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Transnational Investment Arbitration: From Delegation to Constitutionalization?

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The arbitral world is at a crucial point in its historical development, poised between two conflicting conceptions of its nature, purpose, and legitimacy. The larger questions raised in this volume are revealing. To what extent are arbitrators agents of contracting parties, and to what extent are they agents of a larger global community? Should ICSID, or any other arbitration house that claims to offer effective resolution of contractual disputes, resist its own judicialization? Or is judicialization, and the consequent accretion of arbitral 'governance', now inevitable? Should, or must, arbitrators recognize, interpret, and apply overarching – 'constitutional' – norms whose source is public international law? Should, or must, arbitrators balance the rights of investors against public goods, such as the protection of health, the environment, and other human rights when they assess state measures that are allegedly expropriatory, and when fashioning remedies?

In this chapter, we address such questions from the standpoint of delegation theory. In part I, we introduce the basic 'principal–agent' framework (P–A) used by social scientists to explain why actors create new institutions, and we discuss how P–A has been applied to the study of courts. We then use delegation theory to frame a response to the main themes of this book (part II). The arbitral world, we demonstrate, has a choice between two models of its own structure and function, indeed, its very identity. In part III, we focus on the judicialization of investment arbitration. In particular, we consider the extent to which it can be argued that the International Centre for the Settlement of Investment Disputes (ICSID) is developing in a judicial, perhaps even constitutional, direction.

Two caveats deserve mention in advance. First, our objectives are theoretical and explanatory: we seek to provide an account of the current state of affairs from the perspective of delegation theory. This account can be read through normative lenses – readers may support or oppose judicialization, for example – but we take no stand here on the various normative issues raised. Second, this chapter does not constitute a claim that delegation theory is superior to other analytical frameworks, or that it should replace other methods of proceeding. The 'judicialization' and 'constitutionalization' of investor-state arbitration

described in parts II and III illustrate factual and legal developments that deserve wider scholarly attention and analysis.[1]

I. Principals and Agents

Over the past three decades, P–A emerged as a standard approach to research on institutions as diverse as the firm,[2] state organs,[3] and international regimes.[4] In economics, it is the dominant paradigm for analysing problems of corporate governance and industrial organization; in political science, it is associated with 'rational choice' approaches to government. Although scholars use it for varied purposes, P–A is popular for three main reasons. First, it explains the origin and persistence of institutions – or modes of governance,[5] if one prefers – in light of the specific functional demands of actors who need governance. Second, it offers ready-made, appropriate concepts that the analyst can adapt easily to virtually any governance situation. Third, it helps to organize empirical research on the dynamics of delegated governance, allowing the analyst to derive testable propositions about the consequences, *ex post*, of delegating in a particular form, *ex ante*. We outline a highly simplified version of the framework here, highlighting relevant features that are agreed upon among scholars who use it, and apply it to courts.

The P–A approach dramatizes the relationship between principals and agents, against the background of a particular set of governance problems. *Principals* are those actors who create *agents*, through a formal act in which the former confers upon the latter some authority to govern, that is, to take authoritative, legally binding decisions. The agent governs to the extent that this authority is exercised in ways that impact upon the distribution of values and resources in the relevant domain of the agent's competence. By assumption, the principals are initially in control, in the strict sense that they have unconstrained discretion to constitute

[1] We are grateful to Ulrich Petersmann who, noting that delegation theory is largely unknown in the scholarly discourse on transnational investment arbitration, asked us to contribute this chapter. In our view, the P–A framework is of value to the extent that it both (1) clarifies theoretically relevant questions and (2) stimulates research on these questions. For a discussion of P–A conceptions of 'member-driven' dispute settlement practices in the WTO, see the contribution by Petersmann in this volume.

[2] J-J Laffont and D Martimort, *The Theory of Incentives: The Principal-Agent Model* (2001); and P Milgrom and J Roberts, *Economics, Organization, and Management* (1992).

[3] eg K Strom, W Müller, and T Bergman (eds.), *Delegation and Accountability in Parliamentary Democracies* (2004).

[4] eg M Pollack, *The Engines of European Integration: Delegation, Agency, and Agenda-Setting in the EU* (2003); and J Tallberg, 'Delegation to Supranational Institutions: Why, How, and with What Consequences?' 25 (2002) *West European Politics* 23–46.

