

IN SEARCH FOR THE OPTIMAL MODEL FOR RESOLVING INTERNATIONAL INVESTMENT DISPUTES

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Abstract. *The International Centre for Settlement of Investment Disputes (ICSID) has been set as an authoritative forum for investment dispute resolution. But lately it has been perceived as dealing with legitimacy crisis. At the same time, within the framework of TTIP negotiations, the European Commission has proposed the formation of International Investment Court. It is still uncertain whether this proposal will be adopted and implemented, but among its anticipated effects is the replacement of investor-to-state dispute settlement system, which is reflected in the ICSID. This paper explores the uniqueness of the ICSID by focusing on a particular part of the procedure: annulment. The analysis shows that the annulment procedure raises significant legal and political issues, which have the potential to undermine social legitimacy of the system as a whole. The aim of this paper is to look into the possibility of placing the International Investment Court in service of overcoming those issues, both legal and political ones.*

Key words: *ICSID, International Investment Court, annulment, appeal, legitimacy*

1. INTRODUCTORY NOTES

The modern era of globalization and the prevalent influence of liberal economy have led to the pursuit of profit by allocating capital where it can accumulate to its fullest potential. State boundaries, applicable legal rules and concepts, have all become capital-friendly and in favor of Host States creating the advantageous investment climates. In circumstances where an investor is operating in another State, the question of how to resolve possible disputes relating to investments becomes of high relevance. The relevant practice in international business circles has demonstrated that the most prominent method for dispute resolution is the Investor-to-state dispute settlement (ISDS) mechanism. The ISDS has been portrayed as a system which is adjusted to the very nature of investment relations.

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This paper explores the features of the ISDS mechanism by analyzing the International Centre for Settlement of Investment Disputes (ICSID) as an institutionalized representative of such a mechanism. This Centre was established in 1965 by the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention)¹ and it operates under the institutional framework of the World Bank group in Washington. The Center's working history of 50 years, the number of contracting States, the number of disputes brought and resolved before it establish the ICSID as an authoritative institution for investment disputes resolution. However, in recent years, the ICSID has been facing a "legitimacy crisis", which is even more intensified by the fact that it has been dealing with what can be described as "private rights, public problems" (Puig, 2012: 566).

In 2013, in the heat of the debate about the ICSID legitimacy crisis, the European Commission was instructed to negotiate a new Transatlantic Trade and Investment Partnership with the United States. Within the framework of TTIP negotiations, in November 2015, the European Commission proposed the establishment of the International Investment Court. The proposed model is suppose to replace the ISDS mechanism, and it "aims at safeguarding the right to regulate and create a court-like system with an appeal mechanism based on clearly defined rules, with qualified judges and transparent proceedings".² Of course, this proposal raises significant concerns about the role that the ISDS should play in future investment-related issues, particularly considering that negotiations between two such great economic systems such U.S. and EU are bound to make an impact on the further development of international investment law.

This paper tries to explore whether developments in cases brought before the ICSID have raised the stakes that the system itself cannot support anymore, and whether it is time to introduce a different concept of investment dispute resolution.

2. THE UNIQUE NATURE OF THE ICSID SYSTEM

The ICSID was originally conceived as a specialized, rules-based and depoliticized international tribunal, which issues awards enforceable as if they were the final judgments of the court of the Contracting State³. The ICSID Convention established "complete, exclusive and closed jurisdictional system, insulated from national law" (Broches, 1987: 288). It offers a self-contained regime, with sensitively balanced approach to both investors' and States' interests. ICSID is based on flexible grounds which make it appealing to the States (Pauwelyn, 2014: 394), and at the same time, elevates foreign investors to a level of recognition in international law, not usually afforded to non-state actors (Tienhaara, 2011: 185).

The ICSID is a unique system which introduces a compromise between finality and the accuracy of the awards. The ICSID Convention contains a form of safeguard mechanism against 'blind' enforcement of the awards (Baetens, 2011: 227). Article 52 of the ICSID

¹ Available at <https://icsid.worldbank.org/ICSID/StaticFiles/basicdoc/partA.htm>

² European Commission press release, from http://europa.eu/rapid/press-release_IP-15-6059_en.htm, accessed 21 March 2016

³ The ICSID Convention art. 54 (1) reads as follows: "Each Contracting State shall recognize an award rendered pursuant to this 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. A Contracting State with a federal constitution may enforce such an award in or through its federal courts and may provide that such courts shall treat the award as if it were a final judgment of the courts of a constituent state."

