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978-1-107-02251-5 - Investment Treaty Arbitration: Judging Under Uncertainty

Andrés Rigo Sureda

Excerpt

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Introduction

The international law of investments has been an area of exponential growth in the last two decades. This development is sustained by two pillars: first, bilateral or multilateral treaties of promotion and protection of investments (BITs) and second, the International Convention on the Settlement of Investment Disputes (ICSID) Convention.

The first BIT is reputed to have been signed in 1959 between Germany and Pakistan. Since then, BITs in excess of 2,700 have been concluded. Although the first such agreements pre-date the debates in the United Nations (UN) on the New International Economic Order, it was precisely in response to the debates in the General Assembly concerning the measure of compensation owed in case of expropriation that the negotiation of BITs started in earnest, first and foremost with the objective to provide prompt, adequate and effective compensation.

The United Kingdom (UK) concluded the first BIT in 1975; the United States launched a BIT programme in 1977. A main feature of BITs is the offer made by the State to investors to arbitrate disputes related to their investments. BITs respond to a liberal doctrine of increased prosperity through foreign investment. They are symbolic of the wave of privatizations and free movement of capital of the last three decades. As investments have soured and cases against States have multiplied, the mood in some countries seems to be changing and new generations of BITs have been more restrictive, as witnessed by the new US model BIT.¹ It is too early to gauge what the effect of the recent financial crisis will be, in particular since

¹ US Model BIT (2004), available at: http://ustraderep.gov/Trade_Sectors/Investment/Model_BIT/Section_Index.html.

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it puts into question the consensus on the role of the State in economic matters prevalent in the last three decades.

The ICSID Convention was signed in 1965 and entered into force in 1966.² The drafting and negotiation of the Convention was sponsored by the World Bank – to which ICSID is affiliated – which adopted the initiative of creating the Centre for the sole purpose of administering legal disputes between investors and States arising out of investments. The World Bank's initiative was prompted by the concern that political risks could deter the flow of foreign private capital to developing countries.³ The submission of disputes to third party settlement was seen as a way to de-politicize them: as a counterpoint to the host State's agreement to third party settlement, the national State of the investor agrees not to pursue the diplomatic protection of the investor, except in cases of non-compliance with the award.

De-politicization of investment disputes through judicial settlement confirms Hersch Lauterpacht's thesis that the characterization of a dispute as a political or legal one is an invalid distinction under international law. Lauterpacht drew attention to the fact that 'disputes of high political importance were submitted to, and settled by, a purely judicial process' and that 'disputes obviously capable of decision on strictly legal lines were withheld from that procedure, on the ground that they were essentially political in their nature'.⁴ Thus a dispute may be legal or political, even if capable of a legal decision. He drew the conclusion that 'it is the refusal of the State to submit the dispute to judicial settlement, and not the intrinsic nature of the controversy, which makes it political'.⁵ However, when by definition one of the parties is a State and disputes concern matters of State policy and regulation, the political context is never far away.

The prohibition of recourse to diplomatic protection in ICSID cases and the fact that more often than not exhaustion of local remedies is not required before recourse to arbitration under investment treaties results in the elimination of two filters – one juridical, another political – before a dispute reaches the international arbitration stage and helps explain the growth of investment treaty arbitration. In any case, the rush of private

² Convention on the Settlement of Investment Disputes between States and Nationals of Other States, 18 March 1965, in force 14 October 1966, 575 UNTS 159.

³ A. Broches, *Selected Essays: World Bank, ICSID, and other Subjects of Public and Private International Law* (Dordrecht: Nijhoff, 1995), 193.

⁴ H. Lauterpacht, *The Function of Law in the International Community* (Oxford: Clarendon Press, 1933), 163. See also, B. Stern, 'Are Some Issues Too Political to Be Arbitrable?' *ICSID Review* 24 (2009) 90.

⁵ *Ibid.*, 164.

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claims against States, even if large in historical terms, is not so in relation to the amount of foreign investment flows during the last decades.⁶ The surge of private party claims against States in the era of investment treaties should not be surprising. Hersch Lauterpacht observed that the origin of most international claims lies in injuries suffered by private parties, and recounted all the cases before the Permanent Court of International Justice (PCIJ) which had originated in injuries to private parties by the respondent State.⁷

The BITs clauses on which most of these claims are based have exposed the vague nature of the standards by which arbitral tribunals are expected to adjudicate the claims, the resulting discretion of the tribunals among a variety of legally justified outcomes and the policy reasons which explicitly or implicitly have inclined a tribunal in favour of one or the other. The *ad hoc* nature of the tribunals and the variety of decisions on controversial issues has brought to the fore issues of consistency and how to solve them. The subject of this monograph is how in the face of uncertainty discretion is exercised. Part I focuses generally on judicial discretion, and more particularly on the choices made by arbitral tribunals as they approach treaty interpretation. Part II is devoted to the search for limits in determining jurisdiction and the content of the standards of protection, and Part III deals with principles, precedents and publicists and the extent to which they may assist in the search for consistency in the exercise of arbitral tribunal discretion.