[5] We define governance as 'the process through which the rule systems in place in any social setting are adapted to the needs and purposes of those who live under them'. A Stone Sweet, 'Judicialization and the Construction of Governance' (1999) 32 *Comparative Political Studies* 147.

(or not to constitute) the agent. Since the principals are willing to pay the costs of delegation – which include expenditures of resources to design a new institution, and to monitor its activities *ex post* – it is assumed that the principals expect the benefits of delegation to outweigh costs, over time. Put simply, delegation takes place in so far as it is functional for (that is, 'in the interest of') principals.

The most common rationales for delegation are also functionalist. Among other reasons, principals choose to constitute agents in order to help them:

- resolve commitment problems: as when the agent is expected to work to enhance the credibility of promises made either between principals, or between principals and their constituents, given underlying collective action problems;
- overcome information asymmetries in technical areas of governance: wherein the agent is expected to possess, develop, and employ expertise in the resolution of disputes and the formation of policy in a given domain of governance;
- enhance the efficiency of rule making: as when principals expect the agent to adapt law to situations (for example, to complete incomplete contracts), while maintaining the authority to update policy in light of the agent's efforts; and
- avoid taking blame for unpopular policies: as when the principals command their agent to maximize specific policy goals that they know may sometimes be unpopular with important societal actors and groups.[6]

These logics will often overlap one another.

The principals' capacity to control the agent is a central preoccupation of the approach, bordering on obsession. The rationalist assumes that any agent may have, or will develop over time, its own interests, and these will at times diverge from those of the principals. To the extent that the agent performs its appointed tasks in ways that were unforeseen and unwanted by the principals, the agent will undermine the social legitimacy of delegation (which is based on the *ex ante* preferences of principals), while producing unwanted policy that may be costly to eradicate. These losses – which we will call 'agency costs' – inhere in the delegation of discretion. Principals thus face a dilemma. In order for them to reap the benefits of delegation, they have to grant meaningful discretionary power to an agent; but the agent may act in ways that undermine the logic of delegating in the first place.[7]

[6] Based on M Thatcher and A Stone Sweet, 'Theory and Practice of Delegation to Non-Majoritarian Institutions' (2002) 25 *West European Politics* 4.

[7] In some situations, the expected return to delegating to the agent will be inversely proportional to limitations placed on the agent's discretion. Principals, after all, can choose to govern themselves, without the help of an agent.

The analyst assumes that principals share this anxiety. Principals will therefore seek to incentivize the agent's work in order to maximize benefits while limiting agency costs. In designing and reforming an institution, the principals choose from a complex menu of options. Principals may give an agent more or less authority to govern in a specific domain *ex ante*; they may create procedures enabling them to monitor the agent's decisions; and they may choose to retain some or no power to undo an agent's decisions *ex post*. This point can be formalized. Any agent's 'zone of discretion'[8] is constituted by (1) the sum of delegated powers (discretion to take authoritative decisions) granted to the agent, minus (2) the sum of control instruments, available for use by the principals to constrain the agent, or overturn its decisions.

The zone of discretion can be defined and assessed without regard to the principals' preferences and policy goals. Nonetheless, one expects such preferences to be fundamental to the choices made. If the principals, for example, seek to bind their successors to a policy of low inflation, they may decide to create an independent central bank, with plenary powers over macro-economic policy, while insulating the bank's decision from interference by present and future elected officials. To take another example, if principals are uncertain about the kind of policy they want, say, in a regulatory domain characterized by technical complexity and scientific risk, they may give an agent the task of developing a regulatory framework as problems emerge and evolve, while retaining effective *ex post* controls. Generally, the more principals seek to precommit themselves to specific outcomes or values, the more discretion they will delegate to an agent, and the weaker will be *ex post* mechanisms of control. In contrast, the more principals seek a rich range of policy alternatives from which to select, on an ongoing basis, the more they will devote resources to monitoring the agent's activities, and the more effective will be the *ex post* mechanisms of control.

