Investor/State Arbitration: Challenges Facing Capital Importing Countries

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Abstract

Investor/state arbitration generally arises from a treaty. The treaty provides for dispute resolution including arbitration under ICSID. Ordinarily, it appears that such arbitration clause will ensure foreign direct investment in capital importing countries. However, there has always been conflict of interest between capital exporting countries and capital importing countries. For the former, they want to ensure that their investment is guaranteed, protected and disputes resolved by international tribunals and for the latter, they want to ensure that they retain or regain their right to their natural resources and disputes resolved by municipal courts. This article examines the challenges faced by capital importing countries in arbitrating under ICSID.

Introduction

The increasing importance of international investment has been accompanied by the rapid development of a new field of international law that defines the obligations of host states towards foreign investors and creates procedures for resolving disputes in connection with those obligations. Investor-state arbitration (also referred to as investment treaty arbitration) examines the international treaties that give investors a right to arbitration of claims. Investor-state arbitration analyzes the rights of private parties under these treaties to arbitrate disputes with countries, the arbitration rules most commonly employed in investor-state disputes, the important elements of substantive law and procedure, the enforcement of awards (including annulment proceedings under ICSID), current developments, including conflict and convergence of interests in capital-importing and capital-exporting countries, restrictions on state sovereignty, analysis of recent investor-state arbitral jurisprudence, and, finally, the emergence of an international investment jurisprudence.

Investor-state arbitration traces the evolution and rapid development of this phenomenon to the establishment of the International Center for the Settlement of Investment Disputes ('**ICSID**') in 1965[2] and the more than 2,700 bilateral investment treaties, most of which treaties have originated in the last twenty years. This development has led to far greater certainty for foreign investors in dealing with their host countries and has incentivized growth in international trade and commerce. Through arbitration,

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2 https://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/CRR_English-final.pdf

investors who have been negatively affected by the acts of a host country, such as, for example, the expropriation of property, now have a fair means of redress.[3] Herein lies the conflict of interests. Whereas the capital exporting countries prefer international tribunals for the resolution of disputes, the capital importing countries prefer their municipal courts for the resolution of disputes. These, among others, are the challenges facing capital importing countries.

In this article, we intend to examine the jurisprudence of investor-state arbitration and challenges faced by capital importing countries.

Evolution of Investor/State Arbitration

The developing countries have been at the mercy of the developed economies. This is compounded by the fact that capital has accumulated in the money centres of the world. Such centres are looking for opportunities in the developing economies. The critical question has been how to balance and protect the investment of foreign nationals vis-a-vis the interest of the host state. However, a development in the latter part of the 20th century has fundamentally altered this. This was done by way of diplomatic protection from the home state.[4] In which case, the home state must agree to submit the arbitration of the dispute to a claim commission. This required the prior intervention of the home state.

There are various versions of the origin of bilateral investment treaties.[5] However, until the seminal work of the Argentine jurist and diplomat, Carlos Calvo in 1868,[6] an individual or a corporation who wished to assert a claim against a foreign state for breach of customary international law could not do so directly. Instead, the individual or corporation concerned had to rely upon his/its government taking up the claim on its behalf. This worked against the colonies because in the case of the major trading countries, influential individuals or corporations convinced their governments to send a small contingent of warships to moor off the coast of the offending state until reparation was forthcoming – the so-called 'gunboat diplomacy'.[7]

Carlos Calvo fought for the rights of newly independent states to be free of such intervention by foreign powers and promoted the so-called 'Calvo doctrine' whereby foreign investors should be in no better position than local investors with their rights and obligations to be determined through the exclusive jurisdiction of the courts of that state or submit to the arbitration of the dispute by a Claims Commission. His thesis was adopted by the First International Conference of American States in 1889. At the Conference an *ad hoc* Commission on International Law adopted his position to wit, 'foreigners are entitled to enjoy all the civil rights enjoyed by natives and shall be accorded all the benefits of the said

3 See generally, C F Dugan, *et al Investor-State Arbitration* (Oxford: Oxford University Press, 2008).

4 See G V Harten *Investment Treaty Arbitration and Public Law* (Oxford: Oxford University Press, 2008) 9 and 18. See also B Kingsbury 'Sovereignty and Inequality' (1998) 9 EJIL 599, 601 (noting that state sovereignty is the 'means by which people can express and be deemed to have expressed, consent to the application of international legal norms and to international institutional competences').

