View metadata, citation and similar papers at core.ac.uk
brought to you by CORE
provided by Hertie School Research Repository

Risky Business or Risky Politics: What Explains Investor-State Disputes?

Zoe Phillips Williams

Dissertation submitted to the Hertie School of Governance in partial fulfillment of the requirements for the degree of Doctor of Philosophy in the Berlin Graduate School for Transnational Studies

Berlin, 2016

Committee First supervisor
Dr. Anke Hassel
Hertie School of Governance

Second supervisor
Dr. Markus Krajewski
Friedrich-Alexander Universität

Reader
Dr. Lauge Poulsen
University College, London

Summary

Although not a clear cut question of treaty compliance, this project takes as its theoretical point of departure two potentially opposing explanations for state compliance with international agreements, and asks whether investor-state disputes are better explained by shifting state preferences toward FDI (or a particular investment), or the lack of state capacity to maintain an investment-friendly environment.

The project is structured around three sub-research questions: 1) which domestic institutions are taking the measures that are subsequently challenged by investors? What is the content of these measures? Against investors in which industries are these measures being taken? 2) Under what economic and political conditions are investor-state arbitration cases most likely to occur?3) Are these changes in policy toward investment the outcome of a shift in preferences on the part of state actors toward investment, or are they instead the result of a lack of institutional capacity to respect IIAs? This project adopts a mixed-methods approach to the research question, with empirical chapters based on the qualitative coding of an original dataset of investor-state disputes; a regression analysis, and three case studies of specific disputes in Canada, El Salvador, and Hungary. Therefore, this project paints a general picture of investor-state disputes not as the result of a failure of bureaucratic capacity, but as incidences in which (private) transnational actor preferences truly conflict with those of domestic actors, and in which the state chooses its obligation to the latter rather than the former.

If we accept that investor-state arbitration has the potential to impose significant costs on states, it is important when either justifying or criticising the regime to have an understanding of for which policy measures, and at whose behest, states are incurring these costs. These findings in turn have relevance for those who wish to improve investor-state relations and avoid investor-state disputes, as well as attempts to reform the investment arbitration system.

Acknowledgements

Numerous people have contributed immensely to the successful completion of this dissertation. First, I would like to thank all the interviewees who gave their time to this project and provided much insight into the political interests involved in investor-state disputes. I would also like to thank my supervisor Dr. Anke Hassel, and my committee Dr. Markus Krajewski and Dr. Lauge Poulsen for their invaluable comments.

I have also benefited greatly from both the academic insight and moral support of my colleagues in the BTS, particularly the members of the writing group, and especially Maurits Meijers and Mathis Lohaus, who read much of the present work, and provided excellent advice. I would also like to thank Megan Pickup, without whose long-distance friendship and PhD-commiseration this process would have been much lonelier.

Finally, I would like to thank my parents, for their endless support of, and interest in my projects, and Étienne Brown, without whom none of this would have happened.

Contents

Summary ... i
Acknowledgements ... ii
List of Figures ... vii
List of Tables ... viii
List of Abbreviations ... ix
Chapter 1 Introduction ... 1
1.1 Research Question and Motivation ... 2
1.2 Theoretical Framework ... 6
1.3 Main Findings ... 9
1.4 Criticism of the Investment Protection Regime ... 14
1.5 Methodology and Case Selection ... 18
1.5.1 The Case Studies: Canada, El Salvador and Hungary ... 19
1.5.2 Practical Considerations and Data Collection ... 22
1.6 Outline ... 23
Chapter 2 Patterns in Investor-State Disputes ... 24
2.1 History and Functioning of Investor-State Arbitration ... 25
2.1.1 History of the Investment Protection Regime ... 25
2.1.2 Treaty Provisions and Arbitration Procedure ... 27
2.1.3 The Benefits and Costs of IIAs for Host States ... 31
2.2 Data Collection & Sources ... 32
2.3 Coding the Cases ... 33
2.4 Home and Host States in Investment Arbitration ... 35
2.5 Outcomes ... 38
2.6 Industries in Investment Arbitration ... 40
2.6 Domestic Institutions and Types of Measures ... 42
2.7 Unknown Cases ... 45
2.8 Conclusion ... 47
Chapter 3 Domestic Demands and International Agreements ... 50

3.1 International Agreements and Domestic Policy 52
3.2 Domestic Preferences and Investor-State Disputes 54
3.2.1 Domestic Interests and Organization 55
3.2.2 State Interests and Investment Agreements 58
3.2.3 Cost-Benefit Calculations and Compliance with IIAs 60
3.2.4 Uncertainty and Investor-State Disputes 64
3.3 Domestic Capacity and Investor-State Disputes 66
3.4 Conclusion 70
Chapter 4 Domestic Institutions & Actor Preferences as Determinants of Investor-State Disputes 72
4.1 Determinants of Foreign Direct Investment 74
4.2 Defining Political Risk 77
4.3 Domestic Institutions, FDI and Political Risk 78
4.4 Foreign Investment and Domestic Preferences 82
4.4.1 Controlling for Industry and Historical Legacy – The Concentration of Disputes in Strategic Industries and Transition States 85
4.5 State Capacity and Investor-State Disputes 89
4.6 Exposure to the IIA Regime and Investor-State Disputes 91
4.7 Conclusion: The Causes of Investor-State Disputes under the IIA Regime 92
Chapter 5 The Determinants of Investor-State Arbitration 95
5.1 The Dataset 95
5.2 The Dependent Variable and Model Choice 95
5.3 Explanatory Variables 98
5.4 Results 102
5.4.1 Regions and Special Cases 102
5.4.2 Exposure 104
5.4.3 Capacity 106
5.4.4 Domestic Preferences and Institutions 109
5.5 Conclusion 114
5.6 Limitations to the Analysis 117
Chapter 6 Bilcon Ltd. v. Canada 118

6.1 IIAs and Investment in Canada and Nova Scotia 118
6.1.1 Canada and NAFTA 119
6.2 Timeline of the Dispute between Bilcon Ltd. and Canada 122
6.2.1 The Arbitration: Bilcon of Delaware Ltd. v. Canada 124
6.3 The Role of Domestic Interests and Institutions in the Bilcon v. Canada Case 129
6.3.1 Domestic Interests: Environmental Groups, Fisherman and Eco-Tourism Providers 129
6.3.2 Organisation of Domestic Interests 132
6.3.3 State Interests and Policy Decisions 134
6.4 Conclusion 137
Chapter 7 Pacific Rim Cayman v. El Salvador 141
7.1 Investment and Mining in El Salvador 142
7.2 Timeline of the Dispute Between Pacific Rim and El Salvador 144
7.2.1 The Arbitration: Pacific Rim Cayman v. El Salvador 148
7.3 The Role of Domestic Interests and Institutions in the Pacific Rim v. El Salvador Case 150
7.3.1 Domestic Interests: Small Scale Agriculture, Water Use and the Environment 150
7.3.2 Organisation of the Anti-Mining Movement 152
7.3.3 State Interests and Policy Decisions 153
7.4 Conclusion 157
Chapter 8 AES Summit Generation & Electrabel v. Hungary 162
8.1 IIAs and Investment in Hungary 164
8.1.1 Investment in the Energy Sector 165
8.1.2 Hungary's Experience with ISDS 166
8.1.3 The Energy Charter Treaty 167
8.2 Timeline of Disputes between Hungary and Electrabel and AES Summit Generation 167
8.2.1 The Arbitration Cases 169
8.3 The Role of Domestic Interests in Electrabel and AES Summit Generation v. Hungary 174
8.3.1 Political Parties and Energy Consumers 174
8.3.2 MVM and Electricity Market Reform 176
8.3.3 State Interests and EU Accession 179
8.4 Conclusion 181
Chapter 9 Conclusion 184

9.1 Summary of Results 185
9.2 Theoretical Significance 190
9.3 Reform of the Investment Protection Regime 192
Works Cited 196
Appendix I: Qualitative Coding 211
1. Respondent States Included in Database 211
2. Coding Scheme – Measures 213
Appendix II: Statistics 214
1. Descriptive Statistics (Population) 214
2. Descriptive Statistics (Case Studies) 214
Canada 214
3. Alternative Models 216
4. Additional Marginal Effects Graphs 223
Appendix III: Case Studies 225
1. List of Interviews 225
2. List of Documents 226
Appendix IV: Publications 228

List of Figures

Figure 2.1GDP per Capita of all IIA Signatories 36
Figure 2.2GDP per Capita of Respondent States 36
Figure 2.3Frequent Respondent States 37
Figure 2.4Outcomes 38
Figure 2.5Industries in Arbitration 41
Figure 2.6Domestic Institutions Involved in Investor-State Disputes 42
Figure 2.7Measures 44
Figure 5.1Distribution of Dependent Variable 96
Figure 5.2Marginal Effect of NAFTA 104
Figure 5.3Marginal Effect of Treaties 106
Figure 5.4Marginal Effect of Crisis 109
Figure 5.5Marginal Effects of Leader Transition 113
Figure 6.1Canada's Disputes by Industry .... **Error! Bookmark not defined.**
Figure 6.2Canada's Disputes by Measure .... **Error! Bookmark not defined.**
Figure 7.1FDI Flows CAFTA .... **Error! Bookmark not defined.**
Figure 8.1Hungary Disputes by Industry .... **Error! Bookmark not defined.**

List of Tables

Table 1.1Case Studies 19
Table 4.1Indicators .... **Error! Bookmark not defined.**
Table 5.1Independent Variables 98
Table 5.2Regional Dummies 102
Table 5.3Exposure 105
Table 5.4 Capacity 107
Table 5.5Preferences and Institutions 110
Table 5.6Full Model .... **Error! Bookmark not defined.**
Table 6.1Arguments and Rulings in Bilcon Case .... **Error! Bookmark not defined.**
Table 7.1Arguments Pacific Rim Case .... **Error! Bookmark not defined.**
Table 8.1Arguments and Rulings AES Summit .... **Error! Bookmark not defined.**

List of Abbreviations

ARENA	Allianza Republicana Nacionalista
BIT	Bilateral Investment Treaty
CAFTA	Central American Free Trade Agreement
CEAA	Canadian Environmental Assessment Agency
CIS	Commonwealth of Independent States
CUFTA	Canadian-US Free Trade Agreement
DFAIT	Department of Foreign Affairs and International Trade
DFO	Department of Fisheries and Oceans
DNR	Department of Natural Resources
EC	European Commission
ECT	Energy Charter Treaty
EIS	Environmental Impact Statement
EU	European Union
FDI	Foreign Direct Investment
FET	Fair and Equitable Treatment
FIPA	Foreign Investment Protection Agreement
FMLN	Frente Farabundo Marti para la Liberacíon Nacional
FTA	Free trade agreement
HEO	Hungarian Energy Office
IIA	International Investment Agreement
ICSID	International Centre for the Settlement of Investment Disputes
ISDS	Investor-State Dispute Settlement
JRP	Joint Review Panel
MARN	Ministerio de Medio Ambiente y Recursos Naturales
MFN	Most Favoured Nation
MINEC	Ministerio de Economía
MLA	Member of the Legislative Assembly
MNC	Multinational Corporation
MP	Member of Parliament
MVM	Magyar Villamos Művek
NAFTA	North American Free Trade Agreement
NSEL	Nova Scotia Department of Environment and Labour
NT	National Treatment
OECD	Organisation for Economic Cooperation and Development
PDDH	Procuraduría para la Defensa de los Derechos Humanos
PPA	Power Purchase Agreement
PROESA	Organismo Promotor de Exportaciones e Inversiones de El Salvador
TPP	Trans-Pacific Partnership

TTIP	Trans-Atlantic Trade and Investment Partnership
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
WWF	World Wildlife Fund

Chapter 1 Introduction

In 2009, the president of the Republic of El Salvador announced the suspension of all mining activity in the country for the remainder of his tenure. In 2006-2007, the Hungarian government briefly reintroduced administrative pricing of electricity as part of its step toward the liberalization of its domestic energy market, and subsequently cancelled the long-term power purchase agreements (PPAs) it had signed in the mid-1990s with foreign-owned electricity generators. Also in 2006, both the federal government of Canada and the provincial government of Nova Scotia opted to heed the advice of an expert panel and deny a permit to an American company which planned to construct and operate a gravel quarry in the Bay of Fundy. What do these three very different government decisions have in common? They, along with many others, have subsequently been challenged by the foreign investors they affect, as alleged breaches of international investment agreements (IIAs) signed between these states and the home countries of the investors. These challenges take the form of legal proceedings before arbitral tribunals.

A variety of different investment and trade agreements allow investors to sue the governments of the states in which they invest. The most common are the over 3,000 bilateral investment treaties (BITs) – traditionally signed between a developed, capital exporting (home) state, and a developing, capital importing (host) state. These agreements contain a number of similar (although not identically worded) provisions on investment protection, and allow investors access to investor-state dispute settlement (ISDS) in the form of binding investor-state arbitration. Regional trade agreements, such as the North American Free Trade Agreement (NAFTA) and Central American Free Trade Agreement (CAFTA) also contain ISDS provisions, as does the Energy Charter Treaty (ECT), and a number of other bilateral free trade agreements.

The classic explanation for IIAs is that these agreements are meant to solve the time inconsistency problem that potentially plagues investors. While states may extend favourable terms to investors in order to attract investment,

> [o]nce the investment is made, the host country no longer needs to offer benefits sufficient to attract the investment, it only has to treat the investor well enough to keep the investment. The difference between the two time periods, (before and after investment) comes about because the host and the investor know that once the firm has made its investment, it typically cannot disinvest fully (Guzman, 1997, p. 661).

In theory then, IIAs therefore offer a way for host states to make a credible commitment to maintaining the conditions it has promised to investors upon entry and respecting investors' rights generally, by means of the enforcement mechanism of ISDS. This supra-national dispute settlement mechanism is additionally appealing to foreign investors who may be less likely to be treated fairly by, or have more difficulty navigating, the host state's judicial system. IIAs should therefore reassure investors who might otherwise be wary of investing in less stable developing states, and lead to greater investment flows into these countries. In this way, IIAs are meant to benefit both capital exporting states (by way of their investors) and capital importing states. Indeed, although recent work casts doubt on whether IIA signings were the result of rational cost-benefit calculations on the part of capital importing states, they were presented as important tools to attract investment by Western policymakers and international organizations (Poulsen, 2015)

However, since the early 2000s, criticism of these agreements has been mounting, especially in light of contradictory evidence regarding whether IIAs in fact increase investment flows to developing countries. As will be discussed at greater length below, critics of IIAs claim that these agreements unduly limit domestic policy space and may lead to a situation of "regulatory chill" in which host states are dissuaded from passing new regulation for fear of an investor challenging the measure via ISDS (Tienhaara, 2009; Van Harten, 2007; Yazbek, 2010).

As these criticisms suggest, the international legal framework which supports economic globalization can place significant demands on host states, which may come into conflict with the preferences of domestic actors – whether these are special interest groups representing domestic industries, specific communities affected by the investment, or larger groups of voters. Exploring these tensions, as highlighted by IIAs and investor-state arbitration, is the broad aim of this project.

1.1 Research Question and Motivation

Proponents of the regulatory chill hypothesis can point to a number of instances in which the threat of arbitration has successfully warded off new regulatory measures. For example, a *New York Times* article from 2013 uncovered that tobacco companies have threatened Canada, as well as a number of African nations, ahead of planned anti-smoking legislation, and these countries have subsequently abandoned plans to pursue these policies (New York Times, 2013). However,

proving the regulatory chill hypothesis requires a reliance on counterfactuals – it is necessary to demonstrate that in the absence of a threat of investment arbitration, the state would have taken the measure in question. This is quite difficult given the sensitivity of the topic to both policymakers and investors, and necessarily limits an investigation to a handful of case studies. Moreover, for the concept of regulatory chill to hold water, we must assume that state actors are formulating policy with knowledge of the investment protection regime and the possible consequences of the planned measure (Côté, 2014).

An understanding of how IIAs and ISDS may have an impact on domestic policy space is nonetheless important, particularly in the face of mounting pressure to reform the regime (UNCTAD, 2013). However, despite the ongoing debate over the impact of the investment protection regime on policy space, there is a lack of data on the relationship between investor-state arbitration and domestic institutions and actors – the relationship at the heart of the regulatory chill hypothesis. Therefore, instead of trying to prove the causal effect of an IIA (or the threat of arbitration) in instances in which the state did not take a policy measure, this project examines cases in which a policy *is* enacted and subsequently challenged by investors, in order to better understand when and where the preferences of domestic actors and foreign investors come into conflict; in other words, I examine instances in which the state chooses to side with domestic demands over those of international actors. Specifically, I ask the following research question: *What role do domestic actors and institutions play in investor-state disputes that culminate in arbitration?*[1]

Investor-state arbitration cases are, with some exceptions, triggered by policy changes toward FDI in general or toward a specific sector or investment project, promulgated by domestic institutions. Therefore, in order to assess the role of domestic actors and institutions in investor-state disputes, this project poses a number of sub-questions, answered by the empirical chapters of this project. These include:

1) Which domestic institutions are taking the measures that are subsequently challenged by investors? What is the content of these measures? Against investors in which industries are these measures being taken?

[1] At this stage, I do not want to assume a causal direction for domestic actors and institutions on the outcome variable, and indeed, the variety of independent variables discussed below are not uniform in their relationship with the dependent variable.

2) Under what economic and political conditions are investor-state arbitration cases most likely to occur?

3) Are these policy changes toward investment the outcome of a shift in preferences on the part of state actors toward investment, or are they instead the result of a lack of institutional capacity to respect IIAs?

What is the relevance of an examination of which domestic actors, represented by which domestic institutions, come into conflict with investors? As mentioned above, trying to prove the counterfactual of the regulatory chill hypothesis beyond a few individual case studies is challenging, made more so by the reluctance of key actors to discuss the issue. Therefore, the primary research question and sub-questions take a different approach to the relationship between domestic policymaking and investor-state disputes, focusing on the underlying causes of investor-state disputes. If we accept that, as will be discussed below, ISDS has the potential to impose significant costs on states, it is important for proponents and opponents of the regime to understand for which policy measures, and at whose behest, states are incurring these costs.

As is discussed at greater length below, the first sub- question is answered via the construction of a dataset of investor-state arbitration cases. From this data, it is possible to inductively identify patterns in investor-state disputes which can help guide further examination of the causes of these conflicts. This question focuses on broad patterns in investor-state disputes – the actors involved (both domestic institutions and investors) and the measures taken – which can go some way toward gaining an overview of which domestic interests are at the heart of these disputes.

The second question, "under what political and economic conditions are investor-state disputes likely to occur?" encompasses a wide range of relevant variables by means of a statistical analysis. The hypotheses related to this analysis are developed from a reading of the literature on political risk and the determinants of expropriation. The variables include (relatively) time invariant factors such as the GDP per capita, corruption and democracy levels of the states that have signed at least one IIA. This analysis further includes the effect that temporally delimited events, such as financial crises or elections, may have on states' propensity to take measures which are challenged by investors in arbitration.

This analysis can again help us determine which factors contribute to the likelihood of a dispute, which may hint at an answer to the final question – namely, whether investor-state

disputes are the outcome of cost-benefit decision-making on the part of state actors, or instead the result of a lack of institutional capacity to respect IIAs. This final question is addressed both by the large-N study and the case studies of specific disputes, and has implications for our normative assessment of the regime. If most investor-state disputes are caused by a lack of bureaucratic capacity or awareness of their obligations, IIAs cannot be said to impose too great a cost on using domestic policy space, as these disputes do not arise from the pursuit of specific policy goals of the host state, but rather an inability to respect previously made commitments. This further implies that investor-state relationships can be quite easily ameliorated with increased technical or bureaucratic capacity. However, if investor-state disputes are instead caused by changes in state preferences toward investment, we may conclude that investor-state dispute settlement can impose costs on states for being responsive to domestic interests. While all international cooperation requires some constraint of domestic behaviour, when the beneficiaries of this are foreign, private actors, and those that bear the costs are domestic groups, criticisms of IIAs on the grounds that they overly constrain domestic policy space and harm domestic interests will be more convincing.

Of course, investor-state arbitration, while usually triggered by a state measure, will not occur unless an investor makes the choice to use this tool to settle the dispute and different investors may be more or less inclined to do so–they may not wish to jeopardize their relationship with the host state or outlay the significant financial resources required in the arbitration process. This project does not attempt to include both the investor and the state "sides of the equation". Instead I hold the interests of investor constant, and look only at the factors that increase or decrease the likelihood that a state will take a measure that is challenged by investors.

One final word is necessary on the choice of the dependent variable of the study as a whole, i.e. investor-state disputes that culminate in investment arbitration. While at first glance this may appear to be a fairly straightforward phenomenon, it is at once a very broad and very specific object of study. On the one hand, cases of investor-state arbitration are only a subset of investor-state disputes (Wellhausen, 2015). More generally, we can understand investor-state disputes as the incidence of an alleged breach by (an entity associated with) the host state of a contract, domestic investment law, or IIA, claimed by an investor. For various reasons, investor-state disputes may not end up before an arbitral tribunal and states may, as the regulatory chill

hypothesis suggests, repeal the measure in question when threatened with arbitration by the investor, or instead choose to settle with the investor out of arbitration. However, unlike studies that focus on one *type* of investor-state dispute, most often expropriation, this project seeks to explain disputes that are instead caused by a very wide range of policy measures. Therefore, the dependent variable of this study is ultimately a snapshot of the investment protection regime in action – comprising both the measures which investors see fit to challenge in arbitration, and which policies states are willing to risk arbitration losses to defend.

1.2 Theoretical Framework

This project falls within the tradition of rational liberal international relations (IR) theory and international political economy (IPE) scholarship, which examines the connection between preferences and interests of domestic actors, and a state's foreign policy choices. Much of this literature discusses the reasons for which states may or may not choose to engage in international cooperation efforts (Moravcsik, 1997, 2012; Simmons, 2010), and in particular with regard to the IPE literature, domestic sources of trade policy (Brewster & Chilton, 2012; Mansfield & Mutz, 2009; Milner, Rosendorff, & Mansfield, 2003; Rosendorff & Smith, 2014). As the research questions stated above make clear, this project focuses on the role that domestic actors and institutions play in investor-state disputes, and I therefore adopt the underlying assumptions in the aforementioned literature – namely that domestic actors are able to act collectively and influence national-level decision-making to the extent that the state may adopt as national preferences those of sub- or non-state actors (Moravscik, 1997, 2012). It is through domestic institutions that these interests are aggregated and policy is enacted (Frieden and Martin, 2003). In analyzing this causal relationship, it is necessary to first identify the relevant actors and interests, and subsequently, how they are able to organize and impact state level preferences regarding foreign policy. Frieden and Martin (2003) elaborate a framework for analyzing this type of domestic-international interaction, and I draw heavily on this work in the analysis of the case studies presented in Chapters 6-8.

In addition, I employ concepts found in the international relations literature on compliance with international agreements. As I discuss in Chapter 3, which expands on my theoretical framework, the concept of compliance is potentially problematic when applied to investor-state disputes, in part due to inconsistencies in arbitral findings, an issue highlighted

later in this chapter. However, the two main approaches to compliance from which I draw – the enforcement approach and the managerial approach – suggest useful starting points to answer more general questions about why states may find themselves in conflict with foreign investors (and possibly in violation of an IIA). Moreover, both of these approaches imply an important role for domestic actors in state compliance with international agreements. On the one hand, the enforcement approach to compliance argues that states only sign and subsequently comply with international agreements when it is in their interest to do so. Therefore, when faced with agreements which require substantial behavioural change, compliance can only be guaranteed if the agreement contains an enforcement mechanism which can impose costs on the state for non-compliance which outweigh the benefits it may receive from not complying (Downs, Rocke, & Barsoom, 1996). This suggests that state preferences are derived from cost-benefit calculations, with the costs of non-compliance provided by the international regime, and costs of compliance most likely supplied by domestic sub- or non-state interest groups, thus highlighting the importance of domestic actors in international cooperation.

The managerial approach suggests very different sources of (non)compliance, which nonetheless derive at least in part from the domestic level. As Chayes and Chayes (1998) argue, noncompliance with international agreements is due in large part to a lack of capacity of states to comply, whether because of unclear treaty obligations, lack of sufficient time to bring domestic regulatory processes and institutions into compliance, or more generally, a lack of domestic capacity to act in a treaty-compliant manner. Thus while (non)compliance is not the result of domestic preferences, it does depend on the strength of domestic institutions.

These two contrasting explanations for treaty compliance can be understood as possible broad “causes” of investor state disputes at the domestic level, although as will become clear, in the case of investor-state disputes these are not mutually exclusive. However, as discussed below, due to the primary role played by private actors (investors) in this regime, with their own motivations to enter into disputes with states, the “causes” of investor-state disputes cannot be found solely within the host state. Therefore, exposure to opportunities to be sued – in the form of the number of IIAs ratified, the amount of FDI hosted in the state and the passage of time (which accounts for increased investor awareness of ISDS) – must at the very least be controlled for, if not understood as an outright cause of these disputes.

At the outset of this project, there was very little political science work on investor-state arbitration. Therefore, in Chapter 4, in which I develop the specific hypotheses related to the two broader explanations for investor-state disputes discussed above, I look at thematically adjacent literature including the work on political risk and large-N studies of expropriation events. Expropriation – when the state forcibly divests an investor of its interest in an investment project – is the most obvious, and dramatic manifestation of an investor-state dispute, and there is a significant body of work that looks at the conditions under which expropriations are most likely to occur. This literature comes to fairly clear conclusions about the role of domestic institutions in causing expropriations – in short that democracies are less likely to expropriate, given their greater respect of rule of law, property rights, and higher numbers of veto players, which increase policy stability (Albornoz, Galiani, & Heymann, 2011; Graham, Johnston, & Kingsley, 2012; Jensen, Johnston, & Lee, 2013; Li, 2005). However, as I show in Chapter 2, investor-state disputes which end up in arbitration are caused by a much wider range of measures than expropriation alone. Therefore, some of the earlier work on political risk (Kobrin, 1979, 1984), which argues that a range of state measures and policies can contribute to political risk for investors, also provides a useful starting point for the development of my hypotheses (see Chapter 4). As will be discussed throughout the book, the issue then becomes one of policy stability, as much as democracy itself, and the importance of the causes of policy instability – changes in the preferences of domestic actors – in causing investor-state disputes.

The domestic interests and actors involved in investor-state disputes, as well as the broader causes of these conflicts, are particularly relevant at a time when the international investment community is considering various options for reform of the ISDS system, as well as the development of domestic level institutions to monitor investor-state relationships and avoid disputes.[2] If we conclude that investor-state disputes are caused by a lack of capacity of state bureaucracy to maintain investment-friendly regulatory environments or confusion over the significance of IIA provisions, then efforts to improve bureaucratic effectiveness and understanding of IIAs at the domestic level, and perhaps efforts to increase the consistency of arbitral awards to reduce uncertainty, should be beneficial reforms to the overall system. On the other hand, if investor-state disputes are primarily caused by changes in preference toward investment, or conflicts between regulatory goals and earlier commitments made to investors,

[2] For example, Peru's Coordination and Response System for International Investment Disputes.

then alternative dispute settlement mechanisms may help to avoid recourse to costly arbitration if investor and state positions are not completely irreconcilable. Finally, however, if domestic actors and investors are both consistently placing pressure on states to comply with irreconcilable demands, disputes will be difficult to avoid. In this case, the most beneficial reforms of the ISDS system, from the perspective of increasing the democratic legitimacy of the regime, will involve ensuring that ISDS does not systemically privilege the interests of one party over the other, and in particular, that arbitrators and investment lawyers do not face serious conflicts of interest that may render illegitimate or biased awards. Different possibilities for reforming the ISDS currently put forward are discussed in the conclusion.

1.3 Main Findings

As already mentioned, the dependent variable of interest is a quite heterogeneous collection of state measures taken regarding investment projects. How can we understand these measures as a single phenomenon? What almost all investor-state arbitration cases have in common is a change in state behaviour[3] toward (an) investment. Therefore, policy stability is central to any explanation of the causes of investor-state disputes – while at one time the state committed itself to protecting foreign investment by means of an IIA, and subsequently welcomed specific investment projects, a policy change occurs that the investor perceives to be disadvantageous. As stated above, I identify two potential explanations for this shift in policy toward foreign investment – a change in domestic preferences toward investment, or a lack of institutional capacity to maintain policy stability. Below, I discuss specific findings regarding the role that domestic preferences and institutions play in investor-state disputes, as they relate to the sub-questions stated above.

1) Which domestic institutions are taking the measures that are subsequently challenged by investors? What is the content of these measures? Against investors in which industries are these measures being taken?

- *Most investor-state disputes relate to measures taken by an administrative institution, and a host state's relationship with a specific investor or project. However, a significant number of disputes are related to regulatory change.*

[3] Defining this shift as a purposive policy change toward investment does not adequately capture the possibility that a lack of capacity, for example to control the corruption of low level officials, is driving investor-state disputes. In these cases, official policy toward an investment would remain the same, and only the actual fulfillment of this stated policy objective would be in question.

Administrative measures have caused the majority of investor-state arbitration cases, and two-thirds of all measures taken related to specific investors, rather than an industry or the private sector as a whole. Indeed, when taken together, the cancellation of, or refusal to grant, a licence or permit make up the largest category of state measures. The prominence of administrative decision-making in causing investor-state disputes may suggest a lack of bureaucratic capacity contributes to investor-state disputes, and indeed, both control of corruption and government effectiveness are negatively correlated with the likelihood of a dispute (see Chapter 5). On the other hand, the national legislature is the single institution most frequently implicated in these disputes (legislative measures have triggered one third of all cases), and regulatory change is the third most frequent trigger of disputes. However, it is difficult, as an in-depth look at specific cases demonstrates, to infer much from the label of legislative or administrative measure; while we might assume that non-legislative measures are removed from direct public pressure, this ignores the reality that domestic interest groups may pressure the state through non-electoral means, and that administrative measures may be taken in reaction to that pressure. Moreover, while it might be tempting to assign a higher normative value to legislative rather than administrative measures, as the case studies demonstrate, administrative measures can be "social regarding" in their aims, while legislative measures can be of a questionable nature, as Hugo Chavez's legislatively approved expropriations suggest.

- *Investor-state arbitration affects a wide array of stakeholders, beyond the official parties to the dispute (i.e. the national state government and the investor), in part due to the industries in which it is concentrated.*

Disputes are concentrated in what are known as "strategic" industries, such as oil, mining and gas (extractive industries), energy utilities (electricity and heat); construction and transportation. That it is investors from these industries that are most frequently involved in these disputes speaks to the degree to which investor-state arbitration has the potential to impact a wide range of stakeholders. For example, the regulation of and energy utilities involve a variety of state-based institutions, and also have a significant effect on energy consumers – a fairly broad category. This underscores the public policy dimension to many investor-state disputes, and suggests that the preferences of a wide range of non-state actors, such as energy consumers or

communities in the vicinity of extractive projects can have a role in state decision-making that leads to a dispute with an investor.

2) Under what economic and political conditions are investor-state arbitration cases most likely to occur?

- *The structure[4] of the investment protection regime and states' exposure to it have a significant impact on which states act as respondents.*

This project finds that the investment protection regime itself has a significant influence on the distribution of arbitration cases. As mentioned above, the original rationale for international investment agreements and ISDS was the protection of foreign investors in developing states with poorly functioning domestic institutions, and leaders with a high propensity to expropriate. Given that most states acting as respondents in arbitration cases are developing countries, this rationale seems to reflect the reality of investor-state disputes; although developed and developing states have signed similar numbers of IIAs, it is mostly developing states that are sued by investors, which suggests that weak institutions are important drivers of these disputes. However, this likely has as much to do with the flow of investment that is covered by an IIA as with the development status of the state. Indeed, as the experience of the signatories to NAFTA clearly demonstrates and the results of the statistical analysis reinforce, when highly developed liberal democracies act as hosts to investment that is covered by an IIA, they are frequently sued by investors. This undermines an explanation for investor-state disputes that privileges a lack of capacity of domestic institutions to maintain policy stability for investors. Moreover, the results of the statistical analysis suggest that a state's exposure to the IIA regime, and in particular, what appears to be growing awareness of ISDS on the part of investors (and likely, their lawyers) plays a significant role in increasing the numbers of investor-state disputes.

- *Investor-state arbitration is frequent in countries we would expect to be undergoing policy change.*

Investor-state arbitration cases are clearly concentrated in middle income and transition (formerly state-planned economy) countries. The concentration of disputes in these states is in part due to these states' role as traditional "host" states for investment covered by an IIA, thus making them likely respondents in a dispute. However, these states may also be more likely to

[4] By structure, I mean the traditional role of states as either hosts or homes of investment and the subsequent flows of FDI that are covered by an IIA.

face challenges in their relationships with investors, both due to capacity issues, and a greater impetus for regulatory change – whether in the form of raising environmental standards or privatizing and liberalizing formerly state-owned enterprises. Indeed, the case studies on disputes between El Salvador and Pacific Rim, and Hungary and AES Summit and Electrabel highlight that investor-state disputes can be triggered by shifting domestic preferences toward specific industrial activity that is part of a much broader policy change (see Chapters 7 and 8).

- *Democratic domestic institutions do not appear to lower the likelihood of an investor-state dispute.*

As discussed at greater length in Chapter 3, there is much debate about the role of democratic institutions in state compliance with international agreements. However, the majority of the literature on the relationship between democracy and expropriation concludes that democracy level is negatively correlated with the likelihood of expropriations. The results of the statistical analysis in this study show the positive correlations between democracy level and the likelihood of a dispute, suggesting that disputes may stem in part from governments responding to public pressure. As will be discussed at greater length in Chapters 3 and 4, this goes against expectations regarding the role of democracy in ensuring respect for international commitments and domestic property rights. Instead, it again underscores the public policy dimension, and wide reach of, investor-state disputes.

3) Are these changes in policy toward investment the outcome of a shift in preferences on the part of state actors toward investment, or are they instead the result of a lack of institutional capacity to respect IIAs?

- *Low levels of institutional capacity (indirectly) contribute to investor-state disputes.*

In the statistical analysis, the variables related to state capacity – particularly economic capacity, in terms of both economic crisis, GDP per capita and economic growth – have the weakest relationship with the likelihood of a dispute. However, higher levels of government effectiveness and better control of corruption, which can serve as indicators of bureaucratic capacity, are negatively correlated with the likelihood of a dispute, suggesting that lack of capacity does contribute to investor-state disputes. The role of government capacity also emerged in the case studies, though in a more nuanced way. In the case of El Salvador, recognition that the government did not have the technical capacity or experience to regulate the extractive sector, contributed to a change in preferences toward the mining industry (see Chapter 6). In Hungary,

the demands of an emerging market economy in the early 1990s led to a push for agreements with investors that would later need to be re-evaluated to meet EU accession requirements (see Chapter 8). Finally, even in Canada, a country with significant ISDS experience, government experts were unable to predict whether a specific measure would both incite arbitration and lead to a negative ruling by the tribunal (see Chapter 7). Ultimately, this project concludes that domestic bureaucratic capacity issues do have a role to play in investor-state disputes.

- *Changes in the preferences of domestic actors toward investment are clearly linked to investor-state disputes.*

On the other hand, domestic preferences toward investment are also found to contribute to state decision-making which led to a dispute with an investor. The variables hypothesized to indicate both negative domestic preference toward investors and the receptiveness of domestic institutions to anti-investment/investor pressure consistently increase the likelihood of a dispute in the large-N study, including as mentioned above, democracy levels, as well as the incidence of an election, presidential system and the dummy for transition countries.

Moreover, in the three case studies, there are clear links between domestic actor preferences, and subsequent changes in policy toward the investment in question. In the cases of Canada and El Salvador, the key non-state actors were broad interest groups – in both cases local communities and environmental groups concerned about the impact of extractive projects – supported by key state agencies. In the case of Hungary, the most influential sub-state actor was the state owned electricity company, although external pressure from the European Union also had a significant impact on the state decision-making which led to the dispute. This case therefore exemplifies both the role that powerful special interests can play in investor-state disputes, and the transnational dimension to the issue.

Therefore, a clear picture emerges regarding the role of changes in domestic preferences toward the investment in question in triggering investor-state disputes. It appears that many investor-state arbitration cases indicate instances in which the state has had to choose between the demands placed on it by domestic actors, and its international commitments enshrined in treaties and agreements, and sides with the former.

Policy instability or reversal can be attributed to weak domestic institutions. As the literature on veto players and political constraints suggests, higher numbers of independent

institutions or individuals whose consent is needed to pass a policy measure increase the ability of states to make credible commitments, to, for example, foreign investors (Henisz & Mansfield, 2006; Henisz & Zelner, 2002; Tsebelis, 2000). However, the line between weak domestic institutions that encourage policy reversal and institutions that are responsive to changing domestic conditions can be difficult to identify. Because the reach of IIAs is so wide, and investors are incentivized to use the system to challenge measures they object to, maintaining policy stability for investors in order to avoid arbitration may come at the expense of responsive domestic institutions. As this project demonstrates, states are still choosing to defend their actions in investment arbitration at the behest of domestic interests, and thus the regulatory chill hypothesis does not hold across the board. However, ISDS does appear to put a cost on states responding to domestic pressure, and at a certain point, an assessment of the causes of investor-state disputes and the effect of the ISDS system becomes a normative rather than empirical question.

1.4 Criticism of the Investment Protection Regime

Investment protection agreements have come under increased scrutiny in recent years, and face strong criticism on a number of fronts. These range from criticisms of fundamental aspects of the regime, such as its professed undue constraining of state sovereignty, to more mutable facets of the regime, such as the incentives facing arbitrators and lawyers to promote its use. This section discusses some of these criticisms, which suggest possible paths to reform, discussed in the conclusion.

Perhaps the most fundamental criticisms of the investment protection regime are those that relate to domestic policy space and regulatory chill – and ultimately questions of state sovereignty – that come from the regime's fundamental blending of public and private interests. At its heart, the regime allows an international tribunal to rule on the legality of policy choices, based on standards which aim primarily to create an environment conducive to the success of the private sector (Elkins, Guzman, & Simmons, 2006; Montt, 2009). Considering that many IIAs do not require the exhaustion of local remedies, it can be argued that "international investment law today is in charge of controlling the regulatory state" (Montt, 2009, p. 19). While all international agreements aim to constrain the sovereignty of contracting states to some degree, most tend to do so in the pursuit of (international) public goods – whether environmental or

labour protection or standard setting for the transportation of hazardous waste or farm products. What sets the investment protection regime apart is the manner in which it combines both public and private law and interests. Unlike commercial arbitration which may involve the state as a private actor, investment arbitration allows private actors to challenge the state in its role as a public actor. Van Harten (2007) clarifies the distinction in the following way: "the passage of legislation is a quintessentially sovereign act... Alternatively, when the Government contracts with a company to tend the lawn in front of Parliament, the Government's conclusion of the contract is a commercial act of the State, one that a private party could carry out" (p. 373). As we will see in Chapter 2, investors routinely challenge legislation and other policies that are, if not always in the "public interest" then certainly acts which private parties could not carry out. Therefore, ISDS allows private, foreign actors to challenge policies and measures which may affect stakeholders far beyond the parties to the dispute (Schill, 2010). This is potentially problematic from a democratic perspective if investors are able to challenge legislation passed by elected officials. As mentioned above, the arbitral tribunal cannot force the state to overturn measures it has already taken if found to be in contravention of the IIA. However, as a recent study has found, respondent states suffer negative reputational effects, which may be accompanied by financial consequences in the form of declining investment inflows, solely by being involved in an arbitration, regardless of whether the tribunal rules that it has violated the IIA (Allee & Peinhardt, 2011). If a state loses the arbitration, it may be forced to pay a significant monetary award to investors. Therefore, while the state is not forced to repeal a democratically enacted policy, it may be punished for taking it.

The conflict between public and private goals is compounded by the conflicting goals of the state (and its constituents) and investors. For example, the regulatory goals of energy policy include "assuring universal and affordable access... and aligning energy production and consumption with the objectives of sustainability and environmental protection" (Krajewski, 2012, p.3). However, these priorities, particularly ensuring universal access for energy consumers, may conflict with the profit-maximization goals of investors in the energy sector who may use ISDS as a tool to challenge policies. Public services more generally are also quite likely to be at the heart of conflicts between public and private interests when it comes to arbitration, in particular as IIAs "lock in" policies that are in place at the time an investment is established. This makes it quite difficult for a state to update policies governing public services in the case of

changing public preferences. For example, “if regulatory frameworks are not developed or fully implemented before private companies begin supplying a particular service, it may become difficult to introduce regulations and activity controls once private actors have started on the market” (Krajewski, 2013, p. 5). More generally, the fact that IIAs constrain the ability of the host state to change policies may be particularly problematic for developing countries which liberalize certain sectors such as public services or extractive industries when regulatory standards are fairly low, and are subsequently unable to raise these standards for fear of provoking arbitration. Finally, at least under most IIAs today, the arbitral tribunal is not required to consider the goals of the state measures in question – most importantly to this discussion, whether or not a measure was taken in the “public interest”. For example a finding of indirect expropriation

> depends predominantly on the degree of interference and the effects of the measure, but not on its purpose or intent. Hence, measures taken for regulatory purposes in public services can amount to indirect or regulatory expropriations if they adversely affect the investor’s assets in such a way that it deprives the investor of the value of the investment (Krajewski, 2013, p. 10)

In this way, investors’ rights are likely to be given priority over public interest goals, if these are found to be in conflict.

This privileging of private over public interest may give rise to a situation of “regulatory chill” if policy makers consider the possible costs imposed by ISDS and refrain from enacting new policies or legislation (Tienhaara, 2009). Skeptics of the regulatory chill hypothesis point to the lack of awareness among policymakers regarding IIAs, arguing that if government actors do not know about the regime their policy choices necessarily cannot be inhibited by it (Côté, 2014). However, as Tienhaara (2009) rightly argues, and anecdotal evidence from other studies, and interviews done as part of this project suggest, investors can make states aware of the potential costs of certain policies by threatening to go to arbitration, and thus ward off regulation which may adversely affect their interests. Moreover, not just the threat of being found liable in arbitration, but the high costs of the arbitration process itself, no matter the outcome, has been cited by state actors as a factor which may encourage states to negotiate with investors rather than defend their policies in arbitration (Gaukrodger & Gordon, 2012). As mentioned above, it is difficult to prove the regulatory chill hypothesis, but it nonetheless is supported by anecdotal evidence and deserves consideration.

Other less fundamental, but still important criticisms are leveled at more specific aspects of the investment protection regime. Connected to the regulatory chill hypothesis is the uncertainty facing states in the arbitration process due to a lack of consistency in arbitral awards – meaning that arbitral tribunals are coming to different conclusions in similar cases (Gaukrodger & Gordon, 2012). One frequently cited inconsistency is the decisions reached by the panels in the *Metalclad v. Mexico* and *Methanex v. United States* NAFTA awards, both ruling on the issue of regulatory takings (indirect expropriation) (Mann, 2007). In the Metalclad case, a Mexican municipality revoked the licence to operate of a waste disposal operation, and Mexico subsequently lost the case on the grounds that they had indirectly expropriated the development. In contrast, in the Methanex case California banned a key chemical component of methanol, and was challenged by a Canadian-owned methanol production on the grounds that this measure was tantamount to expropriation (Mann, 2005). However, in this case, the tribunal ruled that a non-discriminatory regulatory measure could not be deemed to violate NAFTA. As Mann (2007) concludes, "Methanex and Metalclad are irreconcilable decisions. Yet both stand as binding awards, and both have adherents in the literature in other arbitral decisions" (p. 5). This was cited as a concern in a survey of governments conducted by the OECD. A lack of consistency may detract from the "legitimacy and perceived fairness" of ISDS, as well as reducing its cost effectiveness and ability of parties to avoid disputes (Gaukrodger & Gordon 2012, p. 16). This lack of consistency likely stems in part from the design of the regime – over 3,000 non-identical IIAs – as well as the *ad hoc* nature of the investment tribunals themselves (Gaukrodger & Gordon, 2012). As will be discussed below, recognition of this uncertainty and lack of consistency in the arbitration process has spurred calls for reform of the system.

Concern has also been raised regarding the incentives for arbitrators and investment lawyers to increase the use of the regime, as well as possible conflicts of interest related to the multiple roles played by these actors (Van Harten, 2013). In the first instance, both arbitrators and investment lawyers are very highly paid, and thus have an interest in both more and longer cases, and thus may discourage settlement, or be less likely to rule negatively on jurisdictional questions (Gaukrodger & Gordon 2012). It may also be that party-appointed arbitrators are not able to act as neutral judges when they hope to be appointed in subsequent cases, and thus have an interest in appearing to be friendly to either state or investor interests (Gaukrodger & Gordon 2012).

This section has not presented an exhaustive list of the criticisms levied at IIAs and the ISDS mechanism. However, the problems highlighted here correspond to both areas of possible reform as well as themes that recur throughout this project – changing preferences and the time inconsistency problem (right to regulate), lack of capacity or understanding of the investment protection regime, increased by lack of consistency in arbitral awards, uncertainty, and the increased use of the ISDS mechanism by investors.

1.5 Methodology and Case Selection

In examining contribution of domestic actors, preferences and institutions to investor-state arbitration cases, this project examines the empirics of these disputes at a number of levels. As the three sub-research questions suggest, I am interested in both broad patterns underpinning investor-state disputes, and micro-level causal relationships. Following Lieberman (2005), I assume that combining these levels of analysis can afford us greater insight into the relationships in question, and thus employ both a large-N statistical analysis, in which the incidence of an investor-state dispute in a given country-year serves as the dependent variable, and in-depth case studies of specific investor-state disputes. In so doing, I carry out an analysis, which

> assumes an interest in both the exploration of general relationships and explanations and the specific explanations of individual cases... For example, a nested research design implies that scholars will pose questions in forms such as 'what causes social revolutions,' while simultaneously asking questions such as 'what was the cause of social revolution in France?' (Lieberman, 2005, p. 436).

I do just this, posing the general question of what domestic causes can be found for investor-state disputes broadly to a dataset of 583 investor-state disputes. I then turn to the case studies and ask "what caused investor-state disputes in El Salvador, Canada and Hungary?" These case studies are able to provide much more micro-level data on the processes which link the relevant independent variables, first identified in the statistical analysis, to the outcome – investor-state arbitration.

However, before performing either the statistical analysis or the case studies, I present the results of a data collection effort in which I code 583 investment arbitration cases according to various qualitative criteria. Given the relatively recent interest of political science scholars in investment arbitration the rationale behind this first empirical exercise was primarily one of self-edification – it allowed me to get a sense of the "who, what, where, why and when" of investor-

state disputes. Moreover, it allowed for the inductive development of some hypotheses which were subsequently assessed by the statistical analysis. Both the specifics of this coding, and a discussion of the model choice used in the statistical analysis appear in their respective chapters. Thus, I will turn now to a description of the case studies.

1.5.1 The Case Studies: Canada, El Salvador and Hungary

The overall aim of this project is exploratory – to better understand the causes of investor-state disputes under the investment protection regime using the tools afforded to political scientists. Given the preliminary nature of the work on this topic, I have aimed for a "diverse" case selection which "has as its primary objective the achievement of maximum variance along relevant dimensions" (Seawright & Gerring, 2008, p. 301). Given some practical considerations which will be discussed in detail below, these cases do not present variation on all indicators of interest – for example all three are democracies according to the Polity definition. However, this is not a comparative case design; instead I opt for within-case analysis, and hope primarily to examine some of the correlations observed in the statistical analysis, and explore the validity of the expectations proposed by the theoretical framework explained in Chapter 3.

Given the broad explanations for investor-state disputes based on cost-benefit calculations and/or a lack of bureaucratic capacity, the case selection accounts for varying levels of capacity, in this case indicated by GDP per capita and aggregate measures of government effectiveness and control of corruption in order to investigate the role this plays in the development of disputes. However, the results of the statistical analysis presented in Chapter 5 provide further criteria for case selection. The case selection is presented in the following table:

Table 1.1Case Studies

	Pacific Rim v. El Salvador	**Bilcon Ltd. v. Canada**	**AES Summit Generation & *Electrabel v. Hungary***
Industry	Mining (Gold)	Mining (Quarry)	Electricity Generation
Income Level	Lower Middle	High	High
Gov't Effectiveness/Control of Corruption	Low	High	Medium

Number of Previous Arbitration Cases	1	9	3
Relevant IIA	CAFTA & domestic investment law	NAFTA	Energy Charter Treaty
Transition Economy	No	No	Yes
Government System	Presidential	Parliamentary	Parliamentary
Measure precedes an Election?	Yes	Yes	Yes
Polity Score	7	10	10

Given the varying levels of development and government effectiveness/control of corruption related indicators, the case selection can address the role that capacity plays in investor-state disputes. While Hungary is now an OECD country with a high income level, the shift from a planned to a market economy presents administrative and governance challenges that reflect capacity in a different way, but may help explain the strong positive effect of transition economy status on the likelihood of an investor-state dispute. Finally, the number of cases faced previously gives an initial indication of the level of awareness of relevant state actors of the possibilities of arbitration.

The other indicators relate primarily to the impact of changing domestic preferences, toward FDI on the outcome variable – an investment arbitration case. The relationships between these variables were hypothesized and tested on an aggregate level in the statistical analysis, and will be the focus of a more micro-level analysis in the case study chapters.

More generally, these cases can be seen to represent different types which may be more broadly applicable and perhaps contribute to understanding the causes of investor-state disputes in different contexts. As mentioned throughout this introduction, the dependent variable of interest – an investor-state dispute – is in fact the outcome of an extremely diverse collection of policy measures. Given this situation of equifinality, I have not attempted to construct a causal mechanism which can adequately explain all investor-state disputes. However, the cases selected for this study are arguably representative of broader categories.

In many ways, Pacific Rim v. El Salvador is a typical case: a dispute between a middle income country with a presidential system, and an extractive company, stemming from the refusal to grant a permit (one of the most frequently taken measures). However, beyond this, the case serves to demonstrate some of the tensions between sustainable development and associated norms of community participation, and investment protection. Moreover, it exemplifies the ways in which investment arbitration can be triggered by, but also impede, the adaptation of policies to both shifting domestic preferences and to new technical or scientific information.

The dispute between Bilcon and Canada is in some aspects quite similar, as it features an extractive project meeting opposition from communities in the vicinity. However, the case takes place in a very different institutional setting. As a NAFTA signatory, Canada is one of the few OECD countries that has frequently acted as a respondent in arbitration cases. The frequency of cases within NAFTA undermines the argument that investor-state disputes are caused primarily by a lack of bureaucratic or administrative capacity, or awareness of the investment protection regime. Instead, cases in Canada and the United States suggest what the future of ISDS may look like if, in the event that the Trans-Atlantic Trade and Investment Partnership (TTIP) and Trans-Pacific Partnership (TPP) are ratified, more developed states become possible respondents in arbitration. However, like the dispute in El Salvador, this is a case of a local population placing pressure on a government to deny a license or permit to an investor, based on livelihood and environmental concerns. While the policymaking process was quite different, it still demonstrates a similar mechanism at work, therefore underscoring the importance of broad domestic interests and popular pressure in these disputes.

The disputes between Hungary and two foreign electricity generators are quite different from the previous two cases, both in terms of industry involved, and the political issues underpinning the case. This case (the facts of the two arbitration cases are very similar, and therefore I have grouped them together in one case study) demonstrates the complications that arise in investor-state relations in the context of very broad shifts in policy. The relevant policy changes include first the privatization of the electricity sector and the great efforts to attract investment, followed by a second restructuring of the sector to meet the liberalization requirements set out by the EU. Unlike the two preceding cases, here, the relevant actors whose policy preferences changed were powerful special interests at the domestic level, which corresponded with external influences in the form of a competing international regime. However,

on a rhetorical level, popular pressure, this time from energy consumers, was used by opposition parties to pressure the government to take certain measures. This case provides a counterpoint to the previous cases, presenting the influence of a different set of domestic interests, while also more broadly suggesting that investor-state disputes can be triggered by not just competing domestic interests, but those enshrined in other international agreements. It is therefore possible that this case can explain the reasons for the concentration of investor-state disputes in transition economies, and in particular those in process of EU accession.

While these cases do not uncover the workings of one causal mechanism that explains investor-state disputes, I hope that they can instead serve to help explain the patterns in the distribution of investor-state disputes, as well as uncover some common causes and consequences of investment arbitration.

1.5.2 Practical Considerations and Data Collection

The data on which these case studies were based were drawn from a number of sources: 1) documents related to the arbitration proceedings where available; 2) reports on the cases from a subscription based investment treaty news and analysis service (IAReporter.com); 3) newspaper and journal articles; and 4) in-person and phone interviews with relevant government and civil society actors.

The interviews were conducted in fieldtrips between six and eight weeks in Canada, El Salvador and Hungary, with some follow up interviews by phone. The interviewees included civil servants, elected officials, civil society members, and policy experts, depending on the case. As much as possible, potential interviewees were identified from an analysis of the relevant documents, such as decision-makers references in arbitral proceedings, as well as from further suggestions from contacts once in the field. Given language constraints, it was easier in the El Salvador and Canadian cases to read the relevant documents and identify potential interview partners beforehand than in Hungary, where I had to rely much more on the views of those I interviewed.

The interviews were semi-structured, with broadly the same questions posed to each case. Where possible, interviews were recorded and transcribed, but given the sensitive nature of the topic, in some instances this was not possible. For the same reason, a number of interviewees requested anonymity. A full list of interview partners for each case can be found in Appendix 3.

1.6 Outline

Following this introduction, Chapter 2 provides an empirical introduction to the world of investor-state arbitration, explaining the basic workings of the regime, and presenting the broad patterns that result from a qualitative coding of investor-state disputes. Returning to theory, Chapter 3 presents my theoretical framework in more detail, outlining assumptions that structure the remainder of the analysis in the following chapters. Based on a reading of IPE and international relations literature related to investor-state relations, including work on the determinants of FDI inflows, political risk and large-N studies of expropriation, Chapter 4 generates hypotheses regarding the institutional and economic conditions under which investor-state arbitration is most likely. These hypotheses are then tested in Chapter 5 on a dataset of investor-state disputes from 1990-2013. Finally, the case studies presented in Chapters 6-8 look more closely at the relationships uncovered in the statistical analysis, and focus on to what extent the state decisions to take certain policy measures, and subsequently defend them in arbitration, are the result of cost-benefit decision-making, or a lack of state capacity to uphold standards of investment protection agreed upon in the relevant IIA. Chapter 9 concludes.

Chapter 2 Patterns in Investor-State Disputes

Who are the key actors in investor-state disputes? Which states are getting sued most frequently, and by which investors? On a sub-state level, which domestic institutions are passing the measures that are subsequently being challenged by investors? Despite the ongoing debate over the impact and legitimacy of the investment protection regime, there have been few attempts at data collection on the subject of investor-state arbitration's relationship with domestic institutions and actors. Indeed, in 2012 as I began this project, there was very little political science work on investment arbitration, and (to my knowledge) no complete dataset of arbitration disputes that went beyond coding for the industry, claimant, respondent state, and final award of the case. This chapter therefore takes stock of the existing ISDS system in two ways – first by providing a historical overview of IIAs and ISDS, and then presenting the first empirical results of this project, based on data collection and construction of an original dataset of known investor-state arbitration cases, and includes information on the investor and its home state; the respondent state; the industry; the domestic institutions involved in the dispute; and the measure(s) taken which were challenged by the investor.

An overview of the domestic institutions involved and the policies which trigger investor-state disputes is necessary to understand the domestic causes of investor-state disputes, as well as the impact of the investment protection regime on host states. As discussed in the introduction, critics of investor-state arbitration argue that these agreements contribute to regulatory chill and the constraining of domestic policy space, by penalizing states for increasing regulatory standards. However, the bulk of research and reporting on the topic most often presents single case studies of high profile, controversial disputes, in order to advance claims about the negative impact of IIAs. While these cases give us indications of the extent to which the regime can be used by investors in an attempt to impede the pursuit of legitimate policy goals, these studies leave many questions unanswered regarding broader patterns in investor-state dispute settlement. Therefore, the initial motivation for this data collection project was to provide an overview of broad patterns in the distribution of cases across industry and type of state, as well as the policy measures that are challenged by investors in arbitration.

The specific categories I have chosen to explore shed light on the causes of investor state-disputes. For example, the concentration of arbitration cases in middle income countries is in part

a reflection of the pattern of bilateral FDI flows which are covered by IIAs. Which industries are most frequently implicated in investor-state arbitration is also telling, as not all economic activity has the same impact on the host state, and some industrial activity may engender greater discontent among domestic actors. The institutions involved can also suggest which domestic interests are being taken into account when states choose to enter into conflict with an investor, despite the threat of losing the arbitration case. For example, legislation passed in a state parliament likely is taken at the behest of different actors than the actions a state-owned enterprise. Finally, looking at the policy measures themselves can give an indication of the degree to which a change in preference or lack of capacity contributed to the dispute. While at the macro-level we cannot uncover the extent to which policymakers were aware of their state's investment protection commitments and the potential for an arbitration case, we can make some assumptions about whether a measure was related to the management of an economic crisis, or more simply represents a change in preference toward an investment.

Before presenting the results of this first empirical investigation, however, this chapter provides an overview of the history and functioning of investor-state arbitration, which I turn to below.

2.1 History and Functioning of Investor-State Arbitration

In this section I give an overview of the history and development of the investment protection regime, as well as the key provisions of IIAs and the functioning of the arbitration process itself.

