

MINUTES OF THE SPRING MEETING

held on Tuesday 21 April 2015 at the The Hague Institute for Global Justice

ARBITRATION AS A MEANS OF SOLVING INTERNATIONAL DISPUTES: ADVANTAGES AND RISKS

The annual Spring Meeting of the Royal Netherlands Society of International Law was attended by about 40 members and non-members. The Chairman opened the meeting at 7:00 P.M. He then introduced the three speakers and invited them to give their respective presentations, to be followed immediately by a discussion.

The Presentations

The first speaker was **Hugo H. Siblesz**, Secretary-General of the Permanent Court of Arbitration ("PCA"), who, in the brief time available, gave an overview of the history of the PCA and its organisation as well as some general information about arbitration proceedings before the PCA. The PCA was founded in 1899 by the 26 countries participating in the first Hague Peace Conference, held on the initiative of Czar Nicholas II of Russia. The Court was established for the purpose of settling disputes between states by arbitrators of their own choice. It resides at the Peace Palace in The Hague, but PCA hearings and meetings also may be (and are) held outside The Hague. It is a permanent intergovernmental organisation, governed by an Administrative Council. Its International Bureau acts as a secretariat assisting the parties and the arbitrators in proceedings before the PCA. At this time the PCA has 117 Member States, three of which joined in the last three years. Each Member State may nominate up to four Members of the Court, but parties to proceedings are not obliged to select their arbitrators from the list of Members so nominated.

Primary activities of the PCA are (1) the administration of arbitration proceedings, which may be between states or between a state, state entity or intergovernmental organisation and a private party (the latter cases based either on an investment treaty or on a contract), and (2) assisting the parties to a dispute in the selection of arbitrators. PCA proceedings may be conducted under any arbitration rules, such as the UNCITRAL Rules, the PCA Arbitration Rules or rules agreed between the parties. The main advantages of PCA-proceedings are their flexibility with respect to almost all aspects of dispute resolution, most importantly choice of arbitrators, applicable law, procedural rules and the possibility of site visits. The current PCA docket consists of 95 registry cases, of which the majority are investment treaty-based. In all, there have been 47 inter-State arbitrations to date, most of them during the first fifteen years of the PCA's existence and mainly concerning boundary delimitation and demarcation and maritime delimitation. Since the UN Convention on the Law of the Sea came into force in 1994 the PCA has acted or is acting as registry for eleven out of the twelve cases arbitrated under Annex VII of the Convention. The first mixed arbitration was administered by the PCA in 1934, but today these cases and especially investor-State arbitrations constitute the majority of cases of the PCA's docket.

Under the UNCITRAL Rules the PCA's Secretary General is authorised to designate an Appointing Authority (AA) if the parties have not agreed on one. With the parties' agreement

the Secretary General also may act directly as Appointing Authority. Since 1976 the Secretary General has acted as such in more than 550 cases.

The second speaker was **Prof.dr. Jamal Seifi**, Judge at the Iran-United States Claims Tribunal and Professor of Global Law (2015) at Tilburg University. His presentation focused on the “Clean Hands” doctrine in the context of international investment arbitration. This doctrine, based on equity in the Common Law tradition, is to the effect that a party seeking equitable relief cannot take advantage of his own bad behaviour (unclean hands). In other words: *ex dolo malo non oritur actio*. As discussed by the International Law Commission of the United Nations this means that a State may not exercise diplomatic protection if the national it seeks to protect suffered an injury through his or her own wrongful conduct, though the Commission did not include a provision regarding the clean hands doctrine as a condition of admissibility in the draft Articles on diplomatic protection.. Article 39 of the International Law Commission’s Draft Articles on Responsibility of States for Internationally Wrongful Acts provides, however, that in the determination of reparation account must be taken of the contribution to the injury by the injured State’s own conduct or that of any person or entity in relation to whom reparation is sought.

