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CHAPTER 16

Avoiding Unintended Consequences

Jan Paulsson

What issues of coherence? There is no reason to be alarmed about inconsistent *obiter dicta*. Irreconcilable differences in *rationes decidendi* have been far rarer than supposed. From a practitioner's viewpoint, there is no crisis of unpredictability. The structural cures imagined were conceived in haste and would have engendered vast disruption, out of all proportion to the familiar task of establishing jurisprudence in new areas of law. Normative hesitations are likely to be resolved in usual and legitimate ways. The demands for greater transparency, on the other hand, should be viewed with sympathy. They hold a realistic promise of leading to better law. The debate was stimulating and worthwhile. It enabled us to determine that on balance there was no balance. One big idea was bad, the other good.

Debate is healthy, and often constructive. It is most likely to be constructive when those who engage in the dialog are scrupulous about fact and transparent in motive.

Some may well believe that representatives of capital-importing States were mistaken on hundreds of occasions when they signed BITs, and that their interests are in fact adversely affected by such treaties. But if those who hold such views participate in a debate on the ostensible subject of reforming international legal processes relating to investment with the undisclosed determination that anything which stifles the emerging systems of investor protection is good, they are guilty of false pretences. Whether one should dismantle the current system is another debate. It is perfectly legitimate, but should not be

addressed in camouflage; it is perverse to pretend to reform what one would rather destroy.¹

The editors have asked me for a practitioner's evaluation of the suggestions that surfaced in 2005 concerning imaginable corrective features in investment arbitration. One of the attractions of this volume is precisely that it is dominated by undogmatic contributions, at once sophisticated and dispassionate.² Proposals for a universal appellate mechanism, it seems, have little realistic future, while the cry for greater transparency has been muted for the opposite reason: ready acceptance. (Implementation is another matter.) And yet this collection of papers will remain a valuable record of the two debates which concluded the first significant decade of modern investment arbitration.³

Disclosures and Premises

I have participated in a significant number of investment arbitrations—nearly 30 under the ICSID Rules alone. I have served as advocate and arbitrator. (Under what conditions that should be allowed is yet another legitimate debate,⁴ but not one to be addressed in this contribution.) As an advocate, I have represented investors and states alike, somewhat more often the latter than the former. I have acted for the same African State in 14 international arbitrations, reporting to a succession of ministers who over the course of 20 years apparently saw the value of the professional defence of that State's interests. It is not so that whatever is good for lawyers is good for

¹ Dr. Mann writes, in Chapter 13, that the international investment law regime is “institutionally deprived,” explaining that the few relevant institutions “are fragmented in their roles, have no mandate over the overall regime's development process and lack any processes for ongoing review of the evolution of this area of the law.” This is of course a fundamental insight about international law, which, it must also be said, has revealed itself to a multitude of international scholars since well before the days of Grotius. If Dr. Mann believes that the development of investment protection should be put on hold until this inconvenience is repaired, perhaps by a truly representative global conclave in which states—whose treaty practice so far has only maintained the “rotting foundation” of a system whose participants have a “manifest self-interest in the status quo”—would not have a decisive voice, he is in fact standing in the way of progress.

² I have little hesitation in recommending that the reader start with Chapter 14, one of a series of remarkable “working papers” prepared by the Investment Division of the OECD. Authored by Katia Yannaca-Small, these studies provide lucid, informative, and thoughtful descriptions of actual developments unencumbered by personal visions *de lege ferenda*. The last of these virtues cannot be claimed by the present author.

³ To use the words of Professor Franck, when “dispute resolution systems . . . undergo fundamental growth, a re-consideration of the system's efficacy and utility can promote both its integration and legitimacy” (Chapter 9).

⁴ With respect to which one should accept without hesitation that Dr. Mann's pertinent criticism must be answered.

the world. Nor indeed does the prosperity of corporate entities (or that of governments) have any *raison d'être* except as a means to a good end. But I believe the prospect of legal protection of investors to be valuable, to be preserved and enhanced. I might add that I see no paradox in the concept that investor protection would be enhanced by the expansion and clearer articulation of the *obligations of investors*.⁵

I do not choose to defend this position by insisting that foreign investment is a good thing. It is enough that this is the view taken by the representatives of sovereign States everywhere. Nor do I insist that treaty protections measurably increase investment volumes. The data are inconclusive; the methodology of studies of this proposition—and yes, sometimes their motivation—is suspect. What attracts me to the objective of investor protection are above all two positive effects.

First, a good international regime of investor protection holds out the promise over time of reducing the profit margins that investors demand. This is a matter of singular macro-economic importance. Some resource-rich developing countries can afford the legal-risk premium which results from governance by fiat, but for the poorer countries it is an oppressive burden. It will take a long time before investors are willing to put their capital into Sierra Leone in the expectation of as low a rate of return, and over as long a term, as they are happy to accept in Switzerland. Yet there can be little doubt that moving in this direction is in Sierra Leone's interest.

The second effect leads to more immediate benefits: I am encouraged by what I have seen when government officials—like their corporate counterparts—become conscious of the fact that they may have to justify their acts or omissions before neutral international tribunals. This has a way of modifying their conduct in a way which seems to have a positive effect on internal governance. Perhaps through a phenomenon which some sociologists call *compliance pull*, they begin to distance themselves from old habits of opacity, arbitrariness, clientilism. They begin to embrace better practices more consonant with their self-image as modern leaders attached to their country's prestige. They come to demand it of their colleagues. Nor should one forget the positive feedback associated with the ever more frequent successes

⁵ See in this connection Professor Juillard's comments about recent developments under his first—and hypothetical—subheading, "BITs are Imbalanced Instruments" (Chapter 5).

encountered by developing countries in international fora.⁶ Such satisfactions reinforce behaviour that leads to those gratifying results.

With that background, I propose a series of observations. The first, under the heading “Incoherences of the Incoherence Complaint,” is a hard look at the problem purportedly identified by critics of investment arbitration. One can hardly fault investment awards for failing to do the impossible. A failure to understand the notion of *precedent* will lead to unhelpful exaggerations. Any significant legal evolution is a dialog between law-givers (read *BIT drafters*) and law-appliers (read *investment arbitrators*) which perforce takes some time to yield dialectic conclusions—even more so in an international context. The second set of observations describes “Natural Corrections” which I predict will yield satisfactory results and should be allowed to produce their benefits. Next, the section entitled “The Illusion of Cure” examines the decisive drawbacks of proposed structural transformations. Finally, I explain my ready acceptance of the need for greater transparency, and how it relates to the search for coherence and consistency.

