

Foreign Direct Investment, Investment Treaty Arbitration, and the Rule of Law

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I. INTRODUCTION

During the past two decades, the number of investment treaties has tripled.¹ Today, nearly 170 countries have signed onto one or more Bilateral Investment Treaties (“BITs”).² These treaties offer foreign investors a series of economic rights, including the right to arbitrate claims, in hopes of attracting Foreign Direct Investment (“FDI”) that will bring a country infrastructure projects, financing, know-how, new jobs and, economic stability.³

While the number of investment treaties has increased, there has also been a marked increase in FDI, which surged from \$200 billion in 1990 to over \$1 trillion in 2000.⁴ With the increase in investor rights and investment levels, it is not surprising investors have begun to bring claims to enforce their rights when government conduct arguably has an adverse effect on their investment. Since 1985, investors have initiated at least 219 claims—two thirds of which have been filed since 2002—and several pending claims have been valued in excess of \$100 million.⁵

1. In 1992, there were approximately 700 BITs, and by 1995, there were more than 900 BITs between 150 countries. MIRIAN KENE OMALU, *NAFTA AND THE ENERGY CHARTER TREATY* 2 n.10 (1999). Today there are over 2100 BITS. Susan D. Franck, *The Legitimacy Crisis in Investment Arbitration: Privatizing Public International Law Through Inconsistent Decisions*, 73 *FORDHAM L. REV.* 1521, 1522-23 (2005) [hereinafter Franck, *Legitimacy Crisis*]; see also Susan D. Franck, *The Nature and Enforcement of Investor Rights under Investment Treaties: Do Investment Treaties Have a Bright Future*, 12 *U.C. DAVIS J. INT’L L. & POL’Y* 47 (2005) [hereinafter Franck, *Bright Future*] (describing the surge in investment treaties); Antonio R. Parra, *Settlement of Investment Disputes: The Experience of ICSID in Transition Countries and Elsewhere*, in *EUROPEAN BANK OF RECONSTRUCTION AND DEVELOPMENT, LAW IN TRANSITION: CONTRACT ENFORCEMENT* 39 (2001), available at <http://www.ebrd.com/pubs/legal/5083.htm> [hereinafter *LAW IN TRANSITION*]; UNCTAD, *Investor-State Disputes and Policy Implications*, TD/B/COM.2/62 (Jan. 17, 2005), available at http://www.unctad.org/en/docs/c2d62_en.pdf [hereinafter *Policy Implications*].

2. Parra, *supra* note 1, at 39.

3. Franck, *Bright Future*, *supra* note 1, at 48-49.

4. See UNITED NATIONS, *WORLD INVESTMENT REPORT: PROMOTING 2001: PROMOTING LINKAGES*, xiii, 9-10 (2001), available at <http://www.unctad.org/en/docs/wir01full.en.pdf> [hereinafter *WORLD INVESTMENT REPORT 2001*] (noting the increase in FDI and finding worldwide foreign investment was in the order of \$1.3 trillion in 2000). In 1980, FDI was estimated at \$40 billion; by 1994 it had increased to \$222 billion. By 1995, estimates of FDI reached \$315 billion. OMALU, *supra* note 1, at 1-2; see also Rati Ram & Kevin Honglin Zhang, *Foreign Direct Investment and Economic Growth: Evidence from Cross-Country Data for the 1990s*, 51 *ECONOMIC DEVELOPMENT & CULTURAL CHANGE* 205, 205 (2002), available at <http://www.journals.uchicago.edu/EDCC/journal/issues/v51n1/510109/510109.web.pdf> (suggesting that in 1990 FDI was in the order of \$198.4 billion); but see UNITED NATIONS, *WORLD INVESTMENT REPORT 2005: TRANSNATIONAL CORPORATIONS AND THE INTERNATIONALIZATION OF R&D* 3 (2005), available at http://www.unctad.org/en/docs/wir2005ch1_en.pdf [hereinafter *WORLD INVESTMENT REPORT 2005*] (stating that global FDI inflows declined 41% in 2001, 13% in 2002, and 12% in 2003, but rose 2% in 2004).

5. Michael D. Goldhaber, *Arbitration Scorecard: Treaty Disputes*, *AM. LAW.* (June 2005), available at <http://www.americanlawyer.com/focuseurope/treaty0605.html>; see also Franck, *Legitimacy Crisis*, *supra* note 1, at 1521; Parra, *supra* note 1, at 39; Jeswald W. Salacuse, *Explanations For The Increased Recourse To Treaty-Based Investment Dispute Settlement: Resolving The Struggle of Life Against Form?*, in *INTERNATIONAL INVESTMENT LAW: IS THE REGIME THREATENED BY ITS SUCCESS?* (Karl P. Sauvant ed.) (forthcoming 2007).

It is unclear whether the expansion of the BIT network and the right to arbitrate treaty claims has incentivized foreign investment.⁶ The existence of an investment treaty is one variable that may affect decisions to invest internationally. Other critical variables influencing investment choices can include the potential financial risks and benefits to the investor,⁷ the stability of an investment environment,⁸ the availability of appropriate human capital,⁹ access to effective enforcement procedures,¹⁰ embedded personal and professional relationships,¹¹ and other factors.¹² While the availability of investment treaty

6. See ORGANISATION FOR ECONOMIC DEVELOPMENT AND CO-OPERATION, INTERNATIONAL INVESTMENT PERSPECTIVES 35-37 (2005), available at <http://www.oecd.org/dataoecd/13/62/35032229.pdf> (observing the link between FDI flows and the existence of investment treaties with OECD countries but declining to comment upon whether the treaties cause FDI).

7. Presuming that investors are rational actors who seek to maximize their profits and minimize their risks, the literature has sought to isolate those variables most likely to create incentives to invest internationally. See Magnus Blomström & Ari Kokko, *Working Paper 168: The Economics of Foreign Direct Investment Incentives* (Jan. 2003), available at <http://web.hhs.se/eijswp/168.pdf> (analyzing the rationale behind providing incentives to attract FDI and arguing for attracting FDI); Andrew Charlton, *Working Paper No. 203: Incentive Bidding for Mobile Investment: Economic Consequences and Potential Responses* (Jan. 2003), available at <http://www.oecd.org/dataoecd/39/63/2492289.pdf> (analyzing the main costs and benefits of investment incentives and emphasizing the positive and negative consequences of competition between countries and regions offering investors such incentives); see also Stephen M. Penner, *International Investment and the Prudent Investor Rule: The Trustee's Duty to Consider International Investment Vehicles*, 16 MICH. J. INT'L L. 601, 639-41 (1995) (observing that "it would be impossible to determine the desirability of investing in a particular international asset without being able to at least estimate the asset's expected return" and that investors need additional information about particular risks before making an investment).

8. See generally THE WORLD BANK, WORLD DEVELOPMENT REPORT 2005: A BETTER INVESTMENT CLIMATE FOR EVERYONE 19-24, 79-80 (2004), available at http://siteresources.worldbank.org/INTWDR2005/Resources/complete_report.pdf [hereinafter WORLD DEVELOPMENT REPORT]; see also Yitzhak Hadari, *Attracting Foreign Investments in Selected Developing Countries and the Desirable Policy*, 24 INT'L LAW. 121, 122 (1990) (suggesting that where investment incentives are unstable they become less effective in attracting investment, observing that "heavy-handed bureaucracy and administrative procedures are major discouragements to investment" and noting that efforts to streamline a regulatory regime may lead to increases in investment); Penner, *supra* note 7, at 639-40 (observing that regulatory risk may adversely affect investment decisions).

9. See Koji Miyamoto, *Working Paper 211: Human Capital Formation and Foreign Direct Investment in Developing Countries*, (July 2003), available at <http://www.oecd.org/dataoecd/45/25/5888700.pdf> (reviewing the literature on human capital formation and skills development and analyzing their impact on FDI); see also PEADAR KIRBY, MACROECONOMIC SUCCESS AND SOCIAL VULNERABILITY: LESSONS FOR LATIN AMERICA FROM THE CELTIC TIGER 26-27 (2003) (describing Ireland's investment in education as part of its recipe for economic development).

10. See LAW IN TRANSITION, *supra* note 1, at 18-22, 24 (referring to the need for an "acceptable degree of legal and judicial certainty of contract enforcement").

11. See generally Nina Bandell, *Embedded Economies: Social Relations as Determinants of Foreign Direct Investment in Central and Eastern Europe*, 81 SOC. FORCES 411 (2002); Ying Qiu, *Personal Networks, Institutional Involvement, and Foreign Direct Investment Flows into China's Interior*, 81 ECON. GEOGRAPHY 261 (2005).

12. For example, the availability and scope of political risk insurance coverage from entities such as the Overseas Private Investment Corporation (OPIC) or the Multi-lateral Insurance Guarantee Agency (MIGA) might influence investment decisions. See generally Paul E. Comeaux & N. Stephan Kinsella, *Reducing Political Risk In Developing Countries: Bilateral Investment Treaties, Stabilization Clauses, and MIGA & OPIC Investment Insurance*, 15 N.Y. L. SCH. J. INT'L & COMP. L. 1 (1994) (discussing the availability of political risk insurance); see also *infra* notes 96-101 and accompanying text (discussing a variety of factors

arbitration may play some role in influencing investment determinations, the specific scope and impact of that role has not been articulated. Nevertheless, to the extent that dispute resolution mechanisms in investment treaties may influence an investor's decision to invest or affect the manner in which they structure their transaction,¹³ they are worthy of consideration—particularly as countries are targeting effective alternative dispute resolution systems as a method of fostering foreign investment.¹⁴

This article focuses on a small aspect of the puzzle of how, if at all, investment treaties affect foreign investment. Specifically, it will consider the provocative and unexplored question of the role that dispute resolution mechanisms—particularly investment treaty arbitration—play in foreign investment. First, this article provides a background on the role of investment treaties and investment treaty arbitration. Second, it considers how investment treaty arbitration might impact investment decisions. This article then gathers the current empirical evidence that analyzes the general impact investment treaties have on foreign investment decisions. Next, it considers the particular impact investment treaty arbitration, as a specific term of an investment treaty, may have on FDI. This article develops potential models for explaining current links between investment levels and dispute resolution mechanisms; it then speculates on how investment treaty arbitration may create incentives for foreign investment by fostering the development of the rule of law. Ultimately, this article suggests that while investment treaty arbitration may not directly trigger investment, the availability of this dispute resolution mechanism is a factor in an overall decisional matrix. As such, it should play a role in promoting development and the rule of law.¹⁵

affecting investment decisions).

13. See Franck, *Legitimacy Crisis*, *supra* note 1, at 1535 n.46 (observing that investors may structure their investments in order to take advantage of favorable investment treaty rights); see also JULIAN D.M. LEW, LOUKAS A. MISTELIS & STEFAN M. KRÖLL, *COMPARATIVE INTERNATIONAL COMMERCIAL ARBITRATION* 769 (2003) (noting that “investments made by a subsidiary of a global corporation will now fall under at least one BIT”).

14. Express India, *Effective ADR Mechanism Can Fetch More FDI than China* (Nov. 5, 2005), available at <http://www.expressindia.com/fullstory.php?newsid=57809>.

15. While a thorough review of the literature is beyond the scope of this article, the concept of the “rule of law” has been used differently in varying contexts. See, e.g. Faiz Ahmed, *Judicial Reform in Afghanistan: A Case Study in the New Criminal Procedure Code*, 29 HASTINGS INT’L & COMP. L. REV. 93, 95 n.11 (defining “rule of law not as a tangible political or legal condition, nor a political system based on Western notions of liberal democracy, but as a conceptual goal in which all members of a society (regardless of wealth or status) normatively abide by publicly known limits, and face legally-sanctioned punishment for transgressing them”); Asli Ü. Bâli, *Justice Under Occupation: Rule of Law and the Ethics of Nation-Building in Iraq*, 30 YALE J. INT’L L. 431, 446-47 (2005) (offering a functional definition of the rule of law in post-conflict situations); Rachel Kleinfeld Belton, *Competing Definitions of the Rule of Law: Implications for Practitioners* (Carnegie Endowment: Democracy and Rule of Law Project, Paper 55 2005), available at <http://www.Carnegieendowment.org/files/CP55.Belton.FINAL.pdf> (articulating different definitions of the rule of law); Ahmed A. White, *Capitalism, Social Marginality, and the Rule of Law’s Uncertain Fate in Modern Society*, 37 ARIZ. ST. L.J. 759, 763-68 (2005) (referring to the concept of the rule of law and articulating a definition related to capitalism and individual rights); see also *Planned Parenthood of Se. Pa. v. Casey*, 505 U.S. 833, 854 (1992)

II. INVESTMENT TREATIES: OFFERING INVESTORS SUBSTANTIVE RIGHTS AND PROCEDURAL REMEDIES

An investment treaty is an agreement made between two or more sovereigns that safeguards investments made in the territory of the signatory countries.¹⁶ Sovereigns purportedly promulgate these investment treaties as “a means to satisfy the need to promote and protect foreign investment and with a view to enhancing the legal framework under which foreign investment operates.”¹⁷ Investment treaties may have other functions. They may signal receptivity to foreign investments¹⁸ or enhance a nation’s credibility as a reputable international actor.¹⁹ Irrespective of a government’s motivation, the proliferation of investment treaties marks a paradigm shift in investors’ substantive and procedural rights.²⁰

(suggesting that “the very concept of the rule of law underlying our own Constitution requires such continuity over time that a respect for precedent is, by definition, indispensable”). Although Judge Posner expresses some skepticism about the utility of defining basic terms, given its various usages, a brief definition of the term may prove useful. See *Publications Int’l, Ltd. v. Landoll, Inc.*, 164 F.3d 337, 339 (7th Cir. 1998) (Posner, C.J.) (suggesting that “efforts to define intuitive concepts . . . are often both futile and unnecessary. We use with perfect clarity many words that we can’t define, such as ‘time,’ ‘number,’ ‘beauty,’ and ‘law.’”). This article uses the term “rule of law” to refer to: transparency and availability of law; adherence to announced legal principles or principled deviation from such principles; and the consistent, reliable, independent and impartial adjudication of those laws. The author is grateful to Professor Ilhyung Lee for his comments on this point.

16. Franck, *Bright Future*, *supra* note 1, at 52. While these treaties typically take the form of Bilateral Investment Treaties (“BITs”), an emerging trend is the creation of larger, multilateral investment treaties (“MITs”). See, e.g., Gary G. Yerkey, *Bush’s Plan to Create Mideast Free Trade Area by 2013 Could Take Off This Year*, BNA WTO REPORTER (Jan. 20, 2006) (discussing the possibility of a Middle-East trade and investment treaties). MITs, like the North American Free Trade Agreement and Central American Free Trade Agreement, function in the same way as BITs but provide investment protection on a multilateral basis. North American Free Trade Agreement, Dec. 17, 1992, U.S.-Can.-Mex., 32 I.L.M. 612 (1993) (entered into force Jan. 1, 1994), Chapter 11 [hereinafter NAFTA]; United States Trade Representative, CAFTA-DR Final Text, Chapter 10, available at http://www.ustr.gov/Trade_Agreements/Bilateral/CAFTA/CAFTA-DR_Final_Texts/Section_Index.html [hereinafter CAFTA-DR]; Antonio R. Parra, *Provisions on the Settlement of Investment Disputes in Modern Investment Laws, Bilateral Investment Treaties and Multilateral Instruments on Investment*, 12 ICSID REV.-F.I.L.J. 287, 293 (1997) [hereinafter Parra, *Provisions*] (observing that “multilateral instruments vary in legal character, [but] they have much in common with each other and with BITs”). They differ in other respects, however, as they also address trade matters in addition to investment protection. For example, they typically address issues such as rules of origin, customs obligations, sanitary and phytosanitary measures, and cross-border trade in services. See NAFTA, *supra* note 16, at chs. 4, 5, 7, 15; CAFTA-DR, *supra* note 16, at chs. 4, 5, 7, 11.

17. OMALU, *supra* note 1, at 2; see also Franck, *Bright Future*, *supra* note 1; Jeswald W. Salacuse & Nicholas P. Sullivan, *Do BITS Really Work?: An Evaluation of Bilateral Investment Treaties and Their Grand Bargain*, 46 HARV. INT’L L.J. 67, 75-79 (2005) (suggesting the purposes of investment treaties are to (1) protect investment, (2) liberalize markets, and (3) promote investments); Tom Ginsburg, *International Substitutes for Domestic Institutions: Bilateral Investment Treaties and Governance*, 25 INT’L REV. OF L. & ECON. 107, 108 (2005).

18. Kenneth Vandeveld, *The Economics of Bilateral Investment Treaties*, 41 HARV. INT’L L.J. 470 (2000) [hereinafter Vandeveld, *Economics*]; see also Andrew Guzman, *Why LDCs Sign Treaties that Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 VA. J. INT’L L. 639 (1998) (noting that BITs began to take off during the same period that international lawyers began to promote the new international economic order).