2.1.1 History of the Investment Protection Regime

Unlike international trade, the governance of which is to some degree centralized by the World Trade Organization (WTO), investment flows are governed overwhelmingly bilaterally (Elkins, Guzman & Simmons, 2006). Indeed, as is underscored by the most recent debates over the inclusion of ISDS in the TTIP and TPP, as well as the failure of the international community to agree on a Multilateral Agreement on Investment (MAI), efforts to increase international investment protection has long been controversial (Elkins, Guzman, & Simmons, 2006). This is perhaps due in part to the very different, and at times contradictory, interests of participants in the regime of international investment protection; as will be discussed in greater detail in the

following chapters, the preferences of capital exporting and capital importing states toward investment protection standards may diverge significantly.

Early standards for the protection of foreign investors were based on customary international law. However, as Montt (2009) describes in detail, as early as the 19th century, developed and developing (in this case the newly independent Latin American republics) ascribed to different standards of investment protection. On the one hand, developing countries pushed for standards of national treatment, by which foreign investors are treated no worse than domestic investors, while on the other, capital exporting countries promoted international minimum standards of treatment, most famously enshrined in the Hull Rule which meant to ensure "prompt, adequate and effective compensation" in the event of an expropriation by a host state (Montt, 2009, p. 34).

IIAs emerged in the second half of the twentieth century – the oft-cited BIT between Germany and Pakistan, signed in 1959, launched this first wave of BITs, although many of these early era BITs contained only clauses for state-to-state, not investor-state, arbitration. However, the standards of investment protection with which we are familiar today (and will be discussed in greater detail below) was included in the language of these early BITs, many of which were signed between Western European nations and developing countries. Capital exporting, or "home" countries such as the US, Canada and many European countries have developed what are called "Model BITs" (with some key differences between them), which are then generally presented to developing country partners, thus ensuring that investors from one home country generally enjoy the same level of protection in whichever partner countries they invest.

This emerging regime was strengthened by the promulgation of rules governing investment arbitration. In 1966 the ICSID Convention, which established the International Centre for the Settlement of Investment Disputes (ICSID), entered into force. ICSID is an autonomous institution of the World Bank, and provides facilities and procedures for the conciliation and arbitration of investment disputes between investors and governments of the contracting parties to the convention (ICSID Convention). In 1976, the United Nations Commission on International Trade Law (UNCITRAL) promulgated its own set of arbitration rules which have been applied to both commercial arbitration as well as investor-state dispute settlement (Horn, 2008).[5] Unlike ICSID arbitration, UNCITRAL provides only the rules and

[5] BITs and other IIAs contain provisions directing disputing parties toward one or both of these sets of arbitral rules

procedures governing the arbitration itself, but does not offer facilities in which the arbitration may take place. Moreover, until recently, the UNCITRAL rules did not require much in the way of transparency for investment arbitration, unlike ICSID which at the very least discloses the existence of the cases it oversees. In addition, private institutions such as the International Chamber of Commerce (ICC) had been hosting commercial investment arbitration services since the early 20th century, and ICC arbitration has also been included as an option in some BITs.

During the late 1980s and through the 1990s, the speed at which these agreements were adopted increased substantially, with hundreds of new BITs signed. According to Poulsen (2015), this burst of IIA signings accompanied a new focus on the attraction of FDI following the debt crises of the 1980s, and the agreements were seen as a complement to internal reforms. It was at this time that provisions for investor-state arbitration were introduced (Montt, 2009). This boom in new investment agreements was encouraged not just by capital exporting states but by international economic institutions such as UNCTAD and the OECD, in the belief that IIAs contributed to the flow of investment to developing countries (Bernasconi-Osterwalder, et al, 2012). As recent work has shown, while capital exporting nations and international organizations put some effort into the promotion of IIAs, the governments of host countries did not necessarily have a sufficient understanding of the content and consequences of these agreements (Aisbett & Poulsen, 2013; Poulsen, 2015).

ISDS provisions have also become common elements of free trade agreements, beginning with NAFTA in 1994, and followed by CAFTA, ASEAN, the Energy Charter Treaty, and the Peru-US Trade Promotion Agreement. Finally, as mentioned above, at the time of writing, large trade agreements between the European Union (EU) and the United States, the EU and Canada, and the United States and a number of Pacific Rim countries are in negotiations, in which the inclusion of ISDS is proving quite contentious.

2.1.2 Treaty Provisions and Arbitration Procedure

While IIAs do not contain identical wording, it is possible to give a general description of both the key provisions of investment protection, and the process of investment arbitration itself, which is what I turn to in this section.

Nearly all BITs and other IIAs include very similar sections, although the content may differ substantially on some key points. The first of these are the definitions of what constitutes

an investor and an investment (and is thus protected under the agreement), and clarifying the scope of the provisions of the BIT. Most countries have adopted an asset based definition of investment, which extends protection to as many forms of investment as possible, beyond just FDI; this definition of investment includes stocks, bonds and shares in companies, loans related to a specific investment, intellectual property rights, and business concessions, meaning the rights conferred by law or contract (UNCTAD, 2007a). On the other hand, some countries such as Canada in its 2004 Model BIT have adopted closed-list definitions of investment, which exclude from protection anything not explicitly listed in the BIT (UNCTAD, 2007). The definition of investor generally includes both natural and legal persons. Finally, the scope of the application of the BIT may determine both to which investment it applies, as well as which state measures. For example, the Canadian Model BIT states that the treaty is applicable to measures which "relate to" the investment in question. BITs which take this approach thus extend the scope of the agreement to any kind of measure affecting the investor or the investment concerned. Therefore, a broad range of regulations in the host country could potentially fall under the scope of the application of the BIT. The subject matter to which the measures were primarily directed would be irrelevant (UNCTAD, 2007, p.7).

IIAs subsequently include provisions which regulate the entry of an investment into a host country, and will either include both pre- and post-establishment rights for the investor, or more commonly, only the latter. The exclusion of pre-establishment rights leaves to the discretion of the host country which investment to allow into the country, and endows countries the right to refuse those investments which do not conform to its legislation (UNCTAD, 2007). However, some BITs, in particular the US and Canada Model BITs, aim to liberalize investment flows and thus extend non-discrimination provisions to the establishment of investment (UNCTAD, 2007).

More generally, these non-discrimination provisions – National Treatment (NT) and Most Favoured Nation (MFN) treatment – apply once the investment has been made. The former, NT, requires the host state to extend to the investor no worse treatment than it does to domestic investors. MFN, on the other hand, requires the host state to treat the investor no less favourably than it treats investors from any other country (UNCTAD, 2007). Although these are relative standards of treatment, most IIAs also include the absolute standard of Fair and Equitable Treatment (FET). The FET standard has provoked much debate, as many agreements

do not define the terms (UNCTAD, 2007). At the heart of the debate is whether FET should be interpreted as a requirement for treatment that conforms to international minimum standards set out in international law, or whether it is a broader and more demanding standard of treatment, that includes, for example, compensation in the face of financial loss not caused by expropriation (Mayeda, 2007).

Traditionally, expropriation or nationalization, in which the state seizes the property of the investor, has been a primary concern for foreign investors, and triggered the development of IIAs. Unsurprisingly, therefore, unlawful expropriation, in which the investor is not compensated adequately, and the measure is not taken for a public purpose, is prohibited by BITs. However, beyond an outright seizure of property, IIAs tend also to prohibit measures "tantamount to" or "having an effect equivalent to" expropriation (Kingsbury & Schill, 2009). In this case, the definition of expropriation under a BIT expands to include measures which "negatively affect the property's substance or void the owner's control over it" (Kingsbury & Schill, 2009, p. 31). This provision has therefore become controversial, as IIAs do not establish criteria to determine whether or not a state measure has had this effect (UNCTAD, 2007).

Many IIAs also include an umbrella clause which obligates the state to respect other agreements it has made with the investor of the contracting party. This has the effect of bringing contracts signed between the state and the investor under the purview of ISDS, and allowing parties to bring contractual disputes before an investment arbitration tribunal.

Finally, as mentioned above, most IIAs signed from the mid-1980s onward contain a provision allowing for ISDS in the event of a dispute between an investor and host government. These clauses may specify which arbitration rules and forums will be used, whether it be ICSID or UNCITRAL rules, or left up to the discretion of the parties. One key clause included in most BITs addresses the "exhaustion of local remedies" – in other words, if the investor must first attempt to resolve the dispute through the domestic judicial system. While such a clause was a feature of older BITs, many newer BITs do not require that the investor first attempt to address their conflict with the state in local courts (UNCTAD, 2007). Subsequently, an investor is required to present a formal notice of intent to arbitrate to the state in question, describing the dispute. Much of the detail regarding how the arbitration process will unfold is based on which rules are selected, rather than being laid out in the IIA. However, some broad patterns can be identified – for example, most BITs require a period of negotiation between the parties prior to

the initiation of the dispute, and both the state and the investor must consent to resolve the dispute in arbitration if it cannot be done so beforehand by negotiation. Moreover, investors are generally required to submit this notification within three years of the manifestation of the dispute between the parties (UNCTAD, 2007). Following this, the dispute will be formally registered at an arbitral forum – for example the ICC or ICSID – depending on the choice of arbitral rules included in the agreement. After the dispute is registered, both parties to the dispute may select their own arbitrator to sit on the arbitration tribunal, acting as judges in the case. Once these arbitrators are selected, a third arbitrator who will act as the President of the tribunal is selected, either by the first two arbitrators, the parties to the dispute, or in the case of ICSID, the Chairman of ICSID. The arbitration process commences, with the legal teams of the parties presenting arguments at each stage. The arbitrators must first make a ruling on jurisdiction – whether or not the case can be properly heard as an investor-state arbitration case. If the tribunal rules favourably at this stage, the parties then continue on to present their arguments on the merits of the case, disputing the factual basis of the dispute and the legality of the state measure(s) in question. Finally, the tribunal will rule on both liability – whether or not the state is in violation of the IIA – and quantum – the amount the final award, if any, that the state will pay. It is important to note that, while tribunals can award significant damages to the investor, they are not able to force the state to overturn the measure in question as part of the final judgement.

Arbitration proceedings may be discontinued at the request of either party, or due to either party's failure to act (proceed to the next step of arbitration) during the process, or pay the required arbitration fees (Echandi & Kher, 2013). Additionally, arbitration may be discontinued if the parties are able to reach a settlement. The arbitral award is final and binding for both parties. Both the ICSID Convention and the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, signed in New York in 1958 (and often referred to as the New York Convention) provide for means to enforce these awards. The ICSID Convention states that any contracting state must recognize the arbitral award and enforce it through its own federal courts (ICSID Convention, art. 54). The New York Convention similarly requires contracting states to enforce an award in its own courts, and for this reason many BITs require that the arbitration procedure takes place in a state which is a party to the Convention (Tienhaara, 2009).

Arbitral awards are by and large final, and currently no appeals mechanism exists in the investment arbitration system. Under ICSID, an interpretation of an award may be sought, and under very limited circumstances, a party may request an annulment of an arbitral decision if it can prove that the original tribunal was corrupt, exceeded its powers, departed from the rules of the arbitral procedure or did not state the grounds on which it reached the final decision and award (Tienhaara, 2006). Barring these rather extreme circumstances however, the losing party cannot overturn the award.

2.1.3 The Benefits and Costs of IIAs for Host States

As mentioned above, IIAs were promoted to developing states as means to attract greater flows of investment by Western states and international organizations. In "what 'Salacuse has described as the 'grand bargain' of BITs: developing countries promised foreign investors extensive protections in return for the prospect of more capital."

Unfortunately, the evidence for IIAs' success in attracting investment remains mixed. Tobin and Rose-Ackerman (2011) find that BITs do attract foreign investment, but only in low- and middle-income countries with relatively attractive investment environments, thus acting as a complement to, not substitute for, strong domestic institutions. Moreover, they argue, as more countries sign these agreements, increased competition from similarly attractive countries decreases the marginal effect of signing a new BIT. Kerner (2009) argues that BITs do increase FDI and further suggests that a signalling effect attracts investment from home countries beyond the parties to the treaty. On the other hand, Aisbett, (2007) argues that these studies have not adequately accounted for the endogeneity problems inherent to much research on international institutions and FDI and trade flows. Specifically, "increased FDI flows in one year may cause a BIT to be signed in the next, or an improvement in the investment climate of the host [state] may cause a simultaneous increase in both FDI and BIT participation" (p.3). Controlling for this endogeneity, she finds that BITs are generally signed when FDI flows are already increasing, and that while there is correlation between BITs and FDI, a strong argument for causation in a specific direction cannot be made. She further finds no evidence of a signalling effect. The lack of consensus among these studies and others may be due in large part to methodological differences and sample selection. However, it seems clear that although IIAs go hand-in-hand with greater FDI flows, they are not the primary drivers of FDI.

While the benefits of signing an IIA in terms of increased FDI flows are unclear, the costs for host countries are much easier to identify. As Simmons (2013) succinctly argues, "one consequence of ratifying bilateral investment treaties that contain dispute settlement provisions seems quite clear: they have led to a burst of (possibly unanticipated) litigation, especially since the late 1990s" (p. 28). She finds that the likelihood of investor-state arbitration increases for a state with each additional treaty signed, a finding that is replicated in this study (see Chapter 5). Similarly, Schultz and Dupont (2014) argue that investment arbitration was initially used by investors, as it was designed, to substitute for weak domestic courts. However, subsequently, investment arbitration appears to have been used, until the mid-to-late 1990s "as a sword in the hands of economic interests of investors of rich countries against governments of poorer countries, but has since then also been used significantly by investors from rich countries against rich governments" (p. 1150). In other words, international investment law is increasingly being used to set standards for investment protection, "furthering the international rule of law" in a way that privileges the interests of investors over those of states (Schultz & Dupont, 2014, p. 1150) .

At the very least, the increasing numbers of investment arbitration cases suggests that IIAs have not on the whole succeeded in deterring states from what investors consider discriminatory treatment (Gaukrodger & Gordon, 2012; Simmons, 2013). On the other hand, the surge in arbitration cases may also be due in part to an increasingly offensive use of arbitration by investors, encouraged by investment lawyers and arbitrators who have a vested interest in the use of the system, a criticism discussed at greater length in the following section. Regardless, whether because states choose to pursue discriminatory policies despite the costs posed by ISDS, or investors are misusing the system, it is clear that IIAs do impose costs on states which may not be adequately balanced by the questionable impact of these agreements on increasing FDI flows.

2.2 Data Collection & Sources

In the second half of this chapter, I present the results of the qualitative coding of investor-state disputes, which was undertaken as the first stage of this research project.

The dataset includes 584 arbitration cases from 1990-2014 about which sufficient information could be found (at least the home and host state, investor and industry). The data collection began in 2012 and the dataset was updated at the beginning of 2015. Data were

collected from a variety of sources. As mentioned above, there were no comparable datasets at the beginning of this research. However, two databases of investment arbitration cases helped to give me an initial overview – the UNCTAD IIA database and the IIAPP database created by Gus Van Harten at Osgoode Law School in Toronto.[6] Beyond this, I was able to access most of the awards of the cases included from the ITALaw website[7] and the ICSID pending and concluded case lists. Of course, given the rules on transparency of the respective institutions, there is a greater representation of ICSID cases than those under UNCITRAL rules.

The information about the measures taken and actors and institutions involved in the cases was drawn primarily from two sources. The first source of information about an arbitration case is of course the arbitration award, and any other documentation (for example, the initial notice of arbitration) related to the arbitration proceeding. The number of these documents which are publicly available varies significantly from case to case; in some cases nothing is published, in others, only the final award is made public, while in others every procedural step of the arbitration, including submissions from respondents and claimants, is published online. The second source of information which was invaluable to the data collection undertaken here, especially in cases with little other public documentation, was the Investment Arbitration Reporter (IAReporter) website.[8] A subscription-only arbitration and investment treaty news site, this service is extremely thorough in uncovering and publishing information about arbitration cases. It generally provides articles on the background of the cases, as well as analyses of the various rulings at different stages of the arbitration, and the final award. In some cases, it was necessary to find further sources of information on the cases, usually from national news and business news websites.

2.3 Coding the Cases

The coding itself was undertaken in a series of steps. As mentioned above, the entry for each arbitration case includes a number of different elements:

- The respondent state;
- The investor;
- The home state of the investor;

[6] http://www.iiapp.org
[7] http://www.italaw.com
[8] http://www.iareporter.com

- The industry;
- The relevant IIA;
- The case outcome;
- The measure taken ;
- The domestic institution involved, and more generally, the branch of government (administrative, legislative, judicial); and
- The "target" of the measure.

The first five categories are for the most part unambiguous – most obviously the respondent and investor are in the name of each arbitration case. The home state of the investor was considered to be the other signatory of the IIA, although this does not necessarily entail that the nationality of the investor, or ultimate parent company belongs to that state. The industry was first coded inductively, and then categorized more broadly according to the sector classification used by the World Bank.

The final four categories required substantially more investigation. The case outcome was based on reading the relevant awards where possible, as well as the classification of cases on the ICSID and UNCTAD IIA databases, and their categories (see Figure 2.4 below) were adopted here. Both the domestic institutions involved, and the "target" of the measure were coded based on a review of the arbitration proceeding documents and articles from the IAReporter website. The domestic institutions which were the sources of the triggering measure(s) were identified first. These institutions ranged from the office of the executive to the legislature, to various ministries and state-owned enterprises. These were then further categorized as administrative if they were taken by a body made up of unelected officials or by decree; legislative, if a law was passed by an elected body; or judicial, if the measure was the decision of, or resulted from the decision of a domestic court case. A measure was coded as general if it applied to an entire industry or the general population, and specific if it applied to an individual investor or small group of investors within an industry.

Coding the measure taken by the state which triggered arbitration was the most work-intensive part of the data collection, and was done in two steps. I began by first inductively describing the measures after reviewing the relevant data sources. Subsequently, I created categories of measures, and finally assigned each measure to a category. The first source of information was again the documents related to the arbitration proceeding. Specifically, most

final awards contain a summary of the "undisputed" facts of the case, which generally gives a timeline of events, and the specific actions of the state to which the investor objects. If this was ambiguous or unclear, I double-checked my interpretation of the measure using the IAReporter summaries, and other secondary sources of information.[9] The next sections present the results of this data collection, as well as some descriptive statistics from the statistical analysis presented primarily in Chapter 3.

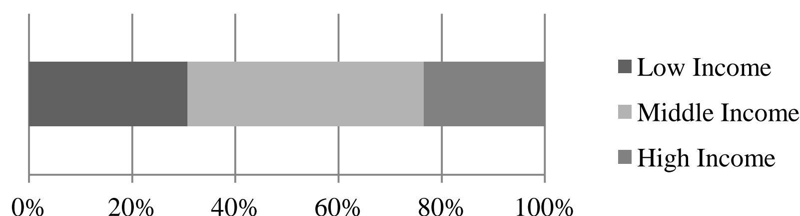
2.4 Home and Host States in Investment Arbitration

Most countries in the world have signed and ratified at least one investment treaty (with some notable exceptions, such as Brazil), and therefore a wide range of countries can, in theory, play the role of both home and host state for FDI. However, the reality looks somewhat different. Most BITs are in fact signed between developed, capital exporting (home) countries, and developing, capital importing (host) countries. Therefore, in the event of an investor-state dispute covered by a BIT, it is generally the latter who is the respondent in arbitration, while the former is merely the home state of the claimant (the foreign investor). Large multilateral or regional investment agreements such as the Energy Charter Treaty (ECT) and NAFTA alter this dynamic somewhat, although at least with regard to the ECT, the respondents have generally been Eastern European and Commonwealth of Independent States (CIS) with investors coming from Western Europe.

The following graphs demonstrate this dynamic. Figure 2.1 shows the distribution of GDP per capita levels (as classified by the World Bank) for all signatories to at least one IIA. Here, the distribution of income levels generally reflects the numbers of developing and developed countries globally.

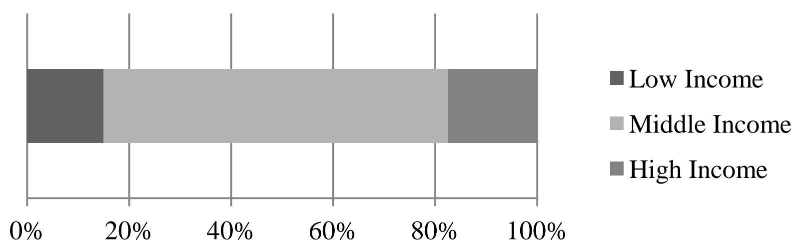
[9] Unfortunately, there was no opportunity to test for inter-coder reliability for this project. However, I attempted to control for intra-coder reliability, reviewing my entire database approximately eight months after it was first completed. This exercise led to some changes, due also to the release of new information about some cases, but overall reinforced my initial coding scheme.

Figure 2.1GDP per Capita of all IIA Signatories



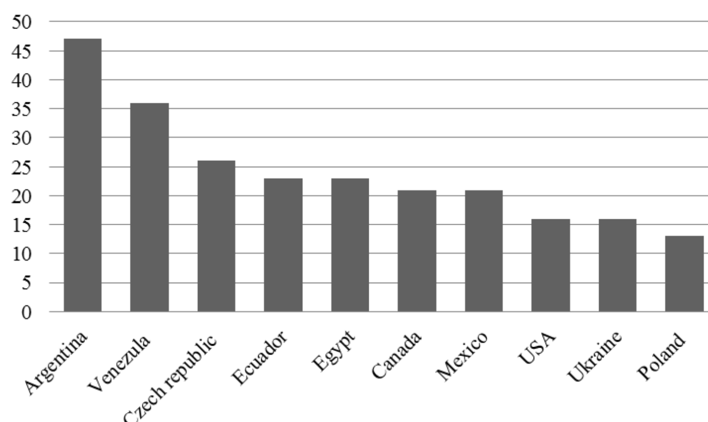
On the other hand, Figure 2.2 shows the distribution of income levels for country-years in which there was at least one case of investment arbitration. Here, we see a clear concentration of investor-state disputes in country-years in which the state is at a middle income level. As stated above, this is due largely to the fact that developed countries, while still attracting more FDI than developing countries, have not signed IIAs among each other. Therefore, most investment that is covered by an IIA flows into developing countries. On the whole, however, the world's least developed countries attract far less FDI, and therefore, most investor-state disputes take place in middle income countries.

Figure 2.2GDP per Capita of Respondent States



However, a slightly different pattern emerges when we look at the countries which have individually faced the greatest number of arbitration cases, shown in Figure 2.3. Interestingly, the top respondent countries are a mix of middle and high income countries. Argentina and Venezuela, as the top two respondents, are rather exceptional cases. Nearly all of Argentina's investment claims are related to measures it took during the financial crisis in the early 2000s. Under Socialist president Hugo Chavez, the Venezuelan government expropriated many foreign owned industries, especially in the extractive sector. On the other hand, the cases in the remaining countries in this graph cannot be explained by any one cause.

Figure 2.3Frequent Respondent States



Of note, however, is the inclusion of Canada, the United States and Mexico – the signatories to NAFTA – among the most frequently respondent countries. Canada and the United States, both high income countries, are not the first countries that come to mind as risky locations for investment. The expectation during the negotiation phase of NAFTA was that its investment protection chapter was for the benefit of US and Canadian investors in less-developed Mexico (Heindl, 2006). However, Mexico is not the most frequent respondent of the three. Instead, both Canada and Mexico have faced an equal number of cases and the United States is not far behind. This rather equal distribution of cases under NAFTA suggests that the traditional rationale for ISDS as creating an additional layer of protection for investors in less stable, developing countries does not necessarily hold up when developed states sign IIAs among themselves. NAFTA cases suggest that either advanced and open democracies are just as likely to take measures which disadvantage investors as developing countries; or that investors, once given the opportunity to use ISDS as a tool to pursue their aims, will do so in a much wider variety of situations than may have been predicted during NAFTA's design and negotiation phase.

The distribution of democracies and non-democracies among IIA signatories is also of interest to this project, given the focus on the contribution of domestic-level politics and policy-making to investor-state disputes. As with GDP, the level of democracy (measured by the country's Polity score) is different when looking at all signatories of IIAs, or the smaller group of states who have acted as a respondent in an arbitration case. In the general population of IIA signatories, the mean Polity score is 3.6 on a scale ranging from -10 (autocracy) to 10 (full democracy), placing it in the anocracy (neither fully autocratic nor democratic) category. However, in country-years with at least one arbitration case, the Polity score is slightly higher at

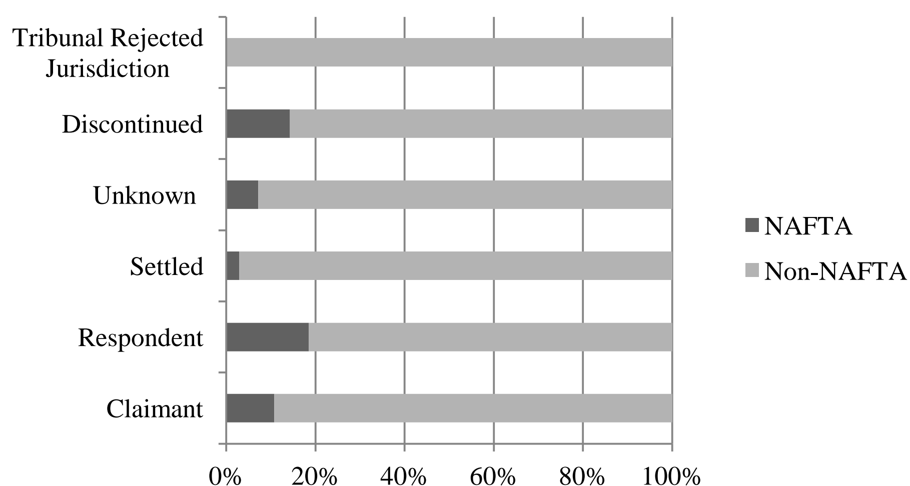
5.1. The relationship between democracy and investment arbitration will be discussed at greater length in following chapters.

Finally, transition, or formerly state-planned economies are very frequently implicated in investor-state arbitration cases. While they make up only 18 percent of the country-years in the database, a transition economy is the respondent state in 32 percent of the cases.

2.5 Outcomes

As can be seen in Figure 2.4 below, investors and states have won roughly the same number of cases so far. However, the distribution of awards in favour of the claimant and respondent are not the same under all IIAs. As we can see below, while claimants have won slightly more cases overall, states win more often under NAFTA than they do under other IIAs. It is interesting to note however, that the United States has yet to lose a NAFTA case, while Canada and Mexico have lost a fair number. Therefore, the overall higher rate of states successfully defending NAFTA claims is in fact driven by the United States' enviable performance in defending itself as a respondent state.

Figure 2.4Outcomes



Another issue of note is the settlement of arbitration cases. It is often difficult to know what a settled case indicates, as the terms of the settlement are often kept confidential. As one former lawyer for the government of Canada, and advisor to many developing countries on investment treaty issues explained,

> We don't know what settlement means, or how many cases a government settles, or what they did in the settlement, simply because of the risk. Not because of the merits of the claim but the risk of a greater judgement. One should not assume that a settlement is an admission that the claim had merit (Interview # 5).

Therefore, a settlement may indicate that the investor has received payment from the host state, if the latter has calculated that they could be forced to pay a greater award if the arbitration process were to be continued. On the other hand, a case may be settled at the behest of the investor, if they similarly do not like their chances of reaching a favourable award if the arbitration runs its course. Either way, the cases that fall into this category may obscure the financial burden that arbitration places on states.

The category of discontinued arbitration proceedings is similarly ambiguous, and it is difficult to ascertain what exactly has taken place in every case. In some instances these cases may have been settled, in others the proceedings may have been discontinued if the parties fail to take the required procedural steps to continue with arbitration; or simply runs out of funds to continue paying its legal team.

Finally, the last category represents cases in which the arbitration tribunal, for a variety of legal reasons, have declined to proceed, given their judgement that investment arbitration is not the proper forum for the resolution of the conflict.[10]

The issue of the burden that investment arbitration places on states is inherently linked to the development status of the respondent. One of many criticisms that have been launched at the IIA regime, particularly by governments such as Bolivia and Ecuador which have been frequent respondents to investment claims, is that the system unfairly targets developing countries. In an statistical analysis, Franck (2009) finds no statistically significant relationship between a country's development status and the outcome of an arbitration case. In a more recent article, she finds that any link between the outcome of an arbitration case and the development status of the respondent country disappears when the country's Polity score is introduced as a control, indicating that "a host state's level of democracy, some aspect of domestic political infrastructure, or other variables or combinations of variables could exert more influence on [arbitration] outcomes" (Franck, 2015, p. 60). Ultimately, while the final award may not depend on a state's development status, the likelihood that they will be involved in investment

[10] The original IIA UNCTAD database sometimes coded TRJ cases as wins for the respondent, and therefore the numbers in this category may be slightly inaccurate.

arbitration at all is certainly greater for developing or middle income states, as discussed above, which may contribute to the perceived unfairness of the system. Whether or not a state's democracy level also makes it more or less likely to be a respondent is the subject of later chapters.

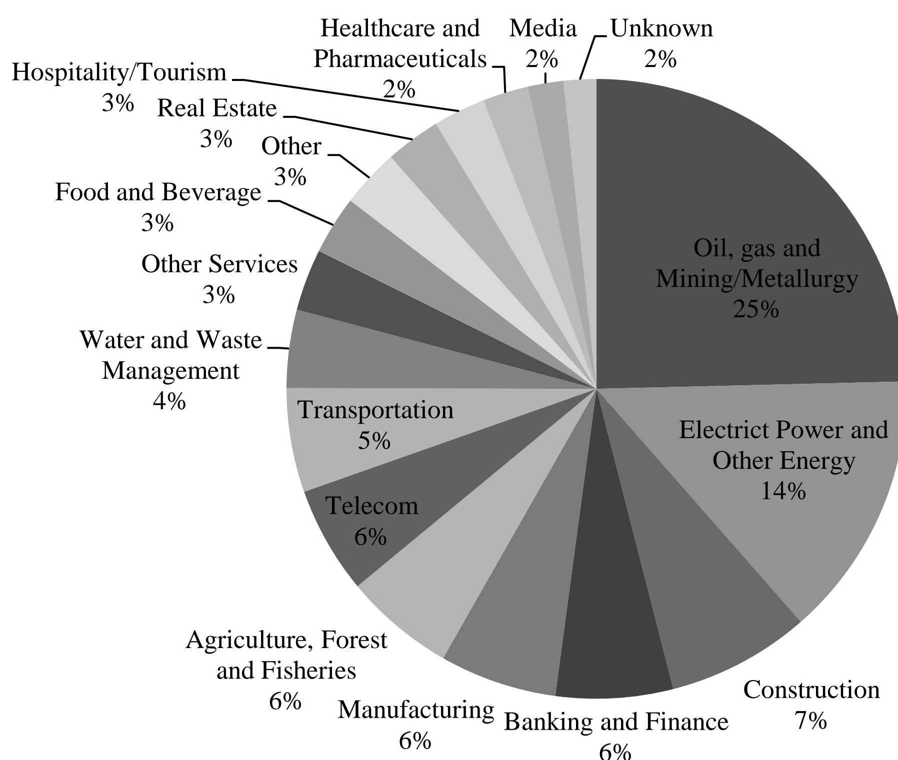
2.6 Industries in Investment Arbitration

Not all investment has the same impact on the host state, and this may account for the distribution of cases by industry. While investors in a wide range of industries have made claims against states, disputes are highly concentrated in the extractive industries of oil, gas and mining. The second largest category is comprised of disputes involving electricity and other energy, which includes the generation and distribution of hydro, coal, wind, solar, geothermal and nuclear energy. The third largest category is construction, which often involves the building of large infrastructure projects such as highways and dams. Figure 2.5 shows the distribution of arbitration cases across other industries.

The top two industry categories – extractives and energy – present specific challenges to states, and it is unsurprising that they make up the majority of cases of investment arbitration. As will be discussed below, much has been written about the politics of extractive industries, and the relationship between investors and states in this sector.[11] Today, given the capital intensive nature of mining and oil and gas extraction, these industries are dominated by foreign corporations, especially in developing countries. However, as the extensive literature on the 'obsolescing bargain' and political risk makes clear, and as will be discussed at greater length in following chapters, foreign investors in extractives are often seen to be especially vulnerable to policy reversal after an investment has been made, given the high sunk costs in any extractive project. As will be discussed in the following chapter, policy change or "instability" is at the heart of many investor-state disputes, and policy measures such as the introduction of a windfall tax, and the refusal to grant an exploitation permit following mining exploration activities, have contributed to many investor-state disputes.

[11] Ranging from literature on the resource curse to the extensive obsolescing barging literature.

Figure 2.5Industries in Arbitration



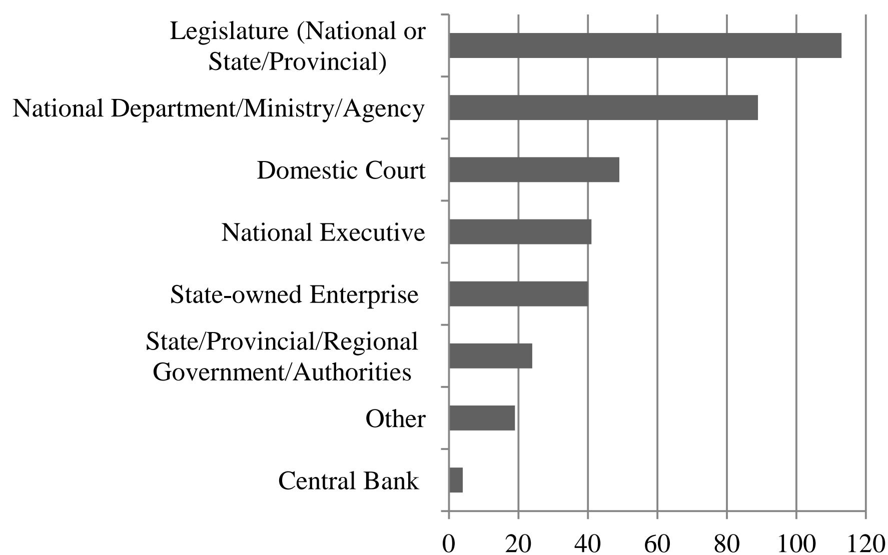
On the other hand, energy generation, distribution and consumption are important areas of national policy, as both industrial and household consumers depend on stable and universally accessible sources of energy. In a liberalized energy market, governments must work with investors to achieve this, but the goals of energy companies and the demands imposed on governments by domestic constituents may not always be complementary, which may in turn contribute to investor-state disputes (Krajewski, 2012). This will be discussed at greater length both in the following chapter, and in Chapter 8, which focuses on disputes between Hungary and two foreign electricity generators.

Disputes are spread across other industries fairly equally. As stated above, I relied primarily on the categories of sectors used by the World Bank for classifying investor-state disputes by industry. In some cases, however, such as health care and pharmaceuticals, I have disaggregated categories (in this case the World Bank categorizes pharmaceuticals as “other industry”) in order to highlight some industries that are particularly relevant to public policy.

2.6 Domestic Institutions and Types of Measures

The domestic institutions involved in an investor-state dispute are those that have formulated and/or enacted the policy measure(s) to which the investor objects. Therefore, we can derive from this an indication of the domestic interests at stake in these disputes. Not all cases involve only one institution, and therefore for each entry, I coded all relevant institutions, relying on the same data sources mentioned above. In some cases, there was significant ambiguity regarding the domestic actors involved; for example, many arbitration documents simply refer to "regional" or "local authorities", which makes coding difficult. Figure 2.6 displays the breakdown of domestic institutions.

Figure 2.6Domestic Institutions Involved in Investor-State Disputes



While of all the domestic institutions listed here the legislature is the single institution most often involved, the majority are administrative or bureaucratic bodies. Therefore it is not surprising that most of the measures taken which are subsequently challenged by investors are administrative. Indeed 61 percent of cases (281) were triggered primarily by administrative measures; 26 percent (117) were triggered by legislative measures alone; and 11 percent (50) were related to judicial decisions.[12] The remainder relate to cases in which the state failed to act

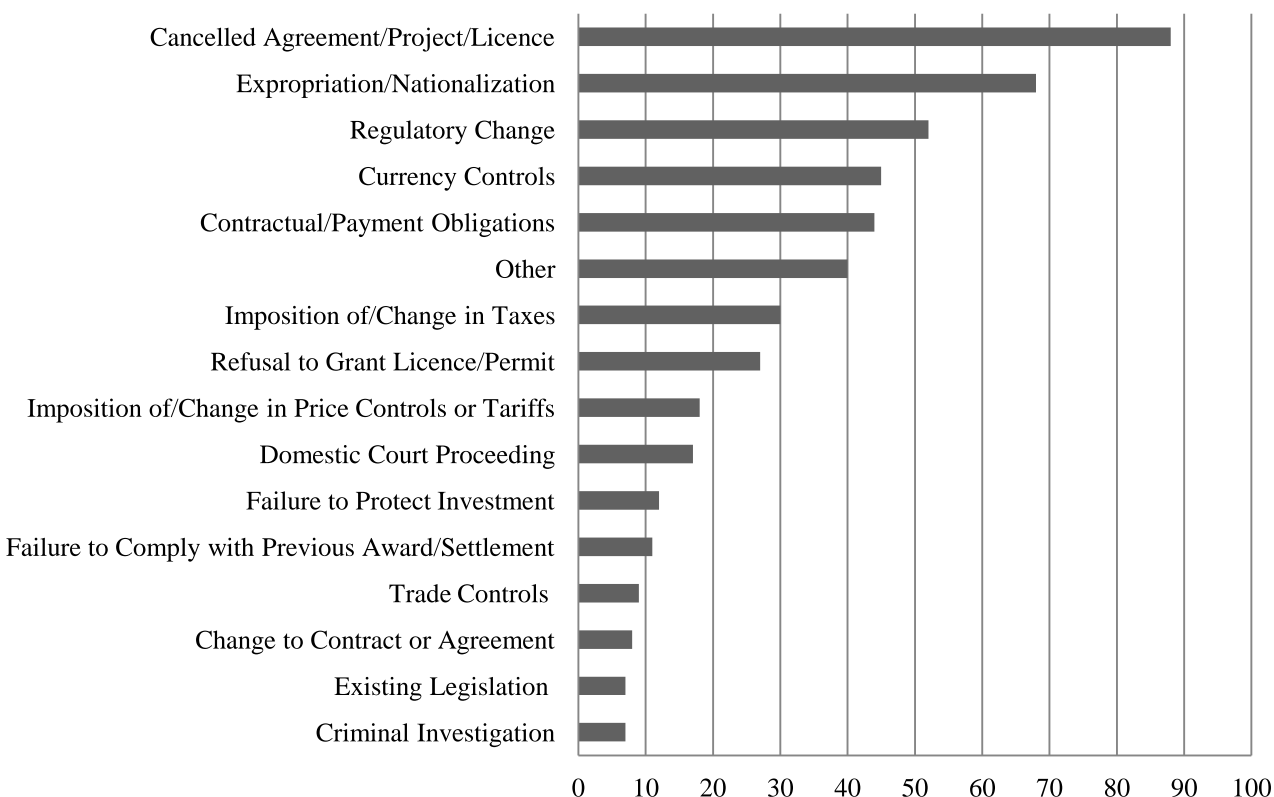
[12] Unfortunately sufficient information was not available to code the relevant institutions and measures for all cases included in the database.

– for example failed to protect an investment from physical harm – and therefore cannot be coded as legislative, administrative or judicial measures per se.

A number of interesting patterns emerge when we look at the groupings of measures taken by institution, state and industry. Slightly less than half of the cases in the legislative category involve Argentina, due to the “pesofication” law passed by the country’s parliament during the financial crisis in 2002. The other respondent countries in this category include Albania, Canada, Czech Republic, Germany, Hungary, Mexico, Panama Slovak Republic, Spain, the United States and Venezuela – the majority of which are high income countries. Therefore, we can see that investors are most frequently challenging legislative measures in developed countries. On the other hand, investor-state disputes in which domestic courts were implicated included a much wider range of respondent states, with high income countries such as Canada and the United States, but many more developing countries such as Egypt, Laos, India, Jordan, Indonesia, Kazakhstan, Pakistan and Sri Lanka ; judicial measures are more routinely challenged by investors in developing states. Unsurprisingly, cases involving state-owned enterprises were concentrated in disputes with extractive companies (oil, gas and mining); public utilities (electricity and other energy, and waste management); and telecommunications companies.

As stated above, I further coded the type of measure taken by the state which was challenged by the investor, and the results are displayed in figure 2.7. The clear majority of cases involve the cancellation of a project, agreement or licence. Investor-state disputes triggered by this measure span different industries and levels of development, but are generally administrative (although a few of these cases also involve judicial decisions). Expropriation of a foreign investment makes up the second largest category of measures taken, although it is important to keep in mind that Hugo Chavez’s series of expropriations make up over 25 percent of these cases. The third most frequent measure is the rather broad category of regulatory change. Included within this category are measures which ban specific industrial activities; ban certain substances (for example, pesticides); or other changes to the regulatory framework of an entire industry. Unsurprisingly, the bulk of these are legislative measures, and with exception of Egypt’s recent change to its minimum wage and Uruguay’s imposition of plain packaging on tobacco products, all of the cases which see investors challenging regulatory measures have a developed country as the respondent. Additionally, half of these cases involve electricity or other energy companies, which underscores the public-policy dimension of these disputes.

Figure 2.7Measures



As I note in the introduction, the measures taken can give a hint at the extent to which the underlying causes of investor-state disputes are related to lack of state capacity or more simply, a change in preferences toward (a specific) investment. For example, the currency control category is made up primarily of investor-state disputes emerging from the Argentine financial crisis; these cases are therefore clearly connected to the state's inability to respect agreements made with investors previously. Similarly, the category of "failure to protect investment" generally relates to the inability of the state to provide physical security to an investment which is also likely connected to state capacity. Finally, the contractual/payment obligations category is more ambiguous, but as Wellhausen (2015) notes, at times governments "have used breach of contracts with foreign firms as a means to supplement budgets in hard times... Breach in the form of withholding payments can provide a third budgeting option apart from cutting spending or raising taxes from domestic actors" (p. 18). This suggests that at times contract breach may be the result of difficult economic circumstances, and an unwillingness to take other policy measures to deal with the crisis.

The final question, and what the above only hints at, is whether most measure are which are challenged by investors are aimed at individual investors, or entire industries. Unsurprisingly, categories such as the cancellation of an agreement, contractual obligations, or the refusal to grant permits are associated with individual investors or projects, while regulatory changes or currency controls have a broader impact aiming to regulate behaviour universally, or within a specific industry. Measures such as expropriations may target only individual investors or an entire industry. Indeed, the majority of measures that lead to arbitration (66 percent) are aimed at specific investors, while 32 percent are aimed at the general population or an entire industry. Again, the remaining two percent of cases refer to those in which the state failed to act, for example to provide an investor protection against terrorist attacks. Of course, “specific” measures may nonetheless be associated with much broader policy changes – for example, the cancellation of a mining permit may be part of efforts by the government to put a halt to all mining activity in the country, as is exemplified by the case study presented in Chapter 7. It is therefore difficult, as in the case of the administrative measures, to infer too much from the fact that a measure was targeted at a specific investor.

2.7 Unknown Cases

One major challenge facing researchers of investment arbitration is the confidentiality surrounding many investor-state disputes. Indeed, cases only officially become public with the consent of both parties to the dispute, and even when the existence of a case is made public, the final award may not be published. Therefore, there are two types of unknown cases: the “known unknowns” in which the incidence of a dispute is made public, but the details of the dispute and final award are not; and the “unknown unknowns” – i.e. the cases which may exist, but about which we know nothing.

Both types of unknown cases provide challenges for this research. This chapter presents the results of the coding of investor-state disputes, but is limited to cases about which a sufficient amount of information can be found; for example, this database excluded cases for which information about the country of origin of the investor, and the type of investment, could not be identified. Therefore, this chapter does not present information about all investor-state disputes that have been made public. However, cases where at least the date of the initiation of arbitration, and the respondent state are known, do appear in the dataset I use for my statistical

analysis in Chapter 3, as the dependent variable employed there is merely the incidence of arbitration in a given country-year. However, the spectre of "unknown unknowns" is more troubling here. If there are statistically significant patterns of cases about which no information is made public – for example, if certain states routinely do not disclose that they have been taken to arbitration – this may bias the results of the statistical study.

In an attempt to address this issue, I corresponded with a number of investment arbitration experts[13] about the issue of unknown cases, and its potential impact on the validity of this study.

There was no clear consensus about the possible number of "unknown unknowns". One interviewee said he estimates that completely unknown cases make up about 10% of the total, while another said it could be "dozens and dozens". On the other hand, Professor Salacuse countered that the number of completely unknown cases was likely not significant. There was a general agreement that the number of cases about which the existence is totally unknown is likely smaller than the cases for which only the final award remains confidential. This is likely because the existence of arbitration cases often becomes public over time. Indeed, all three agreed that the number of unknown cases is declining, as more awards eventually are leaked to the public. In other cases, we are alerted to past arbitrations when either party attempts to enforce or set aside the final award in domestic courts.

In terms of the patterns of the "unknown unknown" cases, it was suggested that Middle Eastern governments may be more secretive about their investment disputes than others, and more generally, that autocratic states might be more likely to keep awards confidential. However, there is at least one example of an advanced democratic state – the United Kingdom – refusing the release the award of an arbitration case in which it was the respondent.[14] In terms of industries, it was further suggested that cases related to defense/security interests would be more likely to be kept confidential.

Recent research which explains the variation in ICSID awards that are kept confidential or remain secret concludes that cases which involve an investment with a particularly long time

[13] These were: Jeswald Salacuse , investment arbitrator and professor of international law at Tufts University; Howard Mann, former NAFTA negotiator and defence lawyer for the Canadian government, currently legal advisor at the International Institute of Sustainable Development, which advises many developing countries in the negotiation of investment treaties; and Luke Peterson, editor of IAReporter which systematically uncovers and researches investment arbitration cases. These interviews were carried out over e-mail in early 2015.
[14] Sanchetti v. United Kingdom.

horizon are more likely to remain secret due to strategic considerations of both parties (Hafner-Burton, Steinert-Threlkeld, & Victor, 2014). It is suggested that investors in these industries may wish to avoid public knowledge of concessions made to host governments, in an attempt to keep disadvantageous policies from being adopted by other states. These authors further argue that states that have already experienced numerous arbitration losses, as well as extremely litigious investors, may also be more likely to keep arbitration confidential. Their first claim is of most interest to this project, and the results reinforce their hypothesis – projects with long time horizons, such as infrastructure projects, mining, and oil investments have the highest probability of being involved in a confidential arbitration. Given their focus on ICSID cases, this study does not immediately shed light on any patterns of "unknown unknowns"; ICSID publishes the names of the claimant and respondent in all arbitration cases carried out under the auspices of the World Bank. However, it is feasible that the mechanism governing the choice to keep ICSID awards confidential may also be operating in cases under different arbitral rules in which there is no requirement to publicize the case at all; in other words, cases arbitrated under UNCITRAL rules may also be more likely to remain secret when the investment has a particularly long time horizon. Given the already high number of known cases in the construction and extractive industries, this would suggest that – at least in terms of industry of the investor – the world of unknown cases is not significantly different than the known cases. Of course, this does not give us any clues as to the identity of the respondent states in these cases, which is of greater interest to this project, when it comes to the validity of the statistical results presented here.

2.8 Conclusion

The goal of this chapter was to provide an overview of the universe of known investment arbitration cases, with a focus on the industries and domestic institutions involved, and the content and target of the measures taken which ultimately motivated the investor to pursue arbitration. A number of initial findings emerge from this first empirical analysis.

First, middle income countries are the most frequent respondents in investment arbitration. This is due primarily to the development of the investment protection regime and global capital flows, as most IIAs are signed between capital importing and capital exporting countries, and developed countries have not historically signed many IIAs together. Therefore, while overall more investment flows to developed countries, investment covered by an IIA flows

primarily into developing, especially middle income, countries, and these countries face greater odds of being to be sued by investors. However, there are some exceptions to this rule – most apparently that of host states within NAFTA. While NAFTA's investment chapter was originally meant to protect American and Canadian investors in Mexico, Canada has been a respondent as many times as Mexico, and the US has also faced a significant number of investment claims (in fact, all three countries are among the most frequent respondents overall). As was discussed in the introduction, IIAs were designed to protect investors in unstable policy environments which are particularly a feature of developing countries, and therefore the initial finding that these disputes are concentrated in developing countries is unsurprising. However, the fact that Canada and the United States are frequent respondents suggests that developed countries are not immune to investment arbitration. Moreover, it is at least in part the aforementioned development of the regime that has led to the concentration of disputes among developing countries, and not the fact that high income, liberal democracies do not take measures which investors find objectionable.

This chapter further examined the industries that are most often involved in investor-state disputes, and finds that it is investments with a significant public policy component – i.e. those in extractive industries and electricity and other energy provision – which are among the most frequent claimants. As will be discussed in later chapters, these industries are quite heavily regulated and impact a wide range of stakeholders and interests, and this may contribute to the frequency with which investors in extractives and energy turn to arbitration.

A number of different domestic institutions are involved in these disputes. Legislative bodies – both national and subnational – are the single institution most frequently implicated in these disputes. However, they are outnumbered by a variety of administrative bodies – from national ministries to state-owned enterprises. Interestingly, it appears that disputes in developed countries more frequently involve legislative measures than those in developing countries, while investors are more often challenging judicial measures in developing countries. Administrative measures make up the greatest category, and are frequent in all states. The fact that investors are more often challenging administrative rather than legislative measures may serve to weaken some of the arguments against ISDS. Critics of the regime worry that democratic processes are hindered by the existence of investment arbitration; particularly, that investors are challenging legislation passed by democratically elected representatives. Proponents of the regime will point to the relatively few legislative measures that have been challenged as proof that the regime

instead serves merely to keep in check discriminatory and arbitrary administrative measures. However, this line of argumentation may underestimate the "legitimacy" of the goals of many administrative measures (while also perhaps overestimating that of legislation in some cases); as will be discussed at greater length in the case studies, it is not the case that administrative policy-making cannot have a significant "public interest" component. Finally, given what is presumably the far higher rate of administrative than legislative decision-making and policy output generally, it is only logical that these administrative policies and institutions are most often implicated in investor-state disputes.

This chapter has presented broad patterns in the distribution of investor-state disputes, in terms of states, industries, and domestic actors involved, and measures taken which are challenged by investors. However, while I have presented some possible explanations for these patterns, elaborating on the possible causal relationships that explains investor-state disputes is the work of the following chapters. The following chapter presents a theoretical account of investor-state disputes based on the literature on political risk, investor-state bargaining, and the determinants of FDI, and develops hypotheses that are tested using statistical analysis in Chapter 5.

Chapter 3 Domestic Demands and International Agreements

Bilateral investment treaties and other investment agreements are the product of the increased legalisation of international economic relations, along with the international trade and finance regimes (Goldstein et al, 2001). However, while IIAs govern the relationship between transnational entities (foreign firms and state governments), investor-state disputes take place largely at the domestic level. Indeed, the subject matter of most of these disputes involve issues of interest to domestic actors – whether narrow interest groups or the wider public – and the measures contested by investors are taken by national or subnational institutions. Therefore, a theoretical perspective which captures the interaction between domestic and international actors and institutions is necessary to adequately understand investor-state disputes; as Simmons (1994) argues, to "artificially segregate international and domestic influences could in fact lead to a misunderstanding of international economic relations. Domestic determinants of preference orderings... should be integrated into an explanation as to why states [find] it difficult to abide by the rules" (p. 11).

I adopt this approach to explaining investor-state disputes, constructing a theoretical framework based on work in liberal IR theory and international political economy, both of which emphasize a causal relationship between the preferences of domestic actors and foreign policy choices made by states. The theoretical assumptions outlined here underlie both the selection of variables included in the large-N study, presented in Chapters 4 and 5, as well as the more in-depth analysis of the specific investor-state disputes included in the case study chapters. What I do not attempt is the elaboration of a causal model which can be applied to a wide range of investor-state disputes. The decision to forgo an attempt to develop a causal model is due to the idiosyncrasies of my dependent variable – the incidence of an investor-state dispute in a given year which culminates in arbitration. As the results of my coding of the known universe of cases presented in the previous chapter clearly demonstrate, what is represented as a "1" in a dataset is, in fact, quite a diverse variable – investors have turned to arbitration as a result of wide range of measures, from expropriation to existing legislation on health care. Therefore, attempts to identify a single causal mechanism which is expected to explain all cases are unlikely to produce a convincing result. However, on a more general level, what is common to nearly all investor-state disputes is a change in policy which investors perceive places them in a disadvantageous

situation. This chapter therefore provides possible causal explanations for these policy changes more broadly, based either on states' cost-benefit calculations or the lack of capacity of state actors to maintain an investment-friendly environment. Within the sections dedicated to these respective explanations, I put forward a number of factors related to investment in particular, which may precipitate changes in domestic preferences toward investment, or weaken state capacity to respect IIAs.

In section 3.2, I present a picture of investor-state disputes as the result of cost-benefit calculations on the part of decision-makers who face competing demands of investors (supported by the investment protection regime) on one hand, and domestic actors on the other. This understanding of investor-state disputes corresponds with the enforcement approach to compliance elaborated by Downs, Rocke, and Barsoom, (1996) which explains treaty compliant behaviour as the result of international agreements that are able to impose sufficiently high costs on states to ensure conformity with treaty demands. This approach, which focuses on cost-benefit decision-making in the face of competing demands of domestic actors and investors, must first identify the domestic and/or state interests which are in opposition to those of the investor, and thus push the state to renege on its earlier commitment to respect investors' rights. In section 3.3 I present a competing explanation, in which lack of state capacity to maintain a sufficient standard of investment protection is the primary cause of investor-state disputes, based on the managerial approach to compliance which explains non-compliant behaviour as the result of vague or unclear treaty language and low levels of bureaucratic capacity (Chayes & Chayes, 1995). In this section I also include a discussion of recent work on BIT diffusion and bounded rationality given the implications of this work on my own research question.

Given that I draw significantly on theories of compliance with international agreements, it is important to mention the limitations of the concept as applied to investor-state disputes. In part, this is due to some idiosyncrasies of the IIA regime. As mentioned in Chapter 1, the investment protection regime is comprised of thousands of similar, though not identical treaties. More importantly, the design of the dispute settlement mechanism gives a significant amount of freedom to the arbitral panel to rely on its own interpretation of the treaty provisions (Van Harten, 2013). Ultimately, this makes determining compliance less than straightforward; in some cases two tribunals have come to differing conclusions regarding very similar issues, or even the

same dispute.[15] This possibility introduces meaningful uncertainty for states and investors alike, if the same facts can be interpreted as both treaty-compliant and non-compliant by different tribunals. It also makes ultimate rulings of compliance perhaps less clear cut than in other kinds of international disputes.

However I argue that the underlying logic of these two approaches to compliance – the managerial and enforcement schools – provide interesting starting points for a discussion of the decision-making that leads to investor-state conflicts. Instead of explaining the ultimate rulings on compliance, the assumptions outlined in sections 3.2 and 3.3 can help us explain what appear to be decisions to take measures that disadvantage investors. In the case of the enforcement approach, this would suggest that the costs of maintaining a policy environment favourable to investors become too high in the face of competing (domestic) pressures. On the other hand, if the managerial approach has greater explanatory power, the origins of investor-state disputes are not found in changing preferences but rather lack of capacity to maintain a stable policy framework for investors which inadvertently leads to unfavourable conditions for investors.

3.1 International Agreements and Domestic Policy

International relations in the post-Cold War era are increasingly legalized (Goldstein, et al, 2001), and while many international regimes and agreements govern inter-state relations, others set international standards for activity that takes place within the state. The push to strengthen the rule of law at the international level is based on the assumption that law provides a more neutral and predictable means of resolving conflict (Slaughter & Raustiala, 2002); for example, the move from the GATT to the WTO was a product of states' frustration with the perceived politicization of the former (Stone Sweet, 1997). Increasingly, the settlement of disputes between international (or transnational) actors falls to these tribunals, removing disputes from the political sphere of diplomatic relations to the (theoretically) more predictable legal realm (Keohane, Moravcsik, & Slaugher, 2001). Thus, while investment treaties and other policy tools that promote economic openness are generally taken as a sign of liberalization, this should not be conflated with less regulation:

> [i]n spite of a tendency to view globalization as a system in which economic actors act free of political chains, numerous examples suggest rather than a dismantling of the political

[15] For example, the often-cited Methanex and Metalclad decisions, as well the different findings of CME/Lauder v. Czech Republic cases, and even the different findings of the Electrabel and AES Summit cases presented in Chapter 8.

> framework, one merely replaces another. The practice of free trade, for example, requires as many laws, regulations and enforcement mechanisms as closed markets, if not more (Chorev, 2005, p. 319).

This move towards legalization creates "constitutional rights and an 'economic constitution'" at the international level which aid in the functioning of global markets (Petersmann, 2011, p. 14). Investment protection is an excellent example of this, as IIAs have remedied deficiencies that existed in investment protection when it was based on customary law alone and investors were dependent on home states to advocate diplomatically on their behalf in any dispute with a host state (Schill, 2010).

However, international legalization has an impact on legislative and regulatory processes at the domestic level, thus highlighting the changing spatial nature of regulation as opposed to its outright decline; as the state exercises less control over the market, new international rules are required to maintain the smooth functioning of economic relations at the international level. In order to meet the standards of investment protection, IIAs require states to maintain an appropriate legal and regulatory framework – one that, with the inclusion of a provision that waives the requirement of investors to first seek legal restitution in domestic courts (local remedies), endows arbitrators with the power to decide on the legality of domestic regulation (Montt, 2009).

