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THE CROSSROADS OF INVESTMENT ARBITRATION

By Susan D. Franck*

International Investment Agreements (IIAs) and associated dispute resolution mechanisms are critical to sustainable global economic development.¹ This paper analyzes investment treaty arbitration (ITA) outcomes and the development status of respondent governments and arbitrators.² Although particularized solutions might usefully address potential problems, the current evidence does not suggest that certain development variables are reliability linked to the outcome of ITAs.

PREVIOUS RESEARCH

Previous research found claimants came primarily from the developed world, namely OECD members or High Income countries, but respondents came from both the developed and developing world.³ Although both governments and investors won cases, governments (57.7%) won more than investors (38.5%). And while the average investor claimed damages of approximately US\$343 million, the average award was around US\$10 million.⁴ In other words, more investors lost than won; and when investors did win, they received less than claimed.

AN OPEN QUESTION

Previous research did not address whether the parties' or arbitrators' development background affected outcome. Given concerns about the legitimacy of ITAs, the issue is critical. If outcome depends upon spurious variables such as a respondent's development status or the development background of an arbitrator's country of origin, this could raise issues about the utility of dispute resolution systems in existing IIAs.

THE RESEARCH

This research used archival data⁵ to assess whether there was a reliable relationship between development status and ITA outcome.⁶

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¹ Susan D. Franck, *Empirically Evaluating Claims about Investment Treaty Arbitration*, 86 N.C. L. REV. 1, 31, nn. 138-39 (2007).

² "Development status" refers to whether a state or its nationals/arbitrators: (1) is a Member or non-member of the Organization for Economic Co-Operation and Development (OECD), (2) High Income, Upper Middle Income, Lower Middle Income, or Low Income using World Bank criteria.

³ Most claimants (89 percent) were OECD Members; one-third of respondents were OECD Members. Using World Bank's classifications, 18 percent of respondent states were "High Income," 45 percent were "Upper Middle Income," 28 percent were "Lower Middle Income" and less than 9 percent were "Low Income." Franck, *Evaluating Claims*, *supra* note 1, at 28-32.

⁴ *Id.* at 49-50, 57-62.

⁵ The data came from eighty-two cases that were publicly available before June 1, 2006. *Id.* at 52. This means that more recent awards against countries like Argentina were not included. *Id.* at 62, n.276.

⁶ Susan D. Franck, *Considering Recalibration of International Investment Agreements: Empirical Insights*, in *THE EVOLVING INTERNATIONAL INVESTMENT REGIME* (Ed. Karl P. Sauvant forthcoming 2010); Susan D. Franck, *Development and Outcomes of Investment Arbitration Awards*, 50 HARV. INT'L L.J. 436 (2009).

One study considered the impact of a respondent's development status on outcome. Various analyses demonstrated that there was no statistically significant relationship between a government's development background and ITA outcome.⁷

Another study considered the relationship among outcome, the developmental status of the respondent state, and the presiding arbitrator's country of origin. These statistical analyses consistently showed that—at the macro level—outcome was not reliably associated with the development status of the respondent, the development status of the presiding arbitrator, or some interaction between those two variables. This held true for both: (1) winning or losing ITAs, and (2) the amounts awarded.⁸

Follow-up pairwise comparisons of the non-significant effects nevertheless revealed two statistically significant micro-effects in one subset of potentially non-representative cases. The data suggested that tribunals with presiding arbitrators from Middle Income countries awarded different damages in cases against High Income countries. If the presiding arbitrator was from a Middle Income country, High Income countries received statistically lower awards than: (1) Upper-Middle Income respondents and (2) Low Income respondents. Awards by Middle Income presiding arbitrators for High Income and Lower-Middle Income respondents were statistically equivalent.⁹

IMPLICATIONS

The data from the research suggested ITA appeared to be functioning reasonably well and, overall, development status was not associate with disparate treatment. That evidence, recognizing the limitations of the data and methods, suggests that radical overhaul, rejection, or rebalancing of procedural rights is not necessarily warranted.