19. Beth A. Simmons & Lisa L. Martin, *International Organizations and Institutions*, in HANDBOOK OF INTERNATIONAL RELATIONS 192 (Walter Carlsnaes, et al. eds., 2002); see also Jennifer Tobin and Susan Rose-

A. Substantive Investment Rights

Rather than relying on the contested meaning of substantive rights under customary international law, such as expropriation, investment treaties articulate specific substantive standards for investment rights.²¹ Essentially, investment treaties offer foreign investors a specific set of substantive rights. Typically, these rights include guarantees of appropriate compensation for expropriation, promises of freedom from unreasonable or discriminatory measures, guarantees of national treatment of the investment, assurances of fair and equitable treatment, promises that investments will receive full protection and security, undertakings that a sovereign will honor its obligations, and assurances that FDI will receive treatment no less favorable than that accorded under international law.²² In other words, investment treaties promise that host governments will not subject investors and their investments to inappropriate risks.²³

Ackerman, *Foreign Direct Investment and the Business Environment in Developing Countries: The Impact of Bilateral Investment Treaties*, 22 (William Davidson Institute Working Paper No. 587, June 2003), available at <http://econpapers.repec.org/paper/wdi/papers/2003-587.htm> [hereinafter Tobin & Rose-Ackerman 2003] (outlining the benefits of investment treaties).

20. After an evolution away from gunboat diplomacy and treaties of Friendship, Commerce and Navigation treaties, the first BIT was signed between Germany and Pakistan in 1959. UNITED NATIONS COMMISSION ON TRADE AND DEVELOPMENT, *BILATERAL INVESTMENT TREATIES IN THE MID 1990S*, UNCTAD/ITE/IIT/7, Sales No. E.98.II.D.8, 8-10 (1998) [hereinafter UNCTAD, BITs in the Mid-1990s]; see also Franck, *Legitimacy Crisis*, *supra* note 1, at 1525-29 (describing the evolution of investment treaties); LAW IN TRANSITION, *supra* note 1, at 16 (describing the shift away from “primitive remedies such as hostage taking, ransom demands and reprisals in ancient times to sophisticated legal frameworks with court enforcement in modern times”).

21. The meanings of some standards may be clearer than disputed definitions under international law, but parties may nevertheless contest their meaning. See Guzman, *supra* note 18, at 641 (discussing the uncertainty and controversy surrounding expropriation, including the rise and fall of the Hull Rule); NAFTA, *supra* note 16, at art. 1110. Meanwhile, other investment rights articulate more vague standards that can make the precise scope of these rights more challenging to delineate. See Rudolf Dolzer, *Fair and Equitable Treatment: A Key Standard In Investment Treaties*, 39 INT’L LAW 87, 87, 90-94 (2005) (explaining that it is unclear “whether the requirement of fair and equitable treatment forms part of customary [international] law” and acknowledging the challenge in delineating the scope of customary international law and fair and equitable treatment); but see Revised U.S. Model Bilateral Investment Treaty, art. 5, Feb. 5, 2004, available at <http://www.state.gov/documents/organization/29030.doc> (providing detailed definitions of the minimum standard of treatment under international law).

22. RUDOLF DOLZER & MARGRETE STEVENS, *BILATERAL INVESTMENT TREATIES* (1995); Franck, *Legitimacy Crisis*, *supra* note 1, at 1529-32; Salacuse & Sullivan, *supra* note 17, at 83-85; Giorgio Sacerdoti, *Bilateral Treaties and Multilateral Instruments on Investment Protection*, in RECUEIL DES COURS 265, 265-75, 299 (1997).

23. Investors are often granted higher security and better treatment than domestic investors participating in the same market. Kenneth Vandeveld, *The Political Economy of the Bilateral Investment Treaty*, 92 AM. J. INT’L L. 621 (1998) [hereinafter Vandeveld, *Political Economy*]. The Trade Promotion Authority Act (“TPA”), in contrast, suggests that foreign investors in the United States should not receive treatment more favorable than that available under U.S. constitutional principles. 19 U.S.C. § 3802(b)(3) (2002). Bipartisan Trade Promotion Authority Act of 2002, S. Rep. No. 107-139, at 15 (2d Sess. 2002) (suggesting that foreign investors must not receive more favorable protection than U.S. investors under the U.S. Constitution); David A. Gantz, *The Evolution of FTA Investment Provisions: From NAFTA to the United States - Chile Free Trade Agreement*, 19 AM. U. INT’L L. REV. 679, 705-07 (2004) (discussing the objectives of the TPA and noting

B. Procedural Investment Rights

Investment treaties are not simply revolutionary because of the substantive protections that they provide. The real innovation of BITs was the provision of procedural rights that gave investors a mechanism to enforce the substantive rights directly.²⁴ In other words, investors not only have rights, they also have an agreed forum to redress alleged wrongs.²⁵

In the past, when a government's violation of international law adversely affected an investment, an investor's remedies were limited.²⁶ Investors' remedies tended to be limited to the following: (1) negotiating with the sovereign; (2) suing the sovereign in the sovereign's own courts where defenses of sovereign immunity may be readily available; (3) asking their home government to negotiate diplomatically on their behalf; or (4) lobbying their home government to espouse a claim on their behalf before the International Court of Justice.²⁷ While some of these options may have provided useful opportunities to solve disputes, they were often ineffectual and investors were unable to redress their grievances satisfactorily.²⁸ Moreover, even when litigation was pursued on an investor's behalf by its home country, it was uncertain whether the investor would receive the financial compensation for its damages.²⁹

In investment treaties, however, sovereigns offer investors the right to arbitrate directly with them for a violation of the treaty. This permits investors to function in a manner akin to a private attorney general by initiating adjudication to redress

Congress was concerned not to give foreign investors an expropriation right "that differs substantially from the right to compensation for takings that U.S. citizens already enjoy").

24. In an effort to exercise their sovereign authority, many governments have preferred to "remain judges in their own cases, interpreting and applying the rules of international law unilaterally." OMALU, *supra* note 1, at 157-58.

25. This prevents the rights in investment treaties from being the equivalent of a legal fiction. See *The Western Maid v. Thompson*, 257 U.S. 419, 433 (1922) (Holmes, J.) (observing that "[l]egal obligations that exist but cannot be enforced are ghosts that are seen in the law but that are elusive to the grasp"); see also Karl N. Llewellyn, *Some Realism About Realism—Responding to Dean Pound*, 44 HARV. L. REV. 1222, 1244 (1931) (observing that the fundamental quality of the law is not just the right but "what can be done: not only 'no remedy, no right' but 'precisely as much right as remedy'").

26. See, e.g., William S. Dodge, *Investor-State Dispute Settlement Between Developed Countries: Reflections on the Australia-United States Free Trade Agreement*, 39 VAND. J. TRANSNAT'L L. 1, 5-8 (2006) (describing the traditional diplomatic protections available to foreign investors harmed by breaches of international law); WORLD DEVELOPMENT REPORT, *supra* note 8, at 178-79.

27. Franck, *Legitimacy Crisis*, *supra* note 1, at 1536-38.

28. Jeswald W. Salacuse, *BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries*, 24 INT'L LAW. 655, 659 (1990) (noting that in the 1970s the United Nations had identified 875 acts of government takings in sixty-two countries over a period of fourteen years prior to the promulgation of BITs; in the United States, the Department of State was aware of 102 existing investment disputes between U.S. nationals and foreign governments, but suggesting that there was no effective protection for vindication of these rights).

29. Even if the claims were successful, the home government may elect not to transfer the damages to the investor. Should a host government elect not to pay, the enforcement mechanism was the passing of a U.N. Security Council Resolution. Franck, *Legitimacy Crisis*, *supra* note 1, at 1537.

inappropriate government conduct.³⁰ By outsourcing the function to those with an interest in the dispute, it also prevents home governments from having to distinguish between appropriate and unmeritorious claims against host governments. Rather than having to put faith in a political or diplomatic process, or simply do nothing, investment treaties provide a reliable, neutral forum for investors to enforce the rules of law articulated in a specific treaty.

Best yet, most investment treaties permit investors to have a degree of control over which method of dispute resolution they ultimately elect.³¹ Some treaties permit investors to litigate their claims or arbitrate their claims on an ad hoc basis under the United Nations Commission on International Trade Law (“UNCITRAL”) Rules or before respected arbitral institutions, such as the International Chamber of Commerce or the Stockholm Chamber of Commerce.³² While ad hoc arbitration under the UNCITRAL Rules has been utilized, the most common form of dispute resolution under investment treaties is to permit arbitration before the World Bank’s International Centre for the Settlement of Investment Disputes (“ICSID”).³³

C. The Investment Arbitration Process

But what exactly is investment treaty arbitration? Typically, it begins with some sort of governmental conduct that adversely affects a foreign investor’s investment. For example, this government conduct might involve the enactment of a law that redenominates local currency,³⁴ the administrative revocation of a

30. Hannah L. Buxbaum, *The Private Attorney General in a Global Age: Public Interests in Private International Antitrust Litigation*, 26 YALE J. INT’L L. 219 (2001); Franck, *Legitimacy Crisis*, *supra* note 1, at 1538; *but see* Occidental Exploration & Production Company v. Republic of Ecuador, [2005] EWCA Civ. 1116, ¶¶ 23-48, available at <http://ita.law.uvic.ca/documents/Ecuador-FinalCAJudgment.doc> (suggesting that the rights in investment treaties are owned by private, individual investors rather than being public rights asserted by private individuals on the public’s behalf).

31. While some treaties permit parties either to litigate their BIT claims before national courts or arbitral tribunals, not all treaties do this. Instead, many treaties limit the acceptable dispute resolution mechanisms to arbitral tribunals. Nevertheless, parties may still have an option to arbitrate before various international institutions, such as the International Chamber of Commerce, the Stockholm Chamber of Commerce, or before an ad hoc arbitral body organized under the UNCITRAL Arbitration Rules. Franck, *Bright Future*, *supra* note 1, at 53-54; Franck, *Legitimacy Crisis*, *supra* note 1, at 1541-43. There may also be opportunities, although not necessarily mandatory, let alone strictly enforced, to engage in some form of amicable resolution. Christoph Schreuer, *Traveling the BIT Route: Of Waiting Periods, Umbrella Clauses and Forks in the Road*, 5 J. WORLD INVEST. & TRADE 231 (2004) [hereinafter Schreuer, *Of Waiting Periods*].

32. Franck, *Bright Future*, *supra* note 1, at 54; Franck, *Legitimacy Crisis*, *supra* note 1, at 1541; Calvin A. Hamilton & Paula I. Rochwerger, *Trade and Investment: Foreign Direct Investment Through Bilateral and Multilateral Treaties*, 18 N.Y. INT’L L. REV. 1, 49-57 (2005); *see also* J. Steven Jarreau, *Anatomy of a BIT*, 35 U. MIAMI INTER-AM. L. REV. 429, 492 (2004) (discussing an investor’s dispute resolution options under the U.S.-Honduras BIT).

33. Franck, *Legitimacy Crisis*, *supra* note 1, at 1542 n.78. Although these mechanisms tend to focus on arbitration as a mechanism of resolving treaty disputes, there are a variety of other options that may be usefully employed in resolving treaty-based claims. Susan D. Franck, *Reconsidering Dispute Resolution Options in International Investment Agreements*, in INTERNATIONAL INVESTMENT LAW: IS THE REGIME THREATENED BY ITS SUCCESS? (Karl P. Sauvant ed.) (forthcoming 2007) [hereinafter Franck, *Dispute Resolution Options*].

34. *CMS Gas Transmission Company v. Argentine Republic*, ICSID Case No. ARB/01/8, Award (May 12, 2005), ¶¶ 64-66, 44 I.L.M. 1205 (2005), available at http://ita.law.uvic.ca/documents/CMS_FinalAward.pdf.

banking license,³⁵ the breach of a government privatization contract,³⁶ or the failure to provide police protection after forcible seizure of an investment.³⁷

If an investor is unable to resolve its dispute with a host government,³⁸ the investor typically initiates arbitration by picking one of the neutral arbitral institutions listed in the investment treaty and submitting a Notice and Request for Arbitration.³⁹ An investor then selects one arbitrator, and the sovereign selects another arbitrator. Thereafter, the parties typically select a third arbitrator who serves as the chair.⁴⁰ Next, the parties gather their evidence and present arguments (typically in private), and the tribunal renders an award that is enforceable worldwide.⁴¹

III. INVESTMENT TREATIES AND FOREIGN DIRECT INVESTMENT

Governments, including the United States, have increasingly found themselves subjected to claims under investment treaties.⁴² Sometimes governments successfully defend claims, but at other times they lose.⁴³ When governments promise investors

35. *Genin v. Estonia*, ICSID Case No. ARB/99/2, Award (June 25, 2001), ¶ 316, 17 ICSID REV.-F.I.L.J. 395 (2002), available at <http://ita.law.uvic.ca/documents/Genin-Award.pdf>.

36. *Eureko B.V. v. Republic of Poland*, UNCITRAL, Partial Award (Aug. 19, 2005), ¶¶ 157, 190 at <http://ita.law.uvic.ca/documents/Eureko-PartialAwardandDissentingOpinion.pdf>.

37. *Wena Hotel Limited v. Arab Republic of Egypt*, Proceeding on the Merits (Dec. 8, 2000), ¶¶ 89-92, 41 I.L.M. 896 (2002), available at <http://ita.law.uvic.ca/documents/Wena-2000-Final.pdf>.

38. Many BITs expressly have waiting periods that require investors to provide proper notice and wait a finite period of time prior to initiating arbitration. Schreuer, *Of Waiting Periods*, *supra* note 31; Hamilton & Rochwerger, *supra* note 32, at 49-50. For a variety of reasons, investors can experience difficulties in negotiating with governments under these conditions. See Barton Legum, *The Difficulties of Conciliation in Investment Treaty Cases: A Comment on Professor Jack C. Coe's "Toward a Complementary Use of Conciliation in Investor-State Disputes-A Preliminary Sketch"*, 21(4) MEALY'S INT'L ARB. REP. 23 (2006); see also Franck, *Dispute Resolution Options*, *supra* note 33.

39. Franck, *Bright Future*, *supra* note 1, at 54. If, however, an investor can elect to arbitrate under the UNCITRAL Rules, this will be an ad hoc arbitration that proceeds pursuant to those rules but without the administrative oversight of an administrative institution.

40. Under the ICSID Convention, parties can agree on the appointment of the president of the tribunal. Art. 37(2)(b) Convention on the Settlement of Investment Disputes Between States and Nationals of Other States of March 18, 1965, 4 I.L.M. 524 (1966) [hereinafter the ICSID Convention]. By contrast, under ad hoc UNCITRAL arbitration, the party-appointed arbitrators agree on the appointment of the Chair. United Nations Commission on International Trade Law Arbitration Rules, Apr. 28, 1976, 15 I.L.M. 701 (1976), art. 7(1) [hereinafter UNCITRAL Rules]. In another variation, a tribunal might be appointed by the ICC Court. See, e.g., Parra, *Provisions*, *supra* note 16, at 306-07, 326.

41. Franck, *Legitimacy Crisis*, *supra* note 1, at 1543-45.

42. Barton Legum, *Investment Treaty Arbitration's Contribution to International Commercial Arbitration*, 60 DISP. RESOL. J. 71, 72 (2005) (suggesting that in early 2000, "the number of awards in investment treaty cases could be measured on one hand. Today there seems to be a new award every week.").

43. Jack J. Coe, Jr., *Taking Stock of NAFTA Chapter 11 in Its Tenth Year: An Interim Sketch of Selected Themes, Issues, and Methods*, 36 VAND. J. TRANSNAT'L L. 1381, 1459-60 (2003) [hereinafter Coe, *Taking Stock*]; Guillermo A. Alvarez & William W. Park, *The New Face of Investment Arbitration: NAFTA Chapter 11*, 28 YALE J. INT'L L. 365, 366-67 (2003); see also Richard Newfarmer, *Beyond Merchandise Trade: Services, Investment, Intellectual Property and Labor Mobility*, in GLOBAL ECONOMIC PROSPECTS 97, 107-08 (2005), available at <http://siteresources.worldbank.org/INTGEP2005/Resources/gep2005.pdf> (indicating investors making claims under NAFTA have alleged over \$1 trillion in damages but the total damages awarded

substantive rights and a forum for vindicating violations of those rights, governments create risks. Those risks relate to the waiver of sovereign immunity, litigation risk⁴⁴ associated with the possible need to defend against investor claims, and the possibility of ultimate liability.⁴⁵ The defense of a treaty claim may require governments to spend millions of dollars. Nevertheless, expending financial resources may be necessary (or at least economically efficient) since a single government measure may lead to claims worth billions of dollars.⁴⁶ Should an investor be successful, a government may have to pay damages associated with the claim, and it may be politically or economically expedient to defend the claim—particularly as awards within the past decade have ranged from approximately \$500,000⁴⁷ to \$18 million⁴⁸ to \$75 million⁴⁹ to \$270 million.⁵⁰

has been in the order of \$35 million). The author is grateful to Mr. Devashish Krishan for bringing this document to her attention.

44. For the purposes of this article, “litigation risk” refers to the possibility that a sovereign may be subject to suit for conduct that allegedly violates an investment treaty. While not all investment treaties permit litigation of a treaty-based claim, this concept refers to risk created from the creation of a dispute resolution mechanism to resolve investors’ claims through an adjudicative process.

45. See Tobin & Rose-Ackerman 2003, *supra* note 19, at 22 (outlining various political costs of investment treaties); Franck, *Legitimacy Crisis*, *supra* note 1, at 1592 (outlining potential financial costs); see also Hamilton & Rochwerger, *supra* note 32, at 20-27 (suggesting a variety of costs related to signing investment treaties).

46. Franck, *Legitimacy Crisis*, *supra* note 1, at 1512; see also Michael D. Goldhaber, *Wanted: A World Investment Court*, AM. LAWYER (Summer 2004), available at <http://www.americanlawyer.com/focuseurope/investmentcourt04.html> (noting that the more than thirty claims brought by investors against Argentina relating to the devaluation of the peso are easily worth \$10 billion). Arguably, the risk of such claims being brought may also serve to chill a state’s legislative or regulatory authority. There is mixed anecdotal evidence on this point. Compare Vicki Been & Joel C. Beauvais, *The Global Fifth Amendment? NAFTA’s Investment Protections and the Misguided Quest for an International “Regulatory Takings” Doctrine*, 78 N.Y.U. L. REV. 30, 133 (2003) (suggesting cigarette manufacturers have used NAFTA to inhibit Canada from enacting antismoking legislation) with Frank E. Loy, *On A Collision Course? Two Potential Environmental Conflicts Between the U.S. and Canada*, 28 CAN.-U.S. L.J. 11, 22 (2002) (noting that Canada did not believe NAFTA litigation had resulted in a regulatory chill, but expressing skepticism that this was correct); Adam Liptak, *Review of U.S. Rulings by NAFTA Tribunals Stirs Worries*, N.Y. TIMES, Apr. 18, 2004 at § 1 (providing an example of where government actors were unaware that their normal activities could subject a government to liability). Interestingly, there is some evidence of a reverse “litigation chill,” where public outcry related to an investor’s suit against a host government may actually provide an incentive for investors to drop a case. See Hamilton & Rochwerger, *supra* note 32, at 23 (noting that a foreign investor “eventually dropped the [ICSID] case against Guyana in light of continued public opposition”).

47. *Pope & Talbot v. Canada*, UNCITRAL, Award in Respect of Damages (May 31, 2002), at <http://ita.law.uvic.ca/documents/Pope-Damages.pdf> (holding Canada liable for \$461,565).

48. *Metalclad Corp. v. Mexico*, ICSID Case No. ARB(AF)/97/1, Award (Aug. 30, 2000), 40 I.L.M. 36 (2001), available at <http://ita.law.uvic.ca/documents/MetalcladAward-English.pdf> (holding Mexico liable for \$16,685,000).

49. *Occidental Exploration and Production Co. v. Ecuador*, LCIA Case No. UN3467, Final Award (July 1, 2004), at http://ita.law.uvic.ca/documents/oxy-ecuadorfinalaward_001.pdf [hereinafter Occidental Award] (holding Ecuador liable for damages for \$75,074,929).

50. *CME Czech Republic B.V. v. Czech Republic*, UNCITRAL, Final Award (Mar. 14, 2003), at http://ita.law.uvic.ca/documents/CME-2003-Final_001.pdf (awarding CME \$269,814,000 in damages for breach of an investment treaty). Similarly, in a decision rendered after the initial draft of this article, a tribunal found Argentina liable in the order of \$165,240,753 for breaching a BIT with the United States. *Azurix Corp. v. Argentine Republic*, ICSID Case No. ARB/01/12, Award (July 16, 2006), <http://ita.law.uvic.ca/documents/AzurixAwardJuly2006.pdf>.

As the risk related to granting these rights becomes more quantifiable, which highlights the significance of the risk, a movement has begun to assess the significance of the benefit of investment treaties by considering whether investment treaties actually achieve the desired objective of promoting foreign investment.⁵¹

A. Anecdotal Evidence

While there is some empirical evidence suggesting that trade liberalization improves investor confidence,⁵² there is mixed anecdotal evidence that investment treaties promote FDI. On one hand, investors such as Ronald Lauder have testified before the U.S. Congress that the Czech Republic “went out of its way to encourage U.S. investors . . . [and] they pointed out that such an investment would be protected by the bilateral investment treaty between the United States and the Czech Republic.” When making his own investment in the Czech Republic, Mr. Lauder explained he did so “with the knowledge that [the investment] was protected unequivocally under the bilateral investment treaty.”⁵³ Other investors have suggested that the existence of certain investment treaties reduce perceived political risk⁵⁴ within a country; they may also have a signaling or reputation-building effect for governments that enact the treaties.⁵⁵

On the other hand, some investors and commercial organizations are not even aware of the existence of investment treaties. For example, in a 1999 survey related to the multilateral Energy Charter Treaty (“ECT”),⁵⁶ many chambers of commerce

51. See generally Jason Webb Yackee, *Are BITs Such a Bright Idea? at Exploring the Ideational Basis of Investment Treaty Enthusiasm*, 12 U.C. DAVIS J. INT’L L. & POL’Y 195 (2005); see also Newfarmer, *supra* note 43, at 107-08 (indicating that “the costs in the form of investor suits are nontrivial and growing” but indicating the “legal and macroeconomic consequences of investment rights is largely unknown”); Franck, *Bright Future*, *supra* note 1, at 49-51 nn.6 & 16 (referring to the debate as to whether BITs achieve their stated goals).

52. OMALU, *supra* note 1, at 219; see also THE NORTH AMERICAN FREE TRADE AGREEMENT 25 (Khosrow Fatmi & Dominick Salvatore eds., 1994) (referring to studies related to trade liberalization in Mexico).

53. *Treatment of U.S. Business in Eastern and Central Europe*, Subcommittee on European Affairs, Sen. Comm. On Foreign Relations, 106th Cong., Send. Sess. at 18 (June 28, 2000) (Testimony of Ronald Lauder, Chairman, Central European Media Enterprises).

54. One wonders whether actuaries share investors’ perceived decrease in political risk when calculating political risk insurance (“PRI”) rates. Should they share this understanding, the decreased risk might reasonably be expected to result in less expensive PRI, which presumably decreases the cost of foreign investment and serves as an incentive for foreign investment. See UNCTAD, *BITs in the Mid-1990s*, *supra* note 20, at 142 (suggesting that “BITs can facilitate the purchase of political risk insurance from public investment insurance agencies and reduce premiums for this insurance”); see also Hamilton & Rochweger, *supra* note 32, at 31-33 (discussing a variety of entities providing political risk insurance). The author contacted the Overseas Private Investment Corporation (“OPIC”), a U.S. entity which issues PRI, and they have not conducted any studies examining whether BITs affect PRI rates. OPIC is unlikely to issue a political risk insurance policy unless the country of investment has an investment treaty with the United States. See Comeaux & Kinsella, *supra* note 12, at 37; 22 U.S.C.A. § 2197(a); see also *supra* note 12 and accompanying text (suggesting the availability of political risk insurance may influence an investment decision).

55. OMALU, *supra* note 1, at 225.

56. European Energy Charter Conference: Final Act, Energy Charter Treaty, Decisions and Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects, 34 I.L.M. 360 (1995), available at

indicated that they had no familiarity with the investment treaty.⁵⁷ One secretary general of an Australian chamber of commerce even went so far as to state, “I have no knowledge of the ECT and doubt whether our members . . . would have much knowledge either . . . I cannot answer your questionnaire and I doubt whether any of the major Chambers of Commerce would be either able or interested either.”⁵⁸ Recognizing this gap in investors’ knowledge—or perhaps the lack of appreciation—of the potential power of investment treaties, lawyers looking to generate the business of investment treaty arbitration market it as “rights you never knew you had.”⁵⁹

While investors may be aware of investment treaties, their existence may only have a marginal impact on the decision to invest. In the context of the North America Free Trade Agreement (“NAFTA”), for example, investors have suggested that the treaty was not the cause of their investment and that, if anything, NAFTA marginally influenced their decision to invest. Instead, these investors focus on the economic liberalization and reforms that began in the 1980s as the primary factor driving their investment determinations.⁶⁰

There are, of course, limits to the generalizability of this anecdotal information. First, it may be unrepresentative of investors’ motivations. Sadly, there is little empirical evidence to assess this issue and determine, in a valid and reliable manner, what factors affect investment decisions. Second, the majority of this anecdotal evidence relates to investor evaluations and decisionmaking in the 1990s. Given the recent proliferation of investment treaty arbitration and the success of certain investors in those arbitrations, one wonders whether FDI decisions today would be influenced differently by the existence of an investment treaty and the availability of investment treaty arbitration.

B. Empirical Analyses

There is also emerging empirical literature that considers whether investment treaties foster FDI.⁶¹ Unfortunately, this literature is inconclusive. Some analysts

<http://www.encharter.org/upload/1/TreatyBook-en.pdf>. It may be inappropriate to make many generalizations about the ECT; although it is a multilateral treaty with a variety of signatories, the scope of its protections relate to the energy sector. *Id.*

57. OMALU, *supra* note 1, at 205.

58. *Id.*

59. Allen & Overy, *In Focus: The Rise of Investment Treaty Arbitration*, <http://www.allenoverly.com/asp/infocus.asp?pageID=3837> (last visited Oct. 22, 2005).

60. OMALU, *supra* note 1, at 221.

61. There is also literature that seeks to explain the proliferation of investment treaties during the last fifty years. While this aspect of the literature is beyond the scope of this article, the phenomenon could be explained in a variety of ways. For example, “learning theory” suggests that governments observe the outcome of previous BIT signings and sign further BITs because BITs work. *See generally* Zachary Elkins & Beth Simmons, *On Waves, Clusters, and Diffusion: A Conceptual Framework*, 598 ANNALS AM. ACAD. POL. SOC. SCI. 33, 42-43 (2005). Another explanation might be the presence of institutional copying, where governments repeat the actions of others in an effort to appear enlightened or receptive to modern international law trends. Ginsburg, *supra* note 17, at 117; Guzman, *supra* note 18, at 667. Yet another suggestion is that the proliferation

suggest that the impact of investment treaties may be negligible. Instead, these “market protagonists” find that other factors relating to the market for FDI are likely to influence investment decisions.⁶² In contrast, another group of scholars has a different perspective. These “treaty protagonists” have found that investment treaties do attract FDI.⁶³

1. Market Protagonists

Analysts from the United Nations Commission on Trade and Development (“UNCTAD”), the World Bank, and elsewhere have conducted research suggesting that investment treaties have a minimal impact on foreign investment.⁶⁴ Nevertheless, to the extent that such treaties do impact investment determinations, these studies suggest that they are one aspect of larger market forces that impact FDI (e.g., the size of the internal market, the gross domestic product (“GDP”) of the host country, pre-existing levels of investment, and the degree of market liberalization).

The UNCTAD studied these issues in the 1990s. While its studies provide a weak indication that signing an investment treaty has a positive influence on FDI,⁶⁵ the UNCTAD study ultimately concluded that BITs play a “minor and secondary role in influencing FDI flows.”⁶⁶ Instead, UNCTAD’s analysis suggests that other factors, such as GDP, population, and levels of domestic investment are more powerful determinants of FDI.⁶⁷ Ultimately, investment treaties may not cause investment, but they may be correlated with investment levels. As UNCTAD cogently explained:

[I]t is generally recognized that investment decisions, and thus FDI flows, are determined by a variety of economic, institutional and political factors, including the size and growth rate of the host-country market, the

of BITs has been driven by competitive pressures between developing nations seeking to attract FDI. Guzman, *supra* note 18, at 676; see also Zachary Elkins, Andrew Guzman & Beth Simmons, *Competing For Capital: The Diffusion of Bilateral Investment Treaties, 1960-2000*, in INTERNATIONAL ORGANIZATION (forthcoming), available at <http://repositories.cdlib.org/cgi/viewcontent.cgi?article=1028&context=bple>.

62. Mary Hallward-Driemeier, *Do Bilateral Investment Treaties Attract Foreign Direct Investment? Only a Bit-and They Could Bite* (June 2003), http://econ.worldbank.org/files/29143_wps3121.pdf; see also M. Sornarajah, *State Responsibility and Bilateral Investment Treaties*, 20 J. WORLD TRADE L. 79, 82 (1986) (suggesting that “in reality attracting foreign investment depends more on the political and economic climate for its existence rather than on the creation of a legal structure for its protection”).

63. Salacuse & Sullivan, *supra* note 17, at 111.

64. This research has tended to focus on bilateral agreements, or BITs, rather than evaluating the impact of multilateral treaties.

65. UNCTAD, BITs in the Mid-1990s, *supra* note 20, at 122. UNCTAD also indicated that there were some foreign investors who encouraged their home governments to conclude BITs where they have existing investments. This would suggest that BITs have the capacity—perhaps not to increase investment flows—but to retain existing levels of foreign investment. *Id.* at 142.

66. *Id.* at 141-42.

67. *Id.* at 118-22.

availability of raw materials or labour. It would therefore be unreasonable to expect that any individual factor, let alone a BIT, could be isolated and ‘credited’ with a decisive impact on the size or increase of FDI flows. Even such important locational determinants as large and growing markets, or oil deposits . . . do not work alone as FDI determinants, but only in tandem with other factors.⁶⁸

Mary Hallward-Dreimer, an economist at the World Bank, expresses further skepticism about the impact investment treaties have on FDI. While she finds only one “significant positive result that a BIT could increase FDI,”⁶⁹ her results generally suggest that the impact of investment treaties is not statistically significant; instead, the size of a host country’s market is a more conclusive determinant of FDI flows.⁷⁰ Hallward-Dreimer’s analysis also suggests that signing a treaty does not enhance property protections, and a “BIT has not acted as a substitute for broader domestic reform. Rather, those countries that . . . already have reasonably strong domestic institutions are most likely to gain from ratifying a treaty.”⁷¹ These results suggest that, to the extent that investment treaties act more as a complement to, rather than a substitute for, domestic institutional reform, the real value from investment treaties may only come when they are a signal of future institutional reforms and trade liberalization.⁷² Thus, trade liberalization or institutional reforms that precede or follow the signing of an investment treaty likely are two factors that will affect investors’ investment decisions.

Jennifer Tobin and Susan Rose-Ackerman also conducted an econometric analysis to isolate the influence that investment treaties have on FDI. Like UNCTAD and Hallward-Dreimer, they find that population and market size—and in some cases GDP—are the crucial variables influencing FDI.⁷³ The general

68. *Id.* at 122.

69. Hallward-Dreimer, *supra* note 62, at 20.

70. *Id.* at 18.

71. *Id.* at 22-23. *But see* UNCTAD, BITs in the Mid-1990s, *supra* note 20, at 111 (finding that BITs signed by African countries had more effect than BITs in other regions because BITs are likely more important where the country is less developed).

72. Hallward-Dreimer, *supra* note 62, at 16, 21-23; *see also* Vandevelde, *Political Economy*, *supra* note 23; Vandevelde, *Economics*, *supra* note 18, at 470 n.10 (observing that investment treaties have the capacity to signal a state’s commitment to a liberal investment regime); DOLZER & STEVENS, *supra* note 22, at 12 (suggesting that BITs “send an important signal to the international business community to the effect that the [state] not only welcomes foreign investment but will also facilitate and protect certain foreign ventures”).

73. Tobin & Rose-Ackerman 2003, *supra* note 19, at 19; *see also* Jennifer Tobin & Susan Rose-Ackerman, *Foreign Direct Investment and Business Environment in Developing Countries: The Impact of Bilateral Investment Treaties*, Yale Law & Economics Research Paper No. 293 at 22-23, 30-31 (May 2, 2005), available at <http://ssrn.com/abstract=557121> [hereinafter Tobin & Rose-Ackerman 2005]. While revising this article, Tobin and Rose-Ackerman produced new scholarship with different results. The new analysis suggests BITs have a positive impact on FDI flows to developing countries but it is highly dependent on the political and economic environment surrounding FDI and BITs. *See* Jennifer Tobin & Susan Rose-Ackerman, *When BITs Have Some Bite: The Political-Economic Environment for Bilateral Investment Treaties*, (Nov. 14, 2006),

results of their analysis suggested that the relationship between investment treaties and FDI is weak with little impact upon FDI.⁷⁴ In the specific context of the effects of U.S. BITs, the data suggested that “signing a BIT with the United States does not correspond to increased FDI inflows.”⁷⁵

Closer analysis of the Tobin/Rose-Ackerman data reveal two interesting findings related to perceived political risk and investment. First, where a country exhibits high levels of political risk, there is a marginal benefit in signing a treaty and, for particularly risky countries, BITs may actually have “a *negative* effect on FDI inflows.”⁷⁶ Second, lower political risk may alleviate the potential adverse effects BITs can have on FDI inflows; however, once a country achieves a minimally low level of political risk, BITs may begin to become important in attracting FDI.⁷⁷

Ultimately, these findings suggest that investment treaties may be important instruments, but the interaction between BITs, political risk, and investment flows is complex. A BIT may be harmful in some circumstances, but in other circumstances, it may have no effect or possibly provide a tipping point for FDI decisions in risky countries where there is also some minimal level of political stability.⁷⁸ Ultimately, given the generally weak relationship between BITs and

<http://www.law.yale.edu/faculty/roseackermancv.htm> (suggesting that “as the coverage of BITs increases, overall FDI flows to developing countries may increase, but the marginal effect of a country’s own BITs on its FDI will fall” and observing that “a stronger political environment for investment and a better local economic environment are complements to BITs”). This is an important shift and indicates this area will require careful consideration in the future.

74. Tobin & Rose-Ackerman 2003, *supra* note 19, at 31; Tobin & Rose-Ackerman 2005, *supra* note 73, at 22-23, 30.

75. Tobin & Rose-Ackerman 2003, *supra* note 19, at 22, 31; Tobin & Rose-Ackerman 2005, *supra* note 73, at 30-31.

76. Tobin & Rose-Ackerman 2005, *supra* note 73, at 22. Tobin and Rose-Ackerman’s original work found “countries that are relatively risky seem to be able to attract somewhat more FDI by signing BITs. For those that are relatively safe for investors the marginal effect of BITs is small.” Tobin & Rose-Ackerman 2003, *supra* note 19, at 31. In the later work, their general findings suggested that the negative effect on FDI flows can grow smaller as a country becomes less risky. Tobin & Rose-Ackerman 2005, *supra* note 73, at 22, 31.

77. Tobin & Rose-Ackerman 2005, *supra* note 73, at 23, 30; Tobin & Rose-Ackerman 2003, *supra* note 19, at 27. In their earlier work, although there was a weak positive relationship between BITs and private domestic investment, as political risk decreased, the number of BITs in force appeared to discourage domestic investment. *Id.* at 27, 31. In their later work, however, it was unclear whether BITs generally discouraged FDI flows. At high level of political risk, BITs could have a negative to neutral effect on FDI. At low levels of political risk, the negative effect would decrease and the data began to suggest a BIT could at some point have a positive effect. Because they found similar results both for their general data as well as data focused on U.S. BITs, they suggested that some form of protection must be in place before BITs can begin to achieve their desired result. Tobin & Rose-Ackerman 2005, *supra* note 73, at 22-24, 30-31.

78. Tobin & Rose-Ackerman, *supra* note 73, at 30. While there is not a traditional BIT between the United States and Vietnam, the two countries entered into an investment agreement in 2001. *See* 66 FED. REG. 31375 (2001); 66 FED. REG. 65019 (2001); *see also* U.S. Department of State, 2005 *Investment Climate Statement–Vietnam* (2005), available at <http://www.state.gov/e/eb/afd/2005/42198.htm>. Since then, U.S. investment in Vietnam has increased to approximately \$2.5 billion. U.S. COMMERCIAL SERVICE, DOING BUSINESS IN VIETNAM: A COUNTRY COMMERCIAL GUIDE FOR U.S. COMPANIES 64 (2004), available at http://www.buyusa.gov/vietnam/en/country_commercial_guide.html.

investment, Tobin and Rose-Ackerman express skepticism as to whether investment treaties in general fulfill their major objective of encouraging FDI.⁷⁹

2. Treaty Protagonists

In contrast, the analysis of other scholars suggests that investment treaties do increase FDI. When looking at U.S. BITs, for example, Salacuse and Sullivan find strong evidence for the conclusion that BITs foster FDI.⁸⁰ Neumayer and Spess,⁸¹ Swenson, and Egger and Pfaffermayr⁸² reach similar conclusions regarding other BITs.

Salacuse and Sullivan find that, when developing countries sign investment treaties with Organization for Economic Co-operation and Development (“OECD”) countries, FDI is likely to increase; and the degree of this investment is likely to be substantially larger if the OECD country is the United States.⁸³ The effect is even larger when analyzing the FDI of those countries that had signed a U.S. BIT and comparing them with nonsignatories.⁸⁴

The preliminary findings of Neumayer and Spess suggest that developing countries that sign more BITs with developed countries receive more FDI flows.⁸⁵ Although they suggest that BITs may sometimes function as substitutes for domestic institutional quality, they also note that the positive effect of BITs on

79. Tobin & Rose-Ackerman 2003, *supra* note 19, at 31; Tobin & Rose-Ackerman 2005, *supra* note 73, at 31.

80. Salacuse & Sullivan, *supra* note 17, at 109, 111. They conclude the following: (1) a “U.S. BIT is more likely than not to exert a strong and positive role in promoting U.S. investment”; (2) a “U.S. BIT is more likely than not to exert a strong and positive role in promoting overall investment”; and (3) a “U.S. BIT is likely to exert more of an impact than other OECD BITs in promoting overall investment.” *Id.* at 111; *see also* Guzman, *supra* note 18, at 680 (noting in an early analysis that “[w]ithout a BIT, a particular developing country will have a much lower level of investment than otherwise”); *but see* Tobin & Rose-Ackerman 2005, *supra* note 73, at 23, 30 (suggesting that Salacuse and Sullivan’s methodology may employ too short a time lag, omit certain variables, such as country-specific effects, and have skewed results as a result of the source of the data).

81. Eric Neumayer & Laura Spess, *Do Bilateral Investment Treaties Increase Foreign Direct Investment in Developing Countries?* (May 2005), available at [http://eprints.lse.ac.uk/archive/00000627/01/World_Dev_\(BITs\).pdf#search=%22washington%20spess%20foreign%20investment%20BIT%22](http://eprints.lse.ac.uk/archive/00000627/01/World_Dev_(BITs).pdf#search=%22washington%20spess%20foreign%20investment%20BIT%22).

82. *See* Deborah L. Swenson, *Why Do Developing Countries Sign BITs?*, 12 U.C. DAVIS J. INT’L L. & POL’Y 131, 152-55 (2005) (finding signing BITs, particularly those with the United States, was positively correlated with larger investment flows but acknowledging that these results may be influenced by other variables such as alternative investment promotion measures); Peter Egger & Michael Pfaffermayr, *The Impact of Bilateral Investment Treaties on Foreign Direct Investment*, 32 J. COMP. ECON. 788 (2004) (reviewing OECD data and finding investment treaties exert a significant positive effect on FDI, particularly if they are implemented and noting that simply signing a treaty has positive—although less significant—effects on FDI).

83. Salacuse & Sullivan, *supra* note 17, at 106.

84. *See id.* at 109 (explaining that a U.S. BIT is correlated with a major FDI increase when compared to those countries without a BIT and suggesting “a U.S. BIT is correlated with an extra \$1 billion (approximately) in increased FDI per year”).

85. Neumayer & Spess, *supra* note 81, at 27. More specifically, countries with a higher cumulative number of BITs, richer countries and fast-growing economies and larger populations receive more FDI, but factors such as high inflation rates deter FDI. *Id.* at 21.

FDI decreases as governments become more stable.⁸⁶ Nevertheless, Neumayer and Spess suggest that by “succumbing to the obligations of BITs,” developing nations will secure the “desired payoff of higher FDI inflows,” specifically those countries “with particularly poor institutional quality stand the most to gain from BITs.”⁸⁷ Ultimately, they conclude that investment treaties “fulfill their purpose and those developing countries that have signed more BITs with major capital exporting developed countries are likely to have received more FDI in return.”⁸⁸

Analysts evaluating multilateral regional trade and investment agreements similarly suggest that such treaties can positively impact foreign investment. Lederman, Maloney, and Serven found that positive FDI flows are more likely when regional treaties create larger markets; but they also discovered that, despite NAFTA’s initial positive influence on FDI, this increase is not sustained over time.⁸⁹ Similarly, a World Bank analyst, who acknowledged the lack of impact that BITs had on direct investment, nevertheless found that regional agreements, which create larger markets, do encourage greater investment.⁹⁰

C. Synthesis of the Literature

Given the mixed nature of the literature and scholars’ different empirical methodologies, it is difficult to draw decisive substantive conclusions.⁹¹ A synthesis of the existing literature might reasonably suggest that, while

86. *Id.* at 22-24. Commentators indicate Neumayer and Spess’ data suggest that the “apparent boost provided by a BIT is bigger in countries that were characterized by a greater risk, and hence likely to benefit more from the decisions to sign a BIT.” Swenson, *supra* note 82, at 135.

87. Neumayer & Spess, *supra* note 81, at 27.

88. *Id.* at 28. Tobin and Rose-Ackerman suggest that the difference between their results and the results of Neumayer and Spess may be due to factors such as a difference in sample size, the extended time period of the countries, and the countries focused on by the two studies. Tobin & Rose-Ackerman 2005, *supra* note 73, at 23.

89. Daniel Lederman, William F. Maloney & Luis Serven, *Lessons from NAFTA for Latin America and the Caribbean Countries: A Summary of Research Findings* (2004), available at http://www.sice.oas.org/geograph/north/lessonsNAFTA_e.pdf.

90. Newfarmer, *supra* note 43, at 109; see also Eduardo Levy Yeyati, Ernesto Stein & Christian Daude, *The FTAA and the Location of FDI* (2004), available at <http://www.bcentral.cl/esp/estpub/estudios/dtbc/pdf/dtbc281.pdf> (suggesting that regional trade agreements have a strong positive impact on inflows); Swenson, *supra* note 82, at 153 (commenting on the effect regional agreements have on foreign investment). Newfarmer acknowledges, however, that FDI is part of a larger complicated web related to GDP, political stability, inflation rates, government effectiveness, and risks of expropriation. Newfarmer, *supra* note 43, at 109.

91. The different empirical analyses employ different methodologies to arrive at their results. Hallward-Driemier, *supra* note 62, at 12 (analyzing country pairs and considering the bilateral flow of FDI from twenty OECD countries to thirty-one developing countries from 1980 to 2000); Neumayer & Spess, *supra* note 81, at 15-21 (gathering data from 119 developing countries between 1970 and 2001, considering their FDI flows—rather than FDI inflows—as a percentage of host country GDP, evaluating the cumulative number of BITs signed, and weighting FDI flows); Salacuse & Sullivan, *supra* note 17, at 104-05 (analyzing the impact of U.S. BITs on aggregate FDI inflows to 100 developing nations by measuring the percentage change in FDI inflows, rather than absolute FDI flows); Tobin & Rose-Ackerman 2003, *supra* note 19, at 12 (analyzing FDI flows between sixty-three countries from 1980 to 2000 and measuring FDI as “inflows to a particular country as a percentage of world FDI inflows for that year”).

investment treaties may have a negligible impact on investment, they are nevertheless part of a wider set of forces fostering FDI.⁹² The nature of current analysis also suggests that certain individual treaties, whether they are bilateral or multilateral agreements or agreements with specific trading partners, may be more likely than others to achieve the desired goal of promoting and retaining foreign investment. Put another way, it is difficult to make generalizations about the influence of investment treaties, particularly where some treaties appear to play a role in increasing FDI to host countries while others may not. Ultimately, this is still an area of important scholarly analysis, and future empirical examination may shed more light on the intricate web of factors influencing foreign investment decisions.

IV. INVESTMENT TREATY ARBITRATION: PROMOTING FDI?

Given that the terms of investment treaties are varied and that there is a possible relationship between the existence of an investment treaty and FDI, it may be useful to inquire as to whether the specific terms of investment treaties affect FDI. Despite the unique innovation in offering investors a forum to remedy their substantive claims, there has been little analysis of whether investment arbitration specifically provides an incentive for foreign investment or otherwise promotes the stability of an internal investment regime. This article considers that issue on a preliminary and particular basis.

Why is it potentially important to focus on the impact of investment arbitration on FDI? There has been some suggestion that dispute resolution provisions are one of the strongest investor protections in investment treaties.⁹³ The former U.S. Treasury Secretary, John Snow, has also suggested that focusing “attention on a dispute resolution process [is] a way to facilitate foreign direct investment.”⁹⁴

While scholars suggest that dispute-settlement procedures in treaties are likely to influence investment behaviors, others suggest that it would be

92. See WORLD INVESTMENT REPORT 2005, *supra* note 4, at 177 (discussing the mixed evidence about the link between treaties and investment and observing that “firms make their investment decisions based on an assessment of opportunities as a package, and treaty protections alone will rarely be decisive. A BIT addresses only one part of firms’ investment equation, and so by itself is not enough to overcome problems with infrastructure or other parts of the investment climate”); see also Ginsburg, *supra* note 17, at 115 (suggesting that although “most think that the purpose of [investment treaties] is to attract investment, the best available evidence suggest that BITs have either no effect or a minimal positive effect on investment flows”).

93. See Newfarmer, *supra* note 43, at 107.

94. Khozem Merchant, *Snow Calls for an Arbitration System to Ease India Fears*, FIN. TIMES, Nov. 8, 2005, available at <http://news.ft.com/cms/s/d810ddf8-5078-11da-bbd7-0000779e2340.html> (on file with the Pacific McGeorge Global Business & Development Law Journal); see also Express India, *supra* note 14 (suggesting that India drew FDI away from China by instituting effective ADR mechanisms and making India a “hub of international arbitration”). Former Secretary of the Treasury John Snow’s remarks involved installing an arbitration system to reduce uncertainty in the timeframe for dispute resolution. *Id.* It is unclear whether the comments were in the context of an international commercial arbitration system or an investment treaty related dispute resolution mechanism. Currently, there is no BIT between the United States and India.

challenging to isolate the effect of individual treaty rights, particularly the role of dispute resolution mechanisms.⁹⁵ To date, there is an absence of empirical evidence considering the relationship between investment arbitration and FDI, and it appears that this evidence is not immediately forthcoming.

Accordingly, this section hypothesizes as to the potential role of dispute resolution provisions in investment treaties, and considers both the direct and indirect ways treaty arbitration might serve as an incentive for FDI. Part A looks directly at the relationship between an investment treaty's dispute resolution mechanism and foreign investment. It suggests several potential models to explain the potential relationship between the dispute resolution mechanisms contained in investment treaties and investment levels. Part B then evaluates how investment treaty arbitration indirectly creates incentives for foreign investment by fostering the development of the rule of law.

A. Case Studies: Considering the Impact of Unique Dispute Resolution Provisions to Evaluate Directly their Influence upon Investment Levels

Entrepreneurs and foreign investors may ultimately make investment decisions based upon a variety of factors,⁹⁶ many of which are likely unrelated to treaty dispute resolution mechanisms. While some businesspeople may perform rational cost-benefit analyses prior to making their investments, other investors may be more concerned with other factors, such as the following: (1) obtaining immediate commercial profit,⁹⁷ which might be implicated in a jurisdiction's tax

95. See Swenson, *supra* note 82, at 133-34; Neumayer & Spess, *supra* note 81, at 9-10; e-mail from Jason Yackee to Susan Franck (Oct. 27, 2005) (on file with author) (suggesting that it might be "possible to isolate the effects of various provisions, but only the "strongest" or most relevant provisions to investors"); Telephone Interview with Jason Yackee (Sept. 27, 2005) (suggesting that coding the impact of the dispute resolution provisions of BITs is nearly impossible and isolating the effect of these provisions is a "hopeless task" but suggesting that anecdotal evidence may be available). Jason Yackee, a Law Fellow at the University of Southern California and a Ph.D. Candidate at University of North Carolina, is analyzing the impact of BITs. Yackee has a grant from the National Science Foundation to conduct research related to why developing countries sign BITs, which in many cases sacrifice attributes of national sovereignty in an attempt to attract investment by multinational corporations.

96. See generally JEAN-FRANCOIS HENNART, A THEORY OF MULTINATIONAL ENTERPRISE 60-61, 88, 164-65, 166-71 (1982); HUGH SCHWARTZ, RATIONALITY GONE AWRY? DECISION MAKING INCONSISTENT WITH ECONOMIC AND FINANCIAL THEORY (1998) (outlining behavioral considerations that appear relevant to financial and economic decisionmaking); Troy A. Paredes, A Systems Approach to Corporate Governance Reform: Why Importing U.S. Corporate Law Isn't The Answer, 45 WM. & MARY L. REV. 1055, 1085-90 (2005) (describing a variety of factors that influence investment decisions, including officers and directors concern about retaining their jobs, maximizing their bonuses, keeping their companies competitive, avoiding shame and embarrassment, and doing "what is right, what is professional, what is honorable, and what is profitable"); see also Diane M. Ring, One Nation Among Many: Policy Implications of Cross-Border Tax Arbitrage, 44 B.C. L. REV. 79, 119 (2002) (suggesting that a "business decision to invest abroad generally seems motivated by business and not taxes"); J. Clifton Fleming, Jr., Robert J. Peroni & Stephen E. Shay, Fairness in International Taxation: The Ability-To-Pay Case for Taxing Worldwide Income, 5 FLA. TAX REV. 299, 305 n.10 (2001) (gathering sources to suggest low foreign tax rates affect the investment location decisions of U.S. multinational corporations).

97. See WORLD INVESTMENT REPORT 2005, *supra* note 4, at 1 (noting that investors are "[d]riven by the quest for profits"); see also ADAM SMITH, WEALTH OF NATIONS (E. Cannon ed., 1937) (arguing people seek to

regime or the stability of internal regulation;⁹⁸ (2) gaining a foothold in an emerging market in the hopes of securing future profits;⁹⁹ (3) engaging in institutional copying by entering a new market or seeking to gain a competitive advantage over competitors in the same market;¹⁰⁰ (4) fostering existing

maximize their rational self-interest); Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CAL. L. REV. 1051, 1060-66 (2000) (discussing the origins of rational choice theory suggesting that rational “actors will attempt to maximize their financial well-being or monetary situation”); but see Elizabeth Asiedu, *On the Determinants of Foreign Direct Investment to Developing Countries: Is Africa Different?*, 30 WORLD DEV. 107, 107, 114-16 (2001) (finding that sub-Saharan Africa is different from other developing countries and FDI there is not responsive to greater returns on investment and identifies other factors such as geographic location, the risk of government policy reversal, and the sector-specific nature of the investment that are more likely to influence investment).

98. WORLD INVESTMENT REPORT 2005, *supra* note 4, at 4-7, 22-4; see also *supra* note 97 and *infra* notes 100, 121, 129 and 133 and accompanying text (discussing the role of taxes in foreign investment). But see Peter K. Nyikuli, *Unlocking Africa’s Potential: Some Factors Affecting Economic Development Investment in Sub-Saharan Africa*, 30 LAW & POL’Y INT’L BUS. 623 (1999) (failing to mention tax policy as a significant factor affecting economic development in Africa); Dirk Willem te Velde, *Policies Towards Foreign Direct Investment in Developing Countries: Emerging Best-Practices and Outstanding Issues*, 6-9 (Mar. 2001), available at http://www.odi.org.uk/IEDG/Meetings/FDI_Conference/DWPaper.pdf (concluding that the policies adopted by developing countries affect FDI locational decisions only after a developing country has put in place such fundamental factors as government stability, basic infrastructure, openness to trade, and sufficient market size). While a thorough analysis of all factors affecting FDI decisions is beyond the scope of these remarks, commercial profitability can also be affected by a variety of factors, such as the availability of skilled labor and labor policies. See generally Ibrahim F.I. Shihata, *Factors Influencing the Flow of Foreign Investment and the Relevance of the Multilateral Investment Guarantee Scheme*, 21 INT’L LAW. 671 (1987); THE DETERMINANTS OF FOREIGN DIRECT INVESTMENT: A SURVEY OF THE EVIDENCE (United Nations 1992); see also John W. Budd & Yijiang Wang, *Labor Policy and Investment: Evidence From Canada*, 57 INDUS. & LAB. REL. REV. 386, 386, 398-99 (2004) (observing that regulatory policies, particularly those related to labor and employment, can impact foreign direct investment); Farhad Noorbakhsh et al., *Human Capital and FDI Flows to Developing Countries: New Empirical Evidence*, 29 WORLD DEV. 1593, 1593, 1602 (2001) (observing that the availability of human capital is a significant factor in the locational decisions of multinational companies when investing abroad and its importance has been increasing over time); George O. White III, *Foreigners at the Gate: Sweeping Revolutionary Changes on the Central Kingdom’s Landscape—Foreign Direct Investment Regulations & Dispute Resolution Mechanisms in the People’s Republic of China*, 3 RICH. J. GLOBAL L. & BUS. 95, 126-30 (2003) (suggesting culture and business relationships impact investment determinations).

99. See Andrea Ewart, *Caribbean Single Market & Economy: What is it and Can it Deliver?*, 11 ILSA J. INT’L & COMP. L. 39, 45 (2004) (observing “[o]ne common motive for foreign direct investment is to boost local sales and market access”); MAURICE SHIFF & L. ALAN WINTERS, *REGIONAL INTEGRATION AND DEVELOPMENT* 101, 117-19 (2003) (focusing on regional investment agreements and noting the importance of market access); see also William B. Barker, *Optimal International Taxation and Tax Competition: Overcoming the Contradictions*, 22 NW. J. INT’L L. & BUS. 161, 177-78 (2002) (explaining that in the past “one of the primary reasons for FDI was market access” but suggesting that today tax incentives play a greater role); Dai Yan, *US\$33.9 billion of FDI Settle in China in First Half Year*, CHINA DAILY, July 13, 2004, available at http://www.chinadaily.com.cn/english/doc/2004-07/13/content_348060.htm (suggesting that foreign investors are drawn to China’s “vast pool of cheap labour and its fast-growing market”).

100. Barker, *supra* note 99, at 198; Been & Beauvais, *supra* note 46, at 31, 38-39; Coe, *Taking Stock*, *supra* note 43, at 1439-40; see also Matthew C. Porterfield, *International Expropriation Rules and Federalism*, 23 STAN. ENVTL. L.J. 3, 88 (2004) (suggesting that international investors may have a comparative advantage to domestic investors who are in the same market); Mao-Chang Li, *Legal Aspects of Labor Relations in China: Critical Issues For International Investors*, 33 COLUM. J. TRANSNAT’L L. 521, 526 (1995) (observing foreign investors can gain a comparative advantage by investing abroad and lowering opportunity costs); HELEN HUGHES & YOU POH SENG, *FOREIGN INVESTMENT AND INDUSTRIALIZATION IN SINGAPORE* 183-89 (observing that foreign investors in Singapore claimed that a primary reason for their entry into the Singaporean market

relationships with individuals or government;¹⁰¹ and (5) taking into account the sophistication and experience of investors and their attorneys. Given that investment treaty arbitration may operate independently from or in conjunction with these factors (or perhaps not at all), it seems appropriate to consider bases for the assertion that investment arbitration may be an incentive for FDI as well as counter-narratives.

Case studies provide useful models for directly evaluating what impact investment treaty arbitration may have upon foreign investment decisions. While many investment treaties provide arbitration as the exclusive final remedy for a breach of treaty rights,¹⁰² levels of FDI in those countries that have opted out of a traditional arbitration model and have unique dispute resolution provisions provide an opportunity to consider the relationship between dispute resolution mechanisms and investment decisions.

This section therefore considers those countries that have signed investment treaties with a limited or no right to investment arbitration. Likewise, there are also countries that afford investors neither substantive nor procedural investment rights. Nevertheless, in all of these situations, these countries experience high levels of foreign investment. Theoretically, a variety of different models could explain these results. Approaches might include a “place holding” model, a “political and economic reality” model, and a “market liberalization” model.¹⁰³

1. The Place Holding Model

In a “place holding” model, investors care less about the particulars of a dispute resolution provision, and care more about establishing a place within a market. China might be viewed as an example of this model.¹⁰⁴ Historically,

was the comparative advantages of the host market).

101. See generally Bandell, *supra* note 11 (suggesting that political, social, and cultural relationships between investors and host state entities are more reliable predictors of FDI than host-country characteristics); Qiu, *supra* note 11 (discussing role of personal and institutional connections between foreign investors, Chinese businesses, and the Chinese government in attracting FDI).

102. The precise number of investment treaties requiring mandatory arbitration of investment disputes is not clear. See generally Parra, *Provisions*, *supra* note 16. The overriding theme appears to be mandatory arbitration of claims, whether before ICSID, the SCC, the ICC, or under the UNCITRAL Rules. Nevertheless, there are important variations. For example, many treaties require mandatory cooling-off or negotiation periods before an investor can initiate arbitration. *Id.* at 332; Franck, *Legitimacy Crisis*, *supra* note 1, at 1540 n.71; Schreuer, *Of Waiting Periods*, *supra* note 31. While a few countries require investors to exhaust their local remedies before initiating a treaty-based claim, many instead require the parties to choose between pursuing claims before either the local courts or an international arbitration tribunal. Parra, *Provisions*, *supra* note 16, at 333-35.

103. This potential list of models is not exhaustive. It is possible that more than one model could reasonably explain investment levels in a particular country. Establishing this nomenclature provides a framework for the discussion and may tease out certain themes in the literature.

104. As with any of the proposed models, confirmation that this model applies to China would be best done empirically on a treaty-by-treaty and country-by-country basis. Specifically, various countries have BITs with China; tracking the specific levels of investment in China by country may be useful to indicate which BITs have the greatest impact. This empirical analysis may suggest that this model will not work for all countries that

China, had a series of BITs that offered substantive investment protections. While some BITs did not offer foreign investors any forum to resolve their disputes,¹⁰⁵ China often permitted Chinese courts to resolve investment disputes. Specifically, although there was a narrow exception permitting arbitration for the valuation of an expropriation claim, China required that all other substantive claims be resolved before national courts.¹⁰⁶

have BITs with China. For example, the United States, which has large levels of foreign investments in China, does not have a BIT with China. Salacuse & Sullivan, *supra* note 17, at 110; *see also* U.S. Trade Representative, *China*, at 1, *available at* http://www.ustr.gov/assets/Document_Library/Reports_Publications/2005/2005_NTE_Report/asset_upload_file469_7460.pdf (stating that the “stock of U.S. foreign direct investment (FDI) in China in 2003 was \$11.9 billion, up from \$10.5 billion in 2002”); K.C. Fung, *Trade and Investment among China, the United States and the Asia-Pacific Economies: An Invited Testimony to the U.S. Congressional Commission 4* (Apr. 30, 2005), *available at* <http://econ.ucsc.edu/faculty/workingpapers/tradeandinvestment.pdf> (indicating that the United States is the second largest foreign investor in China); Theodore W. Kassing, *U.S.-China Trade: Opportunities and Challenges: Keynote Address*, 34 GA. J. INT’L & COMP. L. 101, 102 (2005) (observing that “U.S.-China bilateral trade leapt to \$231 billion” in 2004); ICSID, *Bilateral Investment Treaties: China*, <http://www.worldbank.org/icsid/treaties/china.htm> (last visited Dec. 30, 2006) (failing to indicate that the United States and China have an investment treaty); UNCTAD, *Investment Instruments Online: Bilateral Investment Treaties*, <http://www.unctadxi.org/templates/DocSearch.aspx?id=779> (last visited Dec. 30, 2006). Such a result would suggest that different models might reasonably explain the presence of FDI within a single country. For example, the United States’ experience in China might also be explained by the place-holding model. *See infra* notes 118-20 and accompanying text (describing a market liberalization model); *see also* WORLD INVESTMENT REPORT 2005, *supra* note 4, at 7, 27, 57, 80 (observing that China’s economy has “grown impressively in recent years” and crediting this to the liberalization of the investment climate, which includes providing private property rights and offering economic incentives for business).

105. *See* Agreement on the Mutual Protection of Investments between the Government of the Kingdom of Sweden and the People’s Republic of China, July 1, 1979, arts. 6-7, *available at* http://www.unctad.org/sections/dite/ia/docs/bits/china_sweden.pdf (providing for arbitration of investment disputes between Sweden and China and not other foreign investors, and at the same time, not prejudicing any rights to litigate claims before national courts).

106. *See* Agreement between the Government of the People’s Republic of China and Government of the Kingdom of Denmark Concerning the Encouragement and Reciprocal Protection of Investments, 84 U.N.T.S.83 (No. 24573) (Dec. 4, 1986) art. 8, *available at* http://www.unctad.org/sections/dite/ia/docs/bits/china_denmark.pdf (providing that if a dispute is not settled by negotiation, the dispute shall be “submit[ted] to the competent court of the Contracting Party accepting the investment” but permitting “the amount of compensation resulting from expropriation” to be determined through international arbitration); Agreement between the Government of the People’s Republic of China and the Belgian-Luxembourg Economic Union on the Reciprocal Promotion and Protection of Investments, June 4, 1984, art. 10, *available at* http://www.unctad.org/sections/dite/ia/docs/bits/china_belg_lux.pdf (indicating that investment disputes “shall be subject to the jurisdiction of the State where the investment is located” but providing that the “amount of compensation for expropriation” to be decided by an arbitral tribunal); Agreement between the Government of New Zealand and the Government of the People’s Republic of China on the Promotion and Protection of Investments, 185 U.N.T.S. 1994, June 27, 1994, art. 13, *available at* http://www.unctad.org/sections/dite/ia/docs/bits/china_newzealand.pdf (indicating that investors may “submit the dispute to the competent court” but permitting “the amount of compensation for expropriation” to be decided by an arbitral tribunal); Agreement between the Government of the Republic of Chile and the Government of the People’s Republic of China Concerning the Encouragement and Reciprocal Protection of Investment, Mar. 23, 1994, art. 9, *available at* http://www.unctad.org/sections/dite/ia/docs/bits/chile_china.pdf (requiring disputes to be submitted to competent national courts, but permitting disputes related to amount of compensation for expropriation to be arbitrated); *see also* Agreement between the Government of Australia and the Government of the People’s Republic of China on the Reciprocal Encouragement and Protection of Investments, July 11, 1998, art. XII, *available at* http://www.unctad.org/sections/dite/ia/docs/bits/australia_china.pdf (providing that investors can “initiate proceedings before its competent judicial or

Reliance on national court systems and limited access to arbitration has not stopped investors from making substantial investments in China.¹⁰⁷ This suggests that irrespective of the procedural rights in investment treaties, there are some markets where investors are keen to gain a place or a foothold in a developing market. This “place holding” within a market is perhaps more important than the procedural rights granted by investment treaties.

2. The Political and Economic Reality Model

A “political and economic reality model” might suggest that when existing economic and political relationships are sufficiently strong and stable, the creation of a mechanism to resolve investment disputes is unnecessary.¹⁰⁸ Australia is an example of this model. In particular, Australia and the United States recently finalized a Free Trade Agreement (the “AUSFTA”), which provides substantive investor rights but does not give investors any forum to redress a treaty violation.¹⁰⁹ Rather, Article 11.16 provides that the United States and Australia will serve as “gate keepers”¹¹⁰ that will consult and decide whether to permit an investor to arbitrate a treaty claim.¹¹¹

administrative bodies” or arbitrate “where the parties agree or where the dispute relates to the amount of compensation payable” for expropriation); Parra, *Provisions*, *supra* note 16, at 337 (observing how China restricted the scope of arbitral investment disputes). China has recently shifted away from its traditional model, where the second generation of BITs offered more comprehensive arbitration rights than before. *See* Agreement between the People’s Republic of China and the Federal Republic of Germany on the Encouragement and Reciprocal Protection of Investments, Dec. 1, 2003, art. 9, *available at* http://www.unctad.org/sections/dite/iaa/docs/bits/china_germany.pdf (providing that if disputes cannot be settled they shall be submitted for arbitration); Agreement between the Government of the Czech and Slovak Federal Republic and the Government of the People’s Republic of China for the Promotion and Reciprocal Protection of Investments (Dec. 1991), art. 9, *available at* http://www.unctad.org/sections/dite/iaa/docs/bits/czech_china.pdf (providing that investor-State disputes be resolved either by competent courts or ad hoc UNCITRAL arbitration).

107. In the 1990s, “China was the most popular country in the world for foreign investment, aside from the United States.” Ted G. Telford & Heather A. Ures, *The Role of Incentives on Foreign Direct Investment*, 23 LOY. L.A. INT’L & COMP. L. REV. 605, 612 (2001); *see also* United Nations, *China FDI Fact Sheet*, (2005), *available at* http://www.unctad.org/sections/dite_dir/docs/wir05_fs_cn_en.pdf (providing empirical evidence regarding the increase in FDI inflows to China between 1985 and 2004).

108. This model might also implicate the nature of the economic, political, and legal structures within the signatory states. *See infra* notes 111-13 and accompanying text (noting the evidence of strong economic and political linkages between the United States and Australia).

109. United States-Australia Free Trade Agreement, (Mar. 3, 2004), art. 11, *available at* http://www.ustr.gov/assets/Trade_Agreements/Bilateral/Australia_FTA/Final_Text/asset_upload_file148_5168.pdf [hereinafter AUSFTA].

110. Franck, *Legitimacy Crisis*, *supra* note 1, at 1589-91 (describing the barrier building and gate keeping approach to dispute resolution in investment treaties).

111. AUSFTA, *supra* note 109, at art. 11.16(1). The agreement does not, however, prevent bringing a claim against a government if it is permitted under national law. *Id.* at art. 11.16(2). Australia has also signed an investment agreement with New Zealand that does not provide a specific mechanism for investors to bring investment related claims; instead, the two countries are required to negotiate the claims. *See* Australia New Zealand Closer Economic Relations Agreement, art. 22, *available at* http://www.dfat.gov.au/geo/new_zealand/anz_cer/anzcerta1.pdf; *see also* <http://www.fta.gov.au/default.aspx?FolderID=292&ArticleID=237>; *but see* Singapore Australia Free Trade Agreement, art. 14, *available at* <http://www.dfat.gov.au/trade/negotiations/>

Trade and investment have flowed, and will probably continue to flow, fluidly between these two countries.¹¹² One might speculate that the current dispute resolution system exists because both countries have well-developed rules of law and a reliable and independent court systems.¹¹³ But there might be another explanation. A “political and economic reality” model might suggest that two nations with shared economic and political goals, and substantial cross-border investment flows, recognize that they are both likely to be on the receiving end of investor-State disputes.¹¹⁴ This means that both countries have an incentive to create a dispute resolution mechanism that creates barriers limiting

safta/full_safta.pdf (providing for investor-State dispute resolution and permitting claims to be litigated or arbitrated).

112. The United States Trade Representative has indicated that U.S. FDI in Australia in 2003 was US\$41 billion, and that Australia is currently the fourteenth largest export market for U.S. goods. See United States Trade Representative, *Australia: Trade Summary*, available at http://www.ustr.gov/assets/Document_Library/Reports_Publications/2005/2005_NTE_Report/asset_upload_file243_7453.pdf; see also Statement of Ambassador Josette Sheeran Shiner, *infra* note 113, at 2 (noting that the “[t]wo-way goods and services trade [between Australia and the United States] is nearly \$29 billion”). Similarly, analysis from the Australian government indicates that the United States is the single largest investor in Australia, that U.S. FDI in Australia in 2004 was AUS\$153 million and Australian FDI in the United States during the same time was approximately AUS\$140 billion. See Government of Australia, Investment Australia, United States, http://www.investaustralia.gov.au/media/CFS_United_States.pdf (last visited Dec. 30, 2005) (setting out the levels of FDI between Australia and the United States).

113. The Australian government has explained that there is no investor-State dispute settlement “[i]n recognition of the Parties’ open economic environments and shared legal traditions, and the confidence of investors in the fairness and integrity of their respective legal systems.” Australian Government Department of Foreign Affairs and Trade, *Australia-United States Free Trade Agreement: Guide to the Agreement: 11*, at 6.4 (Mar. 6, 2004), available at http://www.dfat.gov.au/trade/negotiations/us_fta/guide/11.html; see also U.S.-Australia Free Trade Agreement, Subcommittee on Trade, H.R. Committee on Ways and Means at 1 (June 16, 2004) (Testimony of Ambassador Josette Sheeran Shiner, Deputy U.S. Trade Representative), available at http://www.ustr.gov/assets/Document_Library/USTR_Deputy_Testimony/2004/asset_upload_file753_4363.pdf (indicating that the United States and Australia “have long had a special partnership,” common history, and “an unwavering belief in freedom, democracy and the rule of law”).

114. Prior to the enactment of NAFTA, the United States and Canada had a free trade agreement which did offer rights, such as national treatment for investments, but did not permit investor-State dispute resolution. Canada-United States: Free Trade Agreement, arts. 105, 1801-08, 27 I.L.M. 281 (1989). After the enactment of NAFTA, however, both the United States and Canada have found themselves on the receiving end of investment arbitrations. Coe, *Taking Stock*, *supra* note 43, at 1459-60 (providing a table of the outcomes of select arbitration cases under NAFTA, including the number of settlements, amounts claimed, amounts recovered, and costs awarded); see also Todd Weiler, NAFTA Claims: Canada, http://www.naftaclaims.com/disputes_canada.htm (last visited Dec. 21, 2006) (listing claims against Canada); Todd Weiler, NAFTA Claims: United States, http://www.naftaclaims.com/disputes_us.htm (last visited Dec. 21, 2006) (listing claims against the United States). As this may be due to the large investment flows between the United States and Canada, presumably the United States was sensitive to this issue when drafting the United States-Australia Free Trade Agreement. U.S. Trade Representative, Canada, http://www.usembassycanada.gov/content/can_usa/ustr_trade_estimates_2005.pdf (last visited Dec. 30, 2005) (observing that the “stock of U.S. foreign direct investment (FDI) in Canada in 2003 was \$192.4 billion, up from \$170.2 billion in 2002”); U.S. Department of State, *2001 Country Reports on Economic Practices and Trade Policy*, 2 (Feb. 2002), available at <http://www.state.gov/documents/organization/8197.pdf> (observing that in 2000, U.S. FDI in Canada amounted to \$126.4 billion, and Canada’s FDI levels in the United States amounted to \$103.7 billion); Aldo Forgiione, *Weaving the Continental Web: Exploring Free Trade, Taxation, and the Internet*, 9 L. & BUS. REV. AM. 513, 547 (2003) (observing that the “United States has always accounted for a substantial amount of foreign investment in Canada”); see also Dodge, *supra* note 26, at 24 (observing the significant and reciprocal investment flows between the United States and Australia, and commenting that “allowing direct claims under AUSFTA would inevitably have led to a repetition of the Canadian and U.S. experience under NAFTA”).

the potential number of claims. While the Australian approach does not prohibit investors from having a cognizable treaty claim, it does leave discretion to grant a forum in the hands of two governments, which suggests that the substantive rights are legal phantoms.¹¹⁵ Rather than granting control to investors, it moves the resolution of treaty claims into a larger economic, political, and diplomatic dialogue.¹¹⁶

As the AUSFTA entered into force in January 2005,¹¹⁷ it is not clear whether the dispute resolution mechanism in that treaty has impacted either United States investment in Australia or vice versa. The treaty and its effects are, however, worthy of ongoing consideration particularly as other countries may wish to adopt the model.

3. The Market Liberalization Model

In a “market liberalization”¹¹⁸ model, modernization and liberalization of an investment regime facilitates FDI irrespective of the existence of substantive or procedural rights in BITs. Brazil¹¹⁹ and Ireland¹²⁰ might reasonably be viewed as

115. See *supra* note 25 and accompanying text (suggesting that the provisions of legal rights without remedies create ghostlike legal obligations). Nevertheless, the AUSFTA has gone to the trouble to articulate specific substantive rights that, arguably, must be given some meaning. If they were not meant to have an effect, presumably they would not have been included.

116. Presumably investors are still free to bring claims arising out of domestic law before the domestic courts. AUSFTA, *supra* note 109, at art. 11.16. The same cannot be said, however, of international law claims arising under the treaty. See Dodge, *supra* note 26, at 2-4, 24-26 (indicating that claims under the AUSFTA cannot be brought before local courts but can only be resolved under the State-to-State dispute resolution mechanisms).

117. Australian Government Department of Foreign Affairs and Trade, Australia-United States Free Trade Agreement, January 1, 2005, available at <http://www.dfat.gov.au/trade/negotiations/us.html>; John R. Crook, ed., *United States, Australia Settle Disputes Blocking U.S.-Australian Free Trade Agreement*, 99 AM. J. INT'L L. 260, 260 (2005).

118. Whereas modernization refers to updating commercial laws, liberalization refers to the opening up of markets, permitting public participation in areas previously relegated to the government, and fostering competition. Market liberalization might be marked by a variety of different factors. For example, it might include the creation of new trade rules to build a larger market, relaxing restrictions on industry to permit and enhance market access, enhancing regulatory transparency, and creating incentives for competition. See generally, Newfarmer, *supra* note 43, at 105-06; Frank Barry et al., *The Single Market, the Structural Funds, and Ireland's Recent Economic Growth*, 39 J. OF COMMON MARKET STUD. 537, 537-38 (2001); John Kelly & Mary Everett, *Financial Liberalisation and Economic Growth in Ireland* (Autumn 2004), available at <http://www.centralbank.ie/data/QrtBullFiles/2004%2003%20Financial%20Liberalisation%20and%20Economic%20Growth.pdf>; NINA PAVCNIK ET AL., TRADE LIBERALIZATION AND LABOR MARKET ADJUSTMENT IN BRAZIL 7 (2003), available at http://wdsbeta.worldbank.org/external/default/WDSCContentServer/IW3P/IB/2003/03/29/000094946_03031804031942/Rendered/PDF/multi0page.pdf. But see Asiedu, *supra* note 97, at 115 (suggesting that trade liberalization in Africa is less effective in promoting FDI unless it is consistent with macroeconomic equilibrium).

119. See Charles W. Cookson, *Long-Term Direct Investment in Brazil*, 35 U. MIAMI INTER-AM. L. REV. 345, 356-58 (2004) (suggesting that the implementation confidence building actions, continuity of sound fiscal and monetary policies, and the avoidance of politically expedient solutions are likely to spur economic growth and employment, but noting that the interest rates of the Central Bank plays a critical role in the decision to invest in Brazil); see also WORLD INVESTMENT REPORT 2005, *supra* note 4, at 122 (observing that Brazil's

examples of this model. Both countries have modernized and liberalized their economies during the past two decades. For example, Brazil has privatized businesses to foster competition.¹²¹ The degree of foreign investment in both countries is tremendous¹²² and is linked to their respective domestic economic success.¹²³ Nevertheless, in comparison to the rest of the world, they have a very small number of BITs in force. Specifically, Brazil has signed a handful of BITs¹²⁴ but has not ratified a single one,¹²⁵ while Ireland has only one BIT in

improved corporate governance in its stock markets has improved and has resulted in economic benefits); Scott Appleton, *Brazil: A Giant Awoken*, 59 INT'L BAR NEWS 19, 19-20 (Dec. 2005) (describing Brazil's "enviable position" that is caused by the "relative stability of the government and economic policies" and discussing new legislation designed to encourage continued investment).

120. See generally KIRBY, *supra* note 9; IRYNA PIONTKIVSKA & EDILBERTO L. SEGURA, THE KEY DETERMINANTS OF IRELAND'S ECONOMIC SUCCESS (The Bleyzer Foundation June 2004), available at <http://sigmableyzer.com/files/Ireland-A4-ENG.pdf>; see also Dermott McCann, *Small States in Globalizing Markets: The End of National Economic Sovereignty?*, 34 N.Y.U. J INT'L L. & POL. 281, 296 (2001) (observing that Ireland's economic liberalization, which includes "a consistent strategy of removing restrictions on the financial freedom of foreign investors, lightening their tax load, [and] deregulating the labor market," has created a surge in foreign investment that is linked to an increase in Ireland's GDP).

121. Cookson, *supra* note 119, at 347, 361-62 (2004); see also Appleton, *supra* note 119, at 20 (discussing "public-private partnership legislation intended to pave the way for private investment in [Brazil's] overstretched infrastructure"); Raul Gouvea, *Challenges Facing Foreign Investors in Brazil: A Risk Analysis*, PROBS. & PERSPS. IN MGMT., 63, 65 (2004) (pointing to market reforms and privatizations of the 1990s as factors that increased the efficiency and diversity of Brazilian industries and products); WORLD INVESTMENT REPORT 2001, *supra* note 4, at 237 (referencing a 1999 agreement between Brazil and the United States about the enforcement of competition laws).

122. The aggregate level of FDI in Brazil has been on the increase since 1995. Cookson, *supra* note 119, at 347. In 2000, Brazil had approximately \$34 billion in FDI and was the region's largest recipient of foreign investment. WORLD INVESTMENT REPORT 2001, *supra* note 4, at 29, 64. Ireland has experienced similar economic success. See also U.S. Department of State, 2005 Investment Climate Statement: Ireland, <http://www.state.gov/e/eb/ifa/2005/42063.htm> (on file with the *Pacific McGeorge Global Business & Development Law Journal*) (indicating that U.S. FDI in Ireland in 2003 exceeded \$9 billion, an amount two and a half times the amount of U.S. FDI in China).

123. Telford & Ures, *supra* note 107, at 609-10 (describing the dramatic economic growth of Ireland and noting its shift from being labeled as a "developmental" failure in the 1980s and early 1990s to "Celtic Tiger" phenomenon by the year 2000, which led "to truly remarkable economic growth"); Benjamin Powell, *Economic Freedom and Growth: The Case of the Celtic Tiger*, 22 CATO J. 431 (discussing various possible causes of the "dramatic economic growth" in Ireland during the 1990s); Beth Knight, *Brazilian Auto Industry and the Role of Government Intervention and International Agreements in its Progress Through the 1990s*, 14 TRANSNAT'L L. & CONTEMP. PROBS. 311, 311 (2004) (noting that "Brazil has seen a number of changes in the last fifty years: growth in industrialization, increased privatization, and an opening of their markets to greater foreign investment").

124. Brazil has BITs with Chile, Finland, Netherlands, Venezuela, Cuba, Denmark, Korea and Portugal. See UNCTAD, Investment Treaties Online: Bilateral Investment Treaties, <http://www.unctadxi.org/templates/DocSearch.aspx?id=779> (last visited Dec. 21, 2006). The treaties typically grant investors the right to arbitrate their investment treaty claims. See Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of The Netherlands and the Federative Republic of Brazil, Nov. 25, 1998, art. 9, available at http://www.unctad.org/sections/dite/ia/docs/bits/netherlands_brazil.pdf (permitting investors to litigate their claims before national courts, arbitrate at ICSID or arbitrate on an ad hoc basis under UNCITRAL Rules); see also Agreement between the Government of the Republic of Finland and the Government of the Federative Republic of Brazil on the Promotion and Protection of Investments, Mar. 28, 1995, art. 9, available at http://www.unctad.org/sections/dite/ia/docs/bits/finland_brazil.pdf (same). Nevertheless, these provisions do not appear to be in force. ICSID, *Bilateral Investment Treaties: Brazil* (2004), available at <http://www.worldbank.org/icsid/treaties/brazil.htm> (suggesting that Brazil has only ten bilateral investment treaties that have not

force.¹²⁶ These two countries reflect a phenomenon that UNCTAD observed, namely that BITs may be unrelated to the amount of FDI.¹²⁷ One might reasonably suggest that the economic success, irrespective of the existence of a BIT, reflects a model of market liberalization. In this scenario, internal domestic efforts to liberalize markets,¹²⁸ offer inducements for investment,¹²⁹ follow the rule of law,¹³⁰ and offer reliable dispute resolution¹³¹ provide the critical incentives

entered into force); *see also* U.S. Department of State, Brazil: 2005 Investment Climate Statement, <http://www.state.gov/e/eb/ift/2005/41988.htm> [hereinafter Brazil Investment Climate Statement] (last visited Feb. 6, 2006) (on file with the *Pacific McGeorge Global Business & Development Law Journal*) (indicating that Brazil has fourteen BITs, but none with the United States); UNCTAD, Total Number of Bilateral Investment Agreements Concluded, 1 June 2005, http://www.unctad.org/sections/dite_pcb/docs/brazil.pdf [hereinafter UNCTAD and Brazil BITs] (last visited Feb. 6, 2006) (indicating that Brazil has fourteen BITs with other nations).

125. Bernardo M. Cremades, *Disputes Arising Out of Foreign Direct Investment in Latin America: A New Look at the Calvo Doctrine and Other Jurisdictional Issues*, 59 JUL. DISP. RESOL. J. 78, 81 (2004); Carlos G. Garcia, *All the Other Dirty Little Secrets: Investment Treaties, Latin America, and the Necessary Evil of Investor-State Arbitration*, 16 FLA. J. INT'L L. 301, 314 (2004).

126. Franck, *Bright Future*, *supra* note 1, at 50; Agreement between the Czech Republic and Ireland for the Promotion and Reciprocal Protection of Investments, June 28, 1996, art. 8, *available at* http://www.unctad.org/sections/dite/ia/docs/bits/czech_ireland.pdf (permitting investors to bring their investment disputes before ICSID or on an ad hoc basis pursuant to the UNCITRAL rules); *see also* Department of Foreign Affairs, Irish Treaty Series: Treaty Series 2001, <http://foreignaffairs.gov.ie/treaties/irish-treaty-series-database.asp?yy=2001&dd=2000> (on file with the *Pacific McGeorge Global Business & Development Law Journal*) (describing Ireland's entry into the multilateral investment treaty, the Energy Charter Treaty).

127. *See also* Policy Implications, *supra* note 1, at 141 (indicating that there are "many examples of countries with large FDI inflows and few, if any, BITS").

128. Cremades, *supra* note 125, at 81 (suggesting that "tax and other incentives have encouraged the growth of investment in Brazil").

129. *See generally* Telford & Ures, *supra* note 107, at 607-09 (focusing on the role of government incentives to make locations attractive for foreign investment).

130. Brazil, for example, has a form of social democracy. Cookson, *supra* note 119, at 348, 350-52. Nevertheless, Brazil's adherence to the rule of law has been less consistent. *See generally* Peter Fry, *Color and the Rule of Law in Brazil*, in *THE (UN)RULE OF LAW & THE UNDERPRIVILEGED IN LATIN AMERICA* 186 (Juan E. Méndez, Guillermo O'Donnell, & Paulo Sérgio Pinheiro eds., 1999); Public Broadcasting System, *Commanding Heights: Brazil Rule of Law*, http://www.pbs.org/wgbh/commandingheights/lo/countries/br/br_rule.html (last visited Feb. 4, 2006) (making observations about the development of Brazil's rule of law and its inconsistent approach and difficulties investigating corruption charges); Lisa Valenta, *Disconnect: The 1988 Brazilian Constitution, Customary International Law, and Indigenous Land Rights in Northern Brazil*, 38 TEX. INT'L L.J. 643, 649 (2003) (discussing problems with the rule of law related to threats to government officials). Brazil, however, has made efforts to strengthen this variable and to provide dependable legal protection. *See* Stephen Meili, *Cause Lawyers and Social Movements: A Comparative Perspective on Democratic Change in Argentina and Brazil*, in *CAUSE LAWYERING: POLITICAL COMMITMENTS AND PROFESSIONAL RESPONSIBILITIES* 487, 501 (Austin Sarat & Stuart Scheingold eds., 1998) (observing that the personal motivations of lawyers in Brazil "seem to fall into two discrete categories: a very personal and frequently moral desire to fight injustice, and a more public sense of their individual role in the transition to democracy; that is, a transition that includes adherence to the rule of law"); *see also* Statement by Ambassador Ronaldo Mota Sardenberg Permanent Representative of Brazil to the United Nations Security Council, Justice and the Rule of Law: the UN Role, Oct. 6, 2004, *available at* <http://www.un.int/brazil/speech/004d-rms-csnu-Justice%20and%20the%20Rule%20of%20Law-0610.htm> (observing that Brazil has the "responsibility to instill, uphold and restore greater respect for the rule of law not only at home but also throughout the world"); WILLIAM C. PRILLAMAN, *THE JUDICIARY AND DEMOCRATIC DECAY IN LATIN AMERICA: DECLINING CONFIDENCE IN THE RULE OF LAW* 90-120 (2000) (discussing problems with the Brazilian court system and its lack of administrative infrastructure and discussing methods used to improve case management); Brazil Investment Climate Statement, *supra* note 124 (referring to Brazil's judicial reforms of December 2005).

131. While Brazil has other forms of nontraditional dispute resolution, there is a "long-standing Brazilian

necessary to spur foreign investment. Rather than the existence of a BIT or the right to arbitrate treaty claims, governmental liberalization measures impact foreign investment decisions.¹³² Presumably these good governance measures decrease investment risk and can lead to positive development outcomes.¹³³ Perhaps this is why France, which is Brazil's fourth largest investor, continues to recommend that Brazil promulgate clear and stable rules to foster foreign investment.¹³⁴

4. Preliminary Synthesis

Ultimately, one wonders whether investment treaty arbitration has a specific role to play in fostering foreign investment. Perhaps private dispute resolution provisions created by the parties, for use in enforcing specific negotiated commercial contracts, are a more direct, effective, and reliable manner of controlling investment-related risk.¹³⁵ Lest this sound like a message of gloom and doom for investment arbitration, one must remember both that investment arbitration is a relatively new process that has only been tested thoroughly within the last decade,¹³⁶ and that treaty remedies may begin to take on an enhanced role in investment decisions as more investors recognize the power of their treaty remedies.

adage that one should do everything possible for one's friends, nothing at all for those who are neither friends nor enemies, and apply the law to one's enemies." Cookson, *supra* note 119, at 351. There have already been significant judicial reforms in Brazil, including reductions in red tape and reform of commercial and intellectual property law; continued judicial reform is considered crucial in Brazil because the lack of the rule of law as seen as an element in attracting FDI. *Id.* at 358; see also Brazil Investment Climate Statement, *supra* note 124 (noting that Brazil's reforms have created "binding precedent, [that] should, over time, make judicial decisions more predictable").

132. It is by no means a straightforward task to assign the relative importance of those market liberalizing factors. Economists and political scientists will likely continue this debate. See Anjo Abelaira, *Ireland's Economic Miracle: What is "The Celtic Tiger"?* (2004), available at <http://www.celtia.info/culture/economy/celtictiger.html> (on file with the *Pacific McGeorge Global Business & Development Law Journal*) (describing transformation from one of the poorest countries to one of the wealthiest countries in Western Europe and crediting such factors as foreign investment, deregulation, competition, low levels of tax, and a qualified workforce; but noting that the debate about the relative importance of these factors).

133. See Daniel Kaufman et al., *World Bank Institute Policy Research Working Paper 2196: Governance Matters* 1, 15 (1999), available at <http://www.worldbank.org/wbi/governance/pdf/govmatrs.pdf> (suggesting that there is a strong causal relationship between better governance, including adherence to the rule of law, and better development outcomes); Daniel Kaufmann et al., *Governance Matters: From Measurement to Action*, FIN. & DEVELOPMENT 10, 12 (June 2004), available at <http://www.imf.org/external/pubs/ft/fandd/2000/06/pdf/kauf.pdf> (noting the strong link between strong adherence to the rule of law and high per capita incomes).

134. Cookson, *supra* note 119, at 361 n.68; UNCTAD and Brazil BITs, *supra* note 124.

135. Francis Delacey, *Enforcing Contracts in Developing Countries*, in *LAW IN TRANSITION*, *supra* note 1, at 20-22 (suggesting that "[m]arket-friendly laws and an independent, competent judiciary to implement them have long been credited for fostering economic and industrial development"; noting that "contract enforcement mechanisms, whether formal or informal, are critical to commercial exchange"; and suggesting that judicial reform projects can "enhance contract enforceability by ensuring that impartial and predictable judgments are issued" but that "endorsing the use of arbitration" is likely to enhance contract enforceability).

136. Policy Implications, *supra* note 1, at 12 (providing a chart that suggests a surge in the number of investment treaty cases since the late 1990s).

B. Investment Treaty Arbitration: Indirectly Facilitating FDI by Promulgating the Rule of Law?

A larger question is whether investment treaty arbitration fosters the rule of law and provides incentives to foster fair and legitimate decisionmaking in national institutions. Arguably the availability of treaty arbitration can indirectly facilitate investment by providing adjudicative independence and/or a model for national courts to follow the rule of law. While speculative, a debate is emerging about whether investment treaty arbitration creates an enclave that prevents domestic development of the rule of law. This section surveys the literature on this topic, and suggests that while these concerns about the elimination of the rule of law should be considered and evaluated empirically, it is not clear that investment treaty arbitration adversely affects the rule of law and/or adversely affects the incentive to invest.¹³⁷

Literature has emerged that argues the availability of investment treaty arbitration adversely affects the rule of law in developing countries. These commentators suggest that the existence of international dispute resolution for foreign investment inhibits the development of the rule of law in national courts by creating a regime that provides a privilege to foreign investors and removes investment disputes from local courts.¹³⁸

137. Ginsburg suggests that “[g]iven low observed levels of judicial independence in courts and many developing countries and an information problem regarding foreigners’ ability to observe the quality of such courts, third party dispute resolution seems to facilitate investment. It apparently substitutes for poor institutional environments.” Ginsburg, *supra* note 17, at 113. He does not specify whether this reference to third-party dispute resolution refers to international commercial arbitration on the basis of a private contractual relationship or investment treaty arbitration originating under the treaty, but it appears he is referring to investment treaty arbitration. *See id.* at 111, 113. This is a critical distinction as the two processes redress different rights, have different public implications, and can be administered or enforced in different manners. Parties can generally arbitrate distinct types of investor-State disputes at ICSID: (1) disputes where a sovereign and an investor consent in a commercial agreement to arbitrate their commercial disputes at ICSID; or (2) disputes where a sovereign has unilaterally consented to arbitrate treaty-based claims, and the investor accepts the offer by initiating arbitration. ICSID Convention, *supra* note 40. *See generally* CHRISTOPH H. SCHREUER, THE ICSID CONVENTION: A COMMENTARY (2001) [hereinafter SCHREUER, CONVENTION]; *see also* Franck, *Legitimacy Crisis*, *supra* note 1, at 1543, 1547 (explaining ICSID arbitration can be based upon consent to arbitrate in an arbitration agreement but noting the limitations of ICSID arbitration).

138. *See* Mark Halle & Luke Eric Peterson, *Investment Provisions in Free Trade Agreements and Investment Treaties: Opportunities and Threats for Developing Countries*, Dec. 2005, at 23-24, available at http://www.undprcc.lk/web_trade/publications/BIT-completed.pdf [hereinafter *Opportunities and Threats*] (observing that investment treaties “remove significant disputes between foreign investors and [g]overnment agencies from the purview of local courts and tribunals . . . [while relegating] locals—including domestic businesses, who may be the lifeblood of domestic investment—to the mercies of these inadequate institutions”). *But see* Franck, *Bright Future*, *supra* note 1, at 62 (suggesting that domestic investors, if they structure their investment through a foreign investment vehicle, may also be able to benefit from the rights provided to other investors); *Tokios Tokel s v. Ukraine*, ICSID Case No. ARB/02/18, Decision on Jurisdiction (Apr. 29, 2004), 20 ICSID REV.-F.I.L.J. 205 (2005), available at <http://www.worldbank.org/icsid/cases/tokios-decision.pdf> (holding that a local Ukrainian company that had reincorporated itself in Lithuania could qualify as a foreign investor and benefit from the protections afforded by the Ukraine/Lithuania investment treaty).

Professor Tom Ginsburg suggests that the “impact of BITs on subsequent governance is ambiguous,” and “under some circumstances BITs may lead to lower institutional quality in subsequent years.”¹³⁹ Indeed, Professor Ginsburg suggests that the “decision to bypass domestic courts may reduce courts’ incentives to improve performance by depriving key actors from a need to invest in institutional improvement.”¹⁴⁰

Commentators from the International Institute for Sustainable Development (“IISD”), a Canadian nongovernmental organization, echo these concerns.¹⁴¹ IISD suggests that investment treaties provide foreign investors with an “escape clause,” which might reduce the push for broader improvement of domestic institutions and instead insulate domestic legal institutions.¹⁴²

Others go even further. In a working paper, Professor Ron Daniels suggests that investment treaties have “subverted the evolution of robust rule of law institutions in the development world . . . [because] foreign investors rationally refrain from championing good and generalized rule of law reforms in the developing state, preferring instead to protect their interests by relying on the BIT rule of law enclave.”¹⁴³ He then suggests that BITs “enfeeble host state governments, and, in sharp contrast to the claims made by supporters of the BIT, will end up discrediting the normative legitimacy of the BIT as a rule of law demonstration project.”¹⁴⁴

These assertions overlook several vital matters, which suggest that investment treaty arbitration may actually benefit the rule of law, or at a minimum, do not adversely affect a country’s adherence to the rule of law.¹⁴⁵ Overvaluing and isolating investment treaty arbitration, while simultaneously

139. Ginsburg, *supra* note 17, at 122.

140. *Id.* at 119, 122.

141. *Opportunities and Threats*, *supra* note 138, at 24 (referring to Professor Ginsburg’s work that suggests treaties can reduce local institutional quality).

142. *Id.*

143. See Ronald J. Daniels, *Defecting on Development: Bilateral Investment Treaties and the Subversion of the Rule of Law in the Developing World 2* (Draft Mar. 23, 2004), <http://www.unisi.it/lawandeconomics/stile2004/daniels.pdf> (suggesting that a BIT is a “stand alone enclave in which foreign investors can be largely insulated from the legal and political risks of contracting in the home state and relying on its institution . . . [but such reliance] dulls any interest or incentive on the part of foreign investors to seek to condition their investments in the host developing state on the creation of good rule of law institutions that would be generally accessible to foreign and domestic investors alike”); *id.* at 25 (arguing the “BIT enclave enables foreign investors to exist from [the] domestic legal regime and this, in turn, implies a withdrawal from the domestic debate over the need for, and the character of, good laws and legal institutions”).

144. *Id.* at 30. One might suggest that because BITs’ elimination of the customary international law rule requiring the exhaustion of local remedies before bringing an international claim also undermines the rule of law. Presumably, if foreign investors were required to litigate disputes through domestic courts rather than directly taking their claims to international arbitration, this might build the capacity of local courts by the following: (1) providing domestic courts with an opportunity to articulate relevant principles of domestic law; (2) increasing the transparency of the system; and (3) giving notice to future investors of the relevant domestic legal standards and their application. The author is grateful to Matthew Porterfield for his thoughts on this point.

145. Another explanation might be that other commentators use the concept of the “rule of law” in a different manner than as used in the context of this article.

undervaluing the role of national courts and ignoring the critical role of party control, overlooks the symbiotic relationship between treaty arbitration and court litigation in promoting the rule of law.

1. *Investment Treaty Arbitration as a Complement to Domestic Courts*

Analysis from the World Bank suggests that investment treaty arbitration is not a substitute for local institutions; rather, it can provide a complement to domestic institutional reform. Hallward-Dreiemer's analysis suggests that BITs are more, rather than less, effective in promoting higher institutional quality, particularly where strong institutions already exist.¹⁴⁶ Especially where investment treaties are used to signal the desire to engage in institutional reform and adhere to the rule of law, offering the opportunity to arbitrate investment claims might reasonably create a "race to the top" to adjudicate disputes impartially and fairly, instead of a "race to the bottom."¹⁴⁷ In this manner, investment arbitration has the capacity to fuel domestic support for the rule of law because it will instill an "incipient belief in the capacity of institutions to administer justice impartially."¹⁴⁸ Particularly for those BITs that permit investors to choose between arbitration and court litigation, one might even wonder

146. Hallward-Dreiemer, *supra* note 62, at 21. *But see* Neumayer & Spess, *supra* note 81, at 5 (suggesting that, in contrast to Hallward-Dreiemer, their results "provide some limited evidence that BITs might function as substitutes for poor institutional quality, which would suggest that they are most effective where quality is low, and that they are most successful where they are needed most" but acknowledging that these results are not "robust").

147. See Patricia Shaughnessy, *Promoting Effective Arbitration through Legal Assistance Programmes*, 22 ARB. INT'L 315, 318 (2006) (suggesting in the context of international commercial arbitration that the development of arbitration "is not necessarily the result of ineffective or corrupt courts and it is not a condemnation of a court system . . . [rather a] developed arbitration system is a natural component of a legal system which respects contractual and legal rights"). The challenge, however, is that the investment treaty arbitration may not be an appropriate example of a rule of law, particularly where tribunals articulate vague and contradictory decisions on basic points of law. *See generally* Franck, *Legitimacy Crisis*, *supra* note 1. Nevertheless, to the extent that arbitrators and commentators develop a reliable, consistent, and reasoned doctrine, this model could encourage adherence to the rule of law by domestic courts. *See generally* Franck, *Bright Future*, *supra* note 1.

148. Philip J. McConaughay, *The Scope of Autonomy in International Contracts and Its Relation to Economic Regulation and Development*, 39 COLUM. J. TRANSNAT'L L. 595, 651 (2001); *see also* e-mail from Professor Thomas Wälde to OGEMID (Nov. 23, 2005) (discussing a meeting between UNCTAD and GTZ, the Germany Technical Assistance Agency, which suggested that "the example of successful (impartial, technically-competent) [international] dispute settlement [in BITs] will feed back into the domestic process, by way of signaling good governance, example and pressure by domestic investors for equal treatment"). This might be particularly salient when a tribunal determines government conduct has not violated international law, as in *Methanex. Methanex Corp. v. United States*, UNCITRAL, Final Award (Aug. 3, 2005), 44 I.L.M. 1345 (2005), available at <http://www.state.gov/s/l/c5818.htm>; *but see* Anthony DePalma, *NAFTA's Powerful Little Secret*, N.Y. TIMES, Mar. 11, 2002, at C1; Public Citizen's Global Trade Watch Advertisement, *Fast Track Attack on America's Values*, WASH. POST, Dec. 5, 2001, at A5; Bill Moyers, Transcript: Trading Democracy—A Bill Moyers Special (Feb. 1, 2002), available at http://www.pbs.org/now/transcript/transcript_tdfull.html (suggesting that investment arbitration is illegitimate).

whether investment arbitration might “spur domestic courts to compete for the business of resolving commercial disputes and thus improve their quality.”¹⁴⁹

2. Domestic Courts as a Complement to Investment Treaty Arbitration

National courts are an important complement to the resolution of investment disputes. Arbitration does not occur in a vacuum, and the existence of investment treaty arbitration does not eliminate the need to encourage the development of a court system where rights are adjudicated in an impartial, fair, and predictable manner. Investment treaty arbitration and national courts have a symbiotic relationship. Fostering the development of the rule of law in national courts not only develops local judicial institutions, but it also promotes confidence in the overall process of resolving investment disputes.

National courts may become involved in investment treaty disputes in three distinct ways. First, as many BITs permit investors to bring their claims in national courts, under appropriate circumstances, investors may elect to litigate treaty violations.¹⁵⁰ Not all investment treaties, however, adopt a model that permits investors to choose between court litigation and arbitration.¹⁵¹ Irrespective of whether they are preceded by a cooling-off period that is presumably used to engage in negotiations,¹⁵² governments might reasonably consider moving away from a model of mandatory arbitration of investment treaty disputes. This has several significant benefits. As suggested earlier, it provides parties with an option to litigate before national courts so that problems with public implications can be resolved in a public forum where the dispute arose.¹⁵³ It also gives domestic courts an incentive to provide independent and impartial adjudication of the cases on their dockets. By fostering this general adherence to the rule of law, investors would presumably feel more comfortable resolving their treaty claims before national courts.¹⁵⁴ Finally, it supports

149. Ginsburg, *supra* note 17, at 119. The difficulty with this is that busy domestic courts of general jurisdiction may have little incentive to compete with specialist arbitral tribunals for the resolution disputes related to international law.

150. During a symposium at UC-Davis, Jim Loftis, a partner at Vinson & Elkins, suggested that if a court system is “functioning” and “fair” and courts have demonstrated a “willingness to rule in favor of foreign investors,” he would advise a client to pursue their treaty claims in the national courts. In the context of a tax or regulatory-based treaty claim against the United States, he suggested that litigating in U.S. courts would be more cost-efficient and lead to a better result than arbitration. He nevertheless indicated that he was unaware of an investor with an expropriation claim bringing their claims before a national court in the United States or otherwise. UC-Davis Symposium, *Romancing the Foreign Investor BIT by BIT*, comments of Jim Loftis, Mar. 4, 2005, Disk 2 [CD-ROMs on file with author].

151. See *supra* note 31-33 and accompanying text.

152. See *supra* note 38, 102 and accompanying text.

153. See *supra* notes 31, 150 and accompanying text.

154. Investors might be interested in resolving their disputes before courts if there is evidence that the disputes might be resolved more quickly, cheaply, and fairly than arbitration. The relative values of the dispute resolution options will depend on variables such as the potential court(s) involved, the nature of a potential arbitral tribunal, and the factual and legal context of the dispute.

procedural justice and democratic governance¹⁵⁵ by giving parties the freedom to choose the forum for resolving their disputes.¹⁵⁶

Second, national courts provide critical support to the investment arbitration process. There are various points in the process where the integrity of local courts can impact the efficacy of the dispute resolution process. While a court's role tends to be limited in ICSID arbitration proceedings,¹⁵⁷ national courts have a role to play in enforcing ICSID arbitration awards.¹⁵⁸ In the context of an ad hoc UNCITRAL arbitration, national courts may find themselves playing a greater role. For example, they might evaluate challenges relating to an arbitrator's impartiality and independence¹⁵⁹ or determine whether arbitrators awarded damages in a procedurally improper manner.¹⁶⁰ Confidence in local courts supports confidence in the overall process of resolving treaty claims. While some might suggest that interdependence provides national courts with an opportunity to attack the integrity of the process,¹⁶¹

155. See generally Nancy A. Welsh, *The Thinning Vision of Self-Determination in Court-Connected Mediation: The Inevitable Price of Institutionalization?*, 6 HARV. NEGOT. L. REV. 1 (2001); Nancy A. Welsh, *Making Deals in Court-Connected Mediation: What's Justice Got to do With It?*, 79 WASH. U. L. Q 787 (2001). The author is grateful to Professor Richard Ruben for his insights on this issue.

156. Offering incentives for other dispute resolution methods, such as mediation and conciliation, might also be worth pursuing. See generally Jack J. Coe, Jr., *Toward a Complementary Use of Conciliation in Investor-State Disputes—A Preliminary Sketch*, 12 U.C. DAVIS J. INT'L L. & POL'Y 1 (2005); Franck, *Dispute Resolution Options*, *supra* note 33.

157. The ICSID Convention provides the exclusive forum. ICSID Convention, *supra* note 40, at 524, art. 26. This means that, for those situations where parties might go to local courts for aid, this option is unavailable with ICSID arbitration. SCHREUER, CONVENTION, *supra* note 137, at 347-48. Nevertheless, in those treaty claims proceeding under the UNCITRAL or Stockholm Chamber of Commerce Rules, there are still opportunities for the assistance of local courts. Susan L. Karamanian, *The Road to the Tribunal and Beyond: International Commercial Arbitration and United States Courts*, 34 GEO. WASH. INT'L L. REV. 17 (2002).

158. ICSID Convention, *supra* note 40, at art. 54; see also SCHREUER, CONVENTION, *supra* note 137, at 1100-04.

159. English Arbitration Act of 1996, § 24, available at <http://www.opsi.gov.uk/acts/acts1996/1996023.htm> [hereinafter English Arbitration Act] (permitting courts to remove arbitrators where "circumstances exist that give rise to justifiable doubts as to [their] impartiality"); Swiss Private International Law Act on International Arbitration, art. 180, in *National Report on Switzerland* in KLAUS PETER BERGER, INTERNATIONAL HANDBOOK ON COMMERCIAL ARBITRATION [hereinafter Swiss Arbitration Law] (permitting party to challenge an arbitrator in court where "circumstances exist that give rise to justifiable doubts as to his independence"); United Nations Commission on International Trade Law ("UNCITRAL") Model Law on International Commercial Arbitration, June 21, 1985, Annex 1, art. 13, U.N. Doc. A/40/17, 24 I.L.M. 1302 (1985), available at <http://www.uncitral.org/pdf/english/texts/arbitration/ml-arb/ml-arb-e.pdf> [hereinafter UNCITRAL Model Law] (permitting courts to hear challenges to arbitrators).

160. 9 U.S.C. § 10 (2002); English Arbitration Act, *supra* note 159, at §§ 67-69; Swiss Arbitration Law, *supra* note 159, at art. 190; UNCITRAL Model Law, *supra* note 159, at art. 34. See generally William W. Park, *Illusion and Reality in International Forum Selection*, 30 TEX. INT'L L.J. 135 (1995).

161. There has been some concern about how national courts of Argentina may address enforcement of ICSID arbitral awards. See Osvaldo J. Marzoti, *Enforcement of Treaty Awards and National Constitutions (the Argentinean Cases)*, 7 BUS. L. INT'L 226 (2006); Guido Santiago Tawil, *Arbitration In Latin America: Current Trends and Recent Developments*, at <http://www.bomchilgroup.org/argmar04.html> (last visited Feb. 7, 2006) (observing that "Argentine top officials have publicly argued the incompatibility of ICSID arbitration with the Argentine Constitution, qualified ICSID arbitration as an immature regime, announced their will to return to the Calvo doctrine abandoned during the 90's").

the existence of robust national court systems, which adhere to the rule of law, supports the fair resolution of investment disputes.

Third, even with the availability of courts for international law claims, national courts are still critical venues for the resolution of investors' national law disputes. Investment treaties do not prevent investors from bringing their claims for violations of national law, which relate to their investments, before national courts. Various investment treaty awards suggest that investors typically refer their international law claims to international tribunals but simultaneously refer domestic disputes to domestic courts. For example, in *Occidental v. Ecuador*, the Republic of Ecuador changed its interpretation and application of tax law. Occidental pursued its domestic remedies related to Ecuadorian administrative law before an Ecuadorian national tribunal, and it simultaneously initiated arbitration under the treaty for the alleged violations of international law. This behavior was acceptable.¹⁶²

Ultimately, even if one presumes that foreign investors are stakeholders who are vital to promoting the rule of law and institutional integrity,¹⁶³ their influence does not exit the market purely by creating the right to arbitrate treaty claims. Rather, properly valuing the potential role of national courts in resolving investment disputes suggests that there is a strong incentive to develop the rule of law in national courts and promote the integrity of the dispute resolution process.

3. Arbitration as a Method to Maximize Party Control

Opting to arbitrate treaty claims may have little to do with escaping the jurisdiction of local courts, but may instead be about maximizing party control.¹⁶⁴

162. Occidental Award, *supra* note 49, at ¶¶ 3-5, 32-33, 36, 46-48, 60-62.

163. One wonders whether foreign investors will be effective champions of rule of law reforms. A clear and stable legal environment would no doubt benefit both domestic and international investments. See W. Michael Reisman & Robert D. Sloane, *Indirect Expropriation and its Valuation in the BIT Generation*, 74 BRITISH Y.B. INT'L L. 115, 118 (2003) (noting that "BITs consciously seek to approximate in the developing, capital-importing state the minimal legal, administrative, and regulatory framework that fosters and sustains investment in industrialized capital-exporting states"). While this might suggest that multinational businesses could be useful stakeholders in reform efforts, it is unwise to rely exclusively upon an individual's profit-maximizing goals to push countries down the path of reform. Daniels, *supra* note 143, at 24 n.52 (citing Susan Rose-Ackerman, *Contracting in Politically Risky Environments: International Business and Reform of the State*, Draft Working Paper). Foreign investors with certain relationships with government officials might benefit from a lack of adherence to the rule of law while others might benefit financially from regulatory uncertainty. See WORLD DEVELOPMENT REPORT, *supra* note 8, at 43 (observing that firms "can skew policies in their favor by formal or informal lobbying, controlling access to information or a variety of other strategies" by "capturing" state influence "through informal and opaque channels of influence").

164. Parties may elect to arbitrate treaty claims because of perceived gaps in the integrity of domestic courts. They may also be influenced by a perception that local courts lack public international law expertise or that they will be more likely to win before a tribunal. See, e.g., Don Thompson, *Lawsuits Want to Limit Free Trade Pact Several Groups Claim a NAFTA Provision Weakens State and Federal Laws*, MONTEREY COUNTY HERALD, Feb. 23, 2005, available at http://www.senate.ca.gov/ftp/SEN/COMMITTEE/SUB/BP_INTER_TRADE/_home/Article_2_23_05.doc (referring to a statement a foreign investor made related to a NAFTA claim where he explained "[y]ou use whatever means is at your disposal, wherever you think you have the

Even the United States and Canada, arguably jurisdictions with a strong tradition of the rule of law, have had claims brought against them under NAFTA.¹⁶⁵ Using arbitration may have more to do with party choice, control over the process, and enforceability of an award.¹⁶⁶

Investors may wish to exercise their right to elect a forum that permits them to exert control over how their dispute is resolved. Generally, opting for arbitration increases parties' perceived control, which is often critical in permitting parties to buy-in psychologically to the dispute resolution process; this, in turn, can lead to a productive process and voluntary compliance with an award.¹⁶⁷ Perhaps more specifically, arbitration permits the parties to control the process by tailoring the procedures necessary for the adjudication of the specific dispute. But party choice is best exemplified by the fact that parties have the capacity to control the appointment of one of the arbitrators on the panel. While this provides an opportunity to pick an arbitrator with expertise or experience in a specific area and possibly make the arbitration more efficient,¹⁶⁸ this also means parties can select arbitrators who may be likely to rule in their favor. While all arbitrators must remain independent and impartial,¹⁶⁹ the possibility of indirect

greatest chance of success"); but see James May, *Mining Company Files for NAFTA Arbitration*, INDIAN COUNTRY TODAY, Mar. 9, 2005, available at <http://www.indiancountry.com/content.cfm?id=1096410498> (suggesting Glamis filed the claim because of speed concerns and not wanting to sue California in local courts). These issues have not been evaluated empirically, but they are worthy of future consideration.

165. Weiler, *supra* note 114 (listing claims brought against the United States and Canada under NAFTA). Domestic legislation in the United States and Canada, however, appears to preclude investors bringing international law claims arising under NAFTA in either U.S. or Canadian domestic courts. See 19 U.S.C.A. § 3312(b)(2-3) (providing that "[n]o State Law, or application thereof, may be declared invalid . . . on the ground that [it] is inconsistent with [NAFTA], except in an action brought by the United States. . . . No person other than the United States shall have any cause of action under [NAFTA]"); North American Free Trade Agreement Implementation Act 1993, c.44, § 6(2) (June 23, 1993), available at <http://laws.justice.gc.ca/en/N-23.8/text.html> (providing that except for NAFTA Chapter 11, "no person has any cause of action and no proceedings of any kind shall be taken, without the consent of the Attorney General of Canada, to enforce or determine any right or obligation that is claimed or arises solely under or by virtue" of NAFTA). The same is not true for Mexico. Mexico permits investors to elect to arbitrate or litigate before Mexican Courts. See NAFTA, *supra* note 16, at Annex 1120.1 (providing that a non-Mexican investor can bring a Chapter 11 claim in a Mexican court or administrative tribunal unless the investor has launched an arbitration). One wonders why the United States and Canada felt the need to divert investment treaty claims from domestic courts. This surprising democracy deficit stands in the face of both countries' rule of law traditions. See *supra* notes 152-56 and accompanying text (discussing how nonmandatory arbitration might promote the rule of law).

166. For those BITs that do not allow investors to elect arbitration over national courts, arbitration is then the sole forum in which investors can directly bring their investment claims.

167. See generally Tom R. Tyler, *Procedural Justice, Legitimacy, and the Effective Rule of Law*, 30 CRIME AND JUSTICE 283 (2003) (discussing the importance of the perceived fairness and effectiveness of legal processes in achieving compliance with laws and legal outcomes); see also Tom R. Tyler, *Procedural Fairness and Compliance with the Law*, 133 J. ECON. & STATS. 219, 219, 222-27 (1997) (suggesting that compliance with the law is linked to the legitimacy of the authorities and the procedural fairness of administering the law); ROGER FISHER & WILLIAM URY, GETTING TO YES: NEGOTIATING AGREEMENT WITHOUT GIVING IN 25-26 (1981) (observing that if parties "are not involved in the process, they are hardly likely to approve the product" and instead arguing that parties should be given a stake in the process).

168. For example, if the issue is highly technical, parties will not need to spend as much time and money educating an arbitrator who has special expertise.

169. For arbitration under the ICSID Convention, ICSID Convention Article 57 permits arbitrators to be

control over the outcome is an element missing from court litigation and is typically viewed as a desirable aspect of arbitration.

Investors also may be interested in neutrality. While investors may be interested in having neutral and independent adjudicators, they are more likely desire a neutral forum for dispute resolution that does not unfairly benefit either party or create a “home field” advantage. In this sense, investment arbitration can provide a geographical half-way house.

Investors also may be interested in the enforceability of the award. Both the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards and the ICSID Convention tried and tested mechanisms to enforce tribunal awards. With the Hague Convention on Choice of Courts still unratified and potentially subject to serious reservations, there is no equivalent streamlined enforcement procedure for foreign court judgments.¹⁷⁰ Further, to the extent investors have the option to arbitrate before ICSID, an entity affiliated with the World Bank, there may be institutional gravitas that creates an incentive for sovereigns to comply with ICSID awards, lest they have difficulty securing future World Bank financing.

Ultimately, choosing to arbitrate investment disputes does not mean that local courts are incapable of adhering to the rule of law and administering impartial justice. The adjudicative fairness and neutrality of treaty arbitration provides a useful model for national decisionmakers and usefully promote adherence to the rule of law. Likewise, a domestic court system following the rule of law provides a useful support to the integrity of the investment treaty arbitration process. Ultimately, this symbiotic relationship has the capacity to enhance investor confidence in the resolution of investment-related disputes and provide a useful incentive for foreign investment.

challenged and removed for a “manifest lack of qualities” required by Article 14. ICSID Convention, *supra* note 40, at art. 57. Article 14 of the ICSID Convention requires arbitrators to be of “high moral character and recognized competence in the fields of law, commerce, industry or finance, [and] who may be relied upon to exercise independent judgment.” *Id.* at art. 14. Arbitration under the ICSID Additional Facility Rules contains a similar requirement. *See* ICSID, Additional Facility Arbitration Rules, art. 8, *available at* <http://www.worldbank.org/icsid/facility/facility.htm>. In addition, ICSID recently revised its arbitration rules and now requires arbitrators to disclose circumstances that might cause the arbitrator’s independent judgment to be questioned and maintain an ongoing obligation to notify ICSID of any subsequent issues that arise. *See* ICSID, Arbitration Rules, art. 6, *available at* <http://worldbank.org/icsid/basicdoc/basicdoc.htm> (last visited Dec. 27, 2006). For ad hoc arbitration under the UNCITRAL Rules, arbitrators must be independent, impartial, and disclose those circumstances likely to give rise to justifiable doubts as to their impartiality or independence; an arbitrator can be challenged and removed for failure to be independent or impartial. UNCITRAL Rules, *supra* note 40, at arts. 9-12.

170. Jason Webb Yackee, *Fifty Years Late to the Party? A New International Convention for Non-Arbitral Forum Selection Agreements*, 23 INT’L LIT. QUART. 1 (2006); *see also* Hague Conference on Private International Law, 37: Convention of 30 June 2005 on Choice of Court Agreements, http://www.hcch.net/index_en.php?act=conventions.status&cid=98 (last visited Aug. 29, 2006) (indicating that there are no current Contracting States to the convention).

V. CONCLUSION

As there is mixed empirical and anecdotal evidence about the impact investment treaties have on FDI, it is not surprising that the evidence with regard to the specific effect of investment treaty arbitration is also unclear. Nevertheless, the substantive and procedural rights offered in investment treaties have important implications for foreign investment decisions and the rule of law, and they are certainly worthy of ongoing consideration.

Investment treaty arbitration in particular has a unique role to play in the future of foreign investment. Governments are likely to continue to focus upon the capacity of dispute resolution mechanisms to affect investor confidence, minimize investment risk, and create incentives for investing abroad.¹⁷¹ Meanwhile, as the dispute resolution process at ICSID and other institutions gains momentum, investors are likely to become more sensitized to the benefits that treaty arbitration can offer both at the time of structuring the initial investment and dealing with problems after they arise.¹⁷² One should therefore continue to evaluate the possibilities and pitfalls inherent in this new form of dispute resolution to ensure that it plays a productive role in economic, legal, political and social development.

171. *See supra* note 94 and accompanying text (referring to former Secretary Snow's remarks).

172. *See supra* notes 13, 59 and accompanying text.