Arbitration in the context of investment treaties may concern illegal investments or abuse of the system of investment protection. Recent arbitral practice confirms that no protection will be allowed for investments made contrary to law even if a treaty does not require conformity of the investment with any particular law (*Plama Consortium Ltd v. Bulgaria*, 8 February 2005, ICSID Case No. ARB/03/24). Similarly, the requirement of not having engaged in a serious violation of the legal regime is a tacit condition, inherent in every bilateral investment treaty (*SAUR International S.A. v. Argentine Republic*, 6 June 2012, ICSID Case No. ARB/04/4). An investor who has obtained an investment in the host State through bad faith or violation of the laws of the host state cannot expect to benefit from a treaty’s protection (*Hulley Enterprises Ltd (Cyprus) et al. v. Russian Federation*, 18 July 2014, para. 1352). With respect to the legality of an investor’s behaviour one must distinguish between legality of the creation of the investment, which is a jurisdictional issue and the legality of the investor’s conduct during the life of the investment, which is a merits issue (*Gustav F.W. Hamester GmbH v. Republic of Ghana*, 18 June 2010, ICSID Case No. ARB/07/24, para. 129). If an investor acts illegally, the host state may request to correct such behaviour by imposing sanctions. This should not prevent an investor from making its case before an arbitral tribunal, however, if the investor believes such sanctions are unjustified. To deny an investor the right to do this would undermine the purpose and object of the treaty. (*Hulley Enterprises, supra*, para. 1355).

The third speaker was **Prof.dr. Vesna Lazic**, Senior Researcher at the T.M.C. Asser Institute in The Hague, Associate Professor of International Commercial Arbitration at Utrecht University and Professor of EU Civil Procedure at the University of Rijeka, Croatia. Her presentation highlighted a number of the advantages and disadvantages of arbitration in an international setting.

Important advantages of arbitration may be (1) speedy proceedings (provided everyone involved, including the parties, co-operates), (2) a tribunal with the necessary expertise to handle the often complex subject matter of the dispute, (3) flexibility with respect to e.g. procedural rules, (4) confidentiality and (5) enforceability in many jurisdictions. On the other hand, arbitration may be expensive and the powers of the arbitrators tend to be limited.

Commercial arbitration may take place pursuant to an arbitration clause in the agreement between the parties or a separate submission agreement concluded after the dispute has arisen. It may be based on national laws (statutes). In addition, various investment treaties (there are more than 3000 in all) provide for investor-State arbitration as an efficient mechanism to protect investors from e.g. discrimination by the host country or lack of independence of host country courts. Arbitral decisions may be widely enforced, e.g. in the case of commercial ones pursuant to the New York Convention of 1958 and in the case of investor-State cases under the Washington Convention of 1965. It should be noted, though, that some countries are revoking their investment treaties and that it may become more difficult to include investor-State dispute settlement provisions in future treaties.

The same aspects of arbitration proceedings that are often seen as advantages in some cases may turn into disadvantages. This applies in particular to (1) duration of the proceedings (depending on the parties) and (2) lack of transparency (confidentiality). Apart from this, arbitration may be expensive, arbitral awards may affect (limit) state regulatory powers, arbitrators may not be as independent or impartial as one would like them to be and the flexibility of the process as a whole may cause arbitral decisions to lack the consistency and predictability that are valued in legal judgments.

Within the European Union, the European Parliament has made suggestions to improve the system of investor-State dispute resolution by e.g. improving transparency and introducing the possibility of appeal, the aim being to strike a balance between investor protection and the possibility of public intervention. The European Commission also wishes to introduce a code of conduct for arbitrators and to limit their powers, as well as to make it possible for States to agree jointly on how to interpret the provisions of an investment treaty.

The Discussion

The discussion is chaired by Prof.mr.dr. Willem van Genugten. Immediately following the three presentations, he gives the floor to the audience.

Q. (addressed to H.S.): Can you elaborate on the work the PCA does with the United Nations regarding the arbitration following human tragedies, such as Rana Plaza (collapse of a garment factory in Bangladesh in 2013, in which more than 1000 workers were killed).

H.S.: Among other things, the PCA has been asked to provide expertise on various aspects of mass claims and multi-party arbitration.

