Investor/State Arbitration: Recent Trends

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Introduction

Historically, disputes between foreign investors and their host states were resolved through diplomatic channels. Breaches of customary international law were resolved through this process. At that time, individuals and foreign corporations were mere objects and not subjects of international law. Thus whenever there was a dispute between the foreign investor and his host state, the appeal was normally referred to their home governments for intervention and hence the evolution of gunboat diplomacy.[1]Their home governments sent small contingent of warships to moor off the coast of the offending state until reparation was forthcoming.

There has always been an unsettled relationship between international law and municipal law in the context of diplomatic protection especially where a country, on behalf of its investors, seek reparation for damages suffered by their nationals who are shareholders in a company. In *Barcelona Traction, Light and Power Company Limited*[2], the International Court of Justice (ICJ) had to determine whether Belgium could seek reparation from Spain for damages suffered by its nationals, shareholders of a Canadian company. The key question was whether Spain owed an international obligation to Belgium, such that Belgium could bring a diplomatic protection claim. The ICJ addressed this question by considering whether Belgian shareholders had suffered an injury to a *right*, as opposed to an *interest* and concluded that Belgium had failed to establish *ius standi*; that the

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[1] Nigel Blackaby & Constantine Partasides *Redfern and Hunter on International Arbitration* (5th Edn, Oxford: Oxford University Press, 2009) 465. See generally Katia Yannaca-Small (ed) *Arbitration under International Investment Agreements* (Oxford: Oxford University Press, 2010) and Harten G V Investment Treaty Arbitration and Public Law (Oxford: Oxford University Press, 2008)

[2] Judgment, ICJ Reports (5th Feb 1970): 3: Separate Opinion of Judge Morelli, 234-235, paras 4 and 5.

violation of the company's rights and the resulting damage to the shareholders did not constitute a violation of shareholders' rights. The analysis of the company's rights versus the shareholders' rights was undertaken in accordance with the 'relevant institutions of municipal law'. In particular the ICJ stated that it had 'not only to take cognizance of municipal law but also to refer to it. It is to rules generally accepted by municipal legal systems which recognize the limited company whose capital is represented in shares; and not to the municipal law of a particular state, that international refers.[3] This decision is consistent with the corporate law's distinction between the rights of the shareholders and that of companies as enunciated in *Salomon v Salomon*[4].

How relevant is the decision of the ICJ in the context of investment treaty protection other than diplomatic protection? An investment treaty is a treaty involving two or more countries designed to protect and establish rules for across-the-border investments. In other words, it helps protect investors in one country who own assets held in another country. Countries that agree to such international investment agreements make a commitment to apply the standards outlined in the agreement to foreign investments held inside their own borders.[5] Such a treaty can be bilateral or multilateral. A Bilateral Investment Treaty (BIT) deals primarily with the admission, treatment and protection of foreign investment in the territory of a state party.

Investment treaties are international instruments entered into by States, laying down international standards of protection but the beneficiaries of the treaty protection are entitles or individuals – investors – in relation to their individual investments. These beneficiaries are subject to municipal laws, which also governs the underlying investment that the treaty addresses while the treaty is regulated by international law. A treaty must be interpreted according to the Law of Nations, and not according to any municipal law.[6] The general rule of interpretation of a treaty is contained in section 31 of the Vienna Convention on the Law of Treaties. The interplay between international and municipal law has led one scholar to refer to the investment treaty regime as having a 'hybrid or sui generis character'[7]. This characterization has led to the movement of individuals or entities from 'object' to 'subject' of public international law and has created its own unique problems of conflicts between municipal and international law as international law is no longer applicable between states.[8]

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[3] See also Monique Sasson *Substantive Law in Investment Treaty Arbitration* (The Netherlands: Kluwer Law International, 2010) xxii

[4] (1897) AC 22

[5] See Idornigie P O 'International Investment Agreements (IIAs) and Arbitration' in Azinge E (ed) *Corporate Governance and Responsibility: A Tribute in Honour of Professor I A Ayua* (Lagos: NIALS Press, 2014) p 339

[6] *Asian Agricultural Products Ltd v Republic of Sri Lanka* (Award) 4 ICSID Rep 245, 264

[7] Douglas, 'The Hybrid Foundations of Investment Treaty Arbitration, BYIL (2003): 151 cited in Sasson, fn 3

[8] See *Case Concerning Ahmadou Sadio Diallo (Guinea v Congo*) Preliminary Objections, ICJ General List No. 103, 24 May, 2007, para 88 where the ICJ held thus: '….*in contemporary*

In this chapter contribution, we will examine the nature of investor/state arbitration, the protection offered, legal issues and recent trends.

Nature of Investor/State Arbitration

The first BIT was signed between Pakistan and Germany in 1959. One instrument that has contributed to the development of this area of law is the 1965 Washington Convention for the Settlement of Investment Disputes Between States and Nationals of Other States. Nigeria signed this treaty on 13 July, 1965 and ratified it on 23 August, 1965.

A byproduct of the ICSID Convention is the enactment of investment laws in various jurisdictions[9] and the entering into various bilateral investment treaties (BITs)[10]. A forerunner of the modern BITS is the 'Treaty of Friendship, Commerce and Navigation' (FCN Treaty). The BITs became the natural successors to the FCN Treaties. All these developments provide a right of direct recourse to investors and not subject to the political considerations inherent in the diplomatic protection era. As at 26 April, 2014, 159 countries have signed the ICSID Convention while 150 countries have ratified it[11]. Bolivia and Ecuador have withdrawn their membership while among the countries that have signed, some are yet to ratify the Convention.

It is noteworthy that the first case brought by an investor under the investment protections of a BIT was registered in 1987 but was not decided until 1990.[12] Similarly, the world's first BIT was signed in 1959 between Pakistan and Germany.[13] The growth in this form of dispute resolution in the two decades since then has been exponential.[14] From a humble beginning of 8 registered cases with ICSID in 1998, in 2003 it registered 30 new cases with 63 cases pending. However, as at 30 June, 2012, 390 cases were registered under the Convention and Additional Facility Rules out of which 29% are from South

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international law, the protection of the rights of companies and the rights of their shareholders, and the settlement of the associated disputes, are essentially governed by bilateral or multilateral agreements'.

