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Proportional Pragmatism: A Defense of International Arbitration Agreements in the Face of Asymmetrical Paternalism

*Rusty O’Kane**

Foreign direct investment (FDI) is generally perceived to have a positive impact on the economic well being of developing countries.¹ In particular, international investors provide developing regions of the world with access to capital, job opportunities, and new technologies.² With FDI’s increasingly important role in the global market, a more comprehensive regulatory system has emerged to guide key participants.³

Bilateral investment treaties have developed as an essential piece of the emerging regulatory system. Bilateral Investment Treaties (BITs) are “[international investment] agreements between two countries for the reciprocal encouragement, promotion and protection of investments in each

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¹ See NOAH RUBINS & N. STEPHAN KINSELLA, INTERNATIONAL INVESTMENT, POLITICAL RISK AND DISPUTE SETTLEMENT xxviii–xxix (2005) (discussing the benefits FDI brings to both the investors and host states while further pointing out the positive effect of FDI on the economy of developing countries).

² Viji Rangaswami, Carnegie Endowment for Int’l Peace, Statement at the Carnegie Endowment Workshop on Globalization, International Law, and the Future of International Investment Treaties (July 15, 2005) (summarized by Jennifer Maul and Kate Vyborny), <http://www.carnegieendowment.org/files/IISD.pdf>; see Karl P. Sauvant, *The Rise of International Investment, Investment Agreements and Investment Disputes*, in APPEALS MECHANISM IN INTERNATIONAL INVESTMENT DISPUTES 3 (Karl P. Sauvant ed., 2008) (mentioning FDI as a means to bring goods and services to foreign markets).

³ 1 U.N. CONFERENCE ON TRADE & DEV. [UNCTAD], INTERNATIONAL INVESTMENT AGREEMENTS: KEY ISSUES at xxi, U.N. Doc. UNCTAD/I13/IIT/2004/10 (2004) [hereinafter KEY ISSUES] (noting that the first half of the 21st century will feature an establishment of an international investment law system).

other's territories by companies based in either country."⁴ BITs have greatly proliferated in the last two decades and are playing a significant role in investment protection.⁵ Their number rose from 385 in 1989 to a total of 2,265 in 2003.⁶ By mid-2008, more than 2,619 BITs involving 179 different countries had been ratified or renegotiated.⁷

These treaties have drastically affected the way foreign investors interact with host countries, especially in the area of dispute resolution.⁸ A distinctive feature of many BITs is that they provide for alternative dispute resolution procedures such as international arbitration.⁹ International investment arbitration agreements, authorized by BITs, provide guarantees to the investors of one contracting state when they invest in the territory of the other contracting state.¹⁰ These guarantees include fair and equitable treatment, protection from expropriation, and security for assets.¹¹ In particular, an investor whose rights are violated by a host country may, under the terms of these treaties, pursue international arbitration rather than suing the host State in its domestic courts.¹² International arbitration is advantageous because of "its cross-border enforceability—in other words, an award rendered in one country can be taken, with relative ease, to another country and enforced against the assets of a judgment creditor there."¹³

Numerous concerns have been raised, however, that developing countries are sacrificing too much sovereignty in order to attract FDI and that arbiters are beginning to act more like legislators than neutral decision-

⁴ UNCTAD, *Investment Instruments Online: What are BITs?*, http://www.unctadxi.org/templates/Page_1006.aspx (last visited Sept. 19, 2009) [hereinafter *Investment Instruments Online*].

⁵ RUBINS & KINSELLA, *supra* note 1, at 27–28.

⁶ UNCTAD, *Recent Developments in International Investment Agreements: IIA Monitor*, 2, 6 (2008), http://www.unctad.org/en/docs/webdiaeia20081_en.pdf [hereinafter *Recent Developments*].

⁷ *Id.*

⁸ Sauvart, *supra* note 2, at 7, 9.

⁹ Jarrod Wong, *Umbrella Clauses in Bilateral Investment Treaties: Of Breaches of Contract, Treaty Violations, and the Divide Between Developing and Developed Countries in Foreign Investment Disputes*, 14 GEO. MASON L. REV. 135, 142 (2006).

¹⁰ *Investment Instruments Online*, *supra* note 4.

¹¹ RUBINS & KINSELLA, *supra* note 1, at 28; see also AARON COSBEY, INT'L INST. FOR SUSTAINABLE DEV. [IISD], INTERNATIONAL INVESTMENT AGREEMENTS AND SUSTAINABLE DEVELOPMENT: ACHIEVING THE MILLENNIUM DEVELOPMENT GOALS 22 (2005), http://www.iisd.org/pdf/2005/investment_iias.pdf (explaining that many International Investment Agreements extend definitions of protected investment-related assets to intellectual property rights with protections from expropriation and rights of fair compensation).

¹² *Id.*

¹³ Mark Beeley, *Arbitration in the Dubai International Financial Centre: A Promising Law, but Will it Travel Well?*, 1 INT'L ARB. L. REV. 1, 1 (2009).

makers.¹⁴ Especially troubling for critics is that developing countries are signing onto bilateral investment treaties that provide numerous rights to foreign investors without any guarantees that the treaty will generate pro-development investment.¹⁵ One critic suggested that instead of fostering mutually beneficial reciprocal arrangements, the current system of investment agreements simply allows foreign investors to take advantage of developing countries.¹⁶ As a result, there have been widespread calls for reform or dissolution of the current system in favor of a more uniform approach that would incorporate mandatory development objectives.¹⁷

It is not surprising that in response to the relatively young investment agreement system, there has been a plethora of critiques leveled against it. These critiques are commendable insofar as they point out the system's deficiencies and encourage participants to identify and implement improvements. Nevertheless, such critiques can be perilous when they lose sight of the historical background from which the system arose and the progress that has been made in the last decade.

Many calls for reform exaggerate the treaties' flaws and ignore the benefits that arbitration provisions provide for developing countries. Arbitration provides a neutral and competent decision maker to govern disputes, reduces costs of litigation, and provides faster resolution to investment disputes.¹⁸ Together, these advantages create incentives that promote greater FDI in developing countries, which fosters greater

¹⁴ See M. Somarajah, *A Coming Crisis: Expansionary Trends in International Investment Arbitration*, in APPEALS MECHANISM IN INTERNATIONAL INVESTMENT DISPUTES 39, 40 (Karl P. Sauvant ed., 2008) (suggesting some adverse effect is caused by the increasing number of arbitration awards against developing countries); Johanna Kalb, *Creating an ICSID Appellate Body*, 10 UCLA J. INT'L L. & FOREIGN AFF. 179, 215 (2005) (intrusion into state sovereignty resulting in a significant transfer of control away from States to appointed arbiters); Barton Legum, *The Introduction of an Appellate Mechanism: The U.S. Trade Act of 2002*, in ANNULMENT OF ICSID AWARDS (Emmanuel Gaillard & Yas Banifatemi eds., 2004); Joel P. Trachtman, *The Domain of WTO Dispute Resolution*, 40 HARV. INT'L L.J. 333, 336 (1999) (dispute resolution viewed as not just a mechanism for neutral application of legislated rules, but as a mechanism of legislation and of governance).

