Columbia Center on Sustainable Investment
A JOINT CENTER OF COLUMBIA LAW SCHOOL AND THE EARTH INSTITUTE, COLUMBIA UNIVERSITY

Columbia FDI Perspectives
Perspectives on topical foreign direct investment issues
No. 153 August 3, 2015
Editor-in-Chief: Karl P. Sauvant (Karl.Sauvant@law.columbia.edu)
Managing Editor: Adrian P. Torres (adrian.p.torres@gmail.com)

Legitimizing expectations in arbitration through political risk analysis

by

Robert Ginsburg[*]

In arbitrations concerning the stability of a host country's regulatory framework, many tribunals have echoed a contention from the tribunal in *Saluka v. The Czech Republic*: "[No] investor may reasonably expect that the circumstances prevailing at the time the investment is made remain totally unchanged."[1] Conversely, no investor should reasonably expect that every regulation would change. While no reasonable person could argue with either of these statements, neither of them helps to resolve disputes over a host country's regulations and policies.

In an effort to find common ground between these extremes, scholars and arbitrators have suggested that the reasonableness of investors' expectations should be based (in part) on socio-economic conditions in the host country at the time of the investment.[2] This suggestion has merit: an investor's level of expectations in Malaysia during the East Asian crisis should not be the same as its expectations in Chile during times of financial stability. To date, most tribunals' efforts to examine host country conditions have failed to provide thorough retrospective assessments that accurately reflect the future status of regulatory frameworks. More specifically, such efforts have relied on stereotypes of underdeveloped countries and ambiguous and static assessments of the factors at the time of the investment.[3]

The *Parkerings* tribunal's one-sentence summary of the investment climate in Lithuania in 1998 illustrates the cursory assessments of socio-economic conditions that some tribunals have used to reject claimants' arguments under the fair and equitable treatment clause. "The political environment in Lithuania was characteristic of a country in transition from being a part of the Soviet Union to a candidate for European Union (EU) membership."[4] The tribunal's analysis not only failed to consider the stage of development or differences among former Soviet republics, but also failed to evaluate factors directly related to the stability of regulatory frameworks over time. Unlike the *Parkerings* tribunal, the arbitrators in *Duke Energy v. Ecuador* recognized the need for comprehensive assessments that consider many aspects of a host country's investment climate. Nevertheless, the *Duke Energy* tribunal's review of the context in which the claimant established its expectations relied on very few factors.[5] Because shortsighted assessments do not look for specific precursors to outcomes, they do not help tribunals understand how conditions in host countries at specific points in time should impact expectations about a project's exposure to political risks.

Still, assessments of host countries remain important ways in which to determine the reasonableness of an investor's expectations. Political risk analysis can help investors and tribunals establish legitimate expectations that reflect actual conditions in the host country that impact future exposures.

Political risk analysts examine economic, political, financial, and social conditions in host countries to determine the likelihood that political decisions or social events will have a negative impact on an FDI project. In order to assess the stability of a regulatory framework over the course of an investment, political risk analysts examine the strength of the host country's political institutions. Democratic institutions have a positive impact on regulatory stability.[6] Host governments facilitate policy and regulatory stability by building strong institutions that provide checks and balances within policy frameworks.[7] For example, in countries in which judicial institutions and regulators operate independently from elected officials, discriminatory policies are unlikely to be upheld or implemented. For this reason, analysts review factors that indicate the degree of autonomy that is granted to judicial institutions.

Analysts also consider aspects of a project to determine an investor's exposure to regulatory instability. For example, the political sensitivity of oil exploration projects leaves investors more vulnerable to government interference than investors who manufacture t-shirts.

Political risk analysis can have a significant impact on arbitral disputes. Ideally, arbitrators who obtain customized, historical political risk reports can review the conditions that directly impact regulatory frameworks at the time when expectations were framed. Where tribunals do not have access to customized reports, general political risk assessments can still help arbitrators understand other factors that indirectly impact regulatory frameworks.

While political risk analysis cannot guarantee specific outcomes, it can provide investors and tribunals with an analytical framework to establish the expectations of a reasonable investor.

---

[*] Robert Ginsburg (rbg32@georgetown.edu) is Foreign Direct Investment Manager, State of Illinois, and Adjunct Professor, IIT Chicago Kent College of Law, Chicago, IL. The author is grateful to Theodore Moran, Barbara Steindl and Louis Wells for their helpful peer reviews. **The views expressed by the author of this *Perspective* do not necessarily reflect the opinions of Columbia University or its partners and supporters. *Columbia FDI Perspectives* (ISSN 2158-3579) is a peer-reviewed series.**

[1] *Saluka Investment BVs v The Czech Republic,* UNCITRAL-PCA, Partial Award (March 17, 2006), para 305;

see also El Paso Energy International Company v. Argentina, ICSID Case No. ARB/03/15, Award (October 31, 2011), paras. 367-368.

[2] *See, e.g.*, *Duke Energy Electroquil Partners & Electroquil S.A. v. Republic of Ecuador*, ICSID Case No. ARB/04/19, Award (August 18, 2008), para. 340; (Himpurna California Energy Ltd. v. PT (Persero) Perusahaan Listruik Negara, Final Award (May 4, 1999), XXV Yearbook Commercial Arbitration, paras. 358-359.

[3] *See, e.g.*, *Genin and others v. Estonia*, ICSID Case No. ARB/99/2, Award (June 25, 2001), para. 348; *Parkerings-Compagniet AS v. Lithuania*, ICSID Case No. ARB05/08, Award (September 11, 2007), para. 355.

[4] *Parkerings-Compagniet AS v. Lithuania*, *supra* note 3, at para. 355.

[5] *See Duke Energy*, *supra* note 2, at paras. 340 and 347.

[6] *See* Nathan M. Jensen, *Nation-States and the Multinational Corporation: A Political Economy of Foreign Direct Investment* (Princeton: Princeton University Press, 2008), p. 148.

[7] *Id*.

For further information, including information regarding submission to the *Perspectives*, please contact: Columbia Center on Sustainable Investment, Alex Weaver, amw2209@columbia.edu.

The Columbia Center on Sustainable Investment (CCSI), a joint center of Columbia Law School and the Earth Institute at Columbia University, is a leading applied research center and forum dedicated to the study, practice and discussion of sustainable international investment. Our mission is to develop and disseminate practical approaches and solutions, as well as to analyze topical policy-oriented issues, in order to maximize the impact of international investment for sustainable development. The Center undertakes its mission through interdisciplinary research, advisory projects, multi-stakeholder dialogue, educational programs, and the development of resources and tools. For more information, visit us at http://www.ccsi.columbia.edu.

Most recent *Columbia FDI Perspectives*

- No. 152, Matthew Hodgson, "Cost allocation in ICSID arbitration: theory and (mis)application," July 20, 2015.
- No. 151, Karl P. Sauvant, "We need an international support programme for sustainable investment facilitation," July 6, 2015.
- No. 150, Thomas Jost, "FDI in Russia in Difficult Times," June 22, 2015.
- No. 149, John P. Gaffney, "When is investor-state dispute settlement appropriate to resolve investment disputes? An idea for a rule-of-law ratings mechanism," June 8, 2015.
- No. 148, In Hyeock Lee, Shige Makino and Eunsuk Hong, "Outward FDI does not necessarily cost domestic employment of MNEs at home: Evidence from Japanese MNEs," May 25, 2015.

All previous *FDI Perspectives* are available at http://ccsi.columbia.edu/publications/columbia-fdi-perspectives/.