The Advantages of Investor-State Arbitration as a Dispute Resolution Mechanism in Bilateral Investment Treaties

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Abstract

The objectives of this article are to: (1) discuss the significance of foreign direct investment; (2) analyze important nuances of bilateral investment treaties; (3) explain the importance of investor-state arbitration as a dispute resolution mechanism in bilateral investment treaties; (4) cover the two most common types of rules used in investor-state arbitration hearings; and (5) make general recommendations for improvement of a developing nation's investment laws. The conclusions of this article are: (1) developing nations should promote foreign investment in order to gain access to financial, technological, managerial and other resources that they need; (2) accordingly, developing nations should pursue bilateral investment treaties with foreign countries whose business firms possess those resources; (3) developing nations' investment laws need to be fine-tuned in order to maximize growth and investment; (4) in each bilateral treaty, a developing nation should agree to investor-state arbitration as the dispute resolution mechanism whenever disagreements arise between the developing nation's government and private business firms of the other country; (5) developing nations should become signatories to the International Centre for the Settlement of Investment Disputes (ICSID) Convention; and (6) in any investor-state arbitration hearing which arises, the developing nation should insist on the utilization of rules adopted by the ICSID Convention.

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I. Objectives of the Article

The objectives of this article are to: (1) describe the significance of foreign direct investment; (2) discuss significant nuances of bilateral investment treaties; (3) explain the importance of investor-state arbitration as a dispute resolution mechanism in bilateral investment treaties; (4) cover the two most common types of rules used in investor-state arbitration hearings; and (5) make general recommendations for improvement of a developing nation’s investment laws.

II. Foreign Direct Investment

Foreign Direct Investment (FDI) occurs “when an investor based in one country (the home country) acquires another asset in another country (the host country) with the intent to manage that asset.”1 FDI often occurs when a host country is in need of financial, technological, managerial, and other resources that are necessary for the development of its economy. World FDI surged from only $200 billion in 1990 to more than $1 trillion in 2000.2

FDI has a dramatic impact on a host country. A host country has a sovereign right to regulate FDI and to determine the role it will play in its economic development. A host country’s regulation of FDI, however, is in conflict with the creation of a liberal international economic system designed to maximize the economic prosperity of both the home and the host countries. As a result, there has been a gradual development of international law restricting the host country’s control over FDI by establishment of international arbitral tribunals. Perhaps the best example of this type of international law is the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, often referred to as the Washington Convention. The Washington Convention created the International Centre for Settlement of Investment Disputes (ICSID) and placed it under the aegis of the World Bank. The function of ICSID is to facilitate arbitration proceedings between a host country government and investors in the home country. ICSID provides the facilities and procedural framework for international arbitration, but ICSID itself does not arbitrate disputes. Rather, ICSID provides guidelines for selection of arbitrators and conducting proceedings. Under those guidelines, the majority of the arbitrators must be nationals of countries other than the two parties involved in the dispute.3

III. Bilateral Investment Treaties

On the other hand, a host country may voluntarily qualify its sovereign ability to control FDI by entering into a bilateral investment treaty with the home country govern-

ment. Thus, governments of the home country and the host country have often established parameters over foreign investment by negotiation of a Bilateral Investment Treaty (BIT). More than 2,500 BITs currently exist, affecting 170 countries. Most of the liberalization of host country investment requirements has come through the proliferation of BITs.

BITs grant investors a number of rights, as well as remedies to enforce those rights. The substantive investors' rights commonly found in BITs include the following: (1) guaranteed payment of adequate compensation in the event an investment is expropriated; (2) prohibition of the host country enacting currency controls to prevent the free flow of capital; (3) prohibition of discrimination against the investor in favor of the host country's citizens or other foreigners; (4) fair and equal treatment by the host country; (5) provision of full protection and security of the investment by the host country; (6) a guarantee by the host country that the investor will not be treated less favorably than the minimum standard required by customary international law; and (7) an agreement of the host country to honor all commitments made to the investor.

The following factors account for the perpetuation of the BIT regime: (1) negative consequences may follow if a nation withdraws from a BIT (e.g., enticing future capital flows into that country may become more difficult or more expensive, and a perception that the withdrawing country has become politically risky); (2) BITs ordinarily initially cover a period of ten to fifteen years, with no right of termination of the treaty during that period; and (3) most BITs contain a "continuing effects" clause, which provides that investments made, acquired, or approved prior to the date of the termination of the treaty will be protected by the treaty's provisions for a further term of ten to twenty years.

BITs have become the mainstay of the development of the international investment law regime, but this was not always intended to be the case. Since the creation of the Interna-

4. Burt, supra note 1, at 1027.
6. Burt, supra note 1, at 1027.
7. If the host nation issues a "compulsory license" enabling a foreign investor's intellectual property to be used by the host nation to fulfill a public need (e.g., for public health), the issuance of that license may be considered to be an expropriation of the investor's intellectual property. If this issue goes to arbitration, the arbitrator must consider not only (i) the impact of the government-authorized compulsory license on the investment (i.e., the level of deprivation) and (ii) whether the investor's expectations and reliance on the patent rights as a basis for investment are reasonable and legitimate, but also (iii) the character of the government action, including the regulatory purpose behind the compulsory license. See Christopher Gibson, A Look at the Compulsory License in Investment Arbitration: The Case of Indirect Expropriation, 25 Am. U. INT'L L. REV. 357, 414 (2010).
8. At least one commentator has argued that a host country's violation of its obligations under the World Trade Organization would also be a violation of its obligation to treat investors in a fair and equal manner. See generally, Charles Owen Verrill, Jr., Bilateral Investment Treaties: Arbitrating Investor-State Disputes: Are WTO Violations Also Contrary to the Fair and Equitable Treatment Obligations in Investor Protection Agreements?, 11 ILSA J. INT'L & COMP. L. 287 (2005).
10. Jeswald W. Salacuse, The Emerging Global Regime for Investment, 51 HARV. INT'L L.J. 427, 471–72 (2010). Notwithstanding those impediments to ending a BIT, four countries have recently done so: Bolivia, Ecuador, Russia, and Venezuela. Id. at 471.

FALL 2013
tional Centre for Settlement of Investment Disputes, it has been the goal of many developed, capital-exporting nations to secure a multilateral agreement on investment that would create a uniform body of foreign investment law. However, this project has been often rejected by developing, capital-importing nations and they have argued against both the formation of such an agreement, as well as the principles on which it would be based.\textsuperscript{11}

The "umbrella" clause is a provision commonly found in many BITs that requires each of the two contracting nations to observe all investment obligations they have assumed with respect to investors from the other contracting nation. This type of clause brings otherwise independent investment arrangements between a contracting nation and private investors from the other contracting nation under the treaty’s "umbrella of protection." Its purpose is to create an inter-national obligation to observe investment agreements that investors may enforce when the BIT confers a direct right of recourse to arbitration. More specifically, the history of the umbrella clause makes clear that it was designed to allow for any breach of a relevant investment contract to be resolved under the treaty in an international forum.\textsuperscript{12} At least one commentator has contended that (1) a BIT’s umbrella clause should also apply to obligations arising under a separate contract between an investor of the home country and the government of the host nation; and therefore (2) a BIT tribunal should be able to exercise jurisdiction over breach of contract claims, including a situation when the contract contains an exclusive forum selection clause.\textsuperscript{13}

IV. Investor-State Arbitration

If a bilateral investment treaty (BIT) contains an Investor-State Arbitration (ISA) provision, investors are given the right to, and provided the means to, initiate an arbitral proceeding against a foreign government under international law, seeking redress for violation of the BIT by the foreign government.\textsuperscript{14} In ISA cases, the arbitrator is empowered to interpret the applicable relevant provisions of the BIT as well as the contract between the arbitrating parties.\textsuperscript{15} ISA has enjoyed a remarkable growth in recent years; now, there are more than forty new cases each year.\textsuperscript{16}

\begin{itemize}
  \item \textsuperscript{13} Id. at 174.
  \item \textsuperscript{15} Anthea Roberts, \textit{Power and Persuasion in Investment Treaty Interpretation: The Dual Role of States}, 104 \textit{AJ.I.L.} 179, 225 (2010).
\end{itemize}
Chapter 11 of the North American Free Trade Agreement (NAFTA) is an example of an ISA provision. Chapter 11 allows investors of one NAFTA party (the United States, Canada, or Mexico) to bring claims directly against the government of another NAFTA party before an international panel of arbitrators. Because NAFTA Article 1121 waives the local remedies rule, an investor is not required to exhaust his remedies in a domestic court before filing a Chapter 11 claim. Under Chapter 11, investors may initiate arbitration against the NAFTA party pursuant to either the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL), or the Rules of the International Centre for Settlement of Investment Disputes (ICSID). NAFTA Chapter 11 was the first instance of an investor-state provision allowing such claims by developed nations against each other and has caused some concern in both the United States and Canada.

A few commentators have opined that Chapter 11 disadvantages the three NAFTA nations by inhibiting their investment lawmaking power and subjecting them to claims of foreign investors. They contend that Chapter 11, although originally intended to be a defensive mechanism for investors, has become an offensive weapon too often used by investors against the NAFTA nations. Nevertheless, the majority of commentators have praised Chapter 11 because of its essential role in protecting foreign investors, while acknowledging that Chapter 11 could potentially be misused by those investors.

Notwithstanding the criticism that ISA has often resulted in inconsistent decisions in similar cases, ISA remains the most common dispute resolution mechanism adopted in BITs. Critics should look to the outcomes of arbitration proceedings in order to evaluate the legitimacy of international investment protection and the capacity of arbitrators to live up to the standards of independence, impartiality, and judicial judgment. If they would do so, they would find that arbitrators not only achieve efficient and effective dispute settlement, but they also, through their independent and impartial application of the governing law, foster the international rule of law and an investment-friendly environment. It is also true that investment jurisprudence provides the necessary leeway to implement their policy choices and to legislate in a self-determined and sovereign manner.

17. Ray C. Jones, Notes and Comments, NAFTA: Chapter 11 Investor-to-State Dispute Resolution: A Shield to be Embraced or a Sword to Be Feared?, 2002 B.Y.U. L. REV. 527, 528 (2002). Research has shown that recent developments in legal education around the world have resulted in a diversity of backgrounds and nationalities among the chosen arbitrators. No longer is there a small “exclusive club” of arbitrators. The number of arbitrators has grown and there is a now a greater variety of them to choose from. Tai-Heng Cheng, Precedent and Control in Investment Treaty Arbitration, 30 FORDHAM INT’L L. J. 1014, 1047 – 48 (2007).


19. Jones, supra note 17, at 534.

20. Id.

21. Id.

22. Id.

23. Id.


ner.\textsuperscript{26} If one prefers, by contrast; a world where property interests must yield to any other public interest, where the host nation's contractual promises have no real value in the face of changed political preferences, and where good governance standards cannot be enforced; one can do away with BITs and ISA.\textsuperscript{27} To do so, however, would lead to a chill in the global economy that is not in the best interest of host nations or their citizens.\textsuperscript{28} Therefore, BITs and ISA are "legitimate mechanisms for structuring and stabilizing international investment relations without institutionalizing a pro-investor bias or disregarding the host state's legitimate power to regulate."\textsuperscript{29}

A commonly-held belief has been that investment arbitrators, in an effort to please both parties and to get repeat appointments, often issue compromise decisions that give each party some, but not all, of what he is asking for. Another frequently-held belief maintains that investment arbitrators are usually biased against the host nation and are more likely to give a favorable decision to investors.\textsuperscript{30} However, a recent study tends to refute both of these common beliefs. The study revealed that investment arbitrators are not prone to give compromise awards or to decide in favor of investors. Instead, investment arbitrators usually do what they are supposed to do—issue an unbiased decision based on the evidence in each case. The study emphasized that investment arbitrators strive to be fair and impartial in their decisions because they place a high value on their professional reputations.\textsuperscript{31}

Additionally, a recent study indicated that, in general, the outcome of investment treaty arbitration was not reliably associated with (1) the degree of economic development of the respondent host nation; (2) whether the arbitrator was from an economically developed nation or an underdeveloped one; or (3) a combination of the first two variables.\textsuperscript{32} None of the reported ISA cases involved the United Arab Emirates or any other Arab country. But Turkey was a party in one of the cases.\textsuperscript{33}

One criticism of ISA is that it requires the host nation to make an exception to its sovereign immunity. But ISA and sovereign immunity have similar justifications. Both came into existence in response to a proliferation of interactions between investor firms and foreign host countries. Both aim to achieve access to legal remedies by investor firms whenever they interplay with foreign states. Both strive to avoid the effect of political influence whenever investor firms make demands upon foreign host countries. Toward those ends, both desire to attain a compromise between the interests of investor firms in pursuing their remedies and the interests of foreign host countries in conducting their affairs without interference. Accordingly, both serve as important milestones on the evo-

\begin{footnotes}
\item[26.] \textsuperscript{Id.}
\item[27.] \textsuperscript{Id. at 498.}
\item[28.] \textsuperscript{Id.}
\item[29.] \textsuperscript{Id.}
\end{footnotes}
tionary continuum from a "might makes right" perspective on international relations to one that is grounded in rules. Because of these similar justifications, the law of sovereign immunity can serve as a model for the continuous improvement of ISA.\(^{34}\)

**A. PROPOSALS FOR JUDICIAL REVIEW OF ARBITRAL DECISIONS**

Investor-State Arbitration is so new that most of the claims and decisions employing this apparatus have occurred in the past decade.\(^{35}\) As a result, many parts of the law and procedure remain to be developed.\(^{36}\) The calls for an appellate mechanism emanating from some quarters are partly in response to the fact that, in some of the recent cases, Canadian courts have been asked to help in determining the future viability of ISA.\(^{37}\) Under NAFTA, which is procedurally based on the model of international commercial arbitration, a judicial review of an arbitral award can be initiated by a disputing party in the national courts of the jurisdiction in which the arbitration occurred pursuant to that jurisdiction’s law.\(^{38}\) Those calling for judicial review of arbitral decisions argue there is a need for a second opinion on each arbitration’s issues of fact and law and a need for correctness and consistency, and that those two needs trump the advantages of finality of an arbitrator’s decision.\(^{39}\)

A number of countries around the world have adopted ISA as the dispute resolution mechanism in its BITs, including Argentina;\(^{40}\) Bolivia;\(^{41}\) China;\(^{42}\) Czech Republic;\(^{43}\) Ecuador;\(^{44}\) Japan;\(^{45}\) Mexico;\(^{46}\) and many others.

**V. Rules Used in B.I.T. Arbitral Hearings**

The two most important sources of arbitration rules that may be applied in an arbitration case arising under a BIT are (1) the United Nations Commission on International Trade Law Arbitration Rules, which have each been used in 20 percent of the ISA cases;
and (2) the World Bank's International Centre for the Settlement of Investment Disputes (ICSID) Convention Rules, which have been used in the majority of all ISA cases. This is due to the fact that most of the BITs include a provision expressing a choice to use the ICSID Rules.

A. UNCITRAL Arbitration Rules

The United Nations Commission on International Trade Law was created by the United Nations in 1966 “to further the progressive harmonization and unification of the law of international trade.” Its member states are elected by the U.N.'s General Assembly. Currently, sixty nations are members of UNCITRAL. The United Arab Emirates is not a member of UNCITRAL.

Numerous countries have relied upon the UNCITRAL Model Law as a foundation for their national arbitration laws. The Model Law outlines the arbitration rules to be enacted by a nation and requires courts to provide assistance to arbitrators. Despite the fact that some national arbitration laws have no relationship to the UNCITRAL Model Law, many of those same laws still facilitate the arbitration process. For example, the English Arbitration Act of 1996 recognizes the enforceability of peremptory orders of the tribunal compelling the attendance of witnesses and the production or preservation of evidence.

In 1976, the U.N. Commission on International Trade Law drafted and later adopted the UNCITRAL Arbitration Rules, an extensive set of procedural rules to be used in international commercial arbitrations. Notwithstanding their sweeping popularity, they need to be amended to incorporate evolutionary developments in international arbitral practice. As a result, UNCITRAL may tweak the rules.

In 1985, UNCITRAL drafted and later adopted the UNCITRAL Model Law on International Commercial Arbitration. Parties to bilateral investment agreements that have adopted the UNCITRAL Arbitration Rules are required to use those rules in their ISAs. Almost 100 arbitration cases have been decided using UNCITRAL Arbitration Rules. The Arbitration Rules may be selected pursuant to either a BIT or a regional multilateral

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47. Franck, Empirically Evaluating Claims, supra note 33, at 40.
50. Id.
51. See generally id.
52. Leal-Arcas, supra note 11, at 82.
53. Id. at 82–83.
54. Id.
55. Id.
56. Id.
57. Id.
58. Leal-Arcas, supra note 11, at 82–83.
investment regime (e.g., North American Free Trade Agreement). Although the Rules were originally designed for use in commercial cases, they were recently modified in order to make them more compatible with treaty-based arbitration cases. The Iran-U.S. Claims Tribunal illustrated how the UNCITRAL Rules could be successfully employed in the resolution of claims brought by private parties against a sovereign nation. Presently, these rules are used in a variety of situations: commercial cases, arbitrations under bilateral and multilateral investment treaties, and in preferential trade and investment agreements.

Host nations prefer arbitration under the UNCITRAL Arbitration Rules to some other tribunals (e.g., the International Chamber of Commerce); this is because the Rules have been written by the United Nations, a body held in high esteem. In comparison with ordinary commercial arbitration, the Rules are not perceived as much of a threat to national sovereignty. Private investors in home countries like the UNCITRAL rules because they offer the flexibility of ad hoc arbitration and the security provided by a widely-accepted set of procedural rules. All parties appreciate the confidentiality of UNCITRAL arbitration and its relatively strict jurisdictional requirements.

It should be emphasized that the UNCITRAL Rules are procedural only. The substantive law to be applied in each arbitral hearing is the law of the place in which the arbitration is held.

1. Judicial Review

UNCITRAL Model Law Article 34(2) states six possible grounds for judicial review of an arbitral decision employing the UNCITRAL Rules: (1) invalidity of the agreement to arbitrate; (2) lack of notice to a party or other inability to present the case; (3) inclusion in the award of matters outside the scope of submission; (4) irregularity in the composition of the tribunal or arbitral procedure; (5) non-arbitrability of the subject-matter; and (6) violation of domestic public policy. In the review, the court would not be allowed to consider possible errors of law or to review the application of the facts to the law. Accordingly, the selection of the place of arbitration is a critical factor relating to judicial review and enforcement. If one is going to ask a domestic court to review an international arbitral decision, the claimant in particular wants to be sure that it will receive a fair hearing. This results in a high probability of forum shopping. However, attempts to

60. Id.
61. Id.
62. Id.
63. Id.
64. Id.
66. Id.
67. Id.
69. Laird et al., supra note 35, at 288.
70. Id.
71. Id. at 289.
72. Id.
73. Id. at 289.
obtain judicial review in Canadian courts in NAFTA cases have usually failed, as those courts have usually exhibited a pro-arbitration policy, judicial deference to arbitral decisions, and an appreciation of their advantage of finality.74

2. Recent Changes to the UNCITRAL Rules

The UNCITRAL Rules were not originally tailored for use in ISA.75 The public-interest difference between ISA and commercial arbitration has direct implications for the conduct of the arbitration.76 "For example, there may be a need for particular procedural arrangements, such as separate phases on jurisdiction and admissibility before the submission of a statement of claim, amicus curiae briefs, and consolidation of claims and hearings."

The following amendments were made to make the UNCITRAL Rules more compatible with ISA: (1) limitation of the scope of the Rules to disputes relating to a contract; (2) a statement that the Rules are subject to the controlling national arbitration law of a particular dispute (although the controlling law is not defined); (3) a statement that service upon a state is sufficient if it is delivered to an organ of the state's government and complies with the law of that state pertinent to service of process; and (4) a statement that the arbitrator is empowered to control the arbitration's timetable as he deems appropriate, so long as each party receives equal treatment and an opportunity to present its case.77


Relying on principles of indirect control, an arbitral tribunal created in accordance with Chapter 11 of NAFTA and the UNCITRAL Rules found that the claimant, a family-owned corporation, was an investor in Canada despite the fact its Canadian affiliate was owned only by the family members and not by the corporation.78 The tribunal also found that Canada had violated NAFTA Articles 1102 (national treatment) and 1105 (minimum standard of treatment) by forbidding the claimant to export a certain chemical to the United States for a period of time. Canada sought judicial review by the Federal Court of Canada, contending that the claimant lacked a Canadian investment, which deprived the tribunal of jurisdiction.80 The court decided that Canada had waived its jurisdictional objections.81 In the alternative, the court denied Canada's contentions based on the "correctness" of the tribunal's interpretation of Chapter 11's jurisdictional provisions and on the "reasonableness" of their application to the facts of the particular case.82 Notwithstanding the above, the court did confirm that it possessed a limited scope of judicial review when it stated that "the Canadian submission that the Tribunal erred in law in

74. Id. at 290-92.
76. Id.
77. Id. at 913.
78. Id. at 913-16.
80. Id.
81. Id.
82. Id.
applying Articles 1102 and 1105 in this case is a matter outside the Court's authority under Article 34 [of the Commercial Arbitration Code] to judicially review. A dispute falling within the terms of the submission to arbitration, even if wrongly decided on a point of fact or law, cannot be judicially reviewed.983

VI. ICSID Convention Rules

The International Centre for the Settlement of Investment Disputes (ICSID) is an institution of the World Bank.84 ICSID was founded in 1966 pursuant to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (commonly referred to as the "ICSID Convention" or "Washington Convention").85 As of 2009, 156 countries have signed the ICSID Convention. The United States is also a party to the ICSID Convention, and American citizens have frequently been parties in ICSID arbitrations.86

The ICSID arbitrates investment conflicts between member states serving as host nations and individual investors of other nations. Pursuant to the ICSID Convention, all investment disputes must be arbitrated before the ICSID tribunal. The tribunal attempts to be a fair arbiter of the rights, responsibilities, and claims of all parties and makes a special effort to remove domestic politics and domestic judicial influence from the proceedings.87 Despite the fact it is not a permanent arbitral tribunal, the ICSID provides a legal and organizational framework for arbitration hearings.88 According to the ICSID, "if the parties cannot agree on the place of arbitration, then the arbitration will take place at the World Bank's offices in Washington," D.C., United States.89

ICSID arbitration is subject to four conditions: "(1) the parties must have agreed to submit their dispute for settlement under the ICSID; (2) the dispute must be between a contracting state to the ICSID (or a subdivision or agency of that state) and the national of another contracting state; (3) the dispute must be a legal dispute; and (4) the dispute must arise directly out of an investment made in the host contracting state."90 If the parties consent to ICSID arbitration, all other remedies or forums for resolution are excluded.91 Tribunals convened under the ICSID Convention are truly de-localized; unlike UNCTRAL arbitrations, ICSID arbitrations are not subject to the law of any place of arbitration, and states that are party to the ICSID Convention promise to give awards immediate effect.92 States are prohibited from exercising diplomatic protection after a claim has been

83. Laird et al., supra note 35, at 293–94.
85. Id.
87. Leal-Arcas, supra note 11, at 81.
88. Id.
90. Leal-Arcas, supra note 11, at 81–82.
91. Id.
92. Bjorklund, supra note 68, at 193.
filed with the ICSID, except in cases of failure to comply with an award. Additionally, once a state has agreed to arbitration, it is not allowed to unilaterally revoke its consent or to require an exhaustion of local remedies (unless the agreement provides that exhaustion of local remedies must precede arbitration). After the arbitrator has made an award, the host nation must recognize the award as binding and must enforce the monetary obligations imposed by that award as if it were a final judgment of a court in the host nation.

During the past two decades, the ICSID Rules have become the most commonly used rules in ISA cases. The ICSID oversaw only twenty-six ISA cases between 1966 (the year the ICSID Convention was created) and 1991. During the past twenty years, however, the ICSID has overseen 131 cases, with another 124 cases pending.

The ICSID Convention, in Article 48(3), requires written awards that "deal with every question submitted to the Tribunal, and... that state the reasons upon which it is based." Article 54 provides that "each Contracting State shall recognize an award... as binding and enforce the pecuniary obligations... within its territory as if it were a final judgment of a court in that State." There is no possibility of appeal, and there are no grounds for challenging an investor-state award in court.

These rules also result in the most transparency of the arbitration process. Transparency has several advantages, including the following: (1) higher-quality decision making because those making the decision are aware that third parties may scrutinize it; (2) preservation of the arbitration hearing record, a prerequisite for annulment of the arbitral decision; (3) democratic values and recognition of human rights are more fully afforded; (4) the parties' interests are better protected; (5) decisions in similar cases will be more consistent because prior cases are more likely to be considered in rendering a decision; (6) more legitimacy of the decision; (7) more accountability of host countries to the public; (8) promotion of systemic reform; and (8) promotion of the rule of law in the host country because it demonstrates an example of a successful dispute resolution method that could be experimented with by the host country.

An issue frequently encountered by ICSID arbitrators is whether an investment transaction is covered by both Article 25 of the ICSID Convention on jurisdiction of the Centre and the applicable BIT. Prior arbitration cases that have considered this issue mandate tribunals to evaluate each investment transaction from all aspects of the parties' relation-

93. Leal-Arcas, supra note 11, at 82.
94. Id.
97. Id.
98. Id.
99. Id.
100. Cane, supra note 95, at 463.
101. Gibson, supra note 7, at 418.
ship. The following are factors to be included in the evaluation: when the transaction was made, pre-contract expenses, territorial questions, claims for injuries to direct subsidiaries, and host country approval requirements.

NAFTA is perhaps the only multilateral treaty in which a sufficient number of arbitrations have occurred for the construction of a substantive body of arbitral decisions. Within that body of case law, there has been some criticism that the ICSID Rules, when applied to arbitrations under Chapter 11 of NAFTA, have sometimes resulted in inconsistent decisions. However, one commentator has predicted that, over time, "there will be a convergence in jurisprudence resulting in some level of consistency. As of yet, it is unclear whether this convergence is taking place, given that some of the areas where there is urged to be an inconsistency are still at an early stage of development."

A. Expropriation Damages

Compensation for expropriation of a foreign investment by a host nation is a controversial area of international law because of the broad range of possible remedies and because of its relationship to property rights. In awarding expropriation damages, tribunals at the ICSID generally assess compensation according to the estimated lost profits the injured investor would have earned from the investment, which employs the familiar "expectation measure" from U.S. contract law. But sometimes, ICSID tribunals have granted recovery for actual losses, meaning the costs of the investment, much as a domestic court might award "reliance measure" damages. While the reasoning for the tribunals' decisions to fix damages according to losses incurred as opposed to gains foregone is often unclear, there is a sound economic justification for a reliance-based standard of compensation. Calculation of damages based upon actual investment figures should result in less error than trying to estimate the amount of profits lost because of the expropriation and it should also provide for more confidentiality of sensitive information. These two factors should help to promote the continuation of foreign direct investment in the future, one of the principal goals of the ICSID's dispute resolution process.

B. Review of ICSID Arbitral Decisions

Unlike the UNCITRAL arbitration rules, no judicial review is allowed under the ICSID Rules. This reinforces one of the greatest strengths of the arbitration process—its finality.

104. Id.
105. Id.
109. Id.
110. Id.
111. Id.
112. Id. at 195-96.
113. Gibson, supra note 7, at 418.
However, Article 52 allows an award to be annulled by an ad hoc committee of three different arbitrators if the challenged award "failed to state the reasons on which it was based." If an award is annulled, a third, new tribunal must be formed to re-decide the annulled points of the original award. The Article 52 annulment process thus provides both the formal and the practical impetus for an arbitrator to thoroughly explain the reasons for his decision.

The ICSID Convention's Article 52 review process is an internal annulment mechanism; the domestic court system is not affected. In a UNCITRAL appeal, the court may consider the substantive correctness of the arbitrator's decision and is permitted to substitute its view; but, under the ICSID Convention, an annulment voids the arbitrator's decision partially or fully, and the case is sent to a new tribunal for a new decision. The five grounds for annulment are "(1) the original arbitral tribunal was not properly constituted; (2) the arbitral tribunal manifestly exceeded its powers; (3) a tribunal member was corrupt; (4) there was a serious departure from a fundamental rule of procedure; or (5) the award does not state the reasons upon which it was based." The mere fact that an arbitrator made a mistake of law or fact cannot justify the annulment of an award because neither of those is an enumerated ground.

The United States of America has been pushing for judicial review of ISA decisions because it perceives ISA to be somewhat of an encroachment upon its sovereignty. As a result, recent BITs entered into by the United States and at least twenty other nations have included a judicial review provision. In direct response to that trend, in 2004 the ICSID published a discussion paper entitled "Possible Improvements of the Framework for ICSID Arbitration," which sought to begin the creation of an appeals mechanism to be administered by the ICSID. The main justification mentioned in that paper was to foster coherence and consistency in the case law emerging under BITs. If there are to be appeals, then the suggestion of a single appeals mechanism administered by the ICSID seemed logical. However, the drive toward creation of the ICSID appeals procedure was seemingly slowed in 2005 when another working paper was issued, "Suggested Changes to the ICSID Rules and Regulations." Although the second paper suggests that the ICSID will continue to consider an appellate procedure, it also stated it would be premature to presently attempt to establish such a procedure "because of the difficult technical and policy issues."

114. Franck, *The Legitimacy Crisis*, supra note 9, at 1547.
117. Id.
118. Id. at 289-90.
119. Franck, *The Legitimacy Crisis*, supra note 9, at 1547.
120. Id.
122. Laird et al., *supra* note 35, at 297.
123. Id.
124. Id.
125. Id. at 73.
126. Id.

VOL. 47, NO. 2
C. RECENT CHANGES TO THE ICSID RULES

The dramatic increase in ISA using the ICSID Rules during the past decade led ICSID to implement several reforms in 2006. The amendments were intended to “make the proceedings more streamlined and transparent, while instilling greater confidence in the arbitral process.” With the new amendments, “the rules now provide for preliminary procedures concerning provisional measures, expedited procedures for dismissal of unmeritorious claims, access of non-disputing parties to proceedings, publication of awards, and additional disclosure requirements for arbitrators.” No judicial review was included in the reforms.

One commentator has suggested that the ICSID Rules should be further amended to consider environmental, public health, and labor concerns. She argues this would result in an investment regime that promotes the interests of both investors and host states.

VII. Recommendations

A. DEVELOPING NATIONS SHOULD PURSUE BILATERAL INVESTMENT TREATIES

The following reasons justify developing nations’ continued pursuit of BITs:

1. Developing countries should sign BITs with developed nations in order to promote foreign investment and to increase the financial, technological, managerial, and other resources flowing to their territories. The BIT should contain understandable and enforceable rules designed to protect the interests of all parties; if investors perceive that the rules safeguard their investments, more investment should occur. A BIT between a developed and a developing country is a mutually-beneficial agreement, a pledge of protection of the investor’s capital in exchange for the prospect of receipt of more capital in the future.

2. Developing countries should sign BITs with developed nations because those agreements may facilitate their attainment of other benefits and favors in the future. Even if a developing nation fails to realize increased investment flows from its developed-country treaty partner, the BIT will often result in a closer relationship with the developed country that, in turn, may lead to increased trade, foreign aid, security assistance, technology transfers, or other benefits.

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128. Tuck, supra note 75, at 892.
129. Id.
130. Id.
131. See id., at 282–902.
133. Id.
134. Salacuse, Treatification, supra note 5, at 158.
135. Id. at 158–59.
136. Id. at 159.
137. Id.
138. Id.
3. Developing countries should sign BITs as part of their efforts to liberalize their economies and thereby promote economic growth. Traditionally, developing countries have emphasized central economic planning by the government, state enterprises, a high degree of regulation of the private sector (if it was allowed to exist), and restrictions on international trade and foreign direct investment. Commencing in the late 1980s, most developing nations adopted the neo-liberal economic model, known as the Washington Consensus. The Washington Consensus emphasizes a free market economy instead of state economic planning, the private sector as the primary component of economic growth instead of the public sector, avoidance of excessive regulation of the private sector, and encouragement of international trade and foreign direct investment. Developing countries have viewed BITs as an important instrument in implementation of the Washington Consensus model. And from the developed nations' perspective, BITs are often used as a mechanism to facilitate liberalization of the economies of developing countries.

4. As economic liberalization is pursued and BITs are entered into by developing countries, entrepreneurs in developing countries will be encouraged to pursue their risk-taking ventures. Economic liberalization will send a signal to those business firms that their government wants them to succeed. BITs will also encourage those firms because it will show the commitment of their government to protect the capital of foreigners.

5. Developing countries often have deficient legal systems. Because of this, developing countries should enter into BITs in order to correct some of the drawbacks in their legal systems and in their enforcement of the rule of law. BITs can become international substitutes for deficient domestic legal systems. What is the rationale for this conclusion? When a developing country enters into a BIT, its authorities voluntarily agree not to act in an arbitrary and capricious manner toward foreign investors; this attitude should, in turn, lead them to avoid being arbitrary and capricious toward their own nationals; and eventually, those authorities should experience improved governance and a greater respect for the rule of law.

6. Developing countries should avoid multilateral investment treaties with developed nations. BITs are much more common than multilateral treaties because they allow the developing country to enter into treaties only with nations possessing the specific financial, technological, managerial and other resources that they specifically need.

VIII. Developing Nations Should Include Investor-State Arbitration (Using ICSID Rules) in its Bilateral Investment Treaties

Although mediation and other methods can also be used in resolution of FDI disputes, Investor-State Arbitration (ISA) has become the most commonly used resolution
device. Since 1995, the number of arbitrations pursuant to investment treaties has increased dramatically and the number of those decisions is approaching one hundred. One of the criticisms of ISA is that it does not allow the host country to apply its law in dealing with the dispute. But this criticism is outweighed by the advantages afforded by ISA.

Accordingly, developing countries should agree to ISA (using ICSID Rules) in their BITs for the following reasons:

1. International arbitrators are often uniquely skilled in evaluating complex business transactions and the risks they might pose. "If countries are often willing to trust international arbitration to handle issues as important as nuclear non-proliferation, they should be willing to accept this forum to resolve their international investment disputes." Arbitrators are often much more knowledgeable of the business problems in a specific industry than a judge in the host country with little or no experience in that industry.

2. If international arbitration is chosen as the dispute resolution mechanism, investors and host states will incur more flexibility because a number of factors may be used as the justification for a decision. Arbitrators avoid strict adherence to any one rule of law; they can focus on general legal principles. Therefore, arbitration often results in greater fulfillment of investors' needs while simultaneously protecting the security interests of the host state.

3. Arbitration is a private forum that allows parties to protect business secrets and other confidences, regardless of whether the secrets would qualify for special protection under judicial procedures. Both the investor and the host country desire to protect classified information, and arbitration provides for that.

4. The availability of ISA to resolve disputes is a positive factor taken into account by potential investors and will indirectly promote FDI through its positive impact on the rule of law. Foreign investors will have more incentive to invest because they will know there will be an objective forum to resolve disputes.

5. ISA will promote judicial economy in that it will protect the courts of the developing nations from having to shoulder the burden of resolving onerous, time-consuming BIT claims.

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145. Id. at 143-44.
146. Franck, The Legitimacy Crisis, supra note 9, at 1521.
147. See Jason Webb Yackee, Toward a Minimalist System of International Investment Law, 32 SUFFOLK TRANSNAT'L L.Rev. 303, 323-25 (2009) (arguing that arbitration should not be used as a substitute for the host nation's courts and that its impact should be reduced).
149. Farrar, supra note 3, at 186.
150. Id.
151. Id.
152. Id.
153. Id.
154. Id. at 187.
156. Franck, Foreign Direct Investment, supra note 2, at 340.
157. Id.
6. Developing nations are encouraged to become a signatory to the ICSID Convention. Thereafter, the ICSID Arbitration Rules should be used in all BITs entered into by those nations. As mentioned above, the ICSID Rules have several important advantages over the UNCITRAL Rules; one of these is that they do not allow for judicial review, which increases the degree of finality of the arbitrator's decision. The objectives of finality and correctness are not contradictory. When excellent arbitrators are employed, correctness becomes less of an issue and finality remains workable.  

IX. Conclusions

1. Developing nations should promote foreign investment in order to gain access to financial, technological, managerial, and other resources that they need.
2. Accordingly, developing nations should pursue bilateral investment treaties with foreign countries whose business firms possess those resources.
3. Developing nations' investment laws need to be fine-tuned in order to maximize growth and investment.
4. In each bilateral treaty, a developing nation should agree to investor-state arbitration as the dispute resolution mechanism to be employed whenever a disagreement arises between the developing nation's government and private business firms of the other country.
5. Developing nations should become a signatory to the International Centre for the Settlement of Investment Disputes ("ICSID") Convention.
6. In any investor-state arbitration hearing that arises, the developing nation should insist on the utilization of Rules adopted by the ICSID Convention.

158. Laird et al., supra note 35, at 302.