This essay was written as a response to two prompts provided for the Miami/Young ICCA Scholarship Competition. The two prompts were: “Recent developments in ICSID arbitration – time to think about alternatives?” and “How Do We Design for Legitimacy?”

Recent Developments in ICSID Arbitration:
Too Early to Jump Ship

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Executive Summary

The International Centre for the Settlement of Investment Disputes (ICSID) is experiencing growing pains. As recourse to ICSID arbitration in order to resolve foreign investment disputes becomes more common, ICSID jurisprudence is beginning to raise concerns on a number of fronts about the legitimacy of the system, and whether it will remain a viable method of settling investment disputes in the long term. This paper begins by exploring ICSID’s design, why legitimacy matters to ICSID, and what it means to say that ICSID’s legitimacy is in doubt. It then examines a number of different developments that are presenting challenges to ICSID’s legitimacy: inadequately reasoned awards, inconsistencies in awards and annulment decisions, and potentially problematic interpretive practices of ICSID tribunals with regards to essential security clauses, umbrella clauses, and treaty shopping. After assessing the challenges posed by these developments, the paper urges caution in determining the extent to which ICSID’s legitimacy has been affected by said developments. It argues that the challenges may seem greater at present than they in fact are. It also proposes some less far-reaching solutions for enhancing ICSID’s legitimacy than are being discussed in the investment arbitration community at present.

Introduction

The explosion in the use of investor-state arbitration has brought the ICSID system to a crossroads. On the one hand, the increasing frequency with which it is used indicates that on some level, investor-state arbitration has achieved a level of acceptance as part of the natural order of foreign investment governance. This may seem obvious today, but 30 years ago it was not yet the case, as there were few BITs in existence at the time. Yet the popularity that highlights this achievement is

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simultaneously a source of strain on the system. ICSID’s design represents the acceptance of certain tradeoffs that have become unpalatable in the present day. The magnitude of the downside of these tradeoffs must have been incomprehensible in 1966 when ICSID was established. The virtues of finality of judgments and efficiency were understandably paramount. As ICSID’s caseload has increased, however, it has encountered obstacles that threaten its legitimacy in the eyes of many observers.\(^2\) Among these obstacles are arbitral awards starkly lacking in logical reasoning, contradictory or otherwise incompatible interpretations of identical treaty provisions in similar cases, and interpretations of fundamental provisions that throw into doubt whether the system is serving its intended purpose. These obstacles are in part caused and in part exacerbated by ICSID’s design, including its non-precedential nature, its lack of an appellate mechanism, and the extreme procedural difficulties in reforming ICSID. These problems create situations that some consider untenable, and raise questions about ICSID’s viability going forward.

Legitimacy and ICSID’s Design

ICSID’s framers could not have contemplated today’s volume of investor-state arbitration. Indeed, at ICSID’s birth, bilateral investment treaties (BITs) themselves were not nearly as widespread as they are today – especially in their standalone form. Friendship, Commerce, and Navigation treaties (FCNs), in which foreign investment protections first appeared, became common in the 18\(^\text{th}\) century.\(^3\) Eventually, as the world globalized and states sought to attract capital while investors searched for new investment markets, FCNs gave way to bilateral investment treaties, which unlike FCNs were focused exclusively on investment. These BITs cemented the fundamental investment protections, including a promise of fair and equitable treatment of foreign investments (FET) and promises for prompt, adequate, and effective compensation for takings of investments (expropriation). Furthermore, BITs initially called for the formation of ad hoc tribunals to hear disputes rather than submitting state-espoused claims to the International Court of Justice. BITs exploded in growth beginning in the late 1980s – well after ICSID’s establishment. Prior to 1989, there were fewer than 400 BITs in existence. Today there are over 2500.\(^4\) Correspondingly, ICSID was rarely used over the first several years of its


\(^3\) Vandevelde, supra note 1, at 158.

\(^4\) See RUDOLF DOLZER AND CHRISTOPH SCHREUER, PRINCIPLES OF INTERNATIONAL INVESTMENT LAW 2 (Oxford 2008).
existence – in fact, in its first 20 years, only 20 cases were registered with ICSID. However, over the 10 year period from 1998-2007, over 130 new cases were registered with ICSID, and there are 144 cases are currently pending. Of course, this does not take into account arbitrations that were not made public or that were held outside the auspices of ICSID.

Investor-state arbitration within ICSID was contemplated as a speedy, effective, fair alternative to adjudicating investment disputes within the domestic legal systems of host states. As such, one of its key features is finality. Unlike litigation that can languish in courts for years as parties continually appeal adverse decisions, there is - at least in theory - no review on the merits available in arbitration after a tribunal makes its decision. An award cannot be modified after a judgment is rendered by an ICSID tribunal. The only way an award can be affected after it is made is if a party requests annulment.

Annulment may be granted on only the following grounds: (1) the tribunal was not properly constituted, (2) the tribunal manifestly exceeded its powers, (3) the proceedings were tainted by arbitrator corruption, (4) the tribunal departed from a fundamental rule of procedure, or (5) the award failed to state the reasons upon which it was based. A committee, which is appointed from a list of individuals provided by the parties, reviews the award on these bases and may annul the award in whole or in part if it finds that any of these standards were not met.

