

Why Still ICSID?

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A.

Indeed, why still investment arbitration?

Investment arbitration has come under attack from several quarters. The detractors include some Latin American Governments, the Government of Australia, the European Parliament (or some elements therein) and a number of NGOs and other self-appointed guardians of the public interest.

1. One complaint is that investment protection in general and investment arbitration in particular is all very one-sided. That it works **exclusively in favour of investors** without taking due account of the interests of host States. In fact, some have gone as far as suggesting that the system, epitomized by BITs, is imposed upon unwilling developing countries by capital exporting States which in turn are manipulated by big business.

Conspiracy theories are always attractive. But how does this one explain the growing number of such treaties between developing countries? Is it that the States concerned do not fully understand what they are doing? Or is it perhaps the critics of the system who do not fully understand the benefits of investment arbitration?

The most obvious benefit of investment protection is the attraction of a secure legal framework to new investors. I will return to this point in a moment. But there are other benefits to be reaped by host States. Without access to investor-State arbitration, problems may well escalate on the international plane and to turn into disputes between States. By consenting to investor-State arbitration, States get rid of diplomatic protection which can be a source of irritation in their international relations. For a host State being sued before an investment tribunal is a much lesser evil than being leaned upon by the State Department or by the European Commission.

2. Another charge levelled against investment arbitration and against investment treaties is that they have **no measurable effect on** the volume of added investment and on host State **development**.

a. A look at empirical studies by economists on this point demonstrates that views are sharply divided. Some will tell you that investment protection has no statistically relevant

effect on development. Others will insist on exactly the opposite and are quite convinced of its economic benefits.

Perhaps as lawyers we shouldn't be dismissive of differences of opinion in other disciplines. But I wonder how relevant this empirical research really is. Is a quantitative analysis of investment flows really the most relevant yardstick for the utility of a system of adjudication? Is the existence of a functioning non-coercive method for the settlement of disputes not enough justification? I have never heard anyone trying to justify the work of the Law of the Sea Tribunal in terms of additional volume in international shipping.

b. In addition, the debate surrounding the *Malaysian Historical Salvors* case suggests that we should not take an unduly narrow view of the concept of development. Development is not just a matter of investments flows and GDP. It is also reflected in good governance and of the rule of law. Investment arbitration has made a contribution to this form of development that was perhaps not intended by the drafters of the ICSID Convention and of BITs. The availability of legal standards and of judicial remedies for foreign investors has created awareness and demands in local communities that these standards and procedures should be available generally also as a matter of domestic law. The resulting changes may be spill-over effects and incidental benefits. But they are benefits all the same and should not be underestimated.

3. Yet another concern about investment arbitration is that it leads to **regulatory chill**; that tribunals will stop States from taking measures that are necessary for the public good, such as protecting the environment.

a. These concerns are usually voiced in terms of a hypothetical danger that arises from the mere availability to investors of a judicial remedy. Sometimes real cases are used to illustrate this danger although the illustrations are often incomplete. I remember one meeting, where an NGO representative used the *Methanex* case to illustrate the danger posed by investment arbitration to efforts by States to protect the environment. She painted a vivid picture of the risks posed by methanol to water supplies. She described the measures taken by California and the arguments put forward by *Methanex* before the Tribunal attacking these measures. And there she stopped. What she did not tell the audience, mostly unfamiliar with investment law, was the outcome of the case: that the Claimant lost on all counts and that its attacks on the state's measures were to no avail.

This kind of confusion is also reflected in the European Parliament's resolution of 6 April 2011 on the future European International Investment Policy. It states that the USA was among the first states condemned by international arbitrators for a breach of fair and equitable treatment for adopting legitimate regulation. This is simply incorrect. The US was confronted with claims of this type. But it was not condemned.

In my view the regulatory chill argument is unsupported by the available case law. I am not aware of a case where it can be said that an investment tribunal interfered with measures that were genuinely in the public interest. Rather, my impression is that tribunals have reacted with much sensitivity to issues like the protection of the environment.

b. In addition, this fear of interference by tribunals with administrative action is quite out of line with our legal traditions. Judicial control of public administration and regulation is perfectly normal in many States and is part of good governance. Under some legal systems this judicial control is exercised by the ordinary courts. In other systems it is entrusted to special administrative tribunals. But it is unclear why judicial restraints on administrative discretion should become objectionable when exercised by an international tribunal rather than by a domestic court.

c. In the vast majority of cases investment arbitration is not about stopping host States from taking a particular course of action. It is about obtaining compensation or damages. In other words, if the measures taken are indeed in the public interest as perceived by the host State, the question is not whether they will be taken or not. Rather the question is who is to bear the economic consequences the investor or the local community and in what proportion.

4. **Domestic courts** are sometimes put forward as a viable alternative to investment arbitration. In most cases these would be the courts of the country in dispute. But domestic courts have serious limitations. In fact, one of the very reasons for the introduction of investment arbitration was dissatisfaction with the remedies offered by the domestic courts. Let me just make four brief points on the potential of domestic courts in resolving investment disputes.

(1) First and foremost: it is a sad fact that in many countries (probably in the majority of countries) there is no independent judiciary. → *Paulson, Enclaves of Justice*.

(2) Even where courts are not subject to direct interference by the executive there is inevitably a sense of loyalty towards the forum State and its national interest. After all, the court is an organ of the State concerned and the judge is its employee. Transposed to the world of arbitration this situation would be a classical conflict of interest.

(3) In many cases the source of the investor's grievances is domestic legislation. In such a situation the domestic judge has no choice but to apply the domestic law and is in no position to offer a remedy. Under most constitutions the power of the judiciary to review legislation is limited. The standards offered by international law, including BITs may or may not be part of domestic law. Even if they are, they will rarely supersede contrary legislation.

(4) At times, the domestic courts may themselves be the cause of the investor's grievances. Denial of justice is just the most obvious example. Failures to grant full protection and security or even judicial expropriations are not unheard of. It is evident that in situations of this kind the remedy cannot lie with the domestic courts.

B.

Let me now turn to ICSID. Overall, ICSID has been a resounding success. Its current caseload speaks for itself. If ICSID's spiritual father *Aron Broches* could look down to see how his brainchild has matured he would surely be pleased. He would be pleased but also surprised; and he would be concerned by some developments.

Today's conference will address some of these developments. I am particularly looking forward to the panel on summary procedures. The possibility for an expedited procedure in Article 41(5) of ICSID's Arbitration Rules offers the possibility swiftly to dispose of a case. But it could also become an additional step that is taken as a matter of routine and that further extends proceedings.

Let me briefly address three areas where I see problems with ICSID's current practice.

1. One is **annulment**. We will hear about annulment from panel 2. Annulment was designed to be an exceptional remedy to deal with extraordinary emergency situations. And yet, if we look at recent developments we see that there has been an unusual level of activity in this area.

The activity stems from ever more requests for annulment but also from an increased readiness of *ad hoc* committees to annul. The once extraordinary remedy is in danger of becoming a routine feature of many ICSID cases. This is likely to set the stage for ever more requests triggering a kind of bandwagon effect. There will be growing pressure on counsel for losing parties, governments and investors alike, to try this remedy as part of their due diligence. The consequences will be increasing problems for the Secretary-General to find suitable appointees and a general prolongation of proceedings coupled with increased costs. This is likely to affect confidence in the system's ability to reach final decisions in an efficient and economical way.

2. Another area where I see a problem looming is **compliance** with awards – by one State in particular. To my knowledge Argentina has never paid under any of the awards rendered against it and is actively evading efforts at enforcement. The idea behind this strategy appears to be discouraging potential claimants from even trying to pursue their claims.

There is a serious danger inherent in this situation. Once it becomes apparent that an award debtor may disregard its obligations under awards with impunity, the temptation for other States to follow this example is considerable. The potential danger to the effectiveness of the entire system is evident.

Certain steps to persuade Argentina to honour its obligations are being taken. The United States has begun voting against loans to Argentina from the World Bank and IADB. The effectiveness of this step is still unclear and depends not least on the position of other Members of these lending institutions.

[Ad 1. & 2.] I believe that it would be possible to introduce a relatively simple step to address both sets of problems: those arising in the context of annulment and of compliance. This would be the introduction of the requirement for an award debtor seeking annulment to deposit a **security for compliance with the award**. The security could be given e.g. in the form of a bank guarantee. This would not just be a condition for a stay of enforcement under Arbitration Rule 54. (A guarantee of this kind has sometimes been required by *ad hoc* committees). What I am suggesting is that the security would be a condition for the institution of annulment proceedings.

If the *ad hoc* committee declines to annul, the award would be paid under the security. If the award is annulled the security would be returned. In other words, an unsuccessful attempt at annulment would lead to an automatic and swift payment under the award.

An arrangement of this kind would have a dual effect. It would dampen the desire of award debtors to seek annulment. It would also take care of the problem of compliance and enforcement in cases involving annulments. Obviously, such a step would not be an answer to all open questions surrounding annulment and compliance. But it would go some way in addressing the current problems.

In my view such a step would not require an amendment of the Convention which is close to impossible. All it would take is an adjustment of the Arbitration Rules.

3. The third area where I see a problem is conflicting decisions. There has been extensive discussion on the subject of **consistency** or lack thereof and on the related issue of the precedential value of decisions.

A number of suggestions have been made, notably the introduction of an appeals procedure. In fact, ICSID at one time circulated a discussion paper that canvassed the idea of an appeals facility. It seems that the idea has been quietly laid to rest, presumably not least because it is incompatible with the text of the ICSID Convention. Article 53 provides that an award shall not be subject to any appeal or to any other remedy except those provided for in the Convention.

Also, the most effective way to achieve judicial coherence and consistency is not to submit decisions to review and reversal. Appeal presupposes a decision that has been made, that will be attacked for a perceived flaw and that may be revised and repaired.

I believe there is a better solution to this problems and I apologize to those who have heard me say this before. Rather than remedy the damage after it has occurred, it is more sensible to address the problem of inconsistency through preventive action. A method to secure the coherence of case law that has been remarkably successful is to allow for **preliminary rulings** while the original proceedings are still pending.¹ Under such a

¹ The idea has been put forward before: see *G. Kaufmann-Kohler, Annulment of ICSID Awards in Contract and Treaty Arbitrations: Are there Differences?*, in *E. Gaillard/Y. Banifatemi (eds.), Annulment of ICSID Awards* 289 (2004). See also *G. Kaufmann-Kohler, In search of Transparency and Consistency: ICSID Reform Proposal*, TDM, vol. 2, No. 5, p.8 (2005).

system a tribunal would suspend proceedings and request a ruling on a question of law from a permanent body established for that purpose.

This procedure has been applied successfully in the framework of European Community law. It effectively secures the uniform application of European law by domestic courts in all member States through preliminary rulings of the Court of Justice of the European Communities.

Adapted to investment arbitration this method could provide for an interim procedure whenever a tribunal is faced with an important question. Such an important question could be described as a fundamental issue of investment treaty application, a situation where the tribunal wants to depart from a line of previous decisions or where there are conflicting previous decisions. In such a situation the tribunal would be required to suspend proceedings and request a ruling. Once that ruling has been forthcoming, the original tribunal would resume its proceedings and reach an award on the basis of the guidance it has received through the preliminary ruling. This method could become a successful means to ward off inconsistency and fragmentation.

A mechanism of this kind would require the establishment of a central and permanent or semi-permanent body that is charged with the task of giving preliminary rulings. This would leave Article 53 of the ICSID Convention untouched. A preliminary rulings facility could be established either by ICSID's Administrative Council or through a separate treaty. It would not require an amendment of the Convention.

A number of details would have to be worked out. One is under what circumstances a tribunal would request a preliminary ruling and whether it would be under an obligation to do so. Another question would be whether these rulings would be binding upon the tribunal. Not least, the composition of a body charged with giving preliminary rulings would require detailed discussion.