Therefore, international agreements create a situation in which states may face competing demands – national and even subnational governments are increasingly constrained by and beholden to international norms and regimes, but are first and foremost responsible to domestic actors. In this way, as Frieden and Martin (2003) argue, "globalization, understood as developments in international economic integration, alters the choices available to national governments; this in turn affects national policy (and, one could continue, international outcomes)" (p. 122). As will be discussed at greater length below, this feedback between the international and domestic spheres undoubtedly characterizes investor-state disputes, and it would be remiss to ignore the influence of domestic actors on foreign policy choice in any analysis of the subject.

The "bottom-up" approach to international interactions privileges variation in domestic actor interests in explanations of state engagement with international regimes, and thus assumes that "a domestic coalition of social interests that benefits (ideally or materially) directly and indirectly from particularly regulation of social interdependence is more powerfully represented

in decision-making than the countervailing coalition of losers from cooperation" (Moravcsik, 2012, p. 87). In other words, states do not engage in international cooperation unless it is in the interest of influential domestic actors to do so. Indeed, without "social demands concerning globalization" states would have no incentive to engage with international regimes at all (Moravcsik, 2012, p. 84).

3.2 Domestic Preferences and Investor-State Disputes

This project explores the role of domestic actors and interests in states' policies toward foreign investment, and the domestic drivers of disputes between states and foreign investors. Given their emphasis on the influence of domestic actors on foreign policy decisions, appropriate theoretical approaches to understanding the causes of investor-state disputes can be found in liberal IR theory and IPE literature which similarly focuses on the interplay between domestic and international spheres.

In order to capture this dynamic, Frieden and Martin (2003) advocate for a two-stage analysis of domestic sources of foreign policy decisions, which looks first at the influence of domestic actors on decision makers at the national level, and subsequently examines state decision-making given domestic interests and international constraints such as treaties. First, this analysis requires an identification of the relevant domestic actors, which may be narrow sectoral interest groups, or broader segments of the population. If they are to influence foreign policy choices, these interests must necessarily be organized in some capacity, with the goal of having an impact on a relevant set of state actors. Finally, these interests are mediated through domestic institutions, whether they are electoral, legislative, or bureaucratic, and can influence the position a state will take in its interaction with other states, international organizations, or (transnational) private actors, as circumscribed by the relevant regime (Frieden & Martin, 2003).

We can identify a similar logic explaining the interaction of states with international regimes in the enforcement approach to compliance, which understands compliance as endogenous to state interests. States will comply with international agreements when the costs of non-compliance are greater than those which will be imposed by domestic actors that favour non-compliance. In this section, I discuss domestic actor and state interests vis-à-vis foreign investment through the lens of these theoretical approaches, and describe investor-state disputes as the result of cost-benefit calculations on the part of the state.

3.2.1 Domestic Interests and Organization

The first step in analyzing the impact of domestic actors on international interactions is to identify the relevant domestic actors and their interests. It is difficult to make generalizable claims about patterns of domestic-international interaction, given the range of potential variation. For example, the domestic interests at the heart of the analysis depend on the issue area – whether trade, environment, human rights, or in this case, foreign investment – and therefore must be identified on a case by case basis. The type of interest – narrow or broad – is likely to determine the means by which groups organize, which again depends on the state context in which this organizing takes place; for example human rights advocates in authoritarian states often work in conjunction with international actors to strengthen their relatively weak position vis-à-vis national governments (Keck & Sikkink, 1999). On the other hand, influential special interest groups may rely on official or unofficial lobbying of government actors to attain their policy preferences; these groups can define national policy preferences through "informal networks, personnel rotation between public and private sectors, the threat of disinvestment, and financial inducements for electoral campaigns or personal enrichment" (Murillo, Scartascini, & Tommasi, 2008, p. 21).

Despite this complexity, work on the impact of organized interests on domestic-level institutions has led to more general observations, which can be applied to an analysis of investor-state disputes. Electoral institutions, for example, can play a key role in facilitating domestic actors' influence on foreign policy decisions by communicating their preferences to politicians (Frieden & Martin, 2003; Mattes,et al., 2014). Therefore, the electoral strength of domestic interest groups should determine their ability to affect policy change. However, the ability of groups to successfully advocate for their preferences is also a function of the capacity of these interests to organise. For example, while larger interest groups are generally better able to influence policy through greater electoral leverage, narrower interest groups' access to information and ability to monitor policy outcomes can also empower relatively smaller groups to successfully push for (non-)compliance with an international regime (Dai, 2005, 2007).

The responsiveness of state institutions to domestic actors is therefore central to the ability of interest groups to influence policy. In the first instance, this suggests that democratic institutions will be more responsive to wider interest groups, while autocratic governments will depend on, and therefore consider the demands of, a smaller group of domestic actors (Bueno de

Mesquita & Smith, 2012; Mattes et al., 2014). For example, democracies are more likely to pursue environmental protection policies, as it is more cost effective to provide such public goods when the selectorate is large (Cao & Ward, 2015). Additionally, much work in political economy demonstrates the varied success of interest groups in influencing different branches of democratic governments. For example, while both executive and legislative branches of government are susceptible to electoral pressures, the executive branch is generally more oriented towards international relations and has a greater ability to act unilaterally, while legislative bodies are more attuned to, and constrained by, domestic interests (Brewster & Chilton, 2014). Therefore, they argue that when an international agreement imposes unpopular constraints on domestic policy, "the executive branch [is] more likely to comply and act quickly to comply than Congress" (p.2). However, if an issue is more highly politicized and legislative approval is needed, international cooperation may be more difficult to achieve, as elected officials must be responsive to the varied demands of their constituents. On the other hand, other scholars regard the executive, at least in presidential systems, to be more likely to respond to unilaterally to electoral pressure (Wiesehomeier & Benoit, 2009).

While it is often assumed (especially when it comes to trade policy) that broader (domestic consumer) interests suffer at the expense of narrow sectoral (domestic producer) interests (Milner et al, 2003), the aforementioned work makes it clear that under certain conditions, mass interests can also play a role in policy outcomes, especially when the policies under consideration are highly politically salient (Dai, 2005; Frieden and Martin, 2003). More broadly, this work suggests that there are various ways in which domestic interests may have an impact on foreign policy choices or international interactions, made possible by varying constellations of domestic actors and institutions.

What domestic interests are implicated in policy decisions regarding FDI? Compared to other policy areas, determining the interests affected by foreign direct investment is fairly difficult, requiring, as Frieden and Martin (2003) note, "substantial extension and imagination" (p. 128). While trade policies affect producers and consumers in a comparatively predictable manner, the impact of FDI on the host state is somewhat more ambiguous (Jensen and Lindstadt, 2013).

Like most policy decisions, however, the attraction of FDI will create both local winners and losers, which will in turn shape preferences towards investment. Much of the literature on

the benefits and drawbacks of FDI focus on its effect on the labour market and technology transfer. The potential of FDI to contribute to economic growth is a product of three interrelated features. First, FDI contributes to the capital stock of the host country, and is arguably more stable than other international capital flows such as portfolio investment, because of the difficulties of withdrawing FDI once the investment is made (Colen, Maertens, & Swinnen, 2013). Second, FDI can increase the demand for employment, particularly if it is a "green field" investment, in which a new venture is created, rather than simply a foreign takeover. Similarly, if foreign firms are more technologically intensive, they may create a higher demand for skilled labour, which should in turn raise wages and create an incentive for further investment in education (Moosa, 2002; Pandya, 2010; Pinto, 2013). Finally, foreign firms are generally assumed to be more efficient than local firms (especially in developing countries) and to spur positive spill-over effects through competition with, and imitation by, domestic business (Colen, Maertens & Swinnen, 2013). Therefore, domestic actors who benefit from employment and spillover effects would likely have an interest in maintaining good relations with investors. Indeed, this is the conclusion reached by Pinto (2013) who claims that leftist governments, which depend on labour as an electoral base, are in fact more positively disposed toward FDI than right-wing governments more closely associated with the domestic business-owning class.

However, FDI can have a negative impact on some sectors if the greater competition from more efficient foreign firms "crowds out" domestic businesses. Moreover, the incentives offered to foreign business, such as free trade zones, can unduly disadvantage local firms (Colen, Maertens & Swinnen, 2013). In this case, the domestic actors which would most obviously have an interest in more restrictive policy toward FDI would be those employed or owning businesses in uncompetitive domestic industries.

Additionally, all FDI projects are not created equal. While FDI in manufacturing may, as described by Pinto (2013), win the support of labour, other politically salient issues related to FDI may contribute to anti-investment preferences of domestic actors, an issue which Pinto largely ignores. As I argue in more detail in Section 4.4.1, these relate in large part to the type of investment, and the ways in which specific projects affect local stakeholders, which in turn may also relate to the historical context in which the FDI takes place. In the face of responsive domestic institutions, these interests may be translated into policy measures which are challenged by investors in arbitration.

As discussed above, if the interests involved are those of powerful actors, such as domestic firms or state-owned enterprises, it seems likely that they will pursue their goals through lobbying or unofficial channels. On the other hand, mass interest groups – whether mining-affected communities or electricity consumers – must instead rely on electoral pressure or more contentious forms of politics to communicate their interests to decision-makers. This implies that both elected officials and administrative agencies will be frequently involved in investor-state disputes, and Chapter 2 underscored that both types of domestic institutions take measures which are challenged by investors in arbitration.

In fact, as discussed in the previous chapter, the majority of measures which subsequently trigger investor-state arbitration are administrative (61 percent), with legislative measures at the heart of 26 percent of disputes. This suggests that perhaps electoral pressure is a less common motivating factor in investor-state disputes, as bureaucratic decision-making should be somewhat insulated from these forces. However, it should not be assumed that all administrative decision-making is removed from public involvement or pressure; for example there is a trend toward public participation in the planning stages of large extractive projects, and the rejection of projects due at least in part to public pressure has led to a number of cases of investor-state arbitration.[16] As mentioned above, political economy theories which seek to explain trade protectionism usually predict that concentrated, special interest groups will be most successful in having their demands for protectionist policies met at the expense of more diverse and less organized consumer groups who would benefit from free trade (Milner, Mansfield & Rosendorff, 2002). In the case of investment disputes however, it seems a wider variety of organized groups – populations in the vicinity of extractive projects, citizens concerned with environmental issues, and even voters in contested elections – may also be important and influential “stakeholders”. This suggests that one important means of organization is through public pressure from domestic interest groups, and that mass interests may be frequently implicated in investor-state disputes.

3.2.2 State Interests and Investment Agreements

The second stage of Frieden and Martin’s analysis involves identifying states’ interests or the “outcomes they desire.” Following from the discussion above, national preferences can be derived from the preferences of domestic actors – albeit those that are sufficiently powerful,

[16] For example: *Bilcon of Delaware et al v. Canada*; *St Marys Cement v. Canada*.

whether through elections or less public channels – to have an influence on state decision-making and whose interests therefore become analogous to those of the state (Moravcsik, 1997). In this case, the emphasis must be on an analysis of the organization of these collective interests, and how they affect national-level decision-making. While this approach is necessary to the analysis of individual cases of investor-state disputes, and structures the analysis presented in the case studies in Chapters 6-8, we can additionally deduce some state interests related to the investment regime by revisiting the patterns of investor-state disputes outlined in Chapter 2.

The identification of state interests or preferences is notoriously difficult, given the limitations of inducing preferences by observing state behaviour – it cannot be assumed that observable strategies or outcomes are congruous with the outcomes state actors want to achieve. Instead, state actors may be forced to choose between the "lesser of two evils" when taking certain policy measures, or simply fail to achieve their preferred outcome (Frieden, 1999). However, work on the signing and ratification of BITs suggests that this does indicate a state interest in attracting investment (Poulsen, 2015). The attraction of investment and protection of foreign investors are interests that are likely common to all signatories to an IIA. However, if we adopt the logic of the enforcement approach to compliance, host states which are the respondents in an arbitration case appear to have interests that compete with investment protection and promotion.

What generalizable statements is it possible to make about these competing interests in host states? As was discussed in the previous chapter, investor-state disputes are concentrated in middle income countries. The immediate reasons for this are fairly clear. Historically, most investment treaties have been signed bilaterally between a developed and a developing state, and investment has flowed from the former to the latter; until recently, very few IIAs, with the exception of NAFTA, have been signed between developed state partners. Therefore, most investment covered by an IIA, and that can therefore be the subject of arbitration, is hosted by developing or transition economy countries. However, as the world's poorest countries, mostly located in Sub-Saharan Africa, attract less FDI overall; most investment in fact flows to middle- and high-income countries. This explains in part why middle income countries are frequent respondents in investment arbitration.

However another factor may also play a role in the concentration of disputes in middle income countries – the greater impetus for regulatory change. As Tienhaara (2009) argues,

> Given the low base level of regulation in developing countries, and the pressures from both domestic and international sources for governments to 'catch up' to international best practices, would it not be fair to assume that investors should expect regulation to change even more dramatically in developing countries than in developed ones? (p. 211)

As will be discussed at greater length in the following chapter, policy stability is of central importance to foreign investors, and it is the change of policy governing an investment which often leads to a dispute with a host government. However, as Tienhaara notes, international organizations and regimes often pressure developing countries to improve regulatory standards and domestic actors in these states may also advocate for policy change, especially regarding environmental or labour standards. Similarly, liberalization processes advocated by international financial institutions for developing and transition countries can include the withdrawal of subsidies and other state aid, changing the policy framework on which investors have previously relied. Wherever the pressure is coming from, therefore, developing and democratizing states may be more likely to experience the changing or ratcheting up of regulatory requirements than in developed countries where standards are already fairly high (Tienhaara, 2009; Bonnitcha, 2014). This shift in policy may in turn alter the terms of existing agreements with investors and trigger arbitration. Therefore, while developing states certainly have an interest in attracting FDI, they may also have an interest, due to pressure from both internal and external actors, in changing regulatory standards or policy frameworks governing an array of issue areas.

In short, the most basic interests of the states participating in the investment protection regime include the attraction of investment into host states, and the protection of investors from capital exporting states. Given this project's focus on investor-state disputes, it is interested in the former – the interests of capital importing, or host states. For reasons related in part to the historical pattern of investment flows, most respondent states are middle income, developing or transition states. While these states are undoubtedly highly interested in attracting foreign capital, they also face pressures from domestic and international actors that may lead to policy change that has an impact on the terms of foreign investment.

3.2.3 Cost-Benefit Calculations and Compliance with IIAs

The two previous sections presented a discussion of the interests of domestic actors and states regarding investment on which states base their policy stance toward FDI or particular

investments. At the subnational level, this included the potential negative effects of foreign investment on host populations, both in the form of competition for local business and the impact of the energy and extractive industries on the broader population. At the national level, states that sign IIAs quite likely have an interest in attracting investment but may also face resistance from domestic actors, based on the interests discussed above. More broadly, general shifts in policy at the national level may conflict with commitments made previously to investors.

Following from the assumptions inherent to the enforcement approach to compliance, as well as the framework for analysis of domestic-international interactions elaborated by Frieden and Martin (2003), these interests should form part of the cost-benefit calculations states make in the face of a possible investor-state dispute. However, the strategic setting, delineated in this project by the international investment protection regime, provides the costs which counter the domestic benefits that accrue from taking a certain policy measure; if international agreements are able to impose sufficiently high costs, they constrain states' policy options (Downs, Rocke and Barsoom, 1996). For example, in a study on the imposition of capital controls, Kastner and Rector (2003) find that the international economic regimes can change the cost-benefit calculations made by state actors: when possible sanctions from the enforcement of an international regime are considered, "cost-benefit calculations become more complicated... the higher the costs associated with violating the standards of an international regime, the more a leader would be willing to sacrifice other goals to pursue policies in accordance with that regime (Kastner and Rector, 2003, p. 6). Ultimately, these authors claim that the presence of international regimes which regulate states' policy options will lessen the ability of domestic actors to dictate policy.

This perspective suggests that a state's respect of international rules will depend largely on the interplay between domestic interests and constraints imposed by the regime. This echoes the assumptions put forward in the enforcement approach to compliance, which understands compliance with international agreements as largely a result of treaties which do not place heavy demands on states; in other words, states do not negotiate and sign treaties with which they would find it difficult to comply (Downs, Rocke and Barsoom, 1996). In order to shape the preferences of states to accord with the goals of the agreement, a "deep" regime (i.e. one that requires greater behavioural changes of the signatory states) is more likely to require an attendant enforcement mechanism to ensure compliance; punishment for violations must be greater than

the benefits derived from defection from the regime (Downs, Rocke and Barsoom, 1996). Compliance is therefore understood as endogenous to the preferences of states, which are in turn subject not only to international constraints, but to the demands of domestic actors (Grieco, Gelpi, & Warren, 2009). According to this explanation, violations of international agreements are due to the fact that they place too great a demand on states in the face of countervailing domestic pressures, even considering possible retribution through an enforcement mechanism. Compliance is therefore the result of a deliberate choice, presumably arrived at following a series of cost-benefit calculations. This in turn implies that decision-makers are aware of the possible ramifications of noncompliance with an international agreement, and take this into an account when formulating domestic policy.

Gains from compliance can accrue from international sources – for example, through loans or foreign aid from international financial institutions – as well as domestic. In the case of the latter, the benefits of compliance with an agreement can come from the support of pro-compliance domestic actors who actively support incumbent leaders; as Simmons (2010) notes, "when a potential procompliance constituency is large... and when an international agreement provides significant new information on the government's record of compliance, a government will have strong electoral reasons not to violate international agreements" (p. 278). The benefits of non-compliance are likely derived primarily from the domestic level, as described above, either from the support of influential interest groups or from voters who, for a variety of reasons, may not support treaty-compliant behaviour. As discussed above, the former is generally associated with domestic sectoral interests that stand to either benefit or lose from foreign policy choices (Milner et al., 2003). However, narrow interests may not be compatible with mass interests, and therefore it is necessary for state actors, at least in democracies, to accommodate both. In this way, mass interests, particularly through electoral pressure, can also have an impact on states' compliance with international agreements.

The evidence for the direction of the effect of democratic constituencies and elections on compliance decision-making is ambiguous. One strand of literature argues that democratic states are generally more likely to comply with international agreements, and gives significant credit for this to vigilant voters (Gaubatz, 1996; Jensen, 2003; Milner et al., 2003; North & Weingast, 1989). According to Gaubatz (1996), for example, democratic societies hold certain normative beliefs which facilitate compliance – most importantly a respect for the rule of law – and these

beliefs motivate democratic voters to punish leaders who violate international agreements. Greater transparency in democratic policy-making process also helps domestic actors to hold leaders accountable to prior commitments (Gaubatz, 1996). Milner, et al. (2003) similarly emphasize the role of "audience costs," although, with their focus on trade cooperation, their analysis places greater importance on the material benefits that voters associate with agreements which lower trade barriers. In their view, voters are able to connect their material circumstances to foreign policy decisions and punish or reward leaders accordingly.

However, other scholars argue that the relationship between democracy and treaty compliance "is more complex and less predictable than often assumed" (Slaughter and Raustiala, 2002, p. 548). Most obviously, for democratic pressures to be associated with higher rates of compliance, voters must support the goals of the treaty itself, which cannot be assumed purely on the basis that they belong to a democratic state (Tomz, 2002). Moreover, it is crucial that these voters have access to the information regarding their state's treaty compliance, and a sufficient understanding of the issue to make the connection between treaties and outcomes, which would enable voters to punish non-compliant governments (Dai, 2007). This may be too much to expect of the average voter, given the complexity of most international agreements and the issue areas they seek to govern (Tomz 2002). Therefore, whether domestic voters are simply unable to adequately enforce compliance through elections, or they actively oppose compliance with some agreements, domestic audience costs are insufficient to stop democracies from violating international agreements; for example, Rickard (2010) finds that "the most frequent violators of agreements negotiated within the framework of the WTO are high-functioning democracies with strong, credible opposition parties and regular, competitive elections" (p.712). At the very least, it is clear that a democratic constituency is no guarantee of greater compliance with an international agreement, and may in some cases promote noncompliance. Whatever the direction of the influence, there seem to be strong arguments for the thesis that shifts in domestic preferences, communicated to policymakers via democratic elections, can affect the preference of governments towards international agreements (Slaughter and Raustiala, 2002). This in turn lends support to the enforcement approach to compliance, which gives credit for (non-)compliance with international agreements to purposive action on the part of state actors.

However, in making decisions regarding international agreements, state actors must also consider the costs these impose in the event of non-compliance. In the case of IIAs, a number of

costs can be associated investment arbitration. First, as was discussed in the introduction, is the potentially high cost of the arbitration process itself, as well as the possibility of an ultimate award in favour of the investor. In the event of an investor-state dispute, states may also face reputational costs which decrease its attractiveness to foreign investors in the future. In fact, a recent study found that the fact that a state has been a respondent in an arbitration case, regardless of the ultimate findings of the tribunal, reduces inward FDI flows (Allee & Peinhardt, 2011). Developing countries therefore face particularly high costs for non-compliance with an IIA, given their need for FDI and greater costs to these governments of an award, relative to their GDP. Therefore, these states should be particularly sensitive to the external costs imposed by the regime.

However, as I discuss below, cost-benefit calculations in investor-state disputes pose significant difficulty, as these agreements introduce uncertainty for states at a number of junctures, and thus complicate cost-benefit decision-making.

3.2.4 Uncertainty and Investor-State Disputes

Of course, despite their best efforts at weighing the costs and benefits of a specific policy measure, states face a great deal of uncertainty in the face of international regimes. As Frieden and Martin (2003) argue, uncertainty plays an important role in international cooperation efforts in a number of ways. First, at the time of signing a new agreement, states are uncertain about what their future preferences might be, due to possible changes in the preferences of domestic actors or external conditions (van Aaken, 2009). Therefore, escape clauses – "any provision of an international agreement that allows a country to suspend the concessions it previously negotiated without violating or abrogating the terms of the agreement" – are included in many international agreements in order to allow states more flexibility in meeting their obligations (Milner and Rosendorff, 2001, p.830). This flexibility should reduce official noncompliance or defection from the regime. Escape clauses may be especially important for democracies, as leaders in these states are more sensitive to the changing preferences of domestic constituents in election periods (Rosendorff & Milner, 2001).

However, states face uncertainty not just about their own future preferences (and those of influential domestic actors) but also about the actual scope and implication of contractual or treaty provisions – the rules governing their interactions with other actors (van Aaken, 2009).

Therefore, while there will always be some degree of uncertainty inherent to decision-making, perhaps especially at the international level, effective domestic institutions should go some way towards reducing it, highlighting the importance of bureaucratic effectiveness, and domestic institutions generally, for international cooperation or compliance with international agreements, which will be discussed at further length below.

IIAs are primarily meant to reduce uncertainty for investors by helping states credibly commit to maintaining an investor-friendly environment by means of the threat of investment arbitration. However, IIAs introduce meaningful uncertainty into domestic policymaking as it is likely difficult for a state to predict whether or not an investor will turn to arbitration following the implementation of a specific policy measure; this decision relates to calculations the investor must make given their own assessment of the potential costs and benefits of using this dispute resolution mechanism – information to which the state will not have access. The expansion in use of ISDS as a tool for investors to pursue their interests, as discussed in the introduction, introduces greater uncertainty for states as investors can challenge measures which are only indirectly related to their own operations. This is made possible by the functioning of the arbitration mechanism, by which investors are empowered to initiate arbitration without having to rely on their own governments to advocate for them. According to van Aaken (2009),

> The system is unique for public international law in that it gives investors *ius standi* to take disputes to international tribunals directly, mostly without exhaustion of local remedies. This provision thus gives international investment law immense force, because private (juridical) persons are much more likely to take up their own cases than to rely on governments to grant them diplomatic protection as used to be the case. (p. 513)

Therefore, the potential exists for investors to launch fairly frivolous claims against states, if the barriers for investors' use of arbitration are fairly low.[17] Moreover, the rise of third-party funding of investment arbitration, in which claimants will seek financial support from another firm or investor, who will then share in the award if the claim is successful, increases the capacity of investors to use arbitration to their benefit. This in turn may make it more difficult for states to predict when an investor will turn to arbitration, given that the cost-benefit calculations of the

[17] An excellent example of this is St Marys Cement v. Canada, a case that in many respects was quite similar to the Bilcon v.Canada case presented in Chapter 6. However, in this case the claimant was in fact Canadian, and opened a letterbox company in the US after filing for arbitration under NAFTA Chapter 11. Given that the investor was Canadian (and ultimately owned by a Brazilian multinational), there was no way for the government to anticipate that it would turn to NAFTA arbitration.

investor may be based on an even greater array of factors, for example its ability to access additional funding, than the state initially considers.

Finally, in the event that a dispute with an investor does culminate in arbitration, the state faces uncertainty regarding the ultimate ruling of the tribunal. This uncertainty is exacerbated by the architecture of the investment protection regime, in which there is no single text of outlining standards of investment protection, but rather over 3,000 IIAs, and no sitting judicial body. Moreover, the ad hoc nature of arbitration tribunals introduces yet more uncertainty:

> Since the composition of the tribunals varies from case to case, so may their interpretations. Although some of the variations may be attributed to difference in the wording of the treaty text, sometimes tribunals also interpreted identical wording in different ways, leading to inconsistent interpretation. Many of the interpretations of the vague terms to be found in the BITs are thus highly disputed, thereby creating legal insecurity for investors and states (van Aaken, 2009, p. 514)

Thus is clear that within the context of the investment protection regime, states face a great deal of uncertainty with regard to whether a dispute with an investor will materialize and what the outcome of such a dispute may be. Proponents of the regulatory chill hypothesis discussed in the introduction argue that the threat of arbitration, and uncertainty regarding the outcome, is enough to dissuade some states from taking specific policy measures, even those that are non-discriminatory towards foreign investors and in the public interest. Indeed, significant anecdotal evidence implies that the explicit threat of arbitration has stopped new policy measures in some cases.[18] However, states are clearly continuing to take measures which investors challenge via arbitration. Whether states make these policy decisions unaware that they may lead to arbitration, or whether they consciously choose to risk a dispute with foreign investors at the behest of other interests is less clear. This, and the related issues of bureaucratic capacity, will be discussed in the following section, as an alternative explanation to the causes of investor-state disputes.

3.3 Domestic Capacity and Investor-State Disputes

The ability of an international regime to genuinely constrain domestic policy space is dependent upon the relevant state actors' awareness of the regime in question and the demands it places on the state. This again underscores the role that other domestic institutions play in the formulation

---

[18] References to this phenomenon have come up both in interviews I've conducted, but there are a number of well-known cases: Canada allegedly had plans to introduce plain packaging laws for tobacco, but backed down following the threat of arbitration, and New Zealand, Namibia, Ghana, Togo and Uganda have apparently faced similar warnings. Australia and Uruguay have passed similar policy measures and subsequently faced arbitration. http://www.nytimes.com/2013/12/13/health/tobacco-industry-tactics-limit-poorer-nations-smoking-laws.html?_r=0

and application of domestic policies, though from a different perspective than adopted in the previous sections. In this section, I examine the possibility that investor-state disputes are caused primarily by a lack of capacity of domestic institutions. I extend the concept of capacity here to include host state awareness of the investment protection regime, and therefore discuss the implications of recent work on bounded rationality and BIT diffusion on the present discussion (Poulsen & Aisbett, 2013; Poulsen, 2015). This latter work contributes significantly to our understanding of the role of "the capacities and limits of human decision-making" in policy making (Poulsen, 2015, p. 17).

One strand of literature which takes seriously the role bureaucratic capacity and uncertainty in international cooperation and (non)compliance, is the managerial approach to compliance with international agreements. Instead of interest calculations, proponents suggest, noncompliance is generally inadvertent – due to a lack of bureaucratic capacity, the vagueness of treaty provisions, and the inflexibility of agreements to accommodate changes over time (Chayes and Chayes 1993; Chayes and Chayes, 1998; Freeman, 2013). Financial limitations of the state can reduce capacity, and Chayes and Chayes (1998) argue that this is a problem most acutely faced by developing countries which are more likely to lack technical and bureaucratic resources. Administrative capacity of this kind requires the education and training of personnel, access to sufficient information, and the required mandate or authority to implement compliant policies, without which "rule-consistent behaviour may simply not be within a signatory's choice set" (Simmons, 1998, p.83). Moreover, a lack of political capacity may threaten compliance when a government is unable to ensure that the behaviour of domestic state and non-state actors (such as businesses) is compliant with international standards (Tallberg, 2002).

More recent studies provide empirical evidence to support the importance of state capacity in respecting international agreements such as in human rights treaties (Cole, 2015) and environmental protection standards (Cao and Ward, 2015), drawing on the managerial approach. Cao and Ward (2015) operationalize capacity as the ratio between predicted and actual tax extraction, with predicted levels as a function of GDP per capita. On the other hand, Cole uses index measures of bureaucratic effectiveness, military involvement in the government, and control of corruption. Despite these differing measures of capacity, both studies find that higher levels of state capacity are positively correlated with their respective dependent variables.

State capacity additionally depends in part on the individual policy makers' expertise and awareness of relevant information. Rather than assume that these individuals have access to all relevant information and can easily weigh the costs and benefits of any decision, a bounded-rationality framework assumes that policy makers are "subject to cognitive constraints and often prone to mistakes" (Poulsen, 2015, p. 17). Recent work suggests that bureaucratic awareness of the implications of signing IIAs has historically been low, which could in turn increase the likelihood of non-compliant behaviour. Building on survey data of BIT negotiators and other relevant stakeholders, Aisbett and Poulsen (2013) find that

> practically all officials noted that they were unaware of the far-reaching scope and implications of BITs during the 1990s, when the treaties proliferated… few realized that the treaties had such a considerable reach and were enforceable not just in principle but also in fact (p. 11).

Indeed, it was not until states faced their first arbitration claims that policymakers understood the full extent of the costs of signing a BIT, which for most states did not occur until the turn of the century, when BIT claims took off. Until that time, states that had never faced an arbitration claim underestimated the impact of the regime.

Although focused on explaining the reasons that states have continued to sign BITs despite the significant costs associated with arbitration, this argument complicates the straightforward explanation for investor-state disputes based on cost-benefit calculations presented above. In the context of specific disputes, this work suggests the possibility that states may not be making cost-benefit decisions regarding specific benefits with a full understanding of the potential costs provided by IIA provisions, and would thus take different measures regarding foreign investment if they were acting with full information. However, while this might explain earlier investor-state disputes, or the first disputes faced by an individual state, as time goes on and countries face more claims, the assumption that states do not understand the consequences of these agreements may become less likely. This is, however, an important challenge to the cost-benefit assumptions, and will be explored both in the large-N study and case studies

Ultimately, this focus on capacity and bounded rationality of decision makers underscores the importance, not just of electoral institutions and domestic interests in determining foreign policy choices as discussed in the previous section, but that of capable modern bureaucracies. Indeed,

> in complex, industrial societies, the technicality and complexity of many policy matters, the need for continuing control of matters, and legislators' lack of time and information have caused the delegation of much discretionary authority, which often includes extensive rule-making power, to

> administrative agencies. Consequently, agencies make many decisions and issue many rules that have far-reaching political and policy consequences (Anderson, 2003, p. 53).

While administrative agencies may have limited influence on broad policy direction, they do have significant input into the details of policy measures and how they are put into practice. When administrative decisions are made in a policy area that is additionally governed by an international regime, these agencies must consider both the policy goals set out by elected officials as well as the obligations of the state under the relevant agreement – a situation which may prove quite challenging, especially in developing states with weaker bureaucracies that lack personnel with specific issue-area expertise (Poulsen, 2015). Therefore, it is not just pressure from interest groups, but also the capacity of the relevant institutions themselves that has an impact on policy outcomes; if administrative and regulatory bodies do not have the required information or capacity to integrate international rules into the formulation of policy, this will also affect a state's policy-making with regards to its international commitments (Chayes and Chayes, 1998).

What role does state capacity play in investor-state arbitration? As was discussed in Chapter 2, bureaucratic or administrative state agencies are often implicated in these disputes, and a focus on state capacity may also help to explain the concentration of investor-state disputes in middle income countries, which face challenges related to corruption, political instability, and government capacity (Keijzer, Kraetke, & van Seters, 2013). Therefore, it may be that a further explanation for the concentration of investor-state disputes in middle income countries is that, despite their interest in attracting FDI, they are unable to maintain investment friendly environments and avoid arbitration due to a lack of capacity of domestic institutions. Adopting this line of argument, Freeman (2013) finds that investor-state disputes are caused primarily by a lack of capacity to control corruption and supply adequate private property protection to investors. He therefore concludes that his findings lend empirical support to the managerial school's understanding of compliance. Of course, the relevance of bureaucratic capacity extends beyond the protection of property rights when it comes to explaining the causes of investor-state disputes. As discussed in the previous chapter, investor-state disputes arise in a wide range of issue areas, from environmental protection, to the granting of telecommunication licences, to financial regulation. Therefore, the state's lack of bureaucratic capacity may contribute to investor-state disputes not only due to its inability to secure the property rights of the investor, or

maintain open investment policies, but additionally due to its inability to effectively regulate the industry as a whole in which the investment takes place. The case study of the dispute between El Salvador and Pacific Rim, presented in Chapter 7, underscores point – in this case, the lack of bureaucratic capacity to effectively regulate the mining industry in El Salvador played a large part in the eventual decisions to take policy measures which triggered the dispute.

3.4 Conclusion

This chapter provides the theoretical framework for this project, and draws primarily on liberal IR theory to explain how domestic actors and institutions can influence foreign policy decisions – in this case the treatment of foreign investors, given the constraints imposed on states by IIAs. In the first section, I argue that economic globalization, underwritten by international treaties such as IIAs, can place states in the situation of having to choose between the demands of domestic actors, and those of international agreements. While the concept of compliance is perhaps less fruitfully applied to investor-state arbitration and IIAs than other international agreements, the logic underlying two important approach to explaining compliance – the enforcement approach and the managerial approach – provide a useful starting point for broad explanations of the causes of investor-state disputes, and more abstractly, the way states deal with the potential conflicting demands placed on them by domestic and international actors.

The enforcement approach to compliance, which argues that states only comply with agreements when it is in their interest to do so (and hence that deeper agreements require an enforcement mechanism to increase the costs of non-compliance relative to compliance), suggests that state actors actively decide whether to comply based on cost-benefit calculations. Applied to explanations of investor-state disputes, this implies that state actors decide to risk potential loss in an arbitration case based on the benefits they can accrue from acceding to the "anti-investment" demands of domestic actors. This in turn requires an analysis of the relevant domestic preferences, and the ways these are organized and impact state decision-making, in order to determine the domestic "causes" of investor-state disputes.

On the other hand, the managerial approach to compliance suggests that non-compliance with international agreements is the result of a lack of state capacity to comply, due, for example, to bureaucratic weaknesses or the ambiguity of treaty provisions. In the case of investor-state disputes, then, this would imply that taking measures which harm investors' interests are not the result of explicit cost-benefit calculations, but are inadvertent. This may also arise due to a lack

of awareness among policy-makers of the real costs associated with IIAs and investor-state arbitration, as was suggested may be the case (or at least may have been the case at the beginning of the arbitration boom beginning in the late 1990s), by work on bounded rationality and the decision by host states to enter into investment agreements.

Given the wide range of issues and states implicated in investor-state disputes, it is likely that these potentially competing explanations for the causes of investor-state disputes are not in fact mutually exclusive. In the next chapter I formulate more specific hypotheses about the role of domestic actors and institutions in increasing or decreasing the likelihood of investor-state disputes. These are roughly grouped according to the two broad explanations presented in this chapter, and draw additionally on more subject-specific literature on political risk and expropriation, and the determinants of FDI. These are subsequently tested statistically in Chapter 5.

Chapter 4 Domestic Institutions & Actor Preferences as Determinants of Investor-State Disputes

In Chapter 2, I provide an overview of the industries and states most often involved in investor-state arbitration; which policy measures are being challenged by investors; and which domestic institutions were most often implicated in these disputes. This allows us to identify some very broad patterns in the distribution of investor-state disputes across these categories. The goal of this chapter is to hypothesize the possible causal relationships underlying these patterns based on the theoretical framework presented in Chapter 3. While I focus here on specific variables which can be operationalized and tested in the next chapter by means of regression analysis, these hypotheses relate to the broader explanatory categories identified in the previous chapter – shifts in preferences toward FDI, state capacity, and exposure to the investment regime.

Very little work has looked specifically at the underlying causes of investor-state arbitration. Therefore, this chapter discusses a number of strands of literature which examine investor-state relations more generally in order to apply some of these insights to explanations of investor-state arbitration cases. This includes literature on the determinants of foreign direct investment inflows; factors contributing to political risk and the obsolescing bargain; and finally, studies which explain incidences of expropriation. What connects these three bodies of work is the implicit or explicit importance of policy stability.

The literature on the determinants of FDI focuses on the aspects of a state that make it an attractive host for investment. Most obviously, economic factors such as access to new markets or natural resources play a role in investors' decision making regarding where to make an investment. However domestic institutions and policies, and to a lesser extent, international investment agreements, play a role in attracting FDI as well; indeed, as I will discuss below, institutions which increase policy stability allow firms to take advantage of attractive economic opportunities presented by the host state, while policy instability and weak domestic institutions are unattractive to investors. This literature therefore highlights the importance of institutions in attracting investment and maintaining friendly investor-state relations. The arguments presented in this literature mirror those put forward by scholars who work on political risk, which I turn to in the next section.

Political risk, as opposed to economic risk, is a concept inherent to the understanding of investor-state disputes, as it is exactly this which IIAs are meant to decrease. It is therefore likely that domestic institutions and state behaviour that increase political risk will also be associated with an increase of cases of investor-state arbitration. Interestingly, while political instability and violence present the most obvious forms of political risk, work on the subject suggests that a much wider range of state behaviours and policy measures are considered by investors to increase risk significantly.

Finally, I draw on the literature which more specifically focuses on the causes of expropriation. These studies also examine domestic institutional factors which contribute to the likelihood that leaders will reverse their policy on foreign investment, and forcibly divest owners from their investments. Indeed, as we saw in Chapter 1, expropriations are at the heart of many investor-state disputes, and therefore, it seems plausible that many of the relationships identified in this literature will hold for explaining investor-state disputes that culminate in arbitration.

Going beyond a focus on institutions, I also discuss the role of domestic non- or sub-state actor preferences toward FDI in investor-state disputes. As I argue below, in the face of responsive domestic institutions, the preferences of both narrow and broad interest groups may have the ability to foment a shift in state preferences toward FDI. Therefore, I discuss a number of possible contributing factors to negative in domestic preferences toward investment, drawing in large part on the patterns presented in Chapter 2.

Additionally, as in Chapter 3, I also discuss a different approach to understanding the causes of investors-state disputes which focuses on state capacity. The literature discussed above adopts an explicitly rational choice approach to explaining the formulation of policies which negatively impact investors. Yet, as I discuss below, temporary economic crises, weak bureaucratic capacity and a lack of awareness of the investment protection regime may also engender investor-state disputes – despite the intentions of the state to maintain an investment-friendly environment.

While the literature on expropriation focuses on what is generally an undisputed factual event, the existence of an investment arbitration case again signals something rather different – namely that a measure was taken by a state that an investor has *subjectively* deemed objectionable. Therefore, I argue that an important additional determinant of investor-state arbitration is the investment protection regime itself. Namely, exposure to opportunities to be

sued by an investor – through the amount of investment hosted, investment treaties ratified, and the growing awareness of investors of the possibilities afforded to them by arbitration mechanisms – will increase the number of disputes and therefore must be controlled for.

In the following sections, hypotheses are formulated which will be put to the test in Chapter 5. These causal arguments can be operationalized with variables related to domestic preferences, domestic capacity, and features of the investment protection regime itself.

4.1 Determinants of Foreign Direct Investment

In this section, I briefly examine the determinants of FDI – the characteristics of host states which are associated with higher inflows of investment. These are indicative of what investors perceive as an investment-friendly environment and an examination of the factors which attract foreign investors is a useful starting point for this investigation. As will be discussed below, while economic factors such as market size and natural resources play an important role in investment decisions, investors rely on international agreements and strong domestic institutions to ensure they can reap the benefits of attractive economic conditions, and thus these political and legal factors can also be considered determinants of FDI.

Specific policies related to investment, political institutions, and economic conditions all play a role in attracting FDI, although with varying degrees of importance. Firms choose to invest abroad, according to Dunning, (2001) based on where they can enjoy ownership, internationalization, or locational advantages. Ownership advantages are those that foreign firms have over local businesses, such as intellectual property, while internalization advantages are those that incentivize a firm to engage in vertical integration rather than merely licensing foreign firms to produce a certain product. Finally, advantages, such as the presence of significant new markets, access to natural resources, or efficiency enhancing factors such as cheap and/or skilled labour, determine specific locational choices (Colen, Maertens and Swinnen, 2013).

Beyond the attractiveness of specific characteristics of a host state mentioned above, a set of policies must be in place which ensures foreign investors are able to take advantage of them. One way of indicating to investors that investment protection is a domestic priority is to sign international agreements to that affect – BITs and other IIAs are designed to help states make credible commitments regarding the protection of investors' rights. This commitment – that states will ensure an investment-friendly environment even after an investor has sunk significant

resources into their territory (see discussion of obsolescing bargain below) – may in turn increase investment in two ways. On the one hand, signing a BIT could increase dyadic FDI flows between the two parties to the treaty. On the other, signing BITs with important home countries can send a signal that a potential host state is making an effort to protect foreign investment, which may boost FDI generally (Rose-Ackerman and Tobin, 2011). However, the role of international commitments, including BITs and other IIAs, in encouraging investment remains a source of scholarly debate, with the body of work on the effectiveness of BITs in increasing FDI inflows characterized primarily by a lack of consensus (Aisbett, 2009; Kerner, 2009; Tobin & Rose-Ackerman, 2011); as was discussed at greater length in the introduction, the empirical evidence that IIAs do in fact increase inward FDI flows is quite inconclusive. Indeed, given the widespread adoption of BITs and other IIAs, creating, at least on paper, similarly investment-friendly environments, it is unsurprising that country-specific economic attributes remain of central importance to investors (Busse and Hefeker, 2005).

Other policy choices are made by states in an effort to attract FDI may relate to all businesses operating in the country, or specific sectors. For example, in the 1980s and 1990s, the World Bank and other global financial and development institutions encouraged developing countries to "modernize" their tax codes, for example by lowering mining royalties to attract FDI in the extractive sector (Emel & Huber, 2008). Other countries, particularly in East Asia and Latin America, have promoted their manufacturing industries by offering free trade zones in which companies can take advantage of cheaper labour sources without being subject to import and export taxes. These strategies make sense if locational factors are considered in a firm's investment decisions as outlined above – if these policies lower the cost of business, and capital is highly mobile, then it would follow that they would attract greater investment (Bellak & Leibrecht, 2005; Devereux, Lockwood, & Redoano, 2008; Olney, 2013). Other scholars however find no evidence that higher FDI flows are associated with less regulation. Instead, they argue, domestic political interests keep states from giving into the exigencies of the globalized market, and encourage states to maintain welfare and redistributive policies (Basinger & Hallerberg, 2004).

Whatever the impact of specific policies on FDI, the importance of policy stability for attracting investment is clear, and as "physical investment is partly irreversible, rational behaviour by the private sector calls for withholding investment until much of the residual

uncertainty regarding the success of the reforms is eliminated" (Rodrik, 1991, p. 231). When significant resources have been sunk into an investment, and policies relevant to the investment are changed, investors can lose considerable sums. It is therefore not surprising that the negative effect of policy uncertainty has been found to be stronger for firms that have a higher degree of investment irreversibility (Gulen & Ion, 2015).

Unfortunately for foreign investors, host states can be incentivized to make these kinds of policy changes which alter the investment environment. For example, it can be in the interest of states to impose windfall taxes or to remove subsidies once an investment has been made – particularly because it is difficult for the investor to withdraw its investment without incurring severe economic losses. This is the essence of the obsolescing bargain theory of company-state relations, which assumes that the balance of power between firms and states evolves over time (Eden, 1991). Prior to the entry of an MNE to a host country, the government is in a weaker bargaining position as it attempts to attract FDI, presumably at the expense of other competing countries, by offering investment incentives. However, once the investment has been made and is costly to withdraw, the balance of power shifts in favour of the state, which can then alter the policy framework in which the investment was made (Eden, 1991). Therefore, it may be that the major obstacle facing foreign investors is not high regulatory standards or taxes, so much as the uncertainty that the policies under which the investment was made will not subsequently be changed post-entry (Waelde & Kolo, 2001). This policy stability is in turn dependent on institutions that facilitate intertemporal agreements which ensure that "the political power of the incumbent is not abused… [and which] prevent the prevalence of policies that favour the dominant actor of the moment and ignore others" (Spiller, Stein, & Tommasi, 2008, p. 6).

Thus, domestic political institutions also play a role in attracting FDI by making it easier or more difficult for foreign firms to reap locational benefits, most importantly, by ensuring policy stability. This corresponds, unsurprisingly with the focus of the literature on the determinants of expropriation and political risk, which will be discussed below. Much of the academic literature that focuses on this issue examines whether autocratic or democratic countries play host to more FDI, and will be discussed at length in the next sections.

4.2 Defining Political Risk

While investments may become unprofitable due to changes in the economic climate, FDI is also vulnerable to political events, and it is to ensure against this that countries sign IIAs. According to Kobrin (1979), when we talk about political risk we are concerned with “the impact of events which are political in the sense that they arise from power or authority relationships and which affect (or have the potential to affect) the firm’s operations” (p. 71).

Risk may be categorized in a number of ways. For example, the impact of political events may be on a macro scale, where all FDI in a country is negatively affected, regardless of home country or sector. Alternatively, political processes may create “micro risk” where only particular firms or sectors feel an adverse impact from a political decision (Moosa, 2002). Additionally political events may impact either the firm’s ownership or its operations. In the case of the former, assets may be forcibly expropriated, while in the latter case measures are taken which constrain profitability without destroying the enterprise, for example through the levying of higher taxes (Kobrin, 1984).

Expropriation, the forced divestment of equity ownership (Li, 2005), has typically been the most highly visible manifestation of political risk. Expropriation was relatively common in the 1960s and early 1970s, as post-colonial states took control of foreign-owned businesses, especially in strategic industries such as oil, gas and mining, due in part to a political emphasis on independence; Kobrin (1984) argues that expropriation became a default for governments lacking the administrative sophistication to control foreign business through regulatory means. Expropriation became rarer in the 1980s, as the number of projects left available for expropriation declined, and managerial and administrative ability improved, allowing governments to exert influence over foreign investors by less direct means (Kobrin, 1984). The number of expropriations increased slightly in the 2000s, again primarily in the extractive industry, with leaders in Bolivia and Venezuela recently favouring widespread nationalizations. However, most expropriations today can be defined as indirect, or “creeping expropriations” where governments “use selective enforcement of laws to expropriate the assets or income streams of firms” (Jensen et al., 2013, p. 3).

Of course, while expropriation is the worst-case scenario facing foreign investors, firms can experience adverse effects from wide range of government actions and policies. For

example, in a survey of electricity and telecommunications firms, managers cited "decisions that altered the terms of contracts, the structure of the market or the firm's latitude to set prices or make new service offerings" as typical manifestations of risk (Henisz & Zelner, 2002). In another survey, managers of multinationals listed increased taxation, corruption and judicial uncertainty as the top three obstacles to doing business (Henisz & Zelner, 2002). Transfer risk, the inability to convert and transfer currency and thus repatriate profits, is also cited as a significant and common risk to foreign investors (Graham et al., 2012). These perceptions echo Kobrin's (1984) prescient argument that political risk would come primarily in the form of threats to operations, not ownership.

Kobrin further argued that the oft-cited problems of political instability and violence were not the biggest threats to FDI. While sudden regime changes may cause upheaval, they do not automatically imply the adoption of anti-FDI attitudes, as exemplified by the 1971 coup in Chile that replaced socialist President Allende with the pro-market Pinochet. In fact, he argues,

> Political instability and conflict are not necessary or even frequent prerequisites to constraints imposed on foreign firms as a result of changes in the political environment. Price controls, limitations on foreign ownership and employment, local content regulations, partial or complete expropriation, exchange and import controls, remittance restrictions and the like may result from the regular functioning of the political process owing to losses or gains in the regime's power or to changes in the character and power of the opposition or of interest groups (Kobrin, 1979, p. 39).

The concept of political risk then is inherently connected to policy change. The results of the aforementioned surveys of managers of multinationals emphasize that business interests can be threatened by a wide range of policy measures, including, but not limited to, outright expropriation of an investment. Kobrin (1979) argues that political risk is not manifest only in situations of conflict and instability, but is present in the "regular function of the political process" (p. 39). If this observation holds, political risk should not necessarily be greater in autocracies or unstable states than in democracies. However, as will be discussed in the next section, this is not the conclusion drawn in the bulk of the literature on regime type and FDI.

4.3 Domestic Institutions, FDI and Political Risk

In what follows, I develop the specific hypotheses which will be tested in the next chapter, based on an examination of literature on the relationship between domestic institutions, political risk and in particular, expropriation of foreign-owned investments.

Much of the literature on the role of domestic political institutions in attracting FDI focuses on differences between autocratic and democratic host countries. Some earlier work on the subject concluded that autocratic governments were better able to provide attractive investment conditions to multinationals given their insulation from public pressure. In short, these governments are able to keep wages low and offer better entry deals to MNCs, thus attracting more FDI (Jensen, 2003). On the other hand, the argument goes, democratic leaders may choose to support domestic business interests over foreign investors. Indeed, while the impact of FDI can be quite positive, the entry of foreign firms into a domestic market certainly can create local "losers" by introducing more efficient and competitive practices and pushing out local firms, or in cases such as large-scale extractive investments, render traditional livelihoods unsustainable due to land and water use of mining and oil operations. As a result, local communities or businesses may lobby the government for favourable (protectionist), policies (Acemoglu, 2008; Li & Resnick, 2003). In particular, Li and Resnick (2003) argue that while domestic businesses are able to influence both autocratic and democratic governments, in a democracy, "domestic interests that lose out to MNEs can resort to elections, campaign finance, interest groups, public protest and media exposure" to pressure the government to adopt more favourable policies (p.183). Therefore, the ability of autocratic governments to set investment-friendly policies such as tax breaks and subsidies, even at the expense of domestic interests, should attract more FDI to these host countries (Li & Resnick, 2003). However, the bulk of the recent literature on the subject, including statistical analyses, does not bear this argument out – democracy level is most often positively correlated with inward FDI flows (Freeman, 2013; Jensen, et al, 2012; Jensen, 2003; Li, 2005). Ultimately, the authors of these studies argue, democracies are better able to provide what is most important to investors: a transparent and stable policy environment.

One way in which democracies create an investment-friendly environment is through greater transparency. Given that they are routinely held accountable to voters, democracies are generally more transparent than authoritarian governments, which are often found to be less than open about market-relevant data, manipulating official statistics and forcing investors to rely on informal sources of information (Jensen, 2006). Moreover, a free press, generally a feature associated with democracies, allows foreign investors to better understand and predict government actions (Jensen, 2006). Finally, more transparent instruments to lobby government

officials are more likely to be found in democratic states, giving foreign investors a chance to engage directly with policymaking. While bribery may also provide a method to influence policy decisions in authoritarian states, corruption and FDI are statistically negatively correlated, suggesting that MNEs do not prefer this strategy (Wei, 1997). In fact, poorly functioning institutions and high levels of corruption raise the cost of doing business and therefore are generally correlated with lower levels of FDI (Colen, Maertens & Swinnen, 2013).

Democracies are further associated with the protection of property rights, which is intuitively of great importance to foreign investors. Again, early political theorists feared that democracy would threaten property rights as universal suffrage would empower the poor majority to vote for the redistribution of wealth (Knutsen, 2011). However, as the historical record makes clear, this fear was largely unjustified; neither in Europe and North America, nor in newly democratizing countries, has the advent of democracy been associated with large-scale expropriations (Knutsen, 2011). In fact, recent work finds that autocracies are more likely to expropriate and exhibit less respect for property rights in general. Therefore, investors channel FDI towards locals which exhibit "fundamental democratic rights, such as civil liberties and political rights" (Busse & Hefeker, 2005, p. 10). Therefore, I will test the hypothesis that

- *H: a state's democracy level will be negatively correlated with the likelihood of an investor-state dispute.*

The existence of higher numbers of "veto players" is often employed to explain democratic regimes' respect for property rights (Henisz & Mansfield, 2006; North & Weingast, 1989; Weymouth, 2010). Veto players are individuals or groups in a political system whose consent is necessary for a change to the status quo, and "as the number of veto players in a political system increases, policy stability increases" (Tsebelis, 2000, p. 446). In democracies, institutions such as the legislature and independent judiciaries serve to limit the ability of the executive to engage in opportunistic policymaking, thereby "making the government's commitment to private property credible, reducing expropriation risks for foreign investors, and attracting more FDI" (Li, 2005, p. 3). Effective veto players thus contribute to policy stability, and the ability of governments to make credible commitments. This in turn has been linked to economic growth (Fatás & Mihov, 2013), currency stability (Weymouth, 2010), and commercial openness (Henisz & Mansfield, 2006), as well as increased FDI flows. However, in a recent study, the presence of greater numbers of veto players was argued to significantly change the

type of risk faced by investors, but not do away with it altogether (Graham et al., 2012). Specifically, greater constraints on the executive decreased the likelihood of an expropriation, which, the authors argue, is a highly politically salient event signalling an overall lack of respect for property rights that can impact domestic voters as well as foreign investors. On the other hand, imposing restrictions on the repatriation of capital garners very little domestic public attention, and is thus an easier way for constrained governments to extract rents from foreign investors (Graham et al., 2012). Therefore, veto players may be associated with lower rates of expropriation, but not necessarily impede the government from taking measures that harm the interests of investors altogether. However, since the relationship between policy change and political constraints is generally considered to be negative,

- *H: The presence of greater numbers of veto players will be correlated with a decreased likelihood of investment arbitration.*

On the other hand, institutional features may instead make decision-makers more likely to respond to anti-investor sentiment. For example, while Tsebelis argues that the executive in presidential systems actually enjoys less control over congress, and is therefore, less able to unilaterally pass new laws than leaders in a parliamentary system, presidents often have a high degree of control over their ministries or secretaries (Heffernan, 2005; Verney, 1992). Moreover, presidents are generally directly elected by voters (as opposed to leaders in parliamentary systems, who are chosen by the party), and are thus likely to be more responsive to electoral pressures. As Wiesehomeier and Benoit (2009) note, specifically with reference to Latin American governments, presidents have a high degree of independence from their parties, and "may feel that the exigencies of leadership compel them to adopt a 'Burkean posture' of ignoring partisan mandates for the 'good of the nation'" (p.5). This may make presidents more likely to take unilateral measures against investors, especially when faced with public or special interest group pressure. The high number of investor-state disputes in Latin American countries, all of which are presidential systems, suggests this might be the case. Moreover, as was discussed in Chapter 2, the majority of measures taken which lead to an investor-state arbitration case are administrative not legislative, meaning the influence of the executive and ministries in these decision-making processes is an important factor in these disputes. Therefore,

- *H: States with presidential systems will be more likely to be involved in investor-state disputes.*

Thus, the ability of a state to ensure an investment-friendly policy, according to the veto player argument, is not reliant solely on a democratic system per se, but to the greater number of political constraints within democracies compared to autocracies. More generally, domestic institutions which contribute to policy stability should decrease the number of investor-state disputes in which the state is involved. However, while greater numbers of veto players make policy change less likely, both the status quo and possible policy changes depend also on the preferences of the relevant actors. It should not be assumed that domestic actors in a democracy will necessarily be pro-foreign investment, or have an interest in protecting certain projects. The interests of domestic constituencies will necessarily have an impact on a host country's treatment of foreign investors, as I discuss in the next section.

4.4 Foreign Investment and Domestic Preferences

In this section I argue that if domestic institutions are sensitive to popular discontent regarding FDI, this may result in policy changes that disadvantage investors. In a recent article, Pelc and Ureplainen (2015) come to a very different conclusion regarding the political nature of investment treaty breach. They claim that because governments are the only direct beneficiaries of expropriation, unlike when domestic producers lobby for trade protectionism, governments will not be pressured by domestic interest groups to violate an investment treaty. However, as I have repeatedly argued here, and they themselves admit, investment treaty breaches are not limited to outright expropriation, and instead encompass a wide range of policy measures, opening up space for the influence of non-state actors. Indeed, as I discuss below, the empirical overview of investor-state disputes provided in Chapter 2 suggests a number of "entry points" for domestic actors' preferences to have an impact on an investor-state dispute.

How can we identify shifts in domestic preferences? A change in government is one proxy indicator for such a change in domestic preferences. For example, Rosendorff and Smith (2014) find that changes in leadership that result from a shift in the underlying preferences of a leader's "support coalitions" increase the likelihood of initiation of a dispute at the WTO (see also: Mattes, et al., 2014). This implies that a change in policy following an election is due to the change in preferences of a leader's base of electoral support. Mattes, Leeds and Carroll (2014) conceptualize this base of support in democracies as "those who vote for or associate with the leader's party" (p. 19). In autocracies the source of leader support is rather the small groups – for

example the military – which "hold sway over policymaking" (p. 19). When these groups change, they argue, we are more likely to see policy changes in autocracies.