¹⁵ Somarajah, *supra* note 14, at 39.

¹⁶ M. SORNARAJAH, INTERNATIONAL LAW ON FOREIGN INVESTMENT 258 (2d ed. 2004); see also Somarajah, *supra* note 14 (explaining that the procedures for challenging awards are not suitable for developing country respondents because they would add to the costs of developing countries in dealing with such arbitrations).

¹⁷ HOWARD MANN ET AL., IISD, IISD MODEL INTERNATIONAL AGREEMENT ON INVESTMENT FOR SUSTAINABLE DEVELOPMENT v (2005) [hereinafter MODEL AGREEMENT]; Prakash Loungani & Assaf Razin, *How Beneficial Is Foreign Direct Investment for Developing Countries?*, 38 FIN. & DEV., June 2001, available at <http://www.imf.org/external/pubs/ft/fandd/2001/06/loungani.htm>.

¹⁸ Peter Sherwin et al., *Perceived Advantages and Disadvantages of Arbitration*, in PROSKAUER ON INTERNATIONAL LITIGATION AND DISPUTE RESOLUTION ch.19, Part I (2007), available at <http://www.proskauerguide.com/arbitration/19/1>.

economic development.¹⁹

Countries that heed overly zealous criticism and disavow international investment arbitration agreements risk removing the protections and incentives that attract foreign investment.²⁰ This is not to imply that reform is not necessary; any effective dispute resolution system must evolve with experience. However, critics are ignoring the fact that by establishing greater certainty and security for investors, the arbitration procedures currently in place have encouraged foreign investment and promoted economic development in developing countries.²¹

International investment arbitration agreements have been attacked and defended since their proliferation began almost two decades ago.²² However, the system's defenders have thus far only focused on the inadequacy of specific alternatives or attacked specific proposals.²³ There has yet to be an argument that the autonomy provided by the current system allows developing countries to respond to any perceived disadvantages and adequately protect their own interests. This comment counters the notion that investment arbitration agreements provide too few protections for developing countries in arbitration proceedings.

This comment is divided into four parts. Part I discusses the growth of international investment agreements ("IIAs") with emphasis on arbitration clauses. Part II describes specific criticisms leveled against the arbitration system and describes how the United Nations' revised Model International Agreement on Investment for Sustainable Development ("Model Agreement") is a manifestation of those criticisms. Part III defends the current investment treaty arbitration system by first debunking the criticisms leveled against it and then describing how the current system gives developing countries sufficient autonomy to protect their own interests without the need for intervention. Finally, Part IV concludes that while any system must necessarily be reformed as it evolves with experience, calls for the dissolution of arbitration agreements are overstated and seek to throw out the proverbial baby with the bathwater.

¹⁹ *Id.*; see also RUBINS & KINSELLA, *supra* note 1, at xxviii ("FDI is a potential engine for development, as the foreigner employs and trains local personnel, indirectly encourages secondary service providers and producers of goods, pays taxes, and in some case [sic], leaves behind valuable know-how.").

²⁰ Sauvart, *supra* note 2, at 6–7.

²¹ *Id.*

²² MODEL AGREEMENT, *supra* note 17, at v.

²³ See Daniel S. Meyers, *In Defense of the International Treaty Arbitration System*, 31 HOUS. J. INT'L L. 47, 67–80 (2008) (specifically attacking Gus Van Harten's criticisms that the ITA system lacks accountability, openness, coherence, and independence); see also Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions*, 73 FORDHAM L. REV. 1521 (2005) (arguing that criticisms of bias and unaccountability are without merit).

I. HISTORICAL CONTEXT

Understanding the emergence of international investment arbitration agreements is crucial to a proper defense of the current system. Foreign investment is nothing new, and neither are foreign investment disputes.²⁴ Traditionally, an investor whose investment was harmed by the host state lacked standing under international law to bring a direct claim against the host state.²⁵ Investors only had two options, both of which were unattractive. The investor could, first, assert a claim in the domestic courts of the host state.²⁶ Second, barring remedies from the host state, the investor could appeal to its own government to negotiate with the host state on the investor's behalf as a matter of diplomatic protection.²⁷

However, there were several problems with these remedies. First, domestic courts in host countries were "notoriously unsympathetic to foreign investors' claims" and provided little, if any, redress.²⁸ Second, diplomatic action was not an effective means of protecting investment interests because the investors' home government would rarely accede to a request for assistance. When it did, the outcome of the dispute could be protracted for several years with no guarantee of success.²⁹ Therefore, "prospective foreign investors knew, prior to investing abroad, that if their investments were subsequently injured by host states, there would be no reliable or efficient mechanism to obtain compensation."³⁰

The lack of a reliable and efficient mechanism to resolve disputes not surprisingly caused fear in the international community that investors would be discouraged from investing abroad.³¹ One commentator suggested that "prudent investors will not risk substantial capital in a foreign enterprise unless the . . . legal structure is sufficient to protect the investment."³² This fear was troublesome because of the positive impact that foreign investment has on developing countries.³³ Specifically, it can help alleviate poverty and promote economic opportunities through increases in telecommunications capacity, the construction of roads, and the development of power plants.³⁴

²⁴ R. DOAK BISHOP ET AL., FOREIGN INVESTMENT DISPUTES 2–3 (2005).

²⁵ *Id.* at 2.

²⁶ KEY ISSUES, *supra* note 3, at 348.

²⁷ *Id.*

²⁸ BISHOP, *supra* note 24, at 3.

²⁹ ANDREAS F. LOWENFELD, INTERNATIONAL ECONOMIC LAW 397 (2d ed. 2008).

³⁰ Meyers, *supra* note 23, at 53.

³¹ COSBEY, *supra* note 11, at 12.

³² BISHOP, *supra* note 24, at 7–8.

³³ Susan D. Franck, *Integrating Investment Treaty Conflict and Dispute Systems Design*, 92 MINN. L. REV. 161, 169 (2007).

³⁴ *Id.*; see also Jeswald W. Salacuse, *Towards a Global Treaty on Foreign Investment: The Search for a Grand Bargain*, in ARBITRATING FOREIGN INVESTMENT DISPUTES 51, 56–57 (Norbert Horn ed., 2004) (Germany lost all foreign investment after its defeat in World War

To allay concerns that foreign investors were limiting their capital expenditures because of instability involved with investing abroad, many countries began entering into treaties that provided for a system of independent arbiters to resolve disputes and secure investments.³⁵ The most well known treaty is the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 (“New York Convention”), which has been signed by 144 countries since it was ratified in 1958.³⁶

The New York Convention is the foundation for the entire international arbitration system.³⁷ The treaty adopted by the Convention serves two significant purposes.³⁸ The treaty first requires recognition and enforcement of arbitration awards entered in foreign states, thus giving the awards power across national borders.³⁹ Second, unless the agreement is “null and void, inoperative, or incapable of being performed,” domestic courts in signatory states must recognize and enforce arbitration agreements.⁴⁰

The next major step in the development of international investment protection came in 1966 when signatories to the Washington Convention created the International Centre for the Settlement of Investment Disputes (“ICSID”).⁴¹ The ICSID is an “autonomous international institution” that “provides facilities for conciliation and arbitration of international investment disputes.”⁴² The Washington Convention, also ratified by over 140 countries, created the ICSID as an impartial forum to resolve legal disputes and remove impediments to private investment posed by “the absence of specialized international methods for investment dispute settlement.”⁴³ In fact, the United Nations Conference on Trade and Development (“UNCTAD”) reported that together, these two international investment agreements “constitute ‘the most important protection of

II, but became the leader in BITs by 1997 and has since improved its economy and increased its foreign investment).

