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Research Report

Investor-state dispute settlement: Are arbitrators biased in favor of claimants?

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KIEL POLICY BRIEF

**Investor-state
dispute settlement:
Are arbitrators
biased in favor of
claimants?**



NO. 105 February 2017

Peter Nunnenkamp

ZUSAMMENFASSUNG / ABSTRACT

Eigennützige und parteiische Schlichter werden häufig für die Legitimitätskrise der Streit-schlichtung zwischen privaten Investoren und Staaten (ISDS) verantwortlich gemacht. Die Auswertung der Datenbank der UNCTAD zu ISDS seit Ende der 1990er Jahre ergibt jedoch keine überzeugende Evidenz dafür, dass die Schlichter systematisch voreingenommen wären. Viele Streitfälle werden von Schiedsgerichten verhandelt, die man als unparteiisch einstufen kann. Von den verklagten Staaten bestellte Schlichter sind zudem nicht weniger parteiisch als die von den privaten Klägern bestellten Schlichter. Überdies entscheiden selbst Schieds-gerichte, die voreingenommen und parteiisch erscheinen, häufiger zugunsten der verklagten Staaten als zugunsten der privaten Investoren. Für Entwicklungsländer ist es allerdings schwieriger als für Hoheinkommensländer, Forderungen auf Schadensersatz erfolgreich abzuwehren – vor allem wenn die Präsidenten von Schiedsgerichten in früheren Fällen häufig die Interessen der Kläger vertreten haben.

Self-interested and biased arbitrators are often held responsible for the legitimacy crisis of investor-state dispute settlement (ISDS). Based on UNCTAD's database on ISDS since the late 1990s, we find no compelling evidence that arbitrators are systematically biased. Many disputes are handled by unbiased tribunals, and state-appointed arbitrators are no less pro-state than investor-appointed arbitrators are pro-claimant. Furthermore, even biased tribunals decide more often in favor of respondent states than in favor of private investors. However, it is harder for developing countries, compared to high-income countries, to fend off claims for compensation, in particular when the presidents of arbitration tribunals are biased in favor of private investors.

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INVESTOR-STATE DISPUTE SETTLEMENT: ARE ARBITRATORS BIASED IN FAVOR OF CLAIMANTS?*

by Peter Nunnenkamp

1 INTRODUCTION

According to Simmons (2014: 12), the provisions on investor-state dispute settlement (ISDS) included in various international investment treaties confer “broad and asymmetrical rights for private economic agents.” These provisions may encourage “frivolous litigation” by constraining the regulatory power of democratic states (Pelc 2016). Van Harten (2012) concludes from an examination of trends in legal interpretation that international investment arbitration generally favors the position of claimants, i.e., private investors, over respondent states, and in particular the position of investors based in rich capital-exporting countries. Poorer host countries of foreign direct investment (FDI) may be the first to suffer because of their weak bargaining position. Indeed, Behn et al. (2017: 1) find that “poorer states remain vastly more likely to lose in arbitration than wealthier states.”

Self-interested and biased arbitrators are often held responsible for the legitimacy crisis of international investment arbitration. In particular, “critics hypothesize that investment arbitrators favor their appointing party in a self-interested effort to increase the likelihood of future appointments” (Rogers 2014: 226). However, as stressed by Rogers (2014), such hypotheses have largely remained untested.

This paper contributes to filling this gap by making use of data on 739 cases of ISDS, collected by UNCTAD as of September 2016. Importantly, this database includes information on arbitrators for most, though not all disputes brought to international arbitration. At the same time, UNCTAD reports for most of the concluded cases whether arbitration tribunals reached a decision in favor of the private investor who brought the case to arbitration or in favor of the respondent state.¹ Consequently, the available information allows us to assess whether biased positions of arbitrators are correlated with arbitration outcomes.² The focus is on stylized facts revealing whether biased positions of arbitrators are associated with tribunal decisions against relatively poor respondent states, in order to assess whether

* The author is grateful to Michaela Rank for most efficient research assistance.

¹ Note that 257 disputes (35%) were still pending in September 2016. Investors and states reached a settlement in 15% of all disputes; 6.5% of all cases were discontinued.