The same processes could quite easily be at work with regards to changes to domestic preferences towards FDI, and the subsequent initiation of investment arbitration. Similarly, Bonnitcha (2014) suggests that transitions between regimes, particularly the move from autocratic to democratic systems, may engender investor-state disputes. As mentioned above, the prediction of widespread redistribution of property alongside processes of democratization was not born out. However, if an authoritarian regime has relied on patronage or cronyism to support itself, a transition to democracy may require that previous deals in which foreign investors that were granted overly favourable terms be re-evaluated (Krajewski, 2013). In other words, the new regime may be faced with demands from domestic groups which alter the terms of an investment without resulting in expropriation.[19] Finally, and more generally, electoral pressure may encourage domestic leaders to take measures which are counter to investors' interests, to win the favour of key domestic constituents, in the lead up to a highly contested election. Therefore, to best capture these related, but slightly different dynamics, I put forward that

- *H: leader transitions will be positively correlated with the likelihood of an investor-state dispute.*[20]

This may also manifest itself in the election of governments who are ideologically opposed to FDI, or at least to investment which they do not believe significantly benefits the host state. Traditionally, leftist and nationalist governments have been more prone to expropriate, although recent literature finds an ambiguous effect of the presence left leaning governments on the likelihood of expropriation – being positive, but statistically insignificant (Li, 2005). More recently, Pinto (2013) has come to the opposite conclusion, finding that leftist governments in fact favour FDI as it increases domestic demand for labour. However, as I discuss below, Pinto appears to only consider the influence of FDI in manufacturing – not a sector in which investor-state disputes are concentrated. Indeed, ideological motivations appear to have a role in recent investor-state disputes, as Leftist governments such as Venezuela, Ecuador and Bolivia have

[19] As Bonnitcha (2014) notes, recent cases that challenge policy changes resulting from the Arab Spring in Egypt bear this out.

[20] While an increase in investor-state disputes is likely to come after a regime change, the relationship between an election and a dispute may be more complicated. For instance, a government which senses anti-FDI sentiment may attempt to leverage this during an election, and thus we would see a correlation in investor-state disputes and the lead-up to an election.

adopted a 'post-neoliberal' attitude towards foreign investment, which includes the renegotiation of public service agreements with private enterprises, and tax increases for foreign-owned mining companies. This is due to a "change in policy-maker perceptions regarding the opportunity costs of regulating foreign companies" which is part of a broader rejection of the Washington- consensus model in Latin America over the past decade (Haslam, 2009, p. 121). Indeed, the withdrawal from ICSID of Bolivia, Venezuela and Ecuador – ruled by leftist governments with (in the case of Bolivia and Ecuador) a strong support from indigenous social movements committed to an anti-neoliberal normative agenda – suggests that ideological motivations may have an effect on engagement with the investment regime, and echoes Rosendorff and Smith's (2014) argument regarding the impact of leadership changes on WTO disputes:

- *H: States with leftist governments will be more likely to be involved in investor-state disputes.*

The logic of this argument contradicts to some extent the role of democratic institutions in decreasing the likelihood of an investor-state dispute found in the literature on political risk and expropriation. However, recent work on investor-state disputes comes to similar conclusions. Increasingly, as Simmons (2013) notes, democratic governments are attempting to annul arbitration awards against them, and that these annulment attempts are concentrated in specific sectors – namely water, gas and electricity. This implies that investor-state disputes are being triggered by policies that have an impact on, and perhaps were taken at the behest of, broad domestic interest groups. Thus, while many variables discussed here are predicted to have a similar effect on the dependent variable as they do in studies on expropriation, the underlying causes, found in domestic preferences, may be different. For example the large number of investor-state disputes related to mining, oil and gas projects mirror the pattern of expropriations in the extractive industry. However, a number of these cases stem not from outright expropriation, but pressures on the government from domestic constituents concerned with environmental damage; the viability of traditional livelihoods; and the lack of economic benefits from these projects accruing at the local level. It would be a mistake to write off all investor-state disputes in this sector, therefore, as the result of opportunistic behaviour toward a vulnerable investment for which sunk costs are high and mobility is low. Thus, the impact of democracy level on the likelihood of investor-state disputes is likely to be more ambiguous than on

expropriation alone. This therefore suggests a competing hypothesis to that regarding a state's democracy level, stated above. It may be that democracies are more likely to be involved in investor-state disputes because their institutions are necessarily more sensitive to anti-FDI sentiment.

From this discussion it is clear that the preferences of domestic actors towards FDI cannot be assumed to be positive or negative, and may vary depending on the type of investment, industry. If policymakers are receptive to the pressure from anti-investment domestic interests, then they may be more likely to take a measure which is subsequently challenged by investors in arbitration. One way of determining whether this mechanism is functioning is the correlation between investor-state disputes and changes in government or even regime. However, it is not just the functioning of domestic institutions and the preferences of domestic actors which increase the likelihood of a dispute. The functioning of the investment protection regime itself, and the decision-making process with regard to specific investments, will also have an impact on the likelihood of a dispute. This will be discussed in section 4.6. However, I first briefly discuss the importance of two trends in investor-state disputes which was first presented in the qualitative coding of investor-state disputes presented in Chapter 2.

4.4.1 Controlling for Industry and Historical Legacy – The Concentration of Disputes in Strategic Industries and Transition States

This chapter focuses primarily on the domestic institutions which promote or reduce policy stability, thus in theory diminishing or increasing the likelihood of an investor-state dispute. However, as was discussed in the previous two chapters, there are patterns in the distribution of investor-state disputes that are fairly easy to "eyeball" and must be controlled for, when trying to determine the impact of domestic institutions on the likelihood of a dispute. As we saw in Chapter 2, investor-state disputes are concentrated in just a handful of industries – namely oil, gas and mining, and electricity and other energy.[21] These are generally considered "strategic" industries, which are often formerly state-owned. Of course, domestic businesses in these sectors may be affected by the entrance of foreign firms. As these industries are generally highly regulated and often include state-owned enterprises, there may be numerous government actors

[21] As one interviewee in El Salvador noted, the country has never had an investment dispute in a "normal" sector such as manufacturing, which is also highly internationalized in the country. Instead, disputes are concentrated in strategic sectors such as energy and extractives.

with an interest in these investments. Therefore, the most powerful stakeholders involved in these cases may be domestic competitors or government officials with an interest in extracting rents from foreign investors.

On the other hand, these industries often have a high degree of salience for broader interest groups and foreign investment in both has been highly contentious. Extractive industries, while often having a direct impact on those that live in the vicinity of the project, are also often negatively viewed by the population based on their perceived environmental impact, as well as the idea that mineral rights should remain in the hands of the state (Bebbington, et al., 2008). Investment in public services has the potential to have considerable distributional effects on citizens (Krajewski, 2013). Therefore, investors in these sectors are particularly likely to be faced with anti-investor sentiment, or at least changing preferences towards investment and the concentration of disputes in these areas is indicative of the impact of domestic stakeholders on investor-state disputes.

Investment projects which generate greater negative externalities, and thus are more likely to generate anti-FDI sentiment may be at greater risk of expropriation or other anti-investor measures. The most obvious example of this is investment in the extractive industries. The dependence of a country on resource rents is associated with a range of economic and governance problems, described together as the “resource curse” (Ross, 1999) and lead to lower levels of growth. While many governments offer generous incentives for investors,[22] they may reassess the wisdom of these contracts when rising mineral prices allow companies to make unanticipated profits (Hajzler, 2012). In particular, the effectiveness of the extractive industry as a driver of development is often a catalyst for significant public debate, especially with regards to windfall taxes and the perception of an unfair repatriation of profits on the part of foreign investors.[23] Extractive projects are also associated with higher levels of social conflict and the destruction of traditional livelihoods in nearby communities, to which the many mining company-community conflicts around the world attest (Davis & Franks, 2014; Haslam & Tanimoune, 2016) When these local pressures are combined with rising mineral prices, the

[22] For example, mining royalties as low as 1% in many Latin American countries.
[23] For example, the arbitration case Paushok et. al v. Mongolia was initiated after the country imposed a windfall tax on the gold mining company. This took place in the midst of a public debate about the role of mining in the domestic economy.

incentives for governments to renegotiate contracts to appease domestic interests are quite strong.

Foreign investment in utilities – water, electricity, gas, and sometimes telecommunications – is often quite contentious as well (Moosa, 2002). This may be the case in situations in which the privatization of formerly public services leads to foreign acquisitions of water, gas and electricity utilities. These privatisations can have distributional impacts, with "the biggest 'losers'…those disadvantaged customers who were subsidised under the old regime, but now often denied access" (Chang, 2004, p. 791). When the status quo is changed, voters may punish incumbents. Indeed, Post and Bril-Mascarenhas (2014) find that governments fear being saddled with the blame for removing a program that benefits voters, which leads them, in their example, to maintain inefficient subsidy programs. This work implies that voters are sensitive to changes in programs which affect their well-being, and that politicians are aware to this fact. In the case of investor-state disputes, if privatization leads to higher utilities prices, domestic actors may pressure governments to institute price controls or other measures which negatively affect an investment. This places governments in a situation of facing competing pressures, as IIAs and other agreements may restrict the ability of governments to enact policies such as administrative pricing which can mitigate the impact of privatization on customers (Krajewski, 2012).

Both extractive projects and utilities are also fairly vulnerable to expropriation for quite practical reasons. The sunk costs of an investment in mining or oil extraction are quite substantial, as the investor is quite literally tied to the ground in which the minerals exist. Therefore, it is relatively easy for a host government to take over an investment if they have the incentive to do so. Similarly, public utilities are often less technologically sophisticated projects than other investments, and simpler for local authorities to operate after a takeover (Colen and Guariso, 2013). Unsurprisingly, expropriations are concentrated in extractive industries and utilities, especially since the 1990s, when overall expropriations decreased. In fact, one study has found that while IIAs do not attract more FDI overall, they are associated with an increase in FDI in the extractive industry, perhaps as investors in extractives recognize their uniquely precarious situation (Colen & Guariso, 2013). Therefore,

- *H: the percentage of GDP which is comprised of fuel exports will be positively correlated with the likelihood of a dispute.*[24]

[24] Unfortunately, I have not been able to find sufficient data on utilities privatization to include this in my regressions.

The historical legacy of a state may contribute to its relations with foreign investors, shaping the preferences of the population towards FDI, as well as the policy framework which governs investment. The early scholarly focus on expropriation was due in large part to the effect of colonialism and subsequent independence on the propensity of a state to expropriate (Kobrin, 1984). However, other historical experiences may have an impact on investor-state relations. Transition economies – that is, formerly state-planned economies – are very frequently the respondents in arbitration case, which may be explained in part by the higher levels of corruption in a number of these countries.[25] However, they may also be more often faced with competing international and domestic pressures. For example, policies which have privatized formerly public services such as water, gas and electricity, have been met with resistance from populations who had previously enjoyed universal access (Krajewski, 2012). As Salacuse (2008) notes, the economic liberalization that was undertaken by most countries in the 1980s privileged investors' rights, which "may have led foreign investors to undertake their investment with high and perhaps unrealistic expectations about their importance to the country and their status in it" (p.23). The subsequent disappointment of these expectations, for example when privatization efforts meet domestic resistance to higher prices, may lead to more frequent investor-state disputes. Moreover, as Muchlinski (1996) notes with regard to the Czech Republic (and which can be said of a number of transition economies, at least in Europe) "a complex series of hitherto distinct regulatory fields – foreign investment, privatisation and competition – and the distinct levels of Czech national and European supranational laws, are coming together into an integrated web of standards" (p.659). This alone may create a situation in which investors are disadvantaged by regulatory confusion. A number of cases in which the respondent states argue that regulatory changes were made in order to comply with EU law suggest this possibility.[26] Therefore,

- *H: Transition countries are more likely to be involved in investor-state disputes.*

[25] The mean control of corruption score for countries in my dataset is -0.347 for transition economies and 0.086 for non-transition economies, with lower scores indicating higher levels of corruption.
[26] *Eastern Sugar v. Czech Republic; Electrabel S.A. v. Republic of Hungary* (ICSID Case No. ARB/07/19); *Mercuria Energy Group Limited (Mercuria) v Poland*; *Ioan Micula, Viorel Micula and others v. Romania* (ICSID Case No. ARB/05/20)

4.5 State Capacity and Investor-State Disputes

The previous sections have focused on domestic preferences toward FDI, and the ways in which domestic institutions can increase or decrease investor-state disputes. However, these hypotheses all assume an explicit cost-benefit approach to the policymaking leading to investor-state disputes, which may not reflect reality. As the managerial approach to explaining compliance with international agreements suggests, states may violate treaties because they do not have the capacity to comply (Chayes and Chayes, 1998). In the case of investment treaties, this implies not a deliberate change in policy due to pressure from domestic interest groups, but instead policy change that either inadvertently disadvantages investors or is taken under duress. A state may also fail to live up to its commitment to protect investors through a lack of capacity to act, rather than the enactment of a specific policy measure.

For example, economic crises may have an impact on foreign investors. The notable number of investor-state disputes that arose from the Argentine financial crisis clearly demonstrates that investors' interests can be threatened by deterioration in a host country's economic condition. On the other hand, Jensen et al. (2013) find that on the whole, economic crises lessen the likelihood of an expropriation event and increase market-friendly policies in general. This is due in part to greater host sensitivity regarding reputational damage during a crisis. Furthermore, economic crises make the host state more vulnerable to measures such as the suspension of bilateral or multilateral foreign aid, which could result from a turn toward less market-friendly practices. In this case, political actors external to the state act as a constraint on domestic policy towards foreign investors. Therefore, while there is no clear consensus at this stage, I will test the hypothesis that,

- *H: States in the midst of a financial crisis will be more likely to engage in an investor-state dispute.*

However, capacity relates not only to temporary changes to a state's circumstances, but to the ability of domestic institutions to maintain an investment-friendly environment. For example, Freeman (2013), finds that a state's institutional capacity to protect investors' rights is a strong determinant of investor-state disputes. Specifically, he finds that measures which indicate a control of corruption and a strong rule of law are negatively correlated with the likelihood of an investor-state dispute. Therefore, I will also test the hypothesis that

- *H: state capacity to control corruption will be negatively correlated with the likelihood of a dispute.*

More generally, an institutional awareness of IIAs and state commitments to attract investors' rights, may be linked to institutional capacity, and have an impact on the likelihood of an investor-state dispute. As was discussed above, the purpose of IIAs is often interpreted to be increasing the ability of states to make credible commitments to protect foreign investment (Bonnitcha, 2014). However, the effectiveness of these agreements (or, from a more critical point of view, the likelihood that they create regulatory chill) depends on policy-makers' awareness of the provisions of the agreement and the ability to incorporate this into the policy-making process. Aisbett and Poulsen's (2013) recent survey of BIT negotiators and other relevant stakeholders casts some doubt on whether IIAs have an impact on domestic policymaking prior to the initiation of an arbitration case by an investor, as awareness of these agreements among relevant actors in host states was found to be very low. Instead, their research suggests that IIAs were negotiated without full knowledge of the implications of the treaty on the part of the negotiators (generally officials from foreign affairs and trade offices) let alone the civil servants in the array of ministries and agencies which are often involved in investor-state disputes. In a similar study, it was found that Canadian policymakers in a variety of fields do not routinely consider IIA obligations when formulating new policies (Côté, 2014). However, this may change over time; as states face more arbitration cases and become more familiar with the implications of the agreements, they should be able to make more calculated decisions in the face of competing domestic and investor demands. On the other hand, states that have faced few or no arbitral claims (and/or have very weak administrative capacity) may unknowingly take measures which have the potential to trigger investor-state disputes.[27] Of course, this assertion requires the caveat that it will always be difficult for state actors to predict whether taking a policy measure will result in an investor-state dispute. It likely quite challenging for states to predict when an investor will choose to send a notice of intent to arbitrate and then follow through with the arbitration process, as a number of factors on the "investor side of the equation" may have an impact on their choice to do so. However, it is possible that past arbitration experience may enable a state to better predict what measures will be negatively viewed by investors:

---

[27] This pattern can be seen on a more macro level as some states that have faced a large number of arbitration claims withdraw from ICSID and terminate their BITs. On the other hand, institutional learning may be hampered with high bureaucratic turnover, a problem in many developing countries (Poulsen, 2015).

- *H: state awareness of the regime may decrease the likelihood of an investor-state dispute, as procedures are put into place to ensure that new policies comply with provisions in IIAs.*

Similarly, a strong bureaucracy and legal counsel should help governments take into account their commitments to international investors when developing new policies, and thus avoid conflicts with investors.[28] Therefore,

- *H: government effectiveness will be correlated with a lower likelihood of investor-state disputes.*

4.6 Exposure to the IIA Regime and Investor-State Disputes

Finally, investor-state arbitration cannot take place without the legal regime that makes it arbitration possible and investors willing to use it. While investor-state arbitration was uncommon before the mid-1990s, its use has grown quickly in the past twenty years, and investors' awareness of the possibilities afforded to them by the IIA regime likely has an impact on the number of investor-state arbitration cases. Freeman assumes that "investors will want to resolve their disputes with host governments without having to resort to arbitration if possible" (Freeman, 2013, p. 58). It is not clear that this assumption is correct. As Simmons notes, "one consequence of ratifying bilateral investment treaties that contain dispute settlement provisions seems quite clear: they have led to a burst of (possibly unanticipated) litigation" (Simmons, 2013, p. 28). Moreover, as was discussed in the introduction, the incentives for some actors within the arbitration system promotes its use; indeed,

> as a result of its growth, various factors have developed that encourage recourse to this form of dispute settlement process. In a sense, these factors are a result of the growth in international arbitration, but they may also be a cause for increased recourse [to it] (Salacuse, 2008, p.123).

Salacuse's observation is supported by the publications of law firms which promote the new "innovative" uses of arbitration that allow investors to, in the words of one such publication, challenge "government policies or practices in fields that historically have not been the subject of BIT jurisprudence" including anti-tobacco legislation (Nelson et al., 2013). The likelihood of an investor-state dispute may simply increase over time, as investors become more aware of the possibilities presented by IIAs, and law firms specializing in investment arbitration become more numerous and interested in promoting its use. Therefore, as time goes on and the awareness of

[28] Some states are trying to combat policy-making patterns that lead to investor-state disputes by setting up institutions such as Peru's Coordination and Response System for International Investment Disputes.

the IIA regime and the uses of arbitration increases, disputes may increase as investors turn more often to arbitration, suggesting a competing driver of disputes, perhaps lessening the effect of state awareness of the regime over time, that

- *H: investor awareness over time will increase the likelihood of a dispute.*

Finally, the state must be exposed to opportunities to be sued, and therefore it is likely that the number of IIAs signed and the amount of inward investment itself are determinants of investor-state disputes, as both increase the exposure of states to the regime. Therefore,

- *H: factors that increase a state's exposure to opportunities to be sued, including the amount of investment hosted by the state, and the number of treaties ratified, all increase the likelihood of a dispute.*

4.7 Conclusion: The Causes of Investor-State Disputes under the IIA Regime

In this chapter I have concentrated on the different variables identified in the literature which contribute to an FDI-friendly environment, or conversely, to political risk. What is common to almost all investor-state disputes, from those precipitated by expropriations to those in which an investor challenges a legislative measure, is a change in attitude toward foreign investment generally, or more often, a specific project. Therefore, in this discussion I have endeavoured to focus on indicators that may be associated with, facilitate, or impede the expression of change in preferences towards FDI.

Most of the work cited here that employs statistical analysis to examine the impact of various factors on political risk uses expropriation events as the dependent variable. Given that IIAs were intended to protect investors from exactly this type of risk, I assume that to some extent the factors that contribute to a government's propensity to expropriate will also increase the likelihood of an investor-state dispute. However, investor-state disputes that go to arbitration are triggered by a much more diverse range of measures than outright expropriation alone. Therefore, both the states involved, and the causes of the disputes, may also be somewhat different, as we have already seen in Chapter 2.

As the above discussion indicates, policy stability is inherently tied to domestic political institutions, with strong institutions encouraging leaders to respect intertemporal agreements. As democracies are associated with stronger checks and balances within the political system, as well as greater transparency, these countries should be better able to provide policy stability and predictability. The assumption is often made in the literature that policy makers in democratic

countries are more likely to respect agreements with foreign actors, and that they are held to these commitments by an audience of voters who both favour investment and compliance with international agreement (Jensen, 2003). However, the above discussion on domestic preferences and FDI (as well as the more theoretical discussion in the previous chapter) problematizes this assumption – there are a number of situations in which domestic preferences may not be in favour of protecting foreign investment. Indeed, both democratic and autocratic leaders depend (though in different ways) on their domestic bases of support, and regime type does not ensure that these domestic actors will have preferences which favour foreign investors. Thus, changing economic and political circumstances may make a government unable or unwilling to respect investors' rights. Moreover, while policy stability undoubtedly is preferred by foreign investors, policy changes are often enacted in the face of domestic pressure and therefore, to paraphrase: one man's policy stability may be another man's unresponsive government.

Indeed, the difference in dependent variables between this study, and those which focus solely on expropriation, requires a different normative evaluation, of policy change. Understandably, the bulk of the relevant literature conceives of expropriation as a fairly unequivocal bad – something to be avoided through strong institutions, credible commitments, and the rule of law. However, as discussed in Chapter 2, expropriations are merely a subset of investor-state disputes, which may be triggered by a much wider range of measures; therefore, the fact of an investment arbitration case has a much more ambiguous meaning. Indeed, not all policy changes which negatively impact an investment are necessarily rent-seeking or discriminatory measures, taken at the behest of narrow interests. As we can see in both the categories of policy measures in Chapter 2, as well as the case studies presented in Chapters 6-8, while policies may create losers in the form of foreign investors, they may at the same time be taken for a variety of reasons for which we may or may not find normative support. This raises the issue of the tension between democratic institutions and investor-state disputes which is highlighted both by the results of the statistical analysis and the case studies. While the literature on the determinants of expropriation and protection of investors' rights generally concludes that democratic institutions decrease the likelihood of expropriation, the relationship between democratic institutions and investor-state arbitration is less obvious. Given that democratic institutions may also be more sensitive to anti-investment sentiment of domestic constituencies,

and the wide range of measures which can trigger an investor-state dispute, it appears that the relationship between the two is more ambiguous than has often been assumed.

On the other hand, there may be situations in which the state is unable to maintain an investment-friendly environment, or respect commitments previously made to investors. For example, as Argentina's experience demonstrates, states may breach IIAs when in the midst of a severe financial crisis. Weak domestic institutions may also increase investor-state disputes if control of corruption is low, or perhaps more commonly, there is simply a lack of awareness among different ministries or agencies of commitments made to foreign investors or the possibility of arbitration itself. This points to a different underlying cause of investor-state arbitration – namely, lack of state capacity.

Finally, as discussed above, awareness of, and vested interest in, the investment protection regime itself may be the driver of some disputes. As investors become more aware of the existence of IIAs, and investment lawyers become more interested in promoting the use of arbitration, investors may more commonly resort to arbitration rather than other means of solving a dispute with a host state. Of course, this depends on the state's exposure to the regime, via amount of investment hosted, and IIAs ratified. Therefore, a combination of investor awareness of, and state exposure to, the investment protection regime will likely increase the number of arbitration cases.

In the following chapter, these hypotheses will be put to the test with a statistical study using a dataset of investor-state disputes from 1990-2013.

Chapter 5 The Determinants of Investor-State Arbitration

The previous chapter has formulated a number of hypotheses regarding variables which contribute to the likelihood of investor-state arbitration cases. This chapter provides an empirical test of those hypotheses. These are grouped into three categories which correspond to the broader underlying causes identified in the introduction: those related to state exposure to the investment protection regime; those related to state capacity; and those related to domestic institutions and changing preferences toward FDI, as well, as a full model which includes all the variables. Additionally, building on the discussion in Chapter 2, I present a regression with regional dummies in order to provide a more in-depth look at the distribution of arbitration cases geographically.

5.1 The Dataset

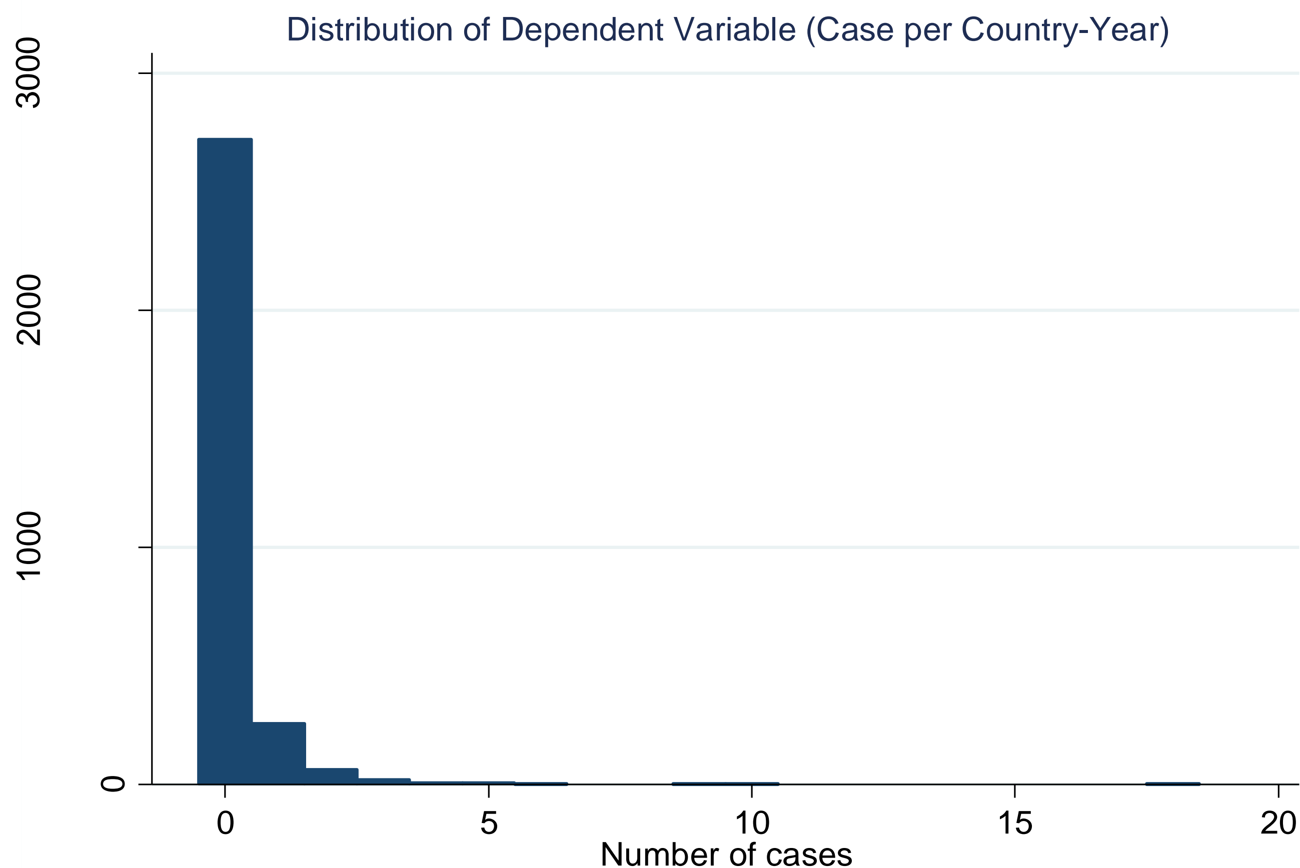
The analysis carried out in this chapter is based on an original dataset of investor-state disputes from 1990-2013. Information on the disputes was gathered from a number of sources which compile information and documents relating to investor-disputes, including the UNCTAD IIA database; the ICSID lists of pending and concluded cases; Andrew Newcombe's ITALaw website; and the Investment Arbitration Reporter service. Included in the dataset are 144 states – all countries that have signed and ratified at least one IIA, as these states have, at least in theory, the opportunity to act as a host state for investment covered by an agreement, and subsequently be taken by an investor to arbitration. A list of these countries can be found in Appendix I.[29]

5.2 The Dependent Variable and Model Choice

The incidence of an arbitration case or cases in a given country-year serves as the dependent variable, and the dataset includes 564 arbitration cases[30] hosted by ICSID, UNCITRAL and other forums such as the International Chamber of Commerce and Stockholm Chamber of Commerce. The year in which the case takes place was determined as the year the case was registered at the respective arbitral forum. Figure 5.1 gives the distribution of the dependent variable.

[29] A few smaller states that have signed an IIA have been excluded due to lack of data for the variables of interest.
[30] The statistical database does not include cases from 2014, given the delay in generating data for the relevant independent variables. Therefore, the number of cases here is different from Chapter 1, which includes 2014 cases.

Figure 5.1Distribution of Dependent Variable



The dependent variable can be measured as a count variable that ranges from 0 to 18 cases in a given country-year. Alternatively, the dependent variable can be expressed by a binary variable, which is 1 when there is at least one case in a given year, and 0 otherwise.

Such a data structure points to a number of possible regression models to choose from. As is often the case with discrete response variables, the data is characterised by over-dispersion – in other words, the variance of the dependent variable greatly exceeds the mean – and there are relatively few positive outcomes on the dependent variable. Therefore, it could be advisable to use a zero-inflated negative binomial model (ZINB). A ZINB model assumes that some variable is inflating the number of observed zeroes; in this case, some countries will always face a negligible risk of arbitration every year, while other countries are more likely to be involved in an investor-state dispute. The first process modeled by the ZINB is a logistic regression to

determine whether the state faces a risk of dispute at all, while the second stage models a count model (NBREG) accounts for the positive number of disputes.[31]

The challenge with a ZINB model is to find a theoretically satisfying variable that accounts for these excess zeroes. In a similar study, Freeman (2013) uses a dummy variable indicating that a country has signed at least one investment treaty in his ZINB model. However, I do not believe this adequately captures the process at work generating these "excess zeroes."[32] The number of treaties ratified may perhaps increase the chances a country has to be faced with arbitration, and therefore a variable indicating the number of treaties signed could be used in the inflation equation. However, among the countries that have signed the most investment treaties are traditional home countries such as Germany, Switzerland and the Netherlands. Therefore, this seems to misrepresent the relationship between number of treaties signed and likelihood of being involved in investor-state arbitration as a host country. One solution could be to create a variable which indicates whether a state is traditionally a "home" or "host" for foreign investment, for example, the amount of inward FDI that is covered by an investment treaty. However, there is not sufficient data for the country-years covered by this dataset to allow for this. Moreover, using a ZINB model is restrictive, in that it does not allow for lags or leads on the independent variables, nor does it support a panel structure.

Therefore, I opt here to use population averaged panel logistic regression, changing the dependent variable to a dummy, indicating whether or not the state has faced one arbitration case in a given year. This decision is based on my assumptions about what I am trying to capture with this model: the underlying factors which contribute to shifting state preferences toward (an) investment. Based on my analysis of the cases, out of the 564 investor-state disputes included in this dataset, 160 (or 28 per cent) are due to the same state measure (and take place in the same year as at least one other case). Other disputes may be explained by more general processes, such as the numerous expropriations and nationalizations taking place in Bolivia, Ecuador and Venezuela, even if they are individually triggered by different state measures. Therefore, the binary dependent variable (rather than a count) may better reflect the state behaviour, which is ultimately what this project is trying to explain, while the count model might better capture the

[31] For a similar use of the ZINB model, see Copelovitch and Pevehouse (2012).

[32] Moreover, it does not make sense to include countries that have not signed an IIA in a database of investor-state disputes, as these countries necessarily will not be involved in an investor-state dispute. However, there are many countries that have signed significant numbers of treaties and not been a respondent in arbitration. Therefore, choosing this variable tells us little about the process generating excess zeroes.

factors which lead investors to turn to arbitration. However, as a robustness check, I include output from the NBREG models in the appendix.

5.3 Explanatory Variables

The independent variables are presented in the following table.

Table 5.1Independent Variables

Category	Hypotheses	Indicator	Hypothesized Effect	Source
Exposure	H_1: factors that increase a state's exposure to opportunities to be sued, including the amount of investment hosted by the state, and the number of treaties ratified, all increase the likelihood of a dispute.	FDI Stock	Positive	World Bank Development Indicators
		Number of Treaties Ratified	Positive	Own collection
	H_2: investor awareness over time will increase the likelihood of a dispute.	Time	Positive	-
Capacity	H_3: States in the midst of a financial crisis will be more likely to engage in an investor-state dispute.	GDP Growth	Ambiguous	World Bank Development Indicators
		Economic Crisis	Ambiguous	(Reinhart and Rogoff, 2010)
	H_4: government effectiveness will be correlated with a lower likelihood of investor-state disputes.	Control of Corruption/Government Effectiveness[33]	Negative	World Bank Governance Indicators
		Political Stability	Negative	World Bank Governance Indicators
		GDP per Capita	Negative	World Bank Development Indicators
	H_5: state awareness of the regime may decrease the likelihood of an investor-state dispute, as procedures are put into place to ensure that new policies comply with provisions in IIAs.	Cumulative Cases faced by state	Negative	Own data collection

[33] Although these variables are measuring different things, they are so highly correlated I have just used the control of corruption variable here.

Institutions and Preferences	H_6: a state's democracy level will be negatively correlated with the likelihood of an investor-state dispute	Level of Democracy	Negative	Polity Score
	H_7: The presence of greater numbers of veto players will be correlated with a decreased likelihood of investment arbitration.	Veto Players	Negative	Political Constraints Index (Henisz, 2005)
	H_8: States with presidential systems will be more likely to be involved in investor-state disputes	Presidential System	Positive	Database of Political Institutions (Beck, et al, 2000)
	H_9: States with leftist governments will be more likely to be involved in investor-state disputes	Leftist Incumbent	Positive	Database of Political Institutions (Keefer and Walsh, 2001)
	H_{10}: Transition countries are more likely to be involved in investor-state disputes.	Transition Country	Positive	Formerly State-Planned Economies
	H_{11}: leader transitions will be positively correlated with the likelihood of an investor-state dispute.	Leader Transition (lead and lag)	Positive	Change of Source of Leader Support (Leeds et al, 2012)
		Change in Source of Leader Support (lead and lag)	Positive	Change of Source of Leader Support (Leeds et al, 2012)
	H_{12}: the percentage of GDP which is comprised of fuel exports will be positively correlated with the likelihood of a dispute.	Extractives (combined oil, gas and minerals rents)	Positive	World Bank Governance Indicators

As was mentioned above, these variables are grouped into three categories, which relate broadly to different explanations of the causes of investor-state disputes. Additionally I include regional dummies.

The regional dummies were originally to be included as control variables. However their inclusion does not have a significant effect on the explanatory variables of interest. However, some regions have a consistently significant, positive or negative correlation with the dependent variable, and are substantively interesting. The dummies represent regions based primarily on the World Bank's definitions, with some small differences. I group Canada, Mexico and the United States together in NAFTA, instead of putting Mexico in the Latin America and Caribbean category. Following the IMF, I include Georgia in the Commonwealth of Independent States (CIS) category. The full list of countries in their regional grouping can be found in the Appendix.

The variables in the first substantive category relate to the state's exposure to the investment regime, and thus opportunities to be taken to arbitration, and test hypotheses 1 and 2. The first is amount of FDI stock hosted by the state ($US). The second is the number of IIAs (BITs and FTAs with investment chapters, as well as the ECT) that the state has ratified. Finally, I include time as a variable related to exposure, to account for the growing awareness of IIAs on the part of investors.

The variables in the capacity category relate to the institutional capacity of the state, as well as temporal issues which may affect the state's ability to respect IIAs, and test hypotheses 3-5. GDP per capita is generally considered to be positively related to good governance or bureaucratic effectiveness (Kaufmann & Kraay, 2003) and is positively correlated with the government effectiveness indicator. I also include a squared term to account for a possible curvilinear relationship between income and investor-state disputes. The control of corruption and political stability variables taken from the World Bank's Governance Indicators, capture, the perception of the extent to which the state is captured by elite or private interests, and the likelihood that the state will be destabilized or overthrown by unconstitutional means (Kaufmann and Kraay 2003).The economic crisis variable is dummy, taken from Reinhart and Rogoff's (2010) dataset of banking and domestic and external debt crises. Finally, the cumulative cases variable is a running total of the number of cases faced by each state. In theory, this could suggest a level of awareness in the government of the possibility of investment arbitration; the more cases a country has faced, the greater understanding of IIAs it will have. If a state is interested in avoiding disputes with investors, therefore, it could use this information to avoid further disputes.[34]

The final category relates to domestic institutions and preferences, which may have an impact on government treatment of foreign investment, and test hypotheses 6-13. These variables are drawn from the discussion on political risk and domestic institutions/preferences presented in the previous chapter. The Polity score measures a state's level of democracy, based on the presence of "institutions and procedures through which citizens can express effective preferences about alternative policies and leaders"; institutionalized constraints on the executive; and guaranteed civil liberties (Marshall & Gurr, 2013, p. 14). The president variable is simply a dummy indicating whether or not a country has a presidential system of government. The veto

[34] Of course, this analysis is, as mentioned in Chapter 2, limited to only known cases.

players indicator is represented by the political constraints index (POLCONV) created by Henisz (2013). This indicator measures “the number of independent veto points over policy outcomes and the distribution of preferences of the actors that inhabit them” (Henisz, 2013). These veto points include the upper and lower houses of the legislature, sub-federal units and the judiciary. The transition country indicator is also a dummy, indicating whether a country was a formerly planned economy. These include the ex-Soviet republics, Eastern Europe, and Cambodia, Laos, China and Vietnam. The leader transition variable is taken from the Change in Source of Leadership Support (CHISOLS) project and indicates a year in which a new leader comes to power that has either the same or different societal support base as the previous leader (Mattes et al., 2014).[35] The leader transition dummy is included with both a lead and a lag, as a dispute could conceivably be more likely either before or after a leader transition. In the first case, a leader may take certain measures to win the support of voters in the run up to an election, while in the latter a leader may be fulfilling promises made to the electorate vis-à-vis a specific investment project or FDI more generally. The leftist incumbent is a dummy variable which is positive when the ruling party is identified with a left wing political ideology, and is taken from the World Bank Political Institutions database.

Finally, I include a lagged dependent variable in all the models. This is because, as Simmons (2013) notes, investor-state disputes often come in groups, “whether this represents a piling on of investors, or the widespread consequences of particular government policies” (p. 30). Either way, it seems likely that the incidence of a case in a previous year will be strongly correlated with the incidence of a case in the current year.

For ease of interpretation, I display the odds ratios rather than the coefficients in the regression tables below. The odds ratio of a logistic regression presents the odds of a “success” (i.e. a 1 on the dependent variable) with a one unit change in the independent variable. The results of odds ratios are always positive; therefore, a coefficient of 1.8 odds ratio means a positive result is 80 percent more likely while a 0.80 coefficient means a positive result is 20 percent less likely.

[35] The leader transition variable includes the SOLS variable which indicates transition only with an underlying change in societal support. In both the NBREG and Logit models, with both a lead and a lag, the SOLS variable on its own was not significant, so I have only included the leader transition variable here.

5.4 Results

In this section I present the results from the models based on the groupings of variables discussed above. In each section I am not testing these groups of variables against each other in the same model, as the explanations for the causes of investor-state disputes are not mutually exclusive. Instead I am interested in the effect of specific variables within their own category of explanation. I present a full model in the appendix as well as the models without the lagged dependent variable.

5.4.1 Regions and Special Cases

Table 5.2 presents the results of the logistic regressions using the regional dummies. Subsequently, the number of ratified IIAs and amount of FDI stock hosted are added as explanatory variables.

Table 5.2Regional Dummies

VARIABLES	(1) case	(2) case	(3) case
Treaties		1.046***	1.040***
		(0.00505)	(0.00649)
FDI Stock			1.079
			(0.0604)
CIS	3.347**	2.382**	2.237*
	(1.984)	(0.841)	(1.023)
Latin America	2.672	2.859***	2.987***
	(1.608)	(0.999)	(1.075)
W. Europe	0.419	0.0361***	0.0313***
	(0.281)	(0.0249)	(0.0246)
NAFTA	12.79***	10.52***	7.231***
	(7.009)	(3.540)	(3.071)
E. & S.E. Asia	1.066	0.349	0.275*
	(0.639)	(0.234)	(0.196)
MENA	1.529	1.076	0.966
	(0.964)	(0.367)	(0.372)
Sub. Africa	0.558	0.975	0.936
	(0.332)	(0.340)	(0.357)
S. Asia	1.788	1.442	1.372
	(1.147)	(0.563)	(0.577)
E. Europe	3.621**	1.297	1.345
	(2.038)	(0.397)	(0.469)
Constant	0.0787***	0.0378***	0.0236***
	(0.0426)	(0.00973)	(0.0126)
Observations	3,083	2,935	2,620
# of iso3n	144	143	136

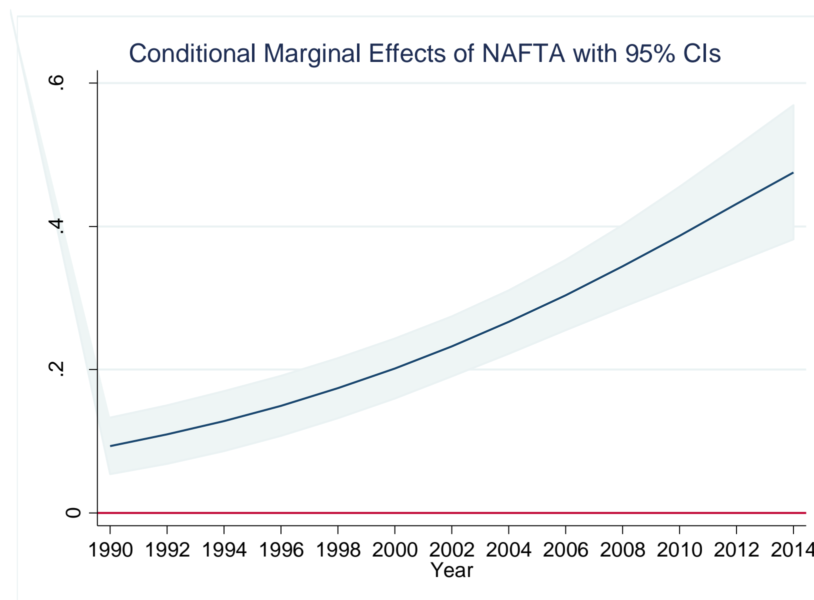
Robust seeform in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Given what we already know about the distribution of arbitration cases from Chapter 2, the results in Table 5.2 are unsurprising. Although the Middle East and North Africa (MENA), Sub-Saharan Africa and South Asia dummies do not have a statistically significant effect on the outcome variable, the direction of the odds ratio is as expected. However, with the inclusion of the number of ratified IIAs and FDI stock hosted, we get a better sense of the degree to which the distribution of cases is driven solely by how much investment different regions attract or how many IIAs they have in force, which therefore sheds light on the "exposure" hypotheses. For example, when the amount of FDI hosted and the number of ratified treaties are not included, the odds of a Western European state being the respondent in an arbitration case are 60% lower than that of a non-Western European state. However, once the positive correlation between the dependent variable and an increase in IIAs ratified and FDI stock hosted is controlled for, the odds that Western European states will be involved in arbitration are 97% lower than a non-Western European country. Similarly, the East and South-East Asian dummy is positively (although insignificantly) correlated with positive outcome on the dependent variable when FDI stock and IIAs are not included in the model; this changes to a negative correlation (which is weakly statistically significant) when these variables are included. The relationship is the same, although in the opposite direction, with the Eastern Europe dummy, suggesting in this case that the greater odds of an Eastern European country becoming involved in an arbitration case is due to some extent to the greater number of treaties signed. On the other hand, Latin American countries have much greater odds of being involved in arbitration, and this goes up to almost three times higher than non-Latin American states when stock and treaties are controlled for, suggesting that in these cases "exposure" to the regime is not what is driving disputes.

Clearly, however, it is the signatories of NAFTA which have the highest odds of becoming involved in an investor-state dispute that goes to arbitration, even when the large amounts of intra-NAFTA FDI are accounted for. Although difficult to say definitively, I assume that the high numbers of NAFTA cases are due in large part to the levels of awareness, or the normalization of the use of the dispute settlement mechanism, among North American investors. Therefore, this lends support to the hypotheses that both increased investor awareness and investment treaties will be correlated with the greater likelihood of a dispute. Lending some credibility to this assertion is the fact that, as can be seen in Figure 5.1, the marginal effect of

NAFTA on the likelihood of a case increases significantly over time, and the practice of investor-state dispute settlement becomes more widespread. Both the marginal effect of NAFTA and the magnitude of the odds ratio is significantly larger than that of the variable indicating the total number of ratified investment treaties, as can be seen in the following section.

Figure 5.2Marginal Effect of NAFTA



The results presented here raise the issue of special cases in the universe of investment arbitration, discussed briefly in Chapter 2. The most obvious is the case of Argentina, with its explosion of arbitration cases following the financial crisis. Venezuela is also an outlier, with its numerous expropriations under the Chávez regime. However, the exclusion of Venezuela and Argentina from the regression does not significantly alter the effect of the Latin America dummy on odds of a country being involved in a dispute. Therefore, it is not only these outlier countries that are behind the higher odds of Latin American countries being involved in arbitration.

5.4.2 Exposure

Table 5.3 presents the results of the models using the variables I have identified as indicative of a state's exposure to the IIA regime. The first, as stated in H_1 is simply time, as a proxy for increased awareness of investment arbitration on the part of investors and investment lawyers. As investor awareness of IIAs grows; as arbitration becomes normalized; and as investment lawyers promote the use of the mechanism, the odds of a state being involved in arbitration

should increase. The other two variables, included in H_2 relate more directly to the opportunities a state has to be sued – the more treaties the state ratifies and the more investment it hosts, the greater the odds that there will be an opportunity for an investor bring the state to arbitration.

As can be seen in Table 5.3, the variables of interest have a significant effect in the hypothesized direction. As predicted by H_1, with each additional IIA ratified, there is a 2.5% increase in the odds a state will be sued in the first model, and 1.2% in the fourth model when the amount of FDI stock hosted by the country and the year are added. When only logged FDI stock is included, an increase in one unit of FDI increases the odds of arbitration by 19%, while this effect becomes insignificant when the number of treaties is also included in the model.

Table 5.3Exposure

	(1)	(2)	(3)	(4)
VARIABLES	case	case	case	case
Lagged DV	3.008***	3.236***	2.612***	2.492***
	(0.588)	(0.633)	(0.477)	(0.493)
Treaties	1.025***			1.012**
	(0.00406)			(0.00541)
FDI Stock		1.189***		1.026
		(0.0485)		(0.0486)
Time			1.335***	1.269***
			(0.0744)	(0.0731)
$Time^2$			0.994***	0.995***
			(0.00181)	(0.00189)
Constant	0.0617***	0.0234***	0.00728***	0.00765***
	(0.00771)	(0.00867)	(0.00299)	(0.00388)
Observations	2,935	2,620	2,937	2,620
# of iso3n	143	136	144	136

Robust seeform in parentheses
*** p<0.01, ** p<0.05, * p<0.1

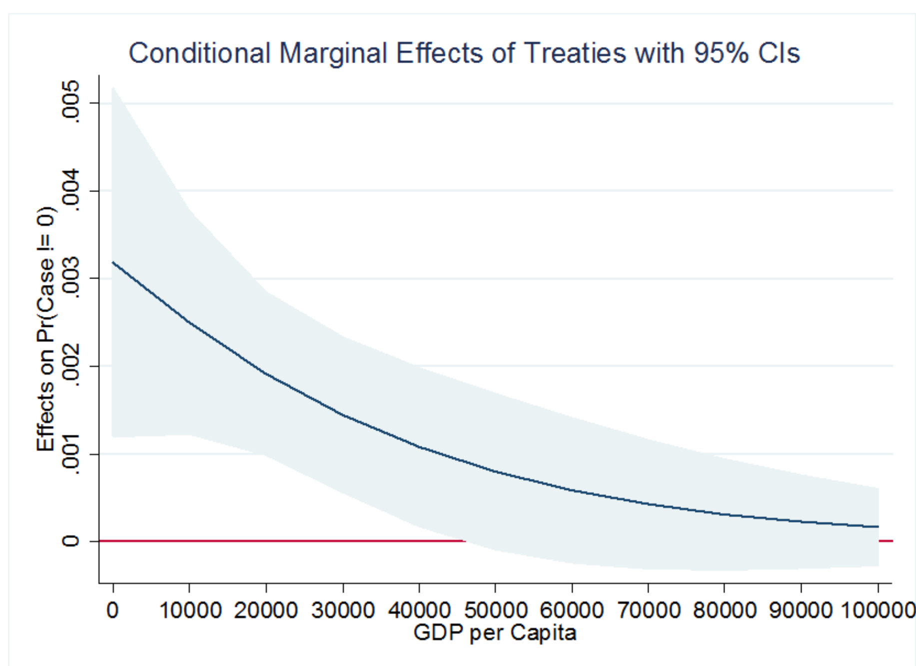
As predicted by H_2, the passage of time has positive relationship with the number of expected cases. With each additional year, the odds of an arbitration case increase between approximately 34 and 27% depending on the model. However, the quadratic term is included and this has a negative relationship with the DV, suggesting that any increase related to time may level off after a certain period.

Finally, the incidence of a case in the previous year is positively and significantly correlated with the dependent variable – a case in the previous year makes a case in the current

year three times more likely – suggesting that investors tend to “pile on” after a state takes an offending measure.

Given that most IIAs cover investment flowing from developed to developing countries, it may be that the impact of an additional ratified IIA is different in developing and developed states. Figure 5.3 shows the marginal effects of the treaties variable at different levels of GDP per capita. As expected, the marginal effect of one additional treaty decreases as GDP per capita increases (before becoming statistically insignificant at approximately $45,000 per capita – a very high income country), suggesting that signing treaties increases the risk of arbitration more for lower and middle income countries than high income countries.

Figure 5.3Marginal Effect of Treaties



5.4.3 Capacity

This section presents the regression results testing hypotheses 3-6. Two types of variables relate to the capacity of states to respect investors’ rights – those relating to awareness of the regime and bureaucratic capacity, and those relating to economic conditions. Therefore, this model includes variables related to institutional capacity as well as just temporal crises. More generally, I expect higher levels of GDP to have a negative correlation with the dependent variable – richer

countries should have higher levels of bureaucratic capacity, and thus be better able to avoid situations in which new policies inadvertently conflict with investors' rights.[36] The state's past experience with arbitration should also have an impact on its ability to assess the risks in new policies, and therefore decrease the likelihood of arbitration. The results are displayed in the table below. Finally, I include the NAFTA variable in these models as a control given the much higher number of cases in the US and Canada than other high income countries. .

Table 5.4 Capacity

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
VARIABLES	case	case	case	case	case	case	case
Lagged DV	2.338***	2.861***	2.786***	2.860***	2.775***	2.837***	2.261***
	(0.485)	(0.620)	(0.574)	(0.580)	(0.548)	(0.562)	(0.469)
FDI Stock	0.975	1.086	1.035	1.002	1.020	1.007	1.078
	(0.0314)	(0.0596)	(0.0544)	(0.0441)	(0.0439)	(0.0424)	(0.0582)
Treaties	1.018***	1.027***	1.022***	1.023***	1.027***	1.025***	1.019***
	(0.00436)	(0.00646)	(0.00511)	(0.00503)	(0.00514)	(0.00508)	(0.00585)
NAFTA	4.287***	13.79***	7.172***	7.958***	11.29***	8.621***	7.745***
	(1.077)	(5.347)	(1.892)	(1.882)	(2.888)	(2.050)	(3.447)
Cumulative Case	1.223***						1.198***
	(0.0513)						(0.0516)
Cumulative Case^2	0.996***						0.996***
	(0.000915)						(0.000888)
GDP per Capita		1.000*					1.000*
		(2.62e-05)					(2.48e-05)
GDP per Capita^2		1.000					1.000
		(5.16e-10)					(4.62e-10)
Crisis			0.767				0.949
			(0.128)				(0.176)
GDP Growth				1.005			1.007
				(0.0126)			(0.0108)
Corruption					0.796***		0.868*
					(0.0446)		(0.0679)
Political Stability						0.883**	1.099
						(0.0481)	(0.0852)
Constant	0.0685***	0.0376***	0.0498***	0.0582***	0.0442***	0.0521***	0.0371***
	(0.0166)	(0.0157)	(0.0204)	(0.0197)	(0.0155)	(0.0171)	(0.0146)
Observations	2,620	2,577	2,612	2,567	2,620	2,620	2,534
Number of iso3n	136	133	133	135	136	136	131

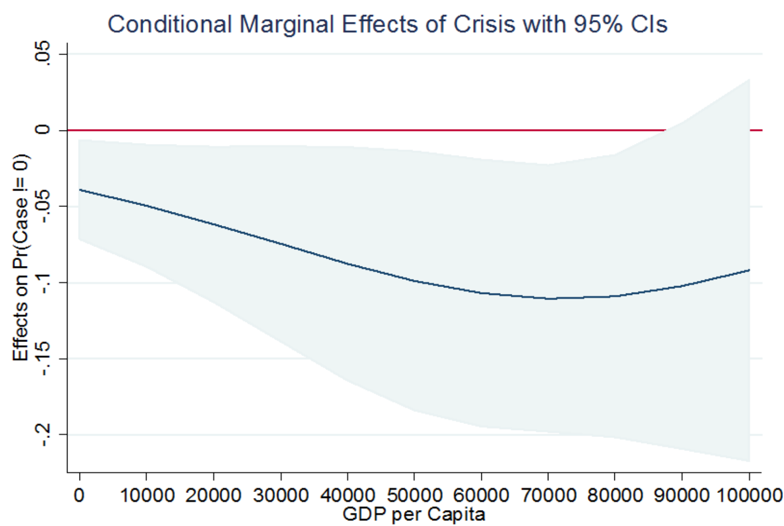
Robust seeform in parentheses
*** p<0.01, ** p<0.05, * p<0.1

[36] However, this relationship should also capture the effect of higher income countries being typical "home" rathr than "host" states for FDI.

The cumulative case variable follows the expected pattern of a non-linear relationship suggesting that states with more experience with ISDS are expected to experience fewer new cases. Although the effect of the cumulative case variable is almost identical to the effect of time in the previous regression table, the correlation between the two is relatively low (0.351). However, both speak to awareness of or experience with the regime, which can from the investor's side suggest greater use of the tool of ISDS, and from the state's side suggest a learning process which could in theory help them avoid further disputes – hence the curvilinear relationship. The variables related to a temporal crisis (H_3) do not have a consistently significant relationship with the dependent variable. Both GDP growth and crisis are statistically insignificant. The results related to bureaucratic capacity are also somewhat ambiguous. Neither GDP per capita, nor its squared term, has an effect on the odds of a case in either direction. However, as predicted, the control of corruption and political stability are negatively correlated with the dependent variable in the first model in which they are included, although the latter is not statistically significant in the full model.

Here again, it seems plausible that the effect of these independent variables would change at different levels of income. Therefore, Figure 5.4 shows the marginal effect of the crisis dummy variable at different levels of GDP per capita. While the effect of crisis on the likelihood of an arbitration case is always negative, we can see that it decreases as GDP per capita increases, until becoming statistically insignificant at the highest levels. This suggests that countries with stronger institutions are in particular less likely to pass measures which harm investors in the midst of a financial crisis.

Figure 5.4Marginal Effect of Crisis



5.4.4 Domestic Preferences and Institutions

As was discussed in Chapter 4, domestic preferences, and the institutions which mediate them can have an impact on investor-state relations, and thus increase or decrease the likelihood of an investor-state dispute. Most obviously, changes in domestic preferences can be expressed through elections and/or regime, and therefore I initially include the leader transition variable (described above). Preferences towards FDI may also be expressed by the ideological leanings of the government, and I include a dummy variable indicating if a left-wing government is in power. The historical context in which the investment takes place may also have an impact, and I include another dummy variable indicating whether a country is a former planned (transition) economy. Finally, investment in certain sectors may be more likely to create conflict with domestic actors than others – particularly that in the extractive industry, and I include a variable measuring the percentage of a state's GDP of oil, gas and mineral rents. However, while preferences toward FDI may shift, domestic institutions should mediate their effect on policy outcomes. As discussed in Chapter 4, there are competing hypotheses regarding the effect of democracy on a state's respect of investors' rights, although more recent work concludes that democracies are better able to protect investment. To test this relationship I include the Polity score. The number of veto players should also have an impact on the likelihood of a dispute, given that greater numbers of veto players make it harder to unilaterally enact changes in policy.

States in which some actors are given greater leeway for unilateral decision-making may be more frequently involved in investor-state disputes, and, as I explain in the previous chapter, I include a presidential dummy variable.

Tables 5.5 presents the results of the regressions employing the variables related to domestic institutions and preferences. These models include more controls than those previous, given the strong correlations between the various explanatory variables, which may bias the results. For example, countries enjoying higher levels of democracy are generally wealthier and tend to attract more investment. Therefore, without the inclusion of FDI stock hosted by the state, the Polity score could pick up the effect of FDI stock on the number of expected cases.