³⁵ Sherwin, *supra* note 18, at ch.19, Part I (explaining that the success of international arbitration can be explained by several major advantages it offers in comparison with litigation, especially litigation in foreign courts).

³⁶ CAMPBELL MCLACHLAN, LAURENCE SHORE & MATTHEW WEINIGER, INTERNATIONAL INVESTMENT ARBITRATION: SUBSTANTIVE PRINCIPLES 3 (2007).

³⁷ *Id.*

³⁸ Sherwin, *supra* note 18, at ch.19, Part IV.

³⁹ Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 38, available at http://www.uncitral.org/pdf/english/texts/arbitration/NY-conv/XXII_1_e.pdf.

⁴⁰ Sherwin, *supra* note 18, at ch.19, Part IV.

⁴¹ International Centre for Settlement of Investment Disputes, About ICSID, http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=ShowHome&pageName=AboutICSID_Home (last visited Nov. 15, 2009).

⁴² *Id.*

⁴³ *Id.*

international foreign investment' to date."⁴⁴

II. SYSTEM UNDER ATTACK

Despite the widely accepted notion that international investment arbitration agreements promote stability and encourage foreign investment,⁴⁵ some critics have suggested that the treaty system needs significant reform, if not complete dissolution.⁴⁶

One prominent critic, Professor M. Sornarajah from the National University of Singapore, attacks the current regime for operating under the "false assumption . . . that a system of international investment arbitration would significantly increase the inflow of capital to developing countries, bringing with it wealth and development to some of the world's poorest citizens."⁴⁷ Further, the United Nations' revised Model Agreement notes, "[m]any observers . . . around the world believe that the current international investment regime is so inherently flawed as to be beyond repair or reform. They argue for the complete dissolution of the regime, and for the construction of an alternative regime specifically focused on the obligations of transnational actors."⁴⁸

Although there have been many criticisms leveled against the current implementation of BITs and arbitration agreements, only the criticism that developing countries are vulnerable to the disadvantages of the arbitration process is addressed here. Specifically, some critics have argued that developing countries are being taken advantage of by developed countries through forced acceptance of arbitration agreements that infringe on their

⁴⁴ NEIL SORENSEN, INST. FOR AGRIC. & TRADE POLICY, *BILATERAL INVESTMENT TREATIES AND DISPUTES* (2001), available at <http://www.tradeobservatory.org/library.cfm?refID=24851>.

⁴⁵ See *On the Bilateral Investment Treaty with Rwanda: Hearing on Treaty Doc. 110-23 Before the S. Comm. on Foreign Relations*, 111th Cong. (Nov. 10, 2009) (testimony of Wesley S. Scholz, Director, Office of Inv. Affairs, Dep't of State) [hereinafter *Scholz Testimony*] ("Foreign investment is an important source of economic growth in the United States and around the globe."); see also Lisa E. Sachs & Karl P. Sauvant, *BITs, DTTs, and FDI Flows: An Overview*, in *THE EFFECT OF TREATIES ON FOREIGN DIRECT INVESTMENT: BILATERAL INVESTMENT TREATIES, DOUBLE TAXATION TREATIES, AND INVESTMENT FLOWS*, xxvii, xxviii–xxxi (Karl P. Sauvant & Lisa E. Sachs eds., 2009).

⁴⁶ MODEL AGREEMENT, *supra* note 17, at v; see also Tolga Yalkin, *International Investment Arbitration: Poisoned at the Root?*, EUR. J. INT'L L., June 24, 2009, available at <http://www.ejiltalk.org/international-investment-arbitration-poisoned-at-the-root/> (discussing the 2009 Annual Conference of The British Institute of International and Comparative Law ("BIICL")).

⁴⁷ MODEL AGREEMENT, *supra* note 17, at v.

⁴⁸ HOWARD MANN ET AL., IISD, *IISD MODEL INTERNATIONAL AGREEMENT ON INVESTMENT FOR SUSTAINABLE DEVELOPMENT: NEGOTIATOR'S HANDBOOK* x (2006) [hereinafter *NEGOTIATOR'S HANDBOOK*], available at http://www.iisd.org/pdf/2005/investment_model_int_handbook.pdf.

sovereignty.⁴⁹ As one critic has noted, many international investors took advantage of BITs even when the investor's home country was not party to the agreement.⁵⁰ For example, Bechtel, a U.S. corporation, used the Bolivia-Netherlands BIT to bring actions against Bolivia.⁵¹ Another example involved General Electric, which used the India-Mauritius BIT and the India-Netherlands BIT to bring actions against India.⁵²

The concern that investors can "take advantage" of developing countries is allegedly compounded both because arbiters are biased in favor of western investors and the system lacks accountability.⁵³ In fact, the stated objective of the United Nations' Model Agreement is "to promote foreign investment that supports sustainable development, in particular in developing and least-developed countries."⁵⁴

One critic has gone so far as to suggest that "[i]nvestment treaties have increasingly been concluded . . . as a way to ensure the security of foreign direct investments generally, but . . . [they] reflect neither the interests of developing countries nor the greater democratization of international institutions."⁵⁵ Critics assert that as a result of these flaws, the arbitration process cannot provide a legitimate dispute resolution mechanism and should be drastically overhauled if not completely dissolved.⁵⁶

A. Vulnerability of Developing Countries

In 2006, Pakistan's then Attorney General, Makhdoom Khan, told a group of investment arbitration specialists that the treaties were "viewed as 'photo-op agreements'—something that governments would sign with visiting foreign dignitaries so as to provide an excuse for a photo opportunity."⁵⁷ This sentiment was echoed at a recent Harvard Law School

⁴⁹ Goh Chien Yen, *The Sharp Edge of International Investment Agreements: Expropriation and Dispute Settlement*, in INTERNATIONAL INVESTMENT AGREEMENTS: ISSUES AND PERSPECTIVES 1, 1–2 (P. Satyanarayana Prasad ed., 2007), available at <http://www.twinside.org.sg/title2/FTAs/Singapore%20Issues/Investment/The%20Sharp%20Edge%20of%20International%20Investment%20Agreements%20GohChienYen.doc>; Somarajah, *supra* note 14, at 39–40.

⁵⁰ Goh Chien Yen, *Expropriation and Investor-State Disputes: The Dangers of International Investment Agreements*, THIRD WORLD RESURGENCE, Oct.–Nov. 2005, available at <http://www.twinside.org.sg/title2/resurgence/182-183/Cover04.doc>.