Notably missing from the grounds for annulment is any sort of mention of a mistake of law. As far as reasoning is concerned, only a total failure to provide reasoning for a decision is grounds for annulment. The purpose of this is clear. At odds in the design of a system of judicial review are the principles of finality and correctness. ICSID's design evinces a clear preference for finality. Settling a dispute quickly is clearly prioritized over engaging in the layers of review that would be required to ensure that a decision is correct. Correctness is left to the tribunal, which must do its best to reach the correct decision on the first try.

Considering the context within which the ICSID system was initially developed, this tradeoff is understandable. With relatively so few disputes in the years leading up to ICSID’s creation – indeed, with relatively so few BITs – it would have been difficult to imagine that arbitral decisions would have especially wide ramifications beyond each individual case. Without scrutiny beyond that of the parties in

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7 Id. art. 52(3).
8 Christoph Schreuer, ICSID Annulment Revisited, 30 LEGAL ISSUES OF ECON. INTEGRATION 103 (2003).
each case, ensuring correctness would naturally be less vital. This is compounded by the fact that ICSID awards are not precedential.\textsuperscript{9} By design, determinations made by ICSID tribunals are intended to have no effect beyond each particular dispute they adjudicate. This again diminishes the importance of correctness, as in theory, an incorrect decision would not be passed downstream to subsequent cases. The virtues of finality on the other hand are clear. The prospect of long, drawn out, multi-tiered battles in the case of a dispute would serve only to make foreign investment a less attractive proposition.\textsuperscript{10} Such a system would also not seem to be enough of a departure from domestic legal systems to warrant the creation of a new institution. Thus, in the context of foreign investment in the mid-20\textsuperscript{th} century, the tradeoff in design of correctness in favor of finality seems reasonable.

Global foreign investment conditions have fundamentally changed in the past 30 years, however. The growth of foreign investment, BITs, and investment arbitration have created new challenges and upset the tradeoffs initially chosen by ICSID’s framers. BITs, for one thing, have grown to not only be ubiquitous but starkly similar across the world. As Stephan Schill has pointed out, BITs have reached a striking level of convergence with respect to their scope, structure, and content.\textsuperscript{11} Most BITs contain the same provisions: FET, national treatment (NT), most favored nation treatment (MFN), full protection and security (FPS), prohibitions on expropriation, guarantees of observance of host state assumed obligations, and recourse to ICSID arbitration in the case of disputes. Most of these provisions are expressed in very similar ways across different BITs, often using identical language. Of particular significance to investor-state arbitration, the default language for many of these clauses is left similarly vague, sometimes knowingly, with states intending to have the standards developed through practice and jurisprudence (despite the lack of de jure stare decisis in ICSID).\textsuperscript{12} The result is that this framework of bilateral commitments resembles a multilateral system. Now consider that the drastically increased caseload of the past 30 years is governed by essentially the same laws, with the same core issues proving pivotal in many cases, and all of a sudden correctness is not something that can be so easily


\textsuperscript{11} Stephan Schill, \textit{The Multilateralization of International Investment Law: The Emergence of a Multilateral System of Investment Protection on the Basis of Bilateral Treaties}, Society of International Economic Law, Working Paper No. 18/08, 7 (note: this citation is a placeholder; the author has asked that this paper not be cited, but I do not currently have access to the book in which he expands on the concepts I cite).

\textsuperscript{12} See KENNETH J. VANDEVELDE, \textit{UNITED STATES INVESTMENT TREATIES: POLICY AND PRACTICE} 76 (1992) (describing that in US BIT negotiations, certain standards were being left vague with the expectation that the precise contents thereof would develop over time).
dismissed. Or perhaps to put it more precisely, tribunals dealing with similar facts that come to very different conclusions on the same issues cannot simultaneously be correct, and this is understandably troubling.

The reason for these concerns is that, with this volume of cases on such similar core issues, cases are treated as precedential to an extent, regardless of initial design. As the global BIT framework has come to resemble a more robust and unitary legal framework, states, investors, and indeed even arbitral tribunals have begun to view it as such. Indeed these entities cannot treat prior arbitral decisions as entirely without precedential effect. Therefore even if jurisprudence on a particular issue is not binding, it does serve to regulate the conduct of those deciding how to act with regards to foreign investment. Thus investor-state arbitration serves an important governance function, regulating the conduct of international actors through non-binding mechanisms. But obviously, if awards are incorrect, whether because of inadequate or nonexistent reasoning, or because incompatible rulings on the same issue exist, making at least one of them incorrect, actors are left without reliable standards to which their conduct can be conformed, frustrating the aim of investment law to make investment climates clearer.

This brings the question of legitimacy to the fore. Legitimacy is a concept central to the effective functioning of any governance institution on which public actors must rely, but it is especially crucial in the context of international institutions. Legitimacy in the political context refers generally to the authority conferred on a governance institution by public acceptance. In the domestic context, legitimacy matters insofar as governments wish for their institutions to reflect and be imbued with democratic values. It is not necessarily, however, fundamental to the functioning of domestic institutions, as a government’s coercive power can serve as the source of authority for an institution. In the international context, on the other hand, this power to coerce does not exist. International governance systems are decentralized and exist only as a result of the will of their subjects; there is no greater power by which to bind subjects to the control of these bodies. Legitimacy, therefore, is a prerequisite to the existence and functioning of international institutions: without public acceptance, international institutions would serve little purpose.