5 Harten, above n 4, 3 and 12.

6 "*Derecho internacional terorico y practico de Europa y America*", Paris 1868.

7 See M Hood *Gunboat Diplomacy 1895-1905* (London: George Allen & Unwin, 1975) 187-8. Thus when the Venevuelan Government announced that it would not repay its debts to European creditors, a naval armada was dispatched by Germany, Great Britain and Italy to blockade Caracas and bombarded coastal facilities.

rights in all that is essential as well as in the form of procedure, and the legal remedies incidental thereto, absolutely in like manner as said natives.'[8]

The Calvo Doctrine was incorporated into the forerunner of the modern investment treaty, the 'treaty of friendship, commerce and navigation' (FCN Treaty).[9] Gunboat diplomacy was brought to an end at the Second International Peace Conference at The Hague in 1907 when the Convention on the Peaceful Resolution of International Disputes was signed. The Convention provided the framework for the conclusion of bilateral investment treaties. Thus, in the event of a dispute between two states arising out of the particular interests of a national of the other state, an independent arbitral tribunal would be formed where the state could espouse the claim of its national (the so-called right of diplomatic protection).[10]

Although the diplomatic protection was a welcome development, Professor Brierley was concerned with the possibility of its being politicized thus leaving investors particularly small and medium-sized enterprises with little recourse save what their government might give them after weighing the diplomatic consequences. This led to more reforms and the creation of the International Centre for the Settlement of Investment Disputes (ICSID) mechanism through the conclusion of the ICSID Convention of 1965.[11]

Bilateral/Multilateral Investment Treaty

A byproduct of the ICSID Convention is the enactment of investment laws in various jurisdictions[12] and the entering into various bilateral investment treaties ('**BITs**').[13] 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. Harten[14] has argued that if foreign investors are permitted to claim compensation under international law, why not a migrant worker who is denied access to the rights and entitlements of domestic employees, or a refugee who is denied asylum and deported to torture, or an indigenous people whose land is polluted and livelihood destroyed by a multinational firm? As at June 30 2011, 157 countries have signed the ICSID Convention while 147 countries have ratified it.[15] Bolivia and Ecuador have withdrawn their membership while among the countries that have signed, some are yet to ratify the Convention.[16]

8 See Nigel Blackaby and Constantine Partasides *Redfern and Hunter on International Arbitration* (5th ed, Oxford, Oxford University Press, 2009) 466.

9 See art 21 of the FCN Treaty between Italy and Colombia of 1894.

10 See the *Panevezys-Saldustsikis Railway Case* decided by the Permanent Court of International Justice – Series A/B 76, p.16 and J L Brierley, *The Law of Nations* (6th ed, Oxford University Press, 1963), 277.

11 ICSID was established by the 1965 Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the ICSID Convention).

12 See the Nigerian Investment Promotion Commission Act of 2004 (s 26), Ghana Investment Promotion Act (GIPA) 1994, South African International Arbitration Act, and Ugandan Arbitration and Conciliation Act of 2000.

13 See the 1959 Abs-Shawcross Draft Convention on Investments Abroad and the 1967 OECD Draft Convention on the Protection of Foreign Property.

14 Harten, above n 4.

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

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.[17] Similarly, the world's first BIT was signed in 1959 between Pakistan and Germany.[18] The growth in this form of dispute resolution in the two decades since then has been exponential.[19] 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 America,[20] 23% from Eastern Europe,[21] 16% from Sub-Saharan Africa,[22] 10% from the Middle East & North Africa,[23] 7% from Central America & Carribean,[24] 9% from South & East Asia & Pacific,[25] 5% from North America[26] and 1% from Western Europe.[27] The oil and gas sector has 25% of these cases. The growth is further reinforced by the fact that as at 30 June 2011,[28] there were over 2,700 BITs[29] being concluded since the first such treaty in 1959.[30]

Other than BITs, there are regional investment treaties ('**RITs**') and multi-lateral investment treaties ('**MITs**').[31] Attempts have been made for a multilateral treaty that would codify liberal standards of investor protection under international law. This would have meant the use of international adjudication for purposes of review and enforcement of such treaties but all such attempts failed.[32]

16 http://en.wikipedia.org/wiki/International_Centre_for_Settlement_of_Investment-Disputes. The countries yet to ratify are Belize, Canada, Dominican Republic, Ethiopia, Guinea-Bissau, Kyrgyzstan, Namibia, Russia, Sao Tome and Principe and Thailand. Other non-members are: Andorra, Angola, Antigua and Barbuda, Bhutan, Brazil, Cook Islands, Cuba, Djibouti, Dominica, Equatorial Guinea, Eritrea, India, Iran, Iraq, Kiribati, Laos, Liechtenstein, Libya, Maldives, Marshall Islands, Mexico, Monaco, Montenegro, Myanmar, Nauru, Niue, North Korea, Palau, Poland, San Marino, South Africa, Suriname, Tajikistan, Tuvalu, Vanuatu, Vatican City, Vietnam, and the rest of states with limited recognition.

17 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.

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

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

20 Made up of Uruguay, Peru, Ecuador, Venezuela and Bolivia.

21 Made up of Uzbekistan, Serbia, Romania, Macedonia, Georgia and Turkmenistan.

22 Made up of The Gambia, Rwanda, DRC and Tanzania.

23 Made up of Jordan, Egypt and Algeria.

24 Made up Grenada, El Salvador and Costa Rica.

25 Made up of Cambodia and Bangladesh.

26 Made up of Mexico, Canada and USA.

27 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.

28 See ICSID 2011 Annual Report http://icsid.worldbank.org/ICSID/FrontServlet.

29 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.

30 See UNCTAD, World Investment Report (2006) XVII, 26. See also http://en.wikipedia.org/wiki/Bilateral_Investment-Treaty.

31 1987 Association of South East Asian Nations (ASEAN) Agreement for the Promotion and Protection of Investments, Chapter 11 of the 1994 North American Free Trade Agreement (NAFTA), Pt 3 and Art 26 of the 1994 Energy Charter Treaty, and the 1994 Colonia and Buenos Aires Investment Protocols of Mercosur.

32 See the draft International Convention for the Mutual Protection of Private Property Rights in Foreign Countries, 1957 – usually referred to as 'a return to the Gay Nineties'.

Protection Offered by the Treaties (Substantive Rights)

Generally, it is the host state that breaches the treaties and/or contract. It is pertinent, therefore, to examine the protection offered by the treaties and remedies available to the investors.[33] 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.[34] The Statute of the ICJ is even more definitive than the ICSID Convention in rejecting the doctrine of judicial precedent.[35]

It should be stressed that there is substantial degree of uniformity in the substantive rights provided in all treaties. However, their scope and application have remained controversial[36] and discomforting to the capital importing countries. They are:

i) **fair and equitable treatment**[37] (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.[38] 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/she 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**[39] – it is 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**[40] – may be direct or indirect or creeping. Also includes measures 'tantamount to' or 'equivalent to' expropriation;

33 See McLachlan, et al, above n 19, 199.
34 See Article 53(1) of the ICSID Convention.
35 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.
36 See McLachlan, et al, above n 19, 200.
37 See Harten above n 4, 86. See also McLachlan, et al above n 19, 226.
38 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.
39 See McLachlan, et al, above n 19, 247.
40 See Maclachlan, et al, above n 19, 265. See also Harten above n 4, 90.
41 See Maclachlan, et al, above n 19, 315.

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[41] – 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**[42] – treating investors no less favourably than that of nationals and companies of the host state (national treatment) or any other state (most favoured nation).[43] They are relative standards and the scope cannot be defined in the abstract.[44] 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**[45] – 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?[46] The consensus is that it does not, to hold otherwise would have had far-reaching legal consequences for the host states.

Attribution under the ILC's Articles on State Responsibility

The Concept of Attribution[47] in investor/state arbitration is well developed under the International Law Commission ('**ILC**') Articles on State Responsibility. Under art 2 of the ILC's Articles on State Responsibility, 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 government. In practice, the general rule is that the only conduct attributable 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] These articles are meant to protect the capital exporting countries to the detriment of capital importing countries even when there are contrary provisions in the underlying contract.

42 See Harten above n 4, 83.

43 See McLachlan, et al above n 19, 251 and 254.

44 See Maffezini v Spain, Supra where the Argentine-Spain BIT was compared with Chile-Spain BIT.

45 See Monique Sasson *Substantive Law in Investment Treaty Arbitration* (Wolters Kluwer: The Netherlands, 2010) 173.

46 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.

47 This is one area where the application of international law inevitably entails consideration of municipal law. See Sasson, above n 45, 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.

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

Contract versus Treaty Claims

The choice of rights by an investor will determine the course of the investment dispute. Does the investor need to choose between treaty rights and contract rights or can the investor pursue both types of rights simultaneously in the same forum, or simultaneously in separate fora? The dispute resolution mechanism in the treaties is usually international arbitration while the underlying contract can provide for litigation and domestic arbitration. The strategic importance of this decision cannot be exaggerated. This decision requires a clear understanding of the distinction and differences between treaty and contract claims. These include:

a) **source of the right** – the source of a treaty right is on the plane of international law which is separate and distinct from a claim of breach of national law or terms of a contract which is the effect of an investor's contractual submission to the jurisdiction of the Host State courts or arbitral tribunals. Thus, a treaty claim is a right established and defined in an investment treaty while the basis of a contract claim is some right created and defined in a contract. Generally, a treaty right can not arise from a contract.

b) **the content of the right** – the content of treaty rights is normally quite distinct from that of contract rights.[49] Treaty rights are generic in nature and defined by international law – rights to national treatment, most favoured nation treatment, non-discriminatory treatment, fair and equitable treatment and compensation in the event of expropriation. Contract rights are normally specific to the investment and defined by the domestic law of the Host State. However, it is possible for the content of the two to overlap. For example, an investor that enjoys a right to compensation for expropriation under a BIT might negotiate and receive an identical right in a concession contract with the Host State or such a right is provided for in a domestic legislation like the 1999 Constitution of Nigeria[50] and the NIPC Act.[51]

c) **the parties to the claim -** in the case of a treaty claim, an investor of the Home State and the Host State are usually the parties. The State Party is the state itself and not a federal or regional unit or any state entity or agency. This is so even if the investor has had no direct contract with the state. However, where the treaty claim is based on an exercise of governmental authority at a lower level, then the investor must demonstrate that the state is responsible for this conduct in international law. The International Law Commission has published its Articles on State Responsibility.[52] The Articles provide that a state is responsible for the conduct of internal organs and such conduct is attributable to the state. According to art 2 of the Articles, 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.

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49 See McLachlan et al, above n 19, 199 and Blackaby and Partasides, above n 8, 488.

50 See s 44(1) of the 1999 Constitution of Nigeria, as amended which provides, inter alia, that no moveable property or any interest in an immovable property shall be taken possession of compulsorily and no right over or interest in any such property shall be acquired compulsorily in any part of Nigeria except in the manner and for the purposes prescribed by law that, among other things requires the prompt payment of compensation.

51 See s 25 of the Nigerian NIPC Act 2004 which provides for guarantees against expropriation.

52 See J Crawford *The International Law Commission's Articles on State Responsibility: Introduction, Text and Commentaries* (Cambridge: Cambridge University Press, 2005).

In contrast, the parties to a contract are the parties to the contract. If the investor enters into a concession contract with the Host State, then the parties to a treaty claim will be identical to the parties to a contract claim.

d) **the applicable law**[53] – this is another potential difference. The applicable law under a BIT normally includes the provisions of the BIT itself, and the general principles of international law.[54] More fundamentally, BITs are regulated by international law.[55] In contrast, concession contracts are normally subject to the domestic law of the Host State. However, a state may not invoke the provision of its internal law as justification for its failure to perform a treaty obligation.[56] Similarly the characterization of an act of a state as internationally wrongful is governed by international law. Such characterization is not affected by the characterization of the same act as lawful by internal law.[57]

e) **the liability of the Host State** – a successful treaty claim results in state responsibility in international law while a successful contract claim results in state responsibility under the rules of its domestic law if the state is a party to the contract.

One of the challenges to an investor is how to avoid duplication of proceedings or parallel proceedings. Many investment treaties anticipate this by providing that an investor can prosecute his claims in domestic courts/tribunals or an international forum or alternatively must waive claims in any other forum as a precondition to international arbitration. However, these two techniques of election and waiver have created further confusion by failing to clearly distinguish between treaty and contract claims.

Dispute Resolution Mechanisms

All BITs/RITs/MITs provide for dispute resolution mechanism. Such mechanisms include litigation before a domestic court/tribunal or arbitration under various rules. However, the most prominent is arbitration under the ICSID Convention.

Where arbitration is under ICSID, the jurisdictional requirements provided in art 25 of the ICSID Convention[58] 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[59] to submit a defined category of disputes (*jurisdiction*

53 See generally Sasson, above n 45, xxi and Harten, above n 4 at 45.

54 See art 42 of the ICSID Convention and Reed et al, Op Cit at 71.

55 See art 31 of the Vienna Convention on the Law of Treaties.

56 See art 27 Ibid.

57 See art 3 of the ILC's Articles on State Responsibility.

58 See C H Schreuer *et al The ICSID Convention: A Commentary*, (2nd ed, Cambridge: University Press, 2009) 71. See also S A Alexandrov 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 R Happ and N Rubins *Digest of ICSID Awards and Decisions: 2003-2007* (Oxford, University Press: 2009) 330.

59 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 et al, above n 58, 190.

ratione materiae) with qualifying claimants (*jurisdiction ratione personae*) to arbitration.[60] In the case of the investor, it is the serving of the Request for Arbitration that gives the consent. Under art 25, the investor will have to demonstrate that:[61]

i) there is a legal dispute;

ii) arising directly out of an investment;

iii) between a Contracting State;

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 to 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.[62]

The disagreement between the parties must also have some practical relevance to their relationship and must not be purely theoretical. It is 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.[63]

Generally the interpretation of art 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[64] and how consent in writing is given. However, consent through the BIT has become accepted practice.[65] Such a BIT must be in force at the relevant time. In *Tradex v Albania*,[66] the Tribunal found that the Request for Arbitration

60 *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.

61 Reed et al, above n 27, 13 and Schreuer, above n 58.

62 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.

63 See *Enron v Argentina*, Decision on Jurisdiction, 14 January, 2004, *Continental Casualty v Argentina*, Decision on Jurisdiction, 22 February, 2006, para 92 and *Pan American v Argentina*, Decision on Preliminary Objections, 27 July 2006.

64 See Schreuer, above n 58, 160.

65 See Schreuer, above n 58, 192.

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

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.[67]

Most BITs provide for 'cooling off periods' or 'consultation periods' for amicable negotiations.[68] It is unsettled whether such provisions are merely procedural or jurisdictional and whether failure to comply vitiates consent.[69]

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;[70] and whether a state's consent to arbitration in a BIT is overridden by a contractual arbitration clause in a related investment contract.[71]

Remedies – Compensation and Restitution

Compensation[72] 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*.[73] It should be noted that, in cases of successful claims for expropriation and other treaty breaches, compensation will not be cumulative.[74] 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.

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67 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.

68 See Schreuer, above n 58, 237.

69 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, above n 27, 49.

70 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.

71 *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.

72 See McLachlan, et al, above n 19, 315.

73 *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.

74 Blackaby and Partasides, above n 8, 488-508.

Reparation, Restitution and Satisfaction[75] - 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.[76] 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.[77]

Challenges Facing Capital Importing Countries

The jurisprudence of investor/state arbitration is an evolving one and faced with challenges especially with respect to capital importing countries. The challenges include the following:

- **maintaining a balance between rights of investors and the host state** – the capital importing countries are usually disadvantaged. Although there is a presumption of equality of bargaining powers, this is not always the case. International law also recognizes the doctrine of the equality of states. However, in practice, states are unequal. No state would like to compromise on the issue of its sovereignty and capacity to protect its territorial integrity. In the case of investor/state arbitration, there is usually a conflict between the need to protect the natural resources of the capital importing countries and the investment of the capital exporting countries, on the one hand, the use of international tribunals and municipal courts, on the other.
- **enforcement of substantive rights** – most of these rights can not be comprehensively defined nor their scope delimited. There is thus a challenge in enforcing them. It is hoped that with the development of a common law of treaty arbitration, a common thread would be found.
- **'fork in the road' provisions and the effect of 'cooling off periods'** – the operation of such clauses ('fork in the road') has posed particular difficulties. These may arise as a result of the interrelation with the treaty/contract divide. Has the choice by the investor of a forum to litigate another part of the same factual dispute really precluded it from treaty arbitration, or on analysis, the other claim was founded on contract (eg a concession contract) rather than treaty? Consequently, the forum for the resolution of disputes should be thoroughly examined bearing in mind the issue of *res judicata* and *lis pendens*. Some investment treaties provide for 'cooling off periods'. It is not clear whether such periods are merely procedural or jurisdictional, however it is submitted that cooling off periods should be procedural and not jurisdictional.

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75 See arts 34, 35 and 37 of the ILC's Articles of State Responsibility. See also Happ and Rubins, above n 58, 366.

76 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".

77 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 and Rubbins, above n 58.

- **constitution of arbitral tribunals** – investment treaty arbitration is almost an exclusive preserve of developed economies. Capacity should be developed in capital importing countries so that their citizens are made members of the tribunals. Just as Europe, during the colonial days established and administered courts, that is almost the same way that Western Europe and North America still dominate the number of arbitrators handling ICSID references.[78] The other challenge is the extent to which states should empower privately contracted arbitrators to determine the legality of sovereign acts and to award public funds to businesses that sustain losses as a result of exercise of sovereign powers.
- **parallel proceedings**[79] – the very nature of investment arbitration gives rise to the possibility of parallel proceedings[80] or the determination in another forum which may be said to affect the issue to be determined by the investment tribunal. Similarly, it is possible that more than one investment tribunal is constituted by a different investment treaty and may be asked to rule upon the same underlying factual dispute.[81] In such a case, should one tribunal stay its proceedings in deference to the alternative tribunal or insist on the priority of its own process?[82] In the case of multiple claims between the same parties on the same subject matter, to what extent are the principles of *res judicata*,[83] *lis pendens*[84] and *electa una via*[85] to be applied? Is there any international instrument on *lis pendens* when, from the same cause of action parallel proceedings are pending involving the same parties?[86] There is an obvious risk that, if the proceedings continue, this may result in two irreconcilable judgments. Will one forum decline jurisdiction or suspend proceedings on the basis of *forum non conveniens* or the 'mechanical first-seised approach'? Alternatively, should both sets of proceedings continue and rules of *res judicata* be used to prevent two judgments/awards? If there are two judgments/awards, rules on recognition and enforcement could be used to decide which one is to have priority. Unfortunately, ICSID does not have such rules but Contracting States are obliged to enforce the pecuniary obligations imposed by that award within their territories as if it were a final judgment of a court in that state.[87]
- **knowledge of existing BITs** – how many nationals of the capital importing states are aware of the existence of the various BITs signed by their governments? Is there any proper documentation as to the exact number in compliance with art 102 of the Charter of the UN obligating member states who are parties to treaties to deposit them with the UN Secretariat?

78 71% of the Arbitrators/Conciliators appointed by ICSID are from Western Europe and North America: ICSID Caseload Statistics, 2011-1, above n 27, 16.

79 See M Cremades and J D M Lew (eds) *Parallel State and Arbitral Procedures in International Arbitration* (Paris: ICC Publications, 2005) and McLachlan et al, above n 19, 79.

80 L O Baptista 'Parallel Arbitrations – Waivers and Estoppel' Cremades and Lew (eds), ibid, 127-151.

81 As was the case with the Lauder Cases, supra based on Czech-Netherlands BIT and Czech-US BIT but with the same facts and different results.

82 See J J Fawcett (ed) *Declining Jurisdiction in Private International Law* (Oxford: University Press, 1995) 27.

83 See Sheppard A 'Res Judicata and Estoppel' in Cremades and Lew (eds), above n 79, 219-267.

84 See Vicuna F O 'Lis pendens arbitralis', ibid, 207-218.

85 See McLachlan et al, above n 19, 95.

86 See Article 21 of the Brussels Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters, 1968.

87 See Art 54 of the Convention.

- **sovereign immunity** – in international law, a distinction is drawn between *actus jure imperii* (purely governmental acts of states) and *actus jure gestiones* (purely commercial activities). Thus, once states descend into the commercial arena, they should desist from claiming sovereign immunity.[88]
- **arbitrating under ICSID or UNCITRAL Arbitration Rules** – ICSID protects foreign investment. Under a BIT, the standards of substantive rights under ICSID arbitration are higher than arbitration under municipal laws under the UNCITRAL Arbitration Rules or similar rules. Arbitration under the BIT adopts international law as its applicable law by virtue of the provisions of the Vienna Convention on the Law of Treaties while contractual rights are determined by domestic laws.
- **complaints from capital importing countries** – loss of sovereignty, unequal bargaining power and poor governance. (ICSID tribunals awarded $133 million against Egypt for expropriating the land of two Italian citizens making it the largest award rendered to individual claimants and $353 million against Czech Republic). Can ICSID be lenient when governments take measures that they view as necessary to shield their citizens from an economic meltdown, with many prominent lawyers arguing that contract maintenance is a priority?
- **politicization of awards** – Argentina has been unable to honour ICSID awards. US-based investors who are owed money are applying pressure on their own government to step up its demands that Argentina complies with the ICSID awards – awards being politicized. The good news is that Chinese Investors (Ping An, a Chinese investment house, suffered a 90% loss on its investment in Fortis during the crisis) are submitting claims against the Belgian government because of its role in pushing the sale of Fortis Bank, a Dutch-Belgian financial firm, to BNP Paribas, a French financial firm, during the financial crisis.
- **forum shopping**[89] – In *CME Czech Republic BV v Czech Republic*,[90] CME Czech Republic, a Dutch company owned by Ralph Lauder, an American cosmetics billionaire but a Dutch investor, was awarded US$353 million against Czech Republic under the Czech Republic-Netherlands BIT on 13 September, 2001. However in *Lauder v Czech Republic*,[91] Lauder, the same American but as the owner of an American company, initiated arbitral proceedings against Czech Republic under the Czech-US BIT, based on the same facts as *CME Czech BV v Czech Republic*,[92] and the claim was dismissed on 3 September, 2001. This is an invitation to forum-shopping by investors.
- **annulment proceedings**[93] – one area of conflict between the capital exporting countries and capital importing countries in relation to ICSID is annulment proceedings provided in arts 50 and 52-53 of the ICSID Arbitration Rules.[94] Under the provisions of art 50(1)(c)(iii) an award can be annulled if

88 See M D Evans (ed) *International Law*, (2nd ed, Oxford, University Press: 2006) 367. See also *Trandtex v CBN* (1977) QB 529.

89 See Harten, above n 4, 113.

90 (Merits) (13 September 2001) 14(3) *World Trade and Arb Materials* 109. As an aside, in 2006 Ralph Lauder reported paid $135 million for Gustav Klimt's Portraits of Adele Bloch-Bauer I, the highest price ever paid for a painting: C Vogel, 'Lauder Pays $135 million, a Record, for a Klimt Portrait' The New York Times (19 June 2006).

91 (Final Award) (3 September 2001), (2002) 4 World Trade and Arb Materials 35.

92 (Merits) (13 September 2001) 14(3) *Word Trade and Arb Materials* 109

93 See Reed et al, above n 27, 162.

94 See also arts 50-52 of the Convention.

the Tribunal was not properly constituted, the Tribunal manifestly exceeded its powers, there was corruption on the part of a member of the Tribunal, there was serious departure from a fundamental rule of procedure and the award failed to state the reasons on which it is based. Quite unlike the provisions in the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards where domestic courts can set aside an award, there is no such provision in ICSID. While the capital importing countries would like their courts to be involved in the process of enforcement or setting aside an award, the capital exporting countries prefer the ICSID, where the only remedy available to an aggrieved party is application for annulment. While the capital exporting countries see annulment proceedings as one of the strengths of ICSID, the capital importing countries see them as infringing on their sovereignty. Over the years, there have been conflicting decisions on the interpretation of arts 50 and 52-53 of the Arbitration Rules bearing in mind that ICSID excludes any appeal or other remedy except those provided in ICSID.[95]

- **judicial precedent** – there is no hierarchy of arbitral tribunals and proceedings are generally private and confidential. No award is absolutely binding on the other. Indeed from the ICJ's judgment to ICSID awards, they are binding on the parties to the proceedings only. It is more complicated when one compares international commercial arbitration or investment treaty arbitration regulated by international law and domestic arbitration regulated by municipal law. Certainty of decision making which is an attribute of judicial precedent is lacking in arbitration.[96]

95 See *Klockner v Cameroon*, ICSID Case No. ARB/81/2, Award, 21 October, 1983 and *Amco Asia v Indonesia* 1CSID Case No. ARB/81/1, Award, 20 November, 1984 (referred to as the first generation of annulment proceedings regarded as turning the annulment proceedings to appellant systems); *MINE v Guinea*, ICSID Case ARB/84/4, Decision on Annulment (22 December, 1989) (second generation – ruled for failure to state reasons); *Wena Hotels v Egypt*, ICSID Case ARB/93/1, Decision on the Application for Annulment, 5 February, 2002, *Vivendi v Argentina*, ICSID Case No. ARB/97/3, Decision on Annulment, 3 July, 2002 and *CMS v Argentina*, ICSID Case No. ARB/01/18, Decision on Annulment, 25 September, 2007 (third generation – raised fresh issues including the role of ICSID Secretariat) and *Sempra v Argentina*, ICSID Case No. ARB/02/16, Decision on Annulment, 29 June, 2010 and *Enron v Argentina*, ICSID Case No. ARB/01/3, Decision on Annulment, 30 July, 2010 (fourth generation – defence of necessity under customary international law and BIT failed): Promod Nair, 'ICSID Annulment Awards: The Fourth Generation' Global Arbitration Review, Volume 5, Issue 5 (October 2010): www.GlobalArbitratioinReview.com. See also C Schreuer 'Three Generations of ICSID Annulment Proceedings' in *IAI International Arbitration Series, No. 1, Annulment of ICSID Awards*, eds. E Gaillard and Y Banifatemi (New York, Juris Publishing, Inc. 2004.

96 See generally Katia Yannaca-Small (ed) *Arbitration Under International Investment Agreements* (Oxford: Oxford University Press, 2010).

Conclusion

Ordinarily, it appears that investor-state arbitration ensures foreign direct investment in capital importing countries. However, there has always been conflict of interest between capital exporting countries and capital importing countries. For the former, they want to ensure that their investment is guaranteed, protected and disputes resolved by international tribunals; for the latter, they want to ensure that they retain or regain their right to their natural resources in accordance with the UN General Assembly Resolution on Permanent Sovereignty Over Natural Wealth and Resources (Resolution 1803). The capital importing countries would also like disputes to be resolved by their municipal courts. This is a major challenge.

Another major challenge facing capital importing countries is the rights and remedies available to the capital exporting countries. Generally, it is the capital exporting countries that invoke the dispute resolution clauses. Instead of invoking the remedies in the underlying contract, the capital exporting countries invoke the remedies in a treaty where one exists because of the protection offered by the treaties. However, the nature and scope of these remedies are indeterminate and unclear.

There are other challenges. The operation of 'fork in the road' provisions in the treaties makes it difficult for the capital importing countries to determine what dispute resolution clause that will be invoked; the effect of the 'cooling off periods' whether they are mandatory or optional because it is unsettled whether such provisions are merely procedural or jurisdictional and whether failure to comply vitiates consent; the possibility of parallel proceedings loom large; the percentage of arbitrators appointed from the capital exporting countries is high; countries like the USA are now politicizing enforcement of arbitral awards and the absence of the doctrine of judicial precedent creates uncertainty in the minds of the capital importing countries.

One wonders, therefore, if the dispute resolution mechanisms in the treaties are not skewed in favour of the capital exporting countries and whether indeed, entering into the treaties actually attracts direct foreign investment.