Convention provides the annulment procedure, under certain restrictive grounds.⁴ The annulment procedure should act as a sort of counter-measure, or a trade-off, given that due to Article 54 of ICSID Convention, the States have no bearing on the enforcement of the awards. Thus, the annulment should enhance the States' confidence and reliance upon the neutrality of the tribunals, and introduce a sense of limited control over the dispute resolution process. But this very safeguard poses a threat to the democratic legitimacy of the system.

The text of the Convention and the negotiating history of Article 52 indicate that "the annulment procedure was intended to be an 'exceptional' remedy, permitted within rigidly fixed limits, consistent with the paramount requirement of finality" (Feldman, 1987: 98). But in practice, the ICSID annulment procedure has started to resemble an appellate process, as a possibility invoked by the parties as a rule, rather than as an exception. This process has been described as "inflationary nature of requests for annulments" (Schreuer, 2011: 212). Some authors even note that, if finality is the purpose for choosing arbitration, the investors should seek other arbitral systems that offer a definitive end to the review process (Padilla, 1988: 343). It is questionable whether this extensive use of the annulment was consented to by States when drafting, signing and ratifying the ICSID Convention (Baetens, 2011: 217).

The idea to introduce the appellate procedure in the ICSID, as a means to enable the substantive review of the awards and thus contribute to the social legitimacy of the system, was abandoned in 2005. It was considered to be premature. Yet, the European Commission's proposal for Investment Court provides a possibility for an appeal.⁵ Theoretically, there is a clear distinction between an appeal and annulment. Not only are they concerned with different aspects of the award and provide for different outcomes but they also indicate that they should be used for achieving different goals. It implies obtaining different resolution of the dispute versus the possibility to arbitrate the dispute *de novo*. However, in practice, appeal and annulment can blur into one another because the former subsumes the latter and because a decision that is grossly incorrect could be viewed as evidence of an illegitimate process (Caron, 1992: 45).

The annulment process in the ICSID has raised questions about whether *ad hoc* committees, entrusted with applying this part of procedure, truly understand the role they are supposed to play, or the boundaries of their authority. They have been observed as hyperactive (Schreuer, 2011: 221). These questions underline the awareness that there is a part of procedure that still does not have a clear governing idea that should frame the mandate of *ad hoc* committees. Yet, there are a growing number of cases in which the parties have filed a request for the annulment of the award.

Furthermore, the question of the *ad hoc* committees' authority raises even more concern with regards to the fact that contemporary investment disputes are reaching far

⁴ Article 52 (1) reads as follows: "Either party may request annulment of the award by an application in writing addressed to the Secretary-General on one or more of the following grounds:

- a) that the Tribunal was not properly constituted;
- b) that the Tribunal has manifestly exceeded its powers;
- c) that there was corruption on the part of a member of the Tribunal;
- d) that there has been a serious departure from a fundamental rule of procedure; or
- e) that the award has failed to state the reasons on which it is based."

⁵ Article 29 of the Transatlantic Trade and Investment Partnership, the European Union's proposal for Investment Protection and Resolution of Investment Disputes, http://trade.ec.europa.eu/doclib/docs/2015/november/tradoc_153955.pdf, accessed 21 March 2016

beyond the issues of protecting the foreign property from unlawful expropriation. Those were the “simple” questions historically presented before the ICSID. Now, these disputes include deliberating over States’ regulatory powers. The public scrutiny of these issues increases with the fact that such important disputes will always involve significant social interests (Stone Sweet, 2010: 70).

There is a particular group of cases brought before the ICSID that demonstrate why the annulment procedure is a treat to the Center’s legitimacy both in legal and political terms. These are the so-called “Argentine Gas Cases”: *CMS*⁶, *Sempra*⁷, *Enron*⁸ and *LG&E*⁹.

The analysis of these cases illustrates the reasoning of *ad hoc* committees, and their crossing from substantive review, which corresponds to appellate procedure, to more annulment consistent decisions, and *vice versa*. That is an aspect of analysis relevant for the legal debate over the legitimacy issue. Another aspect of the provided analysis is to demonstrate how the debate about appeal fits into matters of political importance to the international community.

3. ICSID IN PRACTICE: THE “ARGENTINE GAS CASES”: *CMS, SEMPRA AND ENRON*

In time of economic crisis in Argentina, from the 1990s until 2002, the government undertook regulatory measures in order to prevent further crisis and restore its economy. These measures were unpopular with foreign investors; as a result, a number of claims were brought against Argentina before the ICSID. In most of these cases, the tribunals found against Argentina, issuing awards that in sum amount to more than 80 billion dollars.

In particular, the “Argentine Gas Cases” concern foreign investment in Argentina’s gas industry. They are especially interesting because they are based on virtually the same factual grounds but with significantly different outcomes. The investors in these cases claimed that, by introducing crisis measures, Argentina breached the U.S.-Argentina bilateral investment treaty (BIT). Argentina relied on the “necessity defense”, asserting that in time of severe crisis the State had a sovereign right to prioritize and preserve national interests.

In all these cases, Argentina filed a request for annulment, relying on Article 52(1)b of the ICSID Convention, and claimed that the tribunals have exceeded their powers because, when deciding whether necessity defense applies, the tribunals did not apply the proper law.

These cases demonstrate there is no concurrence about the proper application of “necessity defense”. Of course, the underlying issue is that there is no clear standard which should prevail: the investors’ rights as negotiated in investment treaty, or the State’s right to regulate and insure national peace and security. This has led to the different decisions reached in the “Argentine Gas Cases”, and the difficulties in maintaining the role of *ad hoc* committees to simply assess the validity of the award rendered by the tribunal, not the

⁶ *CMS Gas Transmission Company v. Argentine Republic* (ICSID Case No. ARB/01/8)

⁷ *Sempra Energy International v. Argentine Republic* (ICSID Case No. ARB/02/16)

⁸ *Enron Creditors Recovery Corporation* (formerly Enron Corporation) *and Ponderosa Assets, L.P. v. Argentine Republic* (ICSID Case No. ARB/01/3)

⁹ *LG&E Energy Corp., LG&E Capital Corp. and LG&E International Inc. v. Argentine Republic* (ICSID Case No. ARB/02/1); this case is not analyzed in this paper because there is no annulment decision, but the proceedings are concluded by Order taking note of the discontinuance of the proceeding pursuant to the ICSID Arbitration Rule 44 issued by the Secretary-General.

dispute itself. In these cases, the *ad hoc* committees actually reviewed the award findings for errors of fact or law.

3.1. Legal issues of the “Argentine Gas Cases”

The essence of “the necessity defense” in the three “Argentine Gas Cases” is that Argentina claimed that its liability for any breach or otherwise wrongful act would be precluded by: (1) the customary international law doctrine of necessity, given the state of political and economic crisis in Argentina (the CIL Defense reflected in Article 25 of the Draft Articles on the Responsibility of States for Internationally Wrongful Acts¹⁰), and (2) Article XI of the U.S.–Argentina BIT, a non-precluded measures clause that limits investor protection in certain circumstances (NPM Exception Clause)¹¹. The relevant literature asserts that annulment decisions in these cases have contributed to greater doctrinal clarity (Von Staden, 2011: 225). But the elements of such contribution are identified as ones that have more bearing on treaty interpretation, and the application of different sources of law, not on the application of the ICSID annulment procedure. From the legal point of view, the annulment decisions in *CMS*, *Sempra* and *Enron* cases are criticized because *ad hoc* committees have engaged in appellate review (Von Staden, 2011: 223).

In the *CMS* case award, the Tribunal effectively read the requirements of the customary international law defense of necessity into the NPM clause of the treaty, testing Argentina’s invocation of the NPM clause against the basic requirements of the necessity defense in customary international law (Burke-White et al, 2007: 395). In the *CMS* case, the Tribunal regarded the CIL Defense and the NPM exception as being part of the same issue of claiming a necessity defense (Martinez, 2012: 164). The *CMS ad hoc* committee did not annul the award because it referred to a limited mandate under Article 52 of the ICSID Convention. But it did offer the assessment of the Tribunal’s legal reasoning, by indicating what the *ad hoc* committee would have decided in this particular case. Also, it characterized the Tribunal’s application of the law as cryptic and defective.¹² Even with the award still standing, and it is to be enforced, the *ad hoc* committee in fact undertook the substantive review, and by criticizing the award “cast a shadow of doubt over the quality of ICSID jurisprudence” (Burke-White et al, 2010: 300).

In *Sempra*, the *ad hoc* committee annulled the award because the Tribunal itself explicitly stated that “there is no need to undertake a further judicial review under Article XI”¹³. In other words, in the reasoning of the award, the Tribunal admitted that it did not

¹⁰ Article 25 of the Draft Articles on the Responsibility of States for Internationally Wrongful Acts states:

“1. Necessity may not be invoked by a State as a ground for precluding the wrongfulness of an act not in conformity with an international obligation of that State unless the act:

(a) is the only way for the State to safeguard an essential interest against a grave and imminent peril; and
(b) does not seriously impair an essential interest of the State or States towards which the obligation exists, or of the international community as a whole.

2. In any case, necessity may not be invoked by a State as a ground for precluding wrongfulness if:

(a) the international obligation in question excludes the possibility of invoking necessity; or
(b) the State has contributed to the situation of necessity.”

¹¹ Article XI of the U.S.–Argentina BIT provides, in its entirety: “This treaty shall not preclude the application by either party of measures necessary for the maintenance of public order, the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests.”

¹² *CMS* annulment decision para. 136.

¹³ *Sempra* award para. 388.

apply the law for which it knew regulates the relations between the disputing parties. This explication of the annulment decision only seemingly relates to the authority granted to *ad hoc* committees by Article 52 of ICSID Convention. The analysis of the annulment decision demonstrates that the *ad hoc* committee actually based the decision on its own opinion about the content of the two sources of law¹⁴. According to the *CMS ad hoc* committee, that is exactly to act in the capacity of an appellate body because “the Committee cannot simply substitute its own view of the law and its own appreciation of the facts for those of the Tribunal.”¹⁵

In *Enron*, there is a similar situation. The *ad hoc* committee asserted that there was non-application of the law, but of the expert opinion.¹⁶ But this decision was reached based on the *ad hoc* committee’s opinion on required steps in decision-making process, which relates to appellate review.

There are some opinions that the standard of review must be given a substantive meaning and not be understood in purely formal terms, in the sense of not referring to the applicable law at all. Andreas von Staden stated:

“When litigants decide on the applicable law [...] they do so not because they merely want to see a given textual “shell” relied upon, but because of the content and meaning for which that text stands, given reasonable assumptions as to its interpretation. Applying the proper law is not exhausted by paying lip service to the text in which it is clothed, but rather requires that its content is observed.”(Von Staden, 2011: 223).

But, isn’t this precisely the description of substantive review consistent with an appeal? This approach seeks to explore the legal reasoning of the tribunals, and whether the tribunals understood properly the agreement on the applicable law, the law itself, or the parties’ expectations on the substance of that law. Perhaps this way of thinking would be more prone to the practical needs and reality of dispute resolution and accuracy in decisions, which is the ultimate goal. But it would certainly contribute to more confusion in drawing a line between annulment and an appeal, not only in practice but also in theory. In terms of constraining the operation of ICSID procedures to the legal framework of the ICSID Convention, there would be even more confusion. Article 53 of the Convention clearly states 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 this Convention. The framers of the ICSID Convention were so concerned to avoid intrusion by an *ad hoc* committee into the merits of the tribunal’s award that they amended the language of the Convention in comparison to the draft articles, in order to restrict annulment for excess of powers to cases in which such excess is manifest (Feldman, 1987: 100).

The drafting history and the text of the ICSID Convention go in favor of the limited scope of review under Article 52. The *ad hoc* committees should confine their examination to the competence of the tribunal and the integrity of the arbitration process (Feldman, 1987: 104). However, the practice shows that even with clear knowledge of the distinction between the appeal and the annulment, there is a constant need to modify the differences and introduce less formal constraints to the work of *ad hoc* committees.

¹⁴ *Sempra* annulment decision para. 200.

¹⁵ *CMS* annulment decision para. 136.

¹⁶ *Enron* annulment decision para. 393.

3.2. Political issues of the “Argentine Gas Cases”

The “Argentine Gas Cases” reflect the possible outcomes of dealing with economic crisis, and they do so by reaching deeply into the regulatory freedom of the States. More importantly, they reveal political affiliations of the international community in dealing with such issues. If the international centre, in this case – the ICSID, shows appropriate sensitivity for the State’s needs to maintain and/or recover national economy and address national social interests, it is more likely that such an organization will continue to enjoy the support.

The example of Argentina is a clear warning that this can be regarded as a policy problem for the international community. Facts point out to the same conclusion: there is a huge number of cases pending at ICSID against Argentina; the total amount of the awards against Argentina has reached an enormous sum, and it is uncertain whether Argentina will be able to pay; hence, Argentina is most likely going to plea the “necessity defense” in all of the cases brought against it. It is safe to presume that member States, especially in Latin America, will reevaluate their membership in the ICSID. Due to the deep crisis of global economy, the international community may be faced with a wide range of measures thought to be necessary to deal with the global crisis. The “necessity defense” reassures the States that they are going to enjoy the regulatory freedom needed to implement such measures. They would inevitably have effect on investors’ rights, so it would put stress to the BITs and the ICSID. If the ICSID does not develop a coherent framework for dealing with these cases, the system could well collapse (Stone Sweet, 2010: 19).

The margin of appreciation for introducing political, social and other non-investment elements in balancing antagonistic investor-States relations is one side of the coin for maintaining the ICSID legitimacy. The other side is concerned with whether we have reached doctrinal clarity in terms of application the annulment procedure.

4. JUSTIFYING THE WORK OF *AD HOC* COMMITTEES

The origin of the ICSID is in a multilateral convention, and it is a system that deals with issues of public concern. Its functioning relies on the compliance of the States. But it is difficult to imagine that the States would have ratified the ICSID Convention and abandoned any national possibility of control over the awards. With this respect, the ICSID demonstrates its uniqueness. The annulment procedure stands as a distinctive approach to achieving acceptance and social legitimacy on which so much is insisted upon. But arbitral annulment is actually perceived as a doctrinal consequence of a private conception of dispute resolution (Caron, 1992: 27). Yet, many of ICSID arbitrations raise issues that can only be properly understood as public law questions. Those are the cases “in which the outcome-determinative issue in the arbitration requires a determination of the state’s power and legal authority to undertake regulation in the public interest” (Burke-White et al, 2010: 288). Awards rendered in such arbitrations raise significant social interests and political sensitivity, so there is presumably a higher demand for more substantive correctness.

There is an idea that the very nature of ICSID cases has initiated the process of ICSID *judicialization*. This process is seen as a means to close the gap between substance and form and resolve the discrepancy between the private law-based form of dispute resolution and its underlying substance (host state actions) that is more appropriately governed by public law (Kim , 2011: 242). The governing idea of this concept is that arbitrators act as

public adjudicators because they deliberate on the government's actions. The process of judicialization is seen in the potential of arbitrators to influence and govern the conduct of the States. That potential is obvious in "Argentine Gas Cases" because the awards and annulment decisions in these cases clearly demonstrate appreciation for the latitude the States have to respond to financial and economic crisis, with respect to foreign investors' rights. This, for certain, will have impact on the perception how to shape the future policies of the States.

The trend of judicialization is manifested within the annulment procedure in which *ad hoc* committees have expanded the scope of their mandate to engage in substantive review of awards (Collins, 2013: 342). It is true that the ICSID Convention formally does not offer legal grounds for such an understanding of the *ad hoc* committees' authority. But the question of legality of the *ad hoc* committees' actions has been mitigated by introducing the approach in which the investment tribunals can no longer be viewed solely as agents of the disputing parties (Roberts, 2013: 63). They also have to be regarded as agents of the international community.

The process of judicialization effectively supports the idea of tribunals as courts or administrative agencies, because they have the potential to shape the conduct of sovereign states. But, courts exercise such authority acting on the basis of domestic public law. In that respect, the ICSID suffers from legitimacy deficit (Kim, 2011: 254). Arbitration does not have tenured judges who hold a public office, which makes them more suitable to resolve public law disputes (Brower et al, 2008: 489). The Investment Court can reconcile the legal nature of investment disputes and perceived legitimacy of the system to deal with such issues.

5. CONCLUDING REMARKS: WHY TO OPPOSE THE INTERNATIONAL INVESTMENT COURT

The legitimacy of the ICSID has been much debated with regards to annulment process and the authorities that *ad hoc* committees have appropriated, or misappropriated. The analysis of the *ad hoc* committees' work has shown that they operate as functionally appellate bodies. Though this is not firmly founded in the ICSID Convention, it can be argued that it is in line with process of judicialization. The ICSID *ad hoc* committees have actually demonstrated that insertion of public policies and non-investment issues in investment disputes are duly considered. A shift towards more accurate awards allows for a higher level of acceptance and enforcement of these awards, which are the prerequisites for sustainability of the system. It is rightly said that "ultimately, an award's authority depends on whether it is complied with in practice" (Tams, 2009: 241).

The International Investment Court has the potential to overcome some shortcomings of the ICSID system because it introduces into the legal framework the concepts that the ICSID *ad hoc* committees have developed through their practice.

However, European Commission's proposal has to be based on some fundamental legal concepts, recognized by legal system worldwide. An appellate procedure, as proposed by the EU, is based on the same legal grounds as annulment in the ICSID. Yet, there is a clear difference between the appeal and the annulment. In practice these differences can fade and are not always so easily recognized. Blending the two into one, by means of a normative act, could result in legal confusion. It could also undermine the legal clarity of the regulations used in International Investment Law, which was the original goal set to be achieved by introducing the court-like system.

There is one more aspect of this problem that needs to be considered. The ICSID was originally established in order to promote investments and facilitate the capital flow. It was designed to be in service of business operations and tasked to provide efficient relief for disputes, without employing the cumbersome machinery of diplomatic protection. The ICSID is perceived as being subordinated to the interests of both the States and the investors. On the other hand, the International Investment Court is set to be hierarchically above the States and investors. With regulatory powers at stakes, it can be seen as a manifestation of accumulating too much power in a single institution. The fusion of two procedures into one manifestly adds to that impression.

If the ICSID was fiercely scrutinized, why shouldn't the International Investment Court be? And why further confuse what have already been confusing: the annulment and the appellate procedure?

Finally, as Doak Bishop states: 'the message that the EU is conveying that it has to reinvent the system so it will be 'accountable and credible' is exaggerated and dismissive of the rules already in place, as well as mechanisms already planned within the arbitral community. We should be concerned that this message is exacerbating public fears of the investment arbitral system, rather than reducing them' (Bishop, 2015: 7).

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U POTRAZI ZA OPTIMALNIM MODELOM ZA REŠAVANJE MEĐUNARODNIH INVESTICIONIH SPOROVA

Međunarodni centar za rešavanje investicionih sporova (ICSID) se nametnuo kao autoritativni forum za rešavanje investicionih sporova. Međutim, poslednji period je obeležen pitanjima krize njegovog legitimiteta. Istovremeno, u okviru TTIP pregovora, Evropska Komisija je predložila formiranje Međunarodnog investicionog suda. Još uvek je neizvesno da li će ovaj predlog biti usvojen i realizovan, ali među efektima koje treba da ostvari je zamena investitor-država sistema za rešavanje sporova, čiji je predstavnik ICSID. Ovaj rad istražuje jedinstvenost ICSID-a fokusiranjem na određeni deo postupka: na postupak za poništenje arbitražne odluke. Analiza pokazuje da postupak poništenja pokreće značajna pravna i politička pitanja, sa velikim potencijalom da dovedu u pitanje društveni legitimitet sistema u celini. Cilj ovog rada je da razmotri mogućnost da se Međunarodni investicioni sud uvede kao način za prevazilaženje ovih problema, kako pravne, tako i političke prirode.

Ključne reči: *ICSID, Međunarodni investicioni sud, poništenje odluke, apelacioni postupak, legitimitet*