Incoherences of the Incoherence Complaint

Why have psychologists over the centuries been unable to develop a workable formula to achieve harmony among human beings? Perhaps for the same reason that international arbitrators in the course of a decade of a flurry of investment arbitrations have not been able to develop a workable formula for determining when a commonwealth should compensate an individual for detriment caused by a new policy designed to benefit society as a whole.

Some questions are eternal. To take the issue of compensable regulatory measures—or those of abuse of power, minimum standards of fairness, denial of justice, or discrimination—they are simply immune to resolution by abstraction. Looking backward, it is plain that no national system has reached the promised land of the Answer. Incoherence abounds. (To take the example of a highly respectable and sophisticated legal system and a particular issue which has been the subject of infinite and powerful academic efforts, I have had the occasion to experience the essential truth of a disabused comment that if you ask six German lawyers for an explanation of unjust enrichment,

⁶ To mention three notable successes on the part of respondents from three continents, all decided within three months of each other roughly one year after the April 2006 Symposium: *Ahmonseto, Inc. et al. v. Egypt*, 18 June 2007; *MCI Power Group L.C. and New Turbine, Inc. v. Ecuador*, 31 July 2007; and *Fraport AG Frankfurt Airport Services Worldwide v. Philippines*, 16 August 2007.

you will get a dozen answers.) Looking into what I hope is a counterfactual crystal ball, I perceive that the same irreducible indeterminateness would be generated by appellate investment adjudicators.

So let us not beat about the bush. When critics of international arbitration bemoan the lack of consistency and coherence, they are blaming the process for failing to achieve the impossible—and proposing solutions which would fare no better. Once again, the hidden agenda needs to come out: what is being questioned is the very concept of neutral international adjudication and its necessary constraint on sovereignty. Adjudication of matters of public law is everywhere a constraint on collective sovereignty. Such is its nature and function.

States have good reason to accept the international rule of law, and the binding adjudications of international arbitrators, because it gives them the power to make meaningful promises.⁷ That power is valuable; it makes economic transactions less expensive as the legal-risk premium decreases.

But since there has been so much talk of incoherence, let us consider that debate on its own terms—as if there were no hidden agenda.

It is imperative to sense the difference between the rationale of a case and incidental observations. The decision-making function is exercised when a tribunal upholds or denies a claim. The normative basis of that decision is of particular interest because that is where judges or arbitrators assume their responsibility. If a claim is rejected because the plaintiff has failed to take an obvious step to avert prejudice, we have a clear precedent for the proposition that there is a duty to mitigate. But if a claim is upheld, the basis is a finding of liability. An incidental statement to the effect that “recovery to claimants may be compromised if they fail to mitigate damages, but no proof of such failure was presented here” is *not* the basis for the decision. It may be persuasive of the existence of the norm, but it is of lesser weight.

⁷ As the Permanent Court of International Justice put it in *The SS Wimbledon (Merits)*, Series A, No. 1 (1923) at 25:

“The Court declines to see in the conclusion of any Treaty by which a State undertakes to perform or refrain from performing a particular act an abandonment of its sovereignty. No doubt any convention creating an obligation of this kind places a restriction upon the exercise of the sovereign rights of the State, in the sense that it requires them to be exercised in a certain way. But the right of entering into international engagements is an attribute of State sovereignty.”

To take another example: an investment award may say that claimants must cumulatively satisfy the ICSID Convention definition as well as any BIT definition of the notion of “investment,” but that is not necessarily the holding of the decision if the tribunal decides that both definitions are satisfied. The holding is simply that both definitions are in fact satisfied; it is not necessary to rule on the consequences of a contrary hypothesis. Unless the tribunal says something more, the proposition that both *must* be satisfied is properly understood as a holding only in a case where a claimant is sent packing because it failed under one definition, and the tribunal said it did not matter if it could have succeeded under the second.

Why would anyone care? Is this pedantry? Let me answer with rhetorical questions.

Is there not a world of difference between saying that parachuting is a wonderful sport, and actually stepping out of a plane at 3,000 feet? Between expressing conviction that gold will once again reign supreme and converting all one’s savings into it? Between saying that something must be done to conserve energy and actually signing a public proposal for a ban of popular but wasteful automobiles? The point is obvious: to create *precedents* for the prevalence of sky-jumping, or investments in gold, or public commitment to unpopular reform, talk is not enough.

Arbitrators’ opinions are no more or less interesting than those of any commentators. What we really want to know is the reason which they said led them to the outcome for which they have taken personal responsibility. That is where, we may reasonably surmise, they exhibit particular care.

In the *SGS v. Pakistan* case, I assisted Pakistan. Naturally I was very interested in the parallel case of *SGS v. Philippines*. What happened in my case was that the ICSID tribunal refused to rule on a claim of contractual debt because the contract called for arbitration in Islamabad, not ICSID arbitration. In the Filipino case, a second ICSID tribunal refused to rule on a claim of contractual debt because the contract called for litigation in Makati. There is no difference between those two precedents. The local press in Karachi and Manila were equally jubilant upon the announcements of the respective awards. But did not the *Philippines* arbitrators state that they declined to follow the Pakistan case? True enough, and I have chided one of them in public—in his presence—for having been too discursive. (He appeared to take it in stride.) The only thing wrong with their award was that it *said* that it was different

from *SGS v. Pakistan*—setting a thousand tongues wagging about “inconsistent” ICSID decisions. But do not ask them to explain just how the decisions are irreconcilable unless you are a stalwart of scholasticism.

As for the conflict between the Lauder group and the Czech Republic, it is true that two different UNCITRAL tribunals appreciated the same conduct of the Czech Government in different ways, with radically opposed financial consequences.⁸ That may or may not satisfy the participants in that case (it depends on one’s views of hedging as a litigation strategy). But as *precedents*—as indicators to be used by parties and practitioners to understand legal criteria by which future conduct will be assessed—the two awards are not at all incompatible. Their understanding of the relevant legal standards, including causation, were perfectly congruent; their findings of fact were not. That is untidy, but no catastrophe, nor indeed surprising: such things happen when a story is told in different ways on different occasions to different people. (The Czech Republic surely rues its initial rejection of the claimants’ offer of consolidation of the two cases before the tribunal which awarded nil damages.)

