

On the Low Success Rate of Investor-State Disputes

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Motivation

- ▶ The international **investment regime** has unexpectedly become one of the most **controversial** aspects of global governance.
- ▶ At the centre of the controversy: the mechanism of investor-state dispute settlement (**ISDS**).
- ▶ Central point of contention in CETA, TPP, TTIP.
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Unexpected developments, resulting in unexpected pushback

Everyone's **surprised** by the pushback against ISDS:

- ▶ Cecilia Malmström, recently noted that "In some ways that's **surprising**. Over 60 years, national governments in the EU negotiated 1400 bilateral investment treaties without any **outcry**."
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Recent Shifts in the Regime

- ▶ Modern investment rules emerged in **post-colonial era** to protect investors from expropriation by governments in **weak rule of law** countries.
- ▶ “Substitute” for countries unable to reassure investors making sunk cost investments.
- ▶ But most targets of ISDS today are **developed democracies**.
- ▶ And the median claim is not over “sovereign theft”, or direct expropriation, but over **indirect expropriation**.

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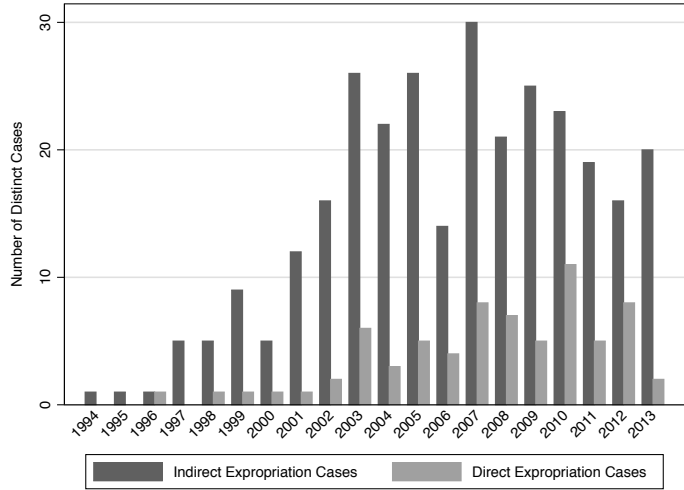
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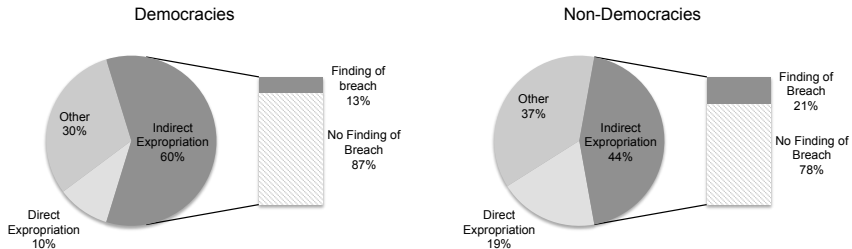
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Direct and Indirect Expropriation Claims Across Time



ISDS and Regime Type



(takes no account of wealth, a key confounding variable)

Indirect Expropriation

- ▶ Expropriation is **indirect** when it does not involve a **transfer of property**, yet deprives the investor of the **use of her property**.
- ▶ It can be "incidental", i.e. there need not be an **intent** to expropriate.
- ▶ A "**dormant issue**" in international law (Escarcena 2014).
- ▶ Also called "indirect expropriation", "disguised expropriation", "tantamount expropriation", "creeping expropriation", "measures equivalent to expropriation", "de facto expropriation"...

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Legal Ambiguity: Two NAFTA cases against Mexico

Metalclad case (2000): "[E]xpropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, [...] but **also covert and incidental interference** with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use [...] of the property even if not necessarily to the obvious benefit of the host state."

VS

Feldman case (2002): "Governments must be **free to act in the broader public interest** through protection of the environment, new or modified tax regimes, the granting or withdrawal of government subsidies, reductions or increases in tariff levels, imposition of zoning restrictions and the like. **Reasonable governmental regulation of this type cannot be achieved** if any business that is adversely affected may seek compensation"

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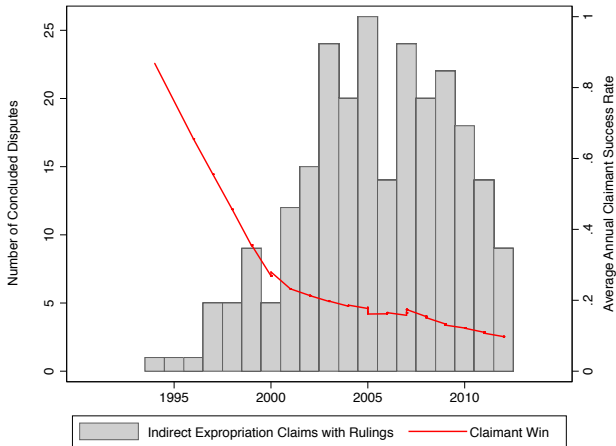
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- ▶ This leads to a further puzzle: **why do firms launch** these disputes in the first place?

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Indirect Expropriation: Trend Over Time



Argument

- ▶ Firms may benefit from filing indirect expropriation claims even when they don't win, if they **deter ambitious regulation**.
- ▶ This side-benefit should **depress the legal merit of claims**, in a way that leads to a lower rate of a success in rulings.
- ▶ It should also be associated with a **lower rate of settlement**, as claimants seek to drag out cases as long as possible.

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Benefits of Expropriation to Government

Direct vs. Indirect Expropriation:

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Costs of ISDS

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 - “contrary to the expectations [...] costs involved in investor-State arbitration have **skyrocketed** in recent years.” (UNCTAD 2010)
 - **\$5.5 million** average cost to states (in ICSID, 2011-2015).
 - Litigation decreases **investment flows**, even if government wins (Allee and Peinhardt 2011).*
- ▶ Governments have incentive to avoid litigation, even if they believe they will ultimately prevail on the merits. Especially likely for **developing countries**.

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Press Release



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Philip Morris International Comments on New Zealand's Standardized Packaging Announcement

LAUSANNE, Switzerland--(BUSINESS WIRE)--Feb. 19, 2013-- Philip Morris International Inc.'s (PMI) (NYSE/Euronext Paris: PM) issued the following statement today regarding the New Zealand government's announcement that it will wait to implement standardized or "plain" packaging for tobacco products until the international legal challenges pending regarding Australia's law are decided:

"In her official statement earlier today announcing New Zealand's plans regarding standardized packaging, Health Minister Tariana Turia said, 'the Government will wait and see what happens with Australia's legal cases, making it a possibility that if necessary, enactment of New Zealand legislation and/or regulations could be delayed pending those outcomes.'

This announcement demonstrates that the New Zealand government recognizes the significant international trade issues with standardized packaging and will not implement it until the pending international legal challenges to Australia's law are resolved. There is no credible evidence that standardized packaging will lower smoking rates, but strong evidence that it will jeopardize jobs, benefit the black market for cigarettes, and is a breach of international trade rules that have already made Australia's policy subject to WTO action."

Anecdotal Evidence

Beyond New Zealand and Australia: **threats alone** can be effective.

- ▶ Canada on plain packaging: faces **threats of ISDS disputes** from the tobacco industry twice, in 1994 and 2001. In both cases, Canada backs down from the proposed law.
- ▶ Indonesia tries to **ban open-pit mining in protected forests**, companies threaten to launch investment disputes under the Aus-Indo and UK-Indo BIT, Indonesia backs down:
"There were investment activities before the Forestry Act was effective. If shut down, investors demand compensation and Indonesia cannot pay." — Indonesian Enviro Minister

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Testable Implications

Direct expropriation claims offer us a useful comparison. If indirect expropriation claims are partly aimed at deterring regulatory ambitions, cases with these claims should be:

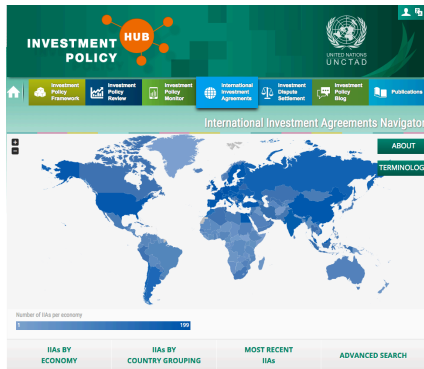
- ▶ **Less likely to settle** than in direct expropriation claims, and more likely to proceed to litigation.
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New High Quality Data



742 disputes, making it the most comprehensive ISDS dataset for the last 20 years.

Table 2: Legal Merit in the Investment Regime

	(1)	(2)
	Pro-Firm Ruling	Pro-State Ruling
Indirect Expropriation Claim	-0.97*** (0.26)	0.65*** (0.25)
Other Legal Claim	-0.61* (0.35)	0.16 (0.40)
GDP/cap (log)	-0.25*** (0.07)	0.18* (0.09)
Country Legal Experience	0.01 (0.01)	-0.02** (0.01)
NAFTA	-0.15 (0.17)	0.16 (0.24)
Energy Charter	0.13 (0.17)	0.05 (0.35)
Claims Number	0.06 (0.05)	0.02 (0.05)
Democracy	0.31** (0.13)	-0.33** (0.16)
Constant	-17.95 (16.21)	0.30 (17.89)
GOES TO RULING		
Amount Sought Private	-0.60** (0.14)	-0.57** (0.20)
Indirect Expropriation Claim	0.94*** (0.26)	0.96*** (0.25)
Other Legal Claim	0.10 (0.25)	0.11 (0.26)
Claimant Experience	-0.06 (0.11)	-0.08 (0.14)
Constant	0.36 (0.26)	0.37 (0.28)
Time cubic splines	Yes	Yes
N	416	416

Heckman probit selection model with maximum likelihood (ML) estimates. First stage estimates likelihood of an award being rendered. Second stage estimates likelihood of a pro-claimant award (column 1) and a pro-state award (column 2). Robust standard errors clustered on the ISIC sector. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

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Findings

These are substantively important effects:

- ▶ **Settlement:** Indirect expropriation cases are **52% more likely to go to a final ruling.**
- ▶ **Merit:** When a case includes an indirect expropriation claim, **odds of claimant winning drop by 51%.**
- ▶ **Corollary about wealth:** Rich governments fare better across the board.

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- ▶ Indirect expropriation claims, the fastest rising type of ISDS claim, are characterized by low (and decreasing) revealed merit, and low settlement rates.

Ongoing Findings: Firm-Level Evidence

I also collect data on claimant firms in 279 ISDS cases.

Large, productive firms appear to be:

- ▶ more likely to settle.
- ▶ more likely to win conditional on an award being issued.
- ▶ they claim more, and are awarded more, in both absolute and relative terms.
- ▶ they are LESS likely to make indirect expropriation claims.
- ▶ they are not the most frequent filers.
- ▶ they file fewer claims per dispute.
- ▶ they are more likely to be secretive.

Conclusion

- ▶ The **shift in the regime** seems real (and unanticipated?)
- ▶ The median ISDS case does not target sovereign theft, but **regulation in democracies**.
- ▶ Evidence from case outcomes consistent with firms filing low-merit disputes to deter regulation.
- ▶ Current negotiations reflect these concerns: TPP, CETA, both addressed "frivolous litigation". Yet such agreements have **growingly uncertain**.

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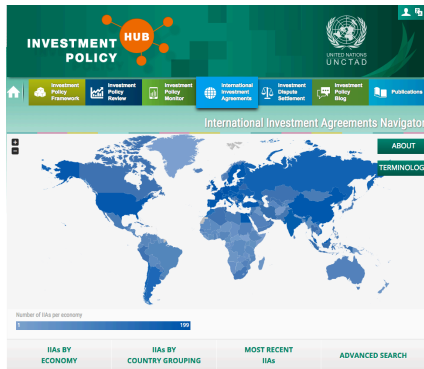
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New Data May Help



742 disputes, making it the most comprehensive ISDS dataset for the last 20 years.

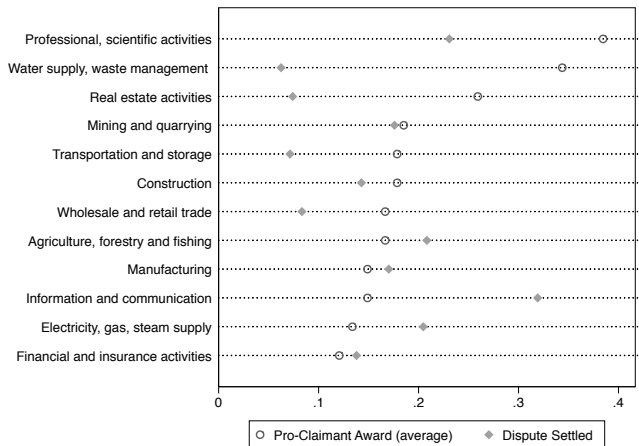
Table 1: Legal Merit in the Investment Regime

	(1)	(2)	(3)	(4)
	(DV: Pro-Firm Award)		(DV: Pro-State Award)	
Indirect Expropriation Claim	-0.61*** (0.18)		0.55*** (0.20)	
Direct Expropriation Claim		0.68*** (0.22)		-0.56** (0.26)
GDP/cap (log)	-0.25*** (0.06)	-0.26*** (0.07)	0.19** (0.09)	0.19** (0.09)
Country Legal Experience	0.01 (0.01)	0.01 (0.01)	-0.02** (0.01)	-0.02** (0.01)
NAFTA	-0.20 (0.18)	-0.18 (0.17)	0.18 (0.24)	0.15 (0.26)
Energy Charter	0.18 (0.20)	0.19 (0.19)	0.00 (0.39)	0.00 (0.36)
Claims Number	0.10*** (0.04)	0.06 (0.04)	-0.00 (0.05)	0.06* (0.04)
Democracy	0.24 (0.17)	0.32** (0.15)	-0.31* (0.17)	-0.33** (0.15)
Constant	-13.09 (14.16)	-11.86 (15.39)	-2.14 (17.91)	-0.99 (17.68)
GOES TO RULING				
Amount Sought Private	-0.61*** (0.12)	-0.74*** (0.16)	-0.57*** (0.18)	-0.76*** (0.18)
Indirect Expropriation Claim	0.89*** (0.16)		0.90*** (0.16)	
Direct Expropriation Claim		-0.42* (0.24)		-0.44* (0.25)
Claimant Experience	-0.07 (0.12)	-0.15 (0.13)	-0.08 (0.15)	-0.18 (0.17)
Constant	0.45** (0.21)	1.08*** (0.25)	0.45* (0.24)	1.12*** (0.29)
Time cubic splines	Yes	Yes	Yes	Yes
N	425	425	425	425

Heckman probit selection model with maximum likelihood (ML) estimates. First stage estimates likelihood of an award being rendered. Second stage estimates likelihood of a pro-claimant award (columns 1-2) and a pro-state award (columns 3-4). Robust standard errors clustered on the ISIC sector. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

Does Industry Matter?

Most of the literature is focused on the industry type (asset mobility, capital intensity)



Is All Else Equal?

- ▶ Claims of indirect expropriation appear to be associated with slightly lower claimed damages on average, and slightly higher awards obtained; yet neither difference is statistically significant.
- ▶ Costs are also similar.
- ▶ Might one type of claim be inherently more "difficult" to litigate than the other?

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The Role of Uncertainty

- ▶ Might the difference in filings and outcomes be driven by the greater legal uncertainty of indirect expropriation case?