² It has to be stressed that a strictly causal identification of bias as a determinant of ISDS outcomes is beyond the scope of this paper.

international arbitration of investment disputes tends to be particularly problematic for developing host countries.³

2 BIASED AND UNBIASED ARBITRATORS

Typically, three arbitrators are involved in each case of ISDS: the arbitrator appointed by the private investor (claimant), the arbitrator appointed by the respondent state, and the president on whom both parties have to agree. The presidents of tribunals can be expected to play a critically important role in deciding on investor-state disputes, assuming that the other two arbitrators tend to serve the interests of the party they are representing. The UNCTAD database provides the names of 426 arbitrators. Interestingly, 11% of all arbitrators performed all three functions—i.e., president, representative of the claimant, and representative of the respondent state—during the period of observation (late 1990s to 2016). However, most arbitrators ‘specialized’ and performed just one function; about half of all arbitrators were active exclusively as representatives of either claimants or respondent states.

The degree of specialization, in combination with the frequency of being involved in ISDS, defines our measure of ‘bias’ of arbitrators toward either the claimant or the respondent state. More precisely, we define bias by the number of disputes in which the arbitrator has served as representative of claimants minus the number of disputes in which the arbitrator has served as representative of respondent states. Positive values of this difference reveal bias in favor of claimants, negative values reveal bias in favor of respondent states.

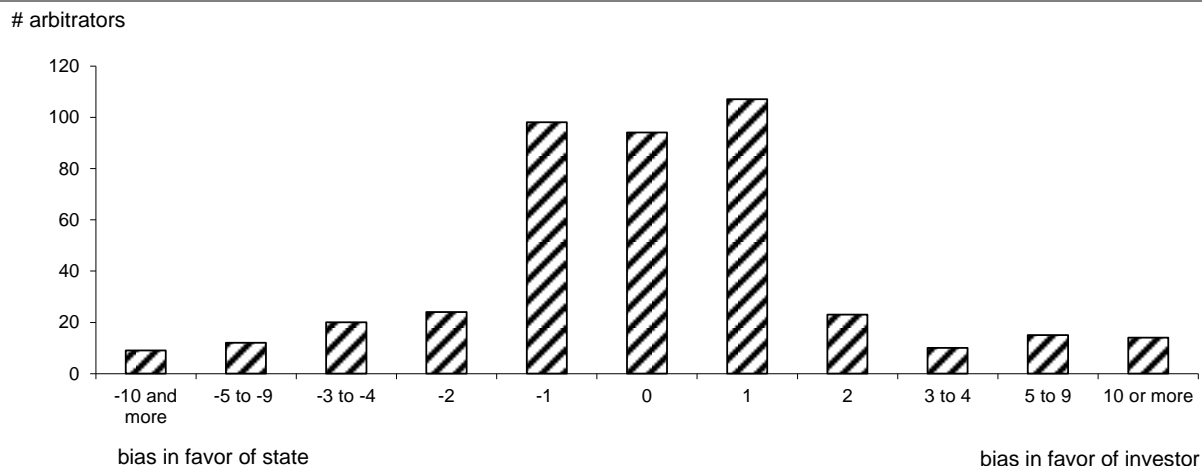
Most arbitrators do not appear to be biased considerably (Figure 1). Just 30% of all arbitrators reveal a bias of larger than one (in absolute terms). This is largely because many arbitrators have been involved in a single case of ISDS since the late 1990s. This is in contrast with the widespread belief that international arbitration of investment disputes is operated almost exclusively by a small elite group of arbitrators. Furthermore, Figure 1 indicates that arbitrators with a stronger bias in favor of investors hardly outnumber arbitrators with a stronger bias in favor of respondent states.

However, the distribution of arbitrators portrayed in Figure 1 does not rule out that some strongly biased arbitrators are critically important players in ISDS, due to the frequency of being reappointed by one particular party. Consequently, we consider the case-specific evidence on biased arbitrators in the following. Figure 2 underscores that strongly biased arbitrators are not a common phenomenon in ISDS proceedings. Taken together, all three types of arbitrators are unbiased or just slightly biased in 54% of all cases.⁴ This share is

³ About 76% of all disputes included in UNCTAD’s database involved respondent states with low or middle per-capita income (according to the World Bank’s classification).