Sensible messages may be perceived by drafters and readers of awards. To a drafter: eschew lectures about issues unnecessary to the disposition of the case. To a reader: if the drafter has yielded to the temptation to digress, treat the thing with a good dose of benign neglect.

As arbitral practice expands, and as the field of international law itself expands in breadth of coverage and complexity, the calibre of awards is liable to greater unevenness. Some awards are influential, others best forgotten. There are awards which have been annulled and awards which have resisted annulment applications. There are awards which have not been tested at all. There are awards signed by panels of renowned jurists and awards rendered by sole arbitrators whose reputations are yet to be made. There are awards rendered by eminent persons careful of their reputation in the field and awards rendered by one-time arbitrators. There are awards rendered by a majority and awards rendered unanimously. Some awards record the merest indication of disagreement, while others are accompanied by an impressive dissent. Some dissents are powerful and elegant and make the majority look fragile; others are partisan diatribes with quite the opposite effect. Some awards are linguistically deficient; others are models of drafting. Some are highly disciplined texts;

⁸ Discussed *inter alia* by Professor. Schreuer and Mr. Legum in Chapters 12 and 15.

others are discursive to the point of self-indulgence. There are awards which seem to be the product of inexorable reasoning, and others which seem nothing but the result of a vote. There are awards signed by arbitrators who maintain impressive consistency from one case to the next, and—I hope in no more than two instances—awards signed by arbitrators who seem not to remember what they put their names to the previous year. Even Homer nods, so arbitrators entitled to the greatest respect occasionally find themselves in cases where the matter at hand seems to defeat their acumen and their patience.

The reality of investment arbitration is that the quality of advocacy varies greatly from case to case. Some speculative claims are prosecuted on a wing and a prayer by inexperienced pleaders, perhaps more in the hope of creating pressure than with the intent of developing a sustained and cogent case before an international tribunal. Such parties—claimants or respondents—may find themselves confronting knotty and fundamental issues which they do not have the resources to deal with. There are limits to *jura novit curia*. Silk purses are not readily produced from sow's ears. And so major issues may be decided in the context of a mediocre debate. Once the decision is handed down, the disappointed party may lose heart and decline to pursue available means of recourse, such as the ICSID ad hoc committee mechanism. What is left may be a decision by a sole arbitrator handicapped by artless pleadings. This is a matter of reality which commentators often ignore when they express concerns about perceived inconsistencies of awards. Arbitrators do not answer exam questions tidily articulated by the finest academics; they decide cases as they are presented, whatever the imperfections of the pleadings and the spottiness of the factual record.

This may be a good place to note that there is something peculiar about the investment arbitration issues which have generated the most debate. What are these issues? One is certainly the scope of most-favoured-nation (MFN) provisions. Another is quite clearly the effect of so-called umbrella clauses (containing the undertaking to respect agreements). A third relates to difficulties arising out of the coexistence of contract claims and treaty claims. A fourth is to assess whether a dispute actually arises out of an investment and therefore qualifies for treaty protection. These four categories of issues have something in common which cannot fail to strike the practitioner: the fact that a respondent state loses a debate concerning MFN clauses, umbrella clauses, or the preclusion of contract claims does not in and of itself cost the state a single penny. They all concern the claimant's access to investment arbitration. That battle can be a Pyrrhic victory for the investor, who is enabled to proceed but may

ultimately lose on the merits and come to regret having embarked upon a costly and losing campaign.

This leads me to whimsical interrogation. What is the opposite of a Pyrrhic victory? Perhaps an Elysian defeat? Surely there must be some expression to describe a bitter disappointment which turns out to be the unique gateway to great satisfaction.

Losing jurisdictional battles can be just such things. The joy of winning dismissal is often ephemeral, as reality sets in—the dispute remains. The simple point is made in a rhetorical question: what is better, prevailing on a jurisdictional objection or losing it—and then winning on the merits?

A good example was the border dispute between Bahrain and Qatar, which Bahrain considered to have been settled in 1939. Qatar disagreed, and over the years kept raising claims to something on the order of one-third of Bahrain, principally the Hawar Islands. This was a problem which simply refused to go away, and marred relations between the brother States for three generations. Finally Qatar brought its case before the International Court of Justice on the foundation of a protocol which Bahrain believed did not create international jurisdiction. This issue was decided against Bahrain, by a narrow majority over vehement dissenting opinions. It was a very annoying defeat for Bahrain, which as the party in possession had no desire for a debate in an international forum whether it should abandon what it considered its territory. Yet six years later, in 2001, having pursued its case vigorously, Bahrain prevailed on the merits and the Hawar Islands remain Bahrain's. The historical problem was resolved. The two countries could move to talk of cooperation instead of confrontation—and so they have.

Similarly, in investment cases many states focus on the objective of avoiding the international forum, only to discover that it was not fully a success; that the problem will not go away.⁹ Consider the parties' posture in

⁹ Professor Sornarajah (Chapter 4), true to form, seems to consider that for a state to have to participate in an investment arbitration is in and of itself a calamity. Yet many states have found it highly satisfactory to be able to address and resolve a poisonous difficulty before a neutral tribunal. Nor is it only in winning that a state shows its reliability; several states have shown that they can be good losers, and I would argue that it is money well spent. Poor countries routinely find it possible to buy gleaming but realistically unusable military hardware for eight-figure amounts in hard currency. If they are unwilling to spend a fraction of such sums as a measure of their adherence to the rule of law, one may conclude that this has more to do with unwise priorities than with impoverishment. (In considering the stakes of this discussion,

the aftermath of the *Lucchetti v. Peru* ICSID award, which the tribunal described thus:

Given that the present Award is responsive to a jurisdictional objection, the factual and legal propositions at the heart of Lucchetti's substantive case have naturally not been tested. Lucchetti contends that it was invited to invest in Peru, made its investment properly, expended tens of millions of dollars in building the most advanced industrial installations in the country, and established a model of operational success, employing a substantial workforce and making good, competitive products with export potential. Lucchetti also stresses that it has not been alleged (let alone proved) that its establishment in Peru as an investor was procured by irregular means. It is therefore in a fundamentally different position than someone whose initial agreement is said to have been procured by fraud or corruption. Most of all, it claims that its assets have been spoliated in a purely arbitrary and pretextual fashion....

