

## Chapter 40

# The Future of Investment Arbitration

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### I. Foreign Investment and Development

There is broad consensus that foreign investment is an important if not the most important factor in economic development. It provides access to a number of indispensable economic resources. These include capital, technology and know-how. The volume of capital transfers through private foreign investment is considerably larger than all forms of public development aid, bilateral and multilateral.

In addition, foreign investment facilitates access to world markets, to worldwide distribution channels and other networks. Not infrequently, foreign direct investment contributes to the improvement of infrastructures in developing countries like telecommunication systems, roads and airports, to the training of the local workforce and to the development of indigenous industries.

This has led most developing countries to revise their previously reserved attitudes towards foreign direct investment and to adopt an open and welcoming attitude. The 1980s, and even more so the 1990s, saw a reversal of the "New International Economic Order" of the 1970s with its emphasis on sovereignty, State regulation and the right to expropriate.

To a large extent the investment climate in a country consists of economic and political factors such as market access, the availability and cost of production factors, taxation, the existence of infrastructures, the existence of a functioning public administration, the level of corruption and political stability.

In addition to economic and political factors, a country's investment climate is determined by the legal framework for foreign investment. This legal environment is, in turn, determined by a number of factors. These include the stability of the legal conditions under which an investor operates, the quality of the local public administration, the transparency of the system of local regulations and an effective system of dispute settlement.

### II. Settling Investment Disputes

The settlement of disputes between host States and foreign investors is a particularly important aspect of the legal protection of foreign investments. In the absence of

other arrangements, a dispute between a host State and a foreign investor will normally be settled by the host State's domestic courts. From the investor's perspective, this is not an attractive option. Rightly or wrongly, the courts of the host State are not seen as sufficiently impartial in this type of situation. In addition, domestic courts are usually bound to apply domestic law even if that law should fail to protect the investor's rights under international law. In addition, the regular courts will often lack the technical expertise required to resolve complex international investment disputes.

Domestic courts of other States are usually not a realistic alternative. In most cases, they lack jurisdiction over investment operations taking place in another country. In addition, sovereign immunity or other judicial doctrines will often make such proceedings impossible.

Diplomatic protection was a frequently used method to settle investment disputes. It requires the espousal of the investor's claim by his or her home State and the pursuit of this claim against the host State. This may be done through negotiations or through litigation between the two States before an international court or arbitral tribunal. But diplomatic protection, too, has several disadvantages. The investor must have exhausted all local remedies in the host country. Moreover, diplomatic protection is discretionary and the investor has no right to it. Also, diplomatic protection is unpopular with States against which it is exercised and may lead to tensions in international relations. Not surprisingly, developing countries do not like being leaned upon by powerful industrialized States. Therefore this method carries political disadvantages for the investor and for both States. It may cause diplomatic friction between the States concerned and cast a shadow over their relations.

### III. Investment Arbitration

Today, direct arbitration between the host State and the foreign investor is the preferred option for the settlement of investment disputes. International arbitration provides an attractive alternative to the settlement of investment disputes by national courts or through diplomatic protection. Arbitration offers the parties the opportunity to select arbitrators who enjoy their confidence and who have the necessary expertise in the field. The private nature of arbitration, assuring the confidentiality of proceedings, is often valued by parties to major economic development projects, although recently there have been calls for more transparency in investment arbitration.

Investment arbitration is in the interest of both investors and host States. Although being exposed to a claim before an international tribunal causes some inconvenience to States, investment protection is actually in the longer term interest of host States. It is no coincidence that the most important legal document governing investment arbitration, the ICSID Convention,<sup>1</sup> was conceived in the framework of an international development institution, the World Bank. The very first sentence of the ICSID

<sup>1</sup> Convention on the Settlement of Investment Disputes between States and Nationals of other States, 575 U.N.T.S. 159 (1966), 4 I.L.M. 532 (1965).

Convention's Preamble refers to the need for international cooperation for economic development and the role of private international investment therein.<sup>2</sup>

The advantage of access to investment arbitration for the investor is obvious: it gains direct access to an effective international forum should a dispute arise. This is an important element of the legal security sought by investors before making a decision to invest.

The advantage to the host State is twofold. The more obvious one is the improvement of the country's investment climate through the possibility of international arbitration. By offering arbitration the host State creates an important incentive to foreign investment. The Tribunal in *Amco v. Indonesia* pointed out that "to protect investments is to protect the general interest of development and of developing countries."<sup>3</sup>

In addition, by consenting to investment arbitration the host State usually protects itself against other forms of foreign or international litigation and political pressure. In particular, a major advantage of ICSID arbitration is that the host State effectively shields itself against diplomatic protection by the State of the investor's nationality.<sup>4</sup>

The 1990s have seen an enormous increase in the number of investment arbitrations instituted by foreign investors against host States. This boom of cases has continued unabated after the turn of the century. What was once seen as an exceptional remedy for unusual situations has become an everyday occurrence. As of April 2009, ICSID's homepage listed 125 pending cases. In 2007 alone, 32 new cases were registered by the Secretary-General of ICSID. Over the years, 161 cases registered by ICSID have been concluded. In addition, there is an undisclosed number of investment arbitrations outside the framework of ICSID. These arbitrations may be administered by the Permanent Court of Arbitration, by the International Chamber of Commerce, by the London Court of International Arbitration, by the Stockholm Chamber of Commerce, or are conducted *ad hoc* mostly under the UNCITRAL Arbitration Rules.

This unexpected success of investment arbitration has not remained without negative consequences. Some countries, especially those that have been the target of a series of claims by investors, have become weary of being the object of recurrent lawsuits by foreign investors and have started thinking of ways to put the genie of

2 "Considering the need for international cooperation for economic development, and the role of private international investment therein. ..."

