Lectures and Addresses

Investment Arbitration: a Voyage of Discovery A Paper Presented at the SJ Berwin International Arbitration Launch, London, November 4, 2004

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Investment arbitration has in recent years resembled an adventurous journey through uncharted waters. It has led to surprising turns and discoveries not unlike the expeditions of famous explorers like Sir John Franklin. The stakes are often high. Claims for several hundred million pounds are by no means unusual. Therefore, it is not surprising to see that the traffic along this route has increased dramatically. There are 82 cases pending at ICSID alone with more awaiting registration. And this does not include arbitrations pending with other arbitration institutions and *ad hoc* arbitrations. Many of these cases are not even in the public domain. The transport in these travels is quite traditional. It takes place essentially in the form of commercial arbitration. But investment arbitration has introduced its own peculiarities.

The first is the way the arbitration agreement is made between the host State and the investor. In the majority of current cases this is not a simple contract, signed by the two parties, but an asymmetrical arbitration agreement. One part of this agreement is a general offer to arbitrate, contained in a treaty between the host State and the investor's State of nationality (or less often in domestic legislation). Most of the time, the offer is contained in a bilateral investment treaty (BIT). At other times it is contained in a regional treaty such as NAFTA or the Energy Charter Treaty. The other part of the agreement, that is the acceptance of that offer by the investor, takes place usually simply through the institution of proceedings.

The asymmetrical nature of the arbitration agreement means that the clause in the treaty dictates the conditions under which it applies. Sometimes there may even be disagreement as to whether there is consent to arbitration at all. If the treaty says "the States hereby submit to arbitration", there clearly is consent. If it says "a dispute shall be submitted" there is also consent. But if it says "in case of a dispute the parties shall consent" there is no valid consent and ICSID won't even register the case. Therefore, reference to arbitration in an investment treaty must be studied carefully before concluding that the arbitration route is open.

Some treaty clauses providing for arbitration are wider than others. Some treaties foresee arbitration for any investment dispute; others, only for disputes involving alleged violations of the treaty itself. Yet another type offers arbitration only for disputes over the amount of compensation in case of an expropriation. Therefore, the fact that there is access to arbitration, in principle, does not mean that one will necessarily be able to reach the desired goal.

Most arbitration clauses in treaties have conditions attached to them. The exhaustion of local remedies is not usually among them. There is agreement that the investor does not need to exhaust all procedural possibilities in the host State before initiating arbitration. In fact, the ICSID Convention in Art.26 specifically says so. But sometimes there are so-called waiting periods. These require the claimant first to seek an extra-judicial settlement for, say, six months. In practice these waiting periods have not constituted a serious obstacle. Even

where the requests for arbitration were premature, investors were usually able to convince the tribunals that any attempts at an amicable settlement would be pointless. Therefore, the tribunals did not send the claimants back to the negotiating table. In some cases, the tribunals even found that the waiting periods were merely procedural and could be disregarded.

A more serious initial obstacle is a requirement found in some BITs that the case first be brought to the host State's domestic courts for a certain period of time, say, 18 months. This is not a requirement to exhaust local remedies. The investor is free to go to arbitration after that period of time even if there is no final decision, which would be quite unlikely anyway. But even the attempt in the domestic courts is burdensome and costly. In countries where the cost of court proceedings depends on the sum in dispute this can be a very expensive interlude. Investors have so far managed to circumnavigate this obstacle with the help of MFN clauses. But of course the appropriate MFN clause may not always be available. In that case a second line of argument may be utilised: the futility of the domestic proceedings, an argument that is well established in the context of the exhaustion of local remedies rule.

Yet another condition of consent that we sometimes find in investment treaties is a so-called fork in the road provision. In a way, this is the exact opposite of the rule that first sends investors to the local courts. Under it, the investor is given a choice between the host State's domestic courts and international arbitration. Once made, that choice is final. In other words, by taking its dispute to the domestic courts the investor ruins its prospects to go to arbitration. It is unlikely that an investor will do that willingly. But an investor may get drawn into all sorts of disputes relating to its investment. For instance, it may be compelled to appeal against an unfavourable decision on pain of losing the possibility to contest it domestically.

Tribunals have adopted a generous attitude towards investors on fork in the road provisions. They have held that the domestic disputes, though related to the international disputes before them, were not identical since the causes of action (and sometimes the parties) were not identical. For instance, if the claim before the tribunal alleged a violation of a BIT and the domestic proceedings concerned an appeal against the decision of a regulatory authority, the two disputes were not the same even though they may have been based on the same facts.

Therefore, the various conditions attached to consent clauses have not turned out to be serious obstacles for investors putting out to sea and starting their journeys along the route of investment arbitration. But before embarkation the passengers need to have their passports checked, sometimes quite literally. The nationality of claimants is important for several reasons. Not all countries are parties to the ICSID Convention. For instance, Canada has not ratified. Therefore, Canadian investors may not avail themselves of its benefits. Also, an investor relying on a BIT must show proof that she is a national of the country that is the host State's treaty partner. Sometimes that can be a problem even for individuals. Recently there was a case in which the investor claimed on the basis of a BIT between Italy and a host State. He produced his Italian passport and several certificates of nationality. But he had applied for and obtained Canadian nationality a few years earlier. Without realising it and unbeknown to the Italian authorities he had thereby lost his Italian nationality. The tribunal found so and rejected the claim.

When it comes to corporations, the problem of nationality can become even more complex. In investment arbitration it is essential that the investor be identified as a foreigner. Otherwise there is no access to arbitration. To give a few examples:

- if the investor operates through a corporation locally incorporated in the host State, the parties may agree in advance to treat that local company as a foreign investor because of its foreign control;

- under the provisions of most BITs the shareholding in a company registered in the host State is itself an investment. Therefore, the shareholder remains protected against adverse action directed at the local company;
- a foreign registered company is still a foreign company even if it is controlled by nationals of the host State.

These examples are enough to demonstrate that the investor's nationality can be the object of careful planning, rather like tax planning. Investors can, as it were, sail under flags of convenience. But there are limits to legal creativity in this field. For instance, some treaties require that for a company's nationality to be recognised it is not sufficient for it be incorporated in a particular country but it must also have an effective place of management there. Or, the assignment of a claim to another company (*e.g.* a subsidiary) with a suitable nationality for the sole purpose of pursuing that claim may not work if the purpose of the transaction is too obvious.

The existence of an investment is another recurrent preliminary question. Most BITs define the concept of an investment so widely that it is difficult to imagine a commercial transaction that is not covered. But if the arbitration takes place under the ICSID Convention there is another threshold that may be a little higher. For instance, under the ICSID Convention there must be an existing investment. Preparatory expenses incurred with a view to a future investment but before the signing of a contract would not be sufficient. On the whole, tribunals have been rather generous when it came to the recognition of an investment. For instance they have held that contracts for the construction of a road, the operation of a rubbish dump, and even the provision of a loan all constituted investments.

To return to my metaphor of a journey by sea—a big problem is often to know whether we are travelling in international or national waters. The applicable law may be international law or the host State's law or, most frequently, both; less often the law of another country. The parties are free to choose the applicable law and this does indeed happen quite often. Many BITs contain choice of law clauses. The result of most of these clauses is a combination of international law and of the host State's law. A default rule in the ICSID Convention, which applies in the absence of a selection of the applicable law by the parties, also directs the tribunal to apply host state law and international law. Obviously, the investor is subject to the regulatory framework of the local law. At the same time it enjoys the protection of international law, that is, of applicable treaties and customary international law. In a particular dispute, the host State will typically insist on the application of its own law, while the investor will seek shelter in international standards.

The practice of tribunals on the issue of applicable law varies considerably. Some will first look at the applicable domestic law and then check it for compliance with international law. In fact, the prevailing view is that the function of international law vis-à-vis domestic law is supplementary and corrective. Other tribunals have gone straight to international law, sometimes treating the host State's domestic law with disdain. Obviously, much in this area will also depend on how the case is pleaded. If both parties restrict their arguments to issues of international law, it is unlikely that the tribunal will embark upon an investigation of a domestic legal system with which it may be quite unfamiliar. The applicable law in investment disputes has turned out to be a dangerous area. It takes great nautical skill to keep the proper balance between the Scylla and Charybdis of the two legal systems. A number of cases have actually foundered on the rocks of the proper or rather the improper law. Some awards have been annulled or set aside for failure to apply the proper law. Others were attacked but salvaged although perhaps some of these should have been left to sink.

Incidentally, the review of arbitral awards has turned out to be another fairly busy side passage. In the case of ICSID arbitration, this is done through an internal annulment procedure. Non-ICSID awards are subject to the traditional supervision and setting aside

procedures under the domestic law of the countries in which the tribunals have their seat. There are currently plans to develop a review mechanism by way of an international appeals facility for investment arbitration.

Finally, let me mention a strange creature that has been discovered on this voyage of investment arbitration. It is a two-headed monster called the treaty claim/contract claim action. Its two heads are pointed different ways and it tries to stumble towards different directions at the same time. Not surprisingly, this creature is neither nimble nor elegant. How did this strange phenomenon come about? Many cases involve investment contracts with their own substantive provisions and dispute settlement procedures. Most often these procedures are restricted to litigation in the host State's domestic courts. At the same time, these cases are covered by an investment treaty providing for international standards of protection and for international arbitration. When the investors start international arbitration on the basis of the treaty, the host States will object, arguing that there is a forum selection clause in the contract which points to its domestic courts. This, in the host State's view, constitutes a waiver of international arbitration.

Most of these objections have been unsuccessful. The tribunals have held that the contractual clauses pointing to domestic courts did not deprive them of their jurisdiction to hear claims for violations of international law, especially BIT claims. With respect to contract claims the outcome of these cases has been mixed. In some cases the tribunals found that they also had the power to decide claims for breach of contract, at least in principle. But the more recent trend seems to be to decline competence for the contract claims and to send the parties to the domestic courts for these. Of course, the crucial problem is how to distinguish one from the other. The facts may lend themselves to claims for breach of contract and for breach of international law. But the standards to be applied are not necessarily the same. Under the new tendency, the investor would have to argue its case twice; once on the basis of the contract before the domestic courts and once before the international tribunal on the basis of international law, especially the treaty. If the investor is unlucky, she may be told by the tribunal that her claim is inherently contractual and hence inappropriate for international arbitration.

For the investor the international tribunal is obviously the more attractive forum. Therefore he will present his case there and describe it as a breach of treaty. This leads to the next question: who decides whether there is a claim under international law or merely a contract claim? Is it sufficient for the claimant to invoke some provision of a BIT? Most tribunals have held that, in principle, the characterisation of the claim for purposes of jurisdiction is undertaken by the claimant. The tribunal will decide on the accuracy of this provisional characterisation in its decision on the merits. Only then will it determine whether or not international law, especially guarantees under a BIT, has indeed been violated. But the claimant's categorisation of a claim as being based on international law is not only provisional but also subject to correction by the tribunal in case of obvious misdescription. Other tribunals have occasionally required a more objective standard already for purposes of jurisdiction, referring to the "essential basis of a claim" or asserting that the test was an objective one.

But the problem is even more complex. As mentioned before, some BITs, in their clauses on dispute settlement, provide for arbitration only in respect of treaty violations. Others refer to investment disputes in general. Should this not make a difference? To make things even more complicated, some treaties contain so-called umbrella clauses. Under these, the States promise to honour any commitments assumed towards investors. The prevailing view is that a clause of this kind puts investment contracts under the protection of the BIT with the consequence that a contract violation also becomes a violation of the BIT. The reaction of tribunals to inclusive treaty clauses of this kind has been mixed. Some have accepted jurisdiction over contract claims, others have declined it. One tribunal said it had jurisdiction over contract claims but still sent the investor to the host State's domestic courts

for the determination of the quantum of the claim. In other words, our monster is very much alive but somewhat disoriented.

I should not conclude my remarks about investment arbitration without at least mentioning State v State arbitration. Practically all treaties provide for it but it is hardly used. In a way this demonstrates the success of investor/State arbitration. The investor's State of nationality is no longer concerned with this type of dispute but leaves its national to pursue her own rights. But we should not be too sure that State v State arbitration will not have a renaissance one day in the investment field. There are signs of uneasiness with what some countries perceive as the excesses of investor/State arbitrations and there are some early signs of States beginning to close off or at least reduce some of its routes. Some arbitral tribunals have reacted to these sentiments by starting to close some gangplanks that seemed too accessible to litigious investors. If this trend continues, the current boom of investor/State arbitration may give way to a mix that includes more cases involving the two States.