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In order to think more precisely about what legitimacy challenges ICSID faces, and how its design relates to those challenges, we must be clear about what we mean by legitimacy. Scholars who have dealt seriously with the concept of legitimacy in law tend to follow the Weberian conception of legitimacy: that it is essentially a property of a governance system that explains why people adhere to rules when they otherwise don’t have to (i.e., in the absence of coercion). Thomas Franck provided a definition of legitimacy tailored for the context of international rules: “Legitimacy is a property of a rule or rule-making institution which itself exerts a pull toward compliance on those addressed normatively because those addressed believe that the rule or institution has come into being and operates in accordance with generally accepted principles of right process.” Thus, perception is a key factor in legitimacy, and this is especially clear in the international realm. If a state considers an institution to be illegitimate, then it may withdraw from the institution, and a significant amount of withdrawals can threaten the institution’s survival. This is a consequence that must be avoided if investor-state arbitration is to retain its effectiveness as a dispute resolution method, as a system of investor protection that few states accept is of very limited use. State perceptions of legitimacy, however, are informed by certain indicators that can be assessed objectively. If we focus then on these indicators, which are essentially components of legitimacy, and their relationships with institutional design, processes, and outcomes, then we can have a better sense of how to address concerns regarding the legitimacy of an institution like ICSID arbitration.

If we accept that the way investors, states, and tribunals treat arbitral decisions essentially turns ICSID arbitration into a system that generates rules that guides the conduct of international actors, then Thomas Franck’s examination of the nature of legitimacy in international rulemaking institutions provides a framework for thinking about the legitimacy of the investor-state arbitration system. Franck’s approach synthesizes a range of previous scholarly inquiries into the nature of legitimacy into one coherent theory appropriate to the international realm. Franck postulated that the components of legitimacy for international institutions can be determined by considering the factors that induce states to comply with them. Using this analysis, he distilled four indicators of legitimacy: determinacy, symbolic

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19 Franck, supra note 15, at 15-17.
validation, coherence, and adherence. Each of these concepts can be adapted to the context of investor-state arbitration. By determinacy, Franck means “the ability of a text to convey a clear message, to appear transparent in the sense that one can see through the language of a law to its essential meaning.” As the rulemaking of tribunals is taken from their award decisions, one can analyze the language and logic of an award for clarity to determine whether its legal reasoning reveals its essential meaning to the point where actors understand how to conform their conduct to the standards elucidated by tribunals. Symbolic validation, which refers to symbolic cues that are culturally accepted to suggest authority or to the authority conferred by the deep-rootedness of institutions, is somewhat less significant in international arbitration, as the procedures laid out in frameworks like ICSID are designed to not only appear symbolically authoritative but to actually substantively be so, and, given that most of its activity has come in the past 15 years, the system is not so deep-rooted as to command respect on the grounds of pedigree alone. Coherence, on the other hand, may potentially be very significant with regards to the legitimacy of investor-state arbitration. In particular, external coherence, or consistency between rules expressed by different tribunals, is an especially important consideration. Given that rulemaking is expressed through particularized, unconnected arbitral decisions, then the possibility that the ICSID system may generate incoherent or even directly contradictory rules clearly exists – and this occurs in practice. Finally, the concept of adherence to rulemaking through investor-state arbitration presents an interesting situation. Adherence refers to the conferral of authority on a primary rule of obligation by a set of secondary rules that reflects an accepted process by which rules are made, interpreted, and applied. Clearly there is a robust set of secondary rules (namely, the ICSID convention) which ICSID tribunals adhere to in making their decisions, but the rules do not actually permit any process by which arbitrators may shape legal obligations beyond each particular case, and so of course nor can they guide the de facto rulemaking that tribunals engage in. Essentially, this makes the other indicators all the more important, since adherence to ICSID’s processes of rulemaking cannot confer legitimacy upon decisions made by tribunals (though we will later see that there are other secondary sources of rules, such as BITs and contracts, that provide opportunities for adherence as well). Together, these four indicators of the objective legitimacy of international institutions are the basis of the legitimacy that states perceive in such institutions. For investor-state arbitration, determinacy and coherence are of utmost importance, since opportunities for symbolic validation and adherence are limited.

21 Id.
22 Id., 34.
This framework for assessing the legitimacy of international institutions, applied to the system of investor-state arbitration, helps us identify the specific ways in which the challenges presented by the recent developments in investor-state arbitration might threaten the legitimacy of the system, as well as suggesting ways to enhance the system’s legitimacy, both by directly addressing those components of legitimacy that are threatened and buttressing those that are not.

**Challenging Developments in ICSID Arbitration**

**Inadequate Reasoning**

The ICSID convention contains a reason-giving requirement, but it provides little guidance as to precisely how to ensure that the requirement is met. It states simply that an award “shall state the reasons upon which it is based”. It says nothing about a minimum standard of quality of reasoning below which reasons could be said to not exist. As mentioned above, a failure to state reasons is a ground for annulment, but annulment committee jurisprudence on the level of the standard has been entirely inconsistent since the very first committees to consider the question.

Inadequacy of reasoning relates directly to legitimacy as described above. It cuts straight to the heart of determinacy, as poor reasoning makes understanding the content of a rule more difficult. There are two particular patterns of problematically inadequate reasoning that permeate investor-state cases and damage the system’s legitimacy. The first, as described by Benedict Kingsbury and Stephan Schill, occurs when tribunals prescribe normative content to the vague standards common in investment treaties without any rigorous justification and then assert that the facts of the case do or do not meet that standard.