[9] See the Nigerian Investment Promotion Commission Act of 2004 (s26), Ghana Investment Promotion Act (GIPA) 1994, South African International Arbitration Act, and Ugandan Arbitration and Conciliation Act of 2000.

[10] See the 1959 Abs-Shawcross Draft Convention on Investments Abroad and the 1967 OECD Draft Convention on the Protection of Foreign Property

[11] See ICSID 2011 Annual Report: https://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDPublicationsRH&actionVal=ViewAnnualReports&year=2011_Eng

[12] See *Asian Agricultural Products Ltd (AAPL) v Republic of Sri Lanka*, ICSID Case No. ARB/87/3, Final Award, June 27, 1990 (1991) 6 ICSID Review – Foreign Investment Law Journal 526

[13] See http://www.bilaterals.org/article-print.php3?id_article=717

[14] C McLaclan, L Shore and M Weiniger *International Investment Arbitration: Substantive Principles* (Oxford University Press: 2008) 5

America[15], 23% from Eastern Europe[16], 16% from Sub-Saharan Africa[17], 10% from the Middle East & North Africa[18], 7% from Central America & Carribean[19], 9% from South & East Asia & Pacific[20], 5% from North America[21] and 1% from Western Europe[22]. The oil and gas sector has 25% of these cases. The growth is further reinforced by the fact that as at 30 June, 2011[23], there were over 2,700 BITs[24] being concluded since the first such treaties in 1959.[25]

It is not certain how many BITs Nigeria has entered into despite the provisions in sections 4 and 5 of the Treaties (Making Procedure, Etc) Act[26] that the Federal Ministry of Justice should be the depository of treaties and maintain a Register of Treaties in Nigeria and Article 102 of the UN Charter that treaties should be registered with the UN Secretariat. However, from the UNCTAD website[27], Nigeria has 22 BITs. Out of the 22 BITs, only four have been ratified and, therefore, in force[28].

As a country at the threshold of industrialization and creating the legal and institutional framework for the attraction of foreign direct investment, it is hoped that efforts will be made to ensure that all the 22 BITs are in force. Similarly, more BITs should be entered into provided that the challenges espoused in this Inaugural Lecture, among others, are taken into account. Nigeria, as a major player in the African continent should spearhead the development of regional

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[15] Made up of Uruguay, Peru, Ecuador, Venezuela and Bolivia
[16] Made up of Uzbekistan, Serbia, Romania, Macedonia, Georgia and Turkmenistan
[17] Made up of The Gambia, Rwanda, DRC and Tanzania
[18] Made up of Jordan, Egypt and Algeria
[19] Made up Grenada, El Salvador and Costa Rica
[20] Made up of Cambodia and Bangladesh
[21] Made up of Mexico, Canada and USA
[22] http://icsid.worldbank.org/ICSID/FrontServlet . See also ICSID, "The ICSID Caseload – Statistics" (Issue 2012-1) p 11-12, http:// icsid.worldbank.org/ICSID/Index.jsp and L Reed *et al Guide to ICSID Arbitration* (2nd ed, The Netherlands, Kluwer Law International, 2011) 7 . 73% of the registered cases are investment treaty cases.
[23] See ICSID 2011 Annual Report http://icsid.worldbank.org/ICSID/FrontServlet
[24] Out of this number, countries like Comoros, Guinea Bissau, Ireland, San Marino, Sao Tome and Principe, Somalia, St Vincent and the Grenadines, Suriname, Tonga and Vanuatu entered into one BIT each while Germany has the highest number of BITs – 147. See http://icsid.worldbank.org/ICSID/FrontServlet
[25] See Idornigie, P O 'Investor/State Arbitration: Challenges Facing Capital Importing Countries' in *The Journal of Arbitrators & Mediators, Australia,* Vol. 31, No.2, 2012 pp 49-63

[26] Cap T20, LFN, 2004
[27] See United Nations Conference on Trade and Development Document No UNCTAD/DIAE/PCG/2008/1 – http://www.unctad.org/en/docs/diaepcb20081_en.pdf . The countries in this list are Algeria, Bulgaria, China, Egypt, France, Finland, Germany, Jamaica, Republic of Korea, Democratic People's Republic of Korea, Italy, Netherlands, Romania, Serbia and Montenegro, Spain, South Africa, Sweden, Switzerland, Taiwan Province of China, Turkey, Uganda and United Kingdom.
[28] Nigeria has been involved in two ICSID Cases – Guadalupe Gas Products Corporation v Nigeria (Case No ARB/78/1) and Shell Nigeria Ultra Deep Limited v Nigeria (Case No ARB/07/18). The former was settled while the latter was withdrawn after conclusion of arbitral proceedings.

investment treaties and produce a template for use by other African States. It is hoped that Nigerian nationals will be encouraged to invest in Nigeria under the same protection offered by the treaties.

Protection Offered

The basic features of a BIT are as follows:

- Preamble
- Definitions
- Admission
- Substantive Rights – fair and equitable treatment, national treatment, most favoured national (MFN) treatment, full protection and security, protection from expropriation and other umbrella clauses
- Compensation for losses
- Free Transfer of payments
- Settlement of Disputes
- Duration[29]

In all Investment Treaties, 'national' or 'investor' and 'investment' are usually broadly defined. A 'national' or 'investor' is either a natural person or a legal person – a legal person constituted or controlled by a national of the other contracting state. Under the Nigeria-Netherlands BIT, 'investment' means every kind of asset and more particularly, though not exclusively: movable and immovable property as well as any other rights *in rem* in respect of every kind of asset; rights derived from shares, bonds and other kinds of interests in companies and joint ventures; claims to money; rights in intellectual property; rights granted under public law or contract including rights to prospect, explore, extract and win natural resources.

If the host state has breached its substantive obligations and if it has, what are the remedies available to the investors[30]. The implications and nature of these remedies are contentious. More fundamentally, there is no doctrine of judicial precedent in arbitration and thus each arbitration is self-contained. This is compounded by the fact that on the same facts and law, different tribunals can reach different decisions. As a general principle, arbitral awards bind only the parties[31]. The Statute of the ICJ is even more definitive than the ICSID Convention in rejecting the doctrine of judicial precedent.[32]

[29] A typical duration is ten years, with the term automatically extended unless and until one party terminates the treaty with notice: Reed, et al, Op Cit at 105
[30] See McLachlan, et al, Op Cit at 199
[31] See Article 53(1) of the ICSID Convention
[32] Article 59 of the Statute of the ICJ provides that the decision of the Court has no binding force except between the parties and in respect of that particular case.

It should be stressed that there is substantial degree of uniformity in the substantive rights provided in all treaties. However, their scope and application has remained controversial[33]. They are

i) **Fair and equitable treatment[34]** (of the investors) and the international minimum standard. This is determined on a case-by-case basis as it is difficult to reduce the words "fair and equitable" to a precise statement of a legal obligation.[35] Failure to ensure transparency in the functioning of public authorities, bad faith, inconsistency, discrimination, changes in the law, denial of justice and the lack of a predictable framework for investment contrary to legitimate expectations of the investor and commitments made by the host state, are breaches of fair and equitable treatment standards. The standard here is non-contingent and therefore, an investor must take the laws as he finds them. Indeed of all the catalogue of rights vouchsafed to investors, none has proved more elusive or occasioned as much recent controversy as this right.

ii) **Full protection and security[36]** – also difficult to give a precise meaning to this. However, a change in law that undermines the investment may amount to a breach of this obligation. The standard here is also non-contingent.

iii) **No arbitrary or discriminatory measures impairing the investment** –these obligations are not defined in the treaties

iv) **No expropriation without prompt, adequate and effective compensation[37] –** may be direct or indirect or creeping. Also includes measures 'tantamount to' or 'equivalent to' expropriation. Expropriation is permissible if done for a public purpose, on a non-discriminatory basis, in accordance with due process of law and on payment of compensation. Thus acts contrary to undertakings and assurances granted to investors may constitute expropriation. However, what is the standard of compensation[38] – full market value or fair market value or liquidated value, replacement value, book value, discounted cash flow (DCF), etc? If there is a track record of profitability, tribunals most readily adopt the DCF.

v) **National and "Most Favoured Nation" Treatment [39] –** treating investors no less favourably than nationals and companies of the host

[33]See McLachlan, et al, Op Cit at 200
[34] See Harten, Op Cit at 86. See also McLachlan, et al Op Cit at 226
[35] See *CME Czech Republic BV (The Netherlands) v The Czech Republic*, Partial Award, September 13, 2001: www.cetv-net.com/arbitration.asp and *Tecnicas Medioambientales TECHMED SA v Estados Unidos Mexicanos*, ICSID Case No. ARB(AF)/00/2, Award, May 29, 2003
[36] See McLachlan, et al, Op Cit at 247
[37] See Maclachlan, et al, Op Cit at 265. See also Harten, Op Cit at 90
[38] See Maclachlan, et al, Op Cit at 315
[39] See Harten, Op Cit at 83

state (national treatment) or any other state (most favoured nation).[40] They are relative standards and the scope cannot be defined in the abstract.[41] These are contingent standards.

vi) **Free transfer of funds related to investments –** this obligation entitles foreign investors to compensation if suddenly affected by currency control regulations or other host state acts which effectively confine the investor's money in the host state.

vii) **Observance of specific investment undertakings – the umbrella clause [42] –** does this clause elevate any violation of contractual obligations in direct agreements between the host state and investors to the status of a treaty breach?[43] The consensus is that it has not, to hold otherwise would have had far-reaching legal consequences for the host states.

viii) **Compensation[44]**for expropriation is usually different from remedies for other international law breaches. BITs do not provide for the damages to which the investor is entitled as compensation for the treaty breaches. However, in appropriate cases, damages would be awarded in line with the 1928 principle set out by the Permanent Court of International Justice in the *Chorzow Factory Case[45]*. It should be noted that in cases of successful claims for expropriation and other treaty breaches, compensation will not be cumulative. Similarly a respondent State has a duty to mitigate its losses; compound interest can be awarded to the investor and while each party bears its own legal costs, the tribunal costs are shared equally.

ix) **The Concept of Attribution[46] –** Under Article 2 of the ILC's Articles on State Responsibility[47], there is an internationally wrongful act of a State when conduct consisting of an action or omission is attributable to the State under international law and constitutes a breach of an international obligation of the State. In theory, the conduct of all human beings, corporations or collectivities linked to the State by nationality, habitual residence or incorporation might be attributed to the State, whether or not they have any connection with the

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[40] See McLachlan, et al Op Cit at 251 and 254

[41] See Maffezini v Spain, Supra where the Argentine-Spain BIT was compared with Chile-Spain BIT

[42] See Sasson, Op Cit at 173

[43] See *SGS v Pakistan*, ICSID Case No. ARB/01/13, August 6, 2003 and *SGS v Philippines*, Decision on Jurisdiction, January 29, 2004: www.worldbank.org/icsid/cases/awards.htm

[44] See McLachlan, et al Op Cit at 315

[45] *Case Concerning the Factory at Chorzow (Claim for Indemnity) (Germany v Poland)*, Judgment on the Merits, September 13, 1928, Collection of Judgments, Permanent Court of International Justice, Series A, No. 17 (1928) 47 where it was held that reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed.

[46] This is one area where the application of international law inevitably entails consideration of municipal law. See Sasson Op Cit at 1 and Art 4 of the ILC Articles of State Responsibility where reference is made to municipal law (internal law) in Art 4(2). See also Art 5

[47] See Crawford James *The International Law Commission's Articles on State Responsibility: Introduction, Text and Commentaries* (Cambridge: Cambridge University Press, 2007)

government. In practice, the general rule is that the only conduct attributed to the State at the international level is that of its organs of government, or of others who have acted under the direction, instigation or control of those organs, that is, as agents of the State.[48]

x) Reparation, Restitution and Satisfaction[49] - Full reparation for the injury caused by the internationally wrongful act shall take the form of restitution, compensation and satisfaction, either singly or in combination, in accordance with the provisions of Chapter II of the ILC's Articles of State Responsibility.[50] Reparation must, so far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed.[51]

Arbitrating Investment Treaty Disputes

Every BIT has a provision on the resolution of disputes[52]. Article 9 of the Nigeria-Netherlands BIT[53] provides thus:

> *Each Contracting State hereby consents to submit any legal dispute arising between that Contracting State and a national of the other Contracting Party concerning an investment of that national in the territory of the former Contracting Party to the International Centre for Settlement of Investment Disputes for settlement by conciliation or arbitration under the Convention on the Settlement of Investment Disputes between States and Nationals of other States, opened for signature at Washington on 18 March, 1965. A legal person which is a national of one Contracting Party and which before such a dispute arises is controlled by nations of the other Contracting Party shall, in*

[48]Brownlie I *Systems of the Law of Nations: State Responsibility* (Part I) (Oxford, Clarendon Press, 1983) 132-166

[49]See Articles 34, 35 and 37 of the ILC's Articles of State Responsibility. See also Happ R and Rubins N *Digest of ICSID Awards and Decisions: 2003-2007* (Oxford, Oxford University Press, 2009) p 366

[50]In *Charzow Factory Case* supra, the PCIJ provided the most-often-cited formula in this field: "The essential principle contained in the actual notion of an illegal act – a principle which seems to be established by international practice and in particular by the decisions of arbitral tribunals – is that reparation must, so far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed".

[51]See also *Enron Corporation and Ponderosa, LP v Argentine Republic*: ICSID Case No ARB/01/3, Award of 22 May, 2007; *CMS Gas Transmission Company v Argentine Republic*, ICSID Case No. ARB/01/8, Award of 25 April, 2005, *Azurix Corporation v The Argentine Republic*, ICSID Case No. ARB/01/02 Award of 14 July, 2006; *ADC Affiliate Ltd and ADC and ADMC Management Ltd v The Republic of Hungary*, ICSID Case No. ARB/03/16, Award of 2 October 2006 and *Siemens AG v The Argentine Republic*, ICSID Case No. ARB/02/8, Award of 6 February, 2007. See generally Happ R and Rubbins N *ibid*

[52] See Art 8 of the UK Model BIT, 2005, Art IX of the US 1994 Model BIT, Art 10 of the Germany Model BIT, 2005 and Art 8 of the Sri Lanka Model BIT.

[53]Ibid

accordance with Article 25(2)(b) of the Convention, for the purposes of the Convention be treated as a national of the other Contracting Party.

Similar provisions are found in all Multilateral Investment Treaties (MITs)[54] and BITs[55]. In the Sri Lanka Model BIT, Article 8 provides for arbitration under ICSID, or the competent tribunal of the Contracting Party in whose territory the investment was made, or the Regional Centre for International Commercial Arbitration in Cairo, or the Regional Centre for Arbitration in Kuala Lumpur, or the International Arbitration Institute of Stockholm Chamber of Commerce or ad hoc arbitration under arbitration rules of UNCITRAL. This type of dispute settlement clause is usually described as a 'cafeteria style' approach where the investor has a choice between a range of different dispute settlement fora. The principle is *electa una via, non datur recursus ad alteram* (When one way has been chosen, no recourse is given to another). This clause represents a marked departure from the position under diplomatic protection procedures whereby an investor is forced to exhaust all available alternative remedies before having his State assert the claim on his behalf.

Where arbitration is under ICSID, the jurisdictional requirements provided in Art 25 of the ICSID Convention[56] must be fulfilled. The scope of the jurisdiction for any investment treaty tribunal is necessarily circumscribed by the dispute settlement clause of the applicable investment treaty. It is the treaty provision that contains the state's consent[57] to submit a defined category of disputes (jurisdictioin *ratione materiae*) with qualifying claimants (jurisdiction *ratione personae*) to arbitration[58]. In the case of the investor, it is the serving of the Request for Arbitration that gives the consent. Under Article 25, the investor will have to demonstrate that[59]

i) there is a legal dispute;
ii) arising directly out of an investment;

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[54]See Article 1120 of the North American Free Trade Agreement (NAFTA) and Articles IX and X of the ASEAN Agreement for the Promotion and Protection of Investments

[55] See Article 8 of the UK 2005 Model BIT, Article X of the US 1994 Model BIT, and Article 10 of the Germany Model BIT

[56]See Schreuer C H *et al The ICSID Convention: A Commentary*, 2nd Edn (Cambridge: University Press, 2009) 71. See also Alexandrov S A The "Baby-boom" of Treaty-Based Arbitrations and the Jurisdiction of ICSID Tribunals: Shareholders as "Investors" and Jurisdiction Ratione Temporis, 4 *The Law and Practice of International Courts and Tribunals* 19 (2005) and Happ R and Rubins N *Digest of ICSID Awards and Decisions: 2003-2007* (Oxford, University Press: 2009) 330

[57] States can give their consent in three ways: by contract, domestic legislation and treaty. See A R Parra 'The Role of ICSID in the Settlement of Investment Disputes' (1999) 16(1) ICSID News 5. In Nigeria, the NIPC Act (s26) gives such consent by legislation where contracts and the various BITs also give such consent. See also Schreuer Op Cit at 190

[58]Jurisdiction *ratione temporis* refers to the application in time of the respective investment treaty. Normally a state can only be liable for the breach of an investment treaty if that treaty was in force at the time the state took action allegedly in violation of the treaty.

[59] Reed et al Op Cit at 13 and Schreuer, Loc Cit

iii) between a Contracting State; and
iv) the national of another Contracting State; and
v) which the parties to the dispute consent in writing to submit to ICSID.

It is noteworthy that the Convention provides no definition of 'legal dispute' or 'investment'. All these can be ascertained from their definition in the BIT. The existence of a dispute may be in doubt in several ways. An open question may not have matured into a dispute between the parties or a difference of opinion may not be sufficiently concrete to amount to a dispute that is susceptible of arbitration. There may have been a dispute that has since become moot. The International Court of Justice (ICJ) has defined a dispute as "a disagreement on a point of law or fact, a conflict of legal views or interests between parties". ICSID Tribunals have adopted similar descriptions of "disputes" often relying on the ICJ's definition[60].

The disagreement between the parties must also have some practical relevance to their relationship and must not be purely theoretical. It is the not the task of ICSID to clarify legal questions *in abstracto.* The dispute must relate to clearly identified issues between the parties and must not be merely academic.[61]

Another issue is the time of the dispute. The ICSID Convention does not indicate at what time a dispute must have arisen. A guide in this area is the BIT. Some BITs apply retrospectively and others prospectively.[62]

In *Tokios Tokeles v Ukraine*, supra, the Respondent argued that the dispute did not arise directly out of an investment because the alleged wrongful acts by Ukrainian governmental authorities were not directed against the Claimant's physical assets. The Tribunal rejected this argument and held thus:

> *For a dispute to arise directly out of an investment, the allegedly wrongful conduct of the government need not be directed against the physical property of the investor. The requirement of directness is met if the dispute arises from the investment itself or the operations of its investment, as in the present case.*

[60]See *Maffezini v Spain*, Decision on Jurisdiction, 25 January, 2000, paras 93, 94.; *Tokios Tokeles v Ukraine,* Decision on Jurisdiction, 29 April, 2004, paras 106, 107; *Siemens v Argentina*, Decision on Jurisdiction, 3 August, 2004, para 159; *Luchetti v Peru*, Award, 7 February, 2005 para 48; *Impregilo v Pakistan*, Decision on Jurisdiction, 22 April, 2005, paras 302, 303; *AES v Argentina*, Decision on Jurisdiction, 26 April, 2005, para 43; *El Paso v Argentina*, Decision on Jurisdiction, 27 April, 2006, para 61; *Suez at al v Argentina*, Decision on Jurisdiction, 16 May, 2006, para 29; *MCI v Ecuador*, Award, 31 July, 2007, para 63

[61]See *Enron v Argentina*, Decision on Jurisdiction, 14 January, 2004, *Continental Casualty v Argentina*, Decision on Jurisdiction, 22 February, 2006, para 92 and *PanAmerican v Argentina*, Decision on Preliminary Objections, 27 July 2006

[62]See Argentina-Spain BIT of 1991 that provides that the BIT shall not apply to disputes or claims originating before its entry into force.

Generally the interpretation of Article 25 of the ICSID Convention is contentious because that is the basis of its jurisdiction. There are arguments as to who is a national of a contracting state[63] and how is consent in writing given. However, consent through the BIT has become accepted practice[64]. Such a BIT must be in force at the relevant time. In *Tradex v Albania*[65], the Tribunal found that the Request for Arbitration had been submitted before the entry into force of the BIT between Albania and Greece. Therefore it was not possible to establish jurisdiction on the basis of that treaty. While the host state may express its consent to ICSID's jurisdiction through the BIT, the investor must perform some reciprocal act to perfect consent. The investor may do this by submitting a request for arbitration to ICSID.[66]

Most BITs provide for 'cooling off periods' or 'consultation period' for amicable negotiations.[67] It is unsettled whether such provisions are merely procedural or jurisdictional and whether failure to comply vitiates consent.[68]

In practice, there are other issues like whether the pre-conditions can be avoided or relying on the "most favoured nation" clause of the applicable treaty in order to access more favourable pre-conditions in other treaties concluded by the host state of the investment[69]; and whether a state's consent to arbitration in a BIT is overridden by a contractual arbitration clause in a related investment contract[70].

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[63] See Schreuer, Op Cit at 160

[64] See Schreuer, Op Cit at 192

[65] Decision on Jurisdiction, 24 December, 1996, 5 ICSID Reports 58. See also *CSOB v Slovakia*, Decision on Jurisdiction, 24 May, 1999, paras 37-43

[66] See also *Tradex v Albania, supra* where the tribunal said: '.... it can now be considered as established and not requiring further reasoning that such consent can also be effected unilaterally by a Contracting State in its national laws, the consent become effective at the latest if and when the foreign investor files its claim with ICSID making use of the respective national law'. In *Zhinvali v Georgia*, (Case No. ARB/00/1) Award, 24 January, 2003 the tribunal found that the host State's offer of consent, contained in its Investment Law, was later accepted in writing by the claimant when it filed its Request for Arbitration. The same position applies where the consent is in a BIT. See AMT v Zaire, (Case No. ARB/93/1), Award, 21 February, 1997. See also Reed, et al Op Cit at 37

[67] See Schreuer, Op Cit at 237

[68] In *Roland S Lauder v The Czech Republic*, Final Award, September 3, 2001, it was held that a six-month waiting period is not a jurisdictional provision and it was waived: www.cetv-net.com/arbitration.asp and *Bayindir v Pakistan* (Jurisdiction) ICSID Case No. ARB/03/29. Compare *Enron Corporation v Argentine Republic* delivered on 14 January, 2004 where it was held that such a six-month requirement was jurisdictional: www.asil.org, *Goetz v Burundi* (Award: First Part) 6 ICSID Rep 3, and Reed et al Op Cit at 49

[69] See *Maffezini v Spain*, ICSID Case No. ARB/97/7, January 25, 2000 (2001) 16 ICSID Review – Foreign Investment Law Journal 212 where Maffezini, a Spaniard relied on another BIT entered into with Chile.

[70] *Lanco v Arginetina*, ICSID Case No. ARB/97/6, December 8, 1998, 40 I.L.M. 457, paras 39-40 where it was held that the BIT took precedence over the contractual claim as long as the arbitration claims allege a cause of action under the BIT.

This raises the issue of the distinction between contractual right and a treaty right. What separates treaty rights from contractual rights is the source of the right. The foundation of a treaty claim is a right established in an investment treaty and this exist on the plane of international law, while the basis of a contractual claim is a right established in a contract which is found in the domestic law.[71] Ultimately, each jurisdiction is responsible for the application of the law under which it exercises its mandate. Different legal consequences may well flow from the application of the different applicable law. For example, if it is a breach of a treaty, the remedies will be the substantive rights provided in the BIT while if it is a breach of contract, the municipal laws will provide their own remedies. In this regard, the provisions of Article 27 of the Vienna Convention on Law of Treaties should be borne in mind – a party may not invoke the provisions of its internal law as justification for its failure to perform a treaty[72]. However *Noble Energy and MachalaPower Cia Ltd v Republic of Equador and Consejo Nactional de Elictricidad* [73] is an example of a pragmatic 'mix and match' approach in which the arbitral tribunal exercised the power to determine investment treaty question and the contract claim in the same proceedings when the claims are related.

In examining the provisions of Article 25 of the ICSID Convention, it is pertinent to also examine the effect of Article 26 of the Convention on the issue of 'consent to submission to the jurisdiction of ICSID'. Article 26 of the Convention provides thus:

> 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.

It is settled that the consent required of a state is met by the State's consent given in the treaty while that of the investor is met by submission of the claim to arbitration. This being so, the exclusion of other remedies under Article 26 will not apply vis-à-vis the investor until such time as he files his request for arbitration. Mclachlan, et al[74] has comprehensively examined this article and came to the following conclusion:

i) The choice of ICSID arbitration is only to be treated as exclusive once it has been commenced. Any prior proceedings in national courts or pursuit of other alternative remedies will be considered in order to

[71] Blackaby and Partasides, Op Cit at 483 and McLachlan et al, Op Cit at 99
[72] See also Article 3 of the ILC's Articles on State Responsibility
[73] ICSID Case No. ARB/05/12
[74] Op Cit at 98

determine whether the state has failed in its substantive obligations under the treaty.

ii) The right to pursue ICSID arbitration for breach of treaty is not waived under Article 26 by the investor's prior invocation of domestic or contractual remedies.

iii) The exclusivity of ICSID arbitration in the case of treaty claims will, however, only relate to the investment dispute which forms the subject of such claim.

It is submitted that the examination of Article 26 boils down to the issue of the distinction between treaty and contractual claims. Furthermore the tribunal jurisprudence on this subject shows that it is difficult and controversial. Be this as it may, the examination of sources of the applicable laws will assist in resolving the issues arising from the treaty/contract divide.

The ICSID Convention will also supply the choice of law rule pursuant to which the law governing the substantive rights in the arbitration will be selected. Article 42 of the ICSID Convention provides:

(1) The Tribunal shall decide a dispute in accordance with such rules of law as may be agreed by the parties. In the absence of such agreement, the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on conflict of laws) and such rules of international law as may be applicable.

(2) The Tribunal may not bring in a finding of *non-liquet* on the ground of silence or obscurity of the law.

(3) The provisions of paragraphs (1) and (2) shall not prejudice the power of the Tribunal to decide a dispute *ex aequo et bono* if the parties so agree.

Section 6 (Articles 53-55)[75] of the ICSID Convention deals with recognition and enforcement of arbitral award under the Convention. Article 53 provides that the award shall be binding on the parties and shall not be subject to any appeal or to any other remedy except those provided for in the Convention while Article 54 provides that each Contracting State shall recognize an award rendered pursuant to the Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State[76]. Article 55 provides that nothing in Article 54 shall be construed as derogating from the law in force in any Contracting State relating to immunity of that State or of any foreign State from execution.

[75] See Reed et al Op Cit at 179

[76] See the Nigerian International Centre for Settlement of Investment Disputes (Enforcement of Awards) Act of 2004 which provides that such award shall have effect as if it were an award contained in a final judgment of the Supreme Court and the award shall be enforceable accordingly.

One significant feature of arbitration under ICSID Convention is section 52 dealing with annulment of an award.[77] A person who is dissatisfied with the award of an ICSID arbitral tribunal may apply for its annulment. The grounds for annulment are: excess of jurisdiction, corruption, serious departure from a fundamental rule of procedure, failure to state the reasons for the award and lack of proper composition of the tribunal. A different panel is usually constituted for this purpose[78].

Legal Issues

It is a truism that the structure of investment treaties are the same for both developed and emerging markets. Indeed, the treaties are essentially agreements between developed and developing economies or as commonly stated between capital-importing and exporting nations. If an investor opts to pursue treaty claims, what are the legal issues usually faced? They are procedural, jurisdictional, substantive and post-award issues. Such issues include:

a) The Parties – nations or individual investors. The question usually is who are the proper parties to the arbitration? That of the nation is easier to ascertain than that of the investor especially the interpretation of an investor in the BIT.
b) The existence of a Treaty – the investor must prove that there is a treaty in force between the home government and the host state.
c) Protected Investors – legal and natural persons. That of 'natural persons' is easier to determine than legal persons. This is so because it is the 'legal person' either constituted under the law of that Contracting Party or legal persons not constituted under the law of that Contracting Part but controlled, directly or indirectly, by natural persons having the nationality of that Contracting Party. The secondary question is what level of 'control' is adequate?
d) Protected Investments – the term 'investments' means every kind of asset and are usually specified generally in the BIT.
e) Cooling Off Periods – when a dispute arises, there is usually a provision for negotiations – cooling off period? Is such provision mandatory or optional?
f) Arbitration under ICSID – the issues connected with this have been analysed.
g) Arbitration under UNCITRAL Arbitration Rules – UNCITRAL Arbitration Rules are used for ad hoc arbitration.
h) Arbitration under Other Rules – other Rules include ICC Rules, LCIA Rules, SCC Rules of Arbitration, AAA Rules.

[77] See also Art 50-53 of the Arbitration Rules
[78] Idornigie P O *Investment Treaty Arbitration and Emerging Markets: Issues, Prospects and Challenges* (Abuja: NIALS Press, 2011) 38

Recent Trends

Since the first BIT was concluded in 1959 and the invocation of the dispute resolution clauses in the BITs, there has been uncertainty regarding the jurisdiction of ICSID and the substantive rights granted by the BITs. Indeed, controversies have bedeviled BITS. Terms or words like 'investor', 'investment', 'control', 'expropriation', 'compensation' and 'attribution' have assumed centre stage. According to the Recent Developments in Investor-State Dispute Settlement[79], these are the recent trends in investor-state arbitration:

a) **Highlights**

i) By end of 2012, 58 new cases were initiated, which constitutes the highest number of known treaty-based disputes ever filed in one year and confirms that foreign investors are increasingly resorting to investor-state arbitration.
ii) Of the 58, 61% were with ICSID, 21% UNCITRAL, 5% SCC and Others 5%
iii) In 66% of the new cases, respondents are developing or transition economies, while the number of cases initiated by developing countries has increased, the majority of new cases (64%) still originate from developed countries.
iv) Claimants have challenged a broad range of government measures, including those related to revocation of licences, breaches of investment contracts, irregularities in public tenders, changes to domestic regulator frameworks, withdrawal of previously granted subsidies, direct expropriations of investments, tax measures and others.
v) At least 42 arbitral decisions were issued in 2012, including decisions on objections to tribunal's jurisdiction, merits of the dispute, compensation and applications for annulment of an arbitral award. 31 of these decisions are in the public domain.
vi) In 70% of the public decisions addressing the merits of the dispute, investors' claims were accepted, at least in part. Nine public decisions rendered in 2012 awarded damages to the claimant, including the highest award in the history of investor-state arbitration (US$1.77 billion) in *Occidental v Ecuador*[80], a case arising out of a unilateral termination by the State of an oil contract.
vii) For the first time in treaty-based arbitration proceedings, an arbitral tribunal affirmed its jurisdiction over a counterclaim lodged by a respondent State against the investor.
viii) The total number of known treaty -based cases reached 514 in 2012 and the total number of countries that have responded to one or more such case increased to 95.

[79] Updated for the Multilateral Dialogue on Investment: 28-29 May, 2013. See UNCTAD Issue No 1 of May 2013. See also website: www.unctad.org/diae and http://investmentpolicyhub.org
[80]

ix) The overall number of concluded cases reached 244. Of these, approximately 42% were decided in favour of the State and approximately 31% in favour of the investor. Approximately 27% of the cases were settled.
x) The public discourse about the usefulness and legitimacy of investor-state arbitration is gaining momentum, especially given that the mechanism is on the agenda of numerous bilateral and regional international investment agreements (IIA) negotiations.
xi) While investor-state arbitration reform options abound, their systematic assessment including with respect to their feasibility, expected effectiveness and implementation methods remains wanting. A multilateral policy dialogue could help to develop a consensus about the preferred course for reform and ways to put it into action.

b) **Most Frequent Respondents**

In investor-state arbitration, the most frequent respondents are:

i) Argentina – 52 cases
ii) Venezuela – 34 cases
iii) Ecuador – 23 cases
iv) Mexico – 21 cases
v) Czech Republic – 20 cases
vi) Canada – 18 cases
vii) Egypt – 17 cases
viii) United States – 15 cases[81].

c) **Jurisdictional Issues**

i) Scope of the dispute resolution clause – in *Iberdrolav v Guatemala*[82] [2012], the tribunal interpreted the reference in Guatemala-Spain BIT to disputes 'concerning matters governed by this agreement' and found that the treaty does not give '*general consent to submit any kind of dispute or difference related to investment […] but only those related to the violations of substantive provisions of the treaty itself'*.

ii) Jurisdictional threshold of a prima facie case - the tribunal in *Iberdolav v. Guatemala* noted that an international tribunal has jurisdiction only if the claimant established "*the facts it alleged, if proven, could constitute a violation of the treaty".* The tribunal accepted the respondent's objection to jurisdiction with respect to the alleged breaches of the

[81] Annex 2 to the Recent Developments in Investor-State Dispute Settlement (ISDS) updated on 28-29 May, 2013
[82] *Iberdrola Energia SA v Republic of Guatemala* (ICSID Case No. ARB/09/5, Award, 17 August, 2012, para 306

provisions on expropriation, fair and equitable treatment and full protection and security since the claimant had not presented "*clear and concrete reasoning"* on what were, in its opinion, the acts of authority of Guatemala that, in international law, could constitute violations of the Guatemala-Spain BIT.

iii) Similarly, the tribunal in *Chevron v. Ecuador II*[83] noted that, for purposes of the respondent's jurisdictional objections, it had to decide whether or not, if the facts alleged by the claimants are assumed to be true, the challenged conduct would be capable of constituting breaches of the BIT. The tribunal noted that the assumption of truth could be reversed if such factual pleadings were "*incredible, frivolous, vexatious or otherwise advanced by the claimant in bad faith."*Furthermore, the tribunal decided that requiring the claimant to establish its case with a 51% chance of success (i.e. on a balance of probabilities) would constitute too high a prima facie standard and that the claimant's case should be "*decently arguable"* or have "a reasonable possibility as pleaded".

iv) On the definition of "investment" for purposes of establishing the scope of application of (as well as the jurisdiction under) an investment treaty, the tribunal in *Caratube International Oil Company (CIOC) v. Kazakhstan*[84] accepted the respondent's objections to jurisdiction having established that the US national in question did not control the claimant company. The "investment" was understood by the tribunal as "*an economic arrangement" requiring a contribution to make profit, and thus involving some degree of risk".* The tribunal found "*no plausible economic motive*" to explain the US national's investment in CIOC, no evidence of a contribution of any kind (the US national's personal guarantees for a loan received by the company from a Lebanese bank were not considered as constituting a sufficient contribution in this case) or any risk undertaken by the US national, and no capital flow between the US national and CIOC.[85]

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[83] (UNCITRAL), PCA Case No. 2009-23, Third Interim Award on Jurisdiction and Admissibility, 27 February, 2012

[84] (ICSID Case No. ARB/08/12), Award 2, November, 2012, para 455.

[85] See other decisions taken on definition of investment (*Standard Chartered Bank v Tanzania* (ICSID) Case No ARB/10/12), Award, 2 November, 2012, paras 196-197 and *Electrabel SA v Hungary* (ICSID Case No. ARB/07/19), Decision on Jurisdiction, Applicable Law and Liability, 30 November, 2012, para 5.43. For the definition of an investor (*Cayman v Salvador* (ICSID Case No. ARB/09/12), Decision on the Respondent's Jurisdictional Objections, 1 June 2012, paras 2.16-17. On the application of MFN to substantive treaty obligations, the tribunal (*Teinver v. Argentina* (ICSID Case No ARB/09/1), Decision on Jurisdiction, 21 December, 2012, para. 186. On the prohibition of discriminatory and arbitrary measures, the tribunal in *Ulysseas v. Ecuador* (UNCITRAL), Final Award, 12 June, 2012, para 293noted that for a measure to be discriminatory it was sufficient that objectively, two similar situations were treated differently and there was no need to establish that the discrimination was somehow related to the nationality of the investor(s) concerned. On the question of arbitrariness, citing the decision in *Enron v. Argentina*, the tribunal stated that, for a

v) On the definition of "investment" for purposes of establishing jurisdiction under Article 25 of the ICSID convention, decisions rendered in 2012 seem to focus their attention principally on three factors: contribution, risk and duration. For example, the tribunal in *Electrabel v. Hungary* noted that *"[w]hile there is incomplete unanimity between tribunals regarding the elements of an investment, there is a general consensus that the three objective criteria of (i) a contribution, (ii) a certain duration, and (iii) an element of risk are necessary elements of an investment*. The tribunal also noted that, while the economic development of the host State was one of the objectives of the ICSID Convention (and a desirable consequence of the investment), it was "*not necessarily an element of an investment."*

vi) On decisions of domestic courts reviewing arbitral awards, the United States Court of Appeals for the D.C. Circuit reversed the decision of the District Court and vacated the final award in *BG v. Argentina*[86] The Court of Appeal stated that the arbitral tribunal rendered its decision without regard to the contracting parties' agreement establishing a precondition to arbitration (in the form of 18-month recourse –to-local-courts requirement). The Court of Appeal noted first that, unless specified in the applicable treaty, "*the question of arbitrability is an independent question of law for the court to decide"* The Court of Appeal then stated that there could be "*only one possible outcome on the arbitrability question before it, namely, that the foreign investor was*

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violation to be found, some important measure of impropriety must be manifest. The tribunal dismissed the claims of discrimination and arbitrariness. On the definition of indirect expropriation, decisions rendered in 2012 have continued to point out the relevance of various elements, with a primary emphasis on the host State measure's adverse effect on the investor. The majority of the tribunal in *Burlington v. Ecuado*r (ICSID Case No ARB/08/5), Decision on Liability , 14 December,2012, para 396 for example, agreed with past decisions focusing on whether the measure has resulted in substantial deprivation. The majority explained that the loss of management or control over the investment was not a necessary element of substantial deprivation: "*what appears to be decisive, in assessing whether there is a substantial deprivation, is the loss of the economic value or economic viability of the investment. The loss of the viability does not necessarily imply a loss of management or control. What matters is the capacity to earn a commercial return. "*On counterclaims by a respondent State, the *Goetz v. Burundi (ICSID Case No* ARB/01/2), Award, 21 June, 2012, paras 267-287decision became the first one in IIA arbitration where the tribunal affirmed its jurisdiction over a respondent's State's counterclaim. Specifically, Burundi sought US$ 1 million from the claimants for their bank's failure to honour the terms of a local operating certificate. The tribunal found that despite the applicable BIT's silence on the matter, it was competent to consider the counterclaim pursuant to Article 46 of the ICSID convention as the counterclaim fell within the jurisdiction of ICSID (i.e related to the investment), was covered by the consent of the parties and directly related to the object of the dispute. Having admitted the counterclaim, the tribunal went on to dismiss it on the merits.

[86] (UNCITRAL), Final Award, 24 December, 2007

required to commence a law suit in Argentina's courts and wait *18 months before filing for arbitration pursuant to the UK-Argentina BIT*."

vii) Enforcement of arbitral awards. Enforcing awards against sovereign States remains a difficult issue as some governments continue not paying earlier arbitral awards rendered against them. Some investors prefer to settle with the respondent State, often for an amount lower than the awarded but with a guarantee of prompt payment, or with the monetary award being fully or partially replaced by other benefits. Other claimant seek to locate respondent's State assets abroad and start enforcement procedures in the relevant third countries. Still others bring the non-payment of awards to the attention of their home governments, with a view to receiving their support. One such example from 2012 is the United States excluding Argentina from the list of countries benefitting from trade preferences, until Argentina pays on ICSID awards in favour of US investors.

viii) Third party funding (TPF) of claims. The practice of involving specialized firms to finance IIA claims against States in exchange for a share in a possible future award or settlement in favour of the claimant has been gaining prominence in the past year and attracted the attention of commentators and scholars. The practice of litigation finance exists in a few countries (Australia, the United States, the United Kingdom and some others) and, in some circumstances, can be viewed as giving access to justice to those claimants who do not have the means to pay hefty legal fees and other litigation costs. On the other hand, there are serious policy reasons against TPF of IIA claims- for example, it may increase the filing of questionable claims. From a respondent's State perspective, such frivolous claims, even if most of them fail, can take significant resources and may cause reputational damage. There are other concerns which put the practice of TPF into direct or indirect conflict with professional ethical rules in some countries. While there is no international regulation of TPF and public knowledge about financing of claims is limited, IIA-related TPF developments need to be monitored closely with a view better to understand trends and their policy implications.

Conclusion

Investor-State Arbitration has continued to generate interest as to the efficacy of BITs. By its very nature entering into BITs is a way of encouraging the capital exporting countries to do business with the capital importing countries and ensure that the interest of the capital exporting countries is protected. Such protections create conflicts in terms of the natural resources of the capital importing countries and the protection of the investment of the capital exporting countries. There is also the conflict of which forum to use to resolve disputes. Whereas the capital importing countries will prefer their local courts, the capital exporting countries prefer international arbitration in a neutral forum.

If disputes are to be resolved by arbitration especially under ICSID, there are various legal issues arising substantially, jurisdictionally and procedurally. For instance, what is the scope of the protection offered by these BITs? Who is an investor and what are investments? What is 'fair and equitable treatment' and 'full protection and security'? Thus several legal issues have remained unresolved. However, in 2012, it became clear that the number of new cases makes arbitrating under ICSID still relevant.

The rate of success of claims by the investors is high (70% in 2012) and in some occasions, high amounts of damages are awarded (eg US$1.77 billion in *Occidental v Ecuador, supra).* This decision demonstrates the protective potential of investor-State Arbitration. However, the continuing trend of investors challenging generally applicable public policies, contradictory decisions issued by tribunals, an increasing number of dissenting opinions, concerns about arbitrators' potential conflicts of interest all illustrate the problems still inherent in the system.

Accordingly, the public discourse about the usefulness, legitimacy and deficiencies of investor-state arbitration is gaining momentum, especially given that the mechanism is on the agenda in numerous bilateral and regional negotiations.

While reform options abound, their system assessment including with respect to their feasibility, expected effectiveness and implementation methods remains wanting. All the same, investor-state arbitration has come to stay given its development.