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Deciding by Numbers: How Do Legal Indicators Impact State Responsibility in Investment Arbitration

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Modern society is amazed by empirical analysis, and the legal world is no exception. Indicators, rankings, and reports have been widely used to compare the independence and efficiency of legal systems with very different cultural and historical backgrounds. They are often regularly published and updated by think tanks and international organizations, both governmental and non-governmental. Examples include the Corruption Perceptions Index (CPI) by Transparency International, the Rule of Law Index by the World Justice Project, the Index of Economic Freedom by the Heritage Foundation, the Economic Freedom of the World Report by the Fraser Institute, as well as the Doing Business Reports, which used to be published by the World Bank Group.

While scholars have discussed the implications of legal indicators for global governance in recent years, there is no literature on the potential impacts of these indicators in investment arbitration.

The Relevance of Legal Indicators in Investment Arbitration

In fact, legal indicators have been widely cited in practice to support a range of arguments. They are most often invoked in the context of claims of denial of justice within the analysis of State responsibility for failing to accord fair and equitable treatment. After all, the primary goal of legal indicators is to compare the efficiency and independence of legal systems across the world. In *Merck v. Ecuador*, for instance, the investors sought to establish that an underlying litigation was influenced by judicial corruption. Before the factual allegations of corruption, the investors set out some authorities demonstrating the extent of judicial corruption in the respondent State. In support of their argument, the investors referred to various legal indicators and reports, including the World Justice Project Rule of Law Index and Transparency International's Corruption Perceptions Index (paras. 161-165). Similarly, the claimant in *Manolium Processing v. Belarus* sought to argue that the respondent's judicial system "does not satisfy international standards of justice." They did so by citing four different legal indicators and noting that the respondent State did poorly in all of them (paras. 700-703).

Relatedly, legal indicators have been cited to support arguments of futility in the context of exhaustion of local remedies. In *K?l?ç v. Turkmenistan*, for instance, the claimant argued that any attempt to settle dispute in the respondent's court would be futile, as no remedy is available. It supported this claim by relying on, *inter alia*, respondent's poor performance in the Transparency

International's Corruption Perception Index (para. 4.3.6).

Beyond claims related to defects in judicial systems, some investors have tried to use legal indicators (creatively) in support of other arguments, such as those relating to the requirement to seek approval of investment under respondent's investment code (*e.g.*, the *Lighthouse* case) and attribution of the actions of a bank to a State (*e.g.*, the *Stati* case). In the first example, the claimant in *Lighthouse v. Timor-Leste* sought to justify its failure to acquire "formal" governmental approval for its investment on the basis that the respondent's judicial system was "nascent and still developing". To support this argument, it noted that that the judicial system of the respondent is ranked poorly in the World Bank's Doing Business Report (para. 305). The argument, however, was rejected by the tribunal, who found that the requirement to get approval is clearly provided in Timorese law (para. 330). In the second example, the claimants in *Stati v. Kazakhstan* argued before the Svea Court of Appeal that actions of a bank should be attributable to the respondent, as the absence of rule of law in the country has allowed the president to control the bank *de facto*. To demonstrate this, the claimants cited to a report by the Swedish Ministry for Foreign Affairs, which in turn relies on data provided in the Rule of law index by the World Justice Project (para. 39).

Beyond supporting individual claims, legal indicators have also been invoked by investors to demonstrate a significant deterioration of investment environment within a period of time. This is the case, for example, in *Alicia Grace and others v. Mexico*, in which the investors emphasized the significant drop of the respondent in the ranking of Corruptions Perceptions Index between the time of investment and the time of the alleged violations (paras. 36-37).

Empirical indicators have been cited not only by investors, but also by respondent States, demonstrating its relevance as a Claimant and Respondent in investment treaty arbitration. For example, countries that performed well in these indicators tend to use them in mounting their defense. In *Beijing Shougang v. Mongolia*, for instance, the respondent argued that it has "remained a democratic country, committed to transparency" by emphasizing that it has outperformed China, the home State of the investors, in the Heritage Foundation's Index of Economic Freedom (para. 14). Similarly, in *Philip Morris v. Uruguay*, the respondent cited to the World Justice Project's Rule of Law Index for the point that "Uruguayan judiciary is recognized as one of the best in the world" (paras. 11.45-11.46).

Arbitral Case Law on the Role of Legal Indicators

Little is known about the actual impact of legal indicators on arbitral decisions as far as the State responsibility is concerned. A preliminary observation is that, while tribunals do take them into account, these indicators generally do not play a decisive role as they do not necessarily reflect the standard of treatment that investors received in the case at hand. As stated by the tribunal in *Niko Resources v. Petrobangla and Bapex*, in relation to an argument partly based on the Transparency International's Corruption Perceptions Index, it is not the role of investment tribunals to pass judgements of general allegations on the legal regime of the respondent State during a certain period. Tribunals can, nevertheless, "take account of these allegations and the supporting material" surrounding a particular claim (paras. 1455-1456).

In this light, tribunals have held that the poor performance of a State with respect to legal indicators cannot lead to a finding of denial of justice *per se*. In the *Manolium Processing* case

referenced above, the tribunal apparently considered the ranking of the respondent host-State in different indicators and found that "the judicial system in Belarus has significant room for improvement, especially as regards the independence of judges from the executive branch." However, it dismissed the claim on the basis that "a claim for denial of justice must rest on the specific treatment given by the courts of the host State to the alien, rather than on the general assessment of the host State's judicial system." (paras. 551-553). Similarly, in the *K?l?ç* case, cited above, the tribunal rejected the claimant's argument as futility cannot be justified by "generalised allegations about the insufficiency of a state's legal system" (para. 8.1.10). On the contrary, it can only be established by "probative evidence that goes to the specificity of the issue in dispute" (para. 8.1.10), which is an element that legal indicators generally cannot provide.

Advantages and Pitfalls of Using Legal Indicators in Investment Arbitration

Empirical data, such as legal indicators, will continue to be cited – and conversely, debated – by parties in investment disputes. Indeed, the research underlying these indicators is generally published by renowned and well-reputed organizations and indeed carried out with scientifically well-established methodologies. In contrast to costly forensic, expert evidence, such indicators are generally free.

However, beyond the issue of the indicators being too general, several reasons caution against the over reliance of such data. Firstly, however objective they may be, these indicators are not free from ethical concerns.

Secondly, the methodology of these indicators can always be disputed. Some of these indicators (such as World Justice Project's Rule of Law Index) reply on questionnaires to "experts", which, in the view of one author, simply reinforces "powerful and misleading elite bias". Their evidential value is left for parties to debate, and ultimately for the tribunal to decide in accordance with its inherent powers.

Lastly, some criteria in these indicators are inevitably influenced by the fiscal capacity of the State concerned. Examples include certain elements of transparency (*e.g.*, the publication of documents and judgments) and the efficiency of the judiciary as well as that of the law enforcement. Developing States should not be unduly prejudiced for performing poorly in legal indicators. As Professor Paulsson stated in *Pantechniki v. Albania*, "international responsibility does not relate to physical infrastructure; states are not liable for denial of justice because they cannot afford to put at the public's disposal spacious buildings or computerised information banks. What matters is rather the human factor of obedience to the rule of law" (para. 76).

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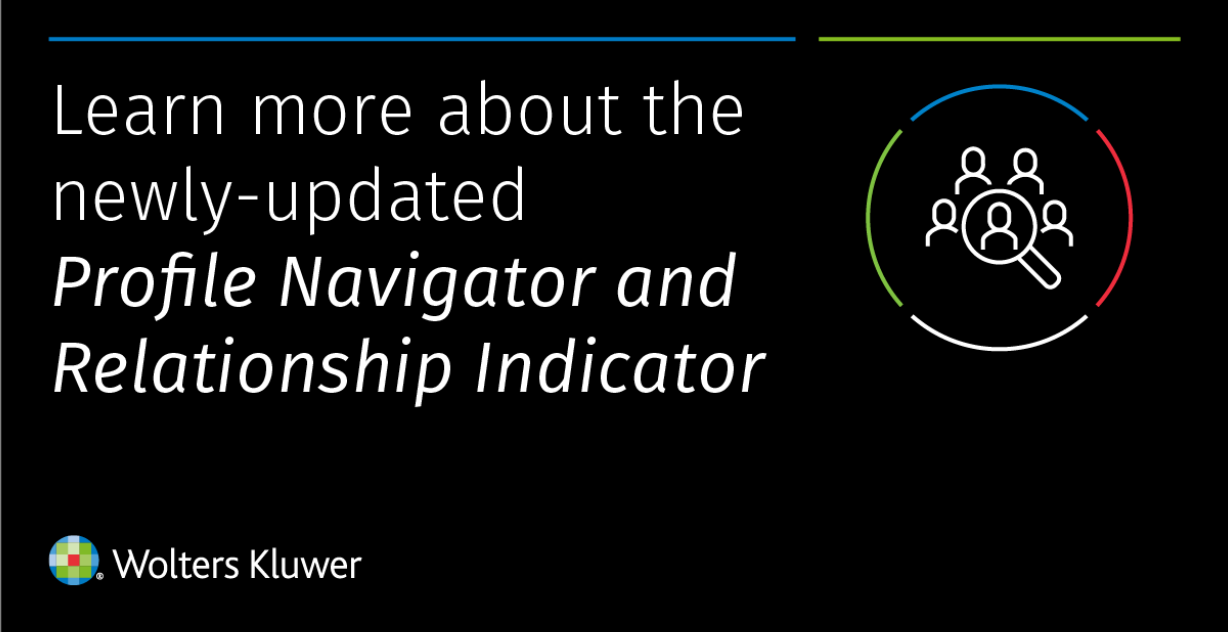

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