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Private Dispute Resolution and Economic Development

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Participatory Governance in South Korea: Legal Infrastructure, Economic Development, and Dispute Resolution

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I. INTRODUCTION

The world's nations are reexamining governance in the face of globalization. Former Soviet block nations are trying to become democracies and privatizing

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their economies. International institutions such as the World Bank[1] are exerting pressure on developing nations to lay the necessary foundation for the rule of law through legal infrastructure and innovations in governance.[2] Non-Governmental Organizations ("NGOs"), such as the American Bar Association's Central European and Eurasian Law Initiative ("CEELI")[3] and United States Agency for International Development ("USAID"),[4] have funded projects to provide assistance with this process. Many of these projects recommend new institutions to resolve conflicts over rights, property, and the legacy of ethnic violence. All of these developments suggest the convergence of national governance systems.

While much attention has focused on Eastern Europe and Central Asia,[5] South Korea, an established industrial economy, has quietly broadened and deepened its democracy,[6] and is presently building new, innovative governance processes into its institutions.[7] There is a paradigm shift under way in South Korea that is framed as public participation in governance. South Korea is building new processes for conflict resolution and civic engagement into its administrative law and practice. It is drawing on the experiences of other countries and adapting them to its cultural context. The Korean Peninsula is the next geographic region to face major challenges of democratization and privatization. The lesson that Germany teaches is that re-unification of North and South Korea is inevitable, and therefore, North Korea[8] will likely inherit the governance systems that South Korea is building today.[9]

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1. Douglas Webb, *Legal and Institutional Reform Strategy and Implementation: A World Bank Perspective,* 30 LAW & POL'Y INT'L BUS. 161 (1999). One observer notes that the World Bank's charter precludes it from interfering with the politics of a member nation, but that administrative law and governance are seen as "neutral and technical" conditions for fostering economic growth. Tom Ginsburg, *Japanese Law Symposium: Dismantling the "Developmental State"? Administrative Procedure Reform in Japan and Korea,* 49 AM. J. COMP. L. 585, 622 (2001).

2. *See* Tamara Lothian and Katharina Pistor, *Local Institutions, Foreign Investment, and Alternative Strategies of Development: Some Views from Practice,* 42 COLUM. J. TRANSNAT'L L. 101 (2003).

3. The Central European and Eurasian Law Initiative, http://www.abanet.org/ceeli/ (last visited Feb. 7, 2006).

4. For reports on various USAID projects on democracy and governance, see USAID, About USAID, Publications, http://dec.usaid.gov/ demo_gov.cfm (last visited Feb. 7, 2006).

5. Webb, *supra* note 1, at 161.

6. Ginsburg, *supra* note 1, at 585-87 (observing that, in Korea, the political environment changed dramatically in the mid-1990s as the result of democratization and constitutional reforms which created incentives for politicians to open up the policy process and adopt a new administrative procedure regime).

7. Kyu Ho Youm, *Freedom of Expression and the Law: Rights and Responsibilities in South Korea,* 38 STAN. J. INT'L L. 123 (2002) (describing massive statutory changes concerning freedom of the press, political rights, and civil liberties since 1987).

8. The Democratic People's Republic of Korea [hereinafter North Korea].

9. Curtis J. Milhaupt, *Privatization and Corporate Governance in a Unified Korea*, 26 IOWA J. CORP. L. 199 (2001). *But see* Joongi Kim, *North Korea: Legal Perspectives and Analyses: Essay: The Challenges of Attracting Foreign Investment into North Korea: The Legal Regimes of Sinuiju and Gaeseong,* 27 FORDHAM INT'L L.J. 1306, 1311 (2004) (describing efforts by North Korea to establish special economic zones to attract international investment in Sinuiju and Gaeseong in which North Korea adopted a comprehensive legal structure similar to the Hong Kong precedent of one country but two systems that may presage a move toward a market-based economic system).

This article examines South Korea's[10] implementation of new governance processes, specifically, its growing use of conflict resolution and civic engagement. First, this article discusses definitions of legal infrastructure. Second, it addresses control over dispute-system design as a lens through which to examine new governance processes. Third, it discusses recent developments in the Korean Judicial and Executive branches. Lastly, it will address the connections between new governance processes and economic development in Korea.

II. GOVERNANCE, LEGAL INFRASTRUCTURE, AND NEW GOVERNANCE PROCESSES SUCH AS DISPUTE RESOLUTION

Governance occurs within the context of legal infrastructure, which includes both substantive and procedural elements.[11] Legal infrastructure's substantive elements include property and contract rights, individual economic freedom, and civil rights. Its procedural elements include the resources and institutions for enforcing rights and resolving disputes.[12] These include not only public sector institutions, such as courts and administrative forums within local, regional, or national agencies, but also private and nongovernmental institutions that help address conflict.

Most broadly, conflict resolution can happen in a court, through a government agency, in a quasi-public context, through a NGO, or in a private context. Traditional governance processes—such as rulemaking or adjudication—are ways of resolving conflict in the creation and enforcement of public law. Rulemaking is the quasi-legislative collection of information to create a new rule, regulation, or guideline of general and prospective applicability. Adjudication is the retrospective examination of facts involving specific parties to determine rights in accordance with a legal standard, such as a statute or regulation. Both of these processes reconcile the conflicting interests of citizens and stakeholders with the public policy goals of elected officials as expressed in law.

Conflict resolution can also happen through a variety of new governance processes. These processes are alternative quasi-judicial and quasi-legislative processes with a variety of names, including alternative or appropriate dispute resolution (ADR), consensus-building, dialogue, and deliberative democracy.[13]

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10. The Republic of Korea [hereinafter South Korea or Korea].

11. *See* Paul B. Stephan, *Relationship of the United States to International Institutions: The New International Law—Legitimacy, Accountability, Authority, and Freedom in the New Global Order*, 70 U. COLO. L. REV. 1555 (1999).

12. Robert Hockett, *From Macro to Micro to "Mission-Creep": Defending the IMF's Emerging Concern with the Infrastructural Prerequisites to Global Financial Stability,* 41 COLUM. J. TRANSNAT'L L. 153, 156 (2002) (observing that the International Monetary Fund is concerned with property law, contract rights, judicial reform, and other market-facilitating legal and institutional arrangements partly as a result of the Asian Monetary Crisis of 1997 to 2000).

13. Lisa Blomgren Bingham, Tina Nabatchi & Rosemary O'Leary, *The New Governance: Practices and*

Increasingly, these alternative processes are becoming an essential feature of governance. The terms consensus-building, dialogue, and deliberative democracy tend to refer to quasi-legislative processes. They help government to engage citizens and stakeholders to identify policy preferences and set priorities that in turn are used to formulate rules, guidelines, and regulations. In the United States, new quasi-legislative governance processes include forms of deliberative democracy[14] such as the 21st Century Town Meeting of AmericaSpeaks,[15] e-democracy, Public Conversations,[16] participatory budgeting, citizen juries, Study Circles,[17] and collaborative policymaking, among others.[18] The term ADR most often refers to quasi-judicial processes that engage citizens and stakeholders in implementing and enforcing public law and policy. ADR includes various forms and models of negotiation, mediation, and arbitration. All new governance processes permit citizens and stakeholders to actively participate in the work of government.

Moreover, these processes are used increasingly at all levels and sectors of governance. They are a feature of the emerging international governance structures, as sovereign nations negotiate treaties that provide for conciliation and dispute settlement, followed by arbitration before new international courts. These processes have not been adequately studied in any of the contexts or sectors in which they are in use, and South Korea is no exception. South Korea is building these new governance processes into a variety of its government institutions, and creating both an opportunity and a need for participation by its citizens and civil society in the policy process. This, in turn, is changing both the nature of information available to government in making public policy choices and the likely range of outcomes in conflict resolution.

III. CONTROL OVER DISPUTE SYSTEM DESIGN

For purposes of this article, private conflict resolution is a new governance process conducted by someone other than a judge in the judicial branch of government, an administrative law judge, or a public servant in the executive branch of government. The outcomes of private conflict resolution vary with the context of the system in which the process occurs. Dispute system design is the

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Processes for Stakeholder and Citizen Participation in the Work of Government, 65 PUB. ADMIN. REV. 547 (2005).

14. For descriptions of all these processes, see National Coalition for Dialogue and Deliberation, www.thataway.org (last visited Nov. 12, 2006); see also Collaborative Governance Initiative of the Institute for Local Government, www.ilsg.org (last visited Nov. 12, 2006).

15. *See* America Speaks, www.americaspeaks.org (last visited Nov. 12, 2006).

16. *See* Public Conversations Project, http://www.publicconversations.org/pcp/index.asp (last visited Nov. 12, 2006).

17. *See* Study Circles Resource Center, http://www.studycircles.org/en/index.aspx (last visited Feb. 7, 2006).