Table 5.5Preferences and Institutions

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
VARIABLES	case	case	case	case	case	case	case	case
Lagged DV	2.927***	2.903***	2.832***	2.784***	2.902***	3.023***	3.312***	2.677***
	(0.574)	(0.560)	(0.565)	(0.566)	(0.559)	(0.793)	(0.718)	(0.738)
Treaties	1.026***	1.027***	1.030***	1.023***	1.027***	1.032***	1.028***	1.029***
	(0.00473)	(0.00483)	(0.00455)	(0.00491)	(0.00473)	(0.00578)	(0.00574)	(0.00600)
FDI Stock	0.960	0.962	0.962	0.993	0.962	0.945	0.960	1.033
	(0.0409)	(0.0422)	(0.0415)	(0.0435)	(0.0409)	(0.0495)	(0.0450)	(0.0589)
Extractives	1.025***	1.024***	1.022***	1.025***	1.024***	1.030***	1.024***	1.024***
	(0.00579)	(0.00568)	(0.00582)	(0.00597)	(0.00570)	(0.00827)	(0.00743)	(0.00790)
NAFTA	8.905***	9.355***	7.888***	9.791***	8.502***	10.86***	10.08***	9.192***
	(1.921)	(1.970)	(2.637)	(2.301)	(1.874)	(3.666)	(2.792)	(2.541)
Polity	1.040**	1.063***	1.058***	1.036*	1.036*	1.049**	1.040*	1.081***
	(0.0199)	(0.0223)	(0.0209)	(0.0198)	(0.0201)	(0.0226)	(0.0211)	(0.0315)
Veto Players		0.514*						0.589
		(0.187)						(0.288)
President			2.258***					2.499***
			(0.513)					(0.805)
Transition				2.247***				2.593***
				(0.484)				(0.622)
Left					1.262			0.903
					(0.198)			(0.177)
Lead Leader Trans						1.679**		1.789**
						(0.405)		(0.450)
Lag Leader Trans							1.113	1.230
							(0.200)	(0.212)
Constant	0.0538***	0.0648***	0.0290***	0.0359***	0.0496***	0.0391***	0.0450***	0.00793***
	(0.0173)	(0.0216)	(0.0118)	(0.0128)	(0.0164)	(0.0159)	(0.0154)	(0.00460)
Observations	2,537	2,527	2,537	2,537	2,537	1,774	2,023	2,015
Number of iso3n	132	132	132	132	132	129	129	129

Robust seeform in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Interestingly, even when FDI stock is controlled for, a country's Polity score is positively correlated with the likelihood of a dispute in most of the models. This contradicts H_6 above, as well as the expectations found in the literature on expropriation and political risk. This suggests that the relationship between democratic institutions and this broader category of investor-state disputes is somewhat different.

On the other hand, while the political constraints variable shows the direction predicted in H_7, the effect is not statistically significant. This may speak to the tension between veto players and anti-investment measures underscored by Graham and Kingsley (2012). As discussed in the previous chapter, these authors find that more veto players were associated with fewer expropriations, but greater restrictions on the transfer of capital (a less highly visible and politically salient method of extracting greater benefit from foreign investment than expropriation). Given that the dependent variable used here covers such a broad range of measures, the ambiguous effect of the political constraints variable is unsurprising.

In all of the models in which it is included, as predicted by H_8, a presidential system was strongly and positively associated with greater numbers of investor-state disputes – increasing the odds of a dispute by over 200%. This confirms the hypothesis stated in the previous chapter that presidents, given their direct election by voters, and ability to influence ministries and administrative agencies, may be more likely to take measures against investors when there is public pressure to do so. While presidents may have less control over legislatures than prime ministers (Tsebelis, 2000), as we saw in Chapter 2, the bulk of measures taken which have been challenged by investors are in fact administrative. Given, finally, the high number of cases in Latin American countries with a presidential system, the strong correlation between presidential systems and more investor-state disputes is not surprising.

A leftist incumbent does not consistently increase the odds of a dispute in either the logit or NBREG models, nor does it reach a level of significance. This inconsistent result is in line with other recent studies on expropriation and investor-state disputes which show a relatively ambiguous link between ideology and expropriation and investment arbitration (Freeman, 2013; Li, 2005).

As predicted by H_{10}, the dummy variable indicating a transition economy is also positively and significantly correlated with an arbitration case in a given country-year, increasing the odds of arbitration between two and nearly four times. Although one explanation for this

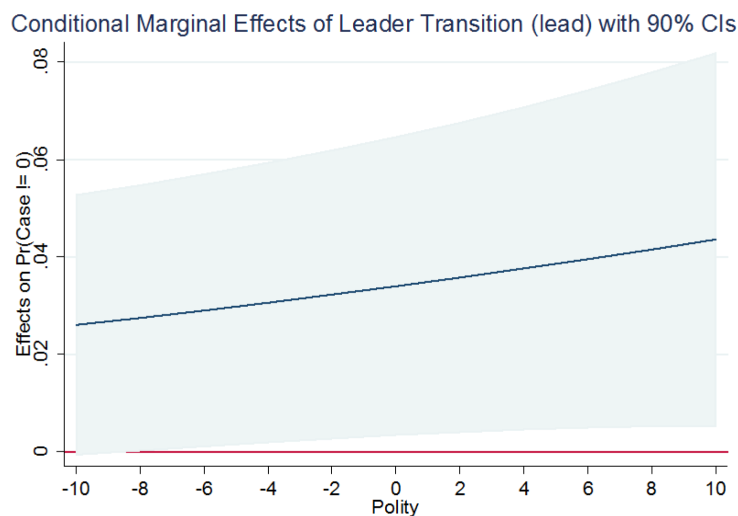
could be the higher levels of corruption in these countries, the positive and significant effect remains the same when control of corruption is included in the model (See Appendix II).

As can be seen in table 5.4, the leader transition variable with a one year lead increases the odds of a dispute by between 60 and 70 percent. This suggests that state actors may be taking measures in the lead up to an election based on popular pressure, in an attempt to generate support. On the other hand, the lagged leader transition variable does not show a significant effect here. Unfortunately this dataset contains observations only up to 2008; the addition of more data points here might clarify the results somewhat. Moreover, the relationship between these dummy variables and the dependent variable assumes that the measure taken which triggered the dispute was taken within the year prior to the date on which the arbitration proceedings were registered. However, this cannot be assumed, and therefore, these results must be read with this limitation in mind.

Finally, as predicted by H_{12}, the extractives variable has a statistically significant, positive correlation with the dependent variable in most of the models above.

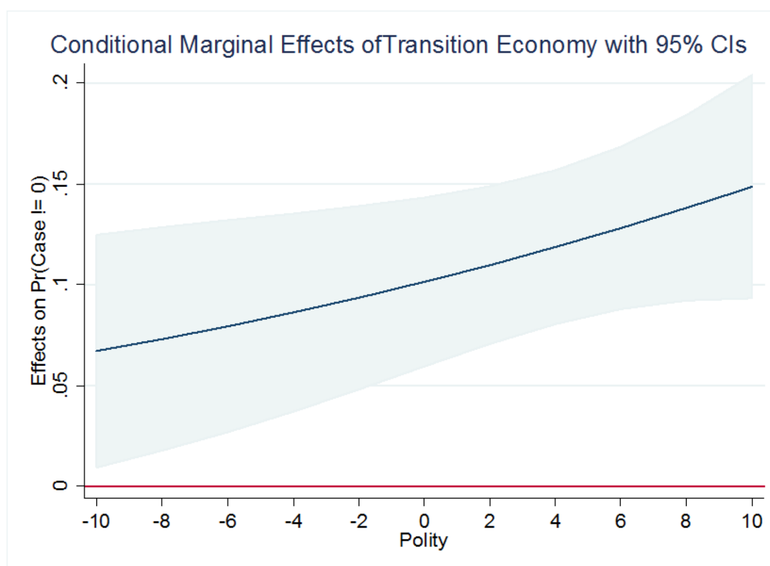
Many of the variables in this category are clearly interrelated – for example, democracies are associated with higher numbers of veto players. Moreover, the responsiveness of leaders to domestic interests is presumably greater in democratic states. Therefore, the relationship between leader transition and investor state disputes is likely to be affected by the state's level of democracy. Figure 5.5 shows the conditional marginal effect of the leader transition with a one year lead, at different levels of democracy. While the change is not very sizeable, we can see that a leader transition has a greater effect on the likelihood of an investor-state dispute at higher levels of democracy.

Figure 5.5Marginal Effects of Leader Transition



Similarly, although more significantly, the marginal effect of being a transition economy on the dependent variable is higher at higher levels of democracy, as shown in Figure 5.6. Although not shown here, the marginal effect of a country having a presidential system has a similar relationship with democracy, with an increased effect in more democratic countries. This suggests that there is a relationship between the responsiveness of state leaders and domestic preferences toward FDI, and the likelihood of an investor-state dispute.

Figure 5.6 Conditional Marginal Effects of Transition Economy



5.5 Conclusion

This second empirical chapter provides an examination of the causes of investor-state disputes on a macro level, by testing the three broad explanations developed in the previous chapter; namely that exposure to the IIA regime, lack of domestic capacity, and changing domestic preferences toward FDI can increase the likelihood of investor-state disputes.

Before addressing these hypotheses however, I look at the likelihood of investment arbitration across regions. Three regions stand out as those with the greatest likelihood of facing an investor-state arbitration case – CIS countries[37], Latin America, and NAFTA. It seems unlikely that the same underlying causes are contributing to the high numbers of disputes in these three regions. Indeed, just by including controls for the number of treaties ratified and FDI stock hosted we can see that the individual effect of the regional dummies change, with the increase in the odds of a dispute from the Latin America dummy only becoming significant once FDI stock and the number of IIAs are controlled for. Given what we know about cases in Latin America – both the high numbers of arbitration cases in some countries such as Argentina and Venezuela, as well as the concentration of politically charged disputes related to the extractive industry – it is not surprising that the region itself is statistically much more likely to be involved in an arbitration case, even when levels of investment are controlled for. On the other hand, the relative impact of the CIS and NAFTA variables decreases slightly, though is still quite high with the inclusion of these extra variables. As discussed above, the drivers of investor-state disputes in these two regions are likely different, given their varying levels of corruption and government effectiveness.

The regional dummies also clearly demonstrate the role of Western European states as traditional home countries, and the way in which NAFTA complicates the developed-developing country division when looking at the traditional rationale for investment protection. Finally, the high likelihood of investor-state arbitration in Latin American and CIS countries also reflects the concentration of disputes in middle income countries, which is likely due in large part to the development of the investment protection regime – with the exception of NAFTA, until now very few investment treaties have been signed between developed country partners.

[37] The transition economy variable could also be seen as a region, and of course includes both the CIS and Eastern European countries, and is similarly positively associated with the likelihood of an investor-state dispute.

As predicted, exposure to the investment regime – in the form of ratified IIAs, FDI stock hosted, and time – increases the likelihood of an investor-state dispute. Although the magnitude of the effect of an additional ratified treaty is not large, it increases the likelihood of a dispute both in the exposure models and when included as a control in the models with regional dummies. More than either of these variables however, the passage of time, which I take as a proxy for investor awareness of the IIA regime (or perhaps the normalization of its use) increases the likelihood of a dispute. Taken together, these results suggest that to some extent if investors are given access to an ISDS mechanism, they will use it. The statistically greater likelihood of a NAFTA country to be taken to arbitration reinforces this point. As discussed in Chapter 2, it is not only Mexico, but also Canada and the US which are frequent respondents in NAFTA cases, which is surprising, given the original *raison d'être* of these agreements – to protect investors in developing countries where the threat of expropriation was high.

The results of models testing the effect of variables related to state capacity are more ambiguous. The dummy variable representing an economic crisis has a significant, but negative effect, at the 90% level in some of the models tested. This suggests that states are not more likely to take anti-investor measures during periods in which economic growth is weak, inflation is high, or they are in the midst of a debt or banking crisis and are instead perhaps restrained from taking these measures when they are more vulnerable. Control of corruption is, as expected, negatively correlated with the likelihood of a dispute in the capacity model, but does not remain significant in the full model.

Finally, the results of the regressions of the variables related to domestic institutions and preferences suggest that domestic preferences have an effect on the likelihood of an investor-state dispute. First, and most surprising, is the positive correlation of a state's Polity score with the likelihood of a dispute, even when the amount of FDI stock is controlled for. This contradicts the conventional wisdom in much of the literature on political risk and expropriation which argues that democracies demonstrate greater respect for property rights and more restraint in their policies toward foreign investors. This is due, these studies argue, to greater transparency and higher numbers of veto players in democracies. However, as was discussed in Chapters 3 and 4, there is some ambiguity regarding the effect of democracy on investors' rights. First, earlier work on expropriation assumed that democratic leaders might give in to populist tendencies and expropriate from foreigners in order to win domestic support, and this dynamic

could explain some investor-state disputes which end in investment arbitration, including those stemming from expropriation. Similarly, although with perhaps a different normative valuation, Bonnitcha (2014) argues that political instability or upheavals may increase the likelihood of a dispute, precisely in cases in which governments become more democratic, and must respond to broader social demands, rather than smaller interest groups (including investors) to whom they had formerly supported via cronyism or patronage. However, it is important to underline the difference made by the dependent variable in this study, as we know that outright expropriation does not make up the majority of measures taken that trigger an investor-state dispute. Therefore, in some instances, governments may be responding to similar domestic pressures by taking less extreme measures than outright expropriation. This is supported by Kobrin (1979) who, as I discuss in Chapter 4, sees political risk not arising primarily from political instability and conflict but "from the regular functioning of the political process owing to losses or gains in the regime's power or to changes in the character and power of the opposition or of interest groups" (p. 39). Of course, these explanations for the role of democracy in investor-state disputes are not mutually exclusive: disputes could conceivably arise from populist pandering; from regime change and democratization; and from everyday regulatory processes. What is notable, therefore, is that democratic institutions cannot be assumed to uphold the commitments enshrined in IIAs – this would require a domestic constituency which is pro-investment. Therefore, explaining the occurrence of investor-state disputes needs to account for institutional constraints faced by state actors in taking a measure, as well as the specific domestic "push" or incentivizing factors that motivate states to take measures against investors.

This brings us back to the different explanations of compliance, found in the enforcement and managerial approaches, as well as discussions of bounded rationality. The clearest results involve variables that are associated with domestic pressure – the country's Polity score, a presidential system, leader changes, and transition countries. Therefore, it seems that the logic of the enforcement approach to compliance better explains the dynamics of investor-state dispute. This, however, does not discount that policy-makers are unaware of the ramifications of investor protection treaties; they may be responding to public pressure without taking into account their obligations under the IIA. The positive relationship between the likelihood of a case and the number of previous cases, as well as the passage of time itself, suggest that experience with investor-state disputes does not do much to lessen the likelihood of a dispute in the future.

5.6 Limitations to the Analysis

There are a number of limitations to the results presented here. For example, at times, investors initiate arbitration proceedings a good few years after the offending measure has been taken – most obviously, many of the arbitration proceedings following the Argentine financial crisis did not get under way until 2004 or 2005. More importantly, the regression results are only able to tell the "state-side of the story"; while it is possible to collect data on investors involved in disputes with states, it is logically impossible to do so for country-years in which no dispute took place. Finally, there is the issue of unknown cases – arbitration proceedings are only made public with the consent of both parties, and therefore the dataset may be missing cases, which was discussed in Chapter 2. This, along with the relatively low number of positive cases, puts limitations on the previous results.

Chapter 6 Bilcon Ltd. v. Canada

This chapter presents the investor-state dispute between Canada and Bilcon of Delaware Ltd. a construction company from New Jersey. The company proposed a quarrying project in Nova Scotia in order to supply itself with the raw material it needed for roads and other construction projects in the United States. The project was to comprise a quarry and marine terminal from which the material would be shipped to the United States. The potential investment generated significant opposition from nearby communities and civil society groups, and underwent a very strict environmental assessment process by a panel of experts, who ultimately recommended that the government not approve the project. Following an official notice that the project would not be approved, the investor turned to arbitration under NAFTA's Chapter 11. As will be discussed in greater detail below, this case is quite clearly an example of the contribution of changing domestic preferences toward an investment to investor-state disputes, rather than a dispute that arose out of a lack of state capacity to maintain an investment-friendly environment.

Beyond this, the case is significant in a number of ways. Firstly, it underscores the element of increased uncertainty that ISDS brings to domestic policymaking. Secondly, it suggests the extent to which ISDS may be driven by investors themselves. Finally it demonstrates the challenge that ISDS can pose to the raising of regulatory standards and the updating or evolution of domestic legal norms (Johnson & Sachs, 2015).

6.1 IIAs and Investment in Canada and Nova Scotia

Although Canada has traditionally been a net importer of capital, with an economy based largely on natural resources, its stance on foreign investment has fluctuated over the years (Luz & Miller, 2002); while during the 1970s, the Foreign Investment Review Agency maintained fairly stringent barriers to investment, Canada's investment climate was liberalized during the 1980s with the Investment Canada Act (ICA) (Dawson, 2012). In the late 1980s, Canada also began to assert its interests as a capital exporter, signing a number of BITs, known in Canada as Foreign Investment Protection Agreements (FIPAs) (Luz & Miller, 2002). Finally, Canada furthered its commitment to free trade and investment with the signing of the Canadian-US Free Trade Agreement in 1988, and the North American Free Trade Agreement (NAFTA) in 1994. Canada

is in fact quite dependent on FDI, particularly from the US – 30 percent of Canadian employment and 75 percent of its manufacturing exports comes from US FDI (Winham, 2007).

This chapter focuses on a case that was triggered by a series of measures taken by both the federal government and the provincial government of Nova Scotia – a province with less experience with foreign investment than other parts of the country. Foreign direct investment in the Atlantic Provinces of Canada is quite low, although Nova Scotia hosts the largest amount of FDI in the region; during the time period relevant to this study, the average annual inflow to the province was US$1.6 billion, although this is due almost entirely to its off-shore oil production (APEC, 2005). Beyond oil extraction, Nova Scotia has traditionally relied on fishing, agriculture, and mining. With the overall decline of the fishing industry in the region, Nova Scotia, along with other Atlantic provinces, suffers from higher rates of unemployment than other parts of the country. Therefore, in the early 2000s the provincial government, led by the Progressive Conservative party, promoted low business taxes and the attraction of FDI as a strategy to encourage economic growth and increase employment rates (NSED, 2000). The areas which the province identified as key economic sectors included fishing and fish products; extractive industries such as forestry, mining, oil and gas; agriculture; tourism and culture; communications and life sciences (APEC, 2002; NSED, 2000). In particular, Nova Scotia adopted welcoming stance toward investment in the mining sector, as laid out in the Department of Natural Resources' 1996 report "Minerals – A Policy for Nova Scotia" which commits to ensuring a competitive business climate and promote the province's mineral potential (DNR, 1996). As the claimants state in their Notice of Intent to Arbitrate, it was in the context of this push for foreign investment that they initiated their investment in the province (Notice of Intent, 2008).

6.1.1 Canada and NAFTA

Negotiations for NAFTA followed the entering into force of the Canadian-US Free Trade Agreement (CUFTA), and Mexico's subsequent suggestion of a bilateral trade agreement with the United States (Abbott, 2000). Despite long-standing economic interdependence, Canada's efforts to lower trade barriers with the United States first through CUFTA, and subsequently with NAFTA faced resistance both within the government and from the electorate due to a long-standing fear of American encroachment on Canadian sovereignty in general, and specific concerns relating to the weakening of Canada's much more expansive welfare state (Golob,

2003; Johnson & Mahon, 2005). According to Abbott (2000), Canada therefore joined the NAFTA negotiations "defensively," as the country had very little previous economic interest in Mexico, but did not want to be left out of the United States' efforts to liberalize Latin American markets.

NAFTA is a highly detailed trade agreement, comprised of twenty-two chapters including Chapter 11 on investment, and is unique in that, at the time of writing, it is the only ratified international agreement regulating substantial investment flows between developed countries. NAFTA's ratification has been followed by increased FDI flows between the three signatories, which many observers attribute to the agreement in general, and Chapter 11 in particular (Abbott, 2000). As we know, however, given the regression results presented in Chapter 5, these increased FDI flows have led to an what was an at the time an unexpected number of investor-state arbitration cases.

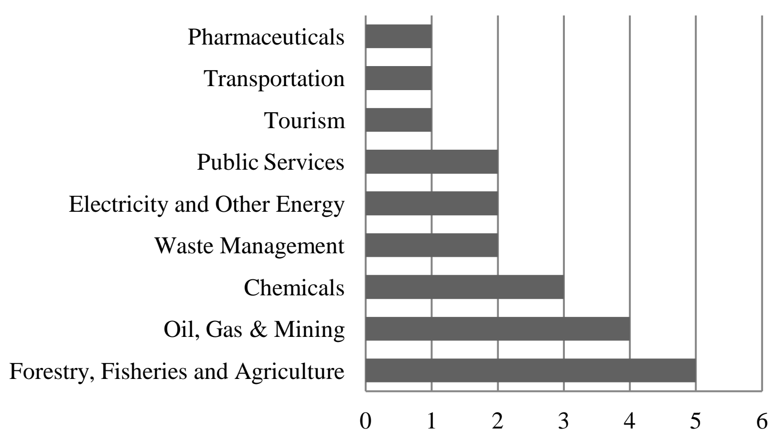
The rationale behind the inclusion of an investor-state arbitration clause in NAFTA was primarily to protect US investors in Mexico, particularly given the country's history of expropriations in the petroleum industry (Heindl, 2006). However, as we saw in Chapter 2, the outcome of NAFTA Chapter 11, in terms of investor-state disputes, has been somewhat different; Canada has been a respondent in at least as many cases as Mexico, and the US is not far behind. Indeed, according to one federal official with whom I spoke "when [Canada] entered into NAFTA, we didn't think we would get sued as much as we are" (Interview #1). Beyond the number of cases, Abbott (2000) argues that the dispute settlement mechanism has " been invoked by private investors in circumstances that were not contemplated by NAFTA negotiators" (p. 522). These likely include the challenges to long-standing Canadian institutions such as Canada Post, and the Canadian Health Act.

Canada was served with its first notice of intent to arbitrate in 1996 by a Mexican generics manufacturer, but arbitration never commenced (CCPA, 2010). The first case that progressed to arbitration, and has subsequently become fairly infamous, is that of Ethyl Corp. v. Canada, in which an American chemicals manufacturer that challenged Canada's ban of MMT, a gasoline additive (*Ethyl Corp v. Canada*). Faced with an arbitration case that appeared to be going in favour of the investor, Canada repealed the ban, issued an apology to the company and settled out of arbitration for $13 million (CCPA, 2010). Thus, the Ethyl case was exemplary of the "capitulatory" manner in which Canada resolved its early arbitration cases (Van Harten,

2011). More recently, Canada has settled high profile cases with Abitibi Bowater for the expropriation of timber and water rights and with Dow Agrosciences over a dispute involving another chemical ban. Canada has also lost significant cases, including one with Mobil Investments over the imposition of Research and Development requirements, as well as the challenge by Bilcon Ltd. discussed in this chapter. On the other hand, Canada has won a number of important cases including challenges to its national postal service, lumber export policies and the Canada Health Act.

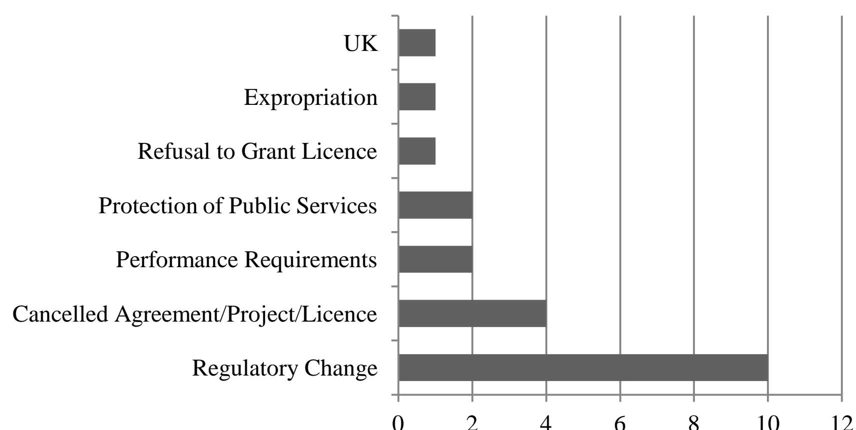
The sectors in which Canada has faced disputes are displayed in Figure 6.1.

Figure 6.1Canada's Disputes by Industry



Many of the sectors in which Canada has experienced disputes mirror those that appear in the top ten sectors for arbitration cases overall. On the other hand, as can be seen in the figure below, almost half of all cases in which Canada has been the respondent have been triggered by investors challenging a regulatory measure.

Figure 6.2Canada's Disputes by Measure



Canada's experience with ISDS under NAFTA has generated significant criticism from civil society, particularly surrounding high profile cases related to the environment, such as the dispute with Lone Pine Resources, a gas exploration company challenging Quebec's provincial ban on fracking[38] and the case discussed in this chapter. Some academic observers have further expressed concern regarding the impact of NAFTA on Canada's federal project. According to Luz and Miller (2002), NAFTA impedes the ability of provinces to regulate FDI "an area where provinces have traditionally exercised significant control. [The result] will likely be a concomitant expansion in federal power at the expense of the provinces" (p. 976) Other observers take the position that "Chapter 11 has not caused an 'erosion of federalism', rather it has created circumstances in which governments may have to pay for federalism and for the maintenance of democratically instituted policies" (McKinley, 2009, p. 100). As will be discussed below, this aptly describes the arbitration case between Bilcon and Canada, in which the federal government was found to be in violation of NAFTA as a result of actions taken primarily by the provincial government of Nova Scotia.

6.2 Timeline of the Dispute between Bilcon Ltd. and Canada

In this section I give an overview of the dispute between Bilcon Ltd. and Canada, including the antecedents to the arbitration and the arbitration process.

The claimants, the Clayton family, own a cement company based in New Jersey, and proposed to construct a 152 hectare quarry and marine terminal on Whites Point in Digby Neck,

[38] See for example: http://canadians.org/media/water/2013/31-May-13.html

Nova Scotia, on the shore of the Bay of Fundy. The company was eager to find sources of aggregate outside the state of New Jersey, where due to higher regulatory standards, opening new quarries was no longer feasible (Richler, 2007). While aggregate is ideally consumed close to the source as transport costs are high, shipping the extracted aggregate from Nova Scotia to the US eastern seaboard was considered an acceptable alternative (Richler, 2007). Initially, the investors claim they met with significant support from the provincial government, especially from Conservative provincial Minister of Fisheries and Agriculture, Gordon Balser, who was also the representative of the riding (electoral district) in which the quarry was to operate (*Bilcon of Delaware v. Canada*, 2015).

In 2002, the company first filed an application with the Nova Scotia Department of Environment and Labour (NSEL) to operate a smaller 3.9 hectare quarry on the site ultimately designated for the larger project[39]; this smaller quarry was to be operated in order to gather data for the assessment of the extractive process on the environment, as well as to stockpile aggregate for future operations (Statement of Defence, 2009). The NSEL determined that as the initial blasting of the rock was itself likely to have detrimental environmental effects, the proponent required authorization from the federal Department of Fisheries and Oceans (DFO) to proceed. In turn, the DFO concluded that an environmental assessment for the larger site, of which this smaller quarry was ultimately a part, was required in order for any blasting activity to take place (Statement of Defence, 2009).

The involvement of the federal DFO put the project under both provincial and federal jurisdiction, and thus the Canadian Environmental Assessment Act (CEAA) directed the environmental application process. In 2003, the DFO advised the claimants to engage the services of an environmental consultant who was familiar with the CEAA process, although the government alleges that they failed to do so for several years (Document #1). At this time, as will be discussed at greater length in subsequent sections, public concern over the project was growing, indicated by the dozens of letters from concerned citizens and environmental groups archived on the CEAA website. Various government agencies also expressed environmental concerns regarding the disruption to marine life habitat, although according to correspondence

[39] The size of the quarry, at 3.9 hectares, was not accidental, as legally a quarry larger than 4 hectares would require approval from the Minister of Environment.

archived on the CEAA, other officials doubted the project posed a significant threat (*Bilcon v. Canada,* 2015).

In 2004, the federal Minister of Environment and his provincial counterpart agreed that the company's proposed project would be assessed by a joint review panel (JRP), which is undertaken when the minister is of the opinion that a project may generate "significant adverse effects" about which there is public concern (CEAA, n.d.). The JRP was comprised of three university professors: biologist Robert Fournier, planner Jill Grant, and geologist Gunter Muecke. The panel was to review Bilcon's Environmental Impact Statement (EIS) and solicit feedback from the public on what should be included in the statement. The panel was then to make further recommendations on the EIS, allow the company to address their concerns, and make a final recommendation to the federal and provincial government based on their own expertise and public comments, regarding whether the project should be given government approval to move forward.

The panel accepted over 600 submissions from the public on what should be included in the EIS, and held public hearings in June of 2007. During the hearings they received testimony from 78 citizens and a further 126 written submissions from local individuals and organisations. Based on this input, as well as consultations with federal ministries, such as Environment Canada and Health Canada, the JRP issued its recommendation in November of 2007 that the project posed a threat to the "core values of the community" as well as "existing and future environmental, social and cultural conditions" (Fournier, et al, 2007). Shortly thereafter, the federal and provincial governments officially rejected the company's proposal. In 2008, the company announced its intent to arbitrate, and arbitration commenced in 2009.

6.2.1 The Arbitration: Bilcon of Delaware Ltd. v. Canada

The arbitral tribunal was constituted in April 2009, under the UNCITRAL arbitration rules, and hosted by the Permanent Court of Arbitration (PCA), and took place in Toronto, Canada. The tribunal released its final Award in March of 2015. A summary of the investor's arguments and the tribunal's rulings is laid out in the table below.

Table 6.1Arguments and Rulings in Bilcon Case

Alleged Breach of NAFTA	**Claimant's Arguments**	**Tribunal's Ruling**
1102 National Treatment	Respondent (in particular various ministries and the JRP) extended more favourable treatment to Canadian investors in like circumstances.	Tribunal finds a breach of 1102
1103 Most Favoured Nation	Respondent extended more favourable treatment to non-Canadian investors with regard to the type and duration of environmental assessment.	Tribunal declines to find a breach of 1103 (investors claims are time barred)
1105 Minimum Standard of Treatment	Misapplication of domestic law; bias and political interference on the part of provincial politicians	Tribunal finds a breach of 1105

According to the investor, their legitimate expectations, based on the welcome they initially received from provincial officials, as well as the province's policies regarding investment and mining, were frustrated unfairly and in violation of NAFTA articles 1102, 1103 and 1105 (see above). The specific measures at the heart of the dispute relate directly to the environmental assessment imposed on the project (Statement of Claim, 2009). First, the investors claimed that the decision of the provincial and federal governments to submit their project to the Joint Review Panel was unwarranted given the features of their proposed project. Moreover, they argued, other investors – both foreign and Canadian - in "like circumstances" have not been subjected to the demanding environmental review process (*Bilcon v. Canada,* 2015).

Additionally, the decision to assess the project by means of a JRP was, the claimants argued, not due to legitimate environmental concerns on the part of the government, but political bias against the project. In the provincial elections of 2003, Progressive Conservative MP Gordon Balser, who had been quite welcoming of the project, lost to local fisherman and Liberal candidate Harold Thériault, who, during the public hearings held by the JRP, claimed that he won the election based on his opposition to the project. Moreover, Robert Thibault, Minister of the DFO and federal MP for the riding in which the proposed quarry would be located, reversed his earlier support for the quarry in the face of public opposition, coming out strongly against it in the public hearings. The claimants argued that these public statements against the quarry were motivated solely by the electoral concerns of Mr. Thibault (Statement of Claim, 2009). They

further argued that the delays they suffered after the project was put under the jurisdiction of the DFO were due to the Minister's desire to extend the process as long as possible (*Bilcon v. Canada*). Therefore, the claimant argued that "behind the scenes there was inappropriate political interference in the regulatory process" (*Bilcon v. Canada*, p.4).

The claimant also took issue with both the way in which the JRP carried out its public hearings, as well as the criteria the panel used to evaluate the project. Regarding the former, the claimant suggested that nationalistic and anti-American sentiments were allowed to dominate the public hearings (*Bilcon v. Canada*). Most important, according to the investors, was the basis on which the JRP ultimately rejected the project – namely, that it conflicted with "core community values." According to the claimant, this concept

> is not among the environmental impacts that are lawful or proper scope of an environmental assessment process under the laws of federal Canada or Nova Scotia. The guidelines for the JRP refer to various social effects, like impact on values such as 'sense of place', but do not refer to the concept of 'community core values'. (*Bilcon v. Canada*, p. 6)

The claimant also argued that the JRP members were biased against the project, and in particular, did not consider possible mitigation efforts which could offset the environmental effects of the quarry. Finally, the claimants argued that in the wake of the JRP's recommendation, Nova Scotia's Minister of Environment refused to meet with them to hear their concerns or allow them any written input to contest the JRP's decision. Therefore, they argue, the Minister "abdicated his responsibility to exercise his independent discretion, denied procedural fairness to Bilcon and failed to explain his decision" (*Bilcon v.Canada*, p.7).

The government of Canada refuted these claims. First, the government denied that the claimants were given special incentives or treatment to convince them to make their investment, and any meetings between the investors and government officials took place after the decision was made to invest (*Bilcon v. Canada*). Furthermore, they argue that given the ecologically sensitive nature of the site chosen by the investor – underscored by its status as a UNESCO Biosphere – the claimant should have expected a rigorous environmental assessment process. Overall, Canada further contested that the expressed environmental concerns were disingenuous, and cited correspondence between ministries to that effect.

While Canada did not deny that Minister Thibault had an interest in the project, given it was to be located in his riding, the government denies he had undue influence on the project's approval process (Government of Canada, 2009). Minister Thibault, in a sworn affidavit, stated

that he had been aware from the outset of both the positive potential the quarry could bring to his riding, as well as the growing concern among his constituents. He further stated that he did not interfere with the assessment of the quarry and did not contribute to, or desire a delay in the process. In addition to Minister Thibault, a number of other government employees contributed sworn affidavits regarding the decision-making process surrounding the project, and were subjected, as the arbiters note in their summary, "to rigorous cross-examination" during the arbitration proceedings (*Bilcon v. Canada,* p. 9). Overall, Canada claimed that all provincial and federal employees "consulted with each other in a normal and lawful manner" (*Bilcon v. Canada*, p. 8).

Canada also defended its decision to subject the investor to the rigorous JRP process. Given the project's size, including both a quarry and a marine terminal, the project would in the very least been subject to a Comprehensive Study, "itself an extensive and rigorous kind of assessment" (*Bilcon v. Canada,* 2015, p. 9). However, because of the public concern the proposed project had generated, the decision to use a JRP, which would allow significant input from the public, was considered reasonable. Moreover, the government contested that the projects cited by the claimant as being in "like circumstances" were not truly comparable, in large part due to varying levels of public concern surrounding them (Statement of Defence, 2009). The government also contested the illegality of the "core community values" criteria, and further notes that, as per the guidelines of the review process, the claimant was given adequate notice by the JRP of the inclusion of this concept in its assessment criteria (*Bilcon v. Canada,* 2015).

Finally, the government of Canada denied that the JRP is in an entity for which Canada is responsible under international law, and further stated that the claimant's argument that Canada breached NAFTA Art. 1105 contravenes international norms surrounding the "minimum standard of treatment", which is generally seen to set a very high threshold and "address matters where state behaviour is egregious." Therefore, a misapplication of domestic environmental law should not be seen to breach this standard, especially when the findings of the JRP could have been fought by the claimant under domestic judicial processes.

As can be seen in the table above, the majority of the arbitrators on the Bilcon tribunal ruled that Canada did breach NAFTA Articles 1102 (National Treatment) and 1105 (Minimum Standard of Treatment). The ruling of breach of Art 1105 hinged on the JRP's failure to take into

account possible mitigation processes when conducting the environmental assessment, based on their belief that the project must not be carried out at all (*Bilcon v. Canada,* 2015). According to the tribunal, this violated CEAA guidelines and did not allow the final decision makers – the governments of Canada and Nova Scotia – access to all the necessary information to fully assess the project. This was, the tribunal decided, a disappointment of the legitimate expectations of the investor – that the project "would be assessed on the merits of its environmental soundness" – based on the initial welcome they had received from provincial officials (*Bilcon v. Canada*, 2015, p. 130). The tribunal blames this outcome on they what they called the JRP's "unprecedented" core community values approach, which was "inimical to the proponents having any real chance of success based on an assessment of their individual project on its merits in accordance with the laws in force at the time" (*Bilcon v. Canada*, 2015, p. 130).

The tribunal further agreed that Canada had breached Art 1102, guaranteeing National Treatment to foreign investors. The tribunal agreed with the claimant that the decision to refer the project to the JRP was unusual, but ruled that these claims were time barred, given that the decision was taken over three years before the investors turned to arbitration.[40] Instead, the breach came from the treatment that the investors experienced as a result of the JRP's failure to take possible mitigation measures into consideration – something that domestic investors in like circumstances had not suffered (*Bilcon v. Canada,* 2015).

As mentioned above, these rulings were not made unanimously, as Donald McRae, Canada's arbitrator, dissented on the ruling of the breach of Art. 1105. He argued that the core community values concept was meant to capture the "human environment effects" of the project, which was well within the mandate of the JRP, and which their final report makes clear (McRae, 2015). He further did not agree with the majority that any possible misapplication of Canadian law by the JRP could amount to a violation of the international minimum standard of treatment (McRae, 2015). Finally, McRae warns of a possible chilling effect for environmental assessment as a result of this ruling (McRae, 2015).

At the time of writing, it has been announced that Canada is petitioning the Canadian Federal Court to set aside the award.

[40] NAFTA limitations period of three years

6.3 The Role of Domestic Interests and Institutions in the Bilcon v. Canada Case

This section provides a more in-depth look at the domestic interest groups implicated in the potential Whites Point Quarry project, and the way in which these groups interacted with provincial and national institutions. It then discusses the decision-making process by policymakers and the extent to which Canada's investment-protection commitments under NAFTA were taken into account.

6.3.1 Domestic Interests: Environmental Groups, Fisherman and Eco-Tourism Providers

As mentioned in the JRP's final report, the proposed quarry generated significant resistance in the communities around Digby Neck, on both environmental and economic grounds. The interested parties came both from the local communities, as well as from provincial and national environmental groups.

The Bay of Fundy is a UNESCO Biosphere reserve, and home to the endangered North Atlantic Right Whale, Atlantic salmon and leatherback turtles (Statement of Defence, 2009). Concern regarding the sensitive environment was emphasized in the public commentary on the project by local citizens, government officials and international environmental groups such as the World Wildlife Fund (WWF) and the Sierra Club. For example, the WWF noted in a letter to the CEAA that "large-scale development, like that proposed for Whites Point, has the potential to destroy or degrade sensitive marine areas before we fully know what merits protection" (Document #2). The letter further noted that, as a member of the Right Whale Recovery Implementation Team, the WWF was concerned about the implications of the project. The Sierra Club of Canada similarly cited concerns regarding Right whales, among other environmental issues such as threats to local biodiversity and greenhouse emissions, in its submission of comments on the draft guidelines of the EIS (Document #3). For its part, in 2005 the DFO submitted comments to the CEAA on the draft EIS guidelines, underlining its concern for local fish habitats in general, and specific at-risk species such as the Atlantic salmon and Right whale (Document #4).

The environmental concerns for the community were quite closely linked to concerns regarding the economic impact of the project. The primary economic activity in the area has traditionally been commercial fishing, particularly for scallops and lobsters (Statement of

Defence, 2009). The concerns that local fisherman had regarding the project were expressed in letters to the CEAA and input into the formulation of the EIS guidelines. For example, a local fishermen's association wrote to the DFO expressing their opposition to the project due to contamination of the bay from ballast water brought by the ships coming from New Jersey, where coastal waters have been contaminated with a lobster parasite. As the letter explains,

> as a result of the proposed quarry operations vessels will transport cargo from the Digby Neck area... to the coastal waters of New Jersey... When these vessels enter our Fundy waters they will dump their ballast in their wake prior to arriving in our port. It is well documented that ballast water transports foreign organisms that harm kelp, seaweed, clams, worms, fish, and various other sea life (Document #5).

Therefore, the association wrote, the quarry project would undermine future fishing operations sustainability of the community generally, and they concluded "we strongly oppose a development where the negative far outweighs the positive." A local fishery articulated a number of concerns regarding the impact of the quarry in a letter to the DFO, which included navigational problems caused by the large marine terminal for small fishing boats, as well as increased traffic in the Bay. The letter exhorts the DFO to "take an open approach to this project by considering these concerns, instead of letting large companies rule with big numbers" (Document #6). A second lobster fisherman's association wrote in with similar concerns (Document #7).

Additionally, the area had recently become a destination for eco-tourism activities such as whale watching, birding, kayaking and canoeing. In a letter to the DFO very early on in the assessment of the project, the Partnership for the Sustainable Development of Digby Neck & Islands Society wrote that "tourism operators in the Bay of Fundy area are presently working hard to promote such sports as salt water kayaking, canoeing and other small boat activities" (Document #8). In the event that a large marine terminal was built in the Cove, the letter explains, these small craft would be put in danger, being forced away from the shoreline and into the strong currents of the bay in order to navigate around the terminal. This sentiment was expressed by a number of other local fishermen (Document #10). A local whale watching tour organizer wrote to the CEAA, extensively detailing concerns both the effect of the quarry on local whale and dolphin populations, as well as on the tourism industry in the area (Document #9).

Therefore, while the quarry would bring jobs to the area, there were concerns that these economic benefits did not outweigh the costs. The company predicted it would provide 34 permanent jobs to the community, but the area supported ten lobster fishing licences which provided approximately 35 jobs (Richler, 2007). Overall, the lobster industry contributed $300 million to the area, and $37 million came from tourism activities (Richler, 2007). Thus, the potential harm to these key industries generated far more fear from the local communities than the opportunities provided by the quarry could allay. As one interviewee summarized "it's not every day that projects get that kind of reaction from the communities, and that was probably a product of the location and its magnitude, and it's a large project in a rural community that has some environmental sensitivities... a lot of concerns originated in the cross section of those issues" (Interview #3).

Over the course of the project assessment hundreds of local residents wrote letters to the CEAA and other government bodies, expression their opposition to the project. Many of these letters spoke not just the potential negative impact of the quarry on specific aspects of the environment or economic activities, but rather concerns related to a broader view of what kind of development was appropriate for the area. For example, one resident wrote "let's...wholeheartedly embrace a new vision for Nova Scotia based on green industries, renewable energy, and high tech enterprises" (Document #11). Others spoke of the importance of preserving the area as it was, where residents could "listen to wild seals sunning themselves on the rocks, watch the sun set, breathe clean air, enjoy the beauty and unspoiled landscape" (Document #12). Lastly, a recurring theme was that the environment and local people would be suffering for the benefit of a foreign investor – as one letter writer expressed,

> this pristine, environmentally sensitive area is in danger of being sacrificed and shipped away by the boatload to another country for the paving of their roads! All this with precious little benefit for the people of Nova Scotia in general, and particularly for those whose lives would be disrupted by the advent of a mega-quarry" (Document #13).

As will be discussed below, these broader concerns, as well as specific worries regarding the local environment and established economic interests, were well articulated by the community and appear to have contributed to the criteria on which the project was judged.

6.3.2 Organisation of Domestic Interests

Opposition to the Whites Point quarry began in the local communities around Digby Neck, with concerned citizens coming together in a group called the Partnership for Sustainable Development of Digby Neck and Islands. Among the goals of the group were to "preserve the pristine nature of Digby Neck and Islands and to promote sustainable development that enhances and quality of life"; and to "stop the mega-quarry for Whites Cove, Little River, Digby Neck and to actively oppose other developments which are inconsistent with the above criteria" (Document #14). Ultimately, the group comprised 350 households (540 individual members) out of the approximately 800 households in Digby Neck and the Islands combined. This group organized fundraisers, raising $100,000 to hire experts to help them in their campaign to stop the quarry. The group also participated in the public consultations held by the investor, as well as the JRP process, and put up "stop the quarry" signs in the area. In 2002, the Municipality of Digby voted against the quarry, and 1,200 people signed a letter stating their opposition to the quarry which was sent to the provincial parliament (Richler, 2007). There was also political support at the local level; "local MLAs, federal MPs were coming out to speak against, local and municipal councils were mostly organized in opposition. There were relatively few speaking out in favour" (Interview #3).

Indeed, the local representatives at the both the federal and provincial level were involved in the fight against the quarry quite directly. Provincial representative Harold Theriault, previously a fisherman in the area, was particularly outspoken against the project, for example hosting a rally in 2006 outside of the provincial legislature in opposition to the quarry (CBC, 2006). As the Claimants noted in the arbitral proceedings, Theriault was adamantly against the quarry and credited his opposition to his electoral success over Gordon Balser, the Conservative MLA who had represented the riding when the project was initiated. Indeed, the election was very close, and Theriault was elected by just 327 votes in Digby in 2003, suggesting that the issue of the quarry may have been a deciding factor (Elections Nova Scotia, 2003). Robert Thibault, the minister of the DFO as well as the federal representative for the Digby riding, was also an important actor in the decision-making process; during the arbitration proceedings the claimants produced correspondence between Thibault and the Minister of Environment, in which the former recommended the JRP process for assessing the quarry (Memorial of the Investors,

2009). Additionally, the claimant cited internal e-mails between DFO staff, one of which stated that the quarry "is in our Minister's riding... the announcement of a joint panel review is of the nature to take a lot of public pressure off the Minister's shoulders for the summer months" (Memorial of the Investors, 2009, p. 34). Thus, it does appear that the two elected officials for the area in which the quarry was to be located had an interest in the project, and the minister of the DFO exerted some influence on the assessment process, at the very least recommending the JRP.

The entire assessment process for the quarry guided what appears to be a great deal of public discontent and resistance to the project through official channels, and opportunities for public input existed at a number of stages throughout. For example, after preparing the EIS Guidelines, the CEAA and the provincial Ministry of Environment provided the public 45 days to review the text and submit comments to the ministry, which were subsequently passed on to the JRP (Document #15). The JRP itself held hearings open to the public, and was mandated to take the comments it received into account when issuing the EIS Guidelines that would be presented to the investor (Document #15). Numerous groups participated, providing testimony and written submissions, many of whom were mentioned in the previous section.

As can be seen in its final report, the JRP required that the investor directly address public involvement, traditional community knowledge, and sustainable development in its EIS. Moreover, it is clear that the JRP took community concerns seriously when writing their final report, as worries expressed by the community regarding ballast water, tourism and fishing opportunities are echoed in the report. For example, the panel writes "the potential effects of the Project on the tourism industry are difficult to predict with any certainty, given the many factors involved, by the Panel acknowledges that those involved in the tourism industry believe that the Project is not consistent with articulated provincial and local policy" (Fournier et al., 2007, p. 11). Less equivocal is their assessment of the quarry's potential impact on the local fishing industry, as they conclude that "the Project would likely have an adverse environmental effect on the socio-economic health and viability of some of the fishing communities of Digby Neck and Islands" (Fournier et al., 2007, p. 11). As mentioned in the previous section, many community members expressed very broad concerns about the potential impact the quarry would have on their way of life and their preferred development trajectory for the area. It is perhaps this that the JRP refers to when they discuss the conflict between the proposed project and the "community's

core values." Indeed, the panel concluded that the greatest negative impact of the project concerned

> community core values... Individuals from Digby Neck and Islands identified these by stressing the importance of a strong sense of place, a living connecting with traditional lifestyles, harmony with the environment, combined with a strong sense of stewardship as a way of life... The imposition of a major long-term industrial site would introduce a significant and irreversible change to Digby Neck and Islands, resulting in sufficiently important changes to that community's core values to warrant the Panel assessing them as a Significant Adverse Environmental Effect that cannot be mitigated (Fournier et al., 2007, p. 14).

As was discussed above, it was this emphasis on core community values which formed the basis of the investor's claims, and was the measure that the majority of the arbitral tribunal argued was a breach of the minimum standard of treatment requirement of NAFTA.

6.3.3 State Interests and Policy Decisions

How did provincial and federal policymakers make the decision to comply with the communities' demands regarding the quarry, and reverse their earlier assurances to the proponent that the government welcomed their project? Moreover, to what extent were decision-makers aware that this policymaking process could trigger NAFTA arbitration?

As described above, the decision-making process itself is at the heart of the dispute – namely why the project was subject to such stringent environmental assessment procedures, and the terms of reference that the JRP used to make its final decision. The material archived by the CEAA gives some access to the decision-making process, and the issues considered relevant by the various government departments involved.

The official consensus of the DFO was that the blasting activity of the quarry would endanger local fish stock, which made the DFO the "responsible authority" for the assessment, thereby automatically requiring that the environmental assessment be carried out jointly by the federal and provincial governments. However, the choice to require the project to be evaluated by the JRP was more discretionary. The recommendation was made by Liberal MP Robert Thibault, who wrote to the federal Minister of the Environment that,

> In light of the information provided by the proponent, DFO believes that the Whites Point Quarry and Marine Terminal, as proposed, are likely to cause environmental effects over a large area of both the marine and terrestrial environments… I am of the opinion that an assessment by a review panel is the most appropriate level of assessment (Document #16)

As discussed above, the archives of the CEAA show that the initial request to form a Joint Review Panel came from the DFO, sent to provincial Ministry of Environment, though the final decision was made by the federal and provincial environment ministers.

The other key issue raised by the claimant was the JRP's reliance on the concept of "community core values" to assess the project, which the claimant argued was not a term that was included in Canadian or provincial policy. The basis for the terms of reference which the panel was to use to assess the project can be found in provincial policy documents, and these suggest a possible foundation for the development of the core community values concept, although it is not explicitly identified. As one provincial civil servant noted, "under our legislation, socio-economic impacts are considered part of environmental effects, and that is maybe a bit different than under different jurisdictions" (Interview #2). Indeed, Nova Scotia's *A Proponent's Guide to Environmental Assessment* lays out an extensive definition of environmental impact which includes both environmental and socio-cultural impacts. For example, the Guide defines environmental effect as "any change... including any effect on socio-economic conditions, on environmental health, physical and cultural heritage or on any structure, site or thing including those of historical... significance" (Nova Scotia Environment, 2001). The JRP Agreement which set the terms for their assessment (and to which the proponent was privy during the whole process) uses the same broad definition. Thus the panel was empowered, for example, to take the "traditional knowledge" of the community into account when assessing the project. Following from this, the EIS Guidelines, which the JRP presented to the investor in 2005, included requirements that the investor "identify the various perspectives and aspirations for the future with the region"; and "consider the relationship between the Project and the relevant community and regional social and economic development strategies, policies and plans" (Fournier et al., 2007, p. 34). The Panel also asked that the investor consider "the perceptions people have about their quality of life and their sense of place" (Fournier et al., 2007, p.36). Therefore, while political concerns were likely an important factor in the local MP's and MLA's opposition to the project, the JRP was required to consider these wide ranging concerns of the community. However, the term "community core values" does not appear in these earlier documents. How the JRP arrived at the use of this term is an open question, although it seems possible, as Canada's arbitrator suggests in his dissent that by "core community values" the JRP simply meant to reference the human environmental effects that were clearly part of the panel's

mandate (McRae, 2015). This was echoed by one of the members of the panel, who explained that in their view, Nova Scotia's provincial legislation allowed for a broad interpretation; "we were applying provincial legislation that includes social considerations. Federal [legislation] is limited to the physical environment, but the provincial legislation is more open. And that gave us much more latitude than would have been available in other provinces" (Interview #3). The term "core community values" is quite broad and does not appear in previous documents related to the specific case of the Whites Point quarry or in broader policy documents. However, it may be that the panel was merely using a new term for what they understood to already be included in the provincial guide to environmental assessment.

How did the "strategic setting," in this case, bound by Canada's NAFTA obligations, affect decision making regarding the Bilcon quarry? Was this dispute ultimately caused by cost-benefit calculations of politicians and civil servants, or by a lack of awareness or understanding of NAFTA?

Both the federal and provincial officials interviewed as part of this project claimed that there is generally a high level of awareness of NAFTA obligations at the federal level, and the Department of Foreign Affairs and International Trade (DFAIT) regularly gives advice regarding obligations imposed by international economic agreements with the passage of new laws and regulations. As one federal official told me, "as a result of our experience with NAFTA… we have gotten quite good at the federal level in taking account of our international investment obligations" (Interview #1). However, this same official admitted that "at the provincial level, it's a work in progress" (Interview #4). This sentiment was echoed by another official who argued that there was greater awareness at the federal level; "our expertise is there. It's growing in the provinces and territories but it wasn't on the radar for them earlier" (Interview #1). A Nova Scotia official explained that, since the province has not been host to many foreign companies, "we wouldn't be as familiar with potential NAFTA obligations. However, we do have folks that provide information and advice on that matter" (Interview #2).

There is evidence that in this case, decisions were made with some degree of awareness of NAFTA provisions, although it appears that the consensus at the time was that it was unlikely that the investor would turn to arbitration. The archived material on the CEAA website shows that e-mails were sent between provincial departments and DFAIT regarding this issue. For example, in an undated e-mail, a DFAIT employee writes that "with regard to the North

American Free Trade Agreement (NAFTA) - the current text in the EIS is generally fine" (Document #17). Moreover, a law professor from the nearby Dalhousie University was commissioned to prepare a report for the JRP on potential NAFTA obligations. This report concluded that "on the basis of an analysis of both the rules and the case law, I do not believe any foreign investor associated with the project would have either opportunity or interest to invoke the provisions of NAFTA Chapter 11 (Winham, 2007, p. 15). Moreover, the public comments to the JRP show that even locally, the issue of NAFTA arose; as one member of the JRP told me "It was an issue that came up quite a bit during the assessment hearings. There were a lot of interveners talking about NAFTA, so I think that right from the beginning we were aware that it was a possible NAFTA challenge" (Interview #3).

However, although they anticipated "some kind of reaction" from the company, the NAFTA case "came as a surprise to a lot of people" (Interview #3). One provincial official noted "what surprised me personally was that if the company had a problem or issue about the process, they had under provincial law and Canadian law, the ability to file for a review [in court]. I think that to us what was surprising was that this was the first avenue of complaint... to go straight to NAFTA, that was surprising" (Interview #2). However, a federal official expressed less surprise that even with attempts to ensure that the decision was compliant with NAFTA obligations, a dispute still arose – "I would say that consultation is helpful in that our measures are consistent with international obligations, but it doesn't necessarily help us to avoid claims. Investors can bring claims if they want to" (Interview #4). It is clear that NAFTA considerations were factored into the decision-making process regarding the Whites Point Quarry, regardless of the fact that Canadian officials and outside experts predicted incorrectly that the investor would turn to arbitration.

6.4 Conclusion

The Bilcon v. Canada dispute is a clear case of domestic non-state actors changing the preferences of states actors toward a specific investment project. Whether or not the investors in this case received special treatment or were offered incentives to invest in Nova Scotia by provincial officials, the province did have official policies in place to attract FDI and spur development in the mining industry. Moreover, that the investors were given the initial opportunity to go through the environmental assessment process implies that there were

government officials who believed the project could be beneficial to the province. Indeed, George Balser, the area's provincial representative when the initial investment was made, spoke about the benefits the project could bring in terms of employment (Memorial of the Investors). However, as was discussed above, local community members had concerns regarding the effect of the project on both the environment and existing economic activity in the area, such as fishing and tourism. The quarry became an election issue in the 2003 provincial election, and an MP who was sympathetic to the views of the quarry's opponents was elected to the riding. This local resistance to the project may have also influenced the federal representative for the area Robert Thibault, who was the Minister of the Department of Fisheries and Oceans – indeed as was discussed above, it was Thibault who suggested the project be assessed by a JRP. Finally, the JRP took the concerns of local people quite seriously, and integrated them into their assessment of the project. Therefore, it appears that local interest group preferences were able to influence a number of stages of decision-making related to the Whites Point Quarry. In its defence, the government cites the high levels of local interest in the project as the reason it was considered appropriate to use the JRP assessment process while similar projects, including a nearby quarry, had been approved following a less stringent environmental assessment. Moreover, the JRP itself refers to the serious threat posed by the project to the "core community values" as the reason that mitigation approaches were not thought to be sufficient. It is this decision, the failure to take into account the company's proposed mitigation measures, which the tribunal ruled was the most severe breach of Canada's NAFTA commitments. However, this can only be understood in the broader context of local opposition to the project and policy-makers' and politicians' identification with these interests, which led them to, for example, suggest the most stringent level of environmental assessment for the project. Following from this observation, it is possible to conclude that the support of citizens in the area provided some incentive for policy makers to change their preferences toward the quarry.

It is clear from the discussion above that these decisions were very much made "in the shadow" of NAFTA obligations, as both DFAIT and outsider experts were consulted regarding the possible breaches of NAFTA. This is unsurprising given Canada's experience as a respondent in NAFTA suits, and policymakers I spoke to at the federal level explained that Canada's bureaucracy has developed some expertise in this area. While provincial policymakers were less familiar with NAFTA at the time, this cannot truly be considered a lack of capacity, as

federal level expertise was relied upon in the decision-making. However, Canadian officials were nonetheless unable to predict that the investors in this case would choose to turn to arbitration rather than pursue any objections they had to the outcome of the environmental assessment process through domestic courts. Aside from the difficulty in predicting when an investor will turn to ISDS, state actors must also assess their chances of being successful in the arbitration. In this case, the final ruling of the arbitral tribunal is also difficult to predict, and was quite remarkable for the expansive understanding of what constitutes a breach of international minimum standards of treatment (NAFTA art. 1105) as well as the domestic bodies that Canada is responsible for under international law – a panel of three university professors who issued a recommendation to the governments of Canada and Nova Scotia.

This underscores one aspect of the wider relevance of this case – namely the uncertainty that ISDS introduces into policymaking for domestic actors. If even well developed bureaucracies such as Canada's, which additionally has significant experience with NAFTA suits, cannot predict which policy measures may trigger an investor-state dispute, it is less likely that developing country policymakers, or those whose countries have faced fewer disputes, will be able to do so. While Canada can bear the costs of an arbitration proceeding and pay the final award if the tribunal rules against it, this type of uncertainty can be quite costly for poorer states.

This case also highlights the extent to which ISDS is driven by the investors themselves. As discussed in previous chapters, ISDS was originally meant to protect foreign investors investing in weak or unstable states in which domestic courts could not be relied upon to fairly adjudicate disputes with the host state. There are very few investment treaties which cover investment flows into developed states, and the assumption has generally been that extra protection for investors is not necessary in contexts in which the rule of law is stronger. As an overview of ISDS cases shows that most respondent states have been developing, middle income countries, the initial rationale for ISDS seems justified. However, NAFTA is an important exception, as it covers FDI flowing from developed home states to developed host states. Although, as mentioned above, Canadian officials assumed that if the investor decided to challenge the final ruling on the quarry they would do so through domestic courts, this proved not to be the case – instead Bilcon turned immediately to international investment arbitration under NAFTA, arguing that Canada had breached international law. Therefore, the Bilcon case demonstrates that when given the opportunity, investors will use ISDS to challenge host state

regulation both in developing and developed states – an important lesson in the face of the potential expansion of ISDS coverage through treaties such as CETA, TTIP and TPP.