This type of reasoning makes it impossible to follow the tribunal’s reasoning from point A to point B. One such example is the decision on liability in LG&E v. Argentina, a dispute arising out of the Argentine financial crisis. In LG&E, one of the tribunal’s tasks was to determine whether Argentina indirectly expropriated LG&E’s investment in Argentina’s gas distribution sector. It proceeded by searching for criteria for indirect expropriation through a hodgepodge of sources. Its resulting definition for indirect expropriation failed to make any mention of the action – regulation – that was at issue. It

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23 ICSID Convention, art. 48(3).
24 THE REASONS REQUIREMENT IN INTERNATIONAL INVESTMENT ARBITRATION 5-16 (Guillermo Aguilar Alvarez & W. Michael Resiman eds., 2008).
25 Kingsbury, supra note 13, at 48.
then failed to actually apply the facts of the case to its criteria in finding that Argentina did not expropriate LG&E’s interests.26

Another even more troubling example of this type of reasoning failure is the umbrella clause analysis (or lack thereof) in the CMS v. Argentina award. CMS, another natural gas company bringing an investment claim against Argentina for its actions in responding to its financial crisis, claimed that Argentina violated the umbrella clause in the US-Argentina BIT. Umbrella clauses are highly contentious provisions that protect investors from contractual breaches by states. Exactly which types of contracts are protected and which kinds of state actions are prohibited by umbrella clauses is very much an unsettled matter in the world of foreign investment law. Despite this, the tribunal in CMS v. Argentina engaged in almost no interpretive analysis whatsoever. The award simply states the tribunal’s position on the content of the umbrella clause and moves on to a (brief) application of its conception of the umbrella clause to the facts.27 It provides no explicit basis for its own interpretation, let alone any reference to the reference to the fact that the interpretation of umbrella clauses is far from settled. This award was ultimately annulled, partially because of the tribunal’s failure to state reasons for its decision on the umbrella clause.28

The other troubling pattern identified by Kingsbury and Schill consists of “a failure to spell out the normative assumptions tribunals are making when interpreting abstract standards...and instead limiting themselves to extensively presenting the facts of a case, with legal issues treated briefly and by assertion more than by legal argumentation and reasoning.”29 In the case they use to illustrate this point, Eastern Sugar B.V. v. Czech Republic, the tribunal never provides an interpretation of the meaning of fair and equitable treatment, presenting instead an arbitrary and broad framework within which fair and equitable treatment was somewhere situated. There is, however, much jurisprudence on the normative content of the fair and equitable treatment standard, and for the tribunal to ignore it not only is unsatisfactory but serves only to confuse parties seeking clarity as to what constitutes fair and equitable treatment.30

27 CMS Gas Transmission Company v. Argentina, ICSID Case No. ARB/01/8, Award ¶ 299 (May 12, 2005).
29 Kingsbury, supra note 13, at 48.
Another example of similarly troubling reasoning can be found in the LG&E award mentioned above, this time in its discussion of necessity. On the subject of necessity, the tribunal largely avoids explaining what it thinks the relevant BIT clause means, instead providing an extensive retelling of the magnitude of Argentina’s financial crisis. Although there are many unsettled parameters to the question of necessity clauses in BITs – whether host states may decide for themselves whether a situation of necessity exists, the extent to which alternative remedies to the situation affect the legality of the state’s actions, the relationship between necessity in BITs and necessity in customary international law – the tribunal for the most part does not provide its assumptions on these issues, emphasizing facts without actually applying them to any standards.

Inconsistent Decisions

Inconsistency across ICSID decisions is a particularly great challenge to the system. As mentioned above, its non-precedential design coupled with the similarity of BITs across the world creates numerous opportunities for inconsistent decisions. To the extent that ICSID decisions are treated as creating rules for the conduct of foreign investment, this is a direct challenge to the legitimacy of ICSID arbitration.

The most troubling instances of inconsistent decisions occur when the relevant facts and relevant treaty provisions are identical in two or more cases. Perhaps the most notorious example of this occurring is a pair of cases referred to collectively as the Lauder arbitrations. Ronald Lauder, an American investor, created a private television station in the Czech Republic in 1992. After the station was up and running, the Czech Media Council changed its treatment of the ownership structure and licensing of the station. Eventually, Lauder brought claims against the Czech Republic under the US-Czech Republic BIT, but also brought claims on behalf of his Dutch investment vehicle, which contributed finances to the station, under the Netherlands-Czech Republic BIT. The cases were arbitrated in London and Stockholm, respectively. While the claims in each case were virtually the same, as were the relevant provisions in the two BITs, the two tribunals came to very different conclusions on the standards regarding expropriation, fair and equitable treatment, and minimum obligations that were expressed in the treaties. In the end, the London tribunal found only a minor breach by the Czech Republic of its BIT with the US and declined to award damages, while the Stockholm tribunal found widespread violations of the Dutch-Czech BIT and ordered the Czech government to pay Lauder’s investment company a

31 LG&E Energy Corp v. Argentina, ICSID Case No. ARB 02/1, Decision on Liability ¶¶ 226-242 (Oct.3, 2006).
32 Franck, supra note 1, at 1558.
massive award. The problem was that the two judgments could not both be correct, as the tribunals came to the opposite conclusions on a number of identical legal questions. On each of these questions, only one of the tribunals could have correctly interpreted and applied the content of the treaty.\textsuperscript{33}