18. *See generally* JOHN GASTIL, THE DELIBERATIVE DEMOCRACY HANDBOOK (John Gastil ed., Jossey-Bass 2005).

concept that dispute resolution occurs through a system of steps and rules for the process, where this system is the product of a conscious series of choices and subject to a wide variation of resulting designs.[19] Originally conceived as describing innovations in a collectively bargained grievance procedure (such as grievance mediation), the concept has broader applicability as a useful way to think about the design of new governance processes.

There are three basic categories of parties with control over dispute system design: (1) private parties who jointly design the system for themselves; (2) one party who designs it unilaterally and uses superior economic power to impose it on the other party; and (3) third parties who design a system for the benefit of others who are the disputants.[20]

An example of the first category of joint private ordering is when two parties design a system together, as is the case in private commercial international arbitrations. Similarly, in labor relations and collective bargaining authorized by law, there are repeat players—both unions and management. Together, they create an organic, self-regulating balanced system for labor mediation and grievance arbitration. These systems are generally seen as fair, useful, functional, and economically efficient.

A second category of private ordering is where one party designs the system unilaterally. This is commonly used and is a growing practice in the United States. The unilateral design of a system is achieved through adhesive mandatory arbitration, in which one party designs an arbitration plan and imposes it through superior economic power on the other party. Under the Federal Arbitration Act and federal preemption, these are enforceable arbitration agreements with a limited scope of review. However, there are some unresolved problems with this form of private ordering, such as power asymmetries. Power asymmetries include to repeat players using their structural advantage in the process to achieve superior outcomes over one-shot players; for example, the individual employee who may only use arbitration once is a one-shot player.[21] Alternatively, some one-party designs use voluntary mediation, and these designs pose less concern.[22]

Finally, there is public institution-building, in which third parties design arbitration or mediation programs for use by disputants. These third parties are not parties to the actual arbitration or mediation, but they create additional means for dispute resolution. These processes are generally seen as fair and balanced. Often, third parties ensure that there is stakeholder and disputant participation or democratic forms of voice in the design process.

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19. WILLIAM URY, JEANNE BRETT, & STEVEN GOLDBERG, GETTING DISPUTES RESOLVED (Jossey-Bass 1989).

20. *See* Lisa Blomgren Bingham, *Control Over Dispute Design and Mandatory Commercial Arbitration*, 67 L. & CONTEMP. PROBS. 221 (2004).

21. *Symposium, Self-determination in Dispute System Design and Employment Arbitration,* 56 U. MIAMI L. REV. 873, 874 n.5 (2002).

22. LISA BLOMGREN BINGHAM, MEDIATION AT WORK: TRANSFORMING WORKPLACE CONFLICT AT THE UNITED STATES POSTAL SERVICE (IBM Center for the Business of Government 2003).

As discussed below, Korea is in the midst of a dramatic growth in third-party dispute system design through initiatives by government. However, it has limited formal private ordering through joint or one-party dispute system designs.

IV. RECENT MOVEMENTS TOWARD NEW GOVERNANCE PROCESSES IN KOREA

This section will describe the backdrop for dispute resolution in Korea. It will also review innovations in progress in the judicial branch of government and then address innovations in the executive branch. This section will briefly examine the administrative law context for these innovations, discuss developments at the National Labor Relations Commission, examine proposals for a national model for public policy conflict resolution, and describe Korea's first major environmental mediation case.

A. The Backdrop for Dispute Resolution in Korea

Toward the end of the twentieth century, Korea moved from a dictatorship to a vibrant and developing democracy, one that has flourished in the past decade. There was dramatic economic growth during this period, something that became known as the "Asian Tiger" phenomenon. However, vertically-integrated corporate conglomerates, called chaebol, dominated the economy.[23] These organizations were very closely held in point of fact, if not de jure. They were founded by families, and control of a chaebol either remained in the hands of the founder or passed to the second- and third-generation of the family.[24]

An economic crisis in 1997-1998[25] was partly a function of dramatic leverage that the chaebol were able to obtain with a centralized and government-supported banking system.[26] For example, these companies obtained a borrowing-to-assets ratio of 500% in 1997.[27] The top thirty chaebol have overlapping boards of directors and stock ownership; total family ownership interests are 43% as a

23. Milhaupt, *supra* note 9, at 205-09.

24. *Id.* at 206.

25. Financial and Corporate Restructuring Assistance Project, *Final Report and Legal Reform Recommendations to the Ministry of Justice of the Republic of Korea,* 26 IOWA J. CORP. L. 546 (2001).

26. Craig P. Ehrlich & Doe Seob Kang, *Independence and Corruption in Korea*, 16 COLUM. J. ASIAN L. 1, 3 (2002) (arguing that a 2001 anticorruption law making it a crime for a public official to accept a gift in excess of 50,000 won had insufficient enforcement tools, and that the economic crisis of 1997 was partly a function of corruption as part of the relationship among the chaebol, the government, and the banks during decades of development from the 1960s to the 1990s).

27. Milhaupt, *supra* note 9, at 207 n.39. *See also* Hockett, *supra* note 9, at 175 (observing that the Asian Financial Crisis began when investors noted weaknesses in the financial system of South Korea and other Asian Nations consisting of weak regulatory oversight, huge, unhedged private short-term debt in foreign currencies, inadequately transparent corporate balance sheet data, corruption, and interlocking governments, banks, and firms); *see also* Ehrlich & Kang, *supra* note 26, at 28-29 (observing that banks continue to extend credit to manufacturers not capable of servicing their debt, and do so at the direction of the government).

function of cross-shareholding in the top thirty chaebol.[28] In addition, these chaebol control 41% of the domestic economy, according to a 1995 study.[29]

There is a cultural tradition of deference to authority from the Confucian era. This deference has an impact on how Korea will use dispute resolution. For example, it can inhibit party empowerment in mediation. Specifically, the Confucian tradition established a governmental meritocracy in which bureaucrats made decisions intending to build a better society and community. This is more consistent with quasi-judicial or arbitral decisionmaking. It is an autocratic, not a democratic, legacy for Korea.

Moreover, the vertical concentration of power in the chaebol tends to suppress disputes. However, as a result of the financial crisis in the late 1990s, substantive laws gave more rights to shareholders, created more transparency, and ensured more accountability for the boards of directors of the chaebol.[30] They also directly addressed cultural traditions of gift-giving that may appear as corruption and bribery under international norms.[31] These reforms tend to introduce more disputes as shareholders and members of the public obtain more information about chaebol board decisionmaking. The prospect of future reunification with North Korea gives added meaning to all law reform in South Korea. Some commentators nevertheless advocate continued reform of corporate governance.[32]

There are also cultural forces that support the use of dispute resolution. Korea has a rich tradition of informal conciliation in communities and at the workplace that stems from its Confucian heritage.[33] In this tradition, elders, superiors, and family clan members may informally intervene, without authority, to effect reconciliation because conflict disrupts the harmony of the community. This informal conciliation stresses both evaluative[34] and directive mediation styles, as those terms are used in more recent U.S. literature.[35] These de facto, informal mediators will not hesitate to tell both parties that the other is at fault, then chide, criticize, suggest solutions, educate, threaten, urge reconciliation,

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28. Milhaupt, *supra* note 9, at 205.

29. *Id*. at 205 n.27. The top 30 chaebols controlled 47.3% in 1995, 47.1% in 1996, 46.6% in 1997, 47.1% in 1998, and 40.6% in 1999. *See* In-Hahk Hwang et al., Chaebol Structure and Policy, *in* INDUSTRY POLICY (KERI 2000). The top five chaebols controlled 26.3% in 1999.

30. Financial and Corporate Restructuring Assistance Project, *supra* note 25, at 546; Ehrlich & Kang, *supra* note 26, at 1.

31. Ehrlich & Kang, *supra* note 26, at 22-24.

32. Milhaupt, *supra* note 9, at 216-17; Ehrlich & Kang, *supra* note 26, at 6 (discussing failure of the 2001 reforms to create the position of independent counsel with tenure or other independent investigative body to address charges of corruption and whistleblowing).

33. Nam Hyeon Kim, James A. Wall, Jr., Dong-Won Sohn & Jay S. Kim, *Community and Industrial Mediation in South Korea,* 37 J. CONFLICT RESOL. 361 (1993); Dong-Won Sohn & James A. Wall, Jr., *Community Mediation in South Korea: A City-Village Comparison*, 37 J. CONFLICT RESOL. 536 (1993).

34. Kim et al., *supra* note 33, at 367-68, 371-73 (about the same for both community and workplace disputes); Sohn & Wall, *supra* note 33, at 541-42 (about the same for both city and village disputes).