Finally, the content of the measure challenged in this case speaks to the way in which ISDS may be used to limit the development of domestic legal norms (Johnson and Sachs, 2015). While for the investors, the JRP's use of the concept "core community values", and the general emphasis on the socio-economic impact of the project was an overreach, to others it may be a welcome addition to the factors on which an industrial project can be judged. Beyond the merits of this specific term, however, this case highlights the ways in which ISDS can be used to challenge stricter regulations or the raising of certain standards – whether in protection of the environment or other public goods (Johnson and Sachs, 2015). In the next chapter, I will discuss how this use of ISDS can pose a particular problem for middle income, developing states.

Chapter 7 Pacific Rim Cayman v. El Salvador

This case study focuses on the investor-state dispute between the Republic of El Salvador and the Canadian gold mining company Pacific Rim. The company began exploration activities in El Salvador in the early 2000s, but after significant delays, was ultimately unable to obtain exploitation licences or the necessary environmental permit to carry out the project. The state measure at the heart of the dispute is the president of El Salvador's declaration of a "de facto" ban on mining, which resulted in a decision to suspend the release of exploitation permits to a number of mining companies with exploration permits in the country. This measure was taken in the context of growing public opposition to mining in the lead up to a highly contested election, as well as a realization on the part of the Ministry of Environment that it did not have the technical capacity to assess and monitor the effects of mining on the country. Therefore, while El Salvador has been very open to foreign investment, and made efforts to attract FDI in the mining sector, this case suggests that under certain conditions public, and particularly electoral, pressure may induce an investment-friendly state to take anti-investor measures. However, it also underscores the relationship between state capacity and investor-state disputes. While it was not necessarily a lack of awareness on the part of relevant policymakers of their obligations under IIAs that contributed to the dispute, the lack of technical capacity in the area in which the investment took place that appears to have contributed to the decision to suspend mining permits in the country.

The dispute between Pacific Rim and El Salvador is in many ways a typical case, based on the large-N analyses presented in Chapters 2 and 5. As a middle income country with a presidential system of government, El Salvador is certainly represented in the categories of most frequent respondent states. Moreover as the dispute involves an extractive industry claimant, this case also illustrates why mining, oil and gas companies are so often embroiled in investor-state disputes discussed in Chapter 3 – namely the threat that the industry is perceived to pose to both the environment and traditional livelihoods by local communities.

Beyond the actors in the dispute, the case exemplifies the convergence of factors that may contribute to the concentration of these disputes in middle income countries. On the one hand, the lack of bureaucratic capacity in the Ministry of Environment led first to a long series of delays for the investor, and allegedly, the to the government's decision to suspend mining

permits. However this case also suggests that countries which are in the process of defining their development priorities, as El Salvador was regarding the place of mining in its development strategy, may be particularly constrained by IIAs – a problem that may face middle income countries most acutely.

7.1 Investment and Mining in El Salvador

El Salvador is Central America's smallest and most densely populated country, and, as a lower middle income country, suffers from high levels of poverty and inequality as well as water shortages and environmental degradation (UNDP, 2010). Following the 1989-1992 civil war, which pitted the conservative central government against left-wing guerrillas, El Salvador made significant attempts to liberalize its economy and attract foreign investment. These initiatives, spearheaded by the right-wing Allianza Republicana Nacionalista (ARENA) party which ruled from 1989-2008, included the writing of a new Investment Law in 1999 which contains a provision for investment arbitration; the creation of the investment promotion agency, PROESA, in 2000; and the 2000 dollarization of the economy. Successive ARENA governments have signed 24 IIAs with developed and developing country partners and joined the US-Central American and Dominican Republic Free Trade Agreement (CAFTA-DR) in 2004. Both the Investment Law and CAFTA's Chapter 10 provide significant investment protection, committing the government to extend the same rights to foreign investors that domestic investors enjoy; prohibiting expropriation without compensation; and providing recourse to international arbitration at the International Centre for the Settlement of Investment Disputes (ICSID). These efforts have been recognised on the international level. For example, in 2006 (during the time period of interest for this study), the World Bank's *Doing Business* report ranked El Salvador 76 out of 155 for ease of doing business – notably, ahead of its regional competitors Costa Rica, Guatemala, Honduras and the Dominican Republic (World Bank, 2006). In 2007, the same publication noted that El Salvador was leading on pro-business reforms in Latin America (World Bank, 2007).

Despite these efforts to create a climate friendly to investment and a generally stable macroeconomic environment, during the last decade El Salvador has failed to attract significant FDI compared to its Central American neighbours (Zegarra, et al, 2007) In a survey of investor perceptions of El Salvador, 49% of investors cited the high crime rates related to a large gang

presence as the biggest impediment to investment,[41] with fears of corruption and lack of policy stability following (Zegarra, et al, 2007). These sentiments were echoed in interviews I carried out with government officials in El Salvador, who recognise that the country has trouble "selling itself" internationally (Interview #7). This is due in part to its violent image and lack of policy stability; "almost always, when we are close to an election, policy uncertainty is the first [concern for investors], and when the government has already been in power one or two years, insecurity and crime take first place" (Interview #8). However, despite this policy instability, prior to the case discussed here, El Salvador had only faced one investor-state arbitration, in which the tribunal rejected jurisdiction over the claim.

As mentioned above, the conservative ARENA party has been in power for the majority of the post-civil war era, a time in which "pro-market elite coalitions were forceful, enjoying a broad electoral base" (Spalding, 2011, p. 2). The Frente Farabundo Marti para la Liberacíon Nacional (FMLN) has been the main opposition party since 2004, when it first participated in presidential elections. The FMLN's origins date back to the civil war, during which it brought together a number of left-wing guerilla organisations to fight the central government. With the signing of the cease-fire in 1992, the guerillas demobilized and the organization was transformed into a political party. The FMLN has been the dominant party in the poorer provinces of Cabañas and Chalatenango which bore the brunt of government repression during the civil war (Wood, 2003). However, in the 2009 presidential election, the FMLN's center-left candidate Mauricio Funes (the first party leader without guerilla credentials) won with 51.3% of the votes (Azpuru, 2010). Funes' election marked the culmination of a shift to the left of the Salvadoran electorate, a country that has traditionally been ideologically to the right of many countries in Latin America. Votes for ARENA candidates have typically been motivated by concerns regarding security and crime, and the country's relationship with the United States. However, Azpuru (2010) notes that voter self-placement has shifted leftwards in recent years, with voters placing economic and welfare concerns ahead of security. Nonetheless, Funes is not a leftist leader in the style of Hugo Chávez or Evo Morales – according to interviewees, both the Funes government and his FMLN successor President Salvador Sánchez Cerén, have continued to enact free market reforms

[41] A well-founded fear, as El Salvador has consistently had the first or second highest homicide rate in region, currently hovering around 70 homicides for every 100,000 persons.

including promoting a public-private partnership law which faced significant civil society criticism (Interview #9; Moreno, 2008).

One issue that has risen to prominence along with the shift leftward of the Salvadoran electorate is the role that mining should play in the country's development. Although mining has a historical presence in El Salvador, it has never contributed substantially to the economy, and the few foreign mining companies operating in El Salvador pulled out during the civil war (Spalding, 2011). However, mining became part of the ARENA government's efforts to attract FDI in the 1990s, and in 1996 the government rewrote the Mining Law to lower royalties and streamline the process of applying for permits. By 2006, eight foreign gold mining companies were operating in some capacity in the country, primarily conducting exploration in the provinces of Cabañas and Chalatenango.

The presence of these foreign mining companies created concern for local communities and organisations, which eventually came together under the banner of the Mesa Nacional Frente a la Minería Metálica (National round table against metals mining) in 2005. Their resistance campaign, later joined by the Catholic Church, international and national NGOs, and Salvadoran universities has proven quite successful. In 2007, a public opinion poll taken by the Universidad Centroamericana in San Salvador recorded 62.5% of the population stating that they did not consider mining appropriate for El Salvador (Durán, 2007). As will be discussed in greater detail below, the national anti-mining mood has had a clear impact on the prospects of mining companies in the country, as political actors at the highest levels turned against mining. In 2008 and 2009, two foreign mining companies, Pacific Rim Cayman and Commerce Group Ltd. sent Notices of Intent to Arbitrate to the government under CAFTA. The next section focuses on the case of Pacific Rim v. El Salvador, an ongoing arbitration case in which the company is making a claim of $301 million against the Salvadoran government.

7.2 Timeline of the Dispute Between Pacific Rim and El Salvador

Pacific Rim Mining Corp., originally headquartered in Vancouver, Canada, began exploration activities in the province of Cabañas, El Salvador in 2002, impressed by the country's pro-foreign investment and mining legal framework (Notice of Arbitration). During 2004-2005, the company began the process of obtaining an exploitation licence from the Ministry of Economy's Bureau of Hydrocarbons and Mines. This process requires the submission of proof of legal

ownership of the land of the concession site, a feasibility study for the project, and an environmental approval from the Ministry of the Environment and Natural Resources (MARN for its initials in Spanish). In order to obtain the environmental permit, a company must submit an Environmental Impact Statement (EIS) detailing the potential environmental impacts of the projects, and the steps that will be taken to remediate them. The final decision on the granting of the permit is made by the Minister of Economy (MINEC), who is required to make his or her decision based on "national interest, the financial and technical capacity of the applicant, and the characteristics of the proposed mining operation" (El Salvador's Preliminary Objections, p. 35).

The process to obtain all required environmental permits and exploitation licences took several years and encountered many delays which the claimant attributed to the lack of expertise of the MARN and MINEC, given their limited experience with mining operations (Memorial on the Merits, 2014). In particular, one aspect of the process – proving that the company owned the land it planned to exploit – seems to have caused confusion for the company and within the various relevant ministries. Specifically, it was unclear whether the company must buy the land from local communities or merely obtain the licence from the state to exploit the subsoil. In correspondence between MINEC and the Secretary for Legislative and Legal Affairs in the Office of the President the Minister of Economy writes that Pacific Rim argued "they will be mining the subsoil and the subsoil belongs to the State; if they request permission from the landowners it would amount to saying that the owners of the surface land are owners of the subsoil" (Memorial on the Merits, p. 109). The Claimant notes that various government bodies did not share an opinion on this issue, and the Claimant actively suggested changes of the Mining Law to the government, arguing that the requirement to seek landowners' permission to mine the subsoil was not consistent with the norms of ownership in the Salvadoran legal system (Memorial on the Merits). Throughout 2005 this issue remained unresolved.

Additionally in 2005, as required, Pacific Rim made its draft EIS available to the public in order to solicit feedback. However, as the document was largely in English, over a thousand pages long, and interested parties were prohibited from making copies in order to read it on their own (McKinley, 2009), the ability of locals to comment was fairly limited (Interview #12). In 2006, the company submitted its final EIS, believing that they had submitted all relevant documentation and that their licence would be granted immanently (Shrake, 2010).

Throughout 2006, against the background of the legal questions mentioned above, Pacific Rim continued exploration activities, as well as pursuing their environmental permit, which included addressing concerns raised in public consultations (Memorial on the Merits).

Between December 2006 until 2008, MARN and other government agencies ceased official communications with the company. During this time, the Ministry of Economy hired an outside expert, Dr. Maneul Vidal-Pulgar, the current environment minister of Peru, to assess the appropriateness of metallic mining for El Salvador, who concluded that "'the Ministry of Environment is not equipped to effectively assume a strong environmental policy regarding mining activity'...due to lack of experience and expertise on the subject, lack of sufficient personnel, and an insufficient budget" (Counter Memorial on the Merits, p. 95). This is relatively unsurprising, given, as mentioned above, that mining was a relatively new industrial activity for El Salvador, and the Ministry of Environment itself was only nine years old. Dr. Pulgar further noted in his report that Salvadorans exhibited distrust of the Ministry of Environment's capabilities to adequately assess the potential impacts of mining activity and expressed concern regarding water use and contamination, deforestation, and the ministry's inexperience (Counter-Memorial on the Merits). Furthermore, he found that the country lacked a "comprehensive vision" for mining development, a water policy to ensure universal access to water, and inadequate mechanisms for citizen participation in decision-making processes (Counter-Memorial on the Merits). He concluded that if mining activity were to progress at this stage, it would result in growing social conflict. Instead, he suggested a Strategic Environmental Assessment be carried out to identify the potential environmental impacts mining would actually have in the country (Counter-Memorial on the Merits).

As a result of this report, the Minister of Environment at the time explained that the ministry would not authorize any project that posed an environmental harm, and specifically mentioned the ministry's lack of capacity to regulate the mining industry. However, subsequently, the Minister publicly reversed his position, stating that El Salvador did not legally prohibit mining (Memorial on the Merits). In 2007, the new minister reiterated that the ministry would not grant permits to mining concessions until the study on the potential effects of mining was completed (Counter-Memorial on the Merits). Ultimately, this environmental assessment was not carried out by President Saca, but was begun in 2009 by the subsequent administration.

During this period, local communities in Cabañas were expressing concern regarding the potential mining activity in their region to Oxfam America (Meija, 2006; Counter-Memorial on the Merits). This resulted in some violent encounters, including the murders of a number of anti-mining activists, allegedly by pro-mining actors (Counter-Memorial on the Merits). It was also during this period that the aforementioned opinion poll on mining in El Salvador was carried out by the Universidad Centroamericana, which showed that the majority of Salvadorans were against mining activity in the country.

During 2007 and 2008, company representatives continued to meet unofficially with high level bureaucrats who assured them that the delays in granting their licence would be resolved (Shrake, 2010). During this period, public opposition to the project was mounting, with the Catholic Bishop's Conference of El Salvador making a statement against mining (CEDES, 2007). At this time, the company officially relocated its headquarters to Reno, Nevada. According to one interviewee, one of El Salvador's lawyers on the case, in 2007 the company first threatened the government with arbitration, and shortly thereafter, El Salvador engaged the legal services of the Washington firm Dewey & LeBouef LLP (Interview #10).

In 2008, President Tony Saca held a press conference at which he stated his intention to revisit the legal framework of mining in the country (Notice of Arbitration). In its Notice of Arbitration, the company claims that, despite the delays in the process of granting a permit, it was not aware of a dispute with the government until Saca's "de facto" ban on mining.[42] In December 2008, Pacific Rim officially filed its Notice of Intent to Arbitrate.

During the election campaign of 2009, FMLN candidate Mauricio Funes expressed his opposition to mining, and in a public event with the Mesa, committed that no new mining permits would be granted were he to win the election (Interview #11). At this point, company representatives claim, they reached out to both President Saca and President-elect Funes to determine whether a negotiated solution could be reached (Shrake, 2010). However, a number of interviewees suggested that the company's only interest was in the granting of the mining concession; they would not accept a negotiated monetary settlement (Interview #12; Interview #10).

[42] According to Luis Parada, this claim is disingenuous given the company's 2007 arbitration threat, and the fact that he was approached to join their legal team at this time (Parada Witness Statement). Moreover, an insistence of ignorance of the dispute until 2008 was an attempt to allow the company to argue that its 2007 nationality change was not motivated by a desire for jurisdiction under CAFTA, which it did not have as a Canadian company.

El Salvador's "de facto" ban continues, and in 2012, the government officially suspended all administrative procedures related to mining (Cabezas, 2014). The creation of a committee to periodically review the technical capacity of El Salvador to play host to mining keeps the possibility for exploitation activities alive. A proposed ban on all mining activity has not been seriously discussed by the Legislative Assembly, despite pressure from the Mesa and support from some FMLN deputies (Interview #9).

In 2013, Pacific Rim was facing severe financial difficulties, and was purchased by the Canadian-Australian company OceanaGold Ltd. for $10.2 million, allowing it to continue the arbitration process against El Salvador.

7.2.1 The Arbitration: Pacific Rim Cayman v. El Salvador

Pacific Rim served El Salvador with a notice of arbitration in April, 2009, and the tribunal was constituted in September of that year. The arbitration is ongoing, with the most recent round of hearings ending in September 2014. A summary of the investor's claims against El Salvador is presented in the table below.

Table 7.1Arguments Pacific Rim Case

Alleged Breach of CAFA/Domestic Investment Law	**Claimant's Arguments**
10.3 National Treatment; 10.4 Most Favoured Nation Treatment; Art. 5 Equal Protection & Art. 6 Non-discrimination	Respondent treated the claimant in an arbitrary manner; there was no indication that the EIA was inadequate on technical grounds; other industries that raise similar environmental concerns extended more favourable treatment
10.5 Minimum Standard of Treatment	Despite the fact that the claimant has complied with all legal requirements to be granted exploration and exploitation licences, the Respondent refuses to allow mining activity that is permitted by its own legislation.
CAFTA Art. 10.7 & Art. 8 Investment law Expropriation and Compensation	The Respondent's conduct has rendered the investment worthless and therefore constitutes an indirect and direct expropriation.

Saca's 2008 "de facto ban" on mining is at the heart of the investor's case against El Salvador, as they claim that until that time, they were not aware of any dispute with the state. Indeed in the Claimant's Memorial on the Merits, the investor's legal team writes that until 2008, the investor

believed it would be granted an environmental permit; "then, with the announcement of the *de facto* ban on metallic mining in Mach 2008, the Executive Branch of the Salvadoran Government illegitimately swept aside the legal and regulatory regime upon which [the] Claimant had relied" (Claimant's Memorial on the Merits, p. 2). The claimant argues that this ban on mining deprived the company of its assets, and had no legal justification. Therefore, while the claimant goes into great detail regarding the various administrative delays they faced in their attempts to secure environmental and exploitation permits, these are not the measures they challenge. Rather they discuss this lengthy administrative process in order to demonstrate that despite these delays, they were always assured by various officials that the government supported the project, and all required licences would eventually be granted (Memorial on the Merits). The claimants therefore attribute delays, until Saca's 2008 announcement, neither to deficiencies in their own documentation submitted to the various ministries, legitimate environmental concerns, nor political opposition to the project. Rather, they underscore a lack of bureaucratic capacity due to the recent arrival of the mining industry in El Salvador.

On the other hand, El Salvador's defence argues that there were a number of deficiencies with the company's applications. First, the government contends that Pacific Rim never successfully completed the purchasing of the concession site from local owners, and was thus unable to provide proof of legal ownership of the entire site (Preliminary Objections). Moreover, the government argues that, instead of concentrating on meeting the requirements for the original concession site, including submitting a final feasibility study, the company continued to expand its exploration activities on land that it did not own. The government alleges that the company was at this point given opportunities to re-submit a feasibility study, but did not do so, and instead allowed its exploration licences for the land to which it had a title expire in 2005. The government further alleges that the company was unable to secure a "social licence to operate", in large part by not adequately addressing the concerns of local communities, particularly regarding water usage. The defence argues that these environmental concerns were shared by the MARN; in particular, the government found deficiencies or lack of information regarding the company's environmental management plan, proposed mitigation measures, cyanide transport, and a mine closure plan (Counter-Memorial on the Merits, 2014). Moreover, as discussed above, these specific concerns arose as the MARN was coming to terms with its lack of capacity to adequately monitor and regulate mining activity (Counter-Memorial on the Merits, 2014).

Therefore, the defence argues, “there was never, as the Claimant alleges, a ‘ban’ (denoting a permanent prohibition) on metallic mining. Rather…El Salvador made the reasonable decision to suspend the review of applications for environmental permits related to metallic mining” (Counter-Memorial on the Merits, 2014, p. 121). El Salvador argues that this policy shift was based on recognition of its lack of technical capacity to properly regulate the mining industry, and that this position is supported by the precautionary principle required by the Salvadoran Constitution (Johnson, 2014). Moreover, the *amicus curiae* brief submitted by the Center for International Environmental Law argues that “the facts underlying the [company’s] claim are deeply intertwined with the social and political change” related to democratization in El Salvador, that led to the emergence of “the grassroots, peaceful opposition to Pac Rim’s proposed mine” (Orellana, 2011, p. 5). However, El Salvador denies that Pacific Rim was unduly affected by this policy shift, given that they did not meet the requirements to be granted the necessary permits.

The arbitration process is ongoing, and thus it remains to be seen how the tribunal will treat these arguments.

7.3 The Role of Domestic Interests and Institutions in the Pacific Rim v. El Salvador Case

This section provides an analysis of the domestic interests that led a reversal of El Salvador’s position on mining, which in turn triggered the arbitration case.

7.3.1 Domestic Interests: Small Scale Agriculture, Water Use and the Environment

Domestic groups relevant to this case exist at the local and national level, and range from traditionally politically disadvantaged groups to some of the most influential actors in the country. Despite this heterogeneity, there was a high degree of coherence in the concerns that they shared. Arguably, this is what led to the successful mobilisation of a wide-spread anti-mining movement in the country.

The groups with the most at stake in the conflict with Pacific Rim are the local communities which would be directly affected by mining operations, and it is indeed these communities which spearheaded the opposition. The communities, located in the province of Cabañas, make their living primarily from subsistence farming, and thus rely heavily on local

surface water for crops and livestock, as well as their own consumption. As mentioned above, El Salvador suffers from a lack of access to drinking water, with almost all surface water in the country severely contaminated, a particularly severe problem in rural areas (McKinley, 2009; Orellana, 2011). Mining is a highly resource-intensive activity, and uses significant amounts of water in its extraction processes, while contributing to the contamination of ground water through its use of chemicals such as cyanide and arsenic. According to Pacific Rim's own EIS, the project would use 240,000 gallons (908,499 litres) of water per day – what the average Salvadoran family uses over a 20 year period (Wilson, 2010). Thus, the threat of water shortages, and further contamination of drinking water for both humans and animals was a significant concern for local communities. Moreover, despite being rural, the area in which the mine was to be located is quite densely populated (194 persons/km^2), intensifying any adverse effects, and increasing the possibility of displacement (Orellana, 2011).

The potential benefits of the mining project did not outweigh the drawbacks for the community. In a news article, the mayor of San Isidro, the municipality closest to the mine site, expressed doubt as to whether the jobs that would be created by the project would be accessible to local community members; "[t]hey talk of 600 jobs, but we ask ourselves how many people from this area will really be able to work with the technology that they bring...Because if not, I doubt that 100 employees will be from this area"[43] (Quezada, 2006). In fact, during arbitration, the company stated that 220 permanent jobs would be created (McCrum et al, 2014). However, in an interview, one of the leaders of the Mesa summed up the concerns of the local communities: "Definitely it isn't the best solution to permit mining in the country – not environmentally, not politically, and even less economically. The companies take everything [out of the country], and leave problems, leave contamination" (Interview #11). This sentiment was echoed by an official from MARN, who stated that, "the Pacific Rim project obviously was going to generate revenue; however the environmental damages would not be covered by the project. Economically, it had utility for the communities in the area and for the country, but only in the short term" (Interview #13).

[43] Most news articles and all interviews have been translated from Spanish.

7.3.2 Organisation of the Anti-Mining Movement

The anti-mining movement has been able to organize successfully, at the local, national and transnational levels, and involve important domestic political institutions. The primary actor in the opposition to mining in El Salvador has been the Mesa, which brought together numerous older community organisations under its banner, playing “a critical brokerage role, linking across community, environmental, human rights, activist research and religious organisations” (Spalding, 2011, p. 8). Although the communities were initially unsure of how to respond to the presence of the mining company, some groups made the decision to visit mining-affected communities in Honduras and Guatemala on a fact-finding mission.[44] Alarmed at what they saw, they began to organise seriously, and the Mesa was convened in 2005 (Interview #11).

They fairly quickly founded a movement in which “everyone is involved... in the first place the affected communities, in almost all places where there is mining, the people are aware of the problems. In some places, especially Chalatenango, the mayors are involved. There, the community development organizations and the Church is involved at the national level, research institutions and universities are against mining” (Interview #11).

The spread of information regarding the environmental and human costs of mining has been an important strategy for the anti-mining movement, and the Mesa has emphasized the threat mining poses to the national water supply, as well as the lack of widespread economic growth associated with mining activity. At the national level, the Universidad Centroamericana held a “National Forum Against Mining” in 2006, and in 2007 carried out the aforementioned public opinion poll which indicated that a majority of the population of El Salvador was against mining activity in the country. A number of think tanks and research institutes have been involved in carrying out and disseminating studies on the impact of mining, and international NGOs such as Oxfam America have lobbied the government to adopt an anti-mining stance (Spalding, 2011). These NGOs have also hired outside experts – hydrologists, economists, environmental scientists and geologists from the United States and Switzerland – to produce reports and analyses of the company’s EIS. These experts have all been highly critical of the company’s environmental protection measures; for example, American hydrologist Robert

[44] Both countries have considerably more experience with mining than El Salvador, hosting mines that are infamous for contributing to severe environmental contamination and human health problems, for example the San Martin mine in Valle de Siria in Honduras owned by GoldCorp, and the Marlin mine in Guatemala owned by Glamis Gold.

Moran points out in his report that the standards proposed by Pacific Rim for acceptable levels of cyanide in mine runoff fell short of American and Canadian standards (Spalding, 2011).

Domestic governmental institutions have also become involved with the anti-mining movement, including the office of the Ombudsman for the Defense of Human Rights (PDDH, its acronym in Spanish), an institution created during the post-war peace process. The Ombudswoman for the Defense of the Environment (an office within the PDDH), has been involved with the work of the Mesa since 2005, and the PDDH's official position on the issue is both against mining in El Salvador, and investment arbitration (Interview #14). The support of the Catholic Church has also contributed significantly to the movement's success. As Spalding (2011) notes, Catholicism is the country's dominant religion, and the Catholic Church enjoys high institutional trust scores among opinion poll respondents. Therefore, "the call by Salvadoran bishops for greater environmental protection, in keeping with pronouncements from other church authorities in Central America and beyond, presented the mining industry with serious challenge" (Spalding, 2011, p. 21).

Finally, on the political level, the FMLN's strong support base in the provinces of Cabañas and Chalatenango – the regions affected by potential mining activity – have incentivized the party to adopt an anti-mining line, and a number of FMLN deputies were directly involved in the activities of the Mesa. On the other hand, many ARENA deputies, remain in favour of attracting mining to the country, according to an interviewee (Interview #9).

According to one interviewee, the mining movement has been successful despite the predisposition of the state to be friendly towards the industry; as he explains, "there is a law that permits mining, there are mining companies that want to exploit minerals, all the economic conditions exist for mining to take place. However the [anti-mining] stance of the communities and pressure from the people do not allow for it" (Interview #11).

7.3.3 State Interests and Policy Decisions

The Mesa and allied organisations were undoubtedly successful in placing mining on the national agenda. But how was the decision made to enact the "de facto" mining ban, and proceed to arbitration against Pacific Rim? What motivated a state, which had put significant efforts towards creating an investment friendly climate, to take anti-investor measures? Finally, what role did uncertainty, or lack of awareness regarding the IIA play in the decision-making process?

When government officials took these measures, did they anticipate that it would trigger an investor-state arbitration proceeding, or were they unaware of the possible consequences of these policy decisions?

The Mesa's efforts to convince various important domestic institutions and the broader public that mining was not appropriate for El Salvador was well timed, given the shift in the nation's political mood. As is discussed above, the traditionally right-leaning electorate was experiencing a shift to the left that coincided with the Mesa's efforts. This put significant pressure on Tony Saca's ARENA party in the lead-up to the elections in 2009, which likely contributed to his efforts to "publicly distance his administration from some traditional party positions … one area where this division can be seen is in his emerging position on the mining concessions which he began to question publicly in 2008" (Spalding, 2011, p. 29). Moreover, it is clear that Funes' adoption of an anti-mining position was directly related to the FMLN's traditional support base among the peasants of Cabañas and Chalatenango, where almost all mining activity in the country has been located. The role of electoral pressure in the decision to enact the "de facto" mining ban was emphasized by a number of interviewees who doubted the sincerity of Saca's anti-mining position. As Saul Baños, the lawyer for the Mesa argued:

> I believe that they saw it as a benefit to their image. Above all, knowing the record of [President Saca], I can say that rather than good intentions, or an environmental concern, it was a political question. It's not the same as if he had done it at the beginning of his mandate. And moreover, if it had been a genuine interest, he could have promoted a law that banned mining (Interview #12).

President Saca's announcement – as the measure ultimately contested by the investors – reinforces the findings presented in Chapter 5 regarding the role of presidents in investor-state disputes. As Wiesehomeier and Benoit (2009) discuss, in relation specifically to Latin American presidents, when these actors are directly elected by the constituents, they may face greater incentives to act unilaterally pass decrees to appeal to the public. This tendency is exacerbated when presidents have a high degree of control over their ministries, and some independence from their party (Wiesehomeier and Benoit, 2009; Heffernan, 2005). This certainly appears to be the dynamic in this case – as Saca made this announcement in an electoral context in which mining had become a key issue, while others in his government and party held pro-mining and investment preferences.

While the political utility of an anti-mining position in the lead up to the 2009 elections is clear, this does not negate the fact that the bureaucratic resistance to Pacific Rim's project began several years earlier. It is important to note that mining was relatively new to El Salvador and, as both news articles and interviewees suggested, the government never had a clear policy towards the industry. For example, when asked why the government had changed its stance towards mining, one interviewee stated "I don't think the government changed its position, rather El Salvador never had a clear position on [mining] or the environment. It's a very controversial subject, and I think that the institutional [capacity] of the MARN was never very strong" (Interview #8). The amicus brief submitted by the Center for International and Environmental Law to the arbitration tribunal echoes this sentiment, arguing that the potential for IIAs to cause "regulatory chill" is exacerbated in developing countries where "rapid legislative development and implementation is needed rather than obstacles to the application of new laws" (Orellana, 2011, p. 13). In the early 2000s, as Pacific Rim was in the midst of applying for exploitation permits, no studies had been carried out regarding the viability of mining in the country, and even then, observers were criticising the government for not having a clear position on mining (Pacas, 2007). It is possible that, prior to the opposition movement spearheaded by the Mesa, officials in El Salvador had never seriously considered the impact of mining on the country. When faced with the strong opposition to mining from the public, it had to develop a policy position in a fairly ad hoc manner.

Indeed, as this lack of serious consideration of the possibilities of mining implies, extractive industries never played a significant role in El Salvador's economic development plan. As one government official outlined, El Salvador has identified a number of strategic sectors in which it endeavours to attract investment – textiles, confections, aeronautics, pharmaceuticals, electronics, and business services such as call centers. Mining has never been a priority for the government (Interview #15). An official from PROESA, El Salvador's investment promotion agency, underlined this point: "PROESA doesn't have a policy of promoting mining... it's necessary to respect the will of the country that doesn't want to attract investment in certain sectors" (Interview #7). Therefore, the lack of reliance on mining (compared to other countries in Latin America such as Peru and Guatemala which depend heavily on the sector and have not conceded to anti-mining movements) may have allowed El Salvador to be more receptive to anti-investor public pressure in this case. This observation is strengthened by the insistence of several

interviewees from various government bodies, that El Salvador has only had disputes with investors in "difficult" strategic sectors such as mining and energy, not with companies in the areas El Salvador wishes to promote, such as manufacturing (Interview #7; Interview #15).

Finally, how did the "strategic setting," in this case, a setting in which state policy options are constrained by the IIA, affect decision making regarding Pacific Rim? Was this dispute ultimately caused by cost-benefit calculations of policymakers or a lack of awareness of their obligations under CAFTA and the national Investment Law?

There was no consensus among interviewees regarding policymakers' levels of awareness of IIAs and the possibility for investment arbitration before the government's dispute with Pacific Rim and other mining companies. The ARENA government had no publicly known experience with investor-state disputes prior to 2009 (Interview #16). Moreover, a number of interviewees spoke negatively of the technical capacity of various government bodies. As one ex-government employee noted, "I think that the dispute resolution mechanisms are not well known. The majority of public officials don't know them, nor are they aware of the content of the bilateral investment treaties we've signed" (Interview #8). Luis Parada, member of El Salvador's legal team, is of the opinion that prior to the Pacific Rim case, "there were perhaps one or two officials in the [Ministry of Economy] who were aware of [IIAs] but they had no idea how it would work" (Interview #10). However, others argued that there were processes in place to ensure that new policies were in compliance with IIA obligations and, "in such a small country there is a great deal of central control, too much, and we have tried to sensitize government employees" to the obligations of investment treaties (Interview #7).

However, regardless of the levels of awareness among public officials regarding the provisions of CAFTA and the Investment Law before the advent of the Pacific Rim arbitration, witness statements from both the prosecution and the defense make it clear that the threat of arbitration was communicated to President Saca's administration before the official Notification of Intent to Arbitrate was sent. Moreover, the president made public statements claiming that he would rather pay fines than allow the granting of mining permits (Gramont, 2009). Therefore, it is clear that the government of El Salvador did make conscious cost-benefit calculations in the face of opposing public and investor pressure, and chose to concede to the former.

Of course uncertainty continues to play a role, both for the government of El Salvador and my own investigation, as the outcome of the arbitration tribunal is unknown. It remains to be

seen whether the gamble of siding with the public over the foreign investor will pay off for El Salvador.

7.4 Conclusion

Like the Bilcon v. Canada case presented in the previous chapter, the anti-mining preferences of broad interest groups played a clear role in shifting the preferences of the government toward the industry. From the end of the civil war in the early 1990s, El Salvador's conservative government had a very open policy toward investment, and made efforts to attract mining projects. Moreover, it appears that many government actors were initially quite supportive of Pacific Rim's projects. However, faced with mounting public pressure against mining, in the lead up to a contested election, the government reversed its position. Indeed, it is clear that political considerations did play a role in state actors' decisions regarding mining development in El Salvador, and the anti-mining movement should be given credit for drawing national attention to the issue. Even if the MARN and other government agencies had been debating the merits of mining for a few years, the timing of Saca's announcement says much and suggests that his was not spurred primarily by environmental concerns. As mentioned in the introduction to this chapter, President Saca's role in the dispute between Pacific Rim and El Salvador fleshes out the finding in the large-N study on the connection between presidential systems and investor-state disputes; executives that are able to act unilaterally, and face incentives (in this case electoral pressure) to enact policy reversal vis-à-vis an investment seem quite likely to do so. This further underscores the role of changing domestic preferences in contributing to investor-state disputes.

Unlike the case discussed in Chapter 6, however, state capacity appears to have also played a role in this dispute. As both the claimant and the state mention repeatedly, mining was new to El Salvador. The claimant uses this as an excuse for the many delays it faced in trying to obtain its environmental and exploitation licences, arguing this lack of capacity slowed down the process, but was not indicative of actual opposition to the project based on genuine environmental concerns on the part of policy-makers. Therefore, the claimant argues, these delays were not an expression of a purposive policy, but rather inhibited the government from fulfilling its stated policy (and legal obligations) of welcoming the investor's project. The government does not deny that there was a lack of capacity, particularly within the MARN to deal with mining activity. However it argues that there was recognition of the deficiencies within

the bureaucracy, particularly regarding assessing and monitoring the environmental impact of mining in the country. Thus, they partially attribute these delays in the claimant's attempts to obtain the required licences, as well as the eventual broad "policy shift" that places a moratorium on mining, to the judgement by the government that it did not at the time have the institutional capacity to regulate mining. Therefore, in this case, a lack of state capacity also contributed to the investor-state dispute in question. However, given the government's aforementioned open stance toward mining, and the significant need for FDI in the country, it is likely that the public opposition played an important role in pointing out this lack of institutional capacity and the weaknesses in the country's regulatory policies related to mining. In the absence of public opposition to mining, the government may not have felt the need to address these issues in the face of increased investment in the extractive sector.

Finally, interviewees suggested that Salvadoran officials did not have much awareness of CAFTA and the potential for investment arbitration prior to this case, especially in the MARN. Therefore, they likely did not consider CAFTA obligations during the processes to assess the project and decide whether or not to grant Pacific Rim the necessary licences. However, as El Salvador's legal representation stated, the investor communicated to the executive at several points that it was considering investment arbitration. Luis Parada claims that arbitration was threatened as far back as 2007, and the investor states that they reached out to both the outgoing President Saca and incoming President Funes regarding the conflict. Indeed, President Saca himself announced that he would rather the government pay $90 million in arbitration than grant the concession (Memorial on the Merits, 2014). Therefore, whether the potential benefits were political support or environmental protection (or likely, a bit of both) the government of El Salvador clearly decided that these outweighed the potential costs posed by arbitration.

However, despite the apparent victory of the anti-mining movement in altering the preferences of the Salvadoran government, mining still remains a possibility for El Salvador, as no legislation officially prohibiting it has been passed. Moreover, a committee has been established to periodically review the technical capacity of El Salvador to play host to mining keeps the possibility for exploitation activities alive. A proposed ban on all mining activity has not been seriously discussed by the Legislative Assembly, despite pressure from the Mesa and support from FMLN deputies (Interview #9).

This brings us to the wider relevance of this case – it highlights the potential effect that ISDS can have on the development of policy in issue areas adjacent to foreign investment. Indeed, it is arguable that the arbitration case between has played a role in stalling decision-making regarding the status of mining in the country. This is in part due to the fear that passing legislation officially banning mining would provoke further arbitration cases. Over 25 mining companies have had concessions granted to them, and while the administrative processes regarding their permits are currently suspended, according to employees at Oxfam America, the fear of provoking further companies to sue the state has impeded the government from promoting a law to officially ban mining (Interview #17). This statement was echoed by Yanira Cortez, deputy attorney for the environment in the PDDH office in an interview with *The Guardian*: "There are so many permits on standby right now, so there is fear that these companies will follow the lead of Pacific Rim" (Provost, 2014).

An interviewee also suggested that the state had analyzed the situation and decided that "in this moment we can't pass a law [prohibiting mining] because it would be counter-productive in the case against Pac Rim" (Interview #14). Similarly, Luis Parada, El Salvador's legal counsel stated,

> That there is no official position on mining is in part due to the arbitration. There are two bills currently before parliament, one is a moratorium and one is an outright ban that would prohibit metallic mining. The government has not taken action on either one, in part because they are waiting for the arbitration to be over (Interview #10).

One reason for this may be that in the context of the arbitration, the defence's argument relies primarily on proving that Pacific Rim 1) did not meet the technical requirements for an environmental permit to be granted, or complete its feasibility study; 2) failed to adequately address the concerns of the local communities as well as outside experts; and 3) did not complete the purchase of the land required for their operations (Counter-Memorial on the Merits, 2014). Moreover, El Salvador argues that numerous external experts advised the MARN to suspend mining activity, due to the ministry's lack of technical capacity to ensure that it did not cause environmental damage, and that constitutionally, the government is required to adopt a precautionary principle towards protecting the environment and human health (Counter-Memorial on the Merits, 2014). However, the MARN's report on mining was only completed in 2012, and as mentioned above, the proposed law which would at least make official the

moratorium on mining has not been passed by the legislature. Therefore, as mentioned above, the defense argues that

> El Salvador's decisions regarding metallic mining in general and Pac Rim's environmental permit specifically did not have any impact on Pac Rim…El Salvador's policy decision did not affect any rights with regard to exploration licences because Pac Rim did not have a right to the exploration licenses for which it claims damages (Counter-Memorial on the Merits, 2014, p. 125).

Thus, in the context of the arbitration case, El Salvador is attempting to underline the technical aspects of its decision-making regarding Pacific Rim's application for an exploitation licence, rather than the political contestation which I have argued contributed first to President Saca's decision to announce a de facto ban on mining; as well as to President Funes' declaration that no mining would take place where he to be elected and his subsequent continuation of this ban. Of course, this does not discount the legitimate concerns that the MARN had about its own technical capacity to monitor the mining industry, or the faults in Pacific Rim's application materials; I do not argue that these considerations played no role in the state's decision-making. However, in front of the tribunal, the defence has made a concerted effort to deny the claimant's position that the decision to withhold Pacific Rim's licence to was a political one. If a law banning mining had been passed after the company had first threatened arbitration, this could undermine the state's argument that it based its decision on technical criteria.

This emphasis on the technical aspect of decision-making is likely due to the lack of value arbitral tribunals have historically placed on a state's political considerations – measures which are seen to be applied hastily due to political pressure are not considered legitimate under the IIA regime, and indeed the normative content of the IIAs and arbitral decisions privileges technical criteria over political considerations (Tucker, 2015; Yazbek, 2010).

Indeed, it is difficult to imagine how a country like El Salvador might enact a measure such as ban on mining, if any concessions had previously been granted, and not subsequently provoke investment arbitration. El Salvador certainly is not above reproach in the way it dealt with Pacific Rim, and it is not clear whether or not the key decision-makers held genuine reservations about the suitability of mining in El Salvador or were more concerned with maintaining political support. However, there do appear to be legitimate questions regarding the feasibility of mining in such a densely populated and water insecure country. In an era when citizens, non-state actors, and international organizations are increasingly concerned with environmentally sound and sustainable development, there may be increased calls to rethink the

promotion of industrial activity which can be particularly harmful to the environment – especially in countries such as El Salvador that do not have a well defined position on the industry, and are not overly dependent on it. Therefore, it may become politically as well as environmentally desirable not to grant licences to extractive projects, regardless of whether they technically meet the legal requirements already in place. Of course, while the passing of anti-mining legislation is perhaps a more desirable approach as it could perhaps avoid charges of breach of National or Most Favoured Nation Treatment provisions, legislative measures may still be challenged as expropriations. Thus, the Pacific Rim v. El Salvador case demonstrates the ways in which ISDS may inhibit broader policy change.

Chapter 8 AES Summit Generation & Electrabel v. Hungary

The case study presented in this chapter focuses on the disputes between Hungary and two foreign-owned electricity generators – AES Summit Generation and Electrabel. Both companies, along with a number of investors, signed long-term Power Purchase Agreements (PPAs) with the Hungarian government in the early 1990s. These agreements provided investors with a guaranteed profit on electricity sold to the state-owned distributor, and were an important tool in the attraction of foreign investment into Hungary's newly-privatized electricity sector after the end of communist rule. However, these agreements attracted criticism domestically as well as internationally. In Hungary, the PPAs were attacked by politicians for providing so-called "luxury" or "excess" profits for the foreign-owned generators. At the EU level, the PPAs raised concerns about illegal state aid and were eventually subject to an investigation by the European Commission (EC).[45] These various pressures led first to changes to the agreements, and ultimately to their termination, which in turn provoked three known investment arbitration cases under the Energy Charter Treaty.[46]

Hungary prevailed in the two disputes discussed here, and notably, both arbitral tribunals viewed as legitimate the state's political motivations for taking the contested measures. For example, the tribunal in the AES Summit case concluded that the government was "motivated principally by widespread concerns relating to reducing ...profits earned by generators and the burden on consumers," and that this was is "a perfectly valid and rational policy objective for a government to address luxury profits" (*AES Summit v. Hungary*, 2010, p. 82). The tribunal was less clear regarding importance to the interests of the state-owned electricity company Magyar Villamos Művek (MVM) in the policy making process regarding the administrative pricing. However, over the course of this research it emerged that the interests of MVM were central to both the reintroduction of the administrative pricing and the cancellation of the PPAs. Therefore, while on a rhetorical level the "mass interests" of Hungarian energy consumers were an important determinant of this investor-state dispute, the interests of a very powerful state actor were also deeply implicated in the decision-making.

[45] "Under Article 87(1) EC, any aid granted by a Member State or through State resources in any form which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as its affects trade between EU Member States, be incompatible with the common market" (Amicus Brief, p. 5).

[46] Very little information about the third, EDF v. Hungary has been made public.

Of further interest is the impact of the EU accession process and EC investigation on the investor-state disputes discussed here. While the majority of the AES Tribunal did not accept that concerns regarding legality under EU law drove Hungary to reintroduce administrative pricing, the tribunal for the Electrabel case did accept that these concerns motivated the government to take the measures in question. This outcome is notable for two reasons. On the one hand, the clash between commitments enshrined in investor-state contracts and states' commitments under EU law suggests the potential for conflict between different international legal regimes.[47] Additionally, and more relevant to the central argument of this thesis, this case illustrates some of the reasons for which transition countries, in particular in Europe, may be more likely to be involved in disputes with investors. As will be discussed below, the Hungarian government signed the PPAs during a period in which the need for foreign investment was acute, and though they were successful in attracting investment, they did not align with the preferences of all the stakeholders involved, in particular given some long-lasting reticence regarding privatization of the electricity market. Furthermore, according to some interviewees, it was quite clear from early on that these agreements would need to be altered to comply with EU accession requirements, which indeed appeared to play a role in the change of preference toward the PPAs.

Over the past twenty-five years, Hungary, as a transition state, has experienced a very rapid evolution of policy regarding the free market and the market for energy in particular – first privatization and then liberalization of markets to comply with EU accession requirements. The interests of non- and sub-state actors have been affected, sometimes negatively, by these policy changes, and it is unsurprising that they have in turn pressured the government for more favourable policies. More generally, these policy changes are complex and different initiatives have at times had conflicting goals – for example, the commitment to maintain policy stability for investors, and the necessity of liberalizing the energy market to meet EU standards. Therefore, a lack of, or at least stretched institutional capacity may also play a supporting role in causing these disputes unclear rules may lead to inadvertent non-compliance (Chayes and Chayes, 1993). More generally, it is clear that some degree of policy instability is part and parcel of a transition to a free market, and as was discussed in earlier chapters, policy instability is in large part what determines political risk for investors. Therefore, the disputes discussed in this

[47] Indeed, legality of intra-EU BITs and the ECT is an ongoing point of contention amongst investors, EU member states and the EC.

chapter shed some light on the statistical results regarding transition countries' propensity to be involved in investor-state disputes, and add further nuance to the interplay between political preferences and capacity and their role in causing investor-state disputes.

8.1 IIAs and Investment in Hungary

Following its first free elections in 1990, Hungary began the transition to a free market economy, which involved the privatisation of firms in a number of "strategic sectors" such as energy, telecommunications, and banking, much of which was accomplished through attracting foreign investment (Kalotay & Hunya, 2000). The desire to attract FDI was not only ideological, but born of necessity: dated infrastructure and low levels of industrial capacity, debt servicing and budget deficits all increased the pressure to attract outside investment, particularly from Western Europe (Roaf, et al., 2014). Happily for the Hungarian architects of privatisation, the country has been one of the more successful post-communist European states in this regard, enjoying significant FDI inflows in the early years of privatization compared with its neighbours, in part due to reforms implemented before the transition period (Hooley et al., 1996; OECD, 2000a). Between 1990 and 2005, FDI stock as a percentage of GDP rose from 1.6 to almost 56 percent (UNCTAD, 2007b).

Hungary's efforts to open its economy and attract FDI were supported not only by domestic legal reforms, but significant engagement on an international level. In 1991, Hungary signed the Europe Agreement with the EU which outlined the first steps toward EU accession. This agreement contained commitments to significantly liberalize trade and ensure domestic compatibility with EU standards in areas such as taxation, state aid, and sectoral policies (OECD, 2000a). Additionally, during this period Hungary ratified many IIAs, signing many BITs in the mid- to late-1990s, as well as the Energy Charter Treaty, which will be discussed at greater length below. These agreements, which contained commitments to liberalize markets, placed significant pressure on the government – the Central and Eastern European states had far less time to come into compliance with EU policy and were expected to be far more open to EU involvement, given the lower capacity of their domestic institutions than Western European states had been (Drahokoupil, 2009)

8.1.1 Investment in the Energy Sector

As mentioned above, the energy sector was largely privatized by the late 1990s. This involved the creation of a two-tier system, with the state-owned MVM retaining its coordinating and distributing role and remaining in state hands, and the privatization of a number of electricity generators. By 1998, 50 percent of the shares of the power generation companies were held by private parties. These generators, sold primarily to Western European investors, were in varying states of disrepair which contributed to the necessity of devising means to attract investment via the long-term PPAs (OECD, 2000b).

As a number of interviewees noted, the government initially had difficulty attracting investment in the energy sector; investors were wary of investing in out-of-date facilities with no guaranteed returns, and regulators faced challenges determining the appropriate price for electricity – which at the time "nobody really knew" (Interview #20) – to privatize, and following the advice of external consultants, the government offered investors the 25 year PPAs (Interview 20). The PPAs, signed between the MVM and the newly foreign-owned generators, committed the MVM to buying a fixed amount of electricity at a price determined by the Hungarian Energy Office (HEO), which would guarantee the investors a profit between eight and ten percent (Interview# 21). According to legislation adopted in 2000, the regulated prices were to remain in place until 31 December 2003, after which, in order to comply with EU requirements, the electricity prices were to be set by the generators (Interview #21).

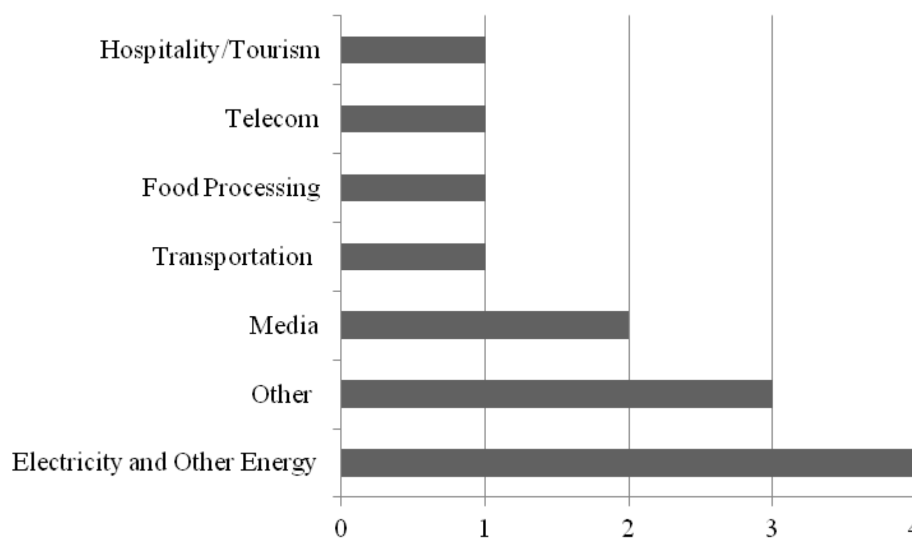
The interests of energy consumers were of importance to policymakers during the privatisation period. During the communist era, energy prices were "far from cost-covering" and significantly lower for households than industrial consumers (OECD 2000b, p. 34). In the mid-1990s, electricity prices rose approximately 25 percent, which was nonetheless less than the amount pushed for by foreign investors (Bakos, 2001). According to commitments made to the IMF and the World Bank, electricity prices in Hungary were required to cover costs by 1996, and 1995 was the first year in which residential rates exceeded industrial rates (OECD, 2000b). However, a number of interviewees expressed the importance to the government of easing this transition for household consumers and thus some effort was made to keep household prices low (Interview #20; Interview #22). As will be discussed at greater length below, this created a situation in which the MVM was buying electricity from the privatized generators at a fixed

price under the PPAs, and selling it at a price low enough that consumers would not face a "shock". When administrative pricing ended in 2003, MVM began selling this electricity at a loss. This constituted the basis for the EC state aid investigation and also, as we shall see, incentivized the MVM to renegotiate the PPAs.

8.1.2 Hungary's Experience with ISDS

Hungary signed and ratified its first IIA in 1987 with Sweden and has signed 59 IIAs in total. Hungary experienced its first investor-state dispute in 2001, related to a claim brought by AES Summit generation, one of the investors discussed in this chapter. This dispute related to changes to AES Summit's PPA and was settled out of arbitration. Subsequently, Hungary has faced at least thirteen claims in the energy and telecom sectors, as well as handful of other industries. The most common measures triggering disputes in Hungary are the cancellation of agreements or projects, and regulatory change.

Figure 8.1Hungary Disputes by Industry



As is common for Eastern European respondent states, all of the disputes faced by Hungary were brought by investors from Western Europe. Hungary is in fact one of the European transition states which has faced the greatest number of claims – only the Czech Republic and Ukraine have been involved in more (public) disputes with investors. At the time of the disputes discussed in this chapter, Hungary had faced three previous claims.

8.1.3 The Energy Charter Treaty

The claims discussed in this chapter were brought under the Energy Charter Treaty, a multilateral agreement with a wide geographical coverage, including most of Western and Eastern Europe, as well as Central Asian states. The treaty was ratified by the original signatories in 1994 and came into effect in 1998. The ECT provides investment protection for firms investing in signatory countries, and provides for investor-state disputes settlement using the ICSID or UNCITRAL rules.

The ECT was initially proposed by the Dutch government to the Council of the European Communities in 1991, with the goal of creating a "European energy community [and] a secure a market economy approach for the reconstruction and restructuring in the energy sector in the former communist countries" (Kleinheisterkamp, 2012, p. 2). Thus, the treaty was meant to combine Western European interests in secure sources of energy, with Eastern European interests in attracting investment. As it takes its cue on liberalisation of energy markets from EU directives on EU energy law, "the ECT has served as a kind of 'waiting room' for subsequent EU membership preparation for the accession countries in Eastern Europe" (Konoplyanik & Wälde, 2006, p. 528).

As with many investment agreements, the investment chapter of the ECT purports to aim to increase investment by decreasing investor risk. According to Konoplyanik and Wälde (2006), the investment chapter of the ECT was modeled after the provisions in NAFTA, and the US and UK model BITs. Like these treaties, the ECT prohibits expropriation without prompt and immediate compensation, and includes provisions guaranteeing MFN or national treatment, and the controversial FET. The treaty requires that signatories create "stable, equitable, favourable and transparent conditions for investors" and provide "constant protection and security" to investment. Additionally, the ECT requires signatories to respect all contractual agreements made with investors (Energy Charter Treaty).

8.2 Timeline of Disputes between Hungary and Electrabel and AES Summit Generation

Belgian company Electrabel S.A. and the British AES Summit Generation purchased majority shares in Hungarian electricity generation plants and signed long-term PPAs with the government in 1995 and 1996 respectively. AES Summit purchased a majority shareholding in

the company Tiszai Eromu Reszvenytarsasag (which became AES Tisza) which included a power station known as Tisza II and two power stations. AES' investment was approximately US$130 million (*AES Summit v. Hungary,* 2010). Electrabel bought majority shares of the Dunamenti power plant, acquiring it from a different investor, in 2001.

As discussed above, these agreements committed MVM to buy electricity at a fixed price from the generators. Between 1997 and 2003 the prices at which the electricity were sold were determined by the Hungarian Energy Office, and issued in Price Decrees that covered four year cycles (*Electrabel v. Hungary,* 2012).

In 2001, AES Summit Generation initiated an arbitration proceeding against Hungary, which has not been made public. The case was settled, and the investor signed a new PPA with the government. Also in 2001, the Hungarian parliament passed new legislation to partially liberalize the electricity market, which went into effect in 2003. From this date on, the generators that had signed PPAs with the MVM were able to negotiate a yearly agreement on the electricity prices that the distributor would pay (*Electrabel v. Hungary,* 2012). The liberalization of the market created so-called "stranded costs" for the MVM; as customers were allowed to move from the public to the free market, the capacity which MVM was required to purchase from the generators exceeded the demand and MVM was therefore paying for electricity from the PPAs that it was no longer able to sell (Szorenyi, 2004). MVM sent invitations to renegotiate the PPAs in 2003, but was not successful in reaching a new agreement with either AES Summit or Electrabel.

In 2004, Hungary acceded to the EU and was therefore required to have full market pricing for electricity by 2007. In 2005, the EC began an investigation into whether MVM's purchase requirements under these agreements constituted illegal state aid (EC, 2009). At the same time, a political debate arose in the Hungarian parliament regarding what were perceived, by some political actors, as unreasonably high profits of the electricity generators following the end of the administrative pricing regime in 2003 (*AES Summit v. Hungary*, 2010). In November of 2005, the Hungarian Energy Office sent a letter to the companies that had signed PPAs, in which it described the current rate of profit as "unjustifiably high" and suggested a limit of seven percent profit (AES award). Again, the government was unable to reach an agreement with the generators, and in 2006, reintroduced administrative pricing through the Price Decree (*AES Summit v. Hungary*, 2010).

In 2007, the investor-state dispute between AES Summit Generation and Hungary was registered at ICSID, with AES in particular challenging the reintroduction of administrative pricing.

In 2008, the EC concluded its investigation, finding that the PPAs did constitute illegal state aid. Hungary did not contest this finding and in 2008, passed legislation to terminate the PPAs. Electrabel, subsequently turned to arbitration, also at ICSID, challenging both the Price Decrees and the PPA termination.

8.2.1 The Arbitration Cases

This section will focus mainly on the dispute between AES Summit Generation and Hungary, with some references to the Electrabel proceedings. As mentioned above, the AES Summit claims focused solely on the reintroduction of administrative pricing, while Electrabel also challenged the termination of the PPAs. In both cases, Hungary defended the measures taken with reference to the requirements of EU accession, and the EC petitioned to present *amicus curiae* briefs in both cases. However, only the tribunal in the Electrabel case accepted that this had in fact influenced the policy making process.

8.2.1.1 AES Summit Generation v. Hungary

The ICSID tribunal for the arbitration between AES Summit Generation and Hungary was constituted on 21 November 2007. A summary of the investor's arguments is displayed in the table below.

Table 8.1Arguments and Rulings AES Summit Case

Alleged Breach of the ECT	Claimant's Arguments	Tribunal's Ruling
Fair and Equitable Treatment	FET includes honouring contractual obligations, which Hungary failed to do. This entails respecting legitimate expectations.	Tribunal declined jurisdiction over contractual claims; found no breach of FET with regard to Hungary's treaty obligations.
Impairment of Investment by arbitrary and discriminatory measures	Hungary's reintroduction of administrative pricing was arbitrary, non-transparent and discriminatory and only aimed at four generators	Tribunal finds that the measure was not unreasonable in the face of concerns regarding the generator's profit rates.