While the Lauder arbitrations are an example of a directly inconsistent set of cases, some entire realms of investment law are defined by inconsistent divergences. Perhaps most notably, umbrella clause interpretive jurisprudence is characterized by a split of opinion as to what the clause means. As mentioned above, umbrella clauses make certain breaches of investment contracts actionable under an investment treaty. Umbrella clauses are complicated mechanisms because they do not explicitly contain substantive dimensions; they simply bring investment contracts under investment treaty protections and thereby provide jurisdiction to investment tribunals over certain investment contract breaches. Umbrella clauses can be worded in a variety of ways, but typically they state that each party agrees to observe obligations they assume with regard to investments by investors of the other party or parties. What kinds of obligations and breaches are covered, however, is generally not immediately clear. Orthodox methods of treaty interpretation and the history of umbrella clauses tend to be relied upon by those that support broader interpretations – the broadest being that the umbrella clause automatically converts any conduct by a state that breaches an investment contract with a foreign national into a breach of the obligations of the investment treaty and gives the tribunal jurisdiction to hear the claim.\textsuperscript{34}

Proponents of narrower interpretations tend to focus their arguments on the potentially significant countervailing considerations, both practical and theoretical in nature, that militate against broad conceptions of umbrella clauses.\textsuperscript{35} Ultimately, the arguments used by both sides contain significant holes, primarily in the failure to address the concerns of the opposition. Instead, tribunals tend to simply state the merits of their chosen view, ignoring the merits of the opposition. Because of this, tribunals for the most part miss the opportunity to develop umbrella clause jurisprudence beyond these two entrenched poles. This is problematic, because it prolongs the bipolar state of the law, which reduces predictability for investors. Because umbrella clause jurisprudence is characterized by the simultaneous

\textsuperscript{33} It should be noted that the Lauder arbitrations were brought under the UNCITRAL rules rather than ICSID, as ICSID does not permit such parallel proceedings. Still, the cases are instructive as to the kind of inconsistency that investor-state arbitration, including ICSID arbitration can result in.

\textsuperscript{34} See, e.g., Eureko B.V. v. Republic of Poland, UNCITRAL, Partial Award (Aug. 19, 2005); Noble Ventures Inc v Romania, ICSID Case No. ARB/01/11, Award, (2005); SGS Société Générale de Surveillance SA v. Paraguay, ICSID Case no ARB/07/29, Award on merits (Feb. 10, 2012).

viability of two incompatible views, investors and states have little guidance as to the level of protection investment law provides for investment contracts. The incoherence among decisions issued by tribunals on umbrella clauses thus causes the legitimacy of investor-state arbitration to suffer.

One significant point should be noted here, however, and that is in regard to at what point a line of cases can truly be considered inconsistent. While umbrella clause jurisprudence has been marked by inconsistency for nearly a decade now, it is possible that over time a consensus approach will emerge. This is what seems to be happening with regards to some aspects of essential security jurisprudence. In particular, the numerous Argentina gas sector cases have grappled with the question of the relationship between essential security clauses in BITs and necessity in customary international law in a variety of ways. For instance, one of the earlier decisions on the issue came in the aforementioned LG&E award. That tribunal found that essential security clauses in BITs and necessity in customary international law, codified in Art. 25 of the Articles of State Responsibility, were essentially the same concept: that both in treaties and in customary international law, certain states of emergency or states of necessity excluded from wrongfulness actions taken by states that would otherwise be counter to their obligations, such as those contained in investment treaties. The tribunal in Enron v. Argentina, dealing with the same issue, expressly stated that recourse to Art. 25 of the Articles of State Responsibility was necessary in order to understand the meaning of the essential security clause of the US-Argentina BIT. This approach was heavily criticized by the tribunal in Continental Casualty v. Argentina and the annulment committees in CMS and Sempra v. Argentina, which argued that the concepts of essential security and necessity were necessarily distinct because the successful invocation of an essential security clause in a BIT precluded the wrongfulness of the state’s action, whereas necessity in customary international law is a concept that operates to excuse an act that has already been deemed wrongful and may still require some remedy despite the successful use of the necessity defense. Therefore the two concepts operate on separate planes of international law, and cannot be conflated. For a time these two sets of views on essential security and necessity co-existed, and so the state of the law could be said to be inconsistent and legitimacy-reducing, but the trend has been towards the latter view, that essential security and necessity are distinct. While views on the relationship between the two concepts is still being developed – they may still have some bearing on each other, even if they are distinct – the law seems to be moving in one direction to a certain extent, and therefore this is no longer an area of major concern with respect to the legitimacy of ICSID dispute settlement. Thus when discussing the impact of ICSID

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36 LG&E Award at ¶ 245.
37 Enron Corporation and Ponderosa Assets, LP v. Argentina, ICSID Case No. ARB/01/3, Award ¶ 333 (May, 22 2007).
decisions that do not cohere with each other on the legitimacy of the system, one must keep in mind that inconsistency may only be a temporary diversion on the path to consensus.

Problematically Broad Concepts in ICSID Decisions

*Expansive conceptions of essential security.* The Argentina gas sector cases are notable with regards to necessity, but perhaps more so in terms of tribunals’ and annulment committees’ findings of necessity or essential security in general, rather than for the relationship between the two concepts in particular. Argentina has consistently been winning these cases, whether in the initial award or on annulment, largely on necessity or essential security grounds. ICSID tribunals are finding that the Argentine financial crisis did constitute a situation that precluded wrongfulness of Argentina’s actions, and annulment committees are finding that those tribunals which found otherwise were sufficiently erroneous as to warrant annulment (annulment committees have essentially folded serious legal error into the “manifest excess of powers” ground for annulment).\(^{38}\) This is a new direction for international law. Traditionally, security exceptions in other treaties such as the GATT have been limited in scope to emergencies where international peace is threatened by conflict.\(^{39}\) While essential security clauses in BITs are generally more open ended, the notion that they apply in situations of economic crisis potentially opens the door for states to disregard investment protections much more often; after all, current events make clear that financial downturns are not rare occurrences, and can be long lasting.\(^{40}\) Thus for tribunals to extend the scope of essential security clauses to economic crisis has the potential of making investment protections largely toothless in those situations where investors especially need to rely on them.