The size of the zone of discretion also has implications for the strategic relationship between the principals and their agent. The smaller the zone of discretion, one might argue, the greater the agent's interest will be in monitoring and anticipating the principal's assessment of its activities. The analyst assumes that the agent is more likely to take decisions that conform to the principals' policy preferences to the extent that the agent wishes to avoid being censured and punished, or having its decisions overturned by the principals. The larger the zone of discretion, however, the less credible is that threat. In some situations – which we will label one of *trusteeship* – it is highly improbable or virtually impossible for principals to overturn the agent's decisions. A further complication flows from the fact that, in many situations, the principals are multiple actors whose preferences may change and diverge over time. Other things equal,

[8] Based on Thatcher and Stone Sweet, n 6 above, 5–6.

the more the principals disagree among themselves about the nature of the agent's tasks and roles, the weaker they will be vis-a-vis the agent.

To illustrate, consider variation in the zone of discretion enjoyed by different types of courts. In a system of legislative sovereignty, the courts are agents of Parliament – the principal. Their task is to enforce the various codes and statutes adopted by the legislator. The judge in such a system operates in a relatively narrow zone of discretion: Parliament can overrule undesirable judicial decisions by amending the statute, using normal legislative procedures (majority vote). Constitutional and supreme courts govern in a much wider zone of discretion. They have the authority to invalidate infra-constitutional norms, including statutes; and the constituent power made the decision rules governing constitutional amendment more complex and restrictive than those governing the making of legislation precisely in order to insulate the constitutional judge's decisions from the reach of political majorities in Parliament. Wider still are the zones of discretion of the courts of many Treaty regimes – including the European Court of Justice, the Appellate Body of the World Trade Organization, and the European Court of Human Rights. One of the peculiarities of treaty law, relative to most national legal systems, is that the decision rule governing the revision of the basic norms is unanimity among the contracting States.

We now depart somewhat from the classic P–A framework. In our view, the framework loses much of its relevance when applied to certain types of agents, in particular, those whose decision-making is insulated, as a legal or practical matter, from *ex post* controls. We prefer to apply a model of 'trusteeship' to situations wherein the principals have conferred expansive, open-ended 'fiduciary' powers on an agent.[9] A trustee is a particular kind of agent, one that possesses authority over those who have delegated in the first place. Note that the judge, in the system of legislative sovereignty, does not govern the Parliament; he or she is an agent of the Parliament's will as expressed in statutory commands. Constitutional courts are trustee courts. They typically exercise fiduciary responsibilities with regard to the constitution; in most settings, they do so in the name of a fictitious entity: the sovereign people. The political parties in Parliament are never principals, with respect to the judge of the constitution, but are themselves subject to the constitutional law, as interpreted by the constitutional judge. Put in blunt strategic terms, in normal circumstances, a trustee court does not fear reversal on the part of a principal. The trustee may well be concerned with its own legitimacy, and the polity's compliance with its decisions, but not because it worries about being 'punished'.

[9] See A Stone Sweet, 'Constitutional Courts and Parliamentary Democracy' (2002) 25 *West European Politics*, building on the contributions of G Majone, 'Two Logics of Delegation: Agency and Fiduciary Relations in EU Governance' (2001) 2 *European Union Politics* 103; and T Moe, 'Political Institutions: The Neglected Side of the Story' (1990) 6 Journal of Law, Economics and Organization 213.

Mapping out a court's zone of discretion does not tell us how the court will actually use its powers. Some predictions are nonetheless implied. Other things equal – although conditions and context are rarely equivalent – the wider a court's zone of discretion, the more likely it will be that it will come to dominate the evolution of the system as a whole. We can expect a trustee court to do so in so far as three conditions are met. First, the court must have a case load. If actors never bring cases to the court, it will accrete no influence over the system. Second, once activated, judges must resolve these disputes and *give defensible reasons* in justification of their decisions. If they do, one output of adjudication will be the production of a case law, or *jurisprudence*, which is a record of how the judges have interpreted and applied the law. Third, those who are governed by the law must accept that meaning is (at least partly) constructed through this jurisprudence, and they must use or refer to relevant case law in future disputes. None of these conditions can be taken for granted as naturally occurring; they are, rather, part of a process called *judicialization*.

In the next section, we apply these ideas to transnational arbitration.