⁵¹ *Id.*

⁵² *Id.*

⁵³ Samrat Ganguly, Note, *The Investor-State Dispute Mechanism (ISDM) and a Sovereign's Power to Protect Public Health*, 38 COLUM. J. TRANSNAT'L L. 113, 123 (1999).

⁵⁴ NEGOTIATOR'S HANDBOOK, *supra* note 48, at 4.

⁵⁵ SORENSEN, *supra* note 44.

⁵⁶ *Id.*

⁵⁷ Luke Peterson, *Out of Order*, FDI MAGAZINE, Oct. 7, 2008, available at http://www.fdimagazine.com/news/fullstory.php/aid/2575/Out_of_order.html.

conference that explored the backlash against investment arbitration.⁵⁸ One of the panelists, Detlev Vagts,⁵⁹ observed that these treaties might be providing greater protection to foreign investors than the countries that signed on initially expected.⁶⁰

Another criticism leveled against investment agreements concerns the disparity in power between the contracting parties involved in bilateral investment treaties.⁶¹ For example, in a letter to the U.S. Senate regarding the U.S.-Uzbekistan BIT, President Clinton wrote that the agreement creates “conditions more favorable for U.S. private investment” and is designed to “protect U.S. investment.”⁶² Additionally, the Director of the Office of Investment Affairs at the U.S. State Department stated that, “BITs . . . establish rules that protect the rights of U.S. investors abroad and provide market access for future U.S. investment.”⁶³ Together, these statements arguably reinforce the notion that investment agreements serve primarily the interests of western nations and corporations at the expense of the developing world.

Specifically, there is concern that disparity of power leads to broad arbitration agreements that infringe on state sovereignty and restrict the host country’s ability to regulate its economy.⁶⁴ A recent example involves the Canadian government’s ban on the residential use of weed-killing chemicals.⁶⁵ Dow Agrosiences, a company based in the United States that produces the chemical, brought suit against Canada seeking compensation for lost business opportunities as a result of what it believes are government expropriations prohibited by the treaty.⁶⁶ Critics argue that this is an example of how foreign investors can unfairly invoke legal provisions to resist health or environmental regulations and inhibit the host country’s

⁵⁸ *Id.* (referring to Harvard University School of Law International Law Society Conference: The Backlash Against Investment Arbitration (April 19, 2008)).

⁵⁹ Bemis Professor of International Law, Emeritus, Harvard University School of Law.

⁶⁰ Peterson, *supra* note 57.

⁶¹ Stefan D Amarasinha & Juliane Kokott, *Multilateral Investment Rules Revisited*, in THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW 120 (Peter Muchlinski, Federico Ortiño & Christoph Schreuer eds., 2008).

⁶² SORENSEN, *supra* note 44.

⁶³ Scholz *Testimony*, *supra* note 45.

⁶⁴ See Peterson, *supra* note 57 (describing the current debate on whether bilateral investment protection treaties show sufficient deference to governments); see also Jan Paulson, *Avoiding Unintended Consequences*, in APPEALS MECHANISMS IN INTERNATIONAL INVESTMENT DISPUTES 246–51 (Karl P Sauvart ed., 2008) (noting the broad variability in awards and decisions which has led some nations to question why they must justify their own actions).

⁶⁵ Luke Peterson, *U.S. Chemical Company Challenges Pesticide Ban*, EMBASSY MAGAZINE, Oct. 22, 2008, available at <http://www.pdamerica.org/articles/news/2008-10-24-10-52-52-news.php> (the case is still pending and it is yet to be seen whether the arbiters will actually rule against Canada).

⁶⁶ *Id.*

ability to promote its national interests.⁶⁷

In 2006, the United Nations issued a report providing guidelines and suggestions for developing countries. The report suggests that developing countries “need to establish and maintain policy coherence in the face of a large number of interacting IIAs.”⁶⁸ The report continues by stating that, “developing countries need to ensure that they have sufficient capacity to analyze the scope of obligations into which they are entering when they conclude an IIA.”⁶⁹ Particularly noteworthy is the UN’s assessment that developing countries “need to improve their capacities to understand” the implications of the commitments contained in IIAs.⁷⁰

B. Bias

Developing countries are allegedly susceptible to unfavorable rulings because of an apparent bias inherent in the forum for arbitration, the ICSID.⁷¹ The structure of the ICSID has raised concerns because it supposedly has a “proclivity [to] place a heavy emphasis on investor protection above other considerations.”⁷²

Another shortcoming of investment agreements, according to critics, is that while a majority of the arbiters who decide cases are from industrialized countries, most of the defendants are developing countries.⁷³ A report by the Institute of Policy Studies found that “of the 300 judges who are looking into 111 pending cases at the ICSID, only 63 came from developing nations.”⁷⁴ The three-member tribunal was comprised entirely of arbiters from developing nations in only one case.⁷⁵

Moreover, the lack of tenure of arbiters compounds this inherent bias by allegedly providing an incentive to interpret treaties in ways that

⁶⁷ See Paulson, *supra* note 64, at 251; see also Peterson, *supra* note 57.

⁶⁸ UNCTAD, Geneva, Switz., *Systematic Issues in International Investment Agreements (IIAs)*, at 5, U.N. Doc. UNCTAD/WEB/ITE/IIA/2006/2 (Mar. 21, 2006), available at http://www.unctad.org/en/docs/webiteia20062_en.pdf.

⁶⁹ *Id.* at 6.

⁷⁰ *Id.*

⁷¹ GUS VAN HARTEN, INVESTMENT TREATY ARBITRATION AND PUBLIC LAW 152–56 (2007) (arguing that the use of private judges to resolve investment treaty issues without supervision by public judges limits the possibility for judicial review of these decisions and undermines the accountability of the system); see Emad Mekay, *Bias Seen In International Dispute Arbiters*, INTER PRESS SERVICE, June 19, 2007, <http://ipsnews.net/news.asp?idnews=38229> (citing the lack of success by governments in ICSID tribunals and suspicions of favoritism in favor of private investors as criticisms of the ICSID’s independence); see also Chien Yen, *supra* note 49.

⁷² Chien Yen, *supra* note 50.

⁷³ Mekay, *supra* note 71.

⁷⁴ *Id.*

⁷⁵ *Id.*

advance the arbiters' own careers and the arbitration industry.⁷⁶ Arbiters are often practicing lawyers, which means that they are in a position to make full legal rulings that could help clients they represent in other matters.⁷⁷ Finally, critics contend that there is too little oversight of arbitral tribunals, which undermines the checks and balances that are essential to any legitimate system of dispute resolution.⁷⁸

One prominent critic of arbitration clauses, Gus Van Harten, argues that bias toward investors also arises from the fact that investors are the ones who initiate claims.⁷⁹ In other words, arbitration proceedings are only initiated when an investor feels the host country has harmed his interests. If investors stopped bringing claims, he argues, arbiters would be out of a job. Therefore, they have an interest in creating a favorable environment for investors' claims so that more claims are filed and more arbitration contracts are awarded.⁸⁰

One proposed solution is to establish a uniform judicial body that would theoretically correct the bias in arbitration panels.⁸¹ Reformers claim that judges would be independent from branches of government, special interest groups, and other inappropriate influences, and would bring increased legitimacy to the current system of dispute resolution.⁸² Job security—regardless of decisions made from the bench—insulates judges from the temptation to further his or her career by interpreting the law in ways that will appease special interests.⁸³

C. Expropriation

Another major criticism is that BITs define impermissible “expropriation” too broadly.⁸⁴ Traditionally, international law defined expropriation as the physical dispossession of the property of the foreign investor by the state.⁸⁵ However, “what constitutes an act of taking of foreign property in international law now has come to be befuddled with difficulty.”⁸⁶ Recent lawsuits, like the one facing Canada, have confirmed some critics' belief that foreign investors will use the treaty provisions on regulatory takings and compensation as “insurance against many risks the firms would otherwise have assumed themselves as part of the normal

⁷⁶ Peterson, *supra* note 57.