THE CAUTIOUS GOOD NEWS

The results cast doubt on arguments that: (1) ITA is the equivalent of tossing a two-headed coin to decide disputes, (2) the developing world is treated unfairly in ITA, and (3) arbitrators from the developed and developing world decide cases differently. The data suggests a basis for cautious optimism about the integrity of ITA.

THE CROSSROADS: TEMPERING THE INITIAL RESULTS

While the simple effects suggest optimism must be tempered, enacting structural safeguards can nevertheless promote procedural justice, help redress perceived concerns about the fairness of IIA dispute resolution, and foster greater confidence in the IIA system.

Creating targeted solutions to address particularized problems responds to stakeholder concerns about systemic integrity. Targeted legislative reforms to specific IIAs might include: minimizing arbitrator discretion and providing greater guidance about how to award damages; strengthening other dispute resolution mechanisms to maximize party interests in negotiated settlements and avoid arbitration; expanding the pool of arbitrators from the developing world; and enacting structural safeguards, such as an arbitrator database or legal advice center, to provide strategic advice about arbitrator appointment.

⁷ Franck, *Recalibration*, *supra* note 6.

⁸ Franck, *Development*, *supra* note 6.

⁹ *Id.*

CONCLUSION

On the basis of the data, ITA outcomes were not generally affected by the development status of the respondent state or presiding arbitrators. This provides some evidence to support the hypothesis that ITA is not generally applied inappropriately. ITA should strive to interpret and apply standards in IIAs in a reasonable and non-arbitrary manner that involves the neutral application of facts to agreed legal principles. ITA should continue interpreting and applying standards in IIAs in a reasonable and non-arbitrary manner that involves the neutral application of facts to agreed legal principles. Adjudicative outcomes that are not based upon spurious variables foster the certainty, coherence, reliability, and predictability that are central to the rule of law, good governance, and international commercial activity. Those foundations are building blocks that ultimately promote international investment, further economic development, and foster the legitimacy of international law.

MAKING LAWS RULE: THE CASE FOR AN INSTITUTIONAL COMPLIANCE APPROACH*

By Diane F. Frey[†]

The purpose of this paper is to contribute to our understanding of how best to establish respect for international human rights in the area of labor rights. Despite almost universal adoption of international labor rights conventions, there is widespread noncompliance. There are many obstacles to effectively implement labor rights but they are often compartmentalized in the process of debating specific reforms. Some commentators argue that laws must be changed, while others contend that it is the enforcement or interpretation of the laws that is the real problem. This paper argues that we need to look at labor rights protections holistically as “institutions” in order to assess obstacles to compliance. Based on this holistic institutional analysis, the paper presents a methodology for identifying reforms appropriate to promote compliance.

The paper first proposes assessing the implementation of international labor rights as institutions rather than measuring them by proxy or indicator. Borrowing from comparative political economy, the standards in International Labour Organization (ILO) Conventions are contrasted with labor rights institutions or “rules of the game” comprised of rules, norms, and actual behaviors. This allows institutional analysis of the multiple pathways through which laws come to rule or, alternatively, become dead letters. The institutional analysis uncovers: (a) the formal institutions, including rules along with their interpretation and enforcement; (b) interactions between formal and informal institutions, including social norms and conventions, such as corruption and blacklisting; and (c) interactions between institutions in different spheres of social and economic life, such as labor and immigration. Interactions along these three dimensions explain the effectiveness of international human rights laws.

Using this framework, it becomes possible to assess institutional outcomes in terms of their compliance with international law and to identify problems and combinations of problems in implementing international law. There may be rule-based problems in which a written rule

* The institutional compliance approach is set out in greater detail in Diane F. Frey, *An Institutional Approach to Compliance: The Case of Forced Labor in Central America and the Dominican Republic*, 17 *ADVANCES IN INDUSTRIAL AND LABOR RELATIONS* (forthcoming 2009), available at SSRN: <http://ssrn.com/abstract=1364242>.

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