

# A Decade of Increasing Awareness of Investment Arbitration and Intensive Activity: an Assessment

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Imagine a visitor to this conference who has been out of touch with developments for the last 10 years but is otherwise well informed about international law in general and international investment arbitration in particular. I leave it to your literary preference whether you want to see our imaginary visitor as a kind of Robinson Crusoe who spent the last decade incommunicado on a remote island or as a time traveller who has just arrived in H.G. Wells' time machine.

I believe we would have to do a lot of explaining to our imaginary visitor before we could expect him to follow what will be said here today. In fact, he would be puzzled just by looking at today's agenda. For instance, what would he make of Emmanuel Gaillard's topic on contract claims and treaty claims and what on earth - he would ask - is an umbrella clause?

Ten years ago treaty arbitration had barely begun to exist. Only one case based on a bilateral investment treaty had been decided and a handful had been instituted. Jan Paulsson had just published his seminal article on arbitration without privity. So the concept would not be unknown to our latter day Robinson Crusoe but he would surely be amazed to learn how dominant treaty arbitration has become. Prior to the last decade nearly all investment arbitration was on the basis of contracts and nearly all claims were contract claims.

The distinction between treaty claims and contract claims, which is so ubiquitous today, was developed by tribunals to defend their jurisdiction in the face of contracts that contained clauses providing for dispute settlement before domestic courts (or sometimes arbitral tribunals). Today, we have reached the curious situation where the jurisdiction of international tribunals over contract claims is sometimes questioned as a matter of principle. But it is useful to remember that contract claims are not inherently outside the jurisdiction of a treaty based tribunal. The answer to this question depends primarily on the jurisdictional clause in the treaty. Some of these clauses restrict the tribunal's competence to treaty violations. Others are quite broad and extend to all investment disputes. And, of course, as Emmanuel Gaillard will explain, umbrella clauses turn contractual obligations into obligations under the treaty.

It is important to remember that the basis of the tribunal's jurisdiction, in a treaty or in a direct contract between the parties is one thing. The scope of the jurisdiction and the applicable law is quite another. The two are not necessarily coextensive. Therefore, a treaty tribunal may well have to decide on contract claims.

The distinction between treaty claims and contract claims has led to a new phenomenon of parallel proceedings before international and domestic judiciaries. It is entirely possible that claims arising from the same facts are litigated as treaty claims before an international tribunal and as claims under domestic law before a domestic court or tribunal. Some treaties contain so-called fork in the road provisions giving investors the choice of pursuing their claims either domestically or internationally. Once that choice is made it is final and cannot be reversed. Tribunals have held consistently that, despite a fork in the road clause, a pursuit of contract claims in domestic courts did not affect the investor's right to go to international arbitration to pursue its treaty claims.

A more ominous use of the distinction between treaty claims and contract claims arises where a host State tries to counteract treaty arbitration by instituting contract proceedings before a domestic court or arbitral tribunal. It is not difficult to see that such a practice, if it were to become common, could seriously undermine investment arbitration. I suspect we are going to see a number of cases in which treaty claims in international proceedings are offset by contract claims in domestic proceedings. In this way the host State can put pressure on the investor to withdraw the international claim or recover any amount that has been awarded or will be awarded against the State.

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The enormous growth of treaty arbitration has had a number of consequences several of which will be discussed today. One is the widespread use of MFN clauses which are so liberally sprinkled over investment treaties. Of course, MFN clauses are neither new nor peculiar to investment treaties. Here our imaginary visitor from the past would give a knowing nod, relieved to see that there is something, after all, that looks familiar.

But it appears that the investment community was not quite prepared for the full consequences of MFN clauses and their effect on investment arbitration. These clauses were invoked for jurisdictional, procedural and substantive issues. Even tribunals that gave effect to them seemed a bit intimidated by their potential effect and eager to contain them with the help of various theories - some more convincing than others. Looking at some of the reactions, especially of host States, one cannot help the feeling that treaty drafters did not fully appreciate the far-reaching repercussions of MFN clauses and somehow wish they could get the genie back into the bottle.

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The most dramatic repercussion of treaty based investment arbitration has clearly been the enormous growth in the number of cases. Ten years ago in 1995 there were five pending ICSID cases (one was a conciliation proceeding). Today over 100 cases are pending. 26 have been registered this year so far. The vast majority of these new cases are based on clauses in treaties offering the host States' consent to jurisdiction. Additionally, there are an unknown number of cases outside of ICSID.

At this point our time traveller, unless he is already speechless, would probably ask how the system can possibly cope with these numbers. The answer is: with difficulty but it still works. One can only be full of admiration for the professionalism and high quality of the work of the ICSID Secretariat under the circumstances. The process of registering requests for arbitration is not quite as swift and smooth as it used to be. Sometimes it is difficult to find arbitrators with appropriate language qualifications.

The number of requests for annulment has also jumped but not disproportionately to the number of cases decided. There are now more annulment proceedings pending than published decision on annulment, so we will probably see more than a doubling of decisions before long.

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Perhaps the biggest problem in the face of this enormous increase has been to maintain the consistency of decisions. I am not talking about conflicting awards in the same case like the

*Lauder* and *CME* decisions against the Czech Republic. There have also been a number of instances where tribunals sitting in different cases have come to conflicting conclusions on identical questions. These differences relate, to a number of issues that will be discussed today and we can expect to hear about them from other speakers before long.

Fortunately the problem of inconsistency is not pervasive. Most tribunals carefully examine earlier decisions and accept these as authority most of the time. But sometimes they disagree with them and make their disagreement known. In addition, the growing number of simultaneous cases makes it increasingly likely that tribunals may reach conflicting results without realizing it. Therefore, the problem of conflicting awards is a reality and has led to a lively discussion on how to address the problem.

One perceived solution is the creation of an appeals facility that would open the possibility to review decisions thereby increasing the chances of a consistent case law. A number of US treaties foresee this possibility and ICSID at one point floated a draft that foresaw the creation of an appeals facility at ICSID. As far as I can see these plans have now been laid to rest, at least for the time being.

Here our visitor from the past, knowing his ICSID Convention, would probably protest. He would recite Article 53 of the ICSID Convention which says that an award shall not be subject to any remedy except those provided for in the Convention. There is an answer to that objection but it is technical and rather inelegant and I would be inclined to spare our visitor that explanation.

If our imaginary visitor was trained in European law he would probably point out that there is a better solution to the problem of inconsistency. Rather than try and fix the damage after the fact through an appeal, it is more economical and effective to address it before it even occurs through a mechanism of preliminary rulings. Under such a system a tribunal would suspend proceedings and request a ruling on a question of law from a body established for that purpose. This method has yielded excellent results in the framework of European law where the Court of Justice of the European Communities performs this function.

The idea is not entirely new in the context of investment arbitration. Professors Kaufmann-Kohler and Wälde have floated it but there seems to have been little echo so far. A number of

details would have to be worked out. One is under what circumstances a tribunal would request a preliminary ruling and whether it would be under an obligation to do so. Another would be whether these rulings would bind the tribunal or would merely constitute recommendations. Not least, the composition of a body charged with giving preliminary rulings would need to be discussed.

But I am convinced that if an institutional solution to the issue of consistency of case law is to be found, a system of preliminary rulings is clearly superior to an appeals procedure. Preliminary rulings would leave Article 53 of the ICSID Convention untouched. They would not affect the principles of expediency and finality, two of the chief assets of arbitration. And they would help to prevent the development of inconsistencies rather than create a costly and time consuming repair mechanism.

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Our visitor from the past would also require to be brought up to date on a number of substantive issues. Expropriation is about as old as investment protection or international law dealing with the treatment of foreigners. The trend away from direct expropriation towards indirect expropriation is not entirely new and has been addressed by quite a few tribunals including the Iran-US Claims Tribunal. What is relatively new is the debate surrounding the State's right to regulate in the context of indirect expropriation. On the one hand it is to be expected and not unreasonable that the State insists on its right to regulate. On the other hand investors insist on the protection of their assets even if the State purports to act in the public interest.

Under most treaty provisions dealing with expropriation the existence of a public purpose is a requirement for the legality of an expropriation together with non-discrimination and appropriate compensation. It would seem to follow that a legitimate public purpose cannot be the basis of an argument that no expropriation has occurred. Rather, the existence of a public purpose is a requirement for the expropriation's legality in addition to compensation.

Some recent treaties, especially of the United States, address this issue in annexes. These state that the distinction between an indirect expropriation and non-compensable regulatory action requires a case-by-case, fact based inquiry that must be made with the help of certain listed

criteria. These criteria will still require a good deal of judicial practice before they give a clear indication of the actual distinction.

I wonder if it is very helpful to discuss this problem in terms of the State's right to regulate. As far as I can see, nobody denies that right. It is also beyond dispute that the State has the right to expropriate. But the right to expropriate has some conditions attached to it. One of them is that there must be a public purpose. Another is that compensation is paid. So ultimately this is not a question of whether the State has the right or not to take action that it deems necessary. It clearly does. The question is merely in what circumstance the investor has to bear the economic consequences of State action and in what circumstances the investor is to be indemnified from public funds for sacrifices made to the public welfare. Jan Paulsson's paper will, so I hope, provide the answer to these questions.

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The standard of fair and equitable treatment has recently become ubiquitous in investment arbitration. I think our Robinson Crusoe would be most surprised to hear that a concept that was hardly discussed 10 years ago has over the last five years advanced to the most important standard in international investment law. I have counted 27 decisions rendered during that period dealing with that standard but there are probably more. Last September there was a one day conference in London that was devoted exclusively to this topic.

Of course the main problem with fair and equitable treatment was its vagueness. But that has not turned out to be an insurmountable obstacle. As Prosper Weil wrote in the year 2000: "The standard of 'fair and equitable treatment' is certainly no less operative than was the standard of 'due process of law,' and it will be for future practice, jurisprudence and commentary to impart specific content to it."<sup>1</sup>

History has proved him right. Case law has in the meantime given contours to this seemingly amorphous topic. Four broad principles have emerged:

- the protection of the investor's legitimate expectations together with the requirement that the host State act transparently and consistently;

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<sup>1</sup> P. Weil, *The State, the Foreign Investor, and International Law: The No Longer Stormy Relationship of a Ménage à Trois*, 15 ICSID Rev.-F.I.L.J. 401, 2000, at 415.

- the observance of procedural propriety and due process;
- freedom from coercion and harassment
- and the general requirement that the host State act in good faith.

An interesting issue in the debate surrounding the fair and equitable treatment standard is its relationship to the international minimum standard under customary law. Of course, where a treaty indicates that its reference to fair and equitable treatment means the traditional minimum standard, that interpretation is to be respected. This is the case in recent treaties of the US and Canada. In the NAFTA context it is accepted that the concept of fair and equitable treatment is equivalent to the minimum standard of treatment under customary international law. This is so because of three special features of Article 1105(1) NAFTA: Article 1105 NAFTA refers to the “Minimum Standard of Treatment” in its heading; Article 1105(1) NAFTA refers to “international law, including fair and equitable treatment”, suggesting that the fair and equitable treatment standard is part of general international law; and Article 1105(1) NAFTA was the object of a binding interpretation by FTC, the NAFTA Free Trade Commission, an authorized treaty body.<sup>2</sup>

But other treaties, such as the Energy Charter Treaty and most BITs lack these features. On the contrary, they sometimes refer to fair and equitable treatment and to the observance of general international law side by side as two separate principles suggesting that they are independent of each other. Tribunals operating outside the NAFTA context have not accepted the position that treaty provisions containing the fair and equitable treatment standard merely reflect customary international law. Rather, they have construed the relevant provisions in BITs as a matter of treaty interpretation.<sup>3</sup>

Of course the NAFTA approach was designed to contain the import of the fair and equitable treatment standard. As it happens, equating fair and equitable treatment with the standard under customary international law may have exactly the opposite effect. Under the NAFTA approach the specific meaning that tribunals have given to fair and equitable treatment may be projected into customary international law. The consequence is that investors may in the future invoke the detailed case law on fair and equitable treatment as part of customary

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<sup>2</sup> Note of Interpretation of the NAFTA Free Trade Commission of 31 July 2001.

<sup>3</sup> See e.g. *Occidental Exploration and Production Co. v. Ecuador*, Award, 1 July 2004, paras 188–190; *CMS Gas Transmission Company v. Argentina*, Award, 12 May 2005, paras. 266–284.

international law even in situations that are not subject to a treaty provision containing that standard.

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Having so far spoken about the last 10 years, let me conclude by making two short remarks about the future of investment arbitration, not necessarily restricted to the next decade.

A number of States are unhappy with the number of cases brought against them and with the outcome of some of these. Argentina, is considering drastic action. Such action may affect the enforcement of awards but may also lead to the limitation or even complete withdrawal from investment arbitration. Other countries might follow suit once they realize that they could be on the losing side of investment arbitrations. So is investor-State arbitration in danger? After all, it is the States that ultimately control the system.

I will not make any predictions about the future but would like to offer some considerations that States might keep in mind. Although it may seem so at first sight, investment arbitration is not a one-sided system that works all in favour of investors. It also carries considerable advantages to host States. The more obvious advantage is a country's improved investment climate brought about by the possibility of international arbitration. In other words, by offering arbitration the host State creates an important incentive to foreign investment.

Another major advantage to host States arising from the system of investor-State arbitration is frequently forgotten. It is the displacement of diplomatic protection. Before investors received the right to pursue claims on their own behalf on the international level, the standard practice was for their home States to protect them by diplomatic means. This method carried political disadvantages for both States. It often created friction between the States concerned and cast a shadow over their relations. Not surprisingly, developing countries do not like being leaned upon by powerful industrialised States. In an investment dispute the limited inconvenience of having to defend a case before an international tribunal may be vastly preferable to the alternative of feeling the pressure of the United States or of the European Commission.

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Finally, is there room for improvement to the existing system? There obviously is and I have already referred to the possibility of introducing a mechanism to obtain preliminary rulings in order to improve the coherence of the case law.

Another area that is less than satisfactory is jurisdiction. Much time and effort is spent on technicalities and fine distinctions that are far removed from the substance and the equities of the cases. In large measure this is the consequence of the bilateral nature of most of the relevant treaties and of the diverse wording of different treaties dealing with jurisdiction.

Think of issues of nationality. An investor seeking protection in ICSID arbitration will have to show that it meets the nationality requirements of the ICSID Convention and of an applicable BIT or regional treaty. Success may depend on whether the investor has created a corporate vehicle in the right country in anticipation of a possible investment dispute. If there happens to be a so-called denial of benefits clause in the treaty even careful nationality planning may not help. The *Tokios Tokelès* and *Soufraki* cases are vivid illustrations of this problem. I hasten to add that I believe that both cases were decided correctly on the basis of the *lex lata*.

All of these technical complications may be a welcome source of employment for specialized lawyers but they have little to do with the creation of a safe environment for investment. Ideas to improve this system may appear utopian at the moment but perhaps we should think about taking a leaf out of international human rights law as far as access to a system of protection is concerned. Under such a system all investors would enjoy equal protection, substantive and procedural, regardless of nationality. Once the State concerned has submitted to the relevant standards these would be applied without distinction.