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ VAN HARTEN, *supra* note 71, at 152–53.

⁸⁰ *Id.* at 153.

⁸¹ *Id.*

⁸² *Id.* at 10.

⁸³ *Id.* at 152.

⁸⁴ See Chien Yen, *supra* note 50; see also Peterson, *supra* note 57.

⁸⁵ Chien Yen, *supra* note 50.

⁸⁶ *Id.*

process of establishing and running a business.”⁸⁷

The inclusion of “regulatory takings” in the definition of expropriation in investment agreements seems to be at the heart of the issue. Supposedly, this inclusion means that “government measures, policies and state laws that affect foreign investment could potentially be regarded as expropriation,” as the case in Canada demonstrates.⁸⁸ Another example is the *Metalclad* case,⁸⁹ where the tribunal found that “expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property . . . but also covert or incidental interference with the use of property which has the effect of depriving the owner . . . of the use or reasonably expected economic benefit of property.”⁹⁰ This expansive definition, critics argue, limits foreign countries’ sovereign ability to govern effectively and forces them to “defend . . . every policy and regulation which affects foreign investment against charges of illegal expropriation or indirect taking.”⁹¹ Therefore, critics would limit the definition of expropriation found in investment agreements and restrict investors’ rights to seek damages even if a country’s regulatory actions hurt their investment.⁹²

D. Model Investment Agreement for Sustainable Development

The United Nations’ proposed Model Agreement addresses the concerns raised by critics but still falls short of creating a better system than the one currently in place. In two critical areas, the Model Agreement goes beyond mere reform and essentially dissolves the current system.

First, the drafters of the Model Agreement accepted critics’ argument that developing countries need more flexibility to expropriate investors’ assets without any obligation to compensate the investors.⁹³ The Model Agreement goes even further by stating that “a regulation that takes title to property would not fall under the indirect expropriation formulation,” meaning that no claim may be filed.⁹⁴ Second, by creating a “governing body” called the Conference of the Parties, the Model Agreement

⁸⁷ *Id.*

⁸⁸ *Id.*

⁸⁹ *Metalclad Corp. v. United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award (Aug. 30, 2000), available at http://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC542_En&caseId=C155.

⁹⁰ *Id.* para. 103; LOWENFELD, *supra* note 29, at 477.

⁹¹ Chien Yen, *supra* note 50.

⁹² *See id.*

⁹³ Daniel M. Price, Partner, Sidley Austin LLP, Statement at the Carnegie Endowment Workshop on Globalization, International Law, and the Future of International Investment Treaties (July 15, 2005) (summarized by Jennifer Maul and Kate Vyborny), <http://www.carnegieendowment.org/files/IISD.pdf>.

⁹⁴ MODEL AGREEMENT, *supra* note 17, art. 8, at 7.

seemingly accepts the criticism that developing countries are unable to adequately promote their own interests in investment treaties.⁹⁵ The Conference, established by the UN, negotiates the provisions of the treaty with the investor and ensures compliance with the provisions of the Agreement.⁹⁶ The host country, however, no longer plays a significant role in negotiating the treaty provisions that will directly affect it.⁹⁷

III. DEFENDING THE SYSTEM

In considering a defense of International Investment Agreements, it is important to pay particular attention to their impact on development. Developing countries seek FDI in order to promote their economic development. In fact, “this is their paramount objective.”⁹⁸ By participating in IIAs, “they have sought to establish a legal framework that reduces obstacles to FDI, strengthens positive standards of treatment and ensure the proper functioning of markets, while also assuring foreign investors a high level of protection for their investments.”⁹⁹

Hundreds of new bilateral investment treaties have been signed over the last decade in order to attract foreign investment.¹⁰⁰ To accomplish this goal, the treaties grant broad investment rights to foreign investors and create flexibility in the resolution of investment disputes.¹⁰¹ The result is a broad network of rights that investors can employ when difficulties arise.¹⁰² This diverse set of rights, though, has occasionally led to divergent findings on issues of liability. So, undeniably, the process of arbitration has created some uncertainty about the full meaning of investors’ rights.¹⁰³ Therefore, some reform to promote consistency may be necessary. However, there is a vast difference between establishing a review method that enhances consistency and abolishing the system or reforming it to the extent that its initial purpose of promoting economic development is abandoned.

Despite widespread criticisms, resolving investment disputes with arbitral tribunals has been an “important factor in fostering foreign investment, encouraging transfers of capital and know-how exchanges, and providing a basis for the long-term benefits of investors and sovereigns

⁹⁵ *Id.* art. 36, at 19–20.

⁹⁶ *See id.*

⁹⁷ *See id.*

⁹⁸ UNCTAD, TRENDS IN INTERNATIONAL INVESTMENT AGREEMENTS: AN OVERVIEW at 87, U.N. Doc. UNCTAD/ITE/IIT13, U.N. Sales No. E.99.II.D.23 (1999).

⁹⁹ *See id.*

¹⁰⁰ Sauviant, *supra* note 2, at 6.

¹⁰¹ *See id.*; RUBINS & KINSELLA, *supra* note 1, at 27; Franck, *supra* note 23, at 1523.

¹⁰² Franck, *supra* note 23, at 1523.

¹⁰³ Jose Alvarez, *Implication for the Future of International Investment Law*, in APPEALS MECHANISM IN INTERNATIONAL INVESTMENT DISPUTES 29, 30–31 (Karl P. Sauviant ed., 2008).

alike.”¹⁰⁴ Recently, “investment arbitration has become one of the most prominent developments in international law.”¹⁰⁵ The very growth of international arbitration agreements over the last decade suggests that arbitration offers advantages to both investors and host states over litigation. In particular, the current system provides both sides sufficient autonomy to pursue their interests in a mutually beneficial arrangement.¹⁰⁶

Arbitration is by its very nature the result of contract formation and can be negotiated by parties in many ways.¹⁰⁷ Parties are “free to select the place of arbitration, the language of the arbitration, the procedure governing the arbitration, the number and identity of arbiters constituting the tribunal, the type of evidence they wish to allow, and so on.”¹⁰⁸ Therefore, it would reduce, rather than strengthen, autonomy to impose a reform that seeks to create a uniform approach to investment agreements.