II. Judicialization

There is no single or best way to use delegation theory. The analyst must make choices about how to model any specific P–A relationship, and these choices will have consequences on how the analysis proceeds. In this section, we will use the P–A construct to conceptualize transnational commercial and investment arbitration in two distinct ways. We expect substantial disagreement among readers about which type of model is the (descriptively or normatively) appropriate model, given that this disagreement maps onto current debates about arbitration's underlying nature and purpose.

The first model would be constructed from the classic assumptions of freedom of contract. We use the conditional tense because we are not aware of other efforts to apply a P–A to arbitration, and what follows is a simplified and abbreviated account.

A P–A relationship is constituted when two contracting parties (the principals) confer upon an arbitrator (the agent) the authority to resolve any dispute that arises under the contract. The principals are also free to select the law governing the contract and the procedures to be used in the dispute settlement process, which are assumed to constrain the arbitrator. To be sure, arbitration has been steadily institutionalized over the past five decades. Rules and procedures have been substantially codified by the major arbitration houses;[10] it is

[10] All established arbitration houses have published rules that are mandatory for those who choose to use their services.

now settled doctrine that arbitral clauses are separable from the main contract;[11] in many parts of the world, the scope of judicial review of arbitral awards has been radically reduced;[12] and issues of *Kompetenz-Kompetenz* have been largely resolved in the arbitrator's favour.[13] However, these developments can be said to push in the same direction: to enhance the agent's authority to enforce the parties' commitments, in the face of a party's temptation to renege, once a contractual dispute erupts.

In this account, an arbitration clause is a commitment device that the parties use to help them resolve the various collective action problems associated with contracting. The legitimacy of arbitral power is not problematic, based as it is on an act of delegation that has been freely consented to by the parties. Further, the authority of the arbitrator is limited to the domain of activity governed by the contract itself. The arbitrator will typically interpret contractual provisions in light of some law of contract, and he or she will apply these interpretations to resolve the dispute, but to the extent that he or she makes law through interpretation, reason-giving, and application, this law-making is retrospective and particular, in that it applies only to a dispute involving a pre-existing contract between two parties. Put negatively, an 'unjust' arbitral ruling is much like a bad business deal, or a good deal gone bad: both exist only 'within the sphere of private contractual prerogative'.

A second type of model would accept as given most of the precepts and logics of the first model, but would reject the view that the arbitrator is merely the agent of the contracting parties. Instead, the analyst adds a level of law and institutional complexity to the equation in order to show that the arbitrator can be meaningfully conceptualized as an agent of the transnational commercial and investment community. Consider the case of transnational commercial arbitration in which the parties to the contract are both private firms. The parties have delegated to the arbitrator, thus constituting a standard, contract-based P–A relationship. However, we would insist, this act of delegation does not take place in a vacuum, or in anarchy, but in the context of an increasingly elaborate legal system.

With the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, signatory States made national courts the public guarantors of private arbitral authority, with regard to recalcitrant parties

[11] That is, the validity of the arbitral clause is not affected by the legal nullity of the contract of which it is a part. In essence, the doctrine forecloses moves by one of the parties to the contract to avoid arbitration by pleading the contract's nullity.

[12] That is, the legal validity of arbitral awards, and thus their enforceability in national law, is presumed.

[13] *Kompetenz-Kompetenz* refers to the formal competence of a jurisdiction to determine its own jurisdiction, or the jurisdiction of another organ. Modern arbitration statutes and case law largely accept that the arbitrator possesses the authority to fix the scope of its own jurisdiction, subject of course to the will of the contracting parties.

seeking to quash foreign arbitral awards in national jurisdictions. In the United States, a series of judicial decisions have famously embraced this role, even so far as recognizing the legitimacy of foreign arbitral awards that apply mandatory US law. In Europe too (but primarily through changes in the relevant statutes), the public policy and inarbitrability exceptions contained in the New York Convention have been narrowed to the point of practical irrelevance. A scholarly war now rages between those who, in effect, consider national courts to be the agents of foreign arbitrators, and those who would see foreign arbitrators as, in effect, agents of States who have determined that arbitration is good for business, and therefore in the national interest. This controversy is evidence, again, of increasing systemic complexity. However, we do not have to take sides in this debate in order to make a crucial point: any transnational contract containing an arbitration clause, and any transnational commercial arbitration, is embedded in a larger system of law.

If the arbitrator is not merely the agent of two contracting principals, but an agent of the greater community, then we might ask if (or assume that) the arbitrator has a responsibility to take into account the community's interests in decisions. There is a great deal of evidence showing that this is, in fact, what is happening. More and more decisions are being published, and certain kinds of decisions are treated by subsequent litigators as having precedential value.[14] Scholars refer to the emergence of an 'arbitral common law', tailored to the needs of specific categories of traders, built as the common law has traditionally been built, through reasons given that later congeal as precedent.[15] Not surprisingly, the question of whether the creation of appellate instances for the arbitral system is being actively debated.[16] Each of the major arbitral tribunals requires that arbitrators give reasons for decisions; and some have developed mechanisms for reviewing these reasons prior to approving awards. In short, arbitrators are becoming – if with some hand-wringing and reluctance – more like courts.[17]

Thus, in contrast to the first model, the second type of model does not assume that arbitrators only make law that is retrospective and particular, or encompassed entirely in the contract. Arbitrators can and should be involved in law-making that is also general and prospective. Whereas proponents of the first model must worry that such law-making would undermine the legitimacy of the agent, advocates of the second model believe that the social legitimacy of arbitration is inextricably tied to the question of how arbitrators deal with various problems faced by the community. It is telling that the insistence on giving reasons, the accretion of precedent, and calls for supervisory or appellate review

[14] K Berger, *The Creeping Codification of the Lex Mercatoria* (1999) 57–74, 214–20.

[15] T Carbonneau, *Lex Mercatoria and Arbitration: A Discussion of the New Law Merchant* (1997) 16–18.

[16] See part III of this chapter.

[17] F Grisel, 'Control of Awards and Re-centralisation of International Commercial Arbitration' (2006) 25 *Civil Justice Quarterly* 166; and A Stone Sweet, 'The New *Lex Mercatoria* and Transnational Governance' (2006) 13 *Journal of European Public Policy* 641–643.

are justified in the name of 'justice'. The major houses are keenly aware that the legitimacy and viability of arbitration will heavily depend upon their capacities to provide a modicum of legal certainty (justice) for both present *and* future users of the system.

We now turn to the main topic of this volume, transnational investment arbitration, wherein one party to the arbitration is a State. As Hirsch notes,[18] the standard conception of investment arbitration closely resembles that of *inter partes* commercial arbitration (essentially our first model). Investment arbitral tribunals are established on an *ad hoc* basis, and their mandate is specifically limited to the settlement of the disputes that have been submitted to them. Tribunals take authoritative decisions whose reach is limited to the parties. Proponents of the first model must find a way to integrate public sources of law into their analysis of investor-State arbitration. Like Jacques Werner,[19] among others in this volume, we believe that the first model is doomed, to the extent that the judicialization process proceeds.[20]

Finally, one of this volume's themes revolves around the question of whether investor-State arbitration has been, or is being, 'constitutionalized'. There are a number of ways in which investment arbitration may be said to be *constitutional*. First, the ICSID is a global institution that governs by virtue of, and with reference to, constituting law that has been ratified by more than 140 sovereign States. The ICSID Convention, Regulations and Rules comprise that constitution and the scope of the Centre's authority is unrivalled in its domain of activity. Most stable, treaty-based international organizations would probably be considered constitutional under this definition.

The second, forcefully advocated by, among others, Ulrich Petersmann (in this volume) takes a systemic perspective.[21] This view acknowledges that the system is not constitutional according to standard ways of thinking drawn from national systems, in so far as there is no unified sovereign in the system, and there is no agreed-upon hierarchy of norms that securely integrates international and national legal orders. In a phrase, the system remains pluralistic. Nonetheless, proponents of this perspective seek to identify those elements that can be characterized as 'constitutional', and then argue that these elements deserve to be given special status in transnational and international legal process. The most commonly invoked elements are *jus cogens* norms, basic human rights, and

[18] See ch 5 above.

[19] See ch 6 above. In contrast to Werner, we think that commercial arbitration is judicializing as well, n 17 above.

[20] It deserves mention that the ICSID has been considered to be more of a 'court' than an 'arbitral body' in the classic sense. B Legum, 'La Réforme du CIRDI: Vers une Juridictionnalisation de l'Arbitrage Transnational?' in F Horchani (ed), *Où va le droit de l'investissement? Désordre normatif et recherche d'équilibre* (2006) 283.

[21] See also A Stone Sweet, 'Constitutionalism, Legal Pluralism, and International Regimes' Indiana Journal of Global Legal Studies (forthcoming 2009).

procedural guarantees associated with due process and access to justice.[22] What is being argued is that these norms constitute an overarching frame, a theoretically supposed 'constitution', within which one finds discrete hierarchies, both national and treaty-based. These systems interact with one another pluralistically, with reference to the frame. One then focuses on the dynamics of pluralist interaction – on inter-regime conflict, resistance, diplomacy, and cooperation – to find evidence that the system is indeed constitutional, and to identify mechanisms of systemic construction.

In this account, the arbitrator as agent, and the ICSID arbitrator, in particular, is bound to interpret and apply these norms when they are material to any arbitral proceeding. The duty flows from the very fact that these norms are constitutional. Furthermore, it is supplemented and reinforced by other norms, such as the call in the Preamble of the Vienna Convention on the Law of Treaties that disputes be resolved 'in conformity with the principles of justice'. Following this line of argument, the ICSID arbitrator is an agent of the contracting parties, an agent of the investment community, and, at least at times, an agent of the global legal (constitutional) order.

III. The Case of ICSID

We have argued (in part I) that the wider a court's zone of discretion is, the more likely it is that it will dominate the evolution of the system as a whole, through its case law. Investor-State arbitral tribunals pose special challenges to the P–A modeller. ICSID tribunals are *ad hoc*, and the parties choose their own procedural rules and arbitrators. Further, arbitrators take decisions in light of multiple sources of law, which will typically include the contract, the relevant BIT, ICSID rules, customary international law, and so on. Interestingly, the mix of *ex ante* and *ex post* controls available to parties to arbitration differs in comparison to adjudication in national courts. In a court, where jurisdiction is compulsory and the procedures and other rules are mandatory, the analyst's attention is usually focused on the *ex post* resources available to parties or principles (those who set up and manage the system). In arbitration, the *ex ante* resources available to the contracting parties are usually relatively more important, with one important exception: an unhappy party, *ex post*, may not choose an arbitrator, now undesirable, in a subsequent case.[23] Most important, the

[22] Although they might object, we read Erica de Wet and Ulrich Petersmann to be representative of this view. See E de Wet, 'The International Constitutional Order' (2006) 55 ICLQ 51; and EU Petersmann, 'Multilevel Trade Governance Requires Multilevel Constitutionalism' in C Joerges and U Petersmann (eds), *Constitutionalism, Multilevel Trade Governance and Social Regulation* (2006).

[23] A more complete model would, therefore, have to take into account the extent to which any given arbitrator, or tribunal, wishes to remain in the good graces of those who select arbitrators and, therefore, is likely to take into account the interests of present and future parties in decisions. We assume that these politics (to be modelled as 'anticipatory reactions') are a normal part of the arbitral world.

parties are capable of shaping the tribunal's zone of discretion, at the contracting moment, and at the point when they constitute the tribunal. However, they must agree to do so; failure to agree will typically translate into an expansion of the tribunal's zone of discretion. Yet the fact that the parties are in dispute will usually mean that agreement to constrain a tribunal's discretionary authority may not be forthcoming.

This last point made, ICSID arbitral tribunals are the judges of their own competence (Article 41 of the ICSID Convention) and have the power to decide on any question of procedure that has not been covered by the ICSID Convention, the Arbitration Rules, or any rules agreed by the parties (Article 44 of the ICSID Convention). At the same time, the parties have limited *ex post* control instruments at their disposal. In the case of the ICSID, parties are pushed into ICSID annulment committees (Article 52 of the ICSID Convention), with highly restricted access to challenges of awards in domestic courts (Article 54 of the ICSID Convention). Further, the ICSID meets each of the three conditions stipulated at the close of part I above: it has an important and steadily expanding case load; tribunals, which are under a duty to give reasons for their decisions (Article 52(1)(e) