6 I.C.S.I.D. Rep. 470, (2003) 15:3 World Trade and Arb. Mat. 55.

[4] *Methanex Corporation v. United States of America* (Merits) (3 August 2005), 44 I.L.M. 1345, (2005) 17:6 World Trade and Arb. Mat. 61.

much softer approaches to the investment rules than do other awards, even though the US constitution is supposed to be, for Schneiderman, the regime's guiding star.

In chapters 5 and 6, Schneiderman reviews another set of cases studies, from South Africa and Colombia for the most part, in order to examine conflicts between investment rules and domestic policy choices involving land reform or social redistribution. In chapter 5, he provides an outstanding review of the political history of black economic empowerment (BEE) legislation in South Africa and its consequent triggering of an investor claim against South Africa. Schneiderman reviews how the legislation was originally approached by the South African government with great caution and concludes that 'broad-based BEE, in sum, is designed to offend, as little as possible, foreign investors and the legal regime for their protection. It is, for the most part, a measured and modest attempt at reversing the apartheid-era project of economic inequality' (154). Even so, two Italian companies brought a treaty claim against South Africa to resist one of the few remaining teeth in the legislation, its requirements for divestment in the mining sector. Schneiderman examines this claim by a careful assessment of how the language of the BEE legislation appears to violate investment treaties, especially their prohibitions on discrimination against foreign investors. It is a troubling account of the apparent collision between investor interests and social reform in circumstances where the redress of past injustice does not occur by great leaps forward but rather in baby steps. For Schneiderman, the case study reveals how 'South Africa's internal policy options will have been shaped by the external environment for the promotion and protection of foreign investment' (157). As to what this says about the pre-eminence of investor interests, Schneiderman concludes glumly that 'state projects, like broad-based BEE, likely will serve as weak vehicles for economic redistribution in a country rife with inequality, while narrowing the available range of preferred policy options' (157). Broadly, alongside his other case studies on land reform in South African and constitutional reform in Colombia, Schneiderman's research reveals how arbitrators are called on to make governing choices in an adjudicative context.

Throughout many of its chapters, the book identifies how arbitrators have interpreted investment treaties in ways that take constitutionalist notions of limited government beyond their domestic trajectories. With respect to US constitutionalism, in particular, Schneiderman opines that the rules regime is 'modeled on, though more expansive in its protections than, the US constitutional experience' (223). The orientation of tribunals, says Schneiderman, tracks that of some US Supreme Court judges 'who have indicated a willingness to expand the takings rule even beyond its conventional limits, centered around land, to the protection of wealth and future profits uncoupled from specific property rights' (53). The predominant ideology at work here is that of governmental self-restraint and thus it offers a particular view of politics and democracy (9):

Exercises of public power are regarded as untrustworthy. Democracy, like markets, is the locus for competition in which self-interest is paramount. At worst, democracy is perverted by

paternalistic interests of exploiting government.... [T]he state is expected to recede from the market and limits placed on its redistributive capacity.

Likewise, versions of the 'rule of law' – a highly contested concept in constitutionalist discourse, needless to say – that win favour in investment-law circles have a distinctly neo-liberal bent (53). Indeed, the investment-rules regime emerges for Schneiderman as an 'institutional partner' of neo-liberalism (2).

Schneiderman references, for example, the *Oscar Chinn* decision of the Permanent Court of International Justice (73). In 1931, Belgium established a *de facto* monopoly in the Belgian Congo for its state-owned river transport company in order to allow it to survive a severe commercial depression. A competing private company, owned by British national Oscar Chinn, was driven from business. The United Kingdom brought a claim against Belgium on Chinn's behalf before the PCIJ. Today, we would no doubt describe Mr. Chinn as a foreign investor and might well see this claim brought by Chinn or his company before an investment treaty tribunal. Moreover, judging by the reactions of most arbitrators to Argentina's currency reforms in the face of its financial crisis of 2001, Mr. Chinn would likely be awarded substantial compensation for the losses arising from what could be characterized as his indirect expropriation, or perhaps his discriminatory and inequitable treatment, at the hands of the Belgian colonial authorities. Most arbitrators would quickly reject as self-serving any response by Belgium (or Argentina) that the foreign investor's position was characterized by the possession of customers and the possibility of making a profit … Favourable business conditions and goodwill are transient circumstances, subject to inevitable changes … no enterprise – least of all a commercial or transport enterprise, the success of which is dependent on the fluctuating level of prices and rates – can escape from the chances and hazards resulting from general economic conditions … they are all exposed to the danger of ruin or extinction if circumstances change.

Yet this passage comes not from an Argentine brief in 2002 but from the PCIJ's reasons for its decision disposing of Chinn's claim in 1934. Clearly, the PCIJ adopted a flexible approach to state regulation in the face of economic uncertainty, one that contrasts abjectly with recent awards against Argentina (99–101). As Schneiderman argues, there has been a 'decided tilt' in the interpretation of international law to favour foreign investors, courtesy of investment arbitrators, in a departure from both domestic constitutionalism and customary international law.

There are a number of ironies in this. One is that the incorporation of an anti-regulatory reflex into investment law is out of place when one considers the absence of any legislative branch in the system. There is no international parliament to 'dialogue' with investment arbitrators in a manner akin to that of constitutional interactions between Congress and the Supreme Court in the United States. Schneiderman cites Robert Howse's observation that 'there is no democratic escape' from the investment disciplines (cited at 191). One might, therefore, expect investment arbitrators to defer to domestic legislatures more frequently and extensively than would a domestic supreme court. Yet the opposite has clearly occurred in many treaty awards. For this

reason, Schneiderman suggests, 'the whole edifice of investment rules seems … out of balance' (231).

A further irony – and one that has emerged very lately – is that the emerging crisis of neo-liberalism can be seen as an indictment of the aggressive approaches of many tribunals. Now that neo-liberal reforms appear to have blown up the US financial system and undermined the global economy, miring Western states in mountains of public debt, it will be interesting to see whether arbitrators still have the temerity to sacrifice regulatory concerns in the interests of compensation for foreign investors. On the other hand, recent harrowing events in international finance have also revealed that by far the greatest threats to social welfare from neo-liberal ideology – through its unbridling of self-serving behaviour in markets – stem from decisions of domestic governments, not those of international adjudicators. What stands out today is not regulatory chill created by investment treaties but the sheer anachronism of an arbitration system built as the institutional hammer of neo-liberalism and just now hitting its nails at a time of resurgent Keynesianism and renewed regulation. Events since the publication of Schneiderman's work have reaffirmed that corporate investment and international financial flows rest on foundations of state support. What else can one take from recent default nationalizations of the private sector and socialization of the cost of market risks gone wrong? As Schneiderman foreshadows, state capitalism has returned with a vengeance to rescue national economies from failed experiments in financial deregulation. Schneiderman describes constitutional models of 'countries from the South' as envisaging 'a regime of constitutional rules and structures that facilitate the exercise of government power through state building and national enterprise' (158, 223–4). But the description might be applied equally to the US and British constitutions, given their evident flexibility to allow the effective expropriation of (bankrupt) assets of major banks and firms so as to manage their restructuring and protect against repossession by foreign creditors. These events make the investment-rules regime's claims to detachment from politics and government look all the more disingenuous or naïve.

A major strength of Schneiderman's work is its examination of the rules regime in light of deeper controversies about the role of government in the economy. On the other hand, the book's core claim of 'constitutionalization' poses a problem. Schneiderman does not go so far as to say that investment treaties establish a system that is akin to domestic constitutions. He is more circumspect: the regime is 'constitution-like' in its legal restraint of governments in ways that are difficult to alter (4, 180). The system 'resembles the structure' of a domestic bill of rights; it 'replicates patterns' of US constitutional protections (223). More strongly, Schneiderman claims that the regime 'can be understood as an emerging form of supraconstitution that can supersede domestic constitutional norms' (3). Even in its more modest version, however, Schneiderman's case for 'constitutionalization' is open to doubt.

In the first place, Schneiderman does not elaborate what it means for a treaty system to resemble a constitutional structure or replicate constitutional patterns. All treaties put

constraints of varying sorts on states. Do they all resemble or replicate domestic constitutions? Or does resemblance come about only when the treaty regime obtains a particular level or form of obligation or enforcement? What is the threshold for resemblance, as opposed to mere likeness, between a treaty system of international review and a constitutional structure? Should an assessment of whether the line is crossed focus on the breadth or intensity of the legal disciplines, or on the duration of a state's obligations, or on the use of adjudication to review conduct and enforce obligations? The adjudicative structure of investment treaties is, indeed, exceptional from an international perspective, just as its reliance on state liability to discipline legislative activity is extraordinary from a domestic viewpoint. But this says more about the form of constitutionalism that is advanced than about a distinction between constitutional and non-constitutional constraint. One could respond that the system's constitutional significance lies rather in its implications – given, especially, the examples of regulatory chill and policy conflict that Schneiderman documents – but here again, it is difficult to see how investment treaties have impacts beyond those of other international regimes. Investment treaties are difficult to amend, for reasons of interstate relations or investor boycott more than of domestic politics, but so too were the unequal treaties of the nineteenth and early twentieth centuries. And yet the unequal treaties were all abrogated or amended in time.

The invocation of national constitutions to frame the investment-rules regime risks elevating investment treaties beyond their actual significance. Both politically and economically, the investment-rules regime facilitates and directs solidarity among capital-exporting states and major investors while isolating capital-importers. But states can abrogate the treaties. They can breach their obligations and refuse to pay awards. The can condemn the arbitration process as unfair. They can retaliate in various ways against foreign investors who bring claims. What they cannot do is prevent the arbitrators from convening themselves as tribunals or stop other states from recognizing and enforcing the awards. But even so, states can respond by removing their assets from arbitration-friendly jurisdictions while questioning the system's legitimacy overall. In short, they can approach the regime simply as one institutional feature of international politics, no more entitled to legitimacy than any other such feature, whether the United Nations Security Council, the International Monetary Fund, or the World Trade Organization. A core weakness of the constitutionalization rubric, used in many settings of international economic law, is its ignoring of the role of constituent authority in the formation of constitutions. The label is applied to international decision-making processes, usually in an effort to piggyback on the legitimacy of domestic courts and constitutions, although these international processes are 'constitutional' only in the very mechanical sense of an adjudicative process followed by final decision. Schneiderman comments that 'we should not understand the rules and structures of economic globalization as the project of some immanent and idealized transnational consensus' (44); and, as he shows convincingly, the investment-rules regime is but one version of constitutionalism among many alternatives. So why tell people that their governments are bound constitutionally when, in fact, they are not?

The claim that a regime is constitutionalized also seems misplaced where the adjudicative arrangement itself lacks integral components of a liberal constitutional structure, including

institutional safeguards of judicial independence and ongoing opportunities for judicial–legislative interaction. Investment arbitration does not even satisfy the modest institutionalized safeguards for judicial independence that are adopted at international courts. It is more appropriately regarded as an adjudicative arm of international executive agencies at the World Bank, the Permanent Court of Arbitration, and private arbitration centres or chambers of commerce. Thus, even if we limit our understanding of constitutionalism to its juridified and court-centred manifestations, as elaborated, for example, by Alexander Hamilton in the *Federalist Papers* (cited at 10), the investment-rules regime departs fundamentally from the constitutionalist models of Western liberal democracy.

Schneiderman makes a powerful case that the investment-rules regime 'has as its object the placing of legal limits on the authority of government, isolating economic from political power, and assigning to investment interests the highest possible protection' (4). The regime 'freezes existing distributions of wealth and privileges "status quo neutrality"' (37). But does this make the regime constitutional or simply neo-liberal? Perhaps the underlying argument is the latter. The neo-liberal project draws on, or seeks to co-opt, constitutionalist traditions, but it has no monopoly over the use of law and adjudication to enable markets or restrain states (or vice versa). Schneiderman suggests as much in chapter 8 through his discussion of the enabling notion of the 'social rule of law' (207), although he downplays the viability of rule of law–based conceptual alternatives. More important, however, is the point that the regime appears not to involve constitutionalization at all but rather the assertion of one brand of legal constitutionalism through the vehicle of investment arbitration.

In three very insightful chapters at the end of the book, Schneiderman presents various ideas for alternative visions and resistance. In chapter 7, he examines how the regime conceives of citizenship in a global economy. He flags the contradiction between the regime's aims of fixity and predictability for investors, on the one hand, and the wider themes of dislocation and insecurity that are associated with globalization for other actors (185). This leads to Schneiderman's diagnosis that the system is based on 'a version of citizenship with identifiable rights and membership in a particular and privileged community' (187) and on a mythology of the global entrepreneur as the pre-eminent world citizen (188–9). His alternative to this privileging of investors is to reinvigorate an enabling vision of constitutionalism in which 'constitutional design institutionalizes deliberative models that, it is hoped, will result in both fair play and impartial public policy' (11). Schneiderman draws on Karl Polanyi's notion of the 'double movement,' (cited at 76) which Schneiderman describes as 'the ability of society to take self-protective measures with regard to land, labour, and money' (185–6). 'It is this capacity for self-protection,' he argues, 'that is under threat by the constitution-like features of the investment-rules regime' (186); indeed, its removal 'may be catastrophic for many people in the world' (225). Schneiderman recalls the commonwealth period of US constitutionalism prior to the Civil War, in which 'it was considered a reasonable-investment backed expectation that property rights would be limited by the state or its delegates in the interests of national

development' (225–6). Property 'was valued for its "dynamic" rather than its "static" features: property "in motion or at risk" was valued over property merely secure or at rest'; likewise, property law 'had less to do with protecting interests than with promoting ventures' (226). In this way, says Schneiderman,

> The law performed an enabling function, generating a framework for action and the release of private energies. Rather than limiting state capacity, the object of constitutional and statutory law was to 'keep open the channels of change' and to enlarge the 'practical range of options in the face of limiting circumstance' … (228)

I doubt that many of these ideas will reassure foreign investors who have major assets sunk in countries with weak judicial institutions. At their best, for Schneiderman, the investment rules are 'a prophylactic to ethnic and race conflict' (230), but, absent cases of ethnic or racial targeting, investors should look to domestic avenues for redress and to investment insurance to protect against abuse (231–4). Resort should be had to anti-discrimination laws and procedural (but not substantive) rights to participate in decision making (237). What about cases where the mistreatment of a foreign investor is ignored by a domestic court or tribunal or is outside the scope of an insurance policy? Schneiderman does not address this directly. The indirect answer is that the aim is not ultimately to protect investors at all costs but to 'restore the equilibrium between the economy and democracy' (235). This is a powerful answer in a time of climate change, global epidemics, and financial instability. As Schneiderman argues, 'an openness to change, one of the great virtues of democratic society … more than ever is a feature worthy of preservation in this age of economic globalization' (236).

Schneiderman concludes also by emphasizing the role of national governments. He is sceptical of attempts to reassert sub-national citizenship as a basis for effective responses to economic globalization, since sub-national entities are less able than national governments to respond to transnational actors and nonetheless bound by the very same investment disciplines (195). More important is their role as 'discursive sites with which to explore political alternatives' (196). Schneiderman also cautions against grand but unproven aspirations for transnational governance; 'the difficulties of achieving the requisite cosmopolitan consciousness and then securing democratically legitimate transnational-legal forms for citizen participation cannot be understated' (8). For all the talk of constitutions, then, the clearest avenue for legal responses lies in state renegotiation or abrogation of the rules regime. 'States … have the capacity to undo that which is being done' (204) and they should pull back from 'binding pre-commitment strategies' that 'seem out of proportion … to the actual objectives of securing increased FDI' (225). This is a realistic assessment, not just of the system, but of its apparently constitutional features. One who opposes this novel adjudicative regime in favour of established frameworks for democratic choice and regulatory innovation should work towards getting responsible government officials to amend or annul the treaties (or contracts) or to conclude new treaties that establish a more acceptable arrangement for review. This is may be a somewhat banal conclusion for a discussion about the constitutionalization of economic globalization, but it is a very sensible one.