There are four areas that have been too easily discarded by critics. First, the decentralized system currently offers developing countries the autonomy to encourage foreign investment in a way they see fit. Second, “[t]here are specific mechanisms in place to address difficulties related to arbiter bias,”¹⁰⁹ which serve as a check on an arbiter’s power and authority. Third, since regulatory takings are as harmful to investors as direct expropriation, they ought to be compensated, especially since the autonomy now available allows host states the freedom to negotiate any protections for policy decisions they might make.¹¹⁰ Finally, if the Model Agreement is adopted by developing countries, it may create a disincentive for foreign investment and thus circumvent one of the very purposes for which the investment agreement system was created.

A. Vulnerability of Developing Countries

Developing countries seek FDI in order to promote their economic development and as a result, have entered into investment agreements to

¹⁰⁴ Franck, *supra* note 23, at 1587.

¹⁰⁵ Efraim Chalamish, *The Future of Bilateral Investment Treaties: A De Facto Multilateral Agreement?* 34 BROOKLYN J. INT’L L. 303, 341 (2009).

¹⁰⁶ Sherwin, *supra* note 18, at ch. 19, Part 1.

¹⁰⁷ *Id.*; see also R. DOAK BISHOP & MONT P. HOYT, INTERNATIONAL DISPUTE RESOLUTION: MEDIATION, CHOICE OF FORUM, AND ARBITRATION CLAUSES (Dec. 2000), available at www.kslaw.com/library/pdf/bishop2.pdf (arguing that “[t]he foundation of international arbitration is its consensual nature; thus, to a great extent, the parties can define the manner in which the arbitral proceedings are conducted”).

¹⁰⁸ *Id.*

¹⁰⁹ Franck, *supra* note 23, at 1587.

¹¹⁰ Michael Pryles, *Limits to Party Autonomy in Commercial Arbitration*, INT’L COUNCIL OF COMMERCIAL ARB., Apr. 2009, at 2, available at http://www.arbitration-icca.org/media/0/12223892171920/damages_in_the_international_arbitration_paper.pdf (“When parties draft an arbitration agreement they enjoy broad freedom to construct a dispute resolution system of their choice.”).

reduce obstacles to FDI.¹¹¹ Those countries have accomplished this by providing foreign investors with legal protection for their investments as well as putting mechanisms in place to assure the proper functioning of markets.¹¹² Specifically, investment arbitration agreements promote a stable environment that is crucial to attracting foreign investors. Arbitration also provides a faster and less expensive alternative to litigation.¹¹³

In choosing to invest scarce resources, investors “naturally consider the opportunities, the legal regime and incentives available at various destinations, and decide on that basis where to invest.”¹¹⁴ Two recent signatories to the New York Convention—Brazil (2002) and the United Arab Emirates (2006)¹¹⁵—are examples of how the current system promotes economic development. Brazil has become an important factor in global trade, and the health of the Brazilian economy frequently makes front-page news.¹¹⁶ The removal of barriers to investment directly fostered this development.¹¹⁷ Although it remains to be seen whether the Brazilian legal system will ultimately uphold arbitration awards under the Convention,¹¹⁸ Brazil has been a key destination for foreign investment since it ratified the Convention.¹¹⁹ The “[United Arab Emirates] . . . and in particular Dubai, is also currently attracting significant foreign investment as part of an overall strategy to move away from an oil-based economy and establish itself as the commercial centre of the Gulf region.”¹²⁰

Finally, even when there is a breakdown in the relationship between

¹¹¹ KEY ISSUES, *supra* note 3, at 54; *see also* Scholz Testimony, *supra* note 45.

¹¹² KEY ISSUES, *supra* note 3, at 54.

¹¹³ RUBINS & KINSELLA, *supra* note 1, at 309–10 (arbitration provides “a reliable, neutral forum for a foreign investor to obtain remedies . . . with the possibility of enforcement across borders”); *see also* Sherwin, *supra* note 18.

¹¹⁴ Nicholas Turner et al., *Post-Conflict Countries and Foreign Investment*, POLICY BRIEF, No. 8, 2008, <http://www.unu.edu/publications/briefs/policy-briefs/2008/pb08-08.pdf>.

¹¹⁵ U.N. Comm’n on Int’l Trade Law, Status: 1958 - Convention on the Recognition and Enforcement of Foreign Arbitral Awards (2010), http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention_status.html (last visited Jan. 6, 2009); *see also* Alexis Mourre, *Perspectives of International Arbitration in Latin America*, 17 AM. REV. INT’L ARB. 597, 603 (2006).

¹¹⁶ Adriana Noemi Pucci, *Arbitration in BRAZIL: Foreign Investment and the New Brazilian Approach to Arbitration*, DISP. RESOL. J., Feb.–Apr. 2005, at 82.

¹¹⁷ *Id.*

¹¹⁸ *See* Omar E. García-Bolívar & Jon Schmid, *The Rise of International Investment Arbitration in Latin America*, LATIN AM. LAW & BUS. REPORT, Dec. 2004, at 1, 3, available at http://www.bg-consulting.com/docs/rise_international_arbitration.pdf.

¹¹⁹ *See* Hans Christiansen & Ayse Bertrand, Org. for Econ. Co-operation & Dev. [OECD], *Trends and Recent Developments in Foreign Direct Investment*, INTERNATIONAL INVESTMENT PERSPECTIVES 11 (2005), available at <http://www.oecd.org/dataoecd/13/62/35032229.pdf>.

¹²⁰ Fernando Peláez-Pier & Yulena Sánchez-Hoet, *The Arbitration Review of the Americas 2008: Venezuela*, GLOBAL ARB. REV. (SPECIAL ISSUE) (2008), available at <http://www.globalarbitrationreview.com/reviews/4/sections/8/chapters/49/venezuela/>.

the investor and the host state, it is a mistake to assume that developing countries are forced to accept unfair provisions and that they are powerless to protect their own interests. In response to the growing number of arbitration claims, developing countries have responded in the most effective way possible: they stopped entering into these agreements and are threatening to withdraw as signatories to the major arbitration conventions.¹²¹ In other words, they have responded within the market.

The number of international investment agreements also grew at a slower rate in 2007 compared to previous years, with the “slowdown mostly attributed to a decline in new bilateral investment treaties (BITs).”¹²² During the first half of 2008, there were eleven new BITs concluded, most of which involved southeast Asian countries.¹²³ India and Japan signed five BITs with the least developed countries in Asia.¹²⁴ The conclusion of a BIT between Myanmar and Thailand further “confirms the trend of more intraregional integration among South-East Asian countries in the framework” of greater regional cooperation.¹²⁵

Latin America has also demonstrated an apparent declining interest in concluding BITs; in fact, “Latin America was already the least active region in 2007.”¹²⁶ Moreover, three Latin American countries—Bolivia, Venezuela, and Nicaragua—announced their intention to withdraw from the ICSID amid accusations of favoritism.¹²⁷ Moreover, there has been a revival in recent years in several Latin American countries of the Calvo Doctrine, which requires foreign investors to exhaust local remedies before invoking arbitration.¹²⁸ This is evidenced “most notably by constitutionality challenges in Argentina, Colombia, and Venezuela against BITs and investment arbitration, and Brazil’s [Private Public Partnership] Law prohibiting international arbitration.”¹²⁹ These cases provide contrary evidence to the contention that BITs are simply a way for Western countries and corporations to exploit less sophisticated developing countries. The actions taken by these three countries demonstrate that they recognize agreements that are beneficial to their interests and are able to effectively

¹²¹ See Fernando Cabrera Diaz, *Ecuador Threatens Cancellation of Oil Contracts Unless ICSID Nixed As Arbitration Forum*, INVESTMENT TREATY NEWS, Aug. 29, 2008, <http://www.investmenttreatynews.org/cms/news/archive/2008/08/29/ecuador-threatens-cancellation-of-oil-contracts-unless-icsid-nixed-as-arbitration-forum.aspx>; see also Damon Vis-Dunbar, *Activists Lobby in Support of Bolivia’s Withdrawal From ICSID*, INVESTMENT TREATY NEWS, Jan. 11, 2008, http://www.iisd.org/pdf/2008/itm_jan11_2008.pdf.

¹²² *Recent Developments*, *supra* note 6, at 2.

¹²³ *Id.* at 6.

¹²⁴ *Id.*

¹²⁵ *Id.*

¹²⁶ *Id.*

¹²⁷ Mekay, *supra* note 71.

¹²⁸ Wenhua Shan, *Is Calvo Dead?*, 55 AM. J. COMP. L. 123, 163 (2007).

¹²⁹ *Id.*

respond when their interests are no longer being respected.

These trends also suggest that developing countries are choosing not to enter into harmful agreements, and when they do enter them, they do so with other regional countries. It is therefore inaccurate to suggest that developing countries are forced to accept standard provisions dictated by developed countries. It is also unnecessary to impose a boilerplate agreement in the mistaken belief that a host country has an insufficient understanding of its own economic development goals to abandon any investment arrangement in which it does not receive a benefit. The current response by developing countries—to reduce their involvement in disadvantageous agreements—is precisely what should happen when treaty provisions no longer produce mutual benefits.

B. Bias

Critics also contend that the system is broken because arbiters are biased in favor of private investors as a result of their self-interest in career advancement.¹³⁰ Moreover, critics cite the lack of transparency in investment arbitration to argue that there is no accountability to correct incidents of bias.¹³¹ These concerns are misplaced.

Bias is not confined to arbiters. Judges are also subject to personal biases, previous work experience, and subsequent career goals, which makes a uniform judicial body just as susceptible to self-interested motives. Therefore, the best solution is to ensure that mechanisms are in place to control suspected bias. As such, the ICSID (and investment arbitration agreements in general) currently incorporates rules that allow arbiters to be removed by either party if there is evidence of suspected bias.¹³² For example, an arbiter may be challenged if circumstances exist that give rise to “justifiable doubts as to his impartiality or independence.”¹³³ Arbiter bias also presents sufficient grounds for challenging arbitration awards on a variety of levels by institutions and courts.¹³⁴

In addition to formal proceedings that protect against arbiter bias, “professional credibility and word-of-mouth recommendations play a role in both the appointment and re-appointment of arbiters.”¹³⁵ Arbitration disputes often deal with billions of dollars, which means that “parties will not accept an arbiter who is likely to be challenged for bias” or one who

¹³⁰ VAN HARTEN, *supra* note 71, at 152–53.

¹³¹ *Id.* at 153.

¹³² Franck, *supra* note 23, at 1595.

¹³³ Henri Alvarez, *Autonomy of International Arbitration Process*, in *PERVASIVE PROBLEMS IN INTERNATIONAL ARBITRATION* 119, 129 (Loukas A. Mistelis & Julian D.M. Lew eds., 2006).

¹³⁴ Franck, *supra* note 23, at 1596–97.

¹³⁵ *Id.*

may be incapable of rendering an enforceable award.¹³⁶ As a result, many of the arbiters in investment treaty cases have exceptional reputations and “are distinguished former judges, respected scholars, and practitioners.”¹³⁷ While the individuals who appoint arbiters may have a “developed-country” bias, the arbiters themselves can be held accountable for inappropriate conduct.¹³⁸ These factors minimize the risk of bias and suggest that international investment arbiters are legitimate decision makers who can dispense justice through the current system of dispute resolution.

C. Expropriation

Regulatory expropriation occurs when a government’s regulatory action deprives a person of property rights.¹³⁹ Previously, the primary concern for investors was outright expropriation, but now the “greater contemporary risk to foreign investors is government interference that does not formally transfer title away from the investor, but damages or destroys his ability to control or benefit from the investment he has made.”¹⁴⁰ Therefore, government measures that eliminate all of an investment’s value may still constitute an expropriation that requires compensation.¹⁴¹

The influential *Restatement (Third) of the Foreign Relations Law of the United States* takes the view that, for the purpose of determining whether there has been an expropriation, international law draws a similar line to that drawn in U.S. jurisprudence.¹⁴² Consequently, as Justice Holmes aptly stated in *Pennsylvania Coal Co. v. Mahon*,¹⁴³ “while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking.”¹⁴⁴ A country should be able to regulate its economy for the benefit of its citizenry, but when it has previously agreed to provide just compensation for any action that deprives an investor of his or her investment, redress should be made.

There is no question that developing countries face a unique problem. Foreign investment brings increased opportunities and economic development. However, as these countries become more sophisticated, they necessarily alter their infrastructure and risk jeopardizing investors’ investments.¹⁴⁵ Developing countries, therefore, should “ensure that they

¹³⁶ *Id.* at 1597.

¹³⁷ *Id.*

¹³⁸ *Id.* at 1598.

¹³⁹ RUBINS & KINSELLA, *supra* note 1, at 6.

¹⁴⁰ *Id.* at 11.

¹⁴¹ *Id.*

¹⁴² See RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 712 (1987).

¹⁴³ 260 U.S. 393, 415 (1922).

¹⁴⁴ *Id.* at 415.

¹⁴⁵ UNCTAD, *supra* note 68, at 5–6.

have sufficient capacity to analyze the scope of obligations into which they are entering when they conclude an IIA.”¹⁴⁶ Further, they ought to improve their institutional capacities to understand the economic and social implications of the commitments contained in IIAs into which they enter.¹⁴⁷

Critics contend that, “the burden of addressing these challenges is likely to weigh disproportionately on developing countries . . . because they often lack the human and financial resources needed to implement agreements.”¹⁴⁸ However, this argument fails to acknowledge or account for the fact that decisions “to create and embrace this system [of International Investment Agreements], and to reciprocally submit to the authority of private arbitrators, are themselves sovereign decisions.”¹⁴⁹ Additionally, mandating that a single entity such as the United Nations be responsible for negotiating on behalf of a developing country’s interests is paternalistic and, ironically enough, infringes on the host country’s sovereignty far more than the current dispute resolution procedures now in place.

D. Model Investment Agreement for Sustainable Development

Developing countries trying to attract FDI that heed critics and implement the Model Agreement risk losing significant investment opportunities because of the strenuous requirements imposed on foreign investors. Although provisions related to “addressing corruption, and improving transparency” in arbitration hearings are laudable,¹⁵⁰ the Model Agreement primarily concerns itself with paternalistic protections of developing countries that, by reducing their autonomy, will actually remove the incentives that encouraged foreign investment in the first place.

The Model Agreement would usher in a return to the previously unworkable investment environment in three major ways. First, it relies on an overstated argument that developing countries need policy space and seeks to maintain this space by restricting causes of action for investors.¹⁵¹ Second, the Conference of the Parties created by the Agreement prevents developing countries from making decisions about what they deem to be in their best interests.¹⁵² Third, it requires investors to exhaust all domestic means of dispute resolution before pursuing arbitration through the Conference of the Parties.¹⁵³

The Model Agreement would restrict the definition of expropriation

¹⁴⁶ *Id.* at 6.

¹⁴⁷ *Id.*

¹⁴⁸ *Id.*; see Sornarajah, *supra* note 14, at 41.

¹⁴⁹ Meyers, *supra* note 23, at 74.

¹⁵⁰ Rangaswami, *supra* note 2.

¹⁵¹ Price, *supra* note 93.

¹⁵² *Id.*

¹⁵³ Rangaswami, *supra* note 2.

under the guise that developing countries need greater “policy space.”¹⁵⁴ As mentioned above, however, expropriation appropriately includes regulatory action that renders an investment essentially worthless.¹⁵⁵ Under the Agreement, if a country “expropriates property through a series of regulations and states that the regulations are for the public good,” no compensation is required.¹⁵⁶ The very nature of expropriation, though, is to promote the public good.¹⁵⁷ Simply because an action is designed to enhance the public good should not “relieve the host government of the obligation to provide fair market compensation.”¹⁵⁸ This provision in the Agreement creates the same uncertainty that persisted prior to the creation of the current system of investment agreements, and thus reduces the incentive to invest in a host country. Investors will be more cautious about their investments if they could lose them without compensation in the face of heavy regulations.

The part of the Model Agreement that establishes the Conference of the Parties is the most radical departure from the current system of investment agreements.¹⁵⁹ The Conference assumes full control over investment relationships and in so doing completely replaces the current autonomy afforded to the parties of investment agreements.¹⁶⁰ The Conference would not just have the power to perform the tasks assigned to it by the Model Agreement but also any “additional tasks as it deems appropriate for the fulfillment of the purposes of the Agreement.”¹⁶¹

Additionally, the Model Agreement imposes obligations on BIT signatories that are inconsistent with the purpose of entering the investment agreement in the first place. For example, “all parties shall have . . . a domestic environmental impact assessment law and social impact assessment law that meets the minimum standards adopted by the Conference of the Parties on these matters.”¹⁶² This additional requirement attempts to achieve too much. It goes beyond the needs of the signatories and has nothing to do with investment promotion.

One of the primary reasons investors prefer arbitration to litigation in the host country is the overwhelming evidence that domestic courts are unfavorable to investors’ interests.¹⁶³ The Model Agreement further risks

¹⁵⁴ Price, *supra* note 93.

¹⁵⁵ RUBINS & KINSELLA, *supra* note 1, at 6.

¹⁵⁶ Price, *supra* note 93.

¹⁵⁷ *Id.*

¹⁵⁸ *Id.*

¹⁵⁹ *Id.*

¹⁶⁰ *Id.*

¹⁶¹ MODEL AGREEMENT, *supra* note 17, art. 36.

¹⁶² *Id.* art. 21.

¹⁶³ William A. Reinsch, President of the Nat’l Foreign Trade Council, Statement at Carnegie Endowment Workshop on Globalization, International Law, and the Future of International Investment Treaties (July 15, 2005) (summarized by Jennifer Maul and Kate

creating disincentives to invest because it requires foreign investors to exhaust all domestic means for dispute resolution before pursuing arbitration.¹⁶⁴ This is problematic because the domestic judicial system in many developing countries is “corrupt, inefficient, and/or inexperienced.”¹⁶⁵ Arbitration alleviates the risk of these unknown factors in foreign courts, which in turn creates a favorable environment for investment and serves the purpose of all parties involved.

IV. CONCLUSION

This comment does not offer a specific approach to reform. The goal of this comment is to suggest that overly zealous criticisms and reform proposals to current investment dispute resolution arrangements should be viewed with skepticism. The current system may need reform. Any system necessarily must change with time and experience. However, the need for such improvements is not so great that without them, the system should be discarded. Critics incorrectly assume that developing countries are unable to fully protect their own interests when they negotiate investment agreements. This assumption ignores the reality of how developing countries have reacted in recent years: rejecting unfavorable treaties and entering into agreements with other regional powers that specifically promote their interests. More credence should be given to the realities of the market before expansive reforms are implemented.

Critics contend that despite demonstrated advantages for both parties to BITs, the system is broken and needs significant overhaul. First, there is a belief that developing countries are falling prey to unscrupulous investors because western, developed countries force developing countries to submit to unfavorable investment agreements. Second, critics contend that arbitration tribunals are biased against the interests of the developing world in favor of investors’ rights. The UN addressed these concerns by trying to impose the Model Agreement on Investment for Sustainable Development, which deviates substantially from the current system of investment agreements.

These criticisms, however, are largely misguided and risk undoing the advances that developing countries have made in promoting FDI on their own. Moreover, critics’ efforts to overhaul the system are paternalistic and remove from developing countries the ability to freely negotiate investment agreements that address their specific needs.

Developing countries have demonstrated that they are more than capable of protecting their own interests. For example, over the last two years, the number of investment treaties has declined, developing countries

Vyborny), <http://www.carnegieendowment.org/files/IISD.pdf>.

¹⁶⁴ Rangaswami, *supra* note 2.

¹⁶⁵ Reinsch, *supra* note 163.

have increased their bargaining power by threatening to withdraw from arbitration conventions, and an increasing number of countries entered into regional agreements that better address the specific needs of the given region that western companies cannot or do not provide.

Investors respond to incentives. Countries that sought to increase investment created a system that addressed one of the primary concerns of foreign investors: instability abroad. Investment arbitration clauses provide a stable mechanism to resolve investment disputes. Limitations on sovereignty have undoubtedly occurred. Contrary to the assertions made by critics, though, this does not mean that host countries must now assume risks normally borne by investors; rather, it reflects the fact that investors will not risk their assets to unstable and uncertain investment environments. This realization led host countries to make concessions for the greater goal of economic development.

Finally, the Model Agreement is a radical departure from the current system and will erase the advances made by developing countries and create a disincentive for investment. The revised addition removes developing countries' autonomy to negotiate on their own behalf and substitutes a system that will impose unreasonable obligations on investors that ultimately provides fewer protections for their investments.

Completely discarding the current system of arbitration agreements would not merely terminate an institution designed to protect those with the resources and wherewithal to invest abroad. It would also terminate a catalyst for economic development and all of the benefits associated therewith.

The lack of protections for foreign investors would mean less investment, which would impede economic development. This result would effectively destroy the entire purpose of entering into investment agreements in the first place. Any proposed reform, therefore, must consider unintended consequences; thus far, critics' proposed reforms ignore them.