


DOES ICSID NEED AN OVERHAUL



Leading members of the arbitration community consider the legitimacy of ICSID as a mechanism for dispute resolution nearly 50 years since the convention was signed, drawing on prominent Latin American cases for analysis. **Sebastian Perry** reports on their conclusions



Nigel Blackaby and George Kahale

There has been some debate in the arbitration community as to whether ad hoc committees are straying beyond their mandate under article 52 of the ICSID Convention, which sets out the five limited grounds on which an award can be annulled.

The treaty's drafters had intended the non-appealability of an award as the "fundamental touchstone" of the process – and had resisted an effort to introduce "a serious misapplication of the law" as an additional ground for annulment. But **George Kahale III**, a partner at Curtis Mallet-Prevost Colt & Mosle LLP in New York, says that to apply the article 52 standards restrictively would mean that "only an award by an extraordinarily incompetent tribunal composed of three complete clowns" could be annulled. "It is hard to imagine any such tribunal being formed," he adds.

A public interest in annulling?

Kahale, who has a policy of only acting for states in investment treaty cases (several

of which are in Latin America), suggests a more expansive view of annulment powers was needed because ICSID itself has strayed so far beyond its original ambit. The system had been conceived primarily to resolve contractual disputes, not claims under bilateral investment treaties, which were scarce at the time of the convention's signing in 1965.

As **Timothy Nelson** of Skadden Arps Slate Meagher & Flom LLP explains: "The annulment system guarantees integrity of procedure, not consistency of result or of doctrine. The drafters of the annulment procedure weren't expecting that ICSID would become a forum for international treaty disputes under 3,000 largely identical BITs." Apart from contracts, the drafters may even have imagined that domestic statutes governing foreign investment would become a more popular vehicle for ICSID jurisdiction, Nelson suggests, which did not in fact transpire.

Kahale says ICSID suffers from a legitimacy problem. Arbitrators "who are not vested with authority by any

government or international body" are shaping international law – and deciding what are often "bet the country" cases. "Given the magnitude of cases today and the issues they deal with, I would prefer to see us err on the side of annulling a decision that is clearly erroneous than upholding it in the interests of finality."

But **Nigel Blackaby** of Freshfields Bruckhaus Deringer LLP is sceptical of the argument that the public interest inherent in BIT cases should encourage a broadening of annulment powers. "There is a public interest in ensuring that states are held accountable in accordance with proper treaty standards that are applied in a reasonably uniform manner, thereby establishing some degree of legal security for investors."

He adds, "It's very dangerous when ad hoc committees seek to apply their own sense of justice when the rules don't actually permit that, thereby conducting a backdoor review of the merits." Blackaby says it also implies "a certain arrogance on



Doak Bishop



George Kahale



Timothy Nelson

the part of ad hoc committee members to presume they're in a better position to determine what the correct application of the law is than the original tribunal that has heard the evidence."

The rules governing the selection of ad hoc committees makes this presumption especially dubious, he says, as "bitter practice" has shown. Because committee members are chosen entirely from the ICSID list, "in many cases they have far less experience of working as adjudicators of investment treaties than the original tribunal."

Wounding but not killing

There is some criticism of "wounding but not killing" – the practice by some ad hoc committees of severely criticising the reasoning or conduct of the original tribunal but stopping short of annulling the award.

This happened in *CMS v Argentina*, where the ad hoc committee identified serious errors of law in the tribunal's handling of the state's necessity defence but

recognised that this was not a ground on which to annul; and in *Vivendi II*, where the committee upheld the award but excoriated one of the arbitrators, Gabrielle Kaufmann-Kohler, for failing to disclose her position on the board of a bank that held shares in the claimant company.

Blackaby, who was counsel to CMS, says that the committee had "decided to stray into a debate that it recognised was not within its mandate" and had made criticisms that were "not linked to the underlying powers the committee said it had." Such behaviour "undermines the system and jeopardises the enforceability of the award", he says. The criticisms in the CMS decision may even have emboldened the *Sempra* and *Enron* ad hoc committees – which dealt with substantially the same legal issues – to go further by annulling those awards, he suggests.

As for *Vivendi II*, this was "another classic example of a committee overstepping its mandate". An ICSID annulment proceeding is "not supposed to be a forum for legal education or an ethics class. A

committee should decide a case on the basis of the powers they have. End of story."

Time for a rethink?

For Kahale, debates about the proper interpretation of "manifest excess of powers" amount to "word games". More sweeping reform is needed, he urges. "I think we need a complete revamping of the ICSID rules, including the rules on annulment. It's time to take cognisance of the fact that we're in a completely different era to when the convention was drafted. These rules just don't work."

He says the contrast between the outcomes in *CMS*, *Sempra* and *Enron* amply illustrated why "the system is broken". Three ad hoc committees had identified serious shortcomings in the reasoning of three similarly worded awards (Chilean arbitrator **Francisco Orrego Vicuña** was tribunal chair in all three arbitrations) but whereas the *Sempra* and *Enron* awards were annulled, *CMS* was not. In other words, "nine distinguished jurists" had found fault with the CMS approach but the award had

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nonetheless been allowed to stand “in the interests of finality”, says Kahale.

This was part of a wider problem both with ad hoc committees and ICSID tribunals, Kahale says – that the outcome of the case is largely determined by the composition of the panel. “In the vast majority of cases, you have a pretty good idea what your chances are just by who’s on the tribunal. Often the case is effectively over as soon as the tribunal is constituted.”

Nelson is resistant to the idea of institutional reform, and draws a comparison with the US court system. “The Second Circuit is a great court but it gets cases horribly wrong from time to time. Yet no one has a problem with the court as an institution.” The solution is rather to ensure “we are putting the right people on these ad hoc committees”, who know to refrain from making gratuitous dicta.

Blackaby says that “the annulment process as it stands has a lot of problems” but “is probably the best thing that will ever work.” He says it might well be time for a rethink but that it was up to “the community of users, both investors and states” to come together and decide this. However, he is pessimistic about the prospects of the 147 states signed up to ICSID being able to agree on an improvement.

But he notes that the debate over whether the ICSID annulment procedure should be reinvented as an appeal process was “entirely separate” from the question of whether ad hoc committees are correctly interpreting the existing provisions. The *Sempra* and *Enron* annulment proceedings were particularly troubling, he said, because the ad hoc committees allowed Argentina to raise new arguments that it never made during the original arbitrations – raising serious due process concerns. “If anyone was engaged in a manifest excess of power, it was the ad hoc committees themselves,” he says.

A system in crisis?

The debate feeds back to Kahale’s portrait of the ICSID system as suffering a crisis of legitimacy. Kahale says that states do not – as others suggest – have a problem with ICSID because they don’t want to be held accountable for treaty breaches. It is rather that states “don’t like the way in which most of the substantive provisions of the BITs have been interpreted and by whom.”

States are concerned that many arbitrators who decide these cases also act as counsel in other BIT cases involving the very same issues – and that “there are virtually no rules on conflicts of interest” in ICSID proceedings, says Kahale. Many arbitrators are “sitting in key positions on multibillion-dollar cases who would never pass a conflicts test applied to a US Supreme Court judge.”

But **Doak Bishop** of King & Spalding LLP questions how there can be a legitimacy problem when states have willingly signed up to the ICSID Convention and the investment treaties providing for the centre’s jurisdiction, and have thus agreed on the rules governing the appointment of arbitrators.

Kahale acknowledges that the states had consented to the process by enacting the treaties. “But many states are revisiting those decisions, which were made without a full understanding of what they were getting into. There have been some withdrawals from ICSID lately,” he says, referring to Ecuador, Bolivia and most recently Venezuela. “I would not be shocked if there were more.” He says the prevailing view of the 1990s and 2000s that investment treaties were necessary to attract inbound foreign investment and encourage growth was no longer the case in many countries. “We are

seeing a questioning of the entire system of BITs and international arbitration.”

Nelson points out that a state’s withdrawal from ICSID or termination of BITs “tells you everything you need to know about whether that country is a good place to do business”.

The investment treaty system had taken hold “because every previous system to give investors protection has failed badly in some respect apart from international arbitration,” Nelson adds. “That’s the one that has actually delivered justice.” The fact that ICSID’s role in the system had evolved to an extent by accident was no argument against it, he says. “I have no problem with the happenstance that happens to be ICSID.”

Blackaby also takes a different view to Kahale. “There are still more countries joining ICSID than leaving, and those that have left are part of a unified political group.” Even Argentina, the country that has faced the largest number of claims at the centre, has not denounced the convention or terminated any BIT. He also cautions against viewing developing states as simplistic innocents when it comes to investment treaties. Venezuela has “cherry picked” certain investment treaties for termination but “has left in place other BITs that it considers beneficial”. Bolivia too has launched a review of its BITs to determine whether they are really encouraging investment.

“These countries are more sophisticated than we give them credit for,” he says. “I don’t think we can say the investment treaty system itself is in crisis.”

This article was first published in Latin Lawyer’s sister publication Global Arbitration Review, and is based on a panel at the conference GAR Live New York at the end of 2012.