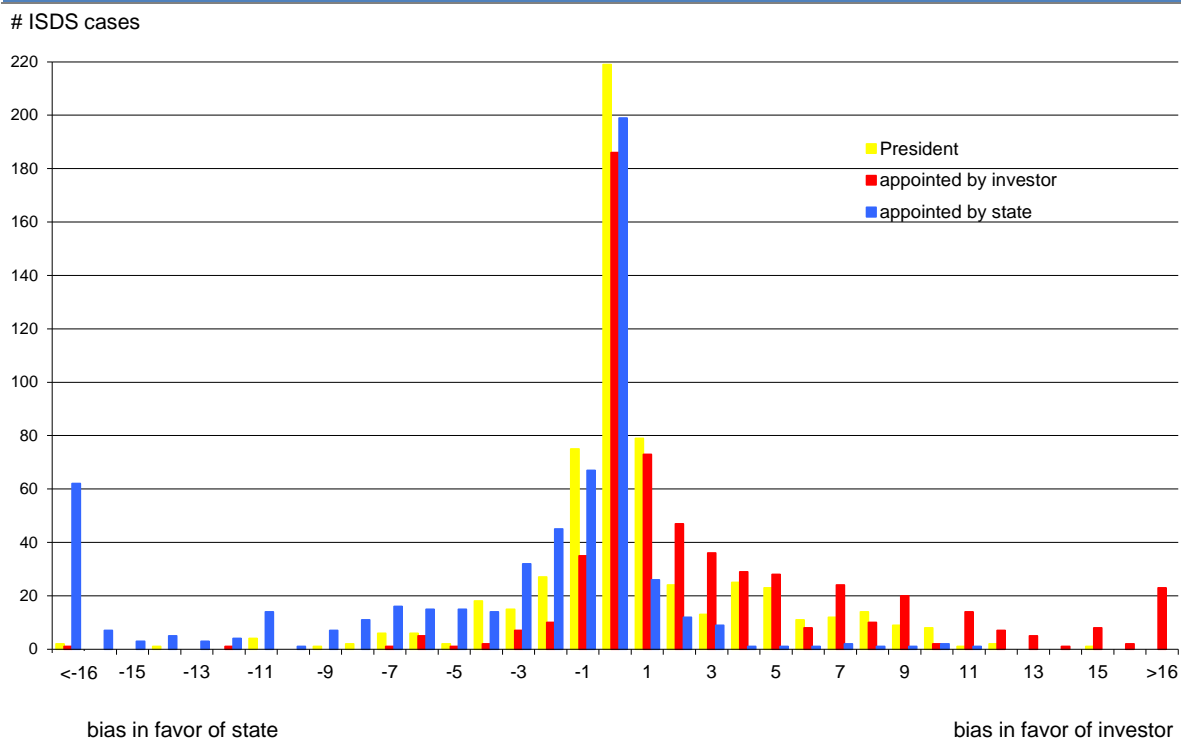
⁴ We consider arbitrators to be just slightly biased if the difference between the number of appointments by claimants and the number of appointments by respondent states is just one or minus one. Note that the bias of

Figure 1:
Distribution of arbitrators according to bias in favor of investors or states



Source: UNCTAD, ISDS database.

Figure 2:
Distribution of ISDS cases according to bias of arbitrators



Source: UNCTAD, ISDS database.

each arbitrator involved in ISDS cases initiated in year t is calculated on the basis of accumulated appointments in all previous years (up to $t-1$).

particularly high for presidents (62%), but still above half of all cases for both types of arbitrators appointed by one particular party. Claimants are not represented by more strongly biased arbitrators than respondent states. This is also evident from the similarly large number of disputes in which the claimants and the respondent states were represented by arbitrators strongly biased in their appointing party's favor (bias >1 and <-1, respectively; see also the upper panel of Table 1). Hence, the evidence on the bias of party-appointed arbitrators does not support the view that international arbitration systematically favors private investors over respondent states. It appears to be more problematic for respondent states that the presidents of arbitration tribunals are biased more often in favor of claimants than in favor of states (143 versus 84 cases).

Table 1:
Number of ISDS cases by bias of arbitrators and income status of respondent states

	Unbiased (0)	Minor bias (1/-1)	Stronger bias in favor of:	
			Investor (>1)	State (<-1)
All respondent states				
President	219	154	143	84
Arbitrator appointed by investor	186	108	264	28
Arbitrator appointed by state	199	93	31	254
Respondent states with high income				
President	48	36	37	26
Arbitrator appointed by investor	36	16	79	8
Arbitrator appointed by state	38	19	8	71
Respondent states with upper-middle income				
President	92	60	50	43
Arbitrator appointed by investor	82	47	103	8
Arbitrator appointed by state	89	29	16	102
Respondent states with lower-middle and low income				
President	79	58	56	15
Arbitrator appointed by investor	68	45	82	12
Arbitrator appointed by state	72	45	7	81

Source: UNCTAD, ISDS database; World Bank, World Development Indicators.

The lower panels of Table 1 differentiate between relatively rich and poor respondent states. In this way, we gain first insights on whether poorer respondent states are disadvantaged in international arbitration of investment disputes. This could happen if cases raised against poorer states were handled by arbitrators biased more strongly in favor of claimants. Two observations indicate that such concerns may be unjustified:

- The number of disputes in which the claimants and the respondent states were represented by arbitrators strongly biased in their appointing party's favor (bias >1 and <-1, respectively) is similarly large for all sub-groups of states in Table 1.
- Cases against states with lower-middle and low income are handled over-proportionately by unbiased or just slightly biased arbitrators. Two thirds of the presidents in ISDS against

states in this income group are unbiased or just slightly biased, compared to 57% of the presidents in ISDS against high-income states.⁵

However, the bias of presidents could still be of concern for respondent states with lower-middle and low income. A stronger bias of presidents handling cases against such states is much more often in favor of investors (56 cases) than in favor of states (15 cases). Hence, the poorest group of states tends to be in a difficult position in those disputes handled by biased presidents, even though the number of such disputes is relatively small.

3 CONSOLIDATED BIAS OF ARBITRATION TRIBUNALS

We now consider the bias of arbitration tribunals as a whole. The ‘consolidated bias’ of each tribunal is given by the sum of the three arbitrators’ individual biases. The bias of the presidents of tribunals is correlated positively with the bias of the arbitrators appointed by claimants, and negatively with the bias of the arbitrators appointed by respondent states.⁶ Moreover, the biases of the two party-appointed arbitrators are correlated negatively.⁷ In other words, the pro-investor bias of presidents and arbitrators representing investors tends to be mitigated, or even offset by arbitrators representing states.

Roughly one third of all disputes are handled by unbiased tribunals or tribunals with just minor consolidated bias (in favor of either party); the remaining disputes are almost equally split between tribunals with stronger pro-investor bias and stronger pro-state bias (Figure 3; see also the first line of Table 2). Distinguishing between cases raised against states at different levels of per-capita income underscores the above noted ambiguous evidence for developing countries. On the one hand, cases against developing countries are handled more often by unbiased tribunals or tribunals with minor bias.⁸ On the other hand, more

Table 2:
Number of ISDS cases by consolidated bias of arbitration tribunals and income status of respondent states

Unbiased (0)	Minor bias (1/-1)	Stronger bias in favor of:	
		Investor (>1)	State (<-1)
All respondent states			
81	99	200	181
Respondent states with high income			
22	13	46	52
Respondent states with upper-middle income			
30	45	88	69
Respondent states with lower-middle and low income			
29	41	66	60

Source: UNCTAD, ISDS database; World Bank, World Development Indicators; own compilation based on minor and stronger consolidated bias as defined in text.

⁵ Moreover, arbitrators appointed by claimants are unbiased or just slightly biased in 55% of the cases raised against states with lower-middle and low income, compared to only 37% of the cases against high-income states.

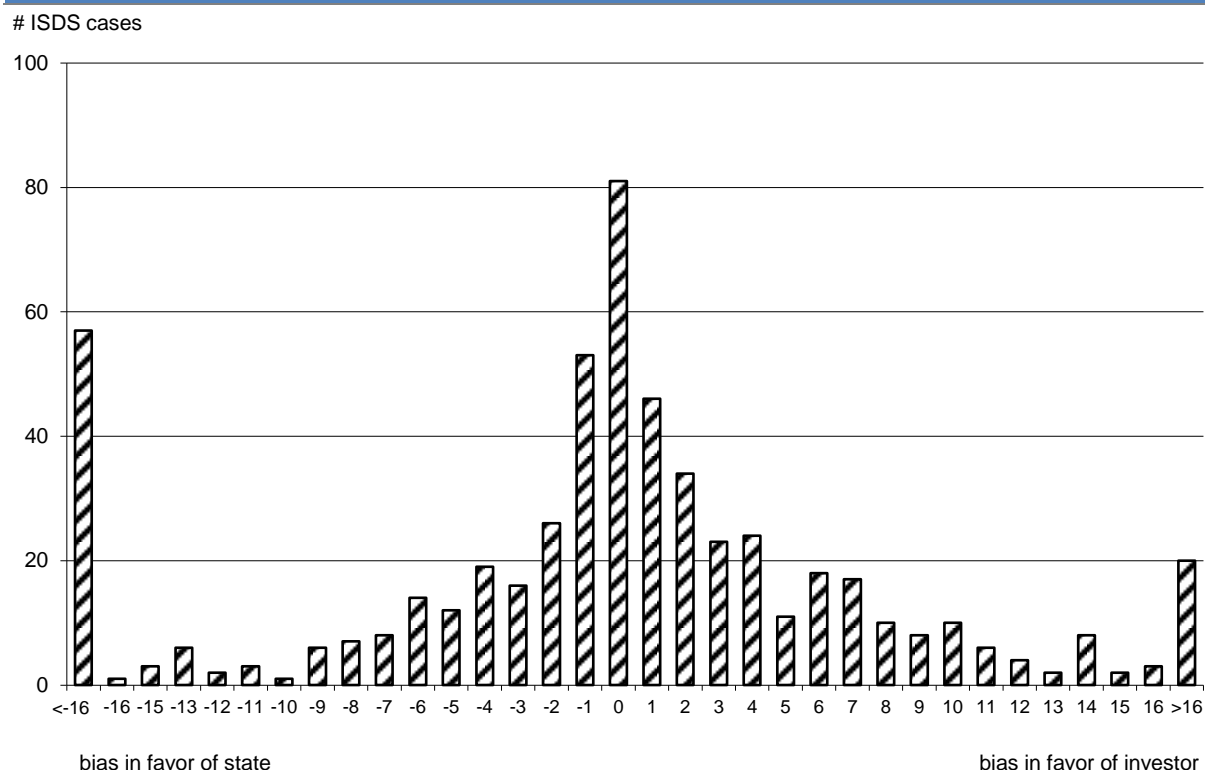
⁶ The correlation coefficients of 0.072 and -0.092 are statistically significant at the 10% and 5% level, respectively.

⁷ The correlation coefficient of -0.15 is statistically significant at the 1% level.

⁸ Unbiased tribunals or tribunals with minor bias handle 36% of the cases against the poorest income group in Table 2; this share is only 26% for cases against the highest income group.

strongly biased tribunals are more often pro-investor than pro-state in cases against developing countries—in contrast to cases against high-income states.

Figure 3:
Distribution of ISDS cases according to bias of arbitration tribunals (consolidated bias)



Source: UNCTAD, ISDS database.

4 BIAS AND ISDS OUTCOMES

As mentioned before, ISDS outcomes are reported by UNCTAD for a smaller number of disputes since many cases were still pending in September 2016. We are particularly interested in tribunal decisions in favor of either the claimant, i.e. the private investor, or the respondent state. Some more of the remaining 298 disputes are lost due to missing information on arbitrators (e.g., 30 cases for presidents). A detailed account of the distribution of cases by income status of respondent states, the bias of the three types of arbitrators and ISDS outcomes in favor of investor or state is provided in the Appendix table.⁹

Looking at the tribunals' presidents, Figure 4 conveys several messages. First of all, cases are decided more often in favor of respondent states than in favor of claimants. The ratio of

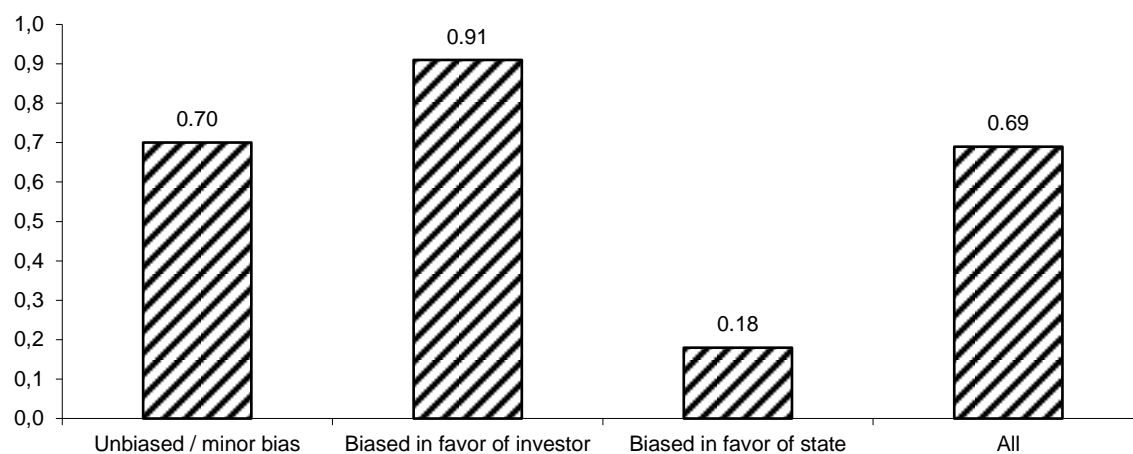
⁹ Instead of distinguishing three income groups, we focus on all low- and middle-income countries in the following in order to keep a sufficiently large number of observations.

investor wins over state wins amounts to 0.69 for cases raised against all states (upper panel of Figure 4). This ratio is higher, though still below one, for cases raised against states with low and middle income (lower panel). This is in line with Behn et al. (2017) who find that developing countries are more likely to lose in arbitration than high-income countries.

Figure 4:
Bias of presidents and ISDS decisions in favor of investors vs. states

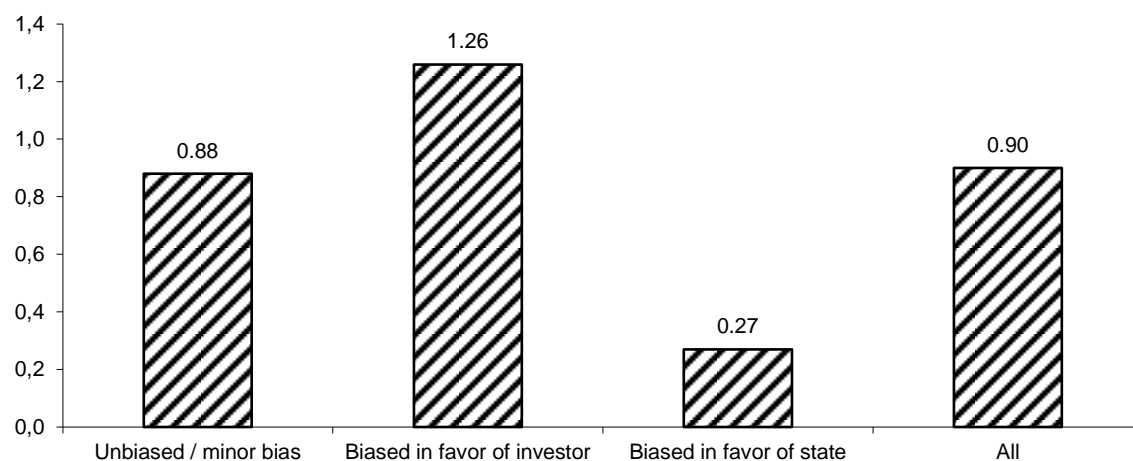
a) Cases against all respondent states

Ratio of decisions in favor of investors vs. states



b) Cases against states with low and middle income

Ratio of decisions in favor of investors vs. states



Source: UNCTAD, ISDS database; own compilation (see Appendix table).

Accounting for the bias of presidents, the ratio of investor wins over state wins closely resembles the average ratio as long as disputes are handled by unbiased and just slightly biased presidents. In contrast, the ratio rises considerably for cases handled by presidents with stronger bias in favor of investors—and it falls dramatically for cases handled by presidents with stronger bias in favor of states. Even with presidents biased in favor of investors, state wins continue to outnumber investor wins in the upper panel of Figure 4. However, the ratio clearly exceeds one (1.26) in the lower panel; i.e., disputes are more often decided against respondent states with low and middle income when presidents are biased in favor of claimants. This underscores that mainly poorer countries are running the risk of losing disputes handled by presidents biased against states.

Looking instead at party-appointed arbitrators, it still holds that the ratio of investor wins over state wins is generally higher for cases against developing countries, compared to cases against all respondent states (see Appendix table for details). Strikingly, however, this ratio is fairly low when private investors are represented by arbitrators who are strongly biased in favor of claimants (0.62 for cases against all states, and 0.93 for cases against developing countries). Recalling the corresponding ratios for cases handled by biased presidents (0.91 and 1.26, respectively), the bias of party-appointed arbitrators appears to play a minor role for ISDS outcomes. The important role of presidents also emerges when comparing the ratios for cases handled by presidents biased in favor of states (0.18 and 0.27 in Figure 4) with the ratios for cases involving state-appointed arbitrators with strong pro-state bias (0.43 and 0.61, respectively; see Appendix table).¹⁰ It seems that mainly the pro-state bias of presidents, rather than that of state-appointed arbitrators, renders investor wins considerably less likely.

Finally, we consider the ‘consolidated bias’ of arbitration tribunals as a whole. The pattern shown in Figure 5 largely resembles the pattern based solely on the bias of presidents. Once again, the ratio of investor wins over state wins is generally higher when limiting the sample to respondent states with low and middle income (lower panel). Not surprisingly, a pro-investor bias of tribunals is associated with an increasing ratio of investor wins over state wins, whereas a pro-state bias is associated with a drastically reduced ratio – similar to what we observed before for biased presidents. The chances of investors to win disputes improve when accounting for the tribunal’s consolidated bias in cases against all respondent states (upper panel of Figure 5, compared to upper panel of Figure 4). This seems to be mainly because state-appointed arbitrators are not effective in serving the interests of respondent states.¹¹ At the same time, claimant-appointed arbitrators with pro-investor bias do not appear to be particularly effective either in fostering the interests of their private clients in

¹⁰ Another surprising finding is that the ratio of investor wins over state wins is *higher* for cases with unbiased and just slightly biased arbitrators appointed by respondent states (0.80 for cases against all respondent states) than for cases with unbiased and just slightly biased presidents (0.70) and arbitrators appointed by claimants (0.69; see Appendix table).

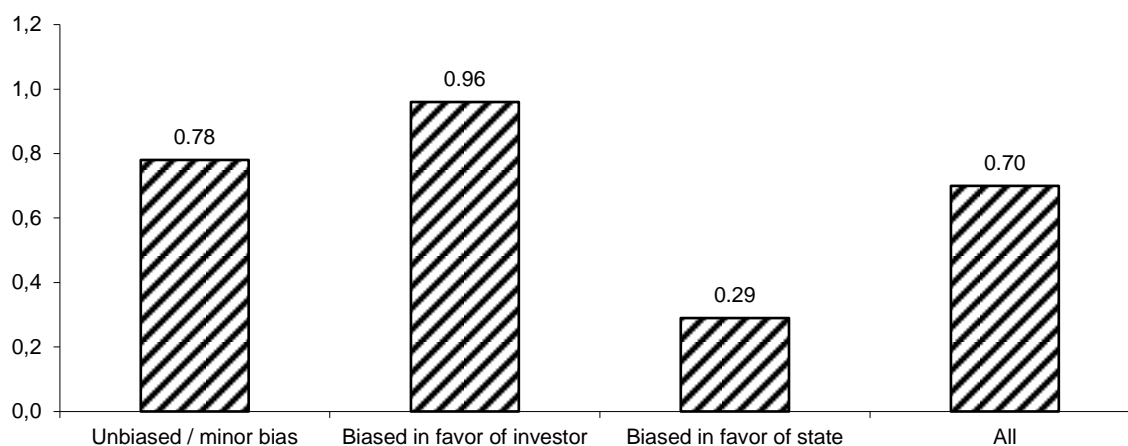
¹¹ Recall the surprisingly high ratio of investor wins over state wins for cases in which state-appointed arbitrators were either unbiased or biased in favor of states.

cases raised against respondent states with low and middle income.¹² Taken together, the available evidence suggests that ISDS outcomes critically depend on the tribunals' presidents.

Figure 5:
Consolidated bias of arbitration tribunals and ISDS decisions in favor of investors vs. states

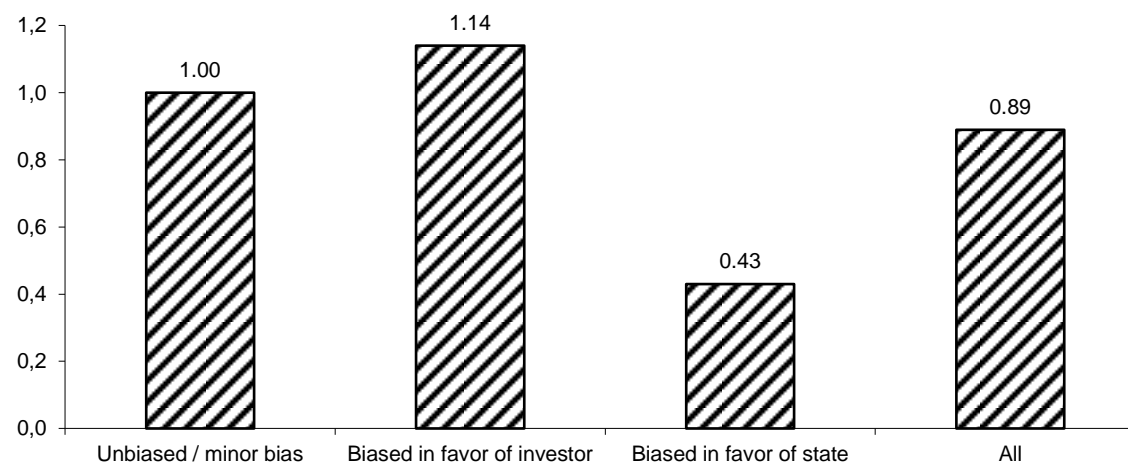
a) Cases against all respondent states

Ratio of decisions in favor of investors vs. states



b) Cases against states with low and middle income

Ratio of decisions in favor of investors vs. states



Source: UNCTAD, ISDS database; own compilation (see Appendix table).

¹² It should be noted that the ratio of investor wins over state wins is lower in Figure 5.b for pro-investor biased tribunals (1.14), compared to Figure 4.b for pro-investor biased presidents (1.26).

5 SUMMARY AND CONCLUSION

Based on UNCTAD's database on 739 disputes since the late 1990s, we find no compelling justification to blame biased arbitrators for the widely perceived legitimacy crisis of ISDS. In particular, many cases raised against developing countries are handled by fairly unbiased tribunals. Moreover, state-appointed arbitrators are no less pro-state than investor-appointed arbitrators are pro-claimant.

As for ISDS outcomes, the ratio of investor wins over state wins is typically below one. Nevertheless, it is harder for developing countries, compared to high-income countries, to achieve state wins in international arbitration of investment disputes. This appears to be largely because of the presidents of tribunals who are biased more often in favor of investors than in favor of less developed states. The states' own representatives in tribunals seem to have less influence on ISDS outcomes. The same tends to apply for biased arbitrators appointed by claimants. All in all, the evidence suggests that respondent states should pay particular attention to the selection of the tribunals' presidents. According to Rogers (2014), few developing countries have made nominations to the list of potential presidents so far. This would have to change in order to strengthen the representation of the interests of developing countries in international arbitration of investment disputes.

It has to be stressed that the stylized facts presented in this paper offer just tentative insights on the links between biased arbitrators and ISDS outcomes. For instance, these links may change over time – a question to be addressed once more information on ISDS outcomes becomes available. Furthermore, causal effects of the tribunals' bias in favor of claimants or respondent states might then be easier to identify by multivariate regression analyses.

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APPENDIX:

Table A1:
Number of ISDS cases by bias of arbitrators

	Cases against all respondent states		Cases against states with low and middle income	
	Decided in favor of:		Decided in favor of:	
	Investor	State	Investor	State
President:				
unbiased	53	66	45	47
minor bias	23	43	23	30
biased in favor of investor	30	33	29	23
biased in favor of state	3	17	3	11
Arbitrator appointed by claimant:				
unbiased	37	70	34	52
minor bias	30	27	28	21
biased in favor of investor	28	45	26	28
biased in favor of state	6	4	5	4
Arbitrator appointed by respondent state:				
unbiased	47	53	43	38
minor bias	21	32	20	24
biased in favor of investor	10	8	8	7
biased in favor of state	23	53	22	36
All three arbitrators:				
unbiased	23	29	21	17
minor bias	22	29	20	24
biased in favor of investor	44	46	40	35
biased in favor of state	12	41	12	28

Source: UNCTAD, ISDS database; own compilation based on 'bias' as defined in text.

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