Q. (addressed to J.S.): In proceedings between a company and one or more individuals, does the "Clean Hands" doctrine provide a balanced outcome if only the cleanliness of the company's hands are assessed?

J.S.: It should be borne in mind that the conduct of the respondent is necessarily under consideration in any proceedings. So it is not solely the conduct of the Claimant which is at issue.

Q.: (addressed to J.S.): If [on the basis of the "Clean Hands" doctrine,] an arbitral court declined to accept jurisdiction or a case is found to be inadmissible, do you not think this is counterproductive? Do you not think the case should be decided on the merits, i.e. the

arbitrators should deal with the substance of the dispute, rather than avoiding it by only looking at a preliminary jurisdictional issue?

J.S.: I see your point. This is an access to justice issue. The parties should not be deprived of access to justice, for example in case of violation of human rights or similar circumstances. It would be different in case of an investment, e.g. where there is corruption or an abuse of the system in acquiring the very investment for which protection is sought. In this context it is useful to look at the Yukos case I referred to in my presentation, , of course without expressing an opinion on the case itself, where a distinction was made between the acquisition stage and the performance stage of the investment. Perhaps Article 39 of the ILC draft Articles, which allows for consideration of the claimant's conduct in the determination of the reparation due provides a better solution in certain circumstances.

Comment (addressed to J.S.): It should be kept in mind that a State's hands may not be clean either, so if proceedings are stopped early, the defendant State's (dirty) hands are not looked at.

J.S.: Both parties' hands are looked at, because the defendant State's conduct constitutes the very subject-matter of the proceedings.

Q. (addressed to V.L.): Would you provide your own assessment of the recent proposals of the Dutch Minister for Foreign Trade and Development Co-operation to establish a permanent International Investment Court. Would it be an independent institution or operate under an existing international organisation?

V.L.: A permanent International Investment Court would enhance uniformity. It will take time, however, to establish such a court. Thus, it is more appropriate to adapt the existing rules on resolving investment disputes by arbitration.

Q. (addressed to V.L.): You referred to the recent proposal of the EU Council to ratify the UN Convention on Transparency, adopted in December 2014. Does the Council view this Convention as a mixed agreement requiring ratification by both the EU and all its Member States? If so, what does this teach us with respect to future ratification of the Transatlantic Trade and Investment Partnership ("TTIP") between the U.S. and the EU and the Comprehensive Economic and Trade Agreement ("CETA") between Canada and the EU.

V.L.: The Convention offers both possibilities and Member States may use the UNCITRAL Rules.

Q. (addressed to J.S.): Is there a link between the "Clean Hands" doctrine and the inclusion in treaties of 'legality' clauses?

J.S.: As I pointed out in my presentation, there are two avenues through which the "Clean Hands" doctrine in its broad sense has been applied by investment arbitration tribunals. Firstly, the legality requirement, which means that illegal investments are not covered by the bilateral investment treaty protection (*Inceysa Vallisoletana S.L. v. El Salvador*, 2 August 2006, ICSID Case No. ARB/03/26 and *Fraport AG Frankfurt Airport Services Worldwide v. The Philippines*, 10 December 2014, ICSID Case No. ARB/11/12). Secondly, the issue of abuse of process, namely abuse of the system of investment protection by investors through an abusive reorganisation of the corporate structure to obtain investment treaty benefits (*Phoenix Action, Ltd v. The Czech Republic*, 15 April 2009, ICSID Case No. ARB/06/5 and *Renée Rose Levy and*

Gremcitel S.A. v. Peru, 9 January 2015, ICSID Case No. ARB/11/17). Your question is related to the legality requirement. In fact, the way the Yukos Tribunal formulated its legality question is instructive: “Can a Clean Hands Principle or Legality Requirement be read into the ECT¹?”² As already noted, the illegality requirement may operate at the jurisdictional phase to render the host State’s consent to the ICSID arbitration invalid. This does not mean, however, that a jurisdictional objection based on the illegality of the investment may not be joined to the merits. Under this scenario, the jurisdictional objection will not be disposed of until after the arbitral tribunal has had the benefit of a substantive briefing by the parties. Indeed, that is what happened in *Fraport*. At the same time, it should be noted that, as confirmed by the *Plama* Tribunal and more recently, by the *Yukos* Tribunal in the context of the ECT, the legality requirement is an inherent requirement and does not need treaty stipulation.

Comment (addressed to V.L.): Investment arbitration also is an alternative to diplomatic protection and domestic litigation, as well as the need to depoliticise the dispute.

Prof. Lazic fully agrees with this comment.

General comment: As recalled by one of the speakers, international investment law and arbitration are often portrayed as being a pro-investor regime. Although this regime needs to be reformed, to call it purely pro-investor in my view is a caricature. International investment law and arbitration are not a pro-investor regime. This is illustrated by the objectives of the regime and the case-law of arbitration tribunals.

First of all, development has always been an objective of international investment agreements, an objective nowadays incorporated into the broader notion of ‘sustainable development’, which is increasingly referred to in the preambles of those agreements. In that regard, the protection of foreign investors is instrumental, i.e., the agreement aims at attracting foreign investors with the view to promoting development. The importance of the development objective is well evidenced by the Report of the Executive Directors on the ICSID Convention (Convention on the Settlement of Investment Disputes between States and Nationals of Other States, Washington 1965) or the statement made by the arbitration tribunal in the *Lemire* case (*Joseph Charles Lemire v. Ukraine*, 28 March 2011, ICSID Case No. ARB/06/18).

Furthermore, empirical studies show that the decisions of arbitration tribunals are more often favourable to states than to foreign investors.

That having been said, one may wonder why such a perception exists? Why are international investment law and arbitration perceived as being pro-investor? To understand this one might refer to this well-known aphorism: “Justice must not only be done; it must be seen to be done.” Indeed, because investment arbitration was originally modelled on commercial arbitration and therefore characterised by confidentiality, I think that the ‘justice’ done by arbitration tribunals as a whole could not be seen and thereby was not completely done. In that regard, I believe that the 2006 revision of the ICSID Rules of Procedure for Arbitration

¹ Energy Charter Treaty, Lisbon 17 December 1994.

² *Hulley Enterprises Ltd (Cyprus) v. The Russian Federation*, supra p.2, at p. 429.

Proceedings or the recent UNCITRAL rules on transparency will make this justice more visible and will improve the legitimacy of international investment law and arbitration.

Q. (addressed to [V.L.]): What is the connection between the pool of arbitrators being closed and the lack of independence among arbitrators?

V.L.: Within the current discussion on the TTIP and CETA the issue of potential conflict of interest has been raised, considering that a number of arbitration specialists participate in investment arbitration in different roles (e.g. as legal counsel in one arbitration and as arbitrators in another). This may trigger the discussion pertaining to impartiality and independence of arbitrators.

Q. (addressed to V.L.): Is the lack of consistency with respect to arbitral rulings considered to be a true disadvantage in the sense that inconsistency has been recorded or documented?

V.L.: To some extent this is a question of interpretation. For example, with respect to the allocation of costs, one may wonder whether there is a lack of consistency. It is not easy to determine this with absolute certainty, because it is difficult to compare reports. It is not always clear how criteria were used.

At this point, to conclude the discussion, the chairman invited the three speakers to give their final comment.

Mr. Siblesz used the opportunity to give a few comments on the TTIP, which is subject to a great deal of discussion and comments in the media. It is the official position of the PCA that the parties to the negotiations themselves should decide what they wish the agreement to cover. There appears to be some inconsistency as to how the most favoured nation clause should be applied. The term "fair and equitable treatment" that is [often] used in investment treaties is too vague and finally, the limited list of arbitrators makes the problems worse.

Prof. Lazic said she agreed with Mr. Siblesz. Prof. Seifi said he had no further comments after which the chairman thanked the speakers for their contribution and invited everyone present to conclude the meeting informally with a glass of wine.