ISSN : 1875-4120
Issue : (Provisional)
Published : October 2012

This article will be published in a future issue of TDM (2012). Check website for final publication date for correct reference.

This article may not be the final version and should be considered as a draft article.

Transnational Dispute Management
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Is Investor-State Arbitration Broken?

by G. Kahale, III

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IS INVESTOR-STATE ARBITRATION BROKEN?

BY: GEORGE KAHALE, III[1]

The short answer is yes. The reasons are many.

A few years ago I went over some of these same issues in an article discussing whether there was a level playing field in investor-state arbitration.[2] The conclusion was that there was a serious problem of the perception of bias in the system, if not actual bias. Given the developments since then in this burgeoning area of practice, this seemed to be the right time to take another look to gauge how much has changed and whether the change has been in the right direction.

This second look is not a statistical study. Although statistical studies have been made, it is highly questionable whether any statistical analysis could ever answer the question posed in this article, at least not without undertaking the arduous task of analyzing in depth the merits of hundreds of investor-state claims.[3] It is my personal experience and that of many of my colleagues, not statistics, that leads me to say that what is needed, and what seems further away now than ever, is a complete overhaul of

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[2] George Kahale, III, *A Problem in Investor/State Arbitration*, 6(1) TRANSNATIONAL DISPUTE MANAGEMENT (March 2009).

[3] *See* Susan D. Franck, *The ICSID Effect? Considering Potential Variations in Arbitration Awards*, 51(4) VIRGINIA JOURNAL OF INTERNATIONAL LAW 825 (2011); Susan D. Franck, *Considering Recalibration of International Investment Agreements: Empirical Insights*, in THE EVOLVING INTERNATIONAL INVESTMENT REGIME: EXPECTATIONS, REALITIES, OPTIONS 73 (J. Álvarez *et al*. eds., Oxford University Press 2011); Susan D. Franck, *An Empirical Analysis of Investment Treaty Awards*, 101 AMERICAN SOCIETY OF INTERNATIONAL LAW PROCEEDINGS 459 (2007); Tony Cole, *The ICSID Effect*, A CANON FOR ARBITRATION AND INVESTMENT LAW, June 6, 2012, *available at* http://arbitrationandinvestmentlaw.wordpress.com/2012/06/06/the-icsid-effect/; Kevin P. Gallagher and Elen Shrestha, *Investment Treaty Arbitration and Developing Countries: A Re-Appraisal* (Global Development and Environment Institute of Tufts University, Working Paper No. 11-01), May 2011, *available at* http://www.ase.tufts.edu/gdae/Pubs/wp/11-01TreatyArbitrationReappraisal.pdf.

investor-state arbitration, top to bottom, beginning to end. The expression "biting the hand that feeds you" may come to mind, but in the long run neither states nor the international arbitration community benefits from sweeping these issues under the rug.

Neutrality. Cost efficiency, flexibility and speed are commonly proclaimed as advantages of international arbitration, but international arbitration never would have gotten off the ground without the perception that it offered a neutral forum for the settlement of transnational disputes. The paradigmatic fact pattern involves a seller from country A selling goods to a buyer in country B across the globe. The disadvantages stemming from each party's distance from and lack of familiarity with the other's jurisdiction lead both to choose arbitration or even more abbreviated expert procedures to settle their disputes, which may be of a technical nature and turn more on fact issues than grand legal principles. Even where difficult legal issues arise, they are rarely of international significance, and no one involved in the process has any interest in developing a body of law for future cases. Many awards never see the light of day, and even if they did, their significance beyond the case at hand is normally nil.

Arbitrators in private, commercial arbitration tend to be chosen not for their views on international law or their political philosophy, but rather for their skill and experience in resolving disputes expeditiously, their commercial and practical sense, and their standing in the arbitration community. While the latter point contributes to the perception of clubbiness, the problem in private, commercial arbitration is not one of bias in the system. Club members are not known for their leanings towards claimants or respondents in general, but rather for the fact of their club membership. For that reason, they are equally likely to be appointed by claimants, respondents or the

appointing authorities. The same unfortunately is not true in investor-state arbitration, where many now believe that there is an unmistakable bias in favor of investors.[4]

Perhaps the clearest indication of bias in the system is that experienced practitioners too often can predict the outcome of an investor-state arbitration based upon the composition of the tribunal, not the merits of the case. In other words, the same facts can lead to different outcomes depending upon the tribunal's proclivities, especially those of the president or chairman of the tribunal, which can be gleaned from prior decisions or writings on the subject of investor-state relations. That is why it is so difficult for experienced claimants' and respondents' counsel to reach agreement on the third arbitrator.

The fact that the outcome can often be predicted based on the composition of the tribunal is not unique to investor-state arbitration. For example, notwithstanding Chief Justice Roberts' decision in this year's health care case,[5] which itself was not as big a surprise as it was said to have been, many U.S. Supreme Court decisions can be predicted by studying the opinions and records of the nine justices. The difference, however, is that those justices are lifetime presidential appointees confirmed by the U.S. Senate to constitute the highest judicial authority in the United States. It is their constitutional function, and their only job, to decide cases. Adherence to a particular

[4] According to a 2010 report of the Productivity Commission in Australia, a range of concerns about investor-state arbitration exists, including: "Institutional bias and conflicts of interest: It has been suggested that there is a 'pro-investor' bias in [investor-state dispute settlement], resulting from the fact that only investors can bring arbitration claims, and the arbitration system relies on investor claims to continue. Further, conflicts of interest can arise in cases where the arbitrator in one case acts as legal counsel in other cases involving the investor." Australian Government Productivity Commission, *Bilateral and Regional Trade Agreements*, Research Report, December 13, 2010, *available at* http://www.pc.gov.au/projects/study/trade-agreements/report, p. 273.

[5] *National Federation of Independent Business v. Sebelius*, 132 S.Ct. 2566, 2012 WL 2427810 (June 28, 2012).

judicial philosophy, liberal or conservative, which is reflected in their legal opinions is not a problem with the system; it *is* the system. Elections do have consequences, and one of them is that the winner gets to nominate federal judges who then have the privilege of going through a grueling and public confirmation process where every aspect of their personal and professional lives is open to scrutiny and debate. That is a far cry from the appointment process in investor-state arbitration.

This state of affairs would be unsatisfactory even if the arbitration community were evenly divided into pro-investor and pro-state camps, but that is not the case. The fact that bias may be impossible to prove through statistical analysis does not mean that the point is invalid. It can be observed at virtually every conference or seminar; it is apparent in writings on investor-state arbitration; and it is reflected in the appointments to arbitral tribunals. If you represent a state in an investor-state arbitration and do not agree on the all-important designation of the third arbitrator, you can only hope that the appointing authority selects someone who is not irretrievably biased in favor of investor positions on critical issues such as the meaning of fair and equitable treatment ("FET") or most-favored-nation ("MFN") clauses in investment treaties, or even the central concept of "investment." The idea of getting an appointment of someone strongly leaning in favor of the normal state position on these or similar issues is as close to a pipedream as it gets.

There has been an interesting debate in the arbitration community as to whether to dispense with party appointments to arbitral tribunals.[6] At least for investor-state arbitration, the focus should be on the appointing authorities, not the parties. They are the ones making the game-changing decisions, choices that can mean a case is over before it starts.

Why is it that there is this perceived bias in the system? There is no easy answer to that question, and there are probably multiple factors at work.

First, even though the club that evolved in private, commercial arbitration is not the same as the one developing in investor-state arbitration, there is substantial overlap,[7] and many of the members grew up in private law firms representing private clients, not states.

Second, although investor-state arbitration is not brand new, the proliferation of cases over the last twenty years under investment treaties, of which there are now around 2700,[8] has effected a sea change, overshadowing commercial arbitration and attracting both practitioners and students all over the world for the first time looking to specialize in the field. When all this began in the 1990s, we were still in the age of

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[6] *See* Jan Paulsson, *Moral Hazard in International Dispute Resolution*, Inaugural Lecture as Holder of the Michael R. Klein Distinguished Scholar Chair, University of Miami School of Law, April 29, 2010, *available at* http://www.arbitration-icca.org/media/0/12773749999020/paulsson_moral_hazard.pdf; Hans Smit, *The Pernicious Institution of the Party-Appointed Arbitrator*, 33 COLUMBIA FDI PERSPECTIVES, December 14, 2010; Alexis Mourre, *Are Unilateral Appointments Defensible? On Jan Paulsson's Moral Hazard in International Arbitration*, KLUWER ARBITRATION BLOG, October 5, 2010; Alyx Barker, *Taking on the "Inner Mafia"*, GLOBAL ARBITRATION REVIEW, October 2, 2012; Alison Ross, *It's Party Time!*, GLOBAL ARBITRATION REVIEW, October 2, 2012.

[7] *See* Anthea Roberts, *Clash of Paradigms: Actors and Analogies Shaping the Investment Treaty System*, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2033167; Gus Van Harten, *Reform of Investor-State Arbitration: A Perspective from Canada*, Draft of commentary, Macdonald Laurier Institute, September 2011, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1960729.

[8] Tillman Rudolf Braun, *Globalization: The Driving Force in International Investment Law*, in THE BACKLASH AGAINST INVESTMENT ARBITRATION 491 (Waibel *et al*. eds., Kluwer Law International 2010), p. 494.

privatization, with the prevailing philosophy being that everything private must be good and the role of the state should be to promote and protect private investment at all costs. Little was heard of the most popular concepts of the 1960s and 1970s, such as Permanent Sovereignty over Natural Resources.[9] In the environment of the 1990s, where states in effect were aligned with investors, it was natural for the pro-investor school of thought to predominate.

Third, there are obviously more investors in the world than states. Investors are not likely to appoint arbitrators who do not sympathize with their position.[10] They may be interested in the same qualities they look for in private, commercial arbitration, but for experienced investors there is another, overarching qualification, which is a candidate's view of international law and investment treaties that strongly favors investor protection at the expense of a state's regulatory powers. On the other hand, it is remarkable how often states will consider appointing arbitrators with pro-investor records, substantially reducing or even eliminating any chance of success in defending the case. That is a function of the overall lack of preparedness of states to defend themselves in investor-state arbitration, a point discussed later in this article.

Conflicts. Conflicts, both real and perceived, generate a lack of confidence in investor-state arbitration. Consistent with the general notion that flexibility in all aspects

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[9] *Permanent Sovereignty over Natural Resources*, G.A. Res. 1803 (XVII), U.N. GAOR, 17th Sess., Supp. No. 17, U.N. Doc. A/5217 (December 14, 1962), p. 15. *See also Declaration on the Establishment of a New International Economic Order*, G.A. Res. 3201 (S-VI), U.N. Doc. A/RES/S-6/3201 (May 1, 1974); *Charter of Economic Rights and Duties of States*, G.A. Res. 3281 (XXIX), U.N. GAOR, 29th Sess., Supp. No. 31, U.N. Doc. A/9631 (December 12, 1974). The word "permanent" seems to have been forgotten.

[10] For a candid discussion of what counsel looks for when considering candidates as arbitrators, *see* Sebastian Perry, *Cairo: Egyptian Perspectives on Arbitral Tribunals*, 7(3) GLOBAL ARBITRATION REVIEW, May 16, 2012 (reporting the views of one practitioner as follows: "He said the most important consideration was to 'select arbitrators to win.' If you get the appointment of an arbitrator wrong, you're done for. No amount of lawyering over the next two years will right that wrong.").

of the system is good, there may be a tendency to believe that conflicts rules should be more relaxed than they are in national courts.[11] Whatever may be the case in private, commercial arbitration, that tendency should be arrested in investor-state arbitration. Yet the trend is actually to the contrary because of the standards deemed to apply in cases at the International Centre for Settlement of Investment Disputes (ICSID).[12]

Many say that the standards of "independent judgment" and "impartiality" embodied in Article 14 of the ICSID Convention, coupled with the provisions of Article 57 of the ICSID Convention requiring a "manifest lack" of those qualities,[13] create a higher bar for disqualification than ordinary conflicts rules.[14] What message does that send? If certain relationships would be unacceptable in most national jurisdictions or even in private, commercial arbitration, should they be allowed in ICSID arbitration,

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[11] *But see KPMG v. ProfilGruppen*, Svea Court of Appeals (Sweden), Decision to Set Aside an Arbitral Award, September 27, 2011 (award set aside because the law firm of one of the party-appointed arbitrators accepted an engagement to represent a client against KPMG).

[12] There seems to be a difference between ICSID cases and cases under the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL), with disqualification of arbitrators being more difficult in ICSID cases. *See* Karel Daele, *Investment Treaty Arbitration: Similar Challenge, Different Outcome*, GLOBAL ARBITRATION REVIEW, March 21, 2012.

[13] Convention on the Settlement of Investment Disputes between States and Nationals of Other States, signed March 18, 1965, entered into force October 14, 1966, 575 U.N.T.S. 159 (ICSID Convention), Articles 14, 57. The English version of Article 14 refers only to "independent judgment," but the Spanish version refers to "impartiality."

[14] *See* Margaret L. Moses, *Reasoned Decisions in Arbitrator Challenges*, 2012 ABA Annual Meeting, August 2-4, 2012, *available at* www.americanbar.org ("Thus, the other members of a tribunal deciding a challenge must ascertain that their fellow arbitrator had a manifest lack of high moral character, a manifest lack of recognized competence in the field, or a manifest lack of independent judgment. This presents a very high bar to disqualification. Arguably, this standard is higher than under most commercial arbitration rules, where arbitrators can be disqualified if there is a reasonable or justifiable doubt about their independence or impartiality."); Christoph Schreuer, THE ICSID CONVENTION: A COMMENTARY (2d ed., Cambridge University Press 2009), p. 1202 ("The requirement that the lack of qualities must be 'manifest' imposes a relatively heavy burden of proof on the party making the proposal."); *OPIC Karimun Corporation v. The Bolivarian Republic of Venezuela*, ICSID Case No. ARB/10/14, Decision on Proposal to Disqualify Arbitrator, May 5, 2011, ¶ 45 ("There thus exists a relatively high burden for those seeking to challenge ICSID arbitrators."); *ConocoPhillips Co. et al. v. The Bolivarian Republic of Venezuela*, ICSID Case No. ARB/07/30, Decision on the Proposal to Disqualify Arbitrator, February 27, 2012, ¶ 56 ("The decisions also recognise that the term 'manifest' in Article 57 means 'obvious' or 'evident' and highly probable, not just possible, and that it imposes a relatively heavy burden on the party proposing disqualification.").

including in megacases involving the most sensitive issues of sovereignty, weighty issues of international law and matters that threaten national security?

Apart from the issue of the standard to be applied, the ICSID rule of having the two non-challenged arbitrators decide a proposal for disqualification should be scrapped. The procedure places the two arbitrators in the most uncomfortable position of deciding on a challenge to one of their peers, making disqualification even less likely to occur. No one enjoys sitting in judgment on such issues, even if there is agreement between the two unchallenged arbitrators. Where there is disagreement, the matter is referred to ICSID for decision, raising the very real prospect that the disqualification proposal will be rejected and the case resumed with all three arbitrators in a less than harmonious atmosphere.[15]

In recent years, disqualification motions have become commonplace in investor-state arbitration, but rarely do they succeed. Some of those motions have been frivolous in nature; others would have warranted disqualification in many jurisdictions, but apparently not in investor-state arbitration. This may reflect the view that flexibility is paramount and rigidity in conflicts rules deprives the system of too many highly qualified players. For states facing claims of previously unheard of dimensions challenging the exercise of their regulatory authority within their own jurisdictions, this flexibility is hardly a laudable feature of investor-state arbitration.

[15] See the discussion in Sebastian Perry, *Cairo: Egyptian Perspectives on Arbitral Tribunals*, 7(3) GLOBAL ARBITRATION REVIEW, May 16, 2012. In a case involving disqualification proposals of the two party-appointed arbitrators, the matter was referred directly to the ICSID Administrative Council. *See Universal Compression International Holdings, S.L.U. v. The Bolivarian Republic of Venezuela*, ICSID Case No. ARB/10/9, Decision of the Proposal to Disqualify Arbitrators, May 20, 2011.

The problem is exacerbated by the fact that it is accepted practice to act as arbitrator in some cases and counsel in others. I recall the view expressed by one appointing authority that while the situation may not be ideal, a practice of not appointing members of private law firms would leave the pool of candidates too small. Could it be that the world is really that short of competent international lawyers willing and able to serve with distinction on international arbitral panels and willing to forego the representation of clients in similar cases? One suspects not.

Given the obvious risks, there should be greater concern about the fact that an arbitrator sitting in a case requiring, for example, a determination of the appropriate FET standard is at the same time arguing that very issue as counsel in another case. Yet some argue that experience as counsel is an indispensable requirement for arbitrators. Useful, perhaps; indispensable, no, particularly if the two roles are performed concurrently, as an increasing number of practitioners and arbitrators have come to realize.[16] Frankly, it is difficult to understand how anyone can be capable of such extraordinary compartmentalization.[17]

Getting Off on the Wrong Foot. The playing field of investor-state arbitration is also tilted by seemingly trivial matters having nothing to do with arbitrators or substance but nevertheless having an impact that is underestimated by the arbitration community. This can be summed up by the expression "getting off on the wrong foot."

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[16] *See* Philippe Sands, *Conflict and Conflicts in Investment Treaty Arbitration: Ethical Standards for Counsel*, in EVOLUTION IN INVESTMENT TREATY LAW AND ARBITRATION 19 (C. Brown & K. Miles eds., Cambridge University Press 2011).

[17] An even more controversial issue is raised by the practice of representing both claimants and respondents in investor-state arbitration. Some have no problem with it, again arguing that the rounded experience makes one a more effective advocate for both. Others do not find it feasible outside of a moot court setting to walk into a hearing room on Monday stridently arguing for an expansive view of FET or MFN and turning around to argue the opposite side on Tuesday in another case.

A claimant always has the advantage at the outset of any arbitration, whether of the commercial or investor-state variety. That is because the claimant dictates the timing of the commencement of the case, presumably after it has hired counsel, done the necessary research and mapped out a strategy, a process that could take months. The respondent may or may not be caught off guard, but even if the claim is anticipated, respondents tend not to do serious preparation until the request for arbitration is imminent or actually filed.[18] That includes factual investigation, legal research, lining up witnesses and experts and, most importantly, selecting an arbitrator.[19]

Much of this disadvantage can be overcome with experienced counsel and normal extensions of time, but under most rules arbitrator appointments still have to be made relatively quickly. For example, the arbitration rules of the ICC, LCIA and UNCITRAL all call for respondent to appoint an arbitrator within 30 days of receipt of the request for arbitration.[20]

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[18] While this is true even for private respondents, the situation is worse in the case of states, as those responsible for handling the defense are often unaware of the underlying facts and sometimes even the existence of the dispute until after the claim is filed, the records of the original transaction or investment may be difficult to find, turnover in personnel is significant and institutional memory is not what it is in the case of the typical private claimant.

[19] This situation can be ameliorated by treaty cooling-off periods or requirements to litigate first in local courts, but some tribunals have actually found it appropriate to ignore such provisions. *See*, *e.g.*, *Abaclat and others v. The Argentine Republic*, ICSID Case No. ARB/07/5, Decision on Jurisdiction and Admissibility, August 4, 2011, ¶¶ 580-590; *Ronald S. Lauder v. The Czech Republic*, UNCITRAL, Final Award, September 3, 2011, ¶¶ 188, 190; *BG Group Plc. v. The Republic of Argentina*, UNCITRAL, Final Award, December 24, 2007. That kind of disregard of treaty provisions led to the setting aside of the *BG* award by a U.S. court. *See Republic of Argentina v. BG Group PLC*, 665 F.3d 1363 (D.C. Cir. 2012). For the opposite view regarding these treaty requirements, see *Murphy Exploration and Production Co. International v. Republic of Ecuador*, ICSID Case No. ARB/08/4, Award on Jurisdiction, December 15, 2010; *Daimler Financial Services AG v. Argentine Republic*, ICSID Case No. ARB/05/1, Award, August 22, 2012.

[20] Rules of Arbitration of the International Court of Arbitration of the International Chamber of Commerce (ICC), as revised on January 1, 2012, Art. 12; London Court of International Arbitration (LCIA) Arbitration Rules, as revised on January 1, 1998, Art. 5.4; UNCITRAL Arbitration Rules, as revised in 2010, Art. 9.

These rules are totally unrealistic and inappropriate for investor-state arbitration, where states are the respondents. Anyone with even the slightest experience in representing states knows that it could take much more than 30 days for a request for arbitration to come to the attention of the right person or department in a government, and that is just the beginning of the process. From there a series of decisions normally have to be made in order to assign responsibilities within the government and engage counsel. In turn, engaging counsel often requires a bidding process, which could take weeks if not months.[21] Even if a bidding process is not required, there may be formal budgetary requirements that must be met before expenditures on the defense can be made. What all this means is that the natural disadvantage of any respondent is magnified when it comes to investor-state arbitration, as states and their counsel have little if any time to consider carefully the first critical decision in any arbitration, the appointment of arbitrator, and little if any time to prepare for the first session, at which certain basic issues, such as the structure and timing of the proceeding, are presented.[22]

At least on this point, the ICSID Arbitration Rules are more hospitable to states. Absent agreement on the method of constitution of the tribunal, the default rule allows a state at least 90 days to come up with its selection, far better than other arbitration

[21] A bidding process is not the ideal way to select counsel. It usually takes too much time, places too much emphasis on cost and is the contracting method least likely to result in the most suitable counsel. In some states, this process is repeated for every case. This stands in stark contrast to the approach of the most battle-ready investors. *See, e.g.*, Alison Ross, *Shell Unveils New Disputes Team*, GLOBAL ARBITRATION REVIEW, May 1, 2012.

[22] The first session should not be taken lightly. Ideally, the outline and strategy for the defense of the case should be thought through before that time in order to be in a position to address intelligently the timing and structure of the proceeding.

rules.[23] Perhaps that is why one hears criticism of this aspect of the ICSID Arbitration Rules at arbitration conferences, the criticism being that it takes too long to form an ICSID tribunal. The criticism should go the other way.

The Drive for Speed. A recurring theme of arbitration conferences and task forces is that speed is good. One of the supposed virtues of arbitration is that it is faster and less expensive than litigation in national courts. Although those attributes may exist to some degree, most practitioners now recognize that they have always been grossly exaggerated. Many cases last for years and legal bills easily soar into the millions of dollars.

This has led to harsh criticism of arbitration and a strong sense that reform is necessary, reform almost always being equated with speed. Unfortunately, the arbitration community has overreacted to the criticism, resulting too often in schedules that sacrifice other important objectives, including the most basic one of arriving at the correct conclusion, for speed.

Once again, the problem is exacerbated in investor-state arbitration. A truncated procedure means even less time for a state respondent to play catch-up. But aside from the disadvantage states face as a result of the difficulty in getting started, there are cases that simply cannot and should not be rushed.

Here two points are worthy of note.

First, many investor-state cases involve jurisdictional issues. In ICSID cases, before the amendment to Arbitration Rule 41(3), tribunals would automatically bifurcate

[23] ICSID Convention, Article 38; ICSID Arbitration Rule 4.

the proceedings to deal with jurisdiction before proceeding to the merits.[24] In 2006, the Rule was amended to leave the issue of bifurcation in the discretion of the tribunal.[25] This, combined with the drive for speed, provides support for claimants opposing bifurcation motions. But that does not mean that the presumption should be against bifurcation. It is one thing to grant to tribunals the discretion to avoid bifurcation where the jurisdictional objections are frivolous or inextricably intertwined with the merits, quite another to reverse the presumption and require states to proceed to the merits notwithstanding the presence of serious jurisdictional objections. In the latter situation, bifurcation remains appropriate.

While it may be that some respondents occasionally raise jurisdictional objections as a delaying tactic, in many instances the objections are serious. As such, they should be dealt with before proceeding to the merits, even if it means risking the prolongation of the case by a year. By definition, a serious objection is not merely a delaying tactic, as a successful jurisdictional objection will shorten the case. Dealing with the preliminary objection at the outset also minimizes the risk that the panel will be tempted to bypass jurisdiction and simply decide the merits, having invested all the time necessary to do both. Bifurcation is appropriate even where the jurisdictional objections

[24] Christoph Schreuer, THE ICSID CONVENTION: A COMMENTARY (2d ed., Cambridge University Press 2009), p. 533 ("Under Arbitration Rule 41(3), as in force until April 2006, the suspension of the proceedings upon the raising of jurisdictional objections was mandatory.").

[25] ICSID Arbitration Rule 41(3) now states: "Upon the formal raising of an objection relating to the dispute, the Tribunal may decide to suspend the proceeding on the merits. The President of the Tribunal, after consultation with its other members, shall fix a time limit within which the parties may file observations on the objection." A similar change was made in the UNCITRAL Arbitration Rules, which used to provide that "[i]n general, the arbitral tribunal should rule on a plea concerning its jurisdiction as a preliminary question" (1976 UNCITRAL Arbitration Rule 21(4)), and now provide that "[t]he arbitral tribunal may rule on a plea referred to in paragraph 2 either as a preliminary question or in an award on the merits." (2010 UNCITRAL Arbitration Rule 23(3)).

do not go to the entire request for arbitration, as trimming down a case before it gets to the end can make a potentially unwieldy arbitration manageable and foster a settlement.

The second point, related to the first, is that arbitrators should not approach a case with preconceived notions of appropriate length. The ICC Arbitration Rules actually provide that awards should be rendered within six months, which of course is virtually impossible in most cases and requires the arbitrators to seek extension after extension, which are routinely granted.[26] No one actually pays attention to the six-month rule, but it does promote the attitude that the first order of business in an arbitration is to fix the end date, irrespective of the issues involved or the amount at stake. It is not uncommon for respondents to be confronted with artificial deadlines created by the belief that a case must, for example, be concluded within two years. Two years may be too long for some cases and too short for others.

Likewise, there is a tendency to assume that hearings should not last more than one or two weeks at most, irrespective of the number or complexity of the issues to be decided or the importance of the case. While tribunals do well to limit the time for argument and cross-examination in cases that do not warrant lengthy hearings, an accelerated schedule and truncated hearing dictated by the drive for speed and congested schedules of individual arbitrators rather than the particularities of the case at hand run the grave risk of a denial of justice. Indeed, given the highly technical nature of certain issues, particularly those relating to quantum, and the voluminous expert reports and documentary evidence submitted by both sides in major arbitrations, it is

[26] Article 30(1) of the ICC Arbitration Rules ("The time limit within which the Arbitral Tribunal must render its final award is six months.").

difficult to see how anyone can truly appreciate all factors necessary to reach the correct decision on the basis of a couple of hours of testimony.

To guard against these risks, it is necessary to change the culture of international arbitration from one in which speed is exalted above all other objectives to one that places a premium on organizing a case in a manner that maximizes the chances of arriving at the correct result. That does not mean that interminable delays should be tolerated. It means that the schedule of both the written pleadings and oral hearings should not be determined based on preconceived notions of the virtue of speed. In addition, tribunals would do well to consider not only bifurcation in appropriate cases, but trifurcation where necessary -- jurisdiction, the merits, and quantum. If an overriding issue emerges within any of the stages, it may be more efficient to treat it separately than to wait until the end, after the submission of thousands of pages of briefs and exhibits and the testimony of fact witnesses and legal, technical and economic experts on the entire case, all or most of which might have been rendered moot by focusing on the one issue.[27]

Finality. The drive for speed is reflected in the arbitration community's attitude toward review of arbitral awards. Everyone knows that awards are not subject to normal appellate review, whether in private commercial arbitration or investor-state arbitration.[28] But there remain grounds on which an award can and should be

[27] In 2006, ICSID introduced Arbitration Rule 41(5), providing for the possibility of early determination of a preliminary objection that a claim is "manifestly without legal merit." Two cases have been dismissed on this ground. *See Global Trading Resource Corp. et al. v. Ukraine*, ICSID Case No. ARB/09/11, Award, December 1, 2010; *Rachel S. Grynberg, Stephen M. Grynberg, Miriam Z. Grynberg, and RSM Production Corporation v. Grenada*, ICSID Case No. ARB/10/6, Award, December 10, 2010.

[28] Convention on the Recognition and Enforcement of Foreign Arbitral Awards, signed June 10, 1958, entered into force June 7, 1959, 330 U.N.T.S. 3 (New York Convention), Article III ("Each Contracting State shall recognize arbitral awards as binding and enforce them in accordance with the rules of procedure of the territory where the award is relied upon, under the conditions laid down in the following articles."); ICSID Convention, Article 53(1) ("The award shall be binding on the parties and shall not be subject to any appeal or to any other remedy except those provided for in this Convention.").

challenged in appropriate cases.[29] Yet the community expresses outrage when such a challenge succeeds.

The most recent example is the decision of the U.S. federal appellate court in the *BG* case.[30] All the court did was hold that the arbitral tribunal had exceeded its powers by refusing to give effect to an express provision in the U.K.-Argentina bilateral investment treaty (BIT) requiring the investor to litigate in Argentine courts before going to international arbitration.[31] That was enough to trigger deep concern about opening the floodgates and unraveling of the system. In the U.S. Supreme Court, the American Arbitration Association, the United States Council for International Business, and a group of twenty academics and practitioners have filed briefs as *amici curiae* supporting BG's position.[32]

In ICSID circles, a debate has been raging on the subject of annulment under Article 52 of the ICSID Convention.[33] Some support the proposition that the grounds for annulment should be narrowly construed to make annulment virtually impossible, even when the original decision is manifestly wrong. Another way of putting it is that in order to be annulled, a decision has to be manifestly the product of a corrupt tribunal or one so incompetent as to be incapable of logical thought. Is that really what we want in investor-state arbitration?

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[29] New York Convention, Article V; ICSID Convention, Art. 52(1).

[30] *Republic of Argentina v. BG Group PLC*, 665 F.3d 1363 (D.C. Cir. 2012).

[31] *Id*. *See* Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Republic of Argentina for the Promotion and Protection of Investments, signed Dec. 11, 1990, entered into force Feb. 19, 1993, 1765 U.N.T.S. 33, Art. 8(2)(a).

[32] *See* Sebastian Perry, *BG v. Argentina Appeal Draws Amicus Briefs*, GLOBAL ARBITRATION REVIEW, September 4, 2012.

[33] *See*, *e.g.*, Sebastian Perry, *Does ICSID Need an Overhaul?,* GLOBAL ARBITRATION REVIEW, October 3, 2012; Promod Nair and Claudia Ludwig, *ICSID Annulment Awards: The Fourth Generation?*, 5(5) GLOBAL ARBITRATION REVIEW, October 28, 2010.

The issue has been crystallized in recent years by three ICSID decisions involving Argentina: *CMS*,[34] *Sempra*,[35] and *Enron*.[36] In all three cases, the original tribunal was chaired by the same arbitrator. And in all three, the tribunals rejected Argentina's defense under Article XI of the U.S.-Argentina BIT (allowing measures taken in the state's "essential security interests")[37] on the ground that the provision embodied the same standard as the state of necessity defense under customary international law as reflected in Article 25 of the Draft Articles on State Responsibility of the International Law Commission (ILC), the conditions of which the tribunals held had not been met.

All three of the *ad hoc* annulment committees considered the original decisions to be incorrect. Yet only the *Sempra* and *Enron* committees decided in favor of annulment. In *CMS*, the original award stood, despite the following remarks of the *ad hoc* committee:

- "The motivation of the award on this point is inadequate."[38]
- "On that point, the Tribunal made a manifest error of law."[39]

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[34] *CMS Gas Transmission Company v. Argentine Republic*, ICSID Case No. ARB/01/8, Decision of the *Ad Hoc* Committee on the Application for Annulment of the Argentine Republic, September 25, 2007 ("*CMS Annulment*").

[35] *Sempra Energy International v. Argentine Republic*, ICSID Case No. ARB/02/16, Decision on the Argentine Republic's Request for Annulment of the Award, June 29, 2010 ("*Sempra Annulment*").

[36] *Enron Creditors Recovery Corp. & Ponderosa Assets, L.P. v. Argentine Republic*, ICSID Case No. ARB/01/3, Decision on the Application for Annulment of the Argentine Republic, July 30, 2010.

[37] Treaty between the United States of America and the Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investment, signed November 14, 1991, entered into force October 20, 1994, S. TREATY DOC. No. 103-2, Art. XI ("This Treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order, the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the Protection of its own essential security interests.").

[38] *CMS Annulment*, ¶ 125.

[39] *Id.*, ¶ 130.

- "The Tribunal. . . simply assum[ed] that article XI and article 25 are on the same footing. In doing so the Tribunal made another error of law."[40]

- "These two errors made by the Tribunal could have had a decisive impact on the operative part of the Award. As admitted by CMS, the Tribunal gave an erroneous interpretation to Article XI."[41]

- "Throughout its consideration of the Award, the Committee has identified a series of errors and defects. The Award contained manifest errors of law. . . . All this has been identified and underlined by the Committee. However the Committee is conscious that it exercises its jurisdiction under a narrow and limited mandate conferred by article 52 of the ICSID Convention."[42]

The unanswered question remains: How is Argentina supposed to feel when it loses a case that nine distinguished international jurists say involved a manifestly incorrect decision?

There is no clear solution to the problem within the framework of the existing system. The Article 52 grounds for annulment are likely to remain the subject of controversy, not so much on the general principles (such as the universally accepted principle that an annulment proceeding is not an appeal), but on the application of those principles in particular cases. That, in turn, will depend largely upon the composition of the particular *ad hoc* committees, which will bring their own predispositions and experiences to the table in drawing fine lines, such as the line between misapplication of the applicable law, generally not considered to be within the annulment ground in

[40] *Id.*, ¶¶ 131-132.

[41] *Id.*, ¶ 135.

[42] *Id.*, ¶ 158.

Article 52(1)(b) of the ICSID Convention,[43] and failure to apply the applicable law, generally considered within Article 52(1)(b).[44]

If one views investor-state arbitration the same as private, commercial arbitration, exalting speed and finality above reaching the right result, this may not be an unsatisfactory state of affairs. In an investor-state case involving the most sensitive issues of sovereignty and having an impact on the development of international law, getting it right is of paramount importance.[45]

It is sometimes argued that the impact of individual decisions is not so important because the principle of *stare decisis* does not apply. However, anyone practicing in this area is aware of the impact individual decisions can have. That is why memorials seem to be getting longer and longer, reaching hundreds of pages, explaining to tribunals what other tribunals have done in cases that supposedly have no *stare decisis* effect. In any event, *stare decisis* aside, it is of little comfort to a state suffering a billion dollar award that is manifestly erroneous on the facts and the law that the decision is not technically binding on other tribunals.

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[43] In *Sempra*, the *ad hoc* committee was able to say, based on a passage in the original decision indicating that it was unnecessary to consider the defense under Article XI of the U.S.-Argentina BIT, that the tribunal had failed to apply the applicable law and thus manifestly exceeded its powers. *Sempra Annulment*, ¶¶ 185, 229. It did note, however, the possibility that a decision purportedly applying the applicable law could be so wrong as to also amount to a manifest excess of powers: "As a general proposition, this Committee would not wish totally to rule out the possibility that a manifest error of law may, in an exceptional situation, be of such egregious nature as to amount to a manifest excess of powers." *Sempra Annulment*, ¶ 164.

[44] At the request of the Philippines, which was upset over the annulment of the award in *Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines*, ICSID Case No. ARB/03/25, the ICSID Secretariat produced a comprehensive review of annulment decisions. The report is a useful compilation of decisions and is available on the ICSID website. ICSID, *Background Paper on Annulment For the Administrative Council of ICSID*, August 10, 2012.

[45] *See* Gabriela Alvarez Avila, *ICSID Annulment Procedure: A Balancing Exercise Between Correctness and Finality*, in ARBITRATION ADVOCACY IN CHANGING TIMES: ICAA CONGRESS SERIES NO. 15 289 (Albert Jan van der Berg ed., Wolters Kluwer Law & Business 2011).

The Infrastructure of Investor-State Arbitration. None of the foregoing would amount to much without the infrastructure of investor-state arbitration. This is the network of approximately 2700 investment treaties, almost all of which provide for international arbitration. ICSID is the mechanism of choice in these treaties, but alternatives, such as UNCITRAL arbitration, are often also provided.

Investment treaties gathered steam in the 1990s, in the age of privatization, around the same time that many states were entering into unfavorable and unsustainable long-term agreements for the exploitation of natural resources.[46] In far too many cases, those negotiating the treaties had little idea of the monster they were creating in the form of unclear provisions that could be molded by international arbitral tribunals set up pursuant to the treaties' arbitration provisions into a set of state obligations far beyond what the negotiators intended.[47] Even where the negotiators

[46] Before 1990, there were less than 400 BITs. Rudolf Dolzer and Margrete Stevens, BILATERAL INVESTMENT TREATIES (Martinus Nijhoff Publishers 1995), Annex II.B. The number of cases has increased dramatically in accordance with the number of BITs signed. *See* Roberto Echandi, *Bilateral Investment Treaties and Investment Provisions in Regional Trade Agreements: Recent Developments in Investment Rulemaking*, in ARBITRATION UNDER INTERNATIONAL INVESTMENT AGREEMENTS: A GUIDE TO THE KEY ISSUES 3 (Katia Yannaca Small ed., Oxford University Press 2010), p. 5 ("From 1987—when the first investor-state dispute based on a BIT was recorded under the arbitral proceedings of [ICSID] of the World Bank—until April 1998, only 14 BIT-related cases had been brought before ICSID, and only two awards and two other settlements had been issued. However, since the late 1990s, the number of cases has grown enormously. The cumulative number of treaty-based cases has risen to at least 290 by the end of 2007, with 182 brought before ICSID (including ICSID's Additional Facility) and more than 100 before other arbitration fora.").

[47] According to a GAR article last year, Pakistan's former Attorney General spoke candidly about his country's experience with bilateral investment treaties at a conference in Mauritius, admitting that, in the past, they were signed "without any negotiation or consideration of the consequences." He reportedly went on to say that most of the treaties were signed because a dignitary was visiting a foreign country or vice versa and the two governments "couldn't think of any other document to sign," and that a BIT "provides a good photo opportunity." Alison Ross, *Former Pakistan AG Opens Up About Investment Treaties*, GLOBAL ARBITRATION REVIEW, January 17, 2011. *See also* Department of Trade and Industry of the Republic of South Africa, *Bilateral Investment Treaty Policy Framework Review: Executive Summary of Government Position Paper*, GOVERNMENT GAZETTE NO. 32386, June 2009 ("[T]he Executive entered into agreements that were heavily stacked in favour of investors without the necessary safeguards to preserve flexibility in a number of critical policy areas. In reviewing the *travaux préparatoires* of the various BITs entered into at the time, it became apparent that the inexperience of negotiators at that time and the lack of knowledge about investment law in general resulted in agreements that were not in the

themselves appreciated the potentially expansive nature of the commitments being negotiated, it is highly unlikely that the political decision-makers did. That situation exists still today in many countries.

Two of the most abused concepts in investment treaties are FET and MFN. This is not the place for an in-depth analysis of either concept or of the pros and cons of the expansive and restrictive interpretations under the various formulations appearing in investment treaties. The point here is that it is hard to believe the negotiators of all or even most of the roughly 2700 BITs understood the fine distinctions between a treaty containing a so-called free-standing FET clause and an FET clause tied to customary international law.[48] Nor is it likely that they envisaged the extent to which MFN clauses could be used, or abused, to import both standards of treatment and procedural provisions considered more favorable in other treaties.[49]

Apart from the risks posed by the inclusion of unclear substantive provisions that are susceptible to differing interpretations, the last few years have provided vivid illustrations of treaty-shopping and the potential for treaty abuse. It is now commonly

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long term interest of the [Republic of South Africa]."); Lauge N. Skovgaard Poulsen, *Sacrificing Sovereignty By Chance: Investment Treaties, Developing Countries, and Bounded Rationality*, London School of Economics and Political Science, June 2011, p. 3 ("By overestimating the benefits of BITs and ignoring the risks, developing country governments often saw the treaties as merely 'tokens of goodwill.' Many thereby sacrificed their sovereignty more by chance than by design, and it was typically not until they were hit by their first claim, officials realised that the treaties were enforceable in both principle and fact."); Lauge N. Skovgaard Poulsen, *The Politics of South-South Bilateral Investment Treaties*, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1674825, pp. 19-20.

[48] *See* United Nations Conference on Trade and Development (UNCTAD), *Bilateral Investment Treaties 1995-2006: Trends in Investment Rulemaking*, U.N. Doc. UNCTAD/ITE/IIT/2006/5 (2007).

[49] In addition to the issues customarily associated with MFN clauses in investor-state arbitration, it may broadly be stated that the MFN concept is difficult to apply in any context. For example, corporate lawyers understand the difficulty in applying contractual MFN clauses on a piecemeal basis, without considering whether the second contract is really more favorable than the first when viewed as a whole or when the entirety of the consideration given in exchange for a benefit is taken into account. The latter exercises can involve complex issues of valuation that are best avoided by simply refusing to agree to an MFN clause.

accepted that, absent treaty provisions barring the practice, an investor from a non-treaty country may structure its investment through a treaty jurisdiction even though it lacks any meaningful connection with it. This is the investment law version of what tax lawyers used to call the "Dutch sandwich," referring to the practice of non-Dutch investors taking advantage of the vast network of Dutch tax treaties to structure investments in third countries through The Netherlands.[50] With this mechanism, 2700 investment treaties are not really necessary, as one Dutch treaty with the host state could suffice to cover investors from any country in the world, clearly not what states had in mind when entering into BITs.[51]

More recently, this expansive view of jurisdiction has been tested in the context not only of investments structured from the outset through a treaty jurisdiction, but of investments restructured into a treaty jurisdiction when trouble arose. The moment at which it is too late to effect such restructuring is a hotly disputed issue,[52] but states with good reason cannot understand how a non-treaty investor can acquire treaty protection

[50] George Kahale, III, *The New Dutch Sandwich: The Issue of Treaty Abuse*, 48 COLUMBIA FDI PERSPECTIVES, October 10, 2011.

[51] Some treaties address this issue by providing for the possibility of denying the treaty's benefits to investors lacking a sufficient connection to a treaty jurisdiction. *See, e.g.*, United States-Australia Free Trade Agreement, signed May 18, 2004, entered into force January 1, 2005, 118 STAT. 919, Art. 11.12(2) ("A Party may deny the benefits of this Chapter to an investor of the other Party that is an enterprise of such other Party and to investments of that investor if the enterprise has no substantial business activities in the territory of the other Party and persons of a non-Party, or of the denying Party, own or control the enterprise."); Energy Charter Treaty, signed December 17, 1994, entered into force April 16, 1998, 2080 U.N.T.S. 95, Art. 17 ("Each Contracting Party reserves the right to deny the advantages of this Part to: (1) a legal entity if citizens or nationals of a third state own or control such entity and if that entity has no substantial business activities in the Area of the Contracting Party in which it is organized").

[52] *Phoenix Action Ltd. v. The Czech Republic*, ICSID Case No. ARB/06/5, Award, April 15, 2009, ¶ 144; *Mobil Corporation et al. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB/07/27, Decision on Jurisdiction, June 10, 2010, ¶ 205; *Pac Rim LLC v. Republic of El Salvador*, ICSID Case No. ARB/09/12, Decision on Jurisdiction, June 1, 2012, ¶ 2.99; Zachary Douglas, THE INTERNATIONAL LAW OF INVESTMENT CLAIMS (Cambridge University Press 2009), ¶¶ 542, 551, 552.

simply by restructuring an unprotected investment into a treaty jurisdiction in anticipation of litigation.

There is a tendency in the arbitration community to think that frustration with arbitral decisions reflecting an expansive view of jurisdiction and state responsibility comes only from states of a certain political persuasion facing numerous investor claims. The evidence is to the contrary. The clearest example of such frustration came in 2001 in the FET interpretation issued by the North American Free Trade Agreement (NAFTA) states: Canada, Mexico, and the United States.[53] Upset at FET decisions reaching beyond the minimum standard of treatment under customary international law, the NAFTA states decided to clarify what they meant by the FET provision in Article 1105 of NAFTA:

> 1. Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.
>
> 2. The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.[54]

The revised model U.S. and Canadian BITs left nothing to chance. The 2004 U.S. model made explicit what was supposed to be the case all along according to the NAFTA Interpretation.[55] It provided as follows:

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[53] NAFTA, Free Trade Commission, *Notes of Interpretation of Certain Chapter 11 Provisions*, July 31, 2001.

[54] *Id.*

[55] The U.S. State Department's official description of the 1994 U.S. Model BIT stated that the "fair and equitable treatment" provision was intended as the "minimum standard of treatment based on customary international law." *See Description of the U.S. Model Bilateral Investment Treaty (BIT)*, Submitted by the State Department, July 30, 1992, Hearings before the Committee on Foreign Relations, United States Senate, 102nd Congress, 2d Session, Aug. 4, 1992, S. HRG 102-795, p. 62. *See also* J. C. Thomas,

> 2. For greater certainty, paragraph 1 prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to covered investments. The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by that standard, and do not create additional substantive rights.[56]

Similarly, the Canadian model BIT provides as follows:

> 1. Each Party shall accord to covered investments treatment in accordance with the customary international law minimum standard of treatment of aliens, including fair and equitable treatment and full protection and security.
>
> 2. The concepts of "fair and equitable treatment" and "full protection and security" in paragraph 1 do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.[57]

Reflections on Article 1105 of NAFTA: History, State Practice and the Influence of Commentators, 17 ICSID REVIEW–FOREIGN INVESTMENT LAW JOURNAL 21 (2002), pp. 49-50 and n. 78 (noting that both before and after the entry into force of NAFTA, the State Department transmitted a series of BITs to the Senate for approval, stating that the obligation to provide "fair and equitable treatment" set out "a minimum standard of treatment based on customary international law."); Kazakhstan Bilateral Investment Treaty, Letters of Transmittal along with the Treaty, September 7, 1993, SENATE TREATY DOC. 103-12 ("Article II contains the Treaty's major obligations with respect to the treatment of investment. . . . [P]aragraph [2] sets out a minimum standard of treatment based on customary international law."); Ecuador Bilateral Investment Treaty, Letters of Transmittal along with the Treaty, U.S. State Department, 103d Congress, 1st Session, September 7, 1993, SENATE TREATY DOC. 103-15 ("Paragraph 3 guarantees that investment shall be granted 'fair and equitable' treatment. . . . This paragraph also sets out a minimum standard of treatment based on customary international law"); Andrew Newcombe and Lluís Paradell, LAW AND PRACTICE OF INVESTMENT TREATIES: STANDARDS OF TREATMENT (Wolters Kluwer 2009), p. 268 ("There is some state practice amongst major capital exporting states suggesting that fair and equitable treatment was viewed as reflecting, and as synonymous with, the minimum standard of treatment. For example, some elements of US, UK, Swiss and Canadian treaty practice suggest that these states considered that fair and equitable treatment reflected the minimum standard of treatment.").

[56] 2004 U.S. Model BIT, Art. 5. The 2004 Model BIT also included an Annex A, which stated that the parties "confirm their shared understanding that 'customary international law' . . . results from a general and consistent practice of States that they follow from a sense of legal obligation." This view has been repeated in the 2012 U.S. Model BIT. *See also North Sea Continental Shelf*, International Court of Justice, Judgment, February 20, 1969, in I.C.J. REPORTS 3 (1969), ¶¶ 74, 77 (outlining how custom is developed in international law).

[57] Canada's 2004 Model Foreign Investment Promotion and Protection Agreement, Art. 5.

The U.S. and Canadian experience inspired similar expressions of frustration in Europe. A committee of the European Parliament on international trade reported as follows in 2011:

> The USA and Canada, which were among the first states to suffer as a result of excessively vague wording in the NAFTA agreement, have adapted their BIT model in order to restrict the breadth of interpretation by the judiciary and ensure better protection of their public intervention domain. The EU should therefore include in all its future agreements a specific clause laying down the right of the EU and [Member States] to regulate . . . . Moreover, standards of protection should be strictly defined, in order to avoid abusive interpretations by international investors. In particular . . . . fair and equitable treatment must be defined on the basis of the level of treatment established by international customary law. . . .[58]

Last year, Australia got upset over challenges to its regulatory authority in the field of cigarette packaging and decided that it would no longer agree to international arbitration:

> The Gillard Government supports the principle of national treatment – that foreign and domestic businesses are treated equally under the law. However, the Government does not support provisions that would confer greater legal rights on foreign businesses than those available to domestic businesses. Nor will the Government support provisions that would constrain the ability of Australian governments to make laws on social, environmental and economic matters in circumstances where those laws do not discriminate between domestic and foreign businesses. The Government has not and will not accept provisions that limit its capacity to put health warnings or plain packaging requirements on tobacco products or its ability to continue the Pharmaceutical Benefits Scheme.

[58] European Parliament, Committee on International Trade, *Report on the Future European International Investment Policy (2010/2203(INI))*, Report No. A7-0070/2011, March 22, 2011, Explanatory Statement, pp. 11-12.

> In the past, Australian Governments have sought the inclusion of investor-state dispute resolution procedures in trade agreements with developing countries at the behest of Australian businesses. The Gillard Government will discontinue this practice.[59]

This year, India has joined the ranks of the disenchanted, indicating its intention "to abolish the investor-state dispute system and renegotiate FTAs."[60] Reportedly, the reason for India's decision to abandon the investor-state dispute system is its "first-hand experience with the potential threat foreign companies pose to public policy on the grounds of investment agreement violations. Since January, multinational corporations have been waging an assault on Indian government policy."[61]

And in Latin America, over the last five years, Bolivia, Ecuador and Venezuela have all withdrawn from ICSID, with Argentina and Nicaragua threatening to do the same.[62] Some believe that this trend will not continue because countries need investment treaties to attract foreign investment, but not all countries share that view.

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[59] Department of Foreign Affairs and Trade of Australia, *Gillard Government Trade Policy Statement: Trading our Way to More Jobs and Prosperity*, April 2011, *available at* http://www.dfat.gov.au/publications/trade/trading-our-way-to-more jobs-and-prosperity.pdf. *See also* Australian Government Productivity Commission, *Bilateral and Regional Trade Agreements*, Research Report, December 13, 2010, Chapter 14, *available at* http://www.pc.gov.au/projects/study/trade-agreements/report.

[60] Jung Eun-Joo, *India Plans to Abolish ISD Clause in FTAs*, BILATERALS.ORG, April 6, 2012.

[61] *Id*. *See also* K.M. Gopakumar, *India: Investment Treaties Stifle Public Policy Objectives*, TWN, April 24, 2012.

[62] *Bolivia Submits a Notice under Article 71 of the ICSID Convention*, ICSID NEWS RELEASE, May 16, 2007; *Ecuador Submits a Notice under Article 71 of the ICSID Convention*, ICSID NEWS RELEASE, July 9, 2009; *Venezuela Submits a Notice under Article 71 of the ICSID Convention*, ICSID NEWS RELEASE, January 26, 2012; *Promueven el Retiro de la Argentina del Ciadi*, EL DIARIO, April 30, 2012; Bill submitted before the Chamber of Deputies of the Argentine Congress on March 21, 2012, to repeal Law No. 24.353 that approved Argentina's adhesion to the ICSID Convention, File No. 1311-D-2012, *available at* http://www1.hcdn.gov.ar/proyxml/expediente.asp?fundamentos=si&numexp=1311-D-2012; Sergey Ripinsky, *Denunciation of the ICSID Convention and BITs: Impact on Investor-State Claims*, UNCTAD, 2 IIA ISSUE NOTE, December 2010, n. 4.

For example, Brazil does not seem to have trouble attracting foreign investment even though it has not ratified a single BIT and is not a member of ICSID.[63]

In 2010, a group of professors joined in a declaration heard around the world, the "Public Statement on the International Investment Regime."[64] They sounded a warning about the ever-expanding interpretations of FET, MFN and other provisions of investment treaties, stating:

> 5. Awards issued by international arbitrators against states have in numerous cases incorporated overly expansive interpretations of language in investment treaties. . . . This is especially evident in the approach adopted by many arbitration tribunals to investment treaty concepts of corporate nationality, expropriation, most-favoured-nation treatment, non-discrimination, and fair and equitable treatment, all of which have been given unduly pro-investor interpretations at the expense of states, their governments, and those on whose behalf they act.[65]

Are the adherents to that declaration right or wrong about investor-state arbitration? The debate goes on, but there is no denying that a large segment of the international law community, and of course the principal actors in international law, the states themselves, seem to find merit in the Public Statement. If *stare decisis* does not apply, the prior decisions complained of should not preclude a new wave of decisions swinging the pendulum back the other way, but that would require more frequent

[63] Researchers also do not all agree that investment treaties play a significant role in attracting foreign direct investment. *See* Gus Van Harten, *Five Justifications for Investment Treaties: A Critical Discussion*, 2(1) TRADE LAW AND DEVELOPMENT 19 (2010), p. 30 ("Doubts about this justification for investment treaties are supported by the fact that empirical research to date is at best mixed on the issue of whether the treaties actually encourage investment. I have reviewed eight empirical studies on the proposition that they do encourage investment, of which five found little or no positive connection between the conclusion of investment treaties and an increase in foreign direct investment.").

[64] *Public Statement on the International Investment Regime*, August 31, 2010, *available at* http://www.osgoode.yorku.ca/public_statement. *See also* M. Sornarajah, *The Neo-Liberal Agenda in Investment Arbitration: Its Rise, Retreat and Impact on State Sovereignty*, in REDEFINING SOVEREIGNTY IN INTERNATIONAL ECONOMIC LAW 199 (W. Shan *et al*. eds., Hart Publishing 2008).

[65] *Public Statement on the International Investment Regime*, August 31, 2010.

appointments by appointing authorities of adherents to a school of thought that has not been popular over the last twenty years in the arbitration community.

Megacases. Is this making a mountain out of a molehill? One could make that argument if little were at stake in investor-state arbitration. That is not the case.

In recent years, we have witnessed the phenomenon of the megacase. Billion dollar claims were virtually unheard of twenty years ago. Now they seem to be commonplace. The sheer size of these cases magnifies every defect in the system into a problem requiring serious attention. One cannot simply say that *most* of the time we get it right. We have to get it right *all* of the time when what is at stake is not merely an academic exercise, but claims in excess of the gross domestic product of many nations.[66] One cannot treat a multibillion dollar investor-state claim in the same manner as an ordinary commercial claim of a couple of hundred thousand dollars or even a few million dollars, with the same methods of selecting arbitrators, the same or lesser rules of conflicts as are applicable in private, commercial arbitration, and the same drive for speed and finality.

What makes the situation more dangerous is the increasing tendency of claimants to grossly exaggerate their claims. Again, it is not unusual for claimants to exaggerate claims. It happens all the time, both in commercial arbitration and in national courts. The combination of the practice of claiming enormous amounts in punitive damages and a jury system spinning out of control helped give U.S. litigation a bad name. Runaway juries are not the problem in arbitration, but the practice of claim exaggeration is still prevalent.

[66] *See* The World Bank, World Development Indicators Database, *Gross Domestic Product 2011*, *available at* http://databank.worldbank.org/databank/download/GDP.pdf.

The idea of claim exaggeration may have its roots in a certain type of negotiation strategy, according to which one starts with a very extreme position and then retreats to a position that is a little less extreme, feigning reasonableness in the process. In the corporate and diplomatic worlds, that can be a risky negotiating strategy, leading to loss of a deal. It nonetheless remains a strategy that experience tells us is used all too frequently.

How does this translate into arbitration? Simply stated, unlike judges, arbitrators have a tendency to compromise. There may be any number of reasons for that. First, the traditional notion that arbitration is by its nature a less formal, more flexible mechanism for dispute resolution can create a favorable environment for compromise, particularly among club members. Second, the absence of normal appellate procedures makes it easier to trade points and come up with an award that may not make a lot of sense legally but nonetheless can withstand attack. And third, some in the arbitration community seem to place a premium on unanimity, which can be difficult to achieve without compromise, particularly in a system in which two of the three members of the tribunal are appointed by the parties. After all, parties do not select arbitrators thinking they are more likely to be supportive of the other side than their own. If for all these reasons and others the spirit of compromise is in the air, as most practitioners think it is, then it is to be expected that some will be tempted to bring claims that would not withstand judicial scrutiny and others will try to set themselves up in the most advantageous position for compromise by imaginatively inflating claims.

The celebration of unanimity is a curious phenomenon that can lead to anomalous results. It may be true that most dissents are made by arbitrators appointed

by losing parties,[67] but that does not mean dissents are a blight on the system. In investor-state arbitration especially, if by the luck of the draw two of the three arbitrators have strong pro-investor views, one appointed by the investor and the other by the appointing authority, and the third arbitrator, appointed by the state, firmly believes that international law has already been stretched to the breaking point to accommodate investors, should the latter compromise on matters of principle or acquiesce in the majority decision just to achieve unanimity? That approach may not be so bad in commercial arbitration, but it can be highly destructive in investor-state arbitration, where important principles are at stake for the state concerned and, given that decisions are cited as precedents notwithstanding the inapplicability of *stare decisis*, for others as well. Whatever the benefits of unanimity may be, they do not justify depriving the international law community of the benefit of a well-reasoned and highly illuminating dissent such as the minority opinion in the *Abaclat* case.[68] We are better off encouraging such dissents than fostering an environment that promotes artificially unanimous opinions that leave us wondering how the tribunals could possibly have arrived at their conclusions.

Just this month, we got a reminder of both the risks posed by a system that vests enormous discretion in arbitrators and the need to make sure that the drive for

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[67] *See* Albert Jan van den Berg, *Dissenting Opinions by Party-Appointed Arbitrators in Investment Arbitration*, in LOOKING TO THE FUTURE: ESSAYS ON INTERNATIONAL LAW IN HONOR OF W. MICHAEL REISMAN 821 (M. Arsanjani *et al.* eds., Koninklijke 2011).

[68] The dissent referred to "the tendency of certain ICSID tribunals to consider any limitation on their jurisdiction - whether inherent in the adjudicative function or carefully negotiated and stipulated in the ICSID Convention or the BITs, to protect the legitimate interests of State parties - as an obstacle in the way of achieving the object and purpose of these treaties, which they interpret as being exclusively to afford maximum protection to investment, notwithstanding the legitimate interests of the host State." *Abaclat and Others v. Argentine Republic*, ICSID Case No. ARB/07/5, Dissenting Opinion of Professor Georges Abi-Saab, October 28, 2011, ¶ 272.

unanimity does not suppress views irreconcilable with those that happen to be in the majority. In the long-awaited decision in the *Occidental* megacase,[69] the ICSID tribunal found that the international oil company had improperly transferred a 40% interest in an oil project in Ecuador without the required governmental approval. The law provided for a remedy of termination of the contract in the event of an unauthorized transfer, and that is what the Government did, but the tribunal held that Ecuador nevertheless was liable because the remedy was "disproportionate." The fact that the company had made the unauthorized transfer was taken into consideration in quantum, reducing the damages by 25%, *i.e.*, several hundred million dollars. The award of approximately US$1.77 billion plus interest was not unanimous, and the scathing dissent used strong language that will no doubt reappear in the annulment proceeding Ecuador has already filed.[70]

Ecuador has already withdrawn from ICSID, but the *Occidental* award will fuel more discontent there and likely in other states as well. Indeed, one can imagine what would be the uproar in the U.S. Congress if an ICSID tribunal were to render an award of a few billion dollars against the United States for exercising its sovereign right to regulate the oil industry, or for exercising an express right granted under U.S. law to

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[69] *Occidental Petroleum Corporation et al. v. The Republic of Ecuador*, ICSID Case No. ARB/06/11, Award, October 5, 2012.

[70] *See* ICSID website, *Occidental* Case Details, Annulment Proceeding; Sebastian Perry, *Ecuador Vows to Fight Oxy Award*, GLOBAL ARBITRATION REVIEW, October 8, 2012. According to the dissent in *Occidental*, the calculation of damages rested on "grossly incorrect legal bases," the majority's analysis of a key legal issue was "based on a total lack of reasons, with the consequence that I was not able to follow the 'reasoning' from point A to point B, as well as gross errors of law in the purported interpretation of the content of Ecuadorian law," and the award in another aspect showed a "manifest excess of power." *Occidental*, Dissenting Opinion of Professor Brigitte Stern, ¶¶ 1, 5. Compare these observations to the text of Article 52(1)(b) and (e) of the ICSID Convention, setting forth two of the grounds for annulment (manifest excess of powers and failure to state reasons), as well as the annulment decisions discussing the meaning of failure to state reasons. *See*, *e.g.*, *Maritime International Nominees Establishment v. Republic of Guinea*, ICSID Case No. ARB/84/4, Decision on Annulment, December 22, 1989, ¶ 5.09 (framing the test for failure to state reasons as whether one can "follow how the tribunal proceeded from Point A to Point B, and eventually to its conclusion"); ICSID, *Background Paper on Annulment For the Administrative Council of ICSID*, August 10, 2012, pp. 47-49.

terminate an oil lease for material breach of its terms. Not long ago the press reported the settlement of a dispute between the U.S. Government and Exxon (together with Statoil) over the Government's refusal to extend the exploration period on an oil lease.[71] Exxon had commenced litigation, naturally in U.S. courts. But that is precisely the kind of case that a foreign company might be tempted to bring to international arbitration under a BIT, claiming that the Government's exercise of its rights violated any number of provisions. It would only take one award to trigger Congressional cries of impermissible infringement upon U.S. sovereignty and calls for the termination of U.S. commitments to submit to any foreign jurisdiction.

Third Party Funding. As in other fields of endeavor, those who feel they can evaluate risk and play the game better than others swoop in to make a profit. Few would have predicted a few years ago that this would be the case with investor-state arbitration, but now it is.

Much has already been said about the growth of third party funding in investor-state arbitration.[72] One can wax eloquent about the virtues of a mechanism that allows claimants to obtain justice that might otherwise be out of reach due to lack of funding, but in a system so fraught with problems, third party funding is a complication investor-state arbitration can do without. From the standpoint of states, the credibility of investor-state arbitration is not enhanced by this type of investment activity.

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[71] *Exxon, Government Settle Dispute over Gulf Leases*, ASSOCIATED PRESS, January 7, 2012, *available at* http://finance.yahoo.com/news/exxon-government-settle-dispute-over-202503725.html.

[72] *See, e.g.*, Alison Ross, *The Dynamics of Third-Party Funding*, 7(1) GLOBAL ARBITRATION REVIEW (2012); Clive Bowman, Kate Hurford & Susanna Khouri, *Third Party Funding in International Commercial and Treaty Arbitration – A Panacea or a Plague? A Discussion of the Risks and Benefits of Third Party Funding*, 8(4) TRANSNATIONAL DISPUTE MANAGEMENT (2011); Bernardo Cremades, Jr., *Third Party Litigation Funding: Investing in Arbitration*, 8(4) TRANSNATIONAL DISPUTE MANAGEMENT (2011); Maya Steinitz, *Whose Claim is This Anyway? Third Party Litigation Funding*, 8(4) TRANSNATIONAL DISPUTE MANAGEMENT (2011).

Third party funding is a bit like drilling for oil. You know you will be drilling a lot of dry holes, but one discovery can make it all worthwhile. Also like the oil industry, where the exploration costs pale in comparison to the cost of full development of a field, it does not take much to commence an arbitration and see how it develops, including both the composition of the tribunal and the state's degree of preparedness to defend itself. This means that an investor losing an investment of a few hundred thousand dollars through some combination of governmental regulations or other action, adverse market conditions, incompetence and plain bad luck may find itself holding a marketable asset at least as valuable as the relatively small investment it lost. Imaginative counsel can construct an FET claim out of virtually any set of facts provided there is some governmental action or inaction in the picture, and any number of experts can be lined up to calculate the millions of dollars in profits that the business would have made if it had only been treated fairly by the host state. With the right tribunal and a state caught off guard or otherwise unable to manage the situation easily, the stage could be set for a settlement that transforms a losing investment into a winner and provides funding for a series of other cases.

Whether or not third party funded cases fit this profile is beside the point. Perhaps some do, and others do not. The fact is that the relatively new phenomenon of third party funding is another unanticipated development and an irritant that is making investor-state arbitration more unpopular than it already has been with states.

Way Forward. Now the hard part: what to do?

There is no easy blueprint for patching up the system, and there is no magic wand that can scrap it so we can start from scratch. The infrastructure of investor-state

arbitration is, by design, so elaborate that it is almost impossible to dismantle. That does not mean that the issue should not be discussed, as heightened sensitivity to the problems plaguing the system is better than the ostrich approach.

Without such heightened sensitivity, the system will continue to deteriorate. Indeed, that result would be a virtual certainty since the dominant pro-investor camp in investor-state arbitration considers reform to be anything that speeds up the arbitration process, limits further a state's ability to raise jurisdictional or similar defenses, promotes increasingly more expansive views of state responsibility and encourages the kind of creativity in tribunals that invariably results in new avenues for investors and greater exposure for states.

Here are a few points for consideration:

- States should review all their investment treaties to determine whether they fully understand their provisions, whether they are serving any salutary purpose and, if not, whether and how the treaties should and can be revised or terminated. Another option worthy of consideration, following the precedent of the NAFTA FET interpretation,[73] would be for states to clarify the meaning of troublesome terms contained in their treaties that are susceptible to molding by arbitral tribunals into obligations that neither contracting state understood or anticipated.

- Proposed new treaties should be subject to rigorous review, with the meaning of terms such as "investment," "national" and "fair and equitable treatment" fully circumscribed. The concept of MFN should be brought under control or eliminated. Like Australia, states should give serious consideration to whether to agree to international arbitration at all, at least as long as the current state of affairs persists.[74]

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[73] NAFTA, Free Trade Commission, *Notes of Interpretation of Certain Chapter 11 Provisions*, July 31, 2001.

[74] The former Attorney General of Pakistan in an interview noted: "If Pakistan is going to seriously negotiate BITs, it needs to set aside an appropriate budget, so that the bureaucracy is well staffed and informed on these matters. Unfortunately, the Government of Pakistan has never considered BITs an important enough issue for this. But look at the legal costs in the three cases against us so far; I'm sure they exceed US$10 million as a very conservative estimate. For less than a fraction of that amount you can set up a department, hire lawyers—perhaps even get some assistance from outside Pakistan—and

- Appointing authorities should show greater sensitivity to the issue of bias in the system and spend more time and effort in ensuring the neutrality of their appointments. That means broadening the pool of candidates and carefully reviewing the track records of all, including those established members of the club whose appointment can be a source of discomfort to states.

- It should be made clear, through formal amendments if necessary, that arbitrators in investor-state arbitration are not subject to lesser standards of conflicts than those in commercial arbitration. If anything, the opposite should be the case. The practice of concurrently acting as counsel in some cases and arbitrator in others involving the same issues is a problem that should also be addressed.

- The arbitration community should abandon the notion that speed is always good. Each case should be allotted the time it deserves, no more and no less, considering the complexity and importance of the issues involved and the amount at stake, and decisions on timing should not be based on preconceived notions of appropriate duration. Bifurcation should be encouraged whenever there is a serious jurisdictional or similar issue unrelated to the merits. If quantum issues are complex, consideration should be given to deferring them as well. And when an overriding issue affecting all or most of the case appears within any phase of the proceeding, the tribunal should consider dealing with it separately rather than having the parties litigate on the basis of multiple alternative scenarios.

- Something should be done about bad awards. If there is any doubt as to whether there is room under ICSID's annulment procedures for annulling an award that is based on manifest errors of law, that doubt should be dispelled.

- Regional organizations and even the United Nations should place the issue of the efficacy and direction of investor-state arbitration on their respective agendas, with a view toward at least formulating more formal and official declarations along the lines of the Public Statement on the International Investment Regime referred to earlier,[75] expressing concern about expansive interpretations of state responsibility and the degree of discretion exercised by arbitral tribunals without adequate mechanisms for review.

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start looking at this process properly. But I don't think the will is there because the need is not felt. But come a day where we are faced with a similar situation as Argentina is now, this may change." Lauge N. Skovgaard Poulsen and Damon Vis-Dunbar, *Reflections on Pakistan's Investment-Treaty Program after 50 Years: An Interview with the Former Attorney General of Pakistan, Makhdoom Ali Khan*, INVESTMENT TREATY NEWS, March 16, 2009.

[75] *See* n. 65, *supra*.

None of the foregoing is radical enough, and all of it may not provide sufficient comfort for states, the principal actors in the system. More fundamental change, such as the creation of regional or international investment courts with full-time judges and strict rules of conflicts and appeal mechanisms should also be explored,[76] but the difficulties in creating a new system to coexist with the old, which is built to last, may be insurmountable. That is why in the short term the best we can hope for is a measure of improvement and rebalancing through heightened awareness.

[76] *See, e.g.*, Antonio R. Parra, THE HISTORY OF ICSID, (Oxford University Press 2012), pp. 325-326; Hildegard Rondón de Sansó, FUNDAMENTAL LEGAL ASPECTS OF INTERNATIONAL INVESTMENT ARBITRATION (Editorial Arte 2012), pp. 100-101; Silvia Fiezzoni, *The Challenge of UNASUR Member Countries to Replace ICSID Arbitration*, 2(3) BEIJING LAW REVIEW 134 (September 2011); Ilija Mitrev Penusliski, *A Dispute Systems Design Diagnosis of ICSID*, in THE BACKLASH AGAINST INVESTMENT ARBITRATION 507 (Waibel *et al*. eds., Kluwer Law International 2010), pp. 529-531; Donald McRae, *The WTO Appellate Body: A Model for an ICSID Appeals Facility?*, 1(2) JOURNAL OF INTERNATIONAL DISPUTE SETTLEMENT 371 (2010); Karl P. Sauvant, ed., APPEALS MECHANISM IN INTERNATIONAL INVESTMENT DISPUTES (Oxford University Press 2008); Gus Van Harten, *A Case for an International Investment Court*, Society of International Economic Law (SIEL) Inaugural Conference 2008 Paper (Working Paper No. 22/08), June 30, 2008; Louis T. Wells and Rafiq Ahmed, MAKING FOREIGN INVESTMENT SAFE: PROPERTY RIGHTS AND NATIONAL SOVEREIGNTY (Oxford University Press 2007), p. 297; Gabrielle Kaufmann-Kohler, *In Search of Transparency and Consistency: ICSID Reform Proposal*, 2(5) TRANSNATIONAL DISPUTE MANAGEMENT (November 2005); Johanna Kalb, *Creating an ICSID Appellate Body*, 10 UCLA JOURNAL OF INTERNATIONAL LAW AND FOREIGN AFFAIRS 179 (2005).