*Broad interpretations of umbrella clauses.* Another challenge to the investment legal regime comes from developments in umbrella clause jurisprudence. Recall that the broad interpretation of umbrella clauses permits any dispute over an investment contract to be adjudicated by an investment tribunal. The tribunal in *SGS v. Pakistan*, which was the first ICSID tribunal to grapple with the interpretation of umbrella clauses, raised a number of concerns about these broad interpretations.

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\(^{38}\) See, e.g., Continental Casualty Company v. Argentina, ICSID Case No. ARB/03/9, Award (Sept. 5, 2008); Sempra Energy International v. Argentina, ICSID Case No. ARB/02/16, Decision on Argentina’s Application for Annulment of the Award (June 10, 2010); Enron Corporation and Ponderosa Assets LP v. Argentina, ICSID Case No. ARB/01/3, Decision on Application for Annulment (July 30, 2010).


Essentially, there are three main policy concerns that seem to motivate narrower umbrella clause interpretations: that opening up ICSID arbitration to contractual disputes that could otherwise be litigated in courts creates a potential for too many claims, burdening the investor-state arbitration system; that there is a fundamental contradiction in attempting to resolve a contract breach in ICSID arbitration when the contract has its own dispute resolution provisions that provide for another means of dispute settlement; and that contractual breaches may not be within the province international law.

With respect to the first concern, some have argued that investor-state arbitration is well suited to handle an increased number of cases based on claims relating to relatively minor breaches of investment contracts by states. They point to the ad hoc nature of the system and the fact that arbitrators can be appointed freely as needed as evidence of the system’s flexibility and capacity. But according to many commentators, the investment arbitration system is arguably already buckling under the weight of its ever-increasing caseload. The number of cases is outpacing the rate at which new arbitrators can be found. The result is that the same arbitrators are taking on more and more cases. It currently takes much longer than in previous decades to reach a decision. The system is no longer as efficient and lightweight as it was meant to be. And the repeated appointments of the same arbitrators is raising questions as to whether or not it is wise to have the same arbitrators hearing so many cases. The opening of investor-state arbitration to garden variety contractual claims could place further stress on the system. Given these stresses and the costs of each proceeding, is ICSID the most appropriate forum for hearing contractual disputes?

In addition, automatically converting all contract breaches to treaty breaches clashes with the traditional distinction between domestic and international law. There is a general presumption that mere breaches of contract do not constitute internationally wrongful acts. Usually, in order to seek remedies under international law, the act which resulted in the breach must have been an exercise of sovereign authority and must amount to a violation of international law itself in order for the breach to be actionable. This raises the question of whether or not it is proper for international tribunals to be hearing claims that are traditionally not governed by international law.

44 See Noble Ventures at ¶ 53; Azurix v. Argentine Republic, ICSID Case No. ARB/01/12, Award, July 14, 2006, para. 315. See also S.M. Schwebel, On Whether the Breach by a State of a Contract with an Alien is a Breach of International Law, in International Law at the Time of its Codification, Essays in Honour of Roberto Ago, III, Giuffre,
The concerns regarding honoring dispute resolution clauses in contracts are a matter both of principle and practicality. It seems like quite an intrusion for an investment tribunal to tell a state that a contract provision it negotiated will be ignored. This is an affront to the freedom to bargain and arguably to sovereignty as well, to the extent that a tribunal binds states to resolve contract disputes in investment arbitration when they never intended this in signing the treaty. This, it should be noted, creates a problem with regards to adherence, the fourth indicator of legitimacy in Franck’s international legitimacy framework. The contract, as the primary source of obligations between the investor and the host state, should be adhered to by an adjudicatory body; if tribunals essentially create a rule that a contract’s dispute resolution provisions can be ignored in favor of arbitration before ICSID, this rule obviously does not adhere to the primary source of binding obligations for the parties. In addition, if the tribunal is going to ignore the contract’s dispute resolution provisions, it has essentially changed the content of the obligation. This does damage to predictability since it is not clear by what standards the tribunal will judge whether a contract breach has occurred if it is not applying the law of the contract, which is domestic law. There is no international contract law.

The most recent umbrella clause decision, contained in the award for SGS v. Paraguay, did indeed embrace a broad reading of the umbrella clause.\(^45\) If these policy concerns hold weight, and if umbrella clause jurisprudence moves in this direction, then the cost of reaching consensus on umbrella clause interpretation may be that ICSID becomes too overburdened by contractual disputes to serve its function, and that it faces additional criticism for freely ignoring contracts and asserting a role in deciding contractual disputes that it is not clear it should play.