35. ROBERT A. BARUCH BUSH & JOSEPH FOLGER, THE PROMISE OF MEDIATION (2d ed. 2003).

compromise in the interest of community harmony, and cap it off with considerable use of alcohol to enable face-saving communication.[36] This cultural tradition is outside any formal dispute-system design. Any formal structures or social institutions for mediation practice that were in place as a result of the Confucian tradition appear to have been suppressed during the Japanese occupation of Korea in the first half of the twentieth century.[37]

Korea does not have dispute resolution in the form of joint private ordering to the same extent as the United States. There is limited use of commercial arbitration.[38] There is the Korean Commercial Arbitration Board ("KCAB"),[39] which handles both domestic cases, defined as those involving parties with their principal offices or permanent headquarters in the Republic of Korea, and international cases, which are all others.[40] Unlike arbitration rules of various U.S. third-party providers, such as the American Arbitration Association,[41] the arbitration rules of the KCAB are reviewed and approved by the Korean Supreme Court.[42] The KCAB reported receiving and opening a total of 210 cases in 2002—163 cases were domestic and 47 cases were international. From the 210 cases, 167 went to an award, 35 were withdrawn, and 8 were stopped.[43] The caseload appears stable. In 2003, the KCAB reported opening a total of 211 cases—173 domestic and 38 international, where a total of 202 cases went to an award, 40 were withdrawn, and 7 were stopped.[44] Generally, about four-fifths of the cases are domestic, and one-fifth are international.[45] Among the international cases, the most common claims are non-payment, delayed shipment, contract cancellation, and unacceptable quality of goods.[46] Korea adopted a version of the United Nations Commission on International Trade Law Model Law on International Commercial Arbitration ("UNCITRAL Model Law") in 1999, and named it the Korean Arbitration Act.[47] Thus, in terms of legal infrastructure for international commercial arbitration, Korea is in the mainstream as a modern industrial economy.

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36. Kim et al., *supra* note 33, at 369.

37. *Id*. at 366.

38. Kwang-Rok Kim, *How Do You Settle Business Disputes with Koreans?: The Advent of a New Amendment to the Korean Arbitration Act,* 15 TRANSNAT'L LAW. 227 (2002).

39. *See* The Korean Commercial Arbitration Board, www.kcab.or.kr/English (last visited Nov. 15, 2005).

40. Arbitration Rules of Korean Commercial Arbitration Board (KCAB), ch. 1, art. 2 (2004), www.kcab.or.kr/English/M6/M6_S2.asp (last visited Nov. 15, 2005).

41. *See* American Arbitration Association, www.adr.org (last visited Nov. 12, 2006) (listing the various rules and protocols administered by the American Arbitration Association).

42. *Id*.

43. These are the most recent statistics on the KCAB website, reported at Korean Commercial Arbitration Board, www.kcab.or.kr/English/ M5/M5_S4.asp (last visited Jan. 2, 2006).

44. *Id*.

45. *Id*.

46. *Id*.

47. Kwang-Rok Kim, *supra* note 38, at 229-30; Arbitration Act of Korea (Amended by Act No, 6083 as of Dec. 31, 1999), www.kcab.or.kr/English/M6/M6_S1.asp (last visited Nov. 15, 2005).

Korea makes very limited use of one-party dispute-system designs, such as mandatory commercial and employment arbitration, as those processes are used in the United States. While Korean credit card companies may be adopting the same language for arbitration as their U.S. peers, there is no equivalent of the Federal Arbitration Act to limit the scope of judicial supervision over abuses. In contrast, the Korean Arbitration Act allows courts broad discretion to set aside awards that are contrary to Korean law or public policy.[49]

Korea does not have a tradition of independent mediation practice.[50] The KCAB offers mediation services as well as commercial arbitration services.[51] It mediates using members of its staff as neutrals, provides its services free of charge, and generally conducts mediation by telephone or correspondence,

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48. One-party dispute system design is permitted under the Arbitration Act of Korea § 8 (3). One use concerns disputes among credit card companies, stores, and customers regarding a customer's use of a credit card. Personal communications with staff members of LG Card Co., Ltd. (January 31, 2006).

49. The Arbitration Act of Korea provides as follows:

Article 36 (Application for Setting Aside Award to Court)

(1) Recourse against an arbitral award may be made only by an application for setting aside to a court.

(2) An arbitration award may be set aside by the court only if:

1. The party making the application furnishes proof that:
   (a) a party to the arbitration agreement was under some incapacity under the law applicable to him; or the said agreement is not valid under the law to which the parties have subjected it, or failing any indication thereon, under the law of the Republic of Korea; or
   (b) a party making the application was not given proper notice of the appointment of the arbitrator or arbitrators or of the arbitral proceedings or was otherwise unable to present his case; or
   (c) the award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or contains decisions on matters beyond the scope of the submission to arbitration. If the decisions on matters submitted to arbitration can be separated from those not so submitted, only that part of the award which contains decisions on matters not submitted to arbitration may be set aside; or
   (d) the composition of the arbitral tribunal or the arbitral procedure were not in accordance with the agreement of the parties, unless such agreement was in conflict with any provision of this Act from which the parties cannot derogate or, failing such agreement, were not in accordance with this Act; or
2. The court finds on its own initiative that:
   (a) the subject-matter of the dispute is not capable of settlement by arbitration under the law of the Republic of Korea; or
   (b) the recognition and enforcement of the award is in conflict with the good morals or other public policy of the Republic of Korea.

(3) An application for setting aside the award shall be made within three months of the date on which the party making that application has received the duly authenticated award or, if a request has been made under Article 34, the duly authenticated copy of a correction or interpretation or an additional award.

50. Kwang-Taeck Woo, *A Comparison of Court-Connected Mediation in Florida and Korea,* 22 BROOKLYN J. INT'L L. 605, 608 (stating that "[v]oluntary mediation by parties' agreement without court intervention was available, but very rare. Accordingly, mediation in Korea is generally a court-connected procedure in which the court intervenes and leads.").

51. *See* Korean Commercial Arbitration Board, www.kcab.or.kr/English/M3/M3_S1.asp (last visited Jan. 2, 2006).

although in-person mediation is available.[52] Unlike the United States, mediation settlements reached with the assistance of the KCAB are not legally binding, but the KCAB reports that most settlements are implemented voluntarily.[53] It reports that in 2002, it opened 470 domestic and international mediation cases, which were divided roughly in half between the two categories.[54] In 2003, it opened 451 cases.[55] The KCAB reports that the majority of international mediation cases involve non-payment, delayed shipment, and unacceptable quality of goods, in that order of frequency.[56]

Thus, Korea has both the legal infrastructure and the institutional capacity for private dispute resolution in the form of commercial arbitration and mediation. Nevertheless, in light of Korea's status as the eleventh largest economy in the world,[57] with a population of 48 million people[58] and a relatively low reported caseload in mediation and arbitration for commercial disputants, it would appear that private dispute resolution is not yet fully institutionalized in Korea.

In contrast, the United States has experienced dramatic growth in party-initiated private ordering and dispute system design. One case is particularly illustrative: the development of the Center for Public Resources ("CPR") Institute. For a period of time, there was a growing phenomenon of Fortune 500 companies suing each other.[59] In-house counsel at these companies decided they needed to reduce their litigation budgets for outside counsel. As a result, these companies joined forces to create CPR, which became the CPR Institute, and they created the CPR Pledge in which they agreed to adopt a policy of using ADR before resorting to the courts.[61] Private companies have certain formal dispute resolution systems, such as labor-management committees, collective bargaining, and related grievance procedures that provide due process. However, in Korea, there are cultural understandings and integration of businesses that suppress disputes among the chaebol. Moreover, there appears to be no formal dispute-system design governing disputes within the chaebol group.

At present, there is limited curriculum on negotiation, mediation, arbitration, and dispute resolution in law departments, public administration programs, and

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52. *Id.*

53. *Id.*

54. Mediation Statistics of the Korean Commercial Arbitration Board, www.kcab.or.kr/English/M5/M5_S4.asp (last visited Nov. 15, 2005).

55. *Id.* The KCAB does not report settlement rates for its mediated cases.

56. *Id.*

57. Financial and Corporate Restructuring Assistance Project, *supra* note 25, at 550.

58. Hoyoon Nam, *U.S.-Style Law School System in Korea: Mistake or Accomplishment?,* 28 FORDHAM INT'L L.J. 879, 880 (2005).

59. Marc Galanter, *Contracts Symposium: Contract in Court; or Almost Everything You May or May Not Want to Know About Contract Litigation,* 2001 WIS. L. REV. 577 (2001).

61. *See* International Institute for Conflict Prevention & Resolution, www.cpradr.org/CMS_disp.asp?page=Abt_Began&M=1.3 (last visited Jan. 2, 2006).

business schools.[62] As a result, there is no substantial institutional infrastructure for negotiation or dispute-resolution training. There are no established professional associations or obvious sources of trained mediators, although there is a roster of arbitrators maintained by the KCAB. These are challenges for implementing private dispute resolution.

There is limited one-party dispute system design activity in South Korea. It stands to reason because this is a culture with more collectivist than individualist traditions. Until recently, there was a tradition of lifetime commitment to the employment relationship. In personal communications with government officials and law professors, there was a universally negative response to the prospect of mandatory, adhesive arbitration clauses. Interviewees expressed considerable concern about corruption in decisionmakers. Interviewees reported that they have no equivalent to the Federal Arbitration Act, which limits judicial review over arbitration awards,[63] nor did they believe it likely that there would be any innovation in legal infrastructure that would permit this kind of adhesive use of arbitration in Korea.[64] In contrast, a recent study in the United States found that one-third of the market basket of goods and services in greater Los Angeles, California, incorporate adhesive arbitration clauses designed unilaterally by the corporate, institutional party.[65]

In contrast to the limited private ordering in Korea, there is exciting innovation by government in institutional legal infrastructure for dispute resolution. This constitutes third-party dispute-system design because the government is designing systems for the use of the public and disputants. This is part of a larger paradigm shift that the government has framed as democracy-building and public participation.[66] Executive branch agencies and institutions are already engaging in activities to implement these new governance processes, anticipating an executive order.[67] The process under discussion essentially builds dispute resolution into governance by allowing the engagement of citizens and stakeholders in governmental decisionmaking processes. However, there are limited institutions and infrastructure to support dispute resolution. For example,

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62. Personal communications with faculty members at Yonsei University Department of Public Administration (September 26, 2005); at Yonsei University Department of Law (September 27, 2005); and at Sungkyunkwan University Business School (September 28, 2005). These universities are in the top five nationwide.

63. For a review of interpretations of the Federal Arbitration Act, see David S. Schwartz, *Mandatory Arbitration: Correcting Federalism Mistakes in Statutory Interpretation: The Supreme Court and the Federal Arbitration Act,* 67 LAW & CONTEMP. PROBS. 55 (2004).

64. For a review of the state of mandatory arbitration in the United States, see Thomas B. Metzloff, *Foreward: Mandatory Arbitration*, 67 LAW & CONTEMP. PROBS. 1 (2004).

65. Linda J. Demaine & Deborah R. Hensler, *"Volunteering" to Arbitrate Through Predispute Arbitration Clauses: The Average Consumer's Experience,* 67 LAW & CONTEMP. PROBS. 55 (2004).

66. The current president was a public interest advocate who sympathizes with the labor union movement. He is a one-term president trying to change the culture for citizen involvement and public participation as his political legacy. This creates a unique window for change.

67. Executive Order for Managing Conflicts in Public Administration (pending legislation).

there is no professional body of mediators in dispute resolution practice. A new center for dispute-resolution training in the executive branch is systematically benchmarking the best practices of other countries. South Korea is a knowledge economy. It has bootstrapped its way up the world economic ladder through education and the development of human capital. The government will benchmark ways to build conflict resolution capacity.

B. The Judicial Branch: The Korean Supreme Court and ADR

Disputes in the civil justice system in Korea differ greatly from that in the United States. The legal profession is small and elite. Legal education does not take place in graduate schools, as in the American model; instead, there are undergraduate law departments with a first degree in law, similar to the European model and what was formerly prevalent in Japan.[68] Professors in these law schools have graduate degrees in law, but most have not practiced law or been admitted to the bar.[69] Those with undergraduate law degrees or those who read the law, but have no formal training, are eligible to take the sabubshihum, the Korean equivalent of the bar exam.[70] Fewer than 1000 people, about 1% of the test-takers, pass it each year, and as a result, there is one lawyer in Korea for every 4800 people.[71] In contrast, in the United States, there is one lawyer for every 300 people.[72]

Upon passing the sabubshihum, prospective lawyers receive two years of additional training at the Judicial Research and Training Institute ("JRTI"), mostly from professors who are judges or prosecutors.[73] Although lawyers in private practice enjoy great prestige and high incomes, there are some lawyers who claim not to have sufficiently lucrative work.[74] On the other hand, there is concern that the small number of lawyers limits access to justice.[75] The government will be experimenting with a set of reforms to provide graduate education in law combined with easing the standards for admission to the bar in order to improve access to justice, permit lawyers to specialize, and ensure that lawyers have a broader general education.[76]

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68. Nam, *supra* note 58, at 33.

69. *Id*. at 913.

70. *Id*. at 885-86 (describing three phases: (1) a multiple choice exam on civil, constitutional, and criminal law, and on English, as well as one elective from criminal policy, international law, international transactions, intellectual property, economy law, labor law, legal philosophy, and tax; (2) an essay examination on administrative law, civil law, civil procedure, commercial, constitutional, and criminal law, and criminal procedure; and (3) an interview covering ethics, specialized knowledge, communication skills, manner and attitude, and creativity and perseverance).

71. *Id.* at 879-80.

72. *Id*. at 880.

73. *Id*. at 888.

74. *Id*. at 902.

75. *Id*. at 916.

76. *Id*. at 895-96 (describing the Korean Supreme Court Judicial Reform Committee's Law School Plan,

Korea is beginning to move from a civil code tradition toward a common law system. The Korean Supreme Court will be supervising an experiment with the jury system.[77] The judicial branch has created and will soon implement a virtual courtroom, in which the courts can conduct full-scale civil trials over the Internet and through the use of video-teleconferencing. This is viewed as a move to make disputing more efficient.

The Korean Supreme Court's Task Force on Civil Justice Reform (the "Task Force") is also undertaking a redesign of the entire national civil justice system to add new forms of ADR—specifically, mediation and arbitration. There will be one new national court-connected dispute system design. In the United States, we have allowed the thousand flowers to bloom; every state and federal court has its own dispute system design and there is wide variation.[78]

At present, Korean judges supervise mediation.[79] Judges may mediate upon the motion of a party or by court referral. Judges may mediate their own cases using a format similar to a judicial settlement conference, or they may appoint a three-person mediation committee (composed of two neutral non-judge commissioners with special subject matter expertise and a judge who chairs); however, they will supervise the case carefully either way.[80] The process resembles med-arb,[81] in which a mediation process can turn into an adjudicatory one if the parties fail to reach a mutual settlement. The mediator-judge may issue an arbitration award that

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under review by a government committee of officials, legal scholars, practitioners, civic activists under the supervision of the Minister of Education and Human Resources Development).

77. Personal communication with June Young Chung, Judge, Deputy Director General for Litigation Affairs and other members of the Korean Supreme Court Task Force on Civil Justice Reform, in Seoul, South Korea (Sept. 26, 2005); email from Jin-suk Chun, MPA and member of the Ministry of Education, Seoul, South Korea (on file with authors) (describing draft bill entitled "The Law of Public Participation in Criminal Justice," drafted by the Commission of Legal System Reform and submitted May 16, 2005, which would implement a five to nine member criminal jury, the number varying with the seriousness of the charge). *See also* Civil Mediation Act § 7.

78. For recent reviews of the literature evaluating various court-connected ADR designs in the United States, see Roselle Wissler, *The Effectiveness of Court-Connected Dispute Resolution in Civil Cases*, 22 CONFLICT RESOL. Q. 55 (2004); and John Lande, *Commentary: Focusing on Program Design Issues in Future Research on Court-Connected Mediation*, 22 CONFLICT RESOL. Q. 89 (2004). Both articles are part of a double issue symposium that collects field and applied research on dispute resolution in seven substantive areas: courts, employment, education, community, victim offender reconciliation, family, and the environment. *See Symposium, Conflict Resolution in the Field: Assessing the Past, Charting the Future*, 22 CONFLICT RESOL. Q. 1-320 (2004).

79. Kwang-Taeck Woo, *A Comparison of Court-Connected Mediation in Florida and Korea*, 22 BROOK. J. INT'L L. 605 (1997) (describing processes in effect under the Civil Mediation Act, Law No. 4202 (Jan. 13, 1990), amended by Law No. 4505 (Nov. 30, 1992), and Law No. 5007 (Dec. 6, 1995)). This law applies to civil mediation, but not family or labor mediation. *Id*. at 609.

80. *Id*. at 613-15.

81. *Id*. at 630. Mediation-arbitration, or med-arb, is a process in which the same neutral third-party first serves as a mediator, but if the parties reach an impasse, the mediator converts to an arbitrator to ensure a final and binding resolution of the dispute. The same neutral conducts two different ADR processes in sequence. For a discussion of the different ways mediation and arbitration can be combined, and of med-arb's strengths and weaknesses, see COMMERCIAL ARBITRATION AT ITS BEST: SUCCESSFUL STRATEGIES FOR BUSINESS USERS 20-30 (Thomas J. Stipanowich & Peter H. Kaskell eds., 2001).

is essentially advisory, where the parties may reject it within a limited time.[82] Moreover, the mediator-judge retains the authority to approve the reasonableness of any voluntary settlement or reject it, substituting his or her own judgment for the parties' solution.[83] There are concerns about confidentiality in this model, as is true with med-arb in the United States; specifically, the parties may be less forthcoming with a mediator who can use any information they share against them in the subsequent arbitration.[84] Moreover, in Korea, mediation processes are open to the public.[85]

Korea has seen a tremendous growth in caseload and a new willingness of individuals to file claims. Disputes are increasing in many different forums,[86] including against administrative agencies[87] and in cases involving constitutional issues.[88] During the period of Japan's occupation of Korea, it had tremendous control over and influence on Korean law, to the extent that eventually proceedings had to be conducted in Japanese before Japanese judges. This made Koreans understandably reluctant to resort to the courts for redress of wrongs.[89] However, since 1987 and the democratization of Korea, disputing patterns have changed; people are more willing to file claims.[90] During the 1990s, the annual number of civil litigations filed in district courts (the first level of the Korean justice system) increased tremendously. For example, approximately 1.5 million cases were filed in 1991, whereas over 4 million cases were filed in 1998.[91] This dramatic increase in caseload has led to the Korean Supreme Court's consideration of a national private ADR system.[92]

The Task Force is conducting research to establish its dispute system design. It is examining the training and qualifications of neutrals, whether mediators should be court employees or outsiders, who will pay the neutrals and how much, and how mediation agreements and arbitration awards are enforced. The court is reconsidering fundamental legal infrastructure. The question is: what forms of

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82. Woo, *supra* note 79, at 630.

83. *Id*. at 629-30.

84. *See* COMMERCIAL ARBITRATION AT ITS BEST: SUCCESSFUL STRATEGIES FOR BUSINESS USERS, *supra* note 80, at 21-22.

85. Woo, *supra* note 79, at 616.

86. *Id*. at 609.

87. Ginsburg, *supra* note 1, at 618-19 (observing that although both Japanese and Korean societies have traditionally been seen as valuing consensus and avoiding courts, in 1995, Korean courts decided 214.9 administrative cases per million persons while Japanese courts decided only 7.6 cases per million persons, and suggesting that this is related to administrative law reform).

88. Woo, *supra* note 78, at 620-21.

89. Ginsburg, *supra* note 1, at 596-97.

90. One study reports dramatic use of a new system for civil complaints and administrative litigation. *Id*. at 610.

91. *See* Sahng Hyeog Ihm, Lawsuit Avoiding Tradition in East Asia and Reconsideration of it in Korean Society 6-7 (May 30, 2002) (unpublished manuscript, on file with authors).

92. Personal communication with Sangjoon Kim, Judge, Deputy Director General for Planning and Coordination, Supreme Court of Korea, in Seoul, South Korea (July 26, 2004).

dispute resolution and what dispute system design will they build into the courts? This raises questions of the timing of dispute resolution, where to mediate, what rules to establish regarding confidentiality, the role other agencies, such as the National Labor Relations Commission, have in the enforcement of the outcomes of ADR, and whether there are other functions or services the court needs to fund. For example, the court will consider matters such as funding research and evaluation. In the United States, in contrast, such funding has mostly come from philanthropy.

Korea's innovation is a response to cultural changes, specifically, increasing prosperity and deepening democracy. The Task Force is engaged in the comprehensive work of dispute system design, and the result will provide private dispute resolution for all those engaged in civil litigation in South Korea.

C. The Executive Branch: Administrative Law and the Bureaucracy in Korea

As the result of almost half a century of occupation by Japan, Korea inherited a body of administrative law and practice that was built on a German model for a modern state.[93] Under this civil code model, bureaucrats operated with substantial administrative discretion, and used informal administrative guidance to induce voluntary compliance by the regulated community under implicit threat of retaliation.[94] They were insulated from meaningful judicial review by a judicial branch staffed with junior judges who lacked subject matter expertise and were trained in a system that acculturated them not to exercise independent supervision over the policy process.[95] However, comparative law scholars have noted that Korea diverged in both law and practice from this common base, and now reflects administrative law infrastructure that fosters transparency, public participation, freedom of information, and meaningful judicial review.[96]

As part of this process of both democratization and administrative law reform in the early 1990s, Korea implemented new mechanisms for voice, participation, and dispute settlement in the executive branch.[97] Specifically, it adopted notice and comment processes not only for rulemaking, but also for legislative proposals, the great majority of which are drafted[98] by government ministries.[99] It created an Ombudsman to receive complaints about the administrative

93. Ginsburg, *supra* note 1, at 589-90.

94. *Id*. at 593-94.

95. *Id*. at 595-96.

96. *Id*. at 615-22.

97. *Id*. at 607 (describing the creation of a designated administrative court of the first instance, a provision eliminating the requirement of exhaustion of administrative remedies, and an Administrative Appeals Commission under the Prime Minister).

98. *Id*. at 608.

99. *Id*. at 607-08 (characterizing these processes as more open than notice and comment rulemaking in the United States because they apply to legislation as well as rulemaking).

bureaucracy from members of the public.[100] It also created a National Grievance Settlement Committee under the Prime Minister to settle civil petitions.[101] The government's newest wave of innovation focuses on forms of dispute resolution, deliberation, and dialogue for both quasi-judicial and quasi-legislative government functions.

D. The Korean National Labor Relations Commission

An example of mediation for quasi-judicial functions is the Korean National Labor Relations Commission ("NLRC"),[102] which is an independent commission responsible for the administration of national private sector labor law.[103] There is approximately an 11% rate of private sector unionism in South Korea.[104] Interviewees report that labor relations are increasingly adversarial. In the private sector, there are comprehensive bargaining units capable of shutting down an entire industry.[105]

The NLRC is a quasi-judicial governmental body, composed of tripartite representatives of workers, employers, and those supporting public interests. It is affiliated with the Department of Labor. The NLRC conducts adjudications regarding unfair labor practices and unfair dismissal, and through its regional structure, executes special labor relations services like mediation and arbitration. The NLRC is considering improvements in governance to broaden its use of mediation and interest-based negotiation.[106] Recent legislative reforms will permit national government workers to join unions for the first time[107] and also create a right for temporary or contract workers to file complaints of discrimination.[108] These are changes in substantive law. These laws are part of an effort to give the private sector more flexibility in designing its workforce and hiring and firing

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100. *Id*. at 608.

101. *Id*.

102. *See* National Labor Relations Commission, http://www.nlrc.go.kr/en/en_index.html (last visited Feb. 7, 2006).

103. Trade Union and Labor Relations Adjustment Act, Act No. 5310, arts. 53-61 (1997) (S. Korea), amended by Act No. 5511 (1998) & Act No. 6456 (2001), *available at* http://wwwdynamic-korea.com/archives/view_archives.php?uid=200500003145&main=doc.

104. In 2003, private sector unionization was 10.8%, and 22.5% out of full time employees have union membership, while temporary and contract workers had 1.5% and 0.4% respectively as of August 2004. *See* Korea Labor Institute, http://www.kli.re.kr/ (last visited Nov. 12, 2006).

105. There are two influential bargaining units in Korea: the Federation of Korean Trade Unions (http://www.efktu.or.kr/~fktueng/); and the Korean Confederation of Trade Unions (http://www.kctu.org/).

106. Personal communications with representatives from the National Labor Relations Commission, in Seoul, South Korea (Sept. 28, 2005).

107. Public Officials Trade Union Act became effective on Jan. 28, 2006. Korean government employees have legally organized government workers' unions. This act legalized unions for government workers.

108. The Equal Employment Act guarantees employees the right to file complaints of sexual discrimination. However, it has been controversial in Korea whether temporary or contract workers are included under this Act.

workers. The Korea Tripartite Commission is responsible for issues of government employee unionization and temporary or contract workers. Nevertheless, the NLRC is anticipating a dramatic growth in caseload, in part related to these initiatives.

The question is: how does one manage the growing caseload? The NLRC is examining system designs from other countries and considering the use of interest-based negotiation and mediation to address the anticipated increase in disputes. The chair of the NLRC holds rank of cabinet minister. The NLRC institutional structure includes a national office and regional offices in which there are professionals who serve as labor mediators and administrative law judges. The NLRC also mediates, arbitrates, and adjudicates.[109] Interviewees report that the mediation style is very directive.[110] As is common with labor mediators in the United States, NLRC mediators report that there is the usual head-knocking, arm-twisting, and reality-testing, in which the mediators give unions and management opinions on the appropriate outcome of a dispute.[111] Evaluative mediation is in some ways like advisory arbitration; the parties receive an outsider's view of the strength of their best alternative to a negotiated agreement. This reality-testing serves as a means to get them talking again, a form of loop-back to negotiation. However, it sometimes simply reinforces an intransigent party who becomes convinced they can win on the merits. Interviewees report that NLRC mediators achieve high settlement rates. On December 31, 2005, the NLRC reported that its average rate of mediation success was 57.8%.[112]

There may be a relationship between increasingly adversarial labor relations and democratization. As Korea opens up new mechanisms for voice through the discrimination statute on contract and temporary workers and through public

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109. The Labor Union and Employee Relations Act §§ 47-80.

110. For a discussion of mediation styles, see ROBERT A. BARUCH BUSH & JOSEPH FOLGER, THE PROMISE OF MEDIATION 76-77 (2d ed. 2003). Evaluative mediators tend to listen to parties' presentations on the merits of the dispute and provide an opinion on the value of the case or its likely outcome in court or before an administrative agency; they evaluate the case substantively. Directive mediators tend to assert control over the structure of the mediation process and to actively guide and direct the parties toward a resolution of the dispute, using various techniques to persuade or pressure the parties to settle. Transformative mediators do not have settlement of the dispute as their goal, but instead focus on providing the parties with opportunities for empowerment and recognition during the course of the process. Empowerment is enhancing the disputant's sense of control and personal efficacy during the process. Recognition is where one disputant understands and acknowledges the perspective, values, or goals of the other disputant. It can take the form of an apology. A final form of mediation is facilitative. *See* CHRISTOPHER W. MOORE, THE MEDIATION PROCESS: PRACTICAL STRATEGIES FOR RESOLVING CONFLICT (2d ed. 1996). This form of mediation helps the parties identify issues, their underlying interests and needs, and helps them brainstorm solutions to the dispute, generally using interest-based negotiation techniques. There is some ongoing discussion within the mediation community as to the boundaries between these models of practice.

111. Personal communications with representatives from regional NLRC offices at the National Conference of the NLRC, Ritz Carleton Hotel, in Seoul, South Korea (Sept. 28, 2005).

112. The National Office's rate is 31.5%, and regional offices' rates range from 44.4% to 82.6%, http://www.nlrc.go.kr/st/stmd_receipt.jsp (last visited Nov. 12, 2006).

sector collective bargaining, increasing numbers of employees may become willing to file claims. There may be a rich flowering of debate and controversy; some view conflict as a fundamentally creative force.

The NLRC convened a national conference in September 2005 to benchmark dispute resolution programs in employment in the United States, and particularly, the REDRESS™ Program at the U.S. Postal Service ("USPS"). This program is one in which there is comprehensive data and published empirical results. After the USPS adopted a mediation program for discrimination complaints, there was almost a 30% drop in administrative law judge adjudications of formal complaints of discrimination.[113] Since 1997, the number of formal complaints of discrimination at the USPS has dropped from a high of 14,000 per year to between 8000 and 9000 per year. A multivariate regression indicated that the drop correlated with the introduction of the mediation program over an eighteen-month period in eighty-five different zip code areas.

There are questions as to whether this program provides a useful model for the NLRC. The REDRESS™ Program uses the transformative model of mediation, one that is not evaluative or directive.[114] It requires a different type of training for the mediators; training that is not readily available in South Korea. Interviewees were exploring training in both interest-based negotiation and mediation. This again raises the question of what institutional infrastructure is necessary to support expanded use of private dispute resolution in Korea.

E. The Executive Branch and Public Participation

The public participation theme is manifest in yet another initiative: the National Conflict Resolution System.[115] This initiative of the Korean presidency will take the form of either an executive order or draft legislation. The proposal is to build a three-stage dispute resolution procedure into all South Korean national government agencies that are responsible for development projects or the management of conflicts over public policy. The three stages are a conflict impact assessment, deliberative polling in selected appropriate cases, and multi-stakeholder mediation. The proposal places an emphasis on civic engagement and public involvement or participation. The conflict impact assessment would determine the adverse consequences of not resolving the conflict. The Korean Environmental Institute is likely to be tasked with performing the conflict impact assessments; it does all the environmental impact statements for major government actions in Korea. It consists of approximately 120 researchers who

113. Lisa Blomgren Bingham & Mikaela Cristina Novak, *Mediation's Impact on Formal Complaint Filing: Before and After the REDRESS™ Program at the United States Postal Service*, 21 REV. PUB. PERSONNEL ADMIN. 308 (2001).

114. BUSH & FOLGER, *supra* note 109.

115. Sun Woo Lee et al., National Conflict Resolution System, Presidential Commission for Sustainable Development (2004).

are trained in economics and the natural and environmental sciences. One role this agency could and should undertake is collecting data on all environmental and public policy cases in which conflict resolution processes are used. There is precedent for this as the U.S. Institute of Environmental Conflict Resolution collects this data nationwide.[116]

The notion of a conflict impact assessment contrasts with a conflict assessment, which is the practice in multi-stakeholder consensus-building and dispute resolution processes in the United States. A conflict assessment serves more of a convening function to determine who the parties are, who should be at the table, how are they are going to structure the process, and whether it is reasonable to mediate the dispute or conflict.[117]

The second step, deliberative polling, is viewed as a means of conflict prevention or avoidance. In deliberative polling, the government convenes a representative sample of the electorate to deliberate on the public policy problem giving rise to the dispute.[118] Impartial policy experts are available to answer questions and provide information. Citizens then deliberate and discuss the policy issues before they vote on their policy preferences. In the United States, voting is done by using information technology, including hand-held digital voting devices keyed with the citizen's demographic information. The voting results are tabulated and incorporated into a statistical report including demographics. The report then becomes critical information for policymakers to use for informed decisionmaking. In the Korean legislation, the third step is conflict resolution through a mediation process.

Executive branch agencies are moving to implement dispute resolution processes. Government agencies have started to develop their own conflict resolution systems. The executive branch has established a training initiative for government officials.

The executive branch is learning how to build a dispute resolution practice infrastructure. The government commissioned the Korean Development Institute School of Public Policy and Management and the Massachusetts Institute of Technology to conduct a comparative conflict resolution studies conference to help South Korea examine how to build a mediation profession by looking at how the profession emerged in the United States, Europe, and Japan. The conference also examined the role of legal infrastructure in the form of enabling statutes, the emergence of professional organizations, the contributions of the

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116. *See* U.S. Institute for Conflict Resolution, www.ecr.gov (last visited Nov. 12, 2006). For information on the national evaluation study, see http://www.ecr.gov/ multiagency/program_eval.htm (last visited Feb. 7, 2006).

117. *See* MOORE, *supra* note 110, at 81-160. *See also* E. FRANKLIN DUKES, MARINA A. PISCOLISH & JOHN B. STEPHENS, REACHING FOR HIGHER GROUND IN CONFLICT RESOLUTION: TOOLS FOR POWERFUL GROUPS AND COMMUNITIES (Jossey-Bass 2000).

118. *See generally* The Center for Deliberative Democracy, Deliberative Polling: Toward a Better Informed Democracy, http://cdd.stanford.edu/polls/docs/summary (last visited Feb. 2, 2006) (describing deliberative polling).

academic community, and the necessary support for researchers. Much work lies ahead for Korea to successfully implement and institutionalize these new governance processes.

F. Environmental and Public Policy Disputes

There has been one significant environmental and public policy mediation case in South Korea: the Han Tan River Dam Project. The two mediators, Dr. Chin-Seung Chung and Dr. Sun Woo Lee, were leaders in the public administration academy. The new governance process was applied to the Hantan River Dam Conflict as an exemplar.

In 1996, 1998, and 1999, there were serious floods in the lower Imjin River areas. The Korean government decided a dam construction was necessary to prevent future flooding.[119] Two-thirds of the Imjin River and its watershed are under the occupation and control of North Korea. Thus, the government had to find an alternative that would enable flood prevention because it could not control the Imjin River. The Hantan River is the biggest of the Imjin River tributaries, so the government thought the Hantan River might be the second best option to control the Imjin River flood. However, the proposal to construct the Hantan River dam created a great deal of conflict involving several parties.

There were five parties: (1) the Ministry of Construction and Transportation ("Ministry"); (2) the Korea Water Resource Corporation ("KWRC") which together with the Ministry was in charge of dam construction; (3) people living in the Dam site and downstream ("PD"); (4) people living in the upper stream area of the Hantan River Dam site ("PU"); and (5) NGOs for environmental movements. The parties had different interests in the dam. Seemingly, the Ministry, KWRC, and PD were in favor of dam construction, while the PU and NGOs were opposed. However, the construction of the dam was very important to the Ministry and the KWRC for their organizational survival because their orientation toward developing national land was criticized. In response to this criticism, the government cancelled its plan to construct a dam a couple of years before the Hantan River Dam conflict occurred. The PD wanted an early decision, regardless of dam construction, because they suffered from restrictions on their property rights during the period of uncertainty. The PU opposed the dam due to the side effects after dam construction[120] as well as for political reasons.[121] The

119. Sun Woo Lee, Chin-Seung Chung & Soo Sun Park, *Study on the Mediation Process of the Hantan River Dam Conflict*, Presidential Commission for Sustainable Development (2005).

120. In fact, they did not have to worry about the side effects because the dam was designed to contain water for less than fifteen days a year, only when there was a warning of possible flooding. In another sense, the Hantan River Dam was designed as a so-called flood-controlling dam, in order to avoid the negative effects brought about by a multi-purpose dam. THE KOREAN ENVIRONMENT INSTITUTE, ENVIRONMENTAL IMPACT ASSESSMENT ON HANTAN RIVER DAM (2001).

NGOs were against any dam, as this would oppose their mission statement and philosophy.

There were four serious obstacles to mediation. First, there was not enough data on the amount of flooding in the Imjin River, and no way to measure it, because the great majority of the river was in North Korea. Second, local elections of the PU made mediation difficult because political candidates locked themselves into positions opposing the dam. Third, there were communication problems and intransigence. For example, a common communication problem involved a first party raising an issue and a second party providing a solution, but the first party refused to accept the solution due to stubbornness. In effect, the first party lacked confidence and trust in the second party, and maintained an unmoving stance on all issues. Fourth, PU representatives had different interests in participating in the mediation process. Some wanted to build their political reputation, while others made efforts to get more benefits for their communities.

The mediation began five years after the conflict began. The mediation team consisted of two professional mediators—one interpersonal conflict resolution skills trainer and one representative from the NGOs. The mediation process started in February 2004. There were thirteen pre-mediation sessions between February and May 2004, and sixteen mediation sessions between June and August 2004.[122] During the premediation sessions, mediators tried to uncover the causes and interests of the parties regarding the conflict and to explain the mediation process to the parties. In doing so, the mediators helped convince the parties to implement the process, so that members of each party understood and participated in the mediation process. The mediation process consisted of four steps: (1) creating a set of ground rules; (2) finding causes; (3) developing alternatives; and (4) building consensus and agreement. The creation of ground rules contributed to building mutual trust among conflicting parties.

Mediators worked with the parties until they agreed that the mediation goal was to determine how to prevent flooding in the lower Imjin River area. Out of seven issues,[123] the most important and controversial issue was to assess the amount of floodwater that would be controlled by the Hantan River Dam. Neither party had superior scientific and technological methods to calculate this amount and its effects on the Imjin River flood. The failure to assess the amount of flooding that the Hantan River Dam would control made it difficult to develop alternatives.

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121. There were two local elections at the end of April and October. Political candidates tried to take advantage of the community opinion against the dam construction, encouraging people's psychological opposition. It made the mediation very difficult. Lee et al., *supra* note 119.

122. PRESIDENTIAL COMMISSION FOR SUSTAINABLE DEVELOPMENT, REPORT ON THE HANTAN RIVER DAM CONFLICT RESOLUTION PROCESS (Feb. 2005).

123. There were seven main issues: legitimacy of decisionmaking on the dam construction; the amount of flooding in Imjin River; the amount of the flood controlled by the Hantan River Dam; environmental effects; cost-benefit analysis; safety; and tourism. Lee et al., *supra* note 119.

In order to advance the mediation process from finding causes to developing alternatives, the mediation team launched into a two-day overnight session. On one hand, mediators emphasized that the parties should raise questions and doubts on the basis of scientific, empirical, and rational arguments. On the other hand, mediators persuaded the parties that they also had to accept answers to these questions and explanations responding to these doubts on the basis of scientific and empirical information. Mediators emphasized that the most important thing was not measuring the flood amount, but finding alternatives to prevent the Imjin River from flooding. Through the two-day overnight session, parties developed five alternatives, one of which was to construct the Hantan River Dam. The parties then worked together to come to a consensus on the best one out of the five alternatives. However, the Ministry, KWRC, and the NGOs each argued for using their own tools to evaluate the alternatives. A three-day overnight session was scheduled to overcome this obstacle to agreement.

Eventually, the parties realized that it was difficult for them to evaluate the alternatives by themselves. The stakeholder groups insisted that they could not reach a mutual, voluntary agreement. They asked the mediators to decide. This is consistent culturally with Korea's authoritarian tradition. In an authority structure, disputants are acculturated not to take responsibility for their own decision to settle. The stakeholders said they all agreed to live with the decision of the mediators. The parties requested that the mediators select one of the five alternatives within a one-month timeframe. The parties committed to each other and to the mediators that they would accept the mediators' decision with no objection. Members of each party approved the agreement on these rules, which essentially turned the mediation into an arbitration process. This concluded the mediation.

The mediators next played the role of arbitrators, issuing a final decision. Three parties accepted the decision, but one of the stakeholder groups, the PU, reneged and appealed the decision to an office within the executive branch that functions similarly to the Inspector General in the United States. That office referred the case to the Prime Minister's office. The Prime Minister's office endorsed the decision of the mediators-turned-arbitrators.

This was Korea's first experience with a large-scale environmental mediation. This illustrates the challenges that lay ahead for institutionalizing these new governance processes in Korea. Not only is there a need to build the infrastructure for practitioners, but also users must learn how to participate effectively in these new processes.

V. IMPLICATIONS OF THE NEW GOVERNANCE PROCESSES IN KOREA

These developments have broad implications. They are viewed as legal infrastructure to support continuing economic development. However, the longer term implications concern possible reunification with North Korea. New governance processes can play an important role in Korea's continuing evolution.

A. Dispute Resolution and Economic Development

Why is the South Korean government embarking on this ambitious program of dispute system design? One motivation has to do with the economy and economic development. One commentator has made a convincing argument that the previous wave of administrative law reform in the 1990s was a function of Korea as a ''developmental state''; that is, a state that "directed economic growth using a variety of activist mechanisms, rather than simply providing an enabling environment for capitalism as required by liberal ideology."[124] Using principal-agency theory from political economy, it is argued that Korea's administrative law reforms were designed to provide avenues for out-of-power political players to influence the policy process because no one party had a lock on re-election or control over the government.[125] This in turn made it possible for the private sector, NGOs, and citizens to have more voice in the policy process.

While the jury is still out, there is a growing body of empirical evidence relating democratic legal infrastructure and the civil justice system to economic growth.[126] There appears to be an underlying motivation for dispute resolution reforms in Korea. For example, in the court system, although the legislative mandate for juries is framed as public participation in governance, what seems to be motivating the dispute system design includes a concern about transaction costs, the economic efficiency of disputes, economic competitiveness, and caseload growth. The Task Force is interested in the research of Marc Galanter on what he has termed the "vanishing trial." His work finds that there is a decrease over the past two decades both in the absolute number of jury trials and the trial rate (from 12% to 2%) in U.S. federal district courts.[127] He suggests that one of the explanations for these results may be the institutionalization of dispute resolution.

Similarly, the work of the Korean National Labor Relations Commission appears to have an underlying economic rationale. Interviewees indicated that they face changes in substantive legal infrastructure concerning individual worker job security. Korea is moving toward more flexible hiring and firing. There were major layoffs in the last fiscal crisis. The political quid pro quo for increased labor-market flexibility is the new statute prohibiting discrimination against temporary and contract workers; the new legal infrastructure also authorizes the opportunity to file more claims, which could increase the administrative case docket of the NLRC. There is a need to make government and public law work efficiently to avoid transaction costs. This motivates the

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124. Ginsburg, *supra* note 1, at 585.

125. *Id*. at 618-19.

126. Frank B. Cross, *What We Know and Do Not Know About the Impact of Civil Justice on the American Economy and Policy: Law and Economic Growth,* 80 TEX. L. REV. 1737 (2002).

127. *See* Marc Galanter, *The Vanishing Trial: An Examination of Trials and Related Matters in State and Federal Courts*, 1 J. EMPIRICAL LEG. STUD. 459 (2004).

need to build new institutions, specifically, forms of private dispute resolution, in order to keep the economy growing.

For the environment, the salient case examples interviewees gave boiled down to "We just can't get it done." One example concerned a project to construct a highway through the mountains. The project was halted when a Buddhist nun went on a hunger strike. Similarly, the problems with achieving a settlement in the Han River Dam dispute present significant economic concerns. There is a need for flood control on the Han River. The water in the river originates in North Korea. The watershed provides 20% of the nation's drinking water; its watershed includes Seoul, the capital city that is home to almost a quarter of the population. There is flooding, and there are concerns about water quality because of the increase in the construction of hotels and restaurants on the river's banks upstream. The government needs to build this dam and cannot get it done without some process for addressing conflict.

In other words, there are significant problems in terms of transportation, land use, flood control, water quality, and sustainable development. Korea needs the institutional infrastructure for dispute resolution to facilitate building the hard infrastructure to solve these problems. Although proposals for either legislation or executive orders are framed as public participation and democracy-building, there is also an economic justification for private dispute resolution.

B. Reunification with North Korea

There are implications for the future reunification of Korea. There is a working group that involves representation from the World Bank, the scholarly community, South Korea, the United States, and other countries planning for reunification.[128] Scholars are considering the experience of reunification in Germany. They are examining privatization experiences in Poland, Russia, and the Czech Republic. Some observe that North Korea will likely inherit South Korea's legal infrastructure, and that corporate law reforms underway in South Korea will aid in the transition of nationalized industry in North Korea to private hands. This could generate a new wave of disputes. In Germany, there were many claims for natural restitution of nationalized property that were brought by heirs of the property owners in both East and West Germany. These claims ended up in the courts and required special legislation. There may also be disputes arising out of claims to private ownership of property nationalized in North Korea.

There are also implications in the area of labor relations. There is little information available on the North Korean economy and work force. However, it is foreseeable that reunification accompanied by privatization and the transition

128. Milhaupt, *supra* note 9.

to a market economy could prompt a wave of unionism in North Korea. This could generate work for the NLRC.

There are implications for the environment because of development. A reunified Korea will need to build a transportation infrastructure between the former North and South Korea. There may be anticipation of these potential future sources of conflict in the developments of legal infrastructure, both in terms of substantive law and institution-building for private dispute resolution in South Korea.

VI. CONCLUSION

Korea is instituting innovations in national governance that are laying the groundwork for the next generation of its citizens to participate more meaningfully in all the aspects of government decisionmaking that affect their lives. These innovations may also contribute to continuing the growth in the economy that made the Asian Tigers the envy of the developing world. Private dispute resolution is an essential part of this legal infrastructure.

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

*Susan D. Franck**

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I. INTRODUCTION

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

While the number of investment treaties has increased, there has also been a marked increase in FDI, which surged from $200 billion in 1990 to over $1 trillion in 2000.[4] With the increase in investor rights and investment levels, it is not surprising investors have begun to bring claims to enforce their rights when government conduct arguably has an adverse effect on their investment. Since 1985, investors have initiated at least 219 claims—two thirds of which have been filed since 2002—and several pending claims have been valued in excess of $100 million.[5]

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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affecting investment decisions).

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

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

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

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

An investment treaty is an agreement made between two or more sovereigns that safeguards investments made in the territory of the signatory countries.[16] Sovereigns purportedly promulgate these investment treaties as "a means to satisfy the need to promote and protect foreign investment and with a view to enhancing the legal framework under which foreign investment operates."[17] Investment treaties may have other functions. They may signal receptivity to foreign investments[18] or enhance a nation's credibility as a reputable international actor.[19] Irrespective of a government's motivation, the proliferation of investment treaties marks a paradigm shift in investors' substantive and procedural rights.[20]

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

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

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

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

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

A. Substantive Investment Rights

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

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

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

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

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

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

B. Procedural Investment Rights

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

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

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

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

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

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

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

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

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

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

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

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

C. The Investment Arbitration Process

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

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

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

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

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

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

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

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

III. INVESTMENT TREATIES AND FOREIGN DIRECT INVESTMENT

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

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

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

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

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

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

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

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

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

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

substantive rights and a forum for vindicating violations of those rights, governments create risks. Those risks relate to the waiver of sovereign immunity, litigation risk[44] associated with the possible need to defend against investor claims, and the possibility of ultimate liability.[45] The defense of a treaty claim may require governments to spend millions of dollars. Nevertheless, expending financial resources may be necessary (or at least economically efficient) since a single government measure may lead to claims worth billions of dollars.[46] Should an investor be successful, a government may have to pay damages associated with the claim, and it may be politically or economically expedient to defend the claim—particularly as awards within the past decade have ranged from approximately $500,000[47] to $18 million[48] to $75 million[49] to $270 million.[50]

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

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

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

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

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

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

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

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

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

A. Anecdotal Evidence

While there is some empirical evidence suggesting that trade liberalization improves investor confidence,[52] there is mixed anecdotal evidence that investment treaties promote FDI. On one hand, investors such as Ronald Lauder have testified before the U.S. Congress that the Czech Republic "went out of its way to encourage U.S. investors . . . [and] they pointed out that such an investment would be protected by the bilateral investment treaty between the United States and the Czech Republic." When making his own investment in the Czech Republic, Mr. Lauder explained he did so "with the knowledge that [the investment] was protected unequivocally under the bilateral investment treaty."[53] Other investors have suggested that the existence of certain investment treaties reduce perceived political risk[54] within a country; they may also have a signaling or reputation-building effect for governments that enact the treaties.[55]

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

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

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

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

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

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

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

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

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

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

B. Empirical Analyses

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

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

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

58. *Id.*

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

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

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

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

1. Market Protagonists

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

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

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

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

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

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

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

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

66. *Id.* at 141-42.

67. *Id.* at 118-22.

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

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

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

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68. *Id.* at 122.

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

70. *Id.* at 18.

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

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

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

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

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

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

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

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

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

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

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

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

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

2. Treaty Protagonists

In contrast, the analysis of other scholars suggests that investment treaties do increase FDI. When looking at U.S. BITs, for example, Salacuse and Sullivan find strong evidence for the conclusion that BITs foster FDI.[80] Neumayer and Spess,[81] Swenson, and Egger and Pfaffermayr[82] reach similar conclusions regarding other BITs.

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

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

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

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

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

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

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

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

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

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

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

C. Synthesis of the Literature

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

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

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

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

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

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

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

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

IV. INVESTMENT TREATY ARBITRATION: PROMOTING FDI?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

1. The Place Holding Model

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

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was the comparative advantages of the host market).

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

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

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

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

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

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

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

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

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

2. The Political and Economic Reality Model

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

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

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

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

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

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

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

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

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

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

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

114. Prior to the enactment of NAFTA, the United States and Canada had a free trade agreement which did offer rights, such as national treatment for investments, but did not permit investor-State dispute resolution. Canada-United States: Free Trade Agreement, arts. 105, 1801-08, 27 I.L.M. 281 (1989). After the enactment of NAFTA, however, both the United States and Canada have found themselves on the receiving end of investment arbitrations. Coe, *Taking Stock*, *supra* note 43, at 1459-60 (providing a table of the outcomes of select arbitration cases under NAFTA, including the number of settlements, amounts claimed, amounts recovered, and costs awarded); *see also* Todd Weiler, NAFTA Claims: Canada, http://www.naftaclaims.com/disputes_canada.htm (last visited Dec. 21, 2006) (listing claims against Canada); Todd Weiler, NAFTA Claims: United States, http://www.naftaclaims.com/disputes_us.htm (last visited Dec. 21, 2006) (listing claims against the United States). As this may be due to the large investment flows between the United States and Canada, presumably the United States was sensitive to this issue when drafting the United States-Australia Free Trade Agreement. U.S. Trade Representative, Canada, http://www.usembassycanada.gov/content/can_usa/ustr_trade estimates_2005.pdf (last visited Dec. 30, 2005) (observing that the "stock of U.S. foreign direct investment (FDI) in Canada in 2003 was $192.4 billion, up from $170.2 billion in 2002"); U.S. Department of State, *2001 Country Reports on Economic Practices and Trade Policy*, 2 (Feb. 2002), *available at* http://www.state.gov/ documents/organization/8197.pdf (observing that in 2000, U.S. FDI in Canada amounted to $126.4 billion, and Canada's FDI levels in the United States amounted to $103.7 billion); Aldo Forgione, *Weaving the Continental Web: Exploring Free Trade, Taxation, and the Internet*, 9 L. & BUS. REV. AM. 513, 547 (2003) (observing that the "United States has always accounted for a substantial amount of foreign investment in Canada"); *see also* Dodge, *supra* note 26, at 24 (observing the significant and reciprocal investment flows between the United States and Australia, and commenting that "allowing direct claims under AUSFTA would inevitably have led to a repetition of the Canadian and U.S. experience under NAFTA").

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

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

3. The Market Liberalization Model

In a "market liberalization"[118] model, modernization and liberalization of an investment regime facilitates FDI irrespective of the existence of substantive or procedural rights in BITs. Brazil[119] and Ireland[120] might reasonably be viewed as

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

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

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

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

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

examples of this model. Both countries have modernized and liberalized their economies during the past two decades. For example, Brazil has privatized businesses to foster competition.[121] The degree of foreign investment in both countries is tremendous[122] and is linked to their respective domestic economic success.[123] Nevertheless, in comparison to the rest of the world, they have a very small number of BITs in force. Specifically, Brazil has signed a handful of BITs[124] but has not ratified a single one,[125] while Ireland has only one BIT in

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

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

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

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

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

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

force.[126] These two countries reflect a phenomenon that UNCTAD observed, namely that BITs may be unrelated to the amount of FDI.[127] One might reasonably suggest that the economic success, irrespective of the existence of a BIT, reflects a model of market liberalization. In this scenario, internal domestic efforts to liberalize markets,[128] offer inducements for investment,[129] follow the rule of law,[130] and offer reliable dispute resolution[131] provide the critical incentives

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

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

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

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

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

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

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

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

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

4. Preliminary Synthesis

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

140. *Id.* at 119, 122.

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

142. *Id*.

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

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

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

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

1. Investment Treaty Arbitration as a Complement to Domestic Courts

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

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

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

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

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

2. Domestic Courts as a Complement to Investment Treaty Arbitration

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

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

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

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

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

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

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

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

procedural justice and democratic governance[155] by giving parties the freedom to choose the forum for resolving their disputes.[156]

Second, national courts provide critical support to the investment arbitration process. There are various points in the process where the integrity of local courts can impact the efficacy of the dispute resolution process. While a court's role tends to be limited in ICSID arbitration proceedings,[157] national courts have a role to play in enforcing ICSID arbitration awards.[158] In the context of an ad hoc UNCITRAL arbitration, national courts may find themselves playing a greater role. For example, they might evaluate challenges relating to an arbitrator's impartiality and independence[159] or determine whether arbitrators awarded damages in a procedurally improper manner.[160] Confidence in local courts supports confidence in the overall process of resolving treaty claims. While some might suggest that interdependence provides national courts with an opportunity to attack the integrity of the process,[161]

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

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

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

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

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

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

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

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

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

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

3. Arbitration as a Method to Maximize Party Control

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

V. CONCLUSION

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

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

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

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