⁶ W. Michael Reisman, 'International Investment Arbitration and ADR: Married but Best Living Apart' *ICSID Review* 24 (2009) 186–7.

⁷ 'Apart from territorial disputes, the great majority of cases of international judicial and arbitral settlement arise out of alleged infractions of private interests – a not untimely reminder that although international law is a law primarily between States, it regulates and protects the interests of the individual, who is the ultimate unit of the law of nations, as indeed of all law. For this reason the private nature of the claim underlying the dispute is not decisive as to its importance for general international law', in H. Lauterpacht, *The Development of International Law by the International Court* (London: Stevens, 1958), 31–2.

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Part I

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1

Uncertainty, judicial discretion and policy

Writing about the work of the International Court of Justice (ICJ), Hersch Lauterpacht pointed to the difficulty of judging between contentions which may deserve equal recognition:

[I]t is seldom a question of a clear and undisputed right against the entire absence of a right. It is, as a rule, a question of giving effect to a better right against a right of less compelling merit.¹

How is the better right determined? He continues:

It is that necessity of making a decision not between claims which are fully justified and claims which have no foundation at all but between claims which have varying degrees of legal merit – it is that necessity which, in common with the activity of legal tribunals generally, characterizes the work of the International Court . . . [M]any a case decided by the Court would not necessarily have given the impression of a manifestly wrong application of the law if the decision had gone the other way . . . It would provide an exercise of some interest and instruction to survey the work of the Court from that point of view.²

I found inspiration in these reflections to choose the subject of the lectures on which this monograph is based and thus honour the publication of *The Function of Law in the International Community* seventy-five years ago.

What criteria are used to measure the ‘varying degrees of legal merit’ of claims? If the Court could decide otherwise without ‘a manifestly wrong

¹ H. Lauterpacht, *Development of International Law by the International Court, being a revised edition of The Development of International Law by the Permanent Court of International Justice* (London: Stevens, 1958), 396–7.

² *Ibid.*, 398.

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application of the law', on what basis does it decide between two acceptable alternatives from a legal point of view? To answer these questions is to determine how judges use their discretion and what policy arguments underlie their choices, whether or not acknowledged by them. These issues are not confined to the ICJ or to international law. They are common to adjudication under any legal system.

A student of judicial discretion, Judge Barak of Israel's Supreme Court has defined it as a normative concept which 'reflects a state of affairs in which a judge must choose among a number of options, none of which the legal system has determined to be the right choice'.³ At the level of the ICJ, Judge Bedjaoui, writing extrajudicially, speaks about the *opportunité*⁴ of decisions:

[L]orsque la norme juridique ouvre au juge le choix entre deux ou plusieurs solutions, toutes légales par conséquent, elle l'investit d'une latitude ou d'une liberté de décision, ce qui lui confère un pouvoir dit discrétionnaire. Grâce à cette liberté, bien encadré par la légalité, le juge tente de prendre *la décision la plus opportune possible*.⁵

The root causes of judicial discretion may be as varied as the nature of the legal system itself: the limitations of language, inability to predict the future, lack of knowledge of a certain field in the course of its development, or lack of agreement on more specific terms. Thus, for instance, Koskeniemi attributes this situation to the reversibility of legal argument:

Reversibility results from the way our legal concepts need to conserve both projects, both conceptual schemes within themselves. For if it were the case that concepts which preferred either community or autonomy would always be preferred, then legal argument would be pointless. Merely to state the dispute would be to state the correct solution . . . In some way all legal arguments used in above examples are valid legal arguments and the issue seems to be only to decide a relative preference between them. But such preference becomes impossible because the initially opposing arguments come to look indistinguishable. Because each legal

³ A. Barak, *Purposive Interpretation in Law* (Princeton University Press, 2005), 208.

⁴ 'Le pouvoir discrétionnaire du juge international, et son corollaire épisodique de circonstance, l'opportunité, appartiennent nécessairement à la fonction judiciaire comme l'ombre à l'homme': M. Bedjaoui, 'L'opportunité dans les décisions de la Cour Internationale de Justice' in Laurence Boisson de Chazournes and Vera Gowlland-Debbas (eds.), *The International Legal System in Quest of Equity and Universality: Liber Amicorum Georges Abi-Saab* (The Hague: Martinus Nijhoff Publishers, 2001), 589.

⁵ 'Ce serait un absurde défi du législateur d'exiger du juge international la stricte application d'une norme dont il ne lui a pas rigoureusement déterminé le contenu'. Ibid., 575.

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concept can and must be argued from an ascending as well as a descending perspective the sole criterion for making a preference is lost.⁶

The area of discretion left to courts and tribunals is related to the generality and vagueness of the law to be applied. The more abstract or general the terms of the norm, the greater the discretion effectively delegated by the legislature or by treaty parties to those tribunals that in the future may interpret them.⁷ Several causes might underlie such generality or vagueness: States may not have been able to agree on the definition of a term, they may have opted to provide for standards of conduct rather than clear-cut rules, they may have intentionally left a certain provision open for future development, or else the field in question may not be sufficiently developed in general.

Discretion is more acutely relevant in international law. Elihu Lauterpacht observes that the uncertainty concerning how international law comes into being is part of the intellectual excitement of the study of international law: 'today's rule reflects in part yesterday's deviance; and . . . the cloth of obligation is partly cut from the pattern of non-conformity'.⁸ The imprecision and the scarcity of substantive rules translate into more significant judicial freedom of determination.⁹

Investment treaties themselves are indeterminate to the extent that they provide standards of compliance, the content of which is left to be specified by arbitral tribunals.¹⁰ This development has parallels in domestic law and

⁶ M. Koskenniemi, *From Apology to Utopia* (Cambridge University Press, 2005), 506 (original emphasis removed).

⁷ '... le pouvoir discretionnaire se nourrit du vague d'une norme juridique'. Bedjaoui, 'L' opportunité', 574.

⁸ E. Lauterpacht, 'The Development of the Law of International Organization by the Decisions of International Tribunals' *Recueil des cours* 152 (1976) 4 377–478 at 389. 'Le processus de création de règles en droit international fait que les normes y jouissent d'une très grande relativité et que celles qui se rapprochent le plus du statut de règles universelles sont souvent ambiguës': J. Salmon, 'Quelques observations sur la qualification en droit international public' in C. Perelman and P. Foriers (eds.), *La motivation des décisions de justice* (Brussels: Bruylant, 1978), 348. 'Bien souvent les contradictions existantes au moment de la création de la règle de droit international n'ont pas été résolues ou ont été mises entre parenthèses. Elles demeurent. Le droit international affectionne les formules ambiguës qui ne résolvent qu'à moitié les choses': *ibid.*, 350.

⁹ Lauterpacht, 'The Development of the Law', 395.

¹⁰ 'Le contenu des traités est souvent très imprécis . . . les traités recourent très fréquemment à la technique du standard: standard du traitement juste et équitable et de la pleine et entière protection par exemple dans les traités relatifs aux investissements. Cette technique qui exclut l'indication d'obligations précises se réfère à un seuil de comportement dont le contenu ne pourra être apprécié par le juge qu'au cas par cas au regard des situations concrètes présentées devant lui. Dans cette technique, les États s'abstiennent

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in the field of human rights. In the case of investment treaties, the States commit themselves, for instance, to fair and equitable treatment of investors and their investments, to provide them with full protection and security, and not to take measures, without compensation, that may be tantamount to expropriation.¹¹ The resulting discretion points to the importance of policy in the decisions of arbitral tribunals. As a general matter, Friedmann drew attention to the unavoidable role of policy in judicial decision making:

The policy element in the judicial decision may be refined; it may be pushed back further and further; the area of uncertainty may be reduced. But there must always remain a point at which a choice has to be made, and it is necessary to determine the factors guiding that choice.¹²

This is even more the case in investment arbitration where the area of uncertainty remains large, and consequently the significance of the reasons for the choice made among possible outcomes:

The justification of the decision must depend upon the reasoned assessment of the relative, or comparative, desirability and undesirability of the consequences which

délibérément d'exercer leur rôle normatif et se reposent sur le juge ou l'arbitre du soin de concrétiser le contenu des obligations': G. Burdeau, 'Le pouvoir créateur de la jurisprudence internationale à l'épreuve de la dispersion des juridictions' *Archives de philosophie du droit* 50 (2007) 289, 297.

¹¹ 'The contrast between rules and standards identifies the fact that with some legal provisions, interpreters have to do a great deal of work in order to give law real content. The meaning of a standard depends on what happens when it is applied, and those who decide what happens are likely to proceed casuistically. Of course casuistical judgments may well generate categories that provide great guidance for the future', C.R. Sunstein, *Legal Reasoning and Political Conflict* (New York: Oxford University Press, 1996), 27. 'It is in justifying the value-judgments which are made in these various situations of judicial discretion that policy arguments are used. By relying on the justifications for new rules, or interpretations of discretionary standards, the judges seek to persuade the legal audience of the rightness of their decision, and to show that they have made a legitimate exercise of the political power entrusted to them': J. Bell, *Policy Arguments in Judicial Decisions* (Oxford: Clarendon Press, 1983), 29–30.

¹² W. Friedmann, 'Legal Philosophy and Judicial Lawmaking' *Colum L. R.* 61 (1961) 821, 826. See also MacCormick, for whom '[w]hen a question is finely balanced, as the question here was and when either answer can be given consistently with the words used in the Act [he is speaking of statutory interpretation], a ruling must be made for one or the other; that ruling, to be justified, must show it to be the more acceptable given a consistent and principled "theory" . . . our answer must depend upon the values we bring to bear on the question', in N. MacCormick, *Legal Reasoning and Legal Theory* (Oxford: Clarendon Press, 1978), 212–13. He continues: 'But there is another theory by reference to which the other is right, and to have reasoned grounds for saying that one theory as against the other is right, we should require a third, higher-order, theory, which might in turn be challenged by a fourth – and so on. Short of an infinite regress we must make, and live with, our own choices . . .', at 213.