3 *Amco v. Indonesia*, Decision on Jurisdiction, Sept. 25, 1983, 1 ICSID Rep. 389, para. 23; see also Award, Nov. 20, 1984, 1 ICSID REP. 413, para. 249.

4 Article 27 of the ICSID Convention provides:

- (1) No Contracting State shall give diplomatic protection, or bring an international claim, in respect of a dispute which one of its nationals and another Contracting State shall have consented to submit or shall have submitted to arbitration under this Convention, unless such other Contracting State shall have failed to abide by and comply with the award rendered in such dispute.
- (2) Diplomatic protection, for the purposes of paragraph (1), shall not include informal diplomatic exchanges for the sole purpose of facilitating a settlement of the dispute.

investment arbitration back into the bottle. The spectrum of ideas to contain investment arbitration is wide and ranges from a limitation of jurisdiction of tribunals to a complete abolition.

A number of complaints about investment arbitration have fuelled the debate about its future. These complaints include lack of consistency and contradiction in the case law of investment tribunals, lack of transparency of the arbitral process, perceived lack of responsiveness to community interests in the host State and interference with the competences of domestic courts. Some observers have gone as far as predicting a backlash against investment arbitration.

#### IV. Consent to Jurisdiction

Investment arbitration, like any form of arbitration, depends on the consent of both parties to the dispute. Consent may be given once a dispute has arisen but advance consent is by far the more promising way to submit to arbitration. Consent to jurisdiction may be given in several ways. The most obvious way is a consent clause in a direct agreement between the parties. Arbitration clauses are a common feature in contracts between States and foreign investors.

Another technique to give consent to investment arbitration is a provision in the national legislation of the host State, most often its investment code. Such a provision offers consent to foreign investors in general terms. Many capital-importing countries have adopted such provisions.<sup>5</sup> The investor may accept the offer in writing at any time while the legislation is in force. In fact, the acceptance may be made simply by instituting proceedings. The host State may withdraw its offer at any time before its acceptance by repealing the legislation. But once the investor has accepted the offer, the resulting agreement can no longer be revoked unilaterally.<sup>6</sup>

Today the vast majority of investment arbitrations are instituted on the basis of consent offered in treaties. Most bilateral investment treaties (BITs) contain clauses referring to investor-State arbitration. The States parties to the BIT offer consent to arbitration to investors who are nationals of the other contracting State. The arbitration agreement is perfected through the acceptance of that offer by an eligible investor, *i.e.* a national of the other State party to the BIT. Some regional treaties such as the NAFTA and the Energy Charter Treaty (ECT) similarly offer consent to investment arbitration.<sup>7</sup>

It is established practice that an investor may accept an offer of consent contained in a BIT by instituting arbitration proceedings. Therefore, where a BIT of this kind is in place, an investor no longer needs a formal arbitration agreement with the host State, but can simply invoke the BIT. The Tribunal in *Generation Ukraine v. Ukraine* stated:

5 See, *e.g.*, *Tradex v. Albania*, Decision on Jurisdiction, Dec. 24, 1996, 5 ICSID Rep. 47, 54.

6 See Article 25(1) *in fine* of the ICSID Convention: "When the parties have given their consent, no party may withdraw its consent unilaterally."

7 NAFTA art. 1122; ECT art. 26.

[I]t is firmly established that an investor can accept a State's offer of ICSID arbitration contained in a bilateral investment treaty by instituting ICSID proceedings. There is nothing in the BIT to suggest that the investor must communicate its consent in a different form directly to the State; ... It follows that the Claimant validly consented to ICSID arbitration by filing its Notice of Arbitration at the ICSID Centre.<sup>8</sup>

Treaty clauses providing for investor/State arbitration vary in scope. Some refer to all disputes concerning investments. Other treaties just refer to violations of the treaty itself. For instance, both the NAFTA<sup>9</sup> and the ECT<sup>10</sup> offer arbitration just for violations of the respective treaty itself. Yet other BITs offer jurisdiction for disputes about the amount of compensation for expropriation owed to an investor.<sup>11</sup> Consent clauses in BITs also vary with respect to procedural requirements that must be met before an investor is permitted to commence arbitration. Most of these clauses provide for waiting periods affording the parties an opportunity for a friendly settlement. Many BITs require the investor to seek a settlement in the host State's domestic courts for a certain period of time before proceeding to international arbitration.

By taking up the offer of consent to arbitration in the treaty, the investor accepts the limitations and conditions that are attached to it. The resulting arbitration agreement between the host State and the investor is subject to the restraints contained in the treaty. Therefore, somewhat paradoxically, consent agreements between investors and host States are nowadays largely dictated by treaties. The availability of access to investment arbitration depends on the existence of treaty provisions to this effect and on the details of the offers in these treaties.

Most-favored-nation (MFN) clauses in most of these treaties have a certain leveling effect but have not always been given full force. Whereas some tribunals have applied MFN clauses to provisions dealing with dispute settlement,<sup>12</sup> others have refused to do so, thereby preserving the unequal treatment provided by different treaties.<sup>13</sup>

8 *Generation Ukraine v. Ukraine*, Award, Sept. 16, 2003, 10 ICSID Rep. 240, paras. 12.2, 12.3.

9 Art. 1116 NAFTA.

10 Art. 26(1) ECT.

11 *See, e.g.*, United Kingdom-China BIT, art. 7.

12 *Maffezini v. Spain*, Decision on Jurisdiction, Jan. 25, 2000, 5 ICSID Rep. 396, paras. 38-64; *Siemens v. Argentine Republic*, Decision on Jurisdiction, Aug. 3, 2004, 12 ICSID Rep. 174, paras. 32-110; *Gas Natural v. Argentine Republic*, Decision on Jurisdiction, June 17, 2005, paras. 24-31, 41-49; *Suez v. Argentine Republic*, Decision on Jurisdiction, May 16, 2006, paras. 52-66; *Suez v. Argentine Republic*, Decision on Jurisdiction, Aug. 3, 2006, paras. 52-68.

13 *Salini v. Jordan*, Decision on Jurisdiction, Nov. 29, 2004, paras. 102-119; *Plama v. Bulgaria*, Decision on Jurisdiction, Feb. 8, 2005, 13 ICSID Rep. 272, paras. 179, 223; *Telenor v. Hungary*, Award, Sept. 13, 2006, paras. 90-100; *Wintershall v. Argentine Republic*, Award, Dec. 8, 2008, paras. 158-197.

## V. Availability of BIT Protection

Despite the large number of BITs, currently estimated at over 2,500, the availability of investment treaty protection, in particular access to arbitration, is by no means comprehensive. The traditional pattern of north-south treaty relationships in this area has been supplemented by treaties with former communist countries and between developing countries. But traditional industrialized States typically have no BIT relations. This is based on the assumption that domestic remedies in these countries will suffice.

This means that if Britain were to nationalize parts of its economy, the remedies available to foreign investors would vary considerably. Argentinean, Estonian, Nigerian and Chinese investors would enjoy the protection of a BIT including access to arbitration. But German, U.S. and Australian investors would not, because Britain has no BITs with these countries.

It follows that protection through BITs is still to a large extent a matter of chance and of nationality. It is unlikely that a system that works on the basis of a multitude of bilateral treaties will ever be able to remedy this situation. Attempts to establish a multilateral system of investment protection have failed so far.<sup>14</sup> Regional treaties have a limited impact. The NAFTA, while important, covers three countries only. The Energy Charter Treaty has a larger number of participating countries<sup>15</sup> but is limited to economic activity in the energy sector.

Even among the investors that have access to international arbitration, the conditions vary considerably, depending on the details of the consent clauses in the respective treaties. States tend to shape investment treaties according to the expectations they hold concerning their role as home countries of investors abroad or as recipients of foreign investors. Investment treaties may be seen as swords to empower investors and as shields protecting host States against investment claims.

The metamorphosis of China's BIT practice is a good example to illustrate the point. Until 2003 most Chinese BITs restricted jurisdiction of investment tribunals to disputes concerning the amount of compensation for expropriation.<sup>16</sup> This narrow jurisdictional clause was evidently based on the perception of China as a capital importing country that sought to avoid broad exposure to claims by foreign investors. With the realization of China's role as a country of origin for international investments, China's attitude has changed. China's Model BIT of 2003<sup>17</sup> and a number of more recent BITs concluded by China now provide for jurisdiction for any legal dispute in connection with an investment. The sword available to Chinese investors has increased considerably with a corresponding reduction of the size of China's shield against investment claims.

14 See Stefan Amarasinha & Juliane Kokott, *Multilateral Investment Rules Revisited*, in THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW 119 (Peter Muchlinski, Federico Ortino & Christoph Schreuer eds., 2008).

15 At the time of writing, the number of Parties stood at 47.

16 See, for example, Article 10(1) of the BIT between China and Hungary of 1991.

17 See China's Model BIT of 2003, art. 9, *reprinted in* RUDOLF DOLZER & CHRISTOPH SCHREUER, *PRINCIPLES OF INTERNATIONAL INVESTMENT LAW* 352, 357 (2008).

Conversely, the United States has undergone a role change from a classical exporter of investments to a country that is also a major recipient of foreign investment. This is reflected in the U.S. Model BIT of 2004 which introduced important limitations to investor protection.<sup>18</sup> The shield has grown at the cost of the sword.

## VI. Withdrawal from Investment Arbitration

A number of countries, especially in Latin America, disenchanted by their roles as respondents, have started to think about strategies that would do away with, or at any rate limit, their exposure to investment arbitration. One such strategy is the denunciation of the ICSID Convention.<sup>19</sup> Article 71 of the Convention provides for denunciation at six months notice.<sup>20</sup> But the denunciation will not affect rights and obligations under the Convention arising out of consent to ICSID's jurisdiction given before the notice of denunciation is received.<sup>21</sup> Therefore, use of this provision will have limited effect. Article 72 is an expression of the more general rule that consent, once given, cannot be withdrawn unilaterally.<sup>22</sup>

It follows that once an offer of consent made by the host State by way of legislation or treaty has been accepted by the investor, the Convention's denunciation will not affect the jurisdiction. If the investor has not perfected consent by the time of the notice for the Convention's denunciation, it will not enjoy the benefits of the Convention. Therefore, a prudent investor will not wait until it is ready to file a request for arbitration before it accepts an offer of arbitration contained in legislation or a treaty. If it does so, it runs the risk of losing the benefit of the ICSID Convention after its denunciation by the host State.

Even if a State that has become weary of investment arbitration manages to escape from the reach of the ICSID Convention, it is not necessarily safe from other forms of investment arbitration. Many BITs provide not only for ICSID arbitration but also for other forms of arbitration such as Additional Facility arbitration or *ad hoc* arbitration under the UNCITRAL Rules. Additional Facility arbitration may be available if either the host State or the State of the investor's nationality but not both are parties

18 See Stephen Schwebel, *The United States 2004 Model Bilateral Investment Treaty: an Exercise in the Regressive Development of International Law*, TRANSNAT'L DISPUTE MANAGEMENT, Apr. 2006.

19 On May 2, 2007, the World Bank received a written notice of denunciation of the Convention from the Republic of Bolivia.

20 Article 71 provides: "Any Contracting State may denounce this Convention by written notice to the depositary of this Convention. The denunciation shall take effect six months after receipt of such notice."

21 Article 72 provides: "Notice by a Contracting State pursuant to Articles 70 or 71 shall not affect the rights or obligations under this Convention of that State or of any of its constituent subdivisions or agencies or of any national of that State arising out of consent to the jurisdiction of the Centre given by one of them before such notice was received by the depositary."

22 Article 25(1) *in fine* of the ICSID Convention.

to the ICSID Convention. Other forms of investment arbitration are independent of participation in the ICSID Convention.

Some countries have indicated that they may seek to terminate or amend BITs to which they are parties thereby reducing the risk of being exposed to investment arbitration. Any such attempt would be effective only to the extent that it conforms to the law of treaties. The primary rule for the termination of a treaty is that it takes place in conformity with the provisions of the treaty or by consent of the parties.<sup>23</sup> An amendment to a treaty may take place by agreement of the parties.<sup>24</sup>

The termination or amendment of BITs by agreement of the States parties to them so as to abolish or curtail investment arbitration, while not impossible, is not a promising strategy to ward off claims. It may be possible to reach agreement to this effect among a limited number of like minded States, but it is unlikely that this will have a decisive effect upon the treaty relations of a particular country. The countries of origin of investments have no incentive to agree to serious limitations to the protection of their nationals.

Most BITs provide for the possibility of their termination, usually after ten years. A typical provision would foresee termination at twelve months notice at any time after that period. But investments made while the treaty was still in force would continue to be covered, typically for another ten or twenty years.<sup>25</sup> Therefore, it is possible for States, weary of investment arbitration, to dismantle their respective obligations over time. Quite apart from the undesirable side effects of such a policy, this method is not going to lead to quick and decisive results. Moreover, the attrition of procedural protections is likely to create negative side effects on the country's investment climate and may actually fuel litigation before the opportunity expires.

This does not mean that investment arbitration in its present form will necessarily stay for good and that there is no realistic way to reform or to abandon it. If a broad consensus were to emerge among States that investment arbitration is no longer in their interest, the technical means to replace it by another form of dispute settlement certainly exist. The termination or amendment of BITs by agreement of the parties is one possibility. A more effective way would be a multilateral treaty that replaces the dispute settlement provisions in existing BITs and regional treaties.<sup>26</sup>

Although investors have been given far reaching procedural rights under the current system, the States still retain ultimate control. The fact that at present the investors and their legal counsel are the driving forces in international investment arbitration does not mean that the States have given up the ability to reform the system. Unilateral withdrawal by individual States from investment arbitration will

23 Vienna Convention on the Law of Treaties art. 54.

24 *Id.* art 39.

25 For examples of provisions of this kind, see Article 13 of the Chinese Model BIT of 2003; Article 12 of the French Model BIT of 2006; Article 14 of the German Model BIT of 2005; Article 14 of the United Kingdom Model BIT of 2005 and Article 22 of the US. Model BIT of 2004. The respective provisions are reproduced in DOLZER & SCHREUER, *supra* note 17, at 358, 367, 374, 384, 405.

26 See Vienna Convention on the Law of Treaties art. 59.



be difficult, but the concerted reform or termination of the current system, although unlikely in the short run, remains a distinct possibility.

## VII. Nationality of Investors

Nationality is very important in investment arbitration. The investor's nationality determines from which treaties it may benefit.<sup>27</sup> If the investor wishes to rely on a BIT, it must show that it has the nationality of one of the two States parties. If the investor wishes to rely on a regional treaty, such as NAFTA or the ECT, it must show that it has the nationality of one of the States parties to the treaty. If the investor wishes to rely on the ICSID Convention, it must show that it has the nationality of a State party to the ICSID Convention. In addition, it must show that it does not have the nationality of the host State.

The investor's nationality is relevant for two purposes. The substantive standards guaranteed in a treaty will only apply to the respective nationals. In addition, the jurisdiction of an international tribunal is determined, *inter alia*, by the claimant's nationality. In particular, if the host State's consent to jurisdiction is offered through a treaty, it will only apply to nationals of a State that is a party to the treaty.

Questions of nationality have played a central role in numerous cases. Tribunals have dealt with issues of loss of nationality by individuals,<sup>28</sup> with questions of dual nationality<sup>29</sup> and with the effectiveness of nationality.<sup>30</sup> Corporate nationality has raised even more difficult questions. The most commonly used criteria for corporate nationality are incorporation or the main seat of the business (*siège social*). Most treaties follow these criteria. Tribunals have had to grapple with arguments directed at the nationality of control over companies and with calls to pierce the corporate veil.<sup>31</sup>

At times, investors structure their investments through companies in third countries taking into account the existence of favorable BITs which provide access to investment arbitration. Nationality planning for purposes of benefiting from these treaties is neither illegal nor illegitimate. In *Aguas del Tunari v. Bolivia*, the Tribunal stated:

27 Exceptionally, the status of foreign investor may be extended to permanent residents. See NAFTA art. 201; ECT art. 1(7)(a)(i). Some treaties require domicile in addition to nationality.

28 *Soufraki v. United Arab Emirates*, Award, July 7, 2004, 12 ICSID Rep. 158.

29 *Olguín v. Paraguay*, Award, July 26, 2001, 6 ICSID Reports 164; *Champion Trading v. Egypt*, Decision on Jurisdiction, Oct. 21, 2003, 10 ICSID Rep. 400.

30 *Feldman v. Mexico*, Decision on Jurisdiction, Dec. 6, 2000, 7 ICSID Rep. 327; *Siag v. Egypt*, Decision on Jurisdiction, Apr. 11, 2007; *Micula v. Romania*, Decision on Jurisdiction and Admissibility, Sept. 24, 2008.

31 *Tokios Tokelès v. Ukraine*, Decision on Jurisdiction, Apr. 29, 2004, 11 ICSID Rep. 313; *Saluka v. Czech Republic*, Partial Award, Mar. 17, 2006; *ADC v. Hungary*, Award, Oct. 2, 2006; *Rumeli v. Kazakhstan*, Award, July 29, 2008.

[I]t is not uncommon in practice, and—absent a particular limitation—not illegal to locate one's operations in a jurisdiction perceived to provide a beneficial regulatory and legal environment in terms, for examples, of taxation or the substantive law of the jurisdiction, including the availability of a BIT. ... The language of the definition of national in many BITs evidences that such national routing of investments is entirely in keeping with the purpose of the instruments and the motivations of the state parties.<sup>32</sup>

But not all attempts at nationality planning have been successful. In particular, the nationality requirements under the ICSID Convention have at times led to intricate problems.<sup>33</sup>

To make things even more complicated, some treaties go beyond formal requirements for the nationality of corporations such as incorporation or seat. They require an economic bond between the corporate investor and the State whose nationality it claims.<sup>34</sup> Such an economic bond may consist of effective control over the corporation by nationals of the State whose nationality is claimed or of genuine economic activity of the company in that State.

This preoccupation with issues of nationality has led to a strange paradox in international investment law. For purposes of access to the rights under treaties, especially to investment arbitration, nationality is decisive and much time and effort is spent in individual cases to prove or disprove a particular nationality. When the cases reach the merits stage the picture changes completely. Discrimination on the basis of nationality is prohibited. Most favored nation clauses in BITs guarantee treatment no less favorable than that enjoyed by nationals of any third state. National treatment, as provided by most BITs, guarantees treatment not less favorable than that enjoyed by host State nationals. Moreover, any discrimination on the basis of nationality would amount to a violation of fair and equitable treatment,<sup>35</sup> a standard which has become the centerpiece of investor protection. Any expropriation, in order to be legal, must meet several requirements one of which is that it is not discriminatory.<sup>36</sup>

32 *Aguas del Tunari v. Bolivia*, Decision on Jurisdiction, Oct. 21, 2005, paras. 330, 332.

33 *Banro American Resources, Inc. v. Democratic Republic of the Congo*, Award, Sept. 1, 2000. Only excerpts of the Award have been published: 17 ICSID REV. 380 (2002); *Autopista v. Venezuela*, Decision on Jurisdiction, Sept. 27, 2001, 6 ICSID Rep. 419; *TSA Spectrum v. Argentine Republic*, Award, Dec. 19, 2008.

34 See, generally, Pia Acconci, *Determining the Internationally Relevant Link between a State and a Corporate Investor*, 5 J. WORLD INVESTMENT & TRADE 139 (2004).

35 See, e.g., *CMS v. Argentine Republic*, Award, May 12, 2005, 44 I.L.M. 1205(2005).

36 Article 6(1) of the United States Model BIT of 2004 is typical of these requirements:

1. Neither Party may expropriate or nationalize a covered investment either directly or indirectly through measures equivalent to expropriation or nationalization ("expropriation"), except:
  - (a) for a public purpose;
  - (b) *in a non-discriminatory manner*;
  - (c) on payment of prompt, adequate, and effective compensation; and

This strange discrepancy between non-discrimination on the basis of nationality for purposes of the standards of treatment and strict adherence to nationality requirements for purposes of access to treaty rights, including arbitration, is only in part a consequence of the treaty basis of international investment law. Bilateral treaties are traditionally based on reciprocity, granting rights only to the two states concerned and to their nationals. Regional treaties such as the NAFTA and the ECT also contain strict nationality requirements. Even the ICSID Convention, a treaty that has 143 Contracting States, requires that a party to proceedings is a national of a Contracting State.<sup>37</sup>

A look at human rights law demonstrates that rights of individuals arising from treaties are not necessarily linked to the nationality of States participating in the treaty. Human rights are universal and even under regional human rights treaties, such as the European Convention on Human Rights, the Contracting States guarantee the rights guaranteed by the Convention to “everyone within their jurisdiction.”<sup>38</sup> The International Covenant on Civil and Political Rights is even more explicit by guaranteeing the rights contained therein “to all individuals ... without distinction of any kind,” including national origin.<sup>39</sup> Therefore, the enjoyment of human rights does not depend on the possession of a particular nationality.

This suggests that the distinction made in investment law between privileged nationals that enjoy treaty rights and non-privileged nationals that do not, is not a necessary consequence of treaty relations. Rather, it is a consequence of the unwillingness of States to grant rights of an economic nature<sup>40</sup> on a general basis beyond the confines of reciprocity. Based on the nature of investment relations, States prefer

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(d) in accordance with due process of law and Article 5 [Minimum Standard of Treatment](1) through (3).

Emphasis added.

- 37 Article 25(1). The Additional Facility is available for investment disputes involving parties only one of which is either an ICSID Contracting State or a national of an ICSID Contracting State. Additional Facility arbitration does not take place on the basis of the ICSID Convention but on the basis of a decision of ICSID’s Administrative Council of September 27, 1978.
- 38 Convention for the Protection of Human Rights and Fundamental Freedoms (1950) art. 1: “The High Contracting Parties shall secure to everyone within their jurisdiction the rights and freedoms defined in Section I of this Convention.”
- 39 International Covenant on Civil and Political Rights art. 2(1): “Each State Party to the present Covenant undertakes to respect and to ensure to all individuals within its territory and subject to its jurisdiction the rights recognized in the present Covenant, without distinction of any kind, such as race, colour, sex, language, religion, political or other opinion, national or social origin, property, birth or other status.” The International Covenant on Economic, Social and Cultural Rights (1966) (CESCR) does not contain a corresponding reference to “all individuals.” But it does prohibit discrimination on the basis of national origin. See CESCR art. 2 (1), (2).
- 40 The rights granted under the CESCR are of a different nature than those granted in investment protection treaties.

not to extend these rights to nationals of States that have not given corresponding undertakings and particularly not to their own nationals.

At present, there is no indication that States are willing to follow the example of human rights instruments in the area of investment law and to grant investors' rights to all investors, including to nationals of countries with which they have no treaty relations and to their own nationals. Therefore, nationality is likely to remain a contested issue in many investment cases. A drastic reduction of nationality problems in investment arbitration could be achieved if a widely accepted multilateral treaty offering consent was to replace the multitude of bilateral treaty relations based on BITs. The lack of progress towards a general multilateral treaty for the protection of investments does not make this a likely contingency for the near future.

### VIII. The Role of Domestic Courts

As pointed out above, one of the purposes of investment arbitration is to avoid the hazards of litigation in the host State's domestic courts. Under traditional international law, before an international claim on behalf of an investor may be put forward in international proceedings, the investor must have exhausted the domestic remedies offered by the host State's courts. But it is well established that, where consent has been given to investor-State arbitration, there is generally no need to exhaust local remedies.<sup>41</sup> Article 26 of the ICSID Convention makes it clear that a State may make the exhaustion of local remedies a condition of consent to arbitration.<sup>42</sup> But that possibility is rarely used. Attempts by respondent States in investment arbitrations to insist on the exhaustion of local remedies have not succeeded.<sup>43</sup>

But domestic courts have not disappeared from the scene of investment arbitration. In fact, there are indications that they are creeping back.<sup>44</sup> Some BITs provide that before an investor may bring a dispute before an international tribunal he or she must seek its resolution before the host State's domestic courts for a certain period of time, often eighteen months. The investor may proceed to international arbitration if

41 STEPHEN M. SCHWEBEL, *Arbitration and the Exhaustion of Local Remedies*, in JUSTICE IN INTERNATIONAL LAW. SELECTED WRITINGS OF JUDGE STEPHEN M. SCHWEBEL 171 (1994)

42 ICSID Convention art. 26:

Consent of the parties to arbitration under this Convention shall, unless otherwise stated, be deemed consent to such arbitration to the exclusion of any other remedy. A Contracting State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under this Convention.

43 *Generation Ukraine v. Ukraine*, Award, Sept. 16, 2003, 10 ICSID Rep. 240, paras. 13.1-13.6.; *IBM v. Ecuador*, Decision on Jurisdiction, Dec. 22, 2003, 13 ICSID Rep. 105, paras. 77-84; *AES v. Argentine Republic*, Decision on Jurisdiction, Apr. 26, 2005, 12 ICSID Rep. 312, para. 69.

44 Christoph Schreuer, *Calvo's Grandchildren: The Return of Local Remedies in Investment Arbitration*, 4 LAW & PRAC. INT'L CTS. & TRIBUNALS 1 (2005).

the domestic proceedings do not result in the dispute's settlement during that period or if the dispute persists after the domestic decision.<sup>45</sup>

Tribunals have held that this was not an application of the exhaustion of local remedies rule.<sup>46</sup> In actual practice, investors in most cases were able to avoid the application of such a rule by invoking most favored nation (MFN) clauses in the same BITs which allowed them to rely on other BITs of the host State that did not contain that requirement.<sup>47</sup>

Contracts between host States and foreign investors frequently contain forum selection clauses referring disputes arising from the application of these contracts to the host States' domestic courts. ICSID Tribunals have distinguished between claims based on BITs and claims based on contracts. The contract claims are subject to contractual forum selection clauses but treaty claims are unaffected by such clauses. Under this consistent practice the treaty-based jurisdiction of international arbitral tribunals to decide on violations of these treaties is not affected by domestic forum selection clauses in contracts. The contractual selection of domestic courts is restricted to violations of the respective contracts.<sup>48</sup>

- 45 Norway's Model BIT of 2007 contains a particularly onerous provision. Under Article 15(3), ICSID arbitration becomes available if "agreement cannot be reached between the parties to this dispute within 36 months from its submission to a local court for the purpose of pursuing local remedies, after having exhausted any administrative remedies; ..."
- 46 See *Maffezini v. Spain*, Decision on Jurisdiction, 25 Jan. 25, 2000, 5 ICSID Rep. 396, para. 28; *Siemens v. Argentine Republic*, Decision on Jurisdiction, Aug. 3, 2004, 12 ICSID Rep. 174, para. 104; *Gas Natural SDG, S.A. v. Argentine Republic*, Decision on Jurisdiction, June 17, 2005, para. 30.
- 47 See *Maffezini v. Spain*, Decision on Jurisdiction, Jan. 25, 2000, 5 ICSID Rep. 396, paras. 54-64; *Siemens v. Argentine Republic*, Decision on Jurisdiction, Aug. 3, 2004, 12 ICSID Rep. 174, paras. 32-110; *Gas Natural SDG, S.A. v. Argentine Republic*, Decision on Jurisdiction, 17 June 2005, paras. 24-49; *Suez, Sociedad General de Aguas de Barcelona S.A. v. Argentine Republic*, Decision on Jurisdiction, May 16, 2006, paras. 52-66; *National Grid PCL v. Argentine Republic*, Decision on Jurisdiction, June 20, 2006, paras. 80-93; *AWG Group Ltd. v. Argentine Republic*, Decision on Jurisdiction, Aug. 3, 2006, paras. 52-68. *But see* *Wintershall v. Argentine Republic*, Award, Dec. 8, 2008.
- 48 *Compañía de Aguas del Aconquija, S.A. & Compagnie Générale des Eaux v. Argentine Republic*, Award, Nov. 21, 2000, 5 ICSID Rep. 299; *Compañía de Aguas del Aconquija, S.A. v. Argentine Republic*, Decision on Annulment, July 3, 2002, 6 ICSID Rep. 340; *CMS v. Argentine Republic*, Decision on Jurisdiction, July 17, 2003, 7 ICSID Rep. 494, paras. 70-76; *SGS v. Pakistan*, Decision on Jurisdiction, Aug. 6, 2003, 8 ICSID Rep. 406, paras. 43-74, 147-173; *Azurix v. Argentine Republic*, Decision on Jurisdiction, Dec. 8, 2003, 10 ICSID Rep. 416, paras. 26-36, 75-79; *Enron v. Argentine Republic*, Decision on Jurisdiction, Jan. 14, 2004, 11 ICSID Rep. 273, paras. 89-94; *SGS v. Philippines*, Decision on Jurisdiction, Jan. 29, 2004, 8 ICSID Rep. 518, paras. 136-155, 160-163; *LG&E v. Argentine Republic*, Decision on Jurisdiction, Apr. 30, 2004, 11 ICSID Rep. 414, paras. 58-62; *Siemens v. Argentine Republic*, Decision on Jurisdiction, Aug. 3, 2004, 12 ICSID Rep. 174, paras. 174-183; *Salini v. Jordan*, Decision on Jurisdiction, Nov. 29, 2004, paras. 92-96; *Impregilo v. Pakistan*, Decision on Jurisdiction, Apr. 22, 2005, 12 ICSID Rep. 245, paras. 286-289; *Camuzzi v. Argentine Republic*, Decision on Jurisdiction, May 11, 2005, paras. 105-119;

In some cases tribunals have required an attempt to obtain redress in domestic courts not as a matter of jurisdiction or admissibility but as part of the evidence that the relevant standard of international law had indeed been violated.<sup>49</sup> The Tribunal in *Generation Ukraine v. Ukraine* determined:

[T]he 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.<sup>50</sup>

Under this doctrine an attempt to seek redress in the domestic courts would be required to demonstrate that a substantive standard, such as protection against uncompensated expropriation or fair and equitable treatment, has indeed been violated.<sup>51</sup>

Requiring investors to go to domestic courts before instituting international proceedings is an effective strategy to undermine investment arbitration. This would not only delay a definitive decision but would also increase the investor's costs. In many cases this delay and added expense could be so prohibitive as to discourage investors from the pursuit of their claims. At the same time, strengthening the role of domestic courts appears superficially innocuous and may actually be portrayed in a positive light. Therefore, the interposition of procedural hurdles in domestic courts is a more promising strategy for States that wish to limit their exposure to investment arbitration than outright withdrawal as discussed above.

### IX. Coherence and Consistency

Discrepancies and contradictions in the practice of investment tribunals have become a matter of concern. There are several areas of investment law that display diverse lines of authority or at least individual decisions that are at odds with established practice.<sup>52</sup>

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*Sempra Energy International v. Argentine Republic*, Decision on Jurisdiction, May 11, 2005, paras. 116-128; *Eureko v. Poland*, Partial Award, Aug. 19, 2005, 12 ICSID Rep. 335, paras. 81, 89, 92-114; *Aguas del Tunari, S.A. v. Argentine Republic*, Decision on Jurisdiction, Oct. 21, 2005, paras. 94-123; *Suez, Sociedad General de Aguas de Barcelona S.A. v. Argentine Republic*, Decision on Jurisdiction, May 16, 2006, paras. 41-45; *National Grid PCL v. Argentine Republic*, Decision on Jurisdiction, June 20, 2006, para. 167-170.

49 See *Waste Management v. Mexico*, Award, Apr. 30, 2004, 11 ICSID Rep. 362, para. 97.

50 *Generation Ukraine, Inc. v. Ukraine*, Award, Sept. 16, 2003, 10 ICSID Rep. 240, para. 20.30 (emphasis in the original); see also *EnCana v. Ecuador*, Award, Feb. 3, 2006, 12 ICSID Rep. 427, para. 194.

51 See also *Parkerings v. Lithuania*, Award, Sept. 11, 2007, paras. 316-320, 344, 360, 361, 449, 453, 454.

52 See Christoph Schreuer & Matthew Weiniger, *A Doctrine of Precedent?*, in *THE OXFORD HANDBOOK OF INTERNATIONAL INVESTMENT LAW* 1188 (Peter Muchlinski, Federico Ortino & Christoph Schreuer eds., 2008).

There are several conceivable ways to address this problem. One is the establishment of an appeals procedure. The United States Model BIT of 2004 as well as a number of U.S. treaties provide for the possibility to establish an appellate body or similar mechanism.<sup>53</sup> It is doubtful whether appellate bodies established under different bilateral treaties would lead to a coherent case law. There is no known practice under these provisions.

An alternative model would be the establishment of a multilateral appeals mechanism. ICSID at one point floated a draft that foresaw the creation of an appeals facility at ICSID, but the idea was quietly dropped soon thereafter.<sup>54</sup> The project of a multilateral appeals mechanism in the framework of ICSID would have created several problems. One of these is the provision of Article 53 of the ICSID Convention which says that an award shall not be subject to any remedy except those provided for in the Convention. Any attempt to amend the ICSID Convention would be far too complex to be realistic.<sup>55</sup>

An appeal presupposes a decision that will be attacked for some alleged flaw in order to be repaired. Rather than try and fix the damage after the fact through an appeal, it is more economical and effective to address it preventively before it occurs. A method to secure coherence and consistency that has been successful in European law is to allow for preliminary rulings while the original proceedings are still pending. Under such a system a tribunal would suspend proceedings and request a ruling on a question of law from a body established for that purpose.<sup>56</sup> Preliminary rulings would leave Article 53 of the ICSID Convention untouched. They would help to prevent the development of inconsistencies rather than create a costly and time-consuming repair mechanism.

The creation of a permanent investment court is another possible solution to the problem of inconsistencies. At present, there is no indication that such a project is under serious discussion. It would require a multilateral treaty essentially replacing the ICSID Convention. In addition, the creation of a permanent court would either necessitate the adaptation of a multitude of bilateral and regional treaties currently offering consent to arbitration, or create its own mechanism for submission by States. Even if these structural problems can be overcome, the selection of judges would pose formidable problems. If, as is likely, the selection would be in the hands

53 See generally Barton Legum, *The Introduction of an Appellate Mechanism: The U.S. Trade Act of 2002*, in ANNULMENT OF ICSID AWARDS 289 (Emmanuel Gaillard & Yas Banifatemi eds., 2004).

54 ICSID Secretariat, *Possible Improvements of the Framework for ICSID Arbitration* (Oct. 22, 2004); ICSID Secretariat, *Suggested Changes to the ICSID Rules and Regulations*, Working Paper (May 12, 2005).

55 Under Article 66, any amendment to the ICSID Convention requires the assent of all States parties to it.

56 See Christoph Schreuer, *Preliminary Rulings in Investment Arbitration*, in APPEALS MECHANISM IN INTERNATIONAL INVESTMENT DISPUTES 207 (Karl P. Sauvant ed., 2008).

of contracting States, there is a danger that the bench, at least initially, would have a disposition in favor of State interests at the cost of investor interests.

Reliance on previous decisions seems the most realistic way to achieve consistency. In fact, reference to earlier decisions is a standard feature in most decisions.<sup>57</sup> Tribunals regularly rely on other earlier awards to the extent that they find their reasoning persuasive.<sup>58</sup> At the same time there is clearly no doctrine of binding precedent.<sup>59</sup>

Attitudes towards consistency in addressing similar legal problems vary. Some arbitrators see it as their duty to decide the particular case without regard to a *jurisprudence constante*. Others see it as their duty to contribute to the development of a coherent body of law. The latter view was expressed by the Tribunal in *Saipem v. Bangladesh* in the following terms:

The Tribunal considers that it is not bound by previous decisions. At the same time, it is of the opinion that it must pay due consideration to earlier decisions of international tribunals. It believes that, subject to compelling contrary grounds, it has a duty to adopt solutions established in a series of consistent cases. It also believes that, subject to the specifics of a given treaty and of the circumstances of the actual case, it has a duty to seek to contribute to the harmonious development of investment law and thereby to meet the legitimate expectations of the community of States and investors towards certainty of the rule of law.<sup>60</sup>

## X. Conclusion

Investment arbitration is likely to remain the most important form of dispute settlement in the relationship of host States and foreign investors for some time. A number of shortcomings have emerged over the years and the initial enthusiasm for invest-

57 For a comprehensive survey of citations, see Jeffery Commission, *Precedent in Investment Treaty Arbitration—A Citation Analysis of a Developing Jurisprudence*, 24 J. INT'L ARB. 129 (2007).

58 See MOHAMED SHAHABUDEEN, PRECEDENT IN THE WORLD COURT (1996); Andrea Bjorklund, *Investment Treaty Arbitral Decisions as Jurisprudence Constante*, in INTERNATIONAL ECONOMIC LAW: THE STATE AND FUTURE OF THE DISCIPLINE (Colin Picker, Isabella Bunn & Douglas Arner eds., 2008); Tai-Heng Cheng, *Precedent and Control in Investment Treaty Arbitration*, 30 FORDHAM INT'L L.J. 1014 (2007); Gabrielle Kaufmann-Kohler, *Arbitral Precedent: Dream, Necessity, or Excuse*, 23 ARB. INT'L (2007); August Reinisch, *The Role of Precedent in ICSID Arbitration*, AUSTRIAN ARB. Y.B. 495 (2008); Christoph Schreuer, *Diversity and Harmonization of Treaty Interpretation in Investment Arbitration*, TRANSNAT'L DISPUTE MANAGEMENT, APR. 2006; PRECEDENT IN INTERNATIONAL ARBITRATION (Yas Banifatemi ed., 2008).

59 *Amco v. Indonesia*, Decision on Annulment, May 16, 1986, 1 ICSID Rep. 509, para. 44; *Gas Natural v. Argentine Republic*, Decision on Jurisdiction, June 17, 2005, para. 36; *Enron v. Argentine Republic*, Decision on Jurisdiction (Ancillary Claim), Aug. 2, 2004, 11 ICSID Rep. 295, para. 25.

60 *Saipem v. Bangladesh*, Decision on Jurisdiction, Mar. 21, 2007, para. 67; see also *Noble Energy v. Ecuador*, Decision on Jurisdiction, Mar. 5, 2008, para. 50.



ment arbitration has given way to a more sober assessment. But it is an exaggeration to speak of an acute crisis or a backlash.

Investment arbitration is largely governed by treaties and is hence under the ultimate control of States. For some States, that have found themselves in the role of respondents in multiple proceedings, the experience has been painful. Despite some discussion of exit strategies, the options for individual States are limited. A new architecture for the settlement of investment disputes is possible only on the basis of a broad consensus.

A more likely development is small changes that limit the exposure of States. New BITs tend to be more cautious in granting procedural as well as substantive rights to investors. Old BITs may be renegotiated or even terminated. ICSID has already introduced stricter standards for the registration of requests for arbitration and tribunals are showing an increasing sensitivity towards the needs of States.