**Treaty Shopping**

Finally, another development in ICSID arbitration that presents a challenge to the system’s integrity is that of treaty shopping. The broad definition of “investment” under most BITs paves the way for parties to access ICSID arbitration when it might otherwise be unavailable to them.\(^46\) This technique is particularly of interest to domestic investors, who, of course, but for treaty shopping, would be unable to access ICSID arbitration. They can treaty shop by forming corporations abroad to serve as investment

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45 SGS v. Paraguay, *supra* note 34, at ¶¶ 89-95.

vehicles for their local investments, allowing them to take advantage of the protections afforded to foreign investors in their home countries by bringing investment claims through the shell corporation in the case of a dispute. This has indeed been the situation in at least two investor-state cases: Tokios Tokelės v. Ukraine and Rompetrol v. Romania. In Tokios, the claimant was a Lithuanian company that did no substantial business in Lithuania and was 99% owned and fully controlled by Ukranian nationals. In Rompetrol, the claimant was a Swiss company, which wholly owned a Dutch company that had contracted with a Romanian state agency, and Rompetrol itself was 80% owned by a Romanian national. In both cases, the tribunals held that despite the possibility that there was abuse of the investor-state system, both claimants met the requirements for standing to bring claims under the respective BITs. If states grow increasingly concerned about abuse of ICSID to circumvent the law, this may raise further questions about ICSID’s viability going forward.

How Challenging Are the Challenges? ICSID’s Legitimacy Going Forward

Inadequate reasoning, inconsistent decisions, and broad conceptions of essential security situations, umbrella clauses, and nationality of investors all present challenges to ICSID, whether to perceptions of its legitimacy or more fundamental questions about its functions and capabilities. The next question, then, is whether ICSID is viable in its current form, or whether it requires major changes - or perhaps whether an entirely different method of resolving investor-state disputes is required. Far-reaching proposals have been advanced, from instituting an appellate mechanism in ICSID, to abolishing investor-state arbitration altogether. It is beyond the scope of this paper to address all the various proposals in existence. There are, however, far less ambitious, and more feasible, ways to strengthen ICSID’s legitimacy and enhance the prospects of its long term survival.

The simplest reform that could be made is to address inadequate reasoning by ICSID tribunals by expanding upon Article 48(3) of the ICSID Convention. At present, Article 48(3) does not even prescribe minimal standards of reason-giving. It seems reasonable and not particularly onerous to suggest that it

47 Tokios Tokelės v. Ukraine, ICSID Case No ARB/02/18, Decision on Jurisdiction and Dissent, ¶ 21, IIC 258 (2004), 20 ICSID Rev. — Foreign Investment L. J. 205.
49 Tokios ¶¶ 52-56; Rompetrol ¶ 85.
50 See, e.g., Tams, supra note 10 (discussing instituting an appellate mechanism in ICSID); Ari Afilalo, Constitutionalization Through the Back Door: A European Perspective on NAFTA’s Investment Chapter, 34 N.Y.U. J. Int’l L. & Pol. 1, 9, 45, 51 (2001) (arguing that original jurisdiction over NAFTA investment disputes be given to national courts); Michael Reisman, Control Mechanisms in International Dispute Resolution, 2 U.S.-MEX. L.J. 129 (1994) (suggesting a permanent court of investment arbitration, rather than ad hoc tribunals).
at least be expanded to require not only reasons, but to require awards to present a logical, reasoned analysis that assigns normative content to investment treaty standards only after a thorough mining of appropriate sources of law and an engagement with the various normative options. At the very least, such an elaboration of the reason giving requirement of the ICSID Convention would give tribunals some guidance in composing their awards, and would give annulment committees a clearer mandate to annul awards in which tribunals did not engage in a sufficiently rigorous process of reasoning. Furthermore, this may lead to tribunals taking better account of prior jurisprudence on similar questions before ruling, which may help address the problem of inconsistency in ICSID caselaw.

There are three potential criticisms of such a reform. The first is that, as alluded to, it opens up the possibility of increased annulments by expanding the reason-giving grounds upon which committees can annul awards, which might seem undesirable. However, if the amendment has its intended effect of encouraging tribunals to engage in more thorough analysis, there should not be a great increase in annulments. Secondly, an argument could be made that calling on tribunals to consider prior decisions on similar questions would make ICSID an inappropriately direct progenitor of international common law of investments and would limit state sovereignty over their investment laws in a way that was not contemplated during the formation of ICSID. However, if ICSID tribunals clarify their jurisprudential inclinations, states would in fact have more control over their investment law, since there would be less unpredictability as to how ICSID tribunals would interpret existing formulations of investment law standards, and if these interpretations were not to the liking of states, they could amend their investment treaties accordingly. The most damaging criticism of this proposition, however, concerns ICSID Convention amendment procedure: namely, that it requires the unanimity of the Contracting States. At the very least, this would be a long and arduous process. Therefore, this proposition, for all its merits, may not be feasible to achieve. Still, given that the amendment does not propose a drastic change that goes to the heart of ICSID’s values, unanimity might not be as unrealistic as it might be on other potential reforms.

The problem of inconsistent decisions is not unique to ICSID tribunals. Other investment treaty dispute resolution systems, such as NAFTA arbitration, also encounter similar threats to their integrity from incoherent rulings. NAFTA, however, has developed a special tool to help address the problem of inconsistent interpretations of NAFTA provisions. When a trio of cases produced divergent jurisprudence on NAFTA’s fair and equitable treatment provision, the three NAFTA parties issued an interpretive note through the NAFTA Free Trade Commission, clarifying what level of protection they believed NAFTA’s
fair and equitable treatment provision required.\textsuperscript{51} This interpretive note was a binding interpretation and thus subsequent NAFTA tribunals have applied the FTC’s interpretation of fair and equitable treatment.

Such a remedy in ICSID would obviously be much more complicated if it required the consent of all the Contracting States. Yet ICSID could fashion a similar interpretive tool and simply require it to be adopted in such a way that it represented substantial consensus. When a troubling instance of inconsistent rulings on an investment treaty standard arises, the ICSID Secretariat could issue a discussion paper outlining the problem and the implications it might have for guiding state conduct. The Secretariat can then solicit comments on the discussion paper from the Contracting States and concerned third parties and incorporate them into a working paper that has the authority of having been drawn up through an open and collaborative process and can be drawn on by future tribunals, and yet is not binding upon them. Allowing tribunals to use the guidance contained in the interpretive working paper could help align divergent lines of thought on certain investment protection standards, but making its use voluntary helps avoid the problem of requiring the consent of all Contracting Parties. Parties to a dispute would still be free to offer their alternative interpretations of the standard at issue and the tribunal would be free to consider them along with the interpretive working paper.

A similar mechanism, though perhaps more far-reaching, difficult to implement, and counterintuitive, could be used to strengthen determinacy even after the publication of an award with weak reasoning. The annulment committee report in \textit{CMS v. Argentina}, while ultimately not annulling the award it criticized, may have performed a useful function by stating in no uncertain terms that the reasoning that the tribunal employed was not sound and should not be taken as an indication of how future tribunals contemplating similar issues might decide.\textsuperscript{52} This served an important signaling function to states, investors, and tribunals alike as to how these issues might be resolved going forward (and indeed, the subsequent Argentina gas sector cases did develop the line of thought advanced by the CMS annulment committee). While this may not be an appropriate task for annulment committees to continue to undertake going forward – not without some sort of amendment of their duties – it seems reasonable that the ICSID Secretariat could play a similar role when it spots a tribunal decision that is similarly egregious in its poor reasoning by issuing a discussion paper clarifying for interested parties that the decision should not be taken as a reflection of ICSID jurisprudence. On the one hand, it may

\textsuperscript{51} For a brief account of the cases and the issuance of the interpretive note, see \textsc{Organisation For Economic Co-operation and Development, International Investment Perspectives 2004} 159-60 (OECD Publishing 2004). \textsc{See also} Franck, supra note 2, at 1581.

\textsuperscript{52} \textit{CMS v. Argentina} at ¶¶ 130-136.
threaten the integrity of the system if the ICSID Secretariat criticizes the rulings of its own tribunals without being able to reverse them – parties may lose faith in the system. On the other hand, however, this would be a determinacy enhancing maneuver as far as the systemic effects of ICSID arbitral awards. Used with the proper discretion, this could be a useful tool.

These proposals would not necessarily fix all of the problems related to inconsistent or weakly reasoned arbitral decisions. For example, in cases like the Lauder arbitrations, reforms that led to more rigorous reason-giving by the tribunals would not necessarily have led to a convergence in decisions. Yet, at the same time, such improvements in the determinacy and coherence of ICSID (de facto) rulemaking would enhance the system’s legitimacy regardless of the existence or nonexistence of defects in its other legitimacy indicators. These proposals are not necessarily mutually exclusive. They could be used in combination to achieve a more robust strengthening of ICSID legitimacy.

Finally, and perhaps most significantly, it should be noted that many of the challenges noted throughout the paper may be alleviated without any corrective action at all on the part of ICSID tribunals or its members (at least, in their capacity as members). Some issues characterized by inconsistency may move towards consensus as ICSID jurisprudence develops. But more significantly, most of the challenges described come as a result of vague standards in BITs. Thus much trouble could be avoided if states amend their BIT provisions to make them more precise and to make them fit what states actually envision for their content. In fact, this is already occurring on a number of fronts. For example, whether the existence of a state of emergency (permitting the operation of an essential security clause of a BIT) is a subjective or objective determination has been hotly contested in ICSID tribunals; however, in order to avoid having tribunals decide this, treaties like the US-Russia BIT expressly state that the essential security clause is self-judging – that is, that the host state can determine for itself whether the requisite situation exists.53 Similarly, in order to deal with treaty shopping, some states have begun drafting what are known as “Denial of Benefits” clauses into their BITs.54 These clauses deny the benefits of the treaty’s investment protections to entities that do not perform substantial business activities in their host state.55 Even a state that is concerned about overly

55 Dolzer, supra note 4, at 55.
broad umbrella clause interpretations can simply exclude umbrella clauses from its BITs. BITs themselves are only beginning to mature. As the next round of BITs are negotiated and as existing ones are amended, some of investment law’s most vexing challenges may fade away.

In conclusion, it is clear that ICSID faces a wide array of challenges. From unforeseen consequences of higher volumes of cases to problematic interpretations of vague BIT clauses, the system is experiencing a number of growing pains. Yet, those concerned with ICSID’s legitimacy should exercise more patience. While these developments in ICSID arbitration do undercut its legitimacy, the system should not be abandoned just because of this initial phase of challenging situations. As with essential security in the Argentina cases, problems like inadequate reasoning and inconsistency may work themselves out. Of course, it remains to be seen whether the position of emerging consensus will be acceptable long term or whether, as mentioned above, investors may find the wider latitude given to states to ignore investment provisions to be untenable. But that is precisely the point: it remains to be seen. In the meantime, states can amend their BITs, and intermediate steps short of massive system overhaul can help ameliorate ICSID’s legitimacy challenges.