National /Most Favoured Nation Treatment	Domestically owned power plants received more favourable treatment	No breach of MFN/NT
Constant Protection and Security	The 2006 Price Decree breached Hungary's obligation to provide legal security	No Breach of obligation to provide constant protection and security.
Expropriation	Hungary expropriated revenues which AES was guaranteed under the PPA.	No evidence of expropriation.

According to AES Summit, Hungary breached its obligations to the investor under the ECT by reintroducing administrative pricing in 2006, by causing MVM to fail to fulfill its contractual obligations (*AES Summit v. Hungary*, 2010). Additionally, by changing the agreement which it had reached with AES in 2001 (following the aforementioned arbitration case), Hungary failed to act in accordance with the investor's legitimate expectations, and uphold its commitment under the ECT to provide a stable policy environment (*AES Summit v. Hungary*, 2010). This policy measure was also taken in a non-transparent way, as Hungary allegedly provided no explanation for how it arrived at the price levels enacted in the 2006 Price Decree.

AES Summit further argued that Hungary's decision to reintroduce administrative pricing was irrational and discriminatory. First, the claimant alleged, the government falsely portrayed this measure as being a response to EC concerns regarding the potential illegal state aid represented by the PPAs. However, AES Summit argued that the profits it was making under the free market pricing regime had no connection to the question of state aid. Additionally, the Price Decree of 2006 only affected four generators; domestically-owned power plants were not subject to the same pricing decrees; and one, the state-owned Paks nuclear plant, was allowed to increase prices during this period. Therefore, the claimants argued that the return to administrative pricing was discriminatory and enacted primarily due to the political debate regarding the so-called "luxury" or "extra profits".

Finally, there was significant debate regarding the applicable law governing the dispute, and in particular, how the ECT interacted with EU law. The claimants argued that due to the

Vienna Convention's edict that a "party may not invoke the provisions of its internal law as justification for its failure to perform a treaty" the potential breach of EU law could not be used to defend Hungary's actions (*AES Summit v. Hungary*).

In response to these allegations, Hungary argued that the investor could not have had any legitimate expectations that administrative pricing would not be reintroduced, as the 2001 PPA signed by AES contained "no representations by MVM or anyone else that the pricing regime would never change again in the future", and the PPA did not include a stabilization clause (*AES Summit v. Hungary*, p. 48). Additionally, Hungary denied that the new pricing scheme was decided upon in a non-transparent manner, and noted that the claimants were invited to comment on the new scheme. However, they further argued that the ECT does not "require states to comply with ideal notions of transparency, in which every single consideration in policy making is first publicly announced (*AES Summit v. Hungary*, p. 53). Finally, in arguing that the decision to reinstate administrative pricing was not arbitrary, Hungary emphasized the fact that "countries which are in the process of becoming members of the European Community are likely to have legislative changes" (*AES Summit v. Hungary*, p. 50).

In its defence, Hungary additionally emphasized the pressure it was under from EC to terminate the PPAs, or to at least "minimize the effects of what the EC considered to be unlawful state aid" (*AES Summit v. Hungary*, p. 50). It underlined that the government had tried to renegotiate the PPAs with the generators, and that AES had refused any renegotiation of the PPA. Therefore, "when the authorities were unable to renegotiate the PPAs, they took the next step, which was the least drastic of the alternatives available. They temporarily restored the system of price caps based on notions of reasonable return that had long been used in Hungary" (*AES Summit v. Hungary*, p.50). Additionally, Hungary argued that it had legitimate concerns regarding the high profit levels of the generators at the expense of consumers (*AES Summit v. Hungary*).

With regard to the claims of breach of MFN and NT, Hungary argued that the reason that the price decrees were only applied to four generators was that only these were identified as having overly high profits. The calculation of the reduction of profits was applied uniformly to all generators and therefore cannot be considered discriminatory. Additionally, Hungary denied that it had expropriated the claimant's investments, as they continued to make a profit under the administrative pricing (*AES Summit v. Hungary*).

Finally, with regard to the tension between EU law and the ECT, Hungary argued, unsurprisingly, that the ECT must be "read in light of one of its own objectives, which is to promote the European Union's key energy objectives, market liberalization and free completion," and therefore it cannot be read as divorced from EU competition law (*AES Summit v. Hungary*, p.33). This argument underscores Hungary's claims to having acted in response to EC pressure to eliminate the state aid represented by the PPAs.

The tribunal ruled in Hungary's favour on all claims of breach of the ECT. First, the tribunal found that Hungary had made no claims guaranteeing that administrative pricing would never be reinstated, and thus the claimant could have no legitimate expectations to that effect. While the enacting of the Price Decrees did not perfectly meet the ideals of transparency, it did not amount to a breach of the ECT as the tribunal did not interpret the FET as requiring "perfection" in state behaviour. Thus, the "the respondent's process of introducing the Price Decrees, while sub-optional [sic], did not fall outside the acceptable range of legislative and regulatory behaviour" (*AES Summit v. Hungary*, p.69).

Of most interest is the tribunal's conclusion regarding the investor's claim of arbitrary and irrational policymaking. Like the claimant, the majority of the tribunal did not accept Hungary's argument that it reintroduced administrative pricing in response to pressure from the EC. This is due in part to the fact that at the time the measure was taken, Hungary had not received the results of the EC's investigation into the potential state aid, and therefore was under no obligation to act (*AES Summit v. Hungary*). Additionally, the tribunal was not convinced that the price cap would truly address concerns regarding state aid (*AES Summit v. Hungary*). Instead, the tribunal concluded that Hungary was motivated by the political debate surrounding the so-called "luxury profits" of the generators. However, the tribunal found it nevertheless found that

> it is a perfectly valid and rational policy objective for a government to address luxury profits. And while such price regimes may not be seen as desirable in certain quarters, this does not mean that such a policy is irrational (*AES Summit v. Hungary*, p. 83).

Hungary's nominee to the tribunal, Dr. Brigitte Stern, dissented from the majority opinion regarding Hungary's motivations. She concluded that it was clear to Hungary at the time that the PPAs were in contradiction to EU policies. Indeed, she cited, amongst other evidence, notes from a meeting with the EC in 2004, where "concerns were expressed by the Commission that the

stranded costs...constitute state aid to the generators, stating that 'it must be ensured that none of the power plants reaches extra profits under the PPAs'" (*AES Summit v. Hungary*, p. 77).

8.2.1.2 Electrabel v. Hungary

The facts of the Electrabel case are quite similar to those of AES Summit. However, in addition to challenging the Price Decrees, the Belgian investor also challenged the termination of the PPAs. The tribunal – which also included Dr. Stern as Hungary's nominee – came to similar conclusions regarding the motivations for the administrative pricing, also took more seriously the role of the EC's state aid findings on Hungary's decision-making.

Electrabel argued that the termination of the PPAs constituted a breach of the FET provision of the ECT, as it breached the investor's legitimate expectations, and that in particular the government did not take "reasonable steps to protect Electrabel as an investor, by seeking an exemption from EU law in relation to the PPAs in Hungary's EU Accession treaty (*Electrabel v. Hungary*, part VI-5). Electrabel further claimed that its investment was expropriated as they were not adequately compensated by the government following the PPA termination.

The tribunal ruled that Hungary did not expropriate, directly or indirectly, Electrabel's investment. It further found that the termination of the PPAs did not breach the FET standard. In short, they found that Hungary was not responsible for the EC's decision regarding the PPAs, and "where Hungary is required to act in compliance with a legally binding decision of an EU institution, recognized as such under the ECT, it cannot (by itself) entail international responsibility for Hungary… The Tribunal considers that it would be absurd if Hungary could be liable under the ECT for doing precisely that which it was ordered to do" (*Electrabel v. Hungary*, Part VI-22).

The tribunal differed from that of AES on the role of EC pressure in leading to the Price Decrees. Like AES, the tribunal found that the investor could have no reasonable expectations that administrative pricing would not be reintroduced. However, in the Electrabel case it underlined context of Hungary's accession to the EU and the necessity of liberalizing the domestic electricity market (*Electrabel v. Hungary* 2012,).

Finally, like the AES tribunal, the Electrabel arbitrators accepted that Hungary had legitimate political motivations for enacting the Price Decrees. Indeed, as the arbitrators write in the final Award, "There is no doubt that by late 2005 and early 2006, there was political and

public controversy in Hungary over the perceived high level of profits… However, politics is what democratic governments necessarily address; and it is not, *ipso facto*, evidence of irrational or arbitrary conduct for a government to take into account political or even populist controversies in a democracy” (*Electrabel v. Hungary* 2012, Part VIII-page 7).

8.3 The Role of Domestic Interests in Electrabel and AES Summit Generation v. Hungary

In this section, I discuss three potential factors which contributed to the shift in Hungary’s preferences toward the PPAs. First in the run up to a highly contested election, the opposition party employed the idea of the “extra profits” of the foreign-owned generators in their campaign. They were able to do this successfully, a number of interviewees argued, given the long-standing ambivalence of the general population regarding privatization and foreign-owned companies, as well as the fear of raising end-user prices of electricity. This led parliament to adopt legislation to reintroduce administrative pricing, the measure challenged by AES Summit Generation and Electrabel. Second, and as importantly, following the partial liberalization of the electricity market in 2003, the MVM began to suffer losses under the PPAs. As will be discussed below, even after privatization the MVM was seen an important player within the Hungarian state apparatus and likely able to influence policy and the timing of the renegotiation of the PPAs in particular suggests MVM’s influence. Finally, internal documents and interviewees suggest that Hungarian state actors were aware of a possible conflict between the PPAs and EU accession requirements, and it is likely that this also contributed to the termination of these agreements.

8.3.1 Political Parties and Energy Consumers

Political parties, ostensibly representing the mass interests of energy consumers, were able to influence the short terms policies of the government toward foreign-owned electricity generators by means of a political contestation – specifically through electoral pressure in the lead-up to the 2006 general elections.

As discussed above, both arbitral tribunals acknowledged that the “extra profits” of the foreign-owned electricity generators became the subject of an intense political debate. This is not surprising given that energy and electricity have been election issues since the end of communism, and that there had been a general unwillingness on the part of post-communist

governments to expose consumers to dramatic price increases (Interview #23). This fits into the more general pattern of political contestation in central Eastern European states; as Bohle and Greskovits (2010) note, in these countries "political contention has been closely...linked to the issue of social protection" (p. 454). Moreover, they note that in the post-communist era, there has been a steady alternation between left- and right-wing parties in power, and

> there has been no clear division of labour between the left and the right in the sense that the former has protected vulnerable social groups while the latter only the economy. Rather, all parties that hoped for mass popular support usually stressed the intrinsic relationships between economic and welfare protectionism... (Bohle & Greskovits, 2007, p. 545).

From the end of the communist rule to the mid-2000s, Hungary's political situation mirrored this description quite closely; from the mid-1990s on, elections were dominated by competition between the Socialist party and the conservative Fidesz, and until the general election in 2006, no incumbent had been granted as second term. Moreover, "economic populism" has dominated political competition, and even the right-wing Fidesz has focused on social protection (Deak, 2013).

It was in this context that Fidesz, then the opposition party, instigated the debate on the electricity generators' "extra profits." This debate emerged in 2005 took place both in parliament and in the media, with "references in the press and elsewhere...made to generators' profits as "extra", "too high," "huge" and "luxury." The Hungarian public was described as "defenceless" against rising prices and it was said that such "luxury profits" must be "knocked down." (*AES Summit v. Hungary,* p. 25) Following the advent of this debate, and in the lead-up to the election in April 2006, the Hungarian parliament passed legislation to enact the price decrees (which set a cap on electricity prices) in March 2006.

According to a number of interviewees, the "extra profits" discourse was first and foremost a political tool in a highly contested electoral race; "[Fidesz] made harsh attacks on the government, and it was just one tool to [do so]... the 'extra profits' served only political purposes" (Interview #24). Similarly, another interviewee explained that the idea of extra profits accruing to the generators was "part of a political argument... I didn't see any detailed analysis of where this extra profit came from" (Interview #20). However, the argument served the interests of both Fidesz and MVM; according to Peter Mihalyi, "Fidesz and [party leader Viktor] Orban invented this term extra profit, [which] was supported by the MVM leadership at the time... what Fidesz was saying [about the extra profits] was essentially correct and very much supported by

the MVM" (Interview #23). Indeed, given the ideological linkages between upper-level management of the MVM and the Fidesz party suggested by a number of interviewees (see below), it is not surprising that these actors would pursue common interests.[48]

However, the measures challenged by the investors were in fact taken by the Socialist government both before and after they won the election. Indeed, it appears that the incumbent government adopted the same discourse toward the generators at the time, perhaps in part because "it was a way for the government to distinguish themselves from the governments of the mid-1990s who had sold everything" (Interview #25). It was public pressure, according to another interviewee, that led the government to adopt these measures as it was "perhaps the only possible way for this government not to lose face, when they had repeated the extra profit, they had to show something to the public" (Interview #20). Indeed, concerns regarding keeping energy prices low for households appear to have spanned the political spectrum, and had been a longstanding election issue. More broadly, the discourse of "extra profits" resonated with a public that opinion polls show did not support foreign ownership of large companies, and was skeptical about capitalism in general (Deak, 2013). Thus an attack on the profits made by these firms "absolutely resonated with voters" (Interview #23).

However, in its defence, Hungary took pains to emphasize the technical rather than political reasons for which it reinstated administrative pricing, including as an attempt to meet EU requirements (Interview #26). Specifically, Hungary argued that as the generators refused to renegotiate the PPAs, the short-term reintroduction of administrative pricing was the "next best thing" to minimize the state aid to the generators. Furthermore, it is clear that the interests of the state-owned MVM played an important role in the overall treatment of the investors who had signed PPAs. In the following two sections, I discuss the evidence that pressure from both the MVM and the EC led to the eventual cancellation of the PPAs.

8.3.2 MVM and Electricity Market Reform

The preferences of the state-owned electricity company toward the PPAs shifted, as over time some of these agreements became disadvantageous for the MVM, and the interests of the MVM

[48] Indeed, since Fidesz has been in power since 2010, the government has taken a similar attitude toward a broader foreign investors, increasing state control of various industries including electricity and gas (Deak, 2013).

can be connected to both the measures challenged by the claimants discussed in this chapter – the ultimate cancellation of the PPAs and the interim reintroduction of administrative pricing.

After the Second World War, Hungary nationalized its electricity supply, and the Hungarian Electricity Board, the MVM, was formed in 1963 (OECD, 2000b). The MVM was corporatized in 1991 after the fall of the communist regime and retained its central position in the Hungarian electricity supply system. At this time, the MVM was divided into two tiers, the first of which was responsible for the overall management and coordination of the electricity system, while the second was further divided into fifteen energy generation and network companies which became independent corporations which were nearly all privatized by 1997 (OECD, 2000b).

The MVM was facing competing pressures at this stage. On the one hand, it was necessary to secure investment in the energy sector, which was, according to one interviewee, a former senior analyst at the Hungarian Energy Office, "not in a very good state" (Interview #24). In fact, during the first phase of privatization, the government was largely unsuccessful at attracting foreign investors, who "sent back the signal that without...a pricing regime, nobody will buy this" (Interview #20). This problem was solved by the implementation of the PPAs, which were "an absolutely clear requirement for the investors"; while they committed the investors to upgrading the power generation infrastructure, they provided a guaranteed profit, and therefore no risk, to the investors (Interview #24). At the same time, they allowed the government to maintain lower end user prices:

> Because the MVM was a state-owned company and could incur some losses, it was able to buy electricity at relatively high prices from the generators, and sell it at a lower price – the MVM was the actor that served this policy objective, the first one to make the deal attractive to investors, and on the other side guaranteed a low price for customers. (Interview #24)

During this period, the MVM was not a proponent of further liberalization (Interviews #20, 21, 23, 24). Indeed, a number of interviewees suggested that the management of MVM continued to have a strong culture of centralized planning and saw itself as quite independent from the state. According to Peter Mihalyi, a former deputy secretary of state for the Ministry of Finance, many of the MVM bureaucrats had "studied in the Soviet Union...they didn't have any background in the Anglo-Saxon economic way of thinking, and ... also were fervent right wing nationalists" (Interview #23). Similarly, another interviewee described the MVM as having "a very different attitude than any other private company," and recalled a meeting at which "at one

point, when I referred to the Hungarian government and the interests of the state, they said 'We are the state.' It was a different attitude" (Interview #24).

The shifting interests of the MVM partially explain the timing of the cancellation of the PPAs. Given the aforementioned attitude of the MVM's managers, it is not surprising that the MVM initially tried to impede the process of further liberalization of the electricity market, including dragging its feet regarding the renegotiation of the PPAs. As more than one interviewee noted, it had been clear for some time within the Hungarian bureaucracy that, due to the impending EU accession, the PPAs would eventually have to be renegotiated or cancelled (Interviews #24, 25). Indeed, a 2006 presentation from the Hungarian Energy Office includes a reference to a 2002 piece of legislation containing the rules for the renegotiation of the PPAs, and concludes that "it would be necessary to renegotiate the PPAs... but this is not in the interest of the MVM" (Document #18). Indeed, during the late 1990s and early 2000s, "the MVM was not incentivized to make this hard decision," and despite being pressured by the government to renegotiate with the foreign-owned generators, they did not do so (Interview #24).

EU accession required the end of the regulated pricing, and the market was significantly liberalized in 2003. This changed the situation of the MVM vis-à-vis PPAs; as mentioned above, when customers were able to move to the free electricity market, MVM had an oversupply of electricity generated by companies covered by the PPAs. It was able to sell this excess supply to electricity traders, but at a significantly lower price then what it had originally paid (Interview #24). It was at this point, according to energy researcher Eva Voszka, the MVM understood that, in the long-term, the dual market was worse for it than full liberalization would be (Interview #21). This led to a shift in attitude of the MVM both toward the pricing scheme and the PPAs more generally, and the demands of the impending EU accession, and the investigation into state aid in particular, allowed the MVM to put pressure on the generators; in this way "this EU investigation was very good for MVM, it was a tool so MVM could refer to this process and say 'I have to do this, I don't want to, but you see there is this investigation' (Interview #24). Tellingly, although the PPAs were officially cancelled in 2008, many agreements were subsequently renegotiated with the same generation companies on very similar terms. Those that were not – including with AES Summit and Electrabel – were those that had been the least profitable for MVM (Interview #24).

As discussed above, the reintroduction of the administrative pricing, which introduced

price caps, was due in large part to a political debate that emerged in the lead-up to the 2006 election. However, it was also clearly in the short term interest of MVM, as it was suffering significant losses since the end of the administrative pricing and the move to the dual market. In the next section, I will discuss the parallel EU pressure to renegotiate the PPAs.

8.3.3 State Interests and EU Accession

In its defence in both cases, Hungary argued that pressure from the EC investigation into whether the PPAs represented illegal state aid was behind the decisions to both temporarily reintroduce administrative pricing and ultimately cancel the agreements altogether.

There is evidence that policymakers were aware of the eventual necessity of terminating the PPAs, both from general policies regarding state aid related to EU accession, and more specifically, from meetings between European and Hungarian officials. In its *amicus* brief to the AES Summit tribunal, the EC noted that the issue arose prior to accession in 2004, as the Europe Agreement, signed between the European Community and Hungary in 1993, "contained rules on State aids very similar to those applicable under the EC treaty" (EC, 2009, p. 5). The 2004 Act of Accession contains similar provisions prohibiting state aid (EC, 2009). In 2001, the EC adopted an official methodology for analysing state aid via stranded costs in the electricity sector, and based on this, in 2005, launched an official investigation into Hungary's PPAs.

Of course, the existence of official policies does not necessarily entail that Hungarian officials would be aware of how these applied to the PPAs. However, the EC states that its concerns regarding the PPAs were communicated to Hungary at the outset of the investigation in 2005. Additionally, several interviewees note that it had been clear for quite some time that the PPAs would conflict with EU accession requirements. As one interviewee claimed, "because of the EU accession, years ago we had already started planning how to deal with the PPAs" (Interview #25) a process which another interviewee said began in the 2000s, at which time it was "known that these agreements can be a problem and an obstacle to liberalization" (Interview #24). In particular, the HEO seems to have been the most willing of government actors to renegotiate or cancel the PPAs; as its aforementioned presentation concluded in 2006, the PPAs did appear to constitute state aid, and thus "it would be necessary to renegotiate or cease the PPAs" (Document #18).

Moreover, Hungarian officials communicated these concerns to the generators; one interviewee explained,

> we believed that sooner or later the MVM would sell some of the assets and we would renegotiate some of these PPAs and after that, there would be a competitive market... you can't join the European market when that contract exists, so we proposed several arguments, why it's useful to shorten or renegotiate the PPA. I personally invited AES for this discussion. They hired one of the best British advisers... the answer was no, forget it, we signed an agreement, and we calculate our future profits from this formula. (Interview #20)

However, this interviewee further noted that the ultimate decision to renegotiate the PPAs did not lie with the HEO but with the government, and "we could not convince the government to be brave enough to cancel the PPAs." It appears, therefore, that while the MVM's interests were still served by the PPAs, and the EC ruling on the state aid was still pending, the government was not motivated to cancel the PPAs outright. This was confirmed by Balázs Felsmann a former State Secretary for Energy, who explained that "at the end, the Hungarian authorities were not ready to [terminate] these PPAs in general and the EU had to take a resolution on that, and effectively the EU regulation stopped the potential usage of the PPAs" (Interview #26).

Some of this reticence to renegotiate or terminate the contracts may have also been due to the resistance put up by the generators themselves. As was noted both by interviewees and in Hungary's defence before the arbitral tribunals, government officials had several times attempted to renegotiate the PPAs with these firms. However, according to one interviewee, "it was clear that some of them accepted the renegotiation and from the beginning it was clear some of them would go to court, we didn't know what kind, but it was clear that they would challenge the decision" (Interview #20). Another interviewee expected that these conflicts would culminate in arbitration because "sometimes you realize there is no room for [compromise], because here they wanted for an additional ten years all of the potential profits and we thought no you made enough profit compared to the privatization deals. We were very far from each other" (Interview #26). This sentiment was echoed by one of Hungary's legal team who noted that "we were more or less aware of the possibility [of arbitration]. It didn't come as a complete surprise" (Interview #27).

Therefore, it seems that policymakers, particularly in the Hungarian Energy Office, were aware that EU accession would entail the eventual renegotiation or cancellation of the PPAs. However, these actors alone did not have the influence to force the issue, particularly when the MVM's interests were still served by the PPAs. However, the changing structure of the energy

market, itself a result of the EU accession process, altered the MVM's view of the PPAs, and this coincided with more direct pressure, in the form of the state aid investigation, to cancel the agreements. As noted above, the Hungarian government defended the reintroduction of administrative pricing as a way to lessen the effect of the state aid in the face of its failure to renegotiate the contracts. As this measure was also taken in the midst of the political debate on "extra profits" it is more difficult to tease out the most important causal factor in that policy-making decision. However, with regard to the cancellation of the PPAs, it appears that a happy convergence of the interests of the MVM and the government, due to its EU accession requirements, led to the cancellation of these agreements.

8.4 Conclusion

The conflicts between Electrabel and AES Summit Generation and Hungary were the result of the confluence of a number of factors. As discussed in the previous two chapters, in the Bilcon and Pacific Rim cases, the governments took measures as a direct response to public pressure – in both cases, as a reaction to the threat of mining activity on local livelihoods and environment. In the disputes between Hungary and the foreign-electricity generators discussed in this chapter, the link to mass interests is less direct, and the "special interests" of the state-owned electricity generator, as well external demands from the EC, also appear to have had an influence on state decision-making regarding the PPAs.

However, the arbitral tribunals in both the AES and Electrabel cases highlighted the importance of mass interests in the governments' decision to reintroduce administrative pricing. While the claimants in both cases accused Hungary of taking this measure for purely political reasons, thus representing it as "irrational" policymaking, the arbitrators legitimized the idea that governments could in fact make political decisions regarding investments, and that this was in itself not a breach of commitments under the ECT – an unusual finding for arbitral tribunals, that in particular stands in contrast to the conclusion of the tribunal in the Bilcon case (see Chapter 6). A closer examination of the role of political interests complicates the picture, slightly. While the debate over the generators' alleged "extra profits" was indeed highly political, it appears to some extent to have been manufactured by the opposition party in the run up to a national election as a tool to criticise the incumbent government. However, it is clear that, as energy is a perennial election issue in Hungary, and there exists widespread ambivalence toward foreign

ownership of large companies and the free market in general, this was fertile ground for the opposition party from which to generate public engagement in the issue.

At least as important as the public interest in the generators' extra profits, however, were the interests of the state-owned electricity company, the MVM. As the broader policy environment underwent significant changes between the late 1990s and early 2000s, MVM's interests with respect to the PPAs shifted. The PPAs served as a bulwark against further liberalization of the market, thus the conservative MVM was not incentivized to renegotiate or cancel them, despite some awareness of possible conflicts between the PPAs and EU accession requirements. However, as the market liberalization continued apace, the PPAs locked the MVM into a situation in which it was suffering significant losses via the stranded costs. Thus, both the reintroduction of administrative pricing, which put a limit on the amount the MVM would pay to the foreign-owned generators, and the eventual early termination of the PPAs, were clearly in the interest of the state-owned company. The degree to which the MVM influenced Fidesz in its "extra profit" discourse is difficult to ascertain, although ideological affinities between the party and upper management of the MVM suggest this is certainly a possibility. Much clearer, however, are the links between the MVM's eventual shift in attitude toward the PPAs in general, and their termination (and subsequent renegotiation). This shift in preferences was due to changing market conditions, and therefore ultimately cannot be separated from the effects of EU accession.

Therefore, the disputes between the electricity generators and Hungary cannot be seen as disconnected from the more general process of EU accession. Indirectly, the demands from the EU to liberalize the energy market changed the conditions under which MVM was operating, and shifted its preferences toward the PPAs, which provided extra motivation for the government to push for their termination. More specifically, the EC investigation into the PPAs as illegal state aid put direct pressure on the government to terminate these agreements, and it did so following the EC's ruling in 2008.

Indeed, it seems that this is a clear case of admittedly very broad political and economic policy changes instigating a shift in state preferences toward the foreign investors, with the shifting interests of the MVM in particular acting as a kind of "intervening variable", leading the government to ultimately take the measures challenged by the investors. As discussed above, the relevant policymakers were aware of the possibility of arbitration (and indeed had been taken to

arbitration by AES Summit in 2001), and thus this seems to be another case in which the "preferences" argument clearly wins out over the "capacity argument."

However, in an indirect way, state capacity to manage the electricity sector plays a role, at least in the antecedents of the case. As discussed above, due to the demands of the transition from the planned to the free market, Hungary was forced to offer the long-term PPAs to the investors in order to attract FDI. This placed MVM in a situation that would become disadvantageous as the electricity market was further liberalized. More generally, as is probably true of any transition country, Hungarian administrators were faced with a difficult tasks "not only... of breaking up an incumbent monopoly power company but with adapting its whole economy to the rules of the market – and with the task of learning what this involved as the country went through the process" (OECD 2000 p. 19). In this way, the disputes between Hungary and the electricity generators may fit into a broader pattern of disputes between investors and transition country governments, and explain why these are so common. Indeed, transition countries are likely to experience issues related to the capacity of the state to manage newly privatized and liberalized markets and industries, as well as those related to the preferences of key actors – whether of voters who have a distrust of the free market, or of industrial actors loathe to relinquish control of key sectors.

Ultimately, however, these cases can be summed up in the succinct words of one interviewee as a shift in state preferences toward the investors:

> in your story, the government is breaching contracts, but they can say, Us? No. It's the European Union. We are doing the right thing. And not without some justification. It was by and large true. In period A, we made an agreement because it was in the interest of the country and in period B we break this agreement because it's in the interest of our country. And that's it. (Interview #23)

Chapter 9 Conclusion

This project has focused on the relationship between domestic actors and institutions and investor-state disputes, in order to better understand for what policy objectives, and at whose behest, states are willing to risk the costs of arbitration. Underlying this question are potentially competing explanations about why states may violate agreements, which focus domestic level variables. On the one hand, investor-state disputes may be the result of weak domestic institutions that fail to maintain the conditions required by an IIA, as suggested by the managerial approach to compliance. On the other, these conflicts may develop when non- or sub-state actors induce a shift in state preferences toward FDI (often in a specific sector, or even individual projects), as suggested by the enforcement approach to compliance. In both cases, the role of domestic institutions in causing or preventing investor-state disputes is central to the explanation, but the causal relationship is different.

What is the relevance of this approach? First, this research sheds light on the functioning of the international investment protection regime by highlighting the conflicts of interest which provoke investor-state disputes. Moreover, as stated in the introduction, if we accept that ISDS has the potential to impose significant costs on states, it is important when either justifying or criticising the regime to have an understanding of at whose behest states are incurring these costs. Indeed, an additional goal of this research was to engage with some of the same questions raised by work on the impact of ISDS on domestic policy space, while avoiding the pitfalls of asking the regulatory chill question – in short, having to prove that the state did not take a measure out of fear of arbitration. However, like this project, the regulatory chill hypothesis is concerned with the content of the measures that may be thwarted by the threat of investment arbitration; if state actors are dissuaded from expropriating investments for private gain or harassing foreign investors, few observers would likely be concerned about regulatory chill. Similarly, if this project uncovered that the majority of the measures challenged in arbitration were targeting investors for individual or narrow interest group gain, there would be little grounds for concern. However, I found that investor-state disputes which culminate in arbitration often touch on issues of public rather than private interest, both because of the industries in which they are concentrated and the types of measures which trigger them. Moreover, investor-state disputes have the potential to affect a wide array of stakeholders who, as can be seen in the

proceeding chapters, are themselves at times advocating for the measures challenged by investors.

As will be discussed below, this project contributes to the discussion on investor-state arbitration and IIAs in a number of ways. First, as it is based on an original dataset of investor-state disputes, coded for the domestic institutions involved and the measures taken which triggered the dispute, it contributes empirical data to an aspect of investor-state disputes that has to date received little attention. In addition, the case studies, based on a political economy analytical framework, highlight the domestic interests and preferences at stake in investor-state disputes. Given that these case studies are representative of broader "types", it may be possible to generalize from these findings. Finally, as will be discussed in the concluding section of this chapter, the findings have implications for the potential reform of the ISDS system, as understanding the general causes of disputes can suggest means of either avoiding disputes or improving existing dispute resolution mechanisms.

9.1 Summary of Results

The investigation was conducted in three stages. First, almost 600 investor-state arbitration cases were coded on various dimensions. These included the income level of the respondent state; the industry of the investor; the domestic institution that took the disputed measure; and the type of measure taken. This allowed me to identify some broad patterns in investor-state disputes, and contributed to the development of hypotheses that were tested statistically. The development of these hypotheses further depended on a reading of literature relevant to investor-state arbitration. This included an approach to compliance with international agreements that takes into account the impact of domestic non-state actors on foreign policy, as well as a more targeted reading of work on investors-state relations. The latter focused primarily on studies of the determinants of expropriation and political risk, as these are evidently phenomena closely related to the causes of investor-state disputes that lead to arbitration. Finally, in order to provide micro-level detail on some of the relationships uncovered in both large-N studies, I chose three case studies of investor-state disputes in Canada, El Salvador and Hungary. The questions posed to these cases concerned the domestic interests behind the policies that were challenged by investors; how these domestic interests managed to shift state preferences toward the investment; and the awareness of state decision-makers of the possibilities of investment arbitration.

As discussed in the introduction, while I do not use a comparative approach, each of these case studies encompasses a number of features that make them, if not typical, important "types" according to the statistical results. For example, as a member of NAFTA, Canada is one of the few developed states that has had significant experience as a host state to investment covered by an IIA. Therefore, Canada can serve as an example for other developed states that may, if the TTIP and TPP agreements are ratified, soon be host to investment covered by an IIA. In many ways El Salvador, as a middle income presidential system is a typical case. Additionally, the dispute discussed in Chapter 7 is centered on extractive operations, which as we have seen, is one of the industries most frequently involved in investor-state arbitration. Finally, the state measure which triggered the dispute is the refusal to grant (or revocation of, according to the claimants) a mining permit, the measure most often challenged by investors. Therefore, this case provides more micro-level detail on many of the relationships expressed in the statistical analysis. Finally, the Hungarian case, in opposition to the two previous, demonstrates the role that powerful domestic sub-state actors can have in fomenting a dispute with a foreign investor. However, beyond this, it underscores a number of issues facing post-communist states in managing foreign investment (particularly in sectors such as electricity which affect many stakeholders), which can explain the concentration of arbitration cases in these countries.

As noted in the introduction, a wide array of state policies and measures are challenged by investors via arbitration. This makes it difficult to develop a causal narrative that fits all investor-state disputes – for instance it is difficult to explain an arbitration case that challenges unfulfilled contractual obligations in the same way as one that follows the imposition of new environmental regulations. However, what is common to almost all investor-state disputes is a shift in policy related to an investment, which is therefore taken as the dependent variable in this study. This shift may be explained, as suggested above, either by an *inadvertent* failure of the state to maintain the policy framework, or by a shift in preferences related to an investment, which leads to a *purposive* change of policy. Inherent to this decision-making process is therefore an awareness of the possibilities of arbitration – if the relevant state actors are not aware of the risk of arbitration then the former explanation (based on the managerial approach to compliance) is more convincing than the latter. However, this project found more evidence for the latter explanation.

Indeed, these disputes do not appear to arise from failures of technical capacity, as much as the very political nature of the issues and policies at stake. The first hint that this is the case comes from the industries in which investor-state arbitration cases are concentrated. As can be seen in Chapter 2, almost 40 percent of known investor-state disputes are related to investments in extractives (oil, gas and mining) or energy generation. As discussed throughout the project, these industries directly affect a much wider range of stakeholders than, for example, manufacturing operations, and groups such as energy consumers or communities affected by extractive projects have mobilized to pressure the state to take measures which trigger investment arbitration. Moreover, while overall the majority of measures in question are administrative, the single domestic institution that is most often involved in investor-state disputes is the legislature, clearly a body meant to respond to some extent to the public interest. However, this should not imply that administrative measures are taken in an environment free from external pressure. Indeed, as both the Canadian and El Salvadoran case studies demonstrate, there can be a clear link between voter or citizen pressure and administrative decisions which in turn provoke an investor to turn to arbitration.

The results of the statistical analyses also strongly suggest that an explanation for investor-state disputes which relies on overt changes in state preference toward an investment are more convincing than arguments that rely on a lack of bureaucratic or technical capacity of host states. Indeed, while the majority of respondent states are middle income countries, which could suggest a link between disputes and lower levels of bureaucratic effectiveness, "exposure" to arbitration, measured by ratified IIAs and FDI stock, may account for this pattern. Indeed, much of the concentration of disputes in these countries has much to do with their status as traditional host states of FDI that is covered by an IIA. The likelihood of developed signatories to NAFTA to be taken to arbitration indicates that, when high income countries are hosts to FDI covered by an IIA, they will also take measures that are subsequently challenged by investors. Moreover, other variables related to capacity, such as government effectiveness, GDP per capita, and GDP growth do not have consistently significant relationships with the dependent variable. On the other hand, variables related to changing preferences/domestic interest groups have a more consistent and expected relationship with the DV. These included variables that, I argue, indicate domestic institutions responsive to the changing preferences of domestic actors (presidential system, polity score; veto players); those that indicate time bound events signifying a change in

preferences (elections); and factors related to the type of state and investment which may increase negative domestic perceptions of FDI (transition country, extractives).

The case studies further highlighted relationships between changing domestic preferences toward FDI (in general or with respect to specific investment projects) and the measures challenged in arbitration. This was the case in both the developed and developing country case studies. For example, the case of Bilcon v. Canada demonstrated that broad interest groups – in this case local communities and local and national environmental groups – can affect state policy toward investors. The case of Pacific Rim v. El Salvador was strikingly similar to the Canadian case in some key ways, despite the very different setting. Similar domestic interest groups managed to shift state preferences toward the mining project, although in this case their efforts resulted in a *de facto* change of national policy, rather than, in as in the Canadian case, a single decision to reject a project. Finally, the Hungarian case focuses on the role of two different types of non-state actor pressure on shifting state preferences toward an investment. In this case, the powerful, narrower interests of the state-owned electricity company motivated the state's change in policy, although on a rhetorical level, the state-owned electricity company MVM and its allies in the Fidesz party leveraged mass interests (this time, energy consumers) to pressure the government to reintroduce administrative pricing. However, the changing market conditions which were themselves the cause of MVM's change in preference toward the investor were the result of EU accession requirements. Therefore, this final case study demonstrates how much broader shifts in policy, in this case the evolution of Hungary toward a free-market economy, can also play a role in changing conditions for investors which they challenge via arbitration. Additionally, this case highlights the potential for conflicting international regimes – in this case the EU and the ECT's conflicting priorities regarding the electricity market in Hungary. In all cases, key decision-makers expressed an awareness of the possibility of ISDS, at the very least because they were threatened with arbitration by the investor in advance of the actual registering of the case, and therefore, lack of awareness of IIAs can also not be seen as a sufficient explanation for investor-state disputes.

However, it cannot be claimed that capacity, broadly defined, does not play any role in investor-state disputes. In each case study, the theme of a lack of capacity indirectly contributed to the eventual dispute. In Canada, it was the inability of bureaucrats, despite consultation with in-house counsel in the lead-up to the final decision on the quarry, to predict that the investor

would turn to arbitration following the decision to reject the project. In El Salvador, the relationship was even less direct, as an eventual recognition that the relevant ministries did not have the capacity to regulate the mining industry contributed to their decision-making regarding issuing new permits. However, it must be added that this was not related to the actual regulation of the investment, nor would it have likely been enough impetus to cancel the project in the absence of public pressure. Finally in Hungary, the necessity of attracting investment in the 1990s, and the weak bargaining position of the state vis-à-vis potential investors, led to the formation of long-term agreements which at least some observers recognized early on would have to be terminated in order to comply with EU regulations. Therefore, in all these cases, some degree of bureaucratic weakness or lack of state capacity did contribute to the dispute, but it cannot be seen as the primary cause.

Finally, the role of exposure to the investment protection regime must itself be noted. As mentioned above, the distribution of investment arbitration cases by respondent state has much to do with investment flows and the division of signatories into host and home states. As the rather special case of NAFTA shows, when traditional home states are also host to investment covered by an IIA, they will be sued by investors. Moreover, in both the Canadian and Hungarian cases, interviewees noted the options other than arbitration that investors had available to them. In Canada, Bilcon could have gone through Canadian courts to repeal the decision of the JRP, while in Hungary, many other investors successfully renegotiated their PPAs with the government. Therefore, investor motivation to use ISDS also undoubtedly contributes to the rate of investor-state arbitration cases. However, just as the existence of prisons does not cause individuals to commit crimes, the mere existence of ISDS does not cause a shift in state preferences toward a specific investment. Therefore, while exposure to opportunities to be sued is an important necessary condition for ISDS to take place, it cannot be understood on its own as a cause of these disputes.

Ultimately therefore, this project finds more evidence for the underlying causes of investor-state disputes based on the logic of the enforcement approach to compliance. This may not be surprising when the chain of events which leads to arbitration is properly understood. As was discussed in the chapter on El Salvador (and as work on regulatory chill hypothesis suggests), investors may unofficially threaten states with arbitration before officially registering the case at an arbitral forum. Additionally, most official arbitral processes include a “cooling off”

stage, during which the investor and state can negotiate and avoid arbitration. Therefore, states which may have inadvertently provoked an investor to turn to arbitration have ample opportunity to reverse the measures in question if their actual preferences toward the investment have not changed. It is therefore logical that states which do decide to follow through with the arbitration process are defending a policy objective, whether this is at the behest of narrow or broader interest groups.

This last point introduces certain normative judgements into the analysis, and it is beyond the scope of this project to determine the extent to which the state measures in question are taken in the "public interest" or for private gain. Indeed, even the case studies presented here, which all touch on public policy issues, can be explained in relation to the interests of narrow interest groups (and indeed, this is how the claimants in these cases present their arguments). The El Salvadoran case has the clearest links to mass interest groups, although the electoral interests of President Saca were clearly tied to his decision to refuse to grant Pacific Rim license to operate. In the Canadian case, the investor accused local politicians of catering to the interests of local anti-American groups opposed to development in their "backyards" to cement their own electoral futures. Finally, the Hungarian dispute has the most obvious connection to narrow interests – in this case those of the MVM. Indeed, in all three cases, electoral pressure directly or indirectly played a part in state-decision-making, as did, in the former two, genuine environmental concerns. The assessment of politicians' and policy-makers' choices in balancing the competing domestic and investor interests therefore rests not only on legal, but also on normative judgements.

Ultimately, the conclusion reached here is that, beyond the fact that the challenged measures represent shifts in preference toward (an) investment, rather than as inadvertent failures to comply with IIA obligations, the actors affected and the content of the measures suggest that these disputes are highly political, and may represent instances in which the preferences of domestic and transnational actors are irreconcilable.

9.2 Theoretical Significance

This project draws on a number of strands of literature that pertain to investor-state relations and state compliance with international agreements, and can therefore contribute to furthering

theoretical discussion in these areas. More generally, this project also speaks to the role of domestic institutions in furthering or resisting economic globalization.

As discussed in Chapter 3, beyond the competing enforcement and managerial approaches, much work has been devoted to explaining the role of domestic institutions in compliance, and – although this may not always be related to an international agreement – expropriation. How do these two bodies of work relate to each other, and this project?

As I conclude above, this project finds more evidence for the enforcement approach to compliance – that state compliance with international agreements is based on cost-benefit calculations – rather than the managerial approach which focuses on the capacity of domestic institutions. This suggests that there are multiple possible sources of (non)compliance can be found at the domestic level, but that these will more likely take the form of interest groups, and institutions responsive to their preferences rather than merely weak domestic bureaucracies. It is thus pressure from these sources that state decision-makers will factor into their cost-benefit calculations when contemplating pursuing policy goals which may conflict with investors' interests.

Much of the literature that focuses on the role played by domestic institutions in democracies with regards to both treaty compliance and preventing expropriation comes to similar conclusions; in short that democracies (and the attendant veto players) are positively correlated with respect for international agreements, property rights, and lower rates of expropriation (Simmons, 2010; Milner, Mansfield and Rosendorff, 2002; Jensen, 2002; Gaubatz, 1996; North and Weingast, 1989). Although not always explicitly based on different theories of compliance, these findings correspond with the logic of the enforcement approach, as these authors often reference audience (electoral) costs with forcing governments to comply – the underlying assumption being that democratic domestic audiences will be in favour with compliance with previous commitments made by the states, and thus hold state actors accountable.

This project problematizes those conclusions when it comes to respecting IIAs, echoing the findings of skeptics such as Tomz (2002) who questions the assumption that democratic audiences will always be in favour of international treaty compliance. Indeed, the results of the large-N analysis show that both democracy level and the incidence of elections are correlated positively with the likelihood of an investor-state dispute, suggesting a role for electoral pressure

in the relevant state decision making processes. The case studies, particularly the examination of the dispute between El Salvador and Pacific Rim, further highlight this connection. This in turn suggests that democratic domestic institutions will not always favour further globalization and liberalization when it comes to FDI. This point is further underscored by the recent debates, primarily in industrialized democracies, regarding the TTIP agreement currently negotiated between the EU and United States; in particular, the European Commission's public consultation on the agreement, which elicited feedback showing significant public concern regarding the impact of these agreements on domestic policy space. As will be discussed briefly below, this has led the EC to take a cautionary stance on the agreement, and in particular, ISDS (European Commission, 2015).

The connection between democratic institutions and investor-state arbitration may be due in part to the dependent variable itself – the very wide array of measures challenged by investors in arbitration. It also echoes the conclusions of earlier work such as that of Kobrin (1979), who noted that political risk often results from the "regular functioning of the political process" (p. 84). If this is the case, what does it mean that "the regular functioning of the political process" is seen by foreign investors as detrimental to their interests, and can be subsequently challenged by them in front of international tribunals? At the very least, it arguably has already led to some pushback against the regime, and calls for reform. As Simmons (2013) has noted, there is an increasing number of democratic states seeking to overturn arbitral rulings that have gone against them, which suggests that "if the investment regime cannot accommodate the legitimate policy space of democratic governments... it may prove quite brittle indeed" (p. 40).

9.3 Reform of the Investment Protection Regime

As discussed in the introduction, IIAs and the ISDS system have come under increasing criticism in recent years as the rate of new disputes has risen, developed states have found themselves as respondents in arbitration, and investors are increasingly seen to be challenging host country regulatory activities (Karl, 2013; UNCTAD, 2013a). This has led to the assessment that the investment protection regime is undergoing a "legitimacy crisis," a perception reinforced by the withdrawal of a number of states from the ICSID Convention (Bolivia, Ecuador and Venezuela); the withdrawal of states from their IIAs (Ecuador, Venezuela, South Africa, Czech Republic,

Indonesia); and the denouncement of ISDS by traditional home states such as Australia and Germany (Schill, 2015). This in turn has triggered a number of states and international institutions to propose (and in some cases begin to implement) systemic reform. As laid out by UNCTAD (2013), these paths to reform include clarifying and/or altering substantive provisions in IIAs; promoting alternative mechanisms of dispute settlement and conflict prevention; introducing an appeals process; and the creation of a standing investment court.

Perhaps the easiest reform to implement would be the promotion of conflict avoidance and alternative dispute resolution mechanisms. This would include non-binding arbitration focused primarily on finding a solution to the conflict rather than determining the legality of a state measure (UNCTAD, 2013). These efforts could also be accompanied by the creation of domestic institutions which would screen government measures for their potential to trigger an investor-state dispute and implement "investor care" conflict management systems which would monitor investor-state relationships for early warning signs of conflict. One such institution, already mentioned in this thesis, is Peru's Investor-State Dispute Management System. However, these initiatives can only "reduce the number of fully-fledged legal disputes" but do not tackle the greater questions of the legitimacy of the regime (UNCTAD, 2013, p. 5).

As Karl (2013) notes, some states have already begun to reform their own IIAs, particularly by rewording provisions to ensure that these treaties do not infringe on their right to regulate, by clarifying the meaning of provisions, introducing exception clauses (related to industries or types of claims), and limiting access to ISDS. For example, the US 2012 Model BIT has clarified the meaning of indirect expropriation "to exclude regulatory measures enacted in the exercise of the government's police powers" (Perera & Demeter, 2013). However, as these authors note, "international law has yet to identify in a comprehensive and definitive fashion precisely what regulations are considered "permissible" and "commonly accepted" as falling within the police or regulatory power of states, and thus, non-compensable" (Perera & Demeter p. 86). Therefore, the impact of changing or clarifying treaty provisions depends also on their interpretation by arbitral tribunals – an issue clearly exemplified by both the diverging rulings of the AES and Electrabel tribunals, and the very different findings on the acceptability of political measures by the tribunals in the Hungarian and Canadian cases (see Chapters 6 and 8).

Given the latitude that tribunals have to interpret treaty provisions, many observers have instead (or in addition) called for the creation of an appellate court, which could review and

correct erroneous arbitral decisions. According to UNCTAD (2013), if "constituted of permanent members, appointed by States from a pool of the most reputable jurists, an appeals facility has a potential to become an authoritative body capable of delivering consistent – and balanced – opinions, which would rectify some of the legitimacy concerns about the current ISDS regime" (p. 8). Schill (2015) echoes this sentiment, claiming that an appellate mechanism would increase the democratic legitimacy of the international investment regime, particularly if its judges are "appointed by participating states in democratic processes, which are modeled, for instance, on how judges of other international courts are selected" (p. 8). However, he also notes that an appellate court could create further legitimacy problems, as permanent institutions may be more likely to increase their jurisprudential powers than the *ad hoc* system currently in place (a concern which relates to the creation of a standing court as well). Moreover, while the creation of an appellate mechanism would be a positive step overall, it could also serve to increase the costs of arbitral proceedings, another criticism directed at ISDS.

Finally, the most radical reform to the investment protection regime would be the creation of a standing court, like the WTO, to settle investment disputes. This court would, like a potential appellate mechanism, consist of judges appointed or elected by states, to sit on a permanent basis, and potentially allow the participation of a third party as *amicus curiae*. Most obviously, this would decrease the perception of conflicts of interest inherent in the current system, in which many individual investment lawyers are appointed by parties to the dispute, and often sit as both judges and lawyers. According to UNCTAD, the establishment of a court would "go a long way to ensure the legitimacy and transparency of the system, facilitate consistency and curacy of decisions and ensure independence and impartiality of adjudicators" (p. 9). On the other hand, as UNCTAD notes, this would also be the most difficult reform to implement. However, there appears to be some momentum in this direction, as in the final months of 2015, the European Commission published its proposal for the creation of a standing court to be included in the TTIP agreement being negotiated with the United States. In addition, in December 2015, the Commission announced the conclusion of negotiations on an EU-Vietnam free trade agreement that includes a "permanent investment dispute resolution system" and an appellate mechanism (Titi, 2016).

These pathways to reform echo the different assumptions made by the approaches to treaty compliance employed throughout this project. In particular, those reforms that attempt to

decrease the incidence of investor-state disputes – such as alternative dispute resolution and conflict avoidance mechanisms – align with the suggestions made by the managerial approach to increase compliance. For example, a mechanism to review state measures for potential conflict with IIAs could help states to avoid disputes arising from lack of bureaucratic capacity (although the poorest states probably do not have the "in-house" expertise to monitor policy-making with an eye toward investment protection commitments).

However, as the case studies presented here demonstrate, the role of lack of capacity in investor-state disputes is more nuanced than a mere lack of understanding of the regime (although to be sure this is not unimportant). In addition to an awareness of the provisions of IIAs, a better understanding of the preferences of potential stakeholders of an investment project, including non-state actors, could help avoid clashes between investors, and sub- and non-state actors. In particular, consultation with these stakeholders in the pre-investment phase, especially for projects in the extractive industries, could significantly reduce conflict as both governments and investors become aware of potential opposition to a project.[49] This in turn could reduce the incidence of measures regarding the cancelation or revocation of licences and permits, which trigger investor-state disputes most often.

However, for consultation to be effective, governments must be willing, at the outset, to refuse an investment or ask an investor to modify plans in the face of domestic actor concerns, which may not be likely, particularly when the bargaining power between the two parties is unequal, as was the case, for example, in Hungary's efforts to attract FDI in the early 1990s. Moreover, while consultation and mediation may avoid full-fledged investor-state disputes in some cases, in others, such as in El Salvador v. Pacific Rim, the interests of the various stakeholders are irreconcilable. In this case, the solutions to treaty compliance which center on increasing capacity will be of little use. Instead, reform of the international investment protection regime must focus on promoting both IIAs and ISDS which can better balance the interests of investors, states and non-state actors

[49] Moreover, the importance of consultation with affected communities is already widely recognized by numerous international organizations and standards such as FPIC and ILO Convention 169, and UNCTAD's new standards on investment and sustainable development.

Works Cited

Abbott, F. M. (2000). NAFTA and the Legalization of World Politics : A Case Study. *International Organization*, *54*(3), 519–547.

Acemoglu, D. (2008). Oligarchic Versus Democratic Societies. *Journal of European Economic Association*, *6*(March), 1–44.

AES Summit Generation v. Hungary, ICSID Case No. ARB/07/22 Award (September 23, 2010).

AES Summit Generation v. Hungary, ICSID Case No. ARB/07/22 Written Subission submitted by the European Commission (January 15, 2009).

Aisbett, E. (2007). *Bilateral Investment Treaties and Foreign Direct Investment: Correlation versus Causation* (No. 1032). Berkeley.

Aisbett, E. (2009). Bilateral Investment Treaties and Foreign Direct Investment: Correlation versus Causation. In L. Sachs & K. Sauvant (Eds.), *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties and Investment Flows*. Oxford: Oxford University Press.

Aisbett, E., & Poulsen, L. (2013). When the claim hits : bilateral investment treaties and bounded rational learning. *World Politics*, *65*, 1–45.

Albornoz, F., Galiani, S., & Heymann, D. (2011). Foreign Investment and Expropriation under Oligarchy and Democracy.

Allee, T., & Peinhardt, C. (2011). Contingent Credibility: The Reputational Effects of Investment Treaty Disputes on Foreign Direct Investment. *International Organization*, *65*(3), 401–432.

Anderson, J. E. (2003). *Public Policy Making: An Introduction*. Boston: Houghton Mifflin.

APEC. (2002). *Foreign Direct Investment in Atlantic Canada*. Halifax.

APEC. (2005). *Attracting the Big Bucks: Foreign Investment in Atlantic Canada*. Halifax.

Azpuru, D. (2010). The Salience of Ideology: Fifteen Years of Presidential Elections in El Salvador. *Latin American Politics and Society*, *52*(2), 103–138.

Bakos, G. (2001). Privatizing and Liberalizing Electricity, The Case of Hungary. *Energy Policy*, *29*(13), 1119–1132.

Basinger, S. J., & Hallerberg, M. (2004). Remodeling the Comeptition for Capital: How Domestic Politics Erases the Race to the Bottom. *American Political Science Review*, *98*(2), 261–276.

Bebbington, A., Lingan, J., Mun, J. P., & Scurrah, M. (2008). Mining and Social Movements: Struggles Over Livelihood and Rural Territorial Development in the Andes. *World Development*, *36*(12), 2888–2905.

Bellak, C., & Leibrecht, M. (2005). *Do low corporate income tax rates attract FDI? Evidence from Eight Central- and East European Countries* (No. 43). *Globalisation, Productivity and Technology*. Nottingham.

Bernasconi-Osterwalder, N., Cosbey, A., Johnson, L., & Vis-Dunbar, D. (2012). *Investment treaties & Why they matter to sustainable Development : Questions and Answers*. Winnipeg.

Bilcon of Delaware Ltd. v. Canada, UNCITRAL (NAFTA), PCA Case No.2009-04 Award on Jurisdiction and Liability (March 17, 2015).

Bilcon of Delaware Ltd. v. Canada, UNCITRAL (NAFTA) Claimant's Notice of Intent. (February 5, 2008).

Bilcon of Delaware Ltd. v. Canada, UNCITRAL (NAFTA) Statement of Claim(January 30, 2009).

Bilcon of Delaware Ltd. v. Canada, UNCITRAL (NAFTA), PCA Case No.2009-04, Memorial of the Investors (June 25, 2011).

Bilcon of Delaware Ltd. v. Canada, UNCITRAL (NAFTA), PCA Case No.2009-04, Dissenting Opinion of Donald McRae (March 10, 2015).

Bohle, D., & Greskovits, B. (2007). Neoliberalism , embedded neoliberalism and neocorporatism : Towards transnational capitalism in Central-Eastern Europe, (January 2015), 37–41.

Brewster, R., & Chilton, A. (2014). Supplying Compliance: Why and When the US Complies with WTO Rulings. *Yale Journal of International Law*, *39*, 201–236.

Bueno de Mesquita, B., & Smith, A. (2012). Domestic Explanations of International Relations. *Annual Review of Political Science*, *15*(1), 161–181.

Busch, M. L., & Mansfield, E. D. (n.d.). The Political Economy of Trade Policy.

Busse, M., & Hefeker, C. (2005). *Political Risk , Institutions and Foreign Direct Investment* (No. 315). Hamburg.

Cabezas, P. (2014). Incoming Minister of the Environment Confirms Continuation of Mining Moratorium in El Salvador. Retrieved from http://www.stopesmining.org/j25/index.php/salvadoran-mining-ban/301-incoming-minister-of-the-environment-confirms-continuation-of-mining-moratorium-in-el-salvador

Cao, X., & Ward, H. (2015). Winning Coalition Size , State Capacity , and Time Horizons : An Application of Modified Selectorate Theory to Environmental Public Goods Provision *. *International Studies Quarterly*, *59*(2), 264–279.

CBC. (2006). Digby Quarry opponents step up lobbying efforts. *CBC News Nova Scotia*. Retrieved September 26, 2015, from http://www.cbc.ca/news/canada/nova-scotia/digby-quarry-opponents-step-up-lobby-efforts-1.583054

CCPA. (2010). *NAFTA Chapter 11 Investor-State Disputes*. Ottawa.

CEAA. (n.d.). What is an environmental assessment by joint review panel? Retrieved February 11, 2016, from https://www.ceaa-acee.gc.ca/default.asp?lang=En&n=B053F859-1#panel02

CEDES. (2007). *La explotación minera en El Salvador - Cuidemos La Casa de Todos*. San Salvador.

Chang, H.-J. (2004). Regulation of Foreign Investment in Historical Perspective. *The European Journal of Development Research*, *16*(3), 687–715.

Chayes, A., & Chayes, A. H. (1995). *The new sovereignty. Complinace with international regulatory agreements*. Cambridge: Harvard University Press.

Chorev, N. (2005). The institutional project of neo-liberal globalism : The case of the WTO. *Theory and Society*, *34*(3), 317–355.

Claimant's Memorial on the Merits ICSID Case No. ARB/09/12. (2014). Washington D.C.

Cole, W. M. (2015). Mind the Gap: State Capacity and the Implementation of Human Rights Treaties. *International Organization*, *69*(2), 405–441.

Colen, L., & Guariso, A. (2013). What type of foreign direct investment is attracted by bilateral investment agreements. In O. De Schutter, J. F. Swinnen, & J. Wouters (Eds.), *Foreign Direct Investment and Human Development The Law and Economics of International Investment Agreements* (pp. 116–137). New York City: Routledge.

Colen, L., Maertens, M., & Swinnen, J. (2013). Determinants of Foreign Direct Investment Flows to Developing Countries: The Role of International Investment Agreements. In O. De Schutter, J. Swinnen, & J. Wouters (Eds.), *Foreign Direct Investment and Human Development The Law and Economics of International Investment Agreements* (pp. 116–137). New York City: Routledge.

Côté, C. (2014). The Chilling Effect of Globalization: A Look at the Impact of International Investment Agreements on National Regulatory Autonomy in the Areas of Health , Safety and the Environment. In *The Political Economy of International Investment Agreements* (pp. 1–36). Bonn.

Dai, X. (2005). *Why Comply? The Domestic Constituency Mechanism*. *International Organization* (Vol. 59).

Dai, X. (2007). *International Institutions and National Policies*. Cambridge: Cambridge University Press.

Davis, R., & Franks, D. (2014). *Costs of Company-Community Conflict in the Extractive Sector* (No. 66). Cambridge.

Dawson, L. (2012). *Potash and BlackBerries: Should Canada Treat All Foreign Direct Investment the Same ?* Ottawa.

Deak, A. (2013). Hungarian Dances – The Origins and the Future of Viktor Orbán's Revolution. *Lithuanian Annual Strategic Review*, *11*(1), 145–168.

Devereux, M. P., Lockwood, B., & Redoano, M. (2008). Do countries compete over corporate tax rates? *Journal of Public Economics*, *92*(5-6), 1210–1235.

DNR. (1996). *Minerals - A Policy for Nova Scotia*.

Downs, G. W., Rocke, D. M., & Barsoom, P. N. (1996). Is the good news about compliance good news about cooperation? *International Organization*, *50*(3), 379–406.

Drahokoupil, J. (2009). *Globalization and the State in Central and Eastern Europe*. New York City: Routledge.

Dunning, J. H. (2001). The Eclectic (OLI) Paradigm of International Production: Past, Present and Future. *International Journal of the Economics of Business*, *8*(2), 173–190.

Durán, J. C. (2007). Estudio sobre conocimientos y percepciones hacia la mineria. *Estudios Centroamericanos*, *63*, 59–62.

Echandi, R., & Kher, P. (2013). Can International Investor-State Disputes be Prevented? Empirical Evidence from Settlements in ICSID Arbitration. *ICSID Review*, *29*(1), 41–65.

Eden, L. (1991). Bringing the Firm Back In: Multinationals in International Political Economy. *Millennium - Journal of International Studies*, *20*(2), 197–224.

Elections Nova Scotia. (2003). 21-Digby Anapolis. Retrieved September 26, 2015, from https://electionsnovascotia.ca/sites/default/files/03dist21.pdf

Electrabel v. Hungary ICSID Case No. AR/7/19, Decision on Jurisdiction, Applicable Law and Liability (November 30, 2012).

Elkins, Z., Guzman, A., & Simmons, B. (2006). Competing for Capital: The Diffusion of Bilateral Investment Treaties, 1960–2000. *International Organization*, *60*(04).

Emel, J., & Huber, M. T. (2008). A risky business: Mining, rent and the neoliberalization of "risk." *Geoforum*, *39*(3), 1393–1407.

European Commission. (2015). *Report on the on line public consultation on investment protection and investr-to-state dispute settlement (ISDS) in the Transatlantic Trade and Investment Partnership Agreement (TTIP)*. Brussels.

Fatás, A., & Mihov, I. (2013). Policy volatility, institutions, and economic growth. *The Review of Economics and Statistics*, *95*(May), 362–376.

Fournier, R., Grant, J., & Muecke, G. (2007). *The Environmental Assessment of the Whites Point Quarry and Marine Terminal Project*. Halifax.

Franck, S. D. (2009). Development and Outcomes of Investment Treaty Arbitration. *Harvard International Law Journal*, *50*, 1–56.

Franck, S. D. (2015). Conflating Politics and Development? Examining Investment Treaty Arbitration Outcomes. *Virginia Journal of International Law*, *55*(1), 13–71.

Freeman, N. W. (2013). Domestic Institutions, Capacity Limitations, and Compliance Costs: Host Country Determinants of Investment Treaty Arbitrations, 1987–2007. *International Interactions*, *39*(1), 54–78.

Frieden, J. (1999). Actors and Preferences in International Relations. In D. A. Lake & R. Powell (Eds.), *Strategic Choice and International Relations* (pp. 39–76). Princeton: Princeton University Press.

Frieden, J., & Martin, L. (2003). International political economy: global and domestic interactions. In I. Katznelson & H. V. Milner (Eds.), *Political Science: The State of the Discipline* (pp. 118–146). New York: W.W. Norton.

Gaubatz, K. T. (1996). Democratic States and Commitment in International Relations. *International Organization*, *50*(1), 109–139.

Gaukrodger, D., & Gordon, K. (2012). *OECD Working Papers on International Improving the System of Investor-State Dispute Settlement*. Paris.

Goldstein, J., Kahler, M., Keohane, R. O., & Slaughter, A.-M. (2001). Introduction: Legalization and World Politics. In *Legalization and World Politics*. MIT Press.

Golob, S. R. (2003). Beyond the Policy Frontier: Canada, Mexico, and the Ideological origins of NAFTA. *World Politics*, *55*(3), 361–398.

Government of Canada. (2009). *Statement of Defence of the Government of Canada*.

Graham, B., Johnston, N. P., & Kingsley, A. F. (2012). How Sovereigns Steal: Political Constraints and the Choice Between Transfer and Expropriation Rents. In *International Political Economy Society Annual Meeting* (pp. 1–46). Princeton.

Gramont, A. De. (2009). *Notice of Arbitration*. Washington D.C.

Grieco, J., Gelpi, C., & Warren, C. (2009). When preferences and commitments collide: The effect of relative partisan shift on international treaty compliance. *International Organization*, *63*(2), 341–355.

Gulen, H., & Ion, M. (2015). *Policy Uncertainty and Corporate Investment*. Retrieved from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2188090

Guzman, A. (1997). Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties. *Virginia Journal of International Law*, *639*(38).

Hafner-Burton, E., Steinert-Threlkeld, Z., & Victor, D. (2014). Transparency of Investor-State Arbitration. In *Workshop on International Cooperation* (pp. 1–50). Montreal.

Hajzler, C. (2012). Expropriation of foreign direct investments: Sectoral patterns from 1993 to 2006. *Review of World Economics*, *148*(1011), 119–149.

Haslam, P. (2009). Is there a Post-Neoliberal Policy Towards Foreign Direct Investment in Chile and Argentina? In L. Macdonald & Arne Ruckert (Eds.), *Post-Neoliberalism in the Americas* (pp. 120–134). London.

Haslam, P. A., & Tanimoune, N. A. (2016). The Determinants of Social Conflict in the Latin American Mining Sector: New Evidence with Quantitative Data. *World Development*, *78*, 401–419.

Heffernan, R. (2005). Why the Prime Minister cannot be a President: Comparing Institutional Imperatives in Britain and America. *Parliamentary Affairs*, *58*(1), 53–70.

Heindl, J. A. (2006). Toward a History of NAFTA ' s Chapter Eleven. *Berkeley Journal of International Law*, *24*(2), 672–686.

Henisz, W. (2013). POLCON_2005 Codebook.

Henisz, W., & Mansfield, E. (2006). Votes and Vetoes: The Political Determinants of Commercial Openness. *International Studies Quarterly*, *50*(1), 189–211.

Henisz, W., & Zelner, B. (2002). *Political Risk Management: A Strategic Perspective*.

Hooley, G., Cox, T., Shipley, D., John, F., Beracs, J., & Kolos, K. (1996). Foreign Direct Investment in Hungary: Resource Acquisition and Domestic Competitive Advantage. *Journal of International Business Studies*, *27*(4), 683–709.

Horn, N. (2008). Current Use of the UNCITRAL Arbitration Rules in the Context of Investment Arbitration. *Arbitration International*, *24*(4), 587–602.

Jensen, N. M. (2003). Democratic Governance and Multinational Corporations: Political Regimes and Inflows of Foreign Direct Investment. *International Organization*, *57*(03), 587–616.

Jensen, N. M. (2006). *Nation-States and the Multinational Corporation: A Political Economy of Foreign Direct Investment*. Princeton: Princeton University Press.

Jensen, N. M., Johnston, N. P., & Lee, C. (2013). *Crisis and Contract Breach: The Domestic and International Determinants of Expropriation*. St Louis.

Jensen, N. M., Johnston, N. P., Washington, Lee, C., & Sahin, A. (2012). Economic shock, political shifts, and sovereign theft: The domestic and international determinants of investment expropriation. In *International Political Economy Society*. Princeton.

Jensen, N. M., & Lindstadt, R. (2013). *Globalization with whom: context dependent foreign direct investment preferences*. St. Louis.

Johnson, L. (2014). El Salvador argues that domestic investment law is not a portal for Pacific Rim mining company to reach international law protections. *IA Reporter*.

Johnson, L., & Sachs, L. (2015). Eyes Wide Shut on ISDS. *The Hill*. Retrieved September 20, 2015, from http://thehill.com/blogs/congress-blog/foreign-policy/239560-eyes-wide-shut-on-isds

Johnson, R., & Mahon, R. (2005). NAFTA, the Redesign, and Rescaling of Canada's Welfare State. *Studies in Political Economy*, *76*, 7–30.

Kalotay, K., & Hunya, G. (2000). Privatization and FDI in Central and Eastern Europe. *Transnational Corporations*, *9*(1), 39–66.

Karl, J. (2013). Columbia FDI Perspectives the Vale Columbia Center on Sustainable International Investment by, (89), 1–4.

Kastner, S. L., & Rector, C. (2003). International Regimes, Domestic Veto-Players, and Capital Controls Policy Stability. *International Studies Quarterly*, (47), 1–22.

Kaufmann, D., & Kraay, A. (2003). *Governance and Growth: Causality which way ? - Evidence for the World , in brief*. Washington D.C.

Keck, M. E., & Sikkink, K. (1999). *Activists Beyond Borders. Advocacy Networks in International Politics*. Ithaca: Cornell University Press.

Keijzer, N., Kraetke, F., & van Seters, J. (2013). *Meeting in the Middle? Challenges and Opportunities for EU Cooperation with Middle-Income Countries* (No. 140).

Keohane, R. O., Moravcsik, A., & Slaugher, A.-M. (2001). Legalized dispute resolution: interstate and transnational. In *Legalization and World Politics* (pp. 73–104). Boston: MIT Press.

Kerner, A. (2009). Why Should I Believe You? The Costs and Consequences of Bilateral Investment Treaties. *International Studies Quarterly*, *53*, 73–102.

Kingsbury, B., & Schill, S. (2009). *Investor-State Arbitration as Governance: Fair and Equitable Treatment, Proportionality and the Emerging Global Administrative Law* (No. 09-46). New York City.

Kleinheisterkamp, J. (2012). Investment Protection and EU Law: The Intra- and Extra-EU Dimension of the Energy Charter Treaty. *Journal of International Economic Law*, 1–25. doi:10.1093/jiel/jgs004

Knutsen, C. (2011). Democracy , Dictatorship and Protection of Property Rights. *Journal of Development Studies*, *47*(1), 164–182.

Kobrin, S. (1984). Expropriation as an Attempt to Control Foreign Firms in LDCs: Trends from 1960 to 1979. *International Studies Quarterly*, *28*(3), 329–348.

Kobrin, S. J. (1979). Political Risk: A Review and Reconsideration. *Journal of International Business Studies*, *10*(1), 67–80.

Konoplyanik, B. A., & Wälde, T. (2006). Energy Charter Treaty and its Role in International Energy. *Journal of Energy & Natural Resources Law*, *24*(4), 523–558.

Krajewski, M. (2012). The Impact of International Investment Agreements on Energy Regulation. In C. Herrmann & J. P. Terhechte (Eds.), *European Yearbook of International Economic Law (EYIEL) Vol. 3 (2012)* (Vol. 3, pp. 343–369). Heidelberg: Springer-Verlag Berlin Heidelberg.

Krajewski, M. (2013). *Investment Law and Public Services*.

Li, Q. (2005). Democracy, Autocracy, and Expropriation of Foreign Direct Investment. In *International Studies Association Annual Meeting*. St. Louis.

Li, Q., & Resnick, A. (2003). Reversal of Fortunes: Democratic Institutions and Foreign Direct Investment In □ows to Developing Countries. *International Organization*, *57*(1), 175–211.

Lieberman, E. S. (2005). Nested Analysis as a Mixed-Method Strategy for Comparative Research. *American Political Science Review*, *99*(3), 435–452.

Luz, M. A., & Miller, M. (2002). Globalization and Canadian Federalism: Implications of the NAFTA's Investment Rules. *McGill Law Journal*, *47*.

Mann, H. (2005). *The Final Decision in Methanex v . United States: Some New Wine in Some New Bottles*. Winnipeg.

Mann, H. (2007). *Issues in International Investment Law and the Regulatory State : Can Exceptions Clauses Create a Safe Haven for Governments ?* Singapore.

Mansfield, E. D., & Mutz, D. C. (2009). Support for Free Trade : Self-Interest , Sociotropic Politics , and Out-Group Anxiety Support for Free Trade: Politics , and Out-Group Anxiety. *International Organization*, *63*, 425–457.

Marshall, M. G., & Gurr, T. R. (2013). Polity IV Project: Political Regime Characteristics and Transitions, 1800-2013. Vienna, Virginia: Center for Systemic Peace.

Mattes, M., Leeds, B. A., & Carroll, R. (2014). Leadership Turnover and Foreign Policy Change : Societal Interests , Domestic Institutions , and Voting in the United Nations * Leadership Turnover and Foreign Policy Change : Societal Interests , Domestic Institutions , and Voting in the United Nations. *International Studies Quarterly*, *59*(2), 280–290.

Mayeda, G. (2007). Playing Fair: The Meaning of Fair and Equitable Treatment in Biilateral Investment Treaties. *Journal of World Trade*, *41*(2), 273–291. Retrieved from http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1427307

McKinley, A. (2009). *A Brief Contextual Analysis of the Legal Suit of Pacific Rim Mining Company Against the Government of El Salvador*. San Salvador.

Meija, T. (2006). Mineria-America Central: Nuevo fiebre del oro. *TierraAmerica*. Retrieved September 28, 2015, from http://www.ipsnoticias.net/2006/08/mineria-america-central-nueva-fiebre-del-oro/

Milner, H. V, Rosendorff, P. B., & Mansfield, E. D. (2003). International trade and domestic politics: the domestic sources of international trade agreements and institutions (pp. 1–41).

Montt, S. (2009). *State liability in investment treaty arbitration*. Portland: Hart Publishing.

Moosa, I. A. (2002). *Foreign Direct Investment. Theory, Evidence and Practice*. New York: Palgrave.

Moravcsik, A. (1997). Taking Preferences Seriously: A Liberal Theory of International Politics. *International Organization*, *51*(4), 513–553.

Moravcsik, A. (2012). Liberal Theories of International Law. In J. L. Dunoff & M. A. Pollack (Eds.), *Interdisciplinary Perspectives on International Law and International Relations* (pp. 83–118). Cambridge: Cambridge University Press.

Moreno, R. (2008). Control hegemonico y apropriacion de recursos naturales. *America Latina En Movimiento*.

Muchlinski, P. T. (1996). A Case of Czech Beer : Competition and in the Transitional Economies Competitiveness. *The Modern Law Review*, *59*(5), 658–674.

Murillo, M. V., Scartascini, C., & Tommasi, M. (2008). *The Political Economy of Productivity: Actors , Arenas , and Policies A Framework of Analysis* (No. 640). Washington.

Nelson, T. G., Kavanagh, D., & Herlihy, D. (2013). *The Increasing Appeal and Novel Use of Bilateral Investment Treaties*. London.

North, D. C., & Weingast, B. R. (1989). Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth-Century England. *The Journal of Economic History*, *XLIX*(4), 803–832.

Notice of Intent. (2008). Toronto: Appleton & Associates.

Nova Scotia Environment. (2001). A Proponent’s Guide to Environmental Assessment. Halifax: Nova Scotia Environment Policy Division.

NSED. (2000). *Opportunities for Prosperity: A New Economic Growth Strategy for Nova Scotians*. Halifax.

OECD. (2000a). *Regulatory Reform in Hungary. Enhancing Market Openness through Regulatory Reform*. Paris.

OECD. (2000b). *Regulatory Reform in Hungary. Regulatory Reform in the Electricity Sector*. Paris.

Olney, W. W. (2013). A Race to the Bottom ? Employment Protection and Foreign Direct Investment, *01267*(August).

Orellana, M. (2011). *Application for Permission to Proceed as Amici Curiae ICSID Case No. ARB/09/12*. Washington D.C.

Pacas, F. (2007). Centroamérica cierra filas contra la minería. *Comunica en Linea*. Retrieved from http://www.uca.edu.sv/virtual/comunica/archivo/jun292007/notas/nota33.htm

Pac Rim Cayman LLC v. Republic of El Salvador Notice of Arbitration (April 30, 2009).

Pac Rim Cayman LLC v. Republic of El Salvador ICSID Case No. ARB/09/12 Republic of El Salvador's Preliminary Objections (January 4, 2010).

Pac Rim Cayman LLC v. Republic of El Salvador ICSID Case No. ARB/09/12 Witness Statement of Thomas C. Shrake (December 31, 2010).

Pac Rim Cayman LLC v. Republic of El Salvador ICSID Case No. ARB/09/12 Claimant Pac Rim Cayman LLC's Memorial on the Merits and Quantum (April 11, 2014).

Pac Rim Cayman LLC v. Republic of El Salvador ICSID Case No. ARB/09/12 The Republic of El Salvador's Counter Memorial on the Merits (October 1, 2014).

Pandya, S. S. (2010). Labor Markets and the Demand for Foreign Direct Investment. *International Organization*, *64*(03), 389–409.

Pelc, K. J., & Urpelainen, J. (2015). When do international economic agreements allow countries to pay to breach ? *Review of International Organizations*, *10*, 231–264.

Perera, T., & Demeter, D. (2013). A Balancing Act: Retaining Investor-State Dispute Settlement Provisions in Investment Agreements and Balancing Stakeholder Interests. *Australian Year Book of International Law*, *31*, 75–116.

Petersmann, E.-U. (2011). Multilevel trade governance in the WTO requires multilevel constitutionalism. In *Constitutionalism, multilevel trade governance and international economic law* (pp. 5–59). Oxford: Hart Publishing.

Pinto, P. M. (2013). *Partisan Investment in the Global Political Economy. Why the Left Loves Foreign Direct Investment and FDI Loves the Left*. Cambridge: Cambridge University Press.

Poulsen, L. (2015). *Bounded Rationality and Economic Diplomacy. The Politics of Investment Treaties in Developing Countries*. Cambridge: Cambridge University Press.

Provost, C. (2014, April 10). El Salvador groups accuse Pacific Rim of "assault on democratic governance." *The Guardian*. Retrieved from http://www.theguardian.com/global-development/2014/apr/10/el-salvador-pacific-rim-assault-democratic-governance

Quezada, R. B. (2006). Explotación minera: los conflictos del oro. *El Faro*. Retrieved from http://archivo.elfaro.net/secciones/observatorio/20060619/observatorio1_20060619.asp

Reinhart, C., & Rogoff, K. (2010). *From Financial Crash to Debt Crisis* (No. 15795).

Richler, N. (2007). Rock Bottom. *The Walrus*. Retrieved from http://www.thewalrus.ca/rock-bottom

Rickard, S. J. (2010). Democratic Differences : Electoral institutions and compliance with GATT / WTO agreements. *European Journal of International Relations*, *16*, 711–729.

Roaf, J., Atoyan, R., Bikas, J., & Krogulski, K. (2014). *25 Years of Transition; Post-Communist Europe and the IMF*. Washington D.C.: Internatiional Monetary Fund.

Rodrik, D. (1991). Policy uncertainty and private investment in developing countries. *Journal of Development Economics*, *36*(2), 229–242.

Rosendorff, B. P., & Milner, H. V. (2001). The Optimal Design of International Trade Institutions: Uncertainty and Escape. *International Organization*, *55*(4), 829–857.

Rosendorff, B. P., & Smith, A. (2014). Domestic Political Determinants of the Onset of WTO Disputes. In *International Political Economy Society Annual Meeting*. Princeton.

Ross, M. L. (1999). The Political Economy of the Resource Curse. *World Politics*, *51*(2), 297–322.

Salacuse, J. (2008). Explanations for the increased recourse to treaty-based investment dispute settlement: resolving the struggle of life against form? In K. P. Sauvant (Ed.), *Appeals Mechanism in International Investment Dispute* (pp. 106–125). New York: Oxford University Press.

Schill, S. W. (2010). Crafting the International Economic Order: The Public Function of Investment Treaty Arbitration and Its Significance for the Role of the Arbitrator. *Leiden Journal of International Law*, *23*(02), 401–430.

Schill, S. W. (2015). *Strengthening the global trade and investment system for sustainable development*. Geneva.

Schultz, T., & Dupont, C. (2014). Investment Arbitration: Promoting the Rule of Law or Over-Empowering Investors? A Quantitative Empirical Study. *European Journal of International Law*, *25*(4), 1–29.

Seawright, J., & Gerring, J. (2008). Case Selection Techniques in Case Study Research: A Menu of Qualitative and Quantitative Options. *Political Research Quarterly*, *61*(2), 294–308.

Shrake, T. (2010). *Witness Statement of Thomas C. Shrake*. Washington D.C.

Simmons, B. (1994). *Who Adjusts? Domestic Sources of Foreign Economic Policy During the Interwar Years*. Princeton: Princeton University Press.

Simmons, B. (2010). Treaty Compliance and Violation. *Annual Review of Political Science*, *13*(1), 273–296. doi:10.1146/annurev.polisci.12.040907.132713

Simmons, B. (2013). Bargaining over BITs, Arbitrating Awards: The Regime for Protection and Promotion of International Investment. *World Politics*, *66*(01), 12–46.

Slaughter, A. M., & Raustiala, K. (2002). International Law , International Relations and Compliance. In Walter Carlsnaes, Thomas Risse, & B. A. Simmons (Eds.), *The Handbook of International Relations* (pp. 538–558). London: SAGE Publications Ltd.

Spalding, R. J. (2011). Transnational Activism and National Action: El Salvador's Anti-Mining Movement. In *The Domestic Effects of Transnational Activism*. Tulane University, New Orleans.

Spiller, P. T., Stein, E., & Tommasi, M. (2008). Political Institutions, Policymaking and Policy: An Introduction. In E. Stein & M. Tommasi (Eds.), *Policymaking in Latin America* (pp. 1–28). Cambridge: Inter-American Development Bank.

Stone Sweet, A. (1997). The new GATT: Dispute resolution and judicialization of the trade regime. In M. Volcansek (Ed.), *Law above nations: Supranational courts and the legalization of politics* (pp. 118–141). Gainesville: University Press of Florida.

Szorenyi, G. (2004). Stranded Cost Compensation Method (State Aid Analysis). Tirana: Energy Regulator's Regional Association. Retrieved from http://www.erranet.org

Tallberg, J. (2002). Paths to Compliance : Enforcement , Management , and the European Union. *International Organization*, *56*(3), 609–643.

Tavernise, S. (2013, December 13). Tobacco industry tactics limit poorer nations' smoking laws. *New York Times*.

Tienhaara, K. (2006). What You Don't Know Can Hurt You: Investor-State Disputes and the Protection of the Environment in Developing Countries. *Global Environmental Politics*, *6*(4), 73–100.

Tienhaara, K. (2009). *The Expropriation of Environmental Governance: Protecting Foreign Investors at the Expense of Public Policy*. Cambridge: Cambridge University Press.

Titi, C. (2016). *The European Union's Proposal for an International Investment Court: Significance, Innovations and Challenges Ahead*. Dijon.

Tobin, J. L., & Rose-Ackerman, S. (2011). When BITs have some bite: The political-economic environment for bilateral investment treaties. *The Review of International Organizations*, *6*(1), 1–32.

Tomz, M. (2002). *Democratic Default : Domestic Audiences and Compliance with International Agreements*.

Tsebelis, G. (2000). Veto Players and Institutional Analysis. *Governance*, *13*(4), 441–474.

Tucker, T. (2015). The concept of the state in investor-state arbitration. In *The Role of the State in Investor-State Arbitration* (pp. 131–161). Leiden: Brill Nijhoff.

UNCTAD. (2007a). *Bilateral Investment Treaties 1995-2006: Trends in Investment Rulemaking*. Geneva.

UNCTAD. (2007b). Country Fact Sheet: Hungary. *World Investment Report*. Retrieved February 13, 2016, from http://unctad.org/sections/dite_dir/docs/wir07_fs_hu_en.pdf

UNCTAD. (2013a). *Reform of Investor-State Dispute Settlement: In Search of a Roadmap*. Geneva.

UNCTAD. (2013b). *Reform of Investor-State Dispute Settlement: In Search of a Roadmap* (No. 2). Geneva.

UNDP. (2010). *Informe sobre Desarrollo Humano El Salvador 2010*. San Salvador.

Van Aaken, A. (2009). International investment law between commitment and flexibility: A contract theory analysis. *Journal of International Economic Law*, *12*(2), 507–538..

Van Harten, G. (2007). *Investment Treaty Arbitration and Public Law*. Oxford: Oxford University Press.

Van Harten, G. (2011). *Reform of investor-state arbitration: A perspective from Canada*. Ottawa.

Van Harten, G. (2013). *Beware the discretionary choices of arbitrators* (No. 110). *Columbia FDI Perspectives*. New York City.

Verney, D. (1992). Parliamentary Government and Presidential Government. In A. Lijphart (Ed.), *Parliamentary versus Presidential Government* (pp. 31–47). Oxford: Oxford University Press.

Waelde, T., & Kolo, A. (2001). Environmental Regulation, Investment Protection and "Regulatory Taking" in International Law. *The International and Comparative Law Quarterly*, *50*(4), 811–848.

Wei, S.-J. (1997). *How Taxing is Corruption on International Investors?* (No. 63). Ann Arbor.

Wellhausen, R. L. (2015). *The Shield of Nationality: When Governments Break Contracts with Foreign Firms*. Cambridge: Cambridge University Press.

Weymouth, S. (2010). Political Institutions and Property Rights: Veto Players and Foreign Exchange Commitments in 127 Countries. *Comparative Political Studies*, *44*(2), 211–240.

Wiesehomeier, N., & Benoit, K. (2009). Presidents, Parties and Policy Competition. *The Journal of Politics*, *71*(04), 1435–1447.

Wilson, L. (2010). Resisting CAFTA and Metal Mining in El Salvador. Retrieved from http://www.cispes.org/programs/anti-mining-and-cafta/resisting-cafta-and-metal-mining-in-el-salvador/

Winham, G. R. (2007). Advice on the application and implications of the North American Free Trade Agreement (NAFTA) to the proposed Whites Point Quarry and Marine Terminal Project. Halifax.

Wood, E. (2003). *Insurgent Collective Action and Civil War in El Salvador*. New York: Cambridge University Press.

World Bank. (2006). *Doing Business in 2006*. Washington D.C.

World Bank. (2007). *Doing Business in 2007*. Washington D.C.

Yazbek, N. (2010). Bilateral investment treaties: the foreclosure of domestic policy space. *South African Journal of International Affairs*, *17*(1), 103–120.

Zegarra, L. F., Rodríguez, M., & Acevedo, C. (2007). *Competitiveness and Growth in Latin America. Country Case: El Salvador*. Washington D.C.

Appendix I: Qualitative Coding

1. Respondent States Included in Database

1. Afghanistan
2. Albania
3. Algeria
4. Angola
5. Argentina
6. Armenia
7. Australia
8. Austria
9. Azerbaijan
10. Bahrain
11. Bangladesh
12. Barbados
13. Belarus
14. Belgium
15. Belize
16. Benin
17. Bolivia
18. Bosnia
19. Botswana
20. Bulgaria
21. Burkina Faso
22. Burundi
23. Cambodia
24. Cameroon
25. Canada
26. Chile
27. Costa Rica
28. Croatia
29. Cyprus
30. Czech Republic
31. Denmark
32. Djibouti
33. Dominica
34. Dominican Republic
35. DRC
36. Ecuador
37. Egypt
38. El Salvador
39. Equatorial Guinea
40. Eritrea
41. Estonia
42. Ethiopia
43. Finland
44. France
45. Gabon
46. Gambia
47. Georgia
48. Germany
49. Ghana
50. Greece
51. Guatemala
52. Guinea
53. Guyana
54. Haiti
55. Honduras
56. Hungary
57. Iceland
58. India
59. Indonesia
60. Iran
61. Ireland
62. Israel
63. Italy
64. Jamaica
65. Japan
66. Jordan
67. Kazakhstan
68. Kenya
69. Korea
70. Kuwait
71. Kyrgyz Republic
72. Laos
73. Latvia
74. Lebanon
75. Libya
76. Lithuania
77. Macedonia
78. Madagascar
79. Malaysia
80. Mali
81. Mauritania
82. Mauritius
83. Mexico
84. Moldova

85. Mongolia
86. Morocco
87. Mozambique
88. Myanmar
89. Namibia
90. Nepal
91. Netherlands
92. New Zealand
93. Nicaragua
94. Nigeria
95. Norway
96. Oman
97. Pakistan
98. Panama
99. Papua New Guinea
100. Paraguay
101. Peru
102. Philippines
103. Poland
104. Portugal
105. Qatar
106. Romania
107. Russia
108. Rwanda
109. Saudi Arabia
110. Senegal
111. Serbia
112. Sierra Leone
113. Singapore
114. Slovak Republic
115. Slovenia
116. South Africa
117. South Sudan
118. Spain
119. Sri Lanka
120. Sudan
121. Suriname
122. Swaziland
123. Sweden
124. Syria
125. Tajikistan
126. Tanzania
127. Thailand
128. Trinidad
129. Tunisia
130. Turkey
131. Turkmenistan
132. Uganda
133. Ukraine
134. United Arab Emirates
135. United Kingdom
136. United States
137. Uruguay
138. Uzbekistan
139. Venezuela
140. Vietnam
141. Yemen
142. Zambia
143. Zimbabwe

2. Coding Scheme – Measures

Code	Definition
Legislative	A measure is coded as legislative if it is a law passed by an elected body – parliament, legislature etc, at either the national or subnational level. Usually found in the "Facts" section of an arbitral award.
Administrative	A measure is coded as administrative if it is taken by the executive, ministries, or other government agencies (including SOEs), without the passing of a law. This includes contractual issues, permitting procedures, and other processes involved in the functioning of these bodies.
Judicial	A measure is coded as judicial if it is the decision of a domestic court.
Not Applicable	A measure is coded as NA if the claimant identifies as lack of government action as being at issue – for example a failure to protect an investment from terrorism.
Unknown	A measure is coded as UK if its source cannot be determined.
General	Measure applies to entire population or entire industry.
Specific	Measure applies to specific investor or smaller group of investors.
Cancellation of licence/permit/contract	State cancels an agreement with an investor
Refusal to grant licence/permit/contract	State refused to grant permission for a project (generally takes place after certain administrative steps have already been taken by the investor).
Regulatory Change	Generally applies population or industry-wide; examples include: ban of specific activity or substance; change to regulatoryE framework governing a specific industry. Examples include withdrawal of subsidies, imposition of plain packaging for cigarettes, change in tariff scheme, minimum wage.
Unfulfilled contractual/payment obligations	State allegedly fails to pay for services rendered or fulfill other contractual requirements
Existing legislation	An investor challenges a law already in force, rather than reacting to a change in law. Examples include Canada Health act, and Black Economic Empowerment provisions.
Failure to protect investment	State fails to protect investment, including against terrorist attacks; protestors; squatters, etc.
Currency measures	Currency devaluations or controls; includes measures taken during the Argentine financial crisis
Failure to Enforce Previous Award/Settlement	State fails to respect conditions of previous award, either domestically or from previous arbitral proceeding.
Trade Controls	Import and export duties, quotas, etc.
Price Controls	Imposition of new tariffs for utilities
Interference with investment	Alleged harassment by government officials

Appendix II: Statistics

1. Descriptive Statistics (Population)

Variable	Obs	Mean	Std Dev	Min	Max
Treaty	3077	22.28209	23.29669	1	155
NAFTA	3083	0.0194616	0.138163	0	1
FDI Stock	2749	1.87e+08	5.29e+09	-4.15e+10	1.33e+11
GDP per Capita	2884	9220.157	13771.36	102.666	110697
GDP Growth	2997	3.975114	6.330416	-62.07651	149.971
Govt Effect	3038	0.037413	1.474134.	-3.4536	4.815308
Political Stab	3038	-0.1585554	1.399086	-5.468624	3.330409
Polity	2816	3.356889	6.773796	-10	10
Veto Player	2844	0.4257029	0.319778	0	0.89432
Transition	3038	0.186831	0.389839	0	1
Left	2937	0.3023493	0.459354	0	1
Crisis	2742	0.2381473	0.4260274	0	1
Leader Trans	2285	0.1684902	0.3743829	0	1

2. Descriptive Statistics (Case Studies)

Canada

Variable	Obs	Mean	Std Dev	Min	Max
Treaty	24	21.08333	9.33398	4	33
NAFTA	24	0.8333333	0.3806935	0	1
FDI Stock	23	285723	183551.9	106867.8	636972.5
GDP per Capita	23	29838.15	11415	19390.49	52218.99
GDP Growth	24	2.266645	1.921533	-2.711471	5.123122
Govt Effect	24	2.054875	1.933825	0	4.026222
Political Stab	24	1.088267	1.035518	0	2.31787
Polity	23	10	0	10	10
Veto Player	23	0.8536841	0 .0082252	0.8391481	0.86288
Transition	24	0	0	0	0
Left	23	0.5652174	0.5068698	0	1
Crisis	23	0.1304348	0.3443502	0	1
Leader Trans	19	0.2105263	0 .4188539	0	1

El Salvador

Variable	Obs	Mean	Std Dev	Min	Max
Treaty	22	13.77273	8.274642	1	21
NAFTA	22	0	0	0	0
FDI Stock	21	3489.628	2943.765	252.61	8634.9
GDP per Capita	21	2481.577	823.1513	1080.485	3789.568
GDP Growth	22	3.066214	2.368849	-3.133046	7.543337
Govt Effect	22	-.352011	.4476864	-1.447845	.0109695
Political Stab	22	-.0034733	.2398967	-.6059355	.5318343
Polity	21	7.190476	4023739	7	8
Veto Player	21	.1981051	.0215152	.160008	.220011
Transition	22	0	0	0	0
Left	21	.1428571	.3585686	0	1
Crisis	21	.2380952	.4364358	0	1
Leader Trans	17	.1764706	.3929526	0	1

Hungary

Variable	Obs	Mean	Std Dev	Min	Max
Treaty	24	43.66667	15.03522	13	58
NAFTA	24	0	0	0	0
FDI Stock	23	43655.14	36579.71	569.5688	103556.5
GDP per Capita	23	7743.598	4172.572	3186.444	15364.68
GDP Growth	22	1.744911	2.834522	-6.55103	4.789353
Govt Effect	24	.9119483	.8722133	0	2.040474
Political Stab	24	.9447674	.9283171	0	2.34937
Polity	24	10	0	10	10
Veto Player	23	.7462342	.0212059	.6667	.7653642
Transition	24	1	0	1	1
Left	23	.7391304	.4489778	0	1
Crisis	23	.6521739	.4869848	0	1
Leader Trans	19	.2631579	.4524139	0	1

3. Alternative Models

Exposure (Panel NBREG)

VARIABLES	(1) totcase	(2) totcase	(3) totcase	(5) totcase
Lagged DV	1.437***	1.482***	1.367***	1.343***
	(0.0643)	(0.0631)	(0.0674)	(0.0563)
Treaties	1.027***			1.018***
	(0.00264)			(0.00484)
FDI Stock		1.213***		0.954
		(0.0315)		(0.0344)
Time			1.356***	1.264***
			(0.0757)	(0.0757)
$Time^2$			0.993***	0.995**
			(0.00185)	(0.00194)
Constant	0.0799***	0.0272***	0.00834***	0.0140***
	(0.0107)	(0.00710)	(0.00339)	(0.00694)
Observations	2,935	2,620	2,937	2,620
Number of iso3n	143	136	144	136

seEform in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Exposure No Lagged DV (Panel Logit)

VARIABLES	(1) case	(2) case	(3) case	(5) case
Treaties	1.030***			1.019***
	(0.00481)			(0.00580)
FDI Stock		1.243***		0.955
		(0.0702)		(0.0400)
Time			1.432***	1.300***
			(0.0861)	(0.0850)
$Time^2$			0.992***	0.994***
			(0.00196)	(0.00212)
Constant	0.0714***	0.0204***	0.00488***	0.0100***
	(0.0103)	(0.0104)	(0.00214)	(0.00526)
Observations	2,935	2,620	3,083	2,620
Number of iso3n	143	136	144	136

Robust seeform in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Capacity (Panel NBREG)

	(1)	(2)	(3)	(4)	(5)	(6)
VARIABLES	totcase	totcase	totcase	totcase	totcase	totcase
Lagged DV	1.358***	1.403***	1.380***	1.368***	1.366***	1.188***
	(0.0354)	(0.0591)	(0.0559)	(0.0490)	(0.0574)	(0.0673)
FDI Stock	1.006	1.085**	1.036	1.028	1.016	1.060
	(0.0368)	(0.0450)	(0.0451)	(0.0372)	(0.0376)	(0.0412)
Treaties	1.024***	1.027***	1.024***	1.029***	1.027***	1.019***
	(0.00453)	(0.00448)	(0.00426)	(0.00401)	(0.00418)	(0.00424)
NAFTA	4.546***	7.768***	4.308***	7.797***	5.710***	4.558***
	(1.615)	(2.311)	(1.025)	(1.894)	(1.403)	(1.709)
Cumulative Case	1.007					1.213***
	(0.0470)					(0.0432)
Cumulative Case^2	1.001					0.996***
	(0.000762)					(0.000902)
GDP/Capita		1.000				1.000
		(2.63e-05)				(2.21e-05)
GDP/Capita^2		1.000				1.000
		(5.59e-10)				(3.94e-10)
Crisis			0.830			1.075
			(0.160)			(0.208)
Corruption				0.750***		0.854**
				(0.0437)		(0.0577)
Political Stability					0.817***	0.992
					(0.0459)	(0.0692)
Constant	0.0747***	0.0455***	0.0637***	0.0499***	0.0593***	0.0432***
	(0.0211)	(0.0143)	(0.0212)	(0.0143)	(0.0170)	(0.0122)
Observations	2,620	2,577	2,612	2,620	2,620	2,574
Number of iso3n	136	133	133	136	136	132

seEform in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Capacity No DV (Panel Logit)

VARIABLES	(1) case	(2) case	(3) case	(4) case	(5) case	(6) case	(7) case
FDI Stock	0.975	1.108	1.054	1.014	1.031	1.021	1.077
	(0.0339)	(0.0736)	(0.0672)	(0.0552)	(0.0500)	(0.0514)	(0.0610)
Treaties	1.020***	1.032***	1.025***	1.027***	1.031***	1.028***	1.022***
	(0.00465)	(0.00721)	(0.00571)	(0.00572)	(0.00583)	(0.00570)	(0.00640)
NAFTA	7.023***	24.19***	11.00***	12.71***	19.21***	13.92***	13.35***
	(2.161)	(11.14)	(3.811)	(4.173)	(7.442)	(4.944)	(6.181)
Cumulative Case	1.268***						1.237***
	(0.0543)						(0.0562)
Cumulative Case^2	0.995***						0.995***
	(0.00109)						(0.00101)
GDP/ Capita		1.000*					1.000
		(2.90e-05)					(2.64e-05)
GDP/Capita^2		1.000					1
		(5.43e-10)					(4.77e-10)
Crisis			0.727*				0.950
			(0.119)				(0.182)
GDP Growth				1.010			1.009
				(0.0116)			(0.0109)
Corruption					0.786***		0.865*
					(0.0462)		(0.0707)
Political Stability						0.866**	1.083
						(0.0504)	(0.0881)
Constant	0.0741***	0.0355***	0.0497***	0.0580***	0.0445***	0.0520***	0.0393***
	(0.0193)	(0.0186)	(0.0250)	(0.0245)	(0.0172)	(0.0205)	(0.0161)
Observations	2,620	2,577	2,612	2,567	2,620	2,620	2,534
Number of iso3n	136	133	133	135	136	136	131

Robust seeform in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Preferences (Panel NBREG)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
VARIABLES	totcase	totcase	totcase	totcase	totcase	totcase	totcase	totcase	totcase
Lagged DV	1.409***	1.412***	1.428***	1.396***	1.407***	1.318***	1.311***	1.303***	1.299***
	(0.0582)	(0.0624)	(0.0583)	(0.0582)	(0.0549)	(0.0463)	(0.0814)	(0.0526)	(0.0753)
Treaties	1.028***	1.029***	1.030***	1.025***	1.028***	1.036***	1.031***	1.036***	1.030***
	(0.00391)	(0.00401)	(0.00394)	(0.00415)	(0.00383)	(0.00459)	(0.00453)	(0.00575)	(0.00502)
FDI Stock	0.968	0.972	0.966	0.991	0.969	0.937*	0.958	0.991	1.012
	(0.0374)	(0.0393)	(0.0376)	(0.0387)	(0.0377)	(0.0361)	(0.0382)	(0.0393)	(0.0417)
Extractives	1.024***	1.022***	1.020***	1.023***	1.023***	1.030***	1.026***	1.023***	1.018***
	(0.00478)	(0.00458)	(0.00504)	(0.00481)	(0.00476)	(0.00715)	(0.00657)	(0.00709)	(0.00632)
NAFTA	5.442***	6.061***	4.949***	5.873***	5.366***	8.688***	7.184***	7.633***	6.557***
	(1.056)	(1.194)	(1.534)	(1.234)	(1.074)	(2.680)	(1.709)	(2.233)	(2.074)
Polity	1.034	1.073***	1.051**	1.030	1.031	1.052***	1.043**	1.096***	1.091***
	(0.0211)	(0.0230)	(0.0209)	(0.0218)	(0.0219)	(0.0204)	(0.0185)	(0.0336)	(0.0279)
Veto Players		0.322***						0.393*	0.356**
		(0.120)						(0.192)	(0.165)
President			2.171***					2.400***	2.575***
			(0.498)					(0.802)	(0.852)
Transition				1.749***				1.787***	2.137***
				(0.368)				(0.398)	(0.473)
Left					1.195			0.811	1.044
					(0.202)			(0.136)	(0.164)
Leader Trans (lead)						1.519**		1.606**	
						(0.279)		(0.311)	
Leader Trans (lag)							1.323		1.301
							(0.266)		(0.260)
Constant	0.0670***	0.0901***	0.0374***	0.0510***	0.0633***	0.0491***	0.0546***	0.0219***	0.0216***
	(0.0192)	(0.0269)	(0.0134)	(0.0170)	(0.0191)	(0.0149)	(0.0164)	(0.0105)	(0.0110)
Observations	2,537	2,527	2,537	2,537	2,537	1,774	2,023	1,766	2,015
Number of iso3n	132	132	132	132	132	129	129	129	129

seEform in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Preferences No DV (Panel Logit)

VARIABLES	(1) case	(2) case	(3) case	(4) case	(5) case	(6) case	(7) case	(8) case	(9) case
Treaties	1.030***	1.031***	1.033***	1.027***	1.030***	1.037***	1.032***	1.033***	1.037***
	(0.00536)	(0.00547)	(0.00504)	(0.00546)	(0.00537)	(0.00675)	(0.00681)	(0.00515)	(0.00672)
FDI Stock	0.969	0.973	0.972	1.002	0.973	0.936	0.969	0.984	1.043
	(0.0504)	(0.0526)	(0.0494)	(0.0517)	(0.0506)	(0.0605)	(0.0628)	(0.0456)	(0.0621)
Extractives	1.028***	1.027***	1.025***	1.029***	1.028***	1.034***	1.028***	1.024***	1.026***
	(0.00639)	(0.00631)	(0.00642)	(0.00647)	(0.00630)	(0.00906)	(0.00849)	(0.00626)	(0.00764)
NAFTA	14.47***	15.29***	12.71***	16.72***	13.69***	19.85***	17.10***	21.18***	20.77***
	(4.257)	(4.648)	(6.442)	(5.115)	(3.967)	(6.460)	(4.931)	(7.665)	(8.374)
Polity	1.043*	1.068***	1.063***	1.038*	1.038*	1.055**	1.043*	1.056**	1.079**
	(0.0227)	(0.0245)	(0.0231)	(0.0225)	(0.0229)	(0.0251)	(0.0238)	(0.0231)	(0.0332)
Veto Player		0.491							0.997
		(0.214)							(0.537)
President			2.467***						2.288**
			(0.652)						(0.744)
Transition				2.648***					2.187***
				(0.647)					(0.555)
Left					1.321				0.972
					(0.236)				(0.209)
Leader trans (lead)						1.558**			1.667**
						(0.351)			(0.399)
Leader trans (lag)							1.005		
							(0.187)		
Corruption								0.773***	0.743***
								(0.0422)	(0.0550)
Constant	0.0536***	0.0648***	0.0269***	0.0333***	0.0483***	0.0443***	0.0473***	0.0395***	0.00785***
	(0.0212)	(0.0267)	(0.0129)	(0.0142)	(0.0196)	(0.0217)	(0.0224)	(0.0144)	(0.00514)
Observations	2,537	2,527	2,537	2,537	2,537	1,774	2,023	2,537	1,766
Number of iso3n	132	132	132	132	132	129	129	132	129

Robust seeform in parentheses
*** p<0.01, ** p<0.05, * p<0.1

Full Model (Panel Logit)

VARIABLES	(1) case
Lagged DV	2.049**
	(0.610)
Time	1.278*
	(0.188)
Time^2	0.995
	(0.00596)
FDI Stock	1.189**
	(0.105)
Treaties	1.018**
	(0.00699)
NAFTA	21.50***
	(11.59)
Extractives	1.019***
	(0.00692)
Polity	1.039
	(0.0313)
Veto Players	2.482*
	(1.262)
President	1.773*
	(0.523)
Transition	2.281***
	(0.558)
Left	0.923
	(0.196)
Leader trans (lead)	1.730**
	(0.445)
Corruption	0.872
	(0.194)
GDP/Capita	1.000**
	(4.57e-05)
GDP/Capita^2	1.000
	(9.82e-10)
Crisis	1.342
	(0.259)
Political Stability	0.912
	(0.0765)
Constant	0.000519***
	(0.000596)
Observations	1,750
Number of iso3n	127

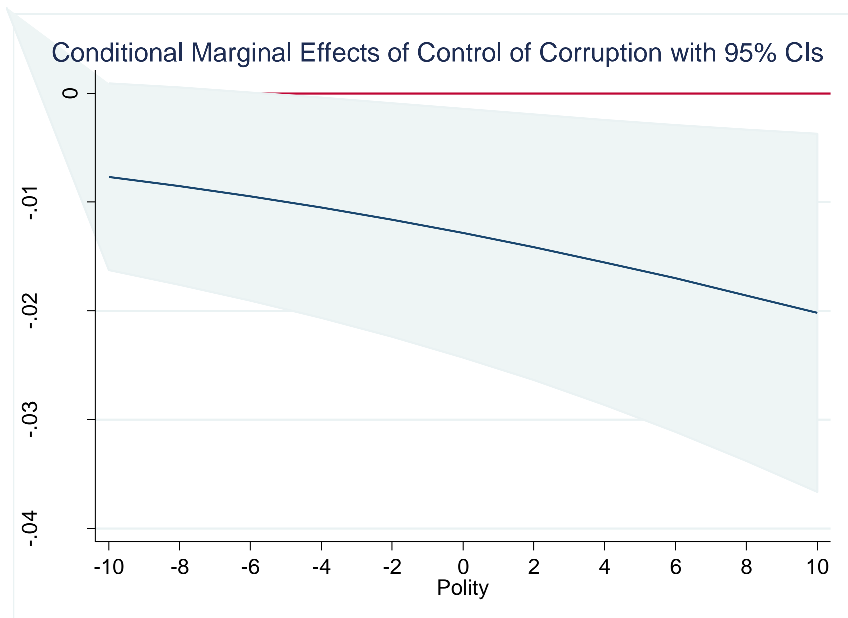
Robust seeform in parentheses
*** p<0.01, ** p<0.05, * p<0.1

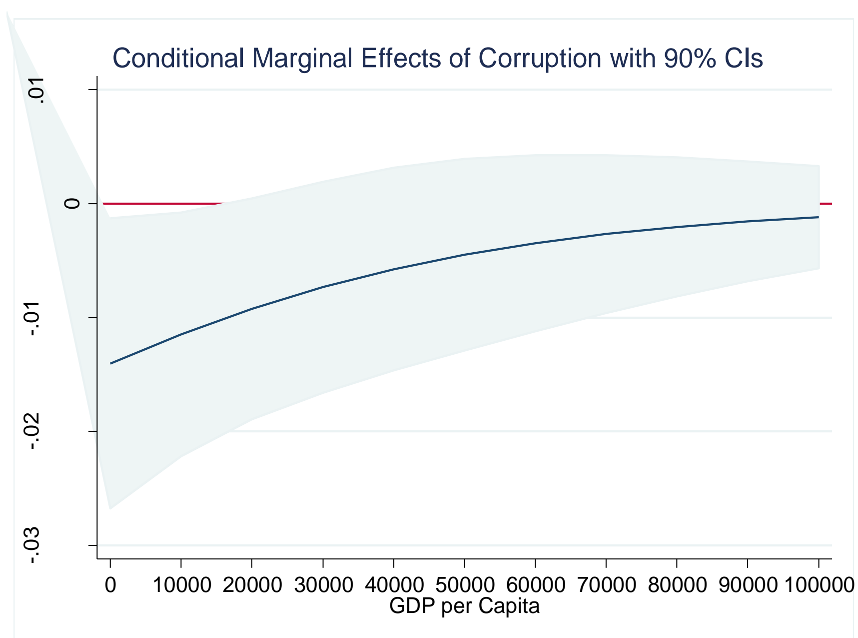
Full Model (Panel NBREG)

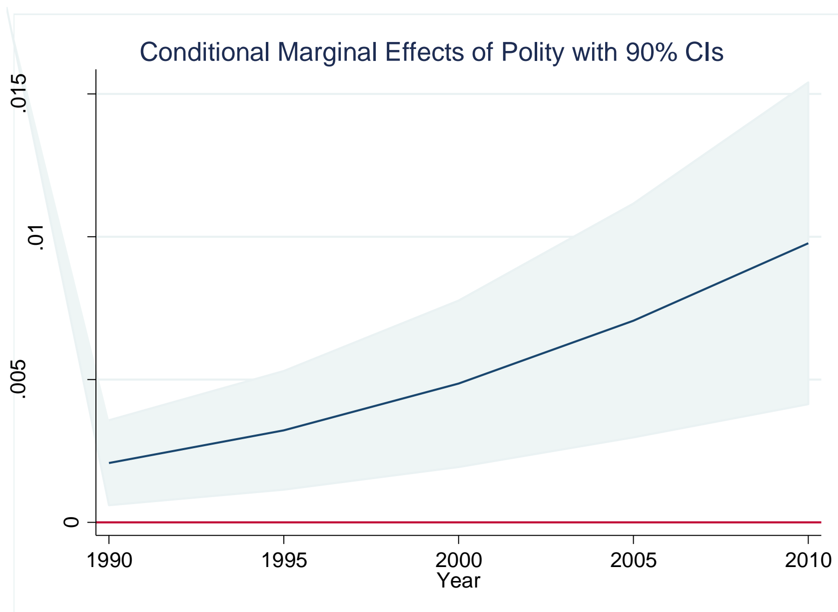
VARIABLES	(1) totcase
Lagged DV	1.226***
	(0.0505)
Polity	1.054*
	(0.0315)
Veto Players	1.497
	(0.723)
President	1.787**
	(0.528)
Transition	1.557**
	(0.323)
Left	0.839
	(0.153)
Leader trans (lead)	1.574**
	(0.296)
Corruption	0.907
	(0.144)
FDI Stock	1.093*
	(0.0572)
Extractives	1.017***
	(0.00629)
Treaties	1.026***
	(0.00695)
Time	1.333**
	(0.179)
$Time^2$	0.993
	(0.00533)
GDP/Capita	1.000*
	(3.81e-05)
$GDP/Capita^2$	1
	(8.43e-10)
Crisis	1.359
	(0.261)
Govt Effect	1.169
	(0.185)
Political Stability	0.897
	(0.0680)
NAFTA	15.43***
	(5.665)
Constant	0.00109***
	(0.00105)
Observations	1,750
Number of iso3n	127

Robust seeform in parentheses
*** p<0.01, ** p<0.05, * p<0.1

4. Additional Marginal Effects Graphs







Conditional Marginal Effects of Polity with 90% CIs
.015
.01
.005
0
1990
1995
2000
2005
2010
Year

Appendix III: Case Studies

1. List of Interviews

Case	Interview #	Interviewee	Date
Canada	1	Anonymous Federal Official	April 11, 2014
	2	Anonymous Provincial Official	May 29, 2014
	3	Interview with JRP Member (by phone)	May 30, 2014
	4	Anonymous Federal Official (by phone)	June 2, 2014
	5	Howard Mann, former NAFTA negotiator and defence lawyer for Canada, current legal counsel at IISD	April 5, 2014
	6	Robert Taylor (Background only)	April 6, 2014
El Salvador	7	Anonymous Official, PROESA	August 7, 2014
	8	Marjorie Trigueros, FUSADES	July 22, 2014
	9	Edgardo Mira, CEICOM	July 9, 2014
	10	Luis Parada, Foley Hoag (by phone)	September 15, 2014
	11	Rodolfo Calles, Mesa	July 14, 2014
	12	Saul Baños, Mesa	August 13, 2014
	13	Anonymous Official, MARN	August 6, 2014
	14	Anonymous Official PDDH	July 23, 2014
	15	Anonymous Official	July 8, 2014
	16	Anonymous Official	August 12, 2014
	17	Anonymous Oxfam employee	August 12, 2014
	18	Anonymous (background only)	
	19	Anonymous (background only)	
Hungary	20	Anonymous official, ERRA	April 15, 2015
	21	Anonymous	April 17, 2015
	22	Eva Voszka, Pezugykutato	May 10, 2015
	23	Peter Mihalyi	May 15, 2015
	24	Anonymous	April 11, 2015
	25	Anonymous	May 5, 2015
	26	Felsmann Balasz	May 10, 2015
	27	Anonymous	April 9, 2015

2. List of Documents

Case	Doc #	Description	Source
Canada	1	Correspondence between Paul Buxton, Project Manager for Bilcon and the DFO (April 14, 2003)	Whites Point Quarry and Marine Terminal Project – Project File CEAA http://www.ceaa.gc.ca/default.asp?lang=En&n=B4777C6B-1
	2	Letter from the World Wildlife Foundation to Steve Chapman, CEAA (September 16, 2003	
	3	Sierra Club of Canada comments on the draft guidelines for the EIS	
	4	Letter from DFO to Steve Chapman, CEAA (January 21, 2005)	
	5	Letter from the West Nova Fishermen's Coalition to the DFO (March 21, 2003)	
	6	Letter from Walker Fisheries to the DFO (March 17, 2003)	
	7	Letter from the Bay of Fundy Inshore Fishermen's Association to Minister Thibault (DFO) (March 21, 2003)	
	8	Letter from the Partnership for Sustainable Development of the Digby Neck and Islands Society to the DFO (March 17, 2003)	
	9	Letter from Brier Island Whale and Seabird Cruises Ltd. to the Joint Review Panel (January 18, 2005)	
	10	Letter from local fisherman to DFO (March 18, 2003)	
	11	Presentation by Helen Whidden to the Joint Review Panel, (June 23, 2007)	
	12	Letter from Eva Holzwarth as part of the Public Hearings conducted by the Joint Review Panel (June 7, 2007)	Whites Point Quarry and Marine Terminal Project – Public Hearings CEAA http://www.ceaa.gc.ca/default.asp?lang=En&n=39C62F9F-1
	13	Letter from Michaele Kustudic as part of the Public Hearings conducted by the Joint Review Panel (n.d.)	
	14	Submission from the Partnership for Sustainable Development of the Digby Neck and Islands Society to the Joint Review Panel (June 25, 2007)	
	15	Agreement concerning the establishment of a Joint Review Panel for the Whites Point Quarry and Marine Terminal Project between the Minister of Environment Canada and The Minister of Environment and Labour Nova Scotia (November 11, 2004)	Whites Point Quarry and Marine Terminal Project – Project File CEAA http://www.ceaa.gc.ca/default.asp?lang=En&n=B4777C6B-1
	16	Correspondence between Mr. Thibault and the Federal Ministry of the	

		Environment (June 26, 2006)	
	17	Correspondence between Rachel McCormick (DFAIT) and Debra Myles (CEAA) (n.d.)	
Hungary	18	Power point presentation “Long-term PPAs in Hungary” (Hungarian Energy Office, 2006)	Interviewee # 21

Appendix IV: Publications

Refereed Journals

The Role of Investor-State Arbitration on Domestic Mining Conflicts, *Global Environmental Politics* [forthcoming 2016 *Global Environmental Politics*].

Book Chapters

What, Where, When and Why? Patterns in Investor-State Disputes in B. Ilge & K. Singh (eds) *Rethinking Investment Treaties: Critical Issues and Policy Choice* (Madhyam). [Forthcoming 2016]

(2015) Domestic demands and international agreements: What causes investor-state disputes? in S Lalani & R. Polanco (eds) *The Role of the State in Investor-State Arbitration* (Martinus Nijhoff/Brill).

Other Publications

(2014) Risky Business or Risky Politics: What explains investor-state disputes? *Investment Treaty News Quarterly*.