The only question entertained by this Tribunal is precisely whether the claim brought by Lucchetti falls within the scope of Peru's consent to international adjudication under the BIT. Lucchetti has not satisfied the Tribunal that this is the case, and thus finds itself in the same situation as it would have been if the BIT had not come into existence. Its substantive contentions remain as they were, to be advanced, negotiated, or adjudicated in such a manner and before such instances as it may find available.¹⁰

How much better, one surmises, to be in the position of Ukraine, having lost the infamous jurisdictional battle in *Tokios Tokelés* only to prevail on the merits.¹¹ The list of similarly situated respondent States is rather quickly lengthening.¹²

A distorting factor in the debate about investment arbitration is often overlooked despite its seeming obviousness. BITs and other instruments of investment protection establish obligations on the part of states. The respondents are therefore nearly invariably states. Like most parties who are sued, they are

is it irrelevant to point out that the UN World Investment Report 2007 announced that foreign direct investment in Africa had doubled over two years to US\$36 billion, and credited a better business environment?)

¹⁰ 7 February 2005, paras. 60 and 62. The author was a member of that tribunal.

¹¹ ICSID, 26 July 2007 (Merits).

¹² The last, as this is written, being *Parkerings Compagniet v. Lithuania*, ICSID, 11 September 2007.

not disposed to accept that they have a case to answer. As a consequence, a chorus of affected states complains that there is something wrong with the system. (In time it will be seen that investors are also likely to find fault with the system as they come to the costly realization that it is not a cure-all to their business problems.) Even states which have traditionally favoured investment protection and have not been exposed to adverse decisions—like the United States, still undefeated in modern investment arbitration practice despite high-profile attempts in cases like *Loewen*, *Mondev*, and *Methanex*—appear discomfited by the very prospect of having to justify their conduct.

Yet the international rule of law necessarily involves restrictions on the freedom to act. They are not inherently inimical, but to be accepted as a matter of enlightened long-term self-interest.

Here another distorting factor comes into play. In a manner reminiscent of the strident debates more than a quarter of a century ago about the short-lived New International Economic Order, challenges to investment arbitration seem to reflect group-think at the seats of international organizations, involving delegations representing anyone but the Ministries of Finance or Commerce, rather than the positions of ministries having primary responsibility for economic policy.

One particularly annoying manifestation of this distortion is the recurrence of purportedly humorous remarks on the theme that developing countries sign BITs without a clue as to their content. When one does not know what else to do in order to proclaim achievement at the end of an uneventful state visit, so the story goes, why not sign a protocol on cultural cooperation—or a BIT? This is preposterous. It may well be that persons who find themselves at international gatherings find it tempting to “defend their countries” by complaining that bad bargains were foisted upon unnamed colleagues by sinister outside forces—even if the objectors had no role in the formulation of policy or in the negotiation of the instruments in question.

This stale joke suffers from the radical defects of being offensive and wrong. Life in many developing countries is extremely challenging, and individual capacity for discernment is often far higher than that required for success in developed systems of governance where it is sufficient merely to master and follow the rules. Norms relevant to investment protection are not complicated in principle: they establish that the government shall not confiscate, discriminate, or abuse its power in unfair ways. Not only do these three great normative categories tend to be uncontroversial; they represent the ardent desires even in

societies sceptical of capitalist models. This, and not ignorance, fecklessness, or manipulation, explains why BITs tend to be so textually compact—and so readily accepted.

Of course there is a fourth category of norms which is of a very different genus: the *procedural* innovation of international arbitration entitling an investor to seek redress. This is the sole cause of the debates reflected in this volume, and it is of course a sea change. The first three substantive categories of norms, grand though they may sound, amount to very little if they are to be applied by courts who are subservient to the very officials who may have violated one of the three. What about foreigners lacking local influence? Should they be given access to neutral, international justice?

BITs readily answer this question in the affirmative. Critics of investment protection have suggested that this reflects an imposition by capital-exporting powers.

How then can they explain that these four pillars of investment protection—three prescriptive, one remedial—were precisely the ones at play in the first modern investment arbitration, namely the case of *SPP v. Egypt*, where the protective instrument was not a treaty at all, but an investment protection law conceived in 1974 by no one but the Egyptian Government itself?

Moving to the present, Ms Joubin-Bret's valuable review of recent practice (as a Senior Advisor at UNCTAD) leads her to comment not only on the "significant increase" in South-South BITs in the decade 1995–2005, but that these show "very little evolution from a qualitative point of view" and indeed "tend to use more general language" and "allow for expansive interpretation."¹³

It is very difficult to imagine any retort to these observations that does not imply further insult to negotiators from developing countries.

Natural Corrections

In 1995, I predicted that there might be "an epochal extension of compulsory arbitral jurisdiction over States, at the behest of private litigants who wish to rely on governmental undertakings even though they have not contracted for a forum."¹⁴ Something like that seems to have happened. I also wrote that the

¹³ Chapter 8.

¹⁴ "Arbitration Without Privity," 10 ICSID REVIEW 232, at p. 256.

prospects for investment arbitration may “depend on the degree of sophistication shown by arbitrators when called upon to pass judgment on governmental actions.”¹⁵

If I may now venture a new prediction, it is that after a sustained flurry of decisions over the past decade we are already likely to see a second wave, or rather a second generation, of investment awards. Its principal characteristics will be the consolidation of dominant trends; the continued isolation of perplexing outliers among awards; and thus, quite simply, more consistent awards.

This process of natural correction is anything but surprising; it is an expected feature of any maturing system.

In the interest of brevity, let us consider three illustrative tendencies in the recognition of norms inherent in the area of State responsibility to foreign investors. Each of them reinforces the defences of respondent States. They may be described as parts of a pendulum swinging the other way, after an initial movement toward the attractive possibilities of BIT-type arbitrations offered to investors (including occasional temptations to adventure).

The three tendencies I perceive involve the acknowledgment of (i) substantial regulatory margins of appreciation, (ii) the requirement that investors substantiate international delicts by demonstrating reasonable efforts to allow the State to rectify incidents of maladministration, and (iii) high barriers to remedies of specific performance or restitution in kind against States.

The landmark *Methanex*¹⁶ decision, rendered unanimously by a tribunal comprised of V.V. Veeder QC (President), Professor Michael Reisman, and William Rowley QC, makes clear that international arbitrators do not award damages for the detrimental consequences of regulatory changes on the sole grounds that they find governmental policy to be wrongheaded. Foreign investors, like nationals, may have to accept such consequences as a local fact of life. A claimant must go further, and demonstrate bad faith, including arbitrariness, discrimination, or disregard of legitimate expectations. A policy decision, such as the State of California’s ban on certain products said to have deleterious effects, will be accepted as compliant with the standards of international

¹⁵ *Id.* at p. 257.

¹⁶ *Methanex v. United States*, UNCITRAL, 3 August 2005.

law if there is a reasonable showing that it was the result of relevant studies undertaken in good faith. Serious government officials are likely to read the award, taken as an indication of standards by which their future acts will be judged, with equanimity.¹⁷ What is required as foundation for regulatory policy is surely the minimum of what principles of decent governance would command; what is tolerated is far more than what the electorate might accept. And why should this not be so?

A second trend makes it impossible to turn investment arbitration into a Court of Common Pleas having the mission of correcting the conduct of every bureaucrat in the world. It is essential that the non-requirement of exhaustion of local remedies does not lead to an uncontrolled expansion of the mission of investment arbitrators. It simply cannot be that each act of every official in every state having signed a BIT is subject to international scrutiny for compliance with international law. This merits elaboration.

It is in the nature of BITs not to require the exhaustion of local remedies. But the concept of exhaustion of remedies needs to be considered with care. It is important to see how differently this concept operates, depending on whether a case arises under a contract or under a BIT.

Consider first a contract between an investor and a state. Before the ICSID Convention was born, if a claim against a state was to be pursued in the domain of public international law it would first have to be unsuccessfully presented to the highest level of national courts. This is not at all how *contractual* arbitration should work. Any contractual breach should be within the exclusive domain of the contractual arbitral tribunal. This is how it is in the realm of private international law, and of course a state's contracts with investors may be subjected to private law arbitration and enforced under the New York Convention. But the ICSID Convention creates arbitration under *public*

¹⁷ The arbitrators wrote notably as follows, in para. 7 of Part IV, Chapter D:

“[A]s a matter of general international law, a non-discriminatory regulation for a public purposes, which is enacted in accordance with due process and, which affects, inter alios, a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation.”

(Health Warning for Persons with a History of Excessive Optimism: No, dear Reader, you have not just discovered the Holy Grail—not even a shortcut. This passage too must be considered in light of the parties' pleading, the facts, and the arbitrators' analytical framework, premises, and qualifications. And even then it remains open-textured: “non-discriminatory,” “public purpose” and “due process” are not self-defining terms—nor is the qualifier “general” when applied to international law.)

international law. In order to ensure that contractual disputes could immediately go to arbitration, the ICSID Convention necessarily pre-empted the rule of exhaustion of local remedies. What this means is very simple. It means that if investors raise any claim of breach of contract subject to ICSID jurisdiction, they may bring it immediately before ICSID.

But what about investors who have no contract with the State, yet consider that the State has violated a BIT because they have not been treated “fairly and equitably” under international law? May *any* such claim be brought *directly* to ICSID?

The answer is: absolutely not. This should not be surprising. Let us begin by asking: who breaches a contract? In a contractual situation, the identity of the respondent is clear. If their contract is with the Ministry of Public Works, investors are not going to be able to sue the Ministry of Foreign Affairs. If their complaint is that the National Oil Company has not paid royalties, they cannot sue the Ministry of Education. And, most importantly, even if they have a contract that fell within the general scope of authority of a particular Ministry, they cannot go to ICSID claiming that a low-level official has repudiated the agreement without explaining that somehow this position must be deemed to have been that of the Ministry as a whole.

The situation under a BIT is quite asymmetrical, which is clear if one asks the analogous question: who is the respondent to a claim of unfairness or discrimination? The State has signed the BIT; but does that mean that actions by any functionary, anywhere in the public sector, entitle the investor to bring a claim before ICSID?

Several awards evidence sensitivity to this matter. The tribunal presided by Sir Arthur Watts in *Saluka* stated that the BIT relevant in that case:

“cannot be interpreted so as to penalise each and every breach by the Government of the rules or regulations to which it is subject and for which the investor may normally seek redress before the courts of the host State ... something more than simple illegality or lack of authority under the domestic law of a State is necessary to render an act or measure inconsistent with the customary international law.”¹⁸

¹⁸ 17 March 2006, ICSID, paras. 442–443.

Similarly, the arbitrators in *Generation Ukraine* reasoned that:

... it is not enough for an investor to seize upon an act of maladministration, no matter how low the level of the relevant governmental authority; to abandon his investment without any effort at overturning the administrative fault; and thus to claim an international delict on the theory that there had been an uncompensated virtual expropriation. In such instances, an international tribunal may deem that the failure to seek redress from national authorities disqualifies the international claim, *not because there is a requirement of exhaustion of local remedies but because the very reality of conduct tantamount to expropriation is doubtful in the absence of a reasonable—not necessarily exhaustive—effort by the investor to obtain correction.*¹⁹ (Emphasis added.)

And in *MCI Power Group et al. v. Ecuador*, the ICSID tribunal observed that a party who fails to seek administrative review acquiesces in the revocation of a permit.²⁰

The third development is the emerging confirmation of a presumption against the availability of specific performance or restitution in kind as a remedy against States. Such measures are perceived by States as severe constraints. The Libyan nationalization cases in the 1970s made most international lawyers realize that specific performance was difficult to obtain. Of these cases, the *Texaco* (1978) award seemed the outlier, not so much because it was wrong as because it was the product of the very unusual posture adopted in the claimants' pleadings. Nevertheless, the spectre of specific performance was sufficiently worrisome for the States-party to NAFTA that they explicitly limited remedies to monetary recovery. Today it is likely that the decision on provisional measures rendered by the ICSID tribunal in *Occidental v. Ecuador* represents a reliable indication that even in the absence of such a treaty provision specific performance is generally unavailable against states in the area of investor protection.²¹ The three unanimous arbitrators, all experienced in the investment field (Fortier, Stern, Williams), did not repudiate the notion

¹⁹ 16 September 2003, ICSID, para. 20.30. (The author was a member of that tribunal.)

²⁰ 31 July 2007, ICSID, para. 302; to similar effect, *Parkerings Compagniet v. Lithuania*, 11 September 2007, ICSID, para. 317.

²¹ Such a presumption may, like others, be reversed by agreement or other special factors, and it is likely that purely conservatory measures, insofar as they are unlikely to impede regulatory coherence beyond the specific case, constitute a different category; see *Tokios Tokelès v. Ukraine*, PO No. 1, 1 July 2003, ICSID; as well as *Enron v. Argentina*, 14 January 2004 (Jurisdiction), ICSID, paras. 76–81.

that specific performance or restitution in kind might be the *preferred* remedy, yet were quick to deem it impossible: “It is well established that where a State has, in the exercise of its sovereign powers, put an end to a contract or a licence, or any other foreign investor’s entitlement, specific performance must be deemed legally impossible.”²² In addition to the *British Petroleum* (1974) and *LIAMCO* (1981) ad hoc awards involving Libya, the tribunal cited the more recent *CMS v. Argentina* to the effect that “it would be utterly unrealistic for the Tribunal to order the Respondent to turn back to the regulatory framework existing before the emergency measures were adopted.”²³

In sum, states should conclude that the awards of first-instance tribunals have not caused the sky to fall. That being so, an important reason to endorse a policy of *festina lente* is that states who win investment arbitrations may be as frustrated as investors are when their triumph is wrested away from them by censors they did not select. (I say this, *inter alia*, from my experience as counsel to Cameroon, victim of the first ICSID annulment.) Investors have shown themselves more than ready to seek annulment—*Klöckner*, *Soufraki*, *Lucchetti*, *Thunderbird Gaming*, *Bayview Irrigation District*, and even the little *Malaysian Historical Salvors*. In other words, it is far from evident that states today should be anxious for the finality of awards to be eroded.

Indeed, one surmises that only the bitterest of disappointment could have motivated the just-named investors to seek annulment at considerable expense and with the prospects of a long and uncertain road ahead. A successful attack on the award does no more than to place them back on square one. Losing investors may be appalled at their poor fortune, in effect throwing good money after bad in pursuing an unavailing international remedy. Thus, after the U.S. Thunderbird Gaming Corporation had experienced the closure of its facilities in Mexico, had unsuccessfully sought arbitration under NAFTA, and had been ordered to pay US\$1.25M in costs to the Government of Mexico, its General Counsel issued a press release the day after the award,²⁴ complaining that his company:

“continuously faces similar acts of interference by government officials in developing countries, but believed that NAFTA would level the playing field in Mexico ... clearly it did not as this same government that shut down the Thunderbird operations has given permits for hundreds of new locations.”

²² 17 August 2007, ICSID, para. 79.

²³ 12 May 2005, ICISD, para. 406.

²⁴ UNCITRAL, 26 January 2006. Petition to set aside denied, 14 February 2007, USDC Col.

The CEO of the corporation added the caustic comment that such other permits “were issued in the country while ... the former Secretaria de Gobernacion was seeking to become the next President of Mexico.”

Disappointed litigants everywhere are tempted to rail at the decision-making process. That does not mean they are right. For each of these unhappy investors, there is probably a state which will say that justice was done.

The Illusion of Cure

The debate could end at this point, with the realization that the problem is much exaggerated; that incidental incongruities are likely to resolve themselves in familiar ways as a relatively new system works its way toward maturity; and that prudence overwhelmingly dictates that one should not be quick to jettison a valuable international mechanism and prematurely expose it to transformations which may be stultifying and destructive.

But it is worthwhile examining the potential for detrimental change.

One of ICSID’s great objectives was to depoliticize investment disputes.²⁵ Diplomatic protection was out; tribunals constituted by the two litigants were in. To create new permanent bodies of ultimate decision-makers raises the spectre of re-politicizing this area by reason of the recruitment of its members—with the additional discomfort of knowing that the fact that the parties selected the arbitrators is likely to invest the latter with greater intuitive legitimacy than their putative censors.

The appellate body is in fact unlikely to have greater moral authority than the first-level arbitral tribunal. Every annulment decision is a repudiation of the award made by the arbitrators chosen by the parties (or in accordance with their agreement). Nor is it likely to assist in improving consistency. First of all, the incidence of inconsistency has been vastly exaggerated by critics unable or unwilling to distinguish ratio from dicta. Second, this is a new area where the jurisprudence must and will feel its way toward consensus; there will be some early aberrations. Third, no arbitrator or appellate body can do the legislator’s job; some cases fall to be decided under imperfect texts.

²⁵ See I. Shihata, “Towards a Depoliticization of Foreign Investment Disputes,” 1 ICSID REVIEW 1 (1988).

Fourth, some fundamental norms are necessarily open-textured. As noted above, no legal system has thus far achieved the feat of developing a simple definition of the limits of non-compensable regulatory action. Great jurists and academics have struggled mightily with this in the U.S. for many generations; the matter remains maddeningly fact-specific. (The latest brave iteration of U.S. efforts at codification, present, e.g., in the 2004 U.S. Model BIT, begins with a series of apparently objective and painstakingly worded tests but then gives the game away by including a criterion described as “character of the government action”—lifted from *Penn Central*²⁶ and full of mystery.²⁷)

The purely structural challenge to the establishment of appellate mechanisms would compound these difficulties. Given the multiplicity of BITs and other instruments underlying investor protection, the plain fact is that one would have to imagine a plethora of distinct appellate mechanisms—each reflecting the desiderata of its drafters, each responsive to different articulations of substantive norms, each with different personnel.²⁸

The ICSID Convention does not contemplate an appellate mechanism. To the contrary, being internationally enforceable ICSID awards are inherently unable to accommodate the intrusion of an appellate mechanism. Could one imagine that recourse to such a mechanism would be a matter of consent, in the ICSID context or otherwise? Hardly. Consent to such a thing is unlikely to find its way into contracts, but would more plausibly appear in newly minted BITs. That would lead to different populations of BITs, and we would all have to start comparing (1) awards, (2) ICSID annulments, (3) new expanded annulments, and 4) resubmitted awards. A monster would be set loose.

Conceptually, a practitioner can contemplate any number of innovations. The idea floated in some U.S. circles of an obligation for tribunals to circulate a draft award to the parties for comment before finalization may sound like a radical proposal, but could well, provided it is policed properly and carried out in good faith, have more than one advantage—including the avoidance of error, or the resolution of the dispute on the basis of a constructive and confidence-building accommodation between the parties before the award becomes an implacable *res judicata*. The idea of preliminary rulings as

²⁶ *Penn Central Transportation Co. v. New York City*, 438 US 104 (1978).

²⁷ I say this despite my awareness of the explanations furnished in the Congress Research Service report of 20 January 1995.

²⁸ See Mr. Legum’s concise and cogent review of structural difficulties (Chapter 15).

described by Professor Schreuer²⁹ is interesting, although it is not easy to see how the example of national courts referring questions relating to European Community law to the EJC can be transposed to legal issues arising from the thousands of instruments under which investment disputes arise. One might well anticipate that the exhortation in treaties that the States-party shall “consider whether to establish a bilateral appellate body or similar mechanism”³⁰ might yield many though-provoking variants. Still, even the good innovations would have the defect of being *different*—leading to the distortion of the international rule of law by centripetal forces.

Non-practitioners are tempted to imagine a conceptually satisfying division between issues of law and fact. On that basis, it is easy to toy with the idea of appeals limited to points of law. In reality, the overlap may be considerable. One would have to come to terms with yet another undefinable criterion—i.e., the test of factual vs legal issues. As ICSID experience with ad hoc annulment committees show, even corrective mechanisms intended to be severely restricted (indeed allowing no appeal even on points of law) have a tendency to duplicate the arbitral process itself in terms of duration, cost, complexity and—dare one say it?—decisions exposed to debate and criticism. (The study of the coherence of ICSID annulment decisions among themselves is a subdiscipline of its own.)

What complaint against any award ever rendered pursuant to a BIT could not be cast as an attack on misapplication of law? An inevitably uneven and very possibly politicized group of decision-makers would have difficulty keeping their mitts off awards—rendered by arbitrators who paradoxically have *greater legitimacy* than they do, given their method of appointment. Cases would become endlessly protracted. The fact that tribunal no. 2 would be instructed to decide in accordance with legal propositions propounded by the appellate body would not stop intelligent downstream arbitrators from recasting a decision as factually contingent. And so back to the appeals body. The process might become a costly nightmare, and I would predict its demise or desuetude.

One particularly pernicious strand of thought would graciously allow investors to participate in investment arbitrations, but not at the ultimate appellate level—that would be a matter for the States-party to the BIT (or other relevant

²⁹ Chapter 12.

³⁰ See, e.g., the Panama–U.S. Trade Promotion Agreement appearing in the Appendix to this volume.

instrument). This is surely a folly. What investor would have the slightest faith in a system where the ultimate decision would be taken without even hearing the claimant, and quite plausibly be dictated by the objective alliance of two States anxious to minimize their responsibility generally? May one responsibly speak of an “international court” of “tenured judges” who will be free of perceived bias without at least a thought to how they will be recruited? Will it be by means of an election by a body comprising only diplomats after the usual rounds of sterile receptions and purely political horsetrading—sometimes with good intentions, sometimes cynical; but frequently frivolous? Or a “regional” international body from a heavily capital-importing continent staffed entirely by “judges” from that region? “Judges” who have spent their entire working lives as the employees of governmental elites? Do not the proponents of such ideas care about investors’ perceptions? It is permissible to answer “no,” of course, just as it is permissible to say that international investment flows should be discouraged, presumably because investment is far too important to be left to investors. This is not, however, a line that goes down well with the economic ministries of poor countries, who tend to believe that investments are mobilized by investors.

We would all like to reach a heaven of consistency and accountability, but in our lifetimes are unlikely to build a tower of Babel to get there.

It would be a sad paradox indeed if the quest for greater legitimacy had the result of undermining legitimacy. The existing system, as noted above, entitles the parties to select arbitrators selected by them, or in accordance with the rules to which they have agreed. Parties have used this opportunity to appoint highly distinguished arbitrators. The first investment case not founded on a contract, *SPP v. Egypt*,³¹ was chaired by a former President of the ICJ. At least four of his successors from The Hague have also served as ICSID arbitrators. But beyond the inherent qualities of the arbitrators, which may of course be variable and debatable, the fundamental point is that they possess the ultimate legitimacy of the parties’ confidence. If an appointing authority steps in to name the presiding arbitrator, the appropriateness of its nomination is a matter of the governance of that institution. Given the primordial role of ICSID and the Permanent Court of Arbitration in the context of investment arbitrations, it merits mention that each of these bodies is subordinate to boards whose memberships are constituted entirely of States.

³¹ ICSID, 14 April 1988 (Jurisdiction) (the author assisted the claimant).

When the ICSID annulment committee in *CMS v. Argentina*³² criticized aspects of the arbitral tribunal's award dealing with Argentina's necessity defence, it noted that if it were "acting as a court of appeal, it would have to reconsider the Award on that ground." This may rekindle ardours for an appellate mechanism. My objection, however, not only remains the same (with the greatest respect, although I accept that a *garde-fou* is required to police excess of jurisdiction and failures of due process, I fail to see that members of ad hoc committees have greater claim to legitimacy in assessing substantive issues than arbitrators chosen by the parties) but I would add that ad hoc decisions themselves are open to criticism. There is no objective final answer. We have already seen three ICSID ad hoc decisions containing dissenting opinions, including those authored by no lesser figures than Professor Francisco Orrego Vicuña and Sir Frank Berman.³³

The Promise of Transparency

From a practitioner's point of view, all is certainly not perfect. The problem is not, I believe from my vantage point as advocate for claimants and respondents alike, one of moral hazard. Critics pointing fingers at an imagined self-selecting group of arbitrators, who callously seek their own advantage without regard to legitimacy or public welfare, are simply unacquainted with reality. Arbitrators are selected by the parties, or in accordance with the parties' agreement. States are not helpless victims, incapable of strategy or tactics.³⁴ Practitioners are no less attached to these questions when representing states than when acting for investors.

The concern is rather one of unevenness in the quality of decision-making in this new field. Some excellent commercial arbitrators seem to have insufficient grounding in public international law. Apart from their unfamiliarity with important recurring issues, they fail to perceive that they are no longer referees in a match which concerns only the participants. Investment arbitrations

³² ICISD, 25 September 2007. (The author was not personally involved in the case, but his firm acted for the claimant.)

³³ *Siag v. Egypt*, ICSID, 11 April 2007; and *Lucchetti v. Peru*, ICSID, 5 September 2007; respectively. See also *Soufraki v. UAE*, ICSID, 27 May 2007 (Nabulsi).

³⁴ To take the example of Europe's least internationally experienced state, when Albania faced its first ICSID case (a not implausible claim that an investor's agricultural plant had been overrun by local groups, with governmental encouragement or tolerance, or at any rate without any governmental reaction as required in the relevant treaty), the government appointed leading international lawyers to represent it. The eminent arbitral tribunal was presided over by Professor Karl-Heinz Böckstiegel. Albania prevailed; ICSID, 29 April 1999.

generate constant public interest. Awards tend immediately to fall into the public domain and contribute to the broad emerging normative tapestry. It may be a serious mistake to perceive one's duty as selecting which of two parties' arguments are better. Even if there is a clear winner, its arguments are not necessarily correct; often they are not. This requires discernment and hard study, lest the arbitral tribunal lend its authority to propositions which may be intuitively convenient in the particular, but are unsound in the general. Commercial lawyers venturing into finely balanced matters of public international law may also be tempted, perhaps by an excess of self-confidence, to deliver themselves of a broad general exposition with the intent of clearing up a troubling issue, presuming hubristically, as it were, to do the world a favour by accounting for their brief foray into this new area. This often leads to trouble.

Equally, public international lawyers may have an inadequate grasp of the proper way to conduct proceedings, not to mention economics and commercial law. It does not help that parties are generally deferential, and may therefore unfortunately steer arbitrators away from the path of modesty. Another undesirable consequence is that such arbitrators, like surgeons operating on someone who has the flu, do what they know rather than what they should, avoiding areas with which they are not familiar but which are at the core of the task at hand.

Finally, the rapid development of investment arbitration has given rise to a problem of recruitment of arbitrators. The challenge is how to ensure inclusiveness without sacrificing quality and impartiality. Investment arbitration needs decision-makers selected from the fullest range of backgrounds. But that does not make it tolerable for arbitral institutions in any given case to appoint unknown and untested persons merely on the basis of their geographic origin, without regard to their lack of verifiable references. Such reservations are of course themselves problematic; they may serve to frustrate the recognition and emergence of deserving individuals outside the major centers of legal resources.

All of this is significantly related to the issue of transparency. Transparency alone will not ensure quality decision-making. Even without increased transparency, I expect that the second decade of modern investment arbitration will already see the rise of a better second generation of awards. (Everyone can learn: parties, lawyers, institutions—even arbitrators.)

Nor is the objective of transparency solely to improve arbitral decision-making. At stake are also important values of accountability and policy-making freedom

to pursue the public interest. But these are vast subjects, much discussed in past and modern literature, and not the direct focus of this volume. Allow me therefore to make a few simple observations about the relationship between transparency and quality of decision-making.

First, what about the perception that confidentiality is per se a valuable *raison d'être* for arbitration? It has already been abundantly pointed out that when the process involves public bodies, secrecy is presumptively suspect. The point I wish to make is broader. Even when the parties are private, the issue is radically different when one compares national settings with the international arena. In the former, the preference for confidentiality may be decisive in the choice between local courts and local arbitrators. The applicable law is neutral, and the question of national discrimination does not arise. So when two parties of the same nationality choose arbitration, they may indeed be seeking confidentiality. When they are of different nationality, on the other hand, they seek neutrality above all. (Seeking to avoid a sidetrack, I propose simply to note that cost and time efficiency, along with the attraction of specialized decision-makers, are features difficult to assess *ex ante* in the international context, and likely to play a minor role as compared to the goal of neutrality.) In other words, investment arbitrations should be transparent not only because they involve states, but also because they are international and therefore above all should be neutral. How can we be satisfied about neutrality unless we can observe this law in action?³⁵

Second, the diligence of arbitrators is improved by the awareness that their work is being observed by others. When arbitration is confidential, bad work may be immune from criticism because the winner will in any event praise it, while the loser's complaints are dismissed as sour grapes. To be observed—to have their decisions dissected and criticized—may annoy some arbitrators. It may increase their workload to have to be more punctilious about matters of form, more thoughtful about matters of substance, more painstaking about their drafting in a foreign language, more careful in the accounts they give of the parties' arguments and their own analysis of the law. It will be a challenge to all, perhaps a discouragement to some who may prefer to decline appointment. So be it.

³⁵ There are particular circumstances when parties have legitimate needs for confidentiality, such as matters of intellectual property and national security. For such specific circumstances, specific agreements are called for.

Third, I perceive a danger that the proponents of transparency may harm the good cause by overreaching. Unlimited access by all and sundry to pleadings, evidence and hearing rooms is disruptive, and may indeed have quite unintended and illegitimate consequences. That also goes for the unlimited right to be heard by self-appointed interested parties, because they would of course then require access to the pleadings, evidence, and hearings. To require all presidents of ad hoc tribunals to inform international organizations of the pendency of certain types of cases is a very poor idea, for a multitude of reasons. There are however a number of good solutions. Decisions of tribunals (orders and awards) may simply be de-confidentialized. In order that awards may be properly understood by third parties, pleadings and transcripts (and possibly the evidentiary record) may be de-confidentialized as well—once the case is over. But such solutions are not appropriate for all types of arbitrations, nor for all types of international treaties. We need a scalpel, not a wrecking ball. Secrecy should always have to be justified, but that does not answer all questions of proper legal process. In investment arbitrations, to the extent that the relevant rules allow discretion, this is part of the arbitral craft, as some distinguished tribunals have already shown; to the extent they do not, the issue falls to determination by specific agreement, whether case by case, BIT by BIT, or otherwise.