6-15-2009

International Investment Arbitration: Winning Losing and Why

Susan D. Franck
Washington and Lee University School of Law, francks@wlu.edu

VALE COLUMBIA CENTER
ON SUSTAINABLE INTERNATIONAL INVESTMENT
A JOINT CENTER OF COLUMBIA LAW SCHOOL AND
THE EARTH INSTITUTE AT COLUMBIA UNIVERSITY

Columbia FDI Perspectives

Perspectives on topical foreign direct investment issues by
the Vale Columbia Center on Sustainable International Investment
No. 7, June 15, 2009
Editor-in-Chief: Karl P. Sauvant (Karl.Sauvant@law.columbia.edu)
Editor: Lisa Sachs (Lsachs1@law.columbia.edu)

International Investment Arbitration: Winning, Losing and Why

by
Susan D. Franck*

We know several things about foreign investment. First, foreign investment matters, reaching US$1.7 trillion in 2008. Second, we know that foreign investors have new international law rights to protect their economic interests. Third, we know that those rights are now being used.

So since we now know that the international legal risk is not illusory, the real questions are: who wins, who loses and why?

While various commentators have asserted a variety of answers to those questions, many have done so without reference to valid and reliable data.[1] In its most benign form, these observations create misinformation but, perhaps more troublingly, might also lead to policy choices based upon unrepresentative anecdotal evidence, supposition or political rhetoric. To help alleviate these possible outcomes, this *Perspective* reviews recent empirical research[2] in order to provide basic information to fundamental questions about investment treaty arbitration (ITA) to create a more accurate framework for policy choices and dispute-resolution strategies.

---

* Associate Professor of Law, Washington & Lee University School of Law. The author thanks Andrea Bjorklund, Christopher Drahozal, Mark Drumbl, Ian Laird, Clint Peinhardt, Andrea Schneider, Jason Yackee and David Zaring for their comments on an earlier draft. Professor Franck can be contacted at francks@wlu.edu. *Columbia FDI Perspectives* is a peer-reviewed series.

[1] *See, e.g.,* Press Release, Food and Water Watch, World Bank Court Grants Power to Corporations (Apr. 30, 2007), *available at* http:// www.foodandwaterwatch.org/press/releases/world-bank-court-grants-power-to-corporations-article12302007.

[2] *See* Susan D. Franck, *Empirically Evaluating Claims about Investment Treaty Arbitration*, 86 N.C. L. REV. 1, 16-23 (2007) [hereinafter *Evaluating Claims*] (describing the method of gathering data from publicly available arbitration award to identify 102 public awards from 82 disputes that resulted in 52 final determinations); Susan D. Franck, *Development and Outcomes of Investment Arbitration Awards*, 50 HARV. INT'L L.J. (forthcoming 2009), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1406714 [hereinafter *Development and Outcomes*] (conducting chi-square and analyses of variance tests at significance levels of $\alpha = .05$).

So who does win and lose international investment treaty arbitration? The answer is: both foreign investors and host states win and lose.[3] The data suggest, however, that they lose in reasonably equivalent proportions. Not including the disputes that ended with an award embodying a settlement, respondent governments, for example, won approximately 58% of the time. Meanwhile, investors won 39% of the cases.[4]

Winning and losing, however, is not just about whether there is a breach of the underlying investment treaty. The amount awarded is also critical. Despite the fact that investors claimed US$343 million in damages on average, that is not what they received. Rather, tribunals awarded investors only US$10 million on average. This US$333 million difference is not insubstantial, and it may give investors a basis for some reflection about the value of arbitration – particularly given the need to pay the arbitral tribunal and the other legal costs associated with bringing a claim.[5]

Knowing which parties actually win and lose begs a further question – namely: why are parties successful? This question is critical given suggestions that ITA is potentially biased.[6] There has been some debate about whether respondents' development status or whether arbitrators come from the developing world improperly affects outcome. If these development variables cause particular results, this would raise issues about the integrity of investment treaties and arbitration.

To address this critical issue, recent research considered whether there was a reliable statistical link between the level of development and ITA outcomes. The results suggest that development variables did not generally cause particular outcomes. One study found that there was no relationship between a government's level of development and the outcome of ITA.[7]

A second study then showed that – at a general 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 investment treaty arbitration, and (2) amounts tribunals awarded against governments. Follow-up tests in the same study showed, however, that there were two statistically significant effects – found in one sub-set of potentially non-representative cases – that suggest arbitration must be used carefully in certain situations. Only where the presiding arbitrator was from a middle income country, the data showed that high income countries received statistically lower awards than: (1) upper-middle income respondents, and (2) low income respondents. Nevertheless, in other circumstances involving middle income presiding arbitrators or all cases involving presiding arbitrators from high

[3] This Perspective defines "winning" and "losing" using quantitative measures: (a) a binary yes/no answer about whether a government breached a treaty, or (b) a scaled quantitative variable of damages awarded. Qualitative approaches might assess experiences with ITA and measure "success" differently. Subjective approaches could consider how parties, with varying levels of familiarity with ITA, and other situational differences understand success.
[4] Approximately 4% of the cases were settlement agreements. Figures do not add up to 100% due to rounding.
[5] Franck, *Empirically Evaluating Claims*, *supra* note 2 at 49-50, 64.
[6] *See, e.g.,* Third World Network, *Finance: Bias Seen in International Dispute Arbiters*, June 22, 2007 (JUN07/02), *available at* http://www.twnside.org.sg/title2/finance/twninfofinance060702.htm ("A little-known entity closely affiliated with the World Bank that mediates disputes between sovereign nations and foreign investors appears to be skewed toward corporations in Northern countries"); Gus van Harten & Martin Loughlin, *Investment Treaty Arbitration as a Species of Global Administrative Law*, 17 EUR. J. INT'L L 121, 148 (2006) ("No matter how well arbitrators do their job, an award will always be open to an apprehension of an institutional bias against the respondent state").
[7] Susan D. Franck, *Considering Recalibration of International Investment Agreements: Empirical Insights*, *in* José E. Alvarez, Karl P. Sauvant and Kamil Gerard Ahmed, *The Evolving International Investment Regime: Expectations, Realities, Options* (New York: Oxford University Press, forthcoming 2009).

income countries, the amounts awarded were statistically equivalent.[8] In other words, in limited circumstances, tribunals with presiding arbitrators from middle income countries made awards that tended to favor developed countries and were different than one might expect from chance alone.

The overall results cast doubt on the 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 evidence creates a basis for cautious optimism about the integrity of ITA and suggests radical overhaul, rejection or rebalancing of these procedural rights is not necessarily warranted. While the follow-up tests and limitations of the data suggest optimism must be tempered properly, a sensible approach would involve creating targeted solutions to address particularized problems and enacting targeted reforms to redress perceived concerns about the international investment regime.

Ultimately, the data suggest that investors and governments won and lost in relatively equal measure, but governments won a bit more. While the data show also that, when they did win, investors ended up with substantially less than they requested. Moreover, the data do not establish that a respondent's development status was a reason why investors or governments were successful in pursuing arbitration. This suggests that why a party wins or loses arbitration may ultimately have more to do with factors other than development, such as the merits of a particular claim or defense. Other factors may also be linked with outcome, such as the business sector involved, the amounts claimed or the type of host state government, but they may not necessarily cause particular results. This suggests that although there are risks in pursing arbitration, there will be times when it is warranted and, ultimately, parties should think carefully about why arbitration is in their interests.

For further information please contact: Vale Columbia Center on Sustainable International Investment, Karl P. Sauvant, Executive Director, (212) 854-0689, Karl.Sauvant@law.columbia.edu or Lisa Sachs, Assistant Director, (212) 854-0691, Lsachs1@law.columbia.edu.

Vale Columbia Center on Sustainable International Investment (VCC), led by Karl P. Sauvant, is a joint center of Columbia Law School and The Earth Institute at Columbia University. It seeks to be a leader on issues related to foreign direct investment (FDI) in the global economy. VCC focuses on the analysis and teaching of the implications of FDI for public policy and international investment law.

Previous Columbia FDI Perspectives

- No. 1. Karl P. Sauvant, "The FDI Recession has Begun," November 22, 2008.
- No. 2. Mark E. Plotkin and David N. Fagan, "The Revised National Security Review Process for FDI in the US," January 7, 2009.
- No. 3. Anne van Aaken and Jürgen Kurtz, "The Global Financial Crisis: Will State Emergency Measures Trigger International Investment Disputes?" March 23, 2009.
- No. 4. Gert Bruche, "A New Geography of Innovation—China and India Rising," April 29, 2009.
- No. 5. Ken Davies, "While Global FDI Falls, China's Outward FDI Doubles," May 26, 2009.
- No. 6. Christian Bellak and Markus Leibrecht, "Improving infrastructure or lowering taxes to attract foreign direct investment?" June 3, 2009.

[8] Franck, *Development and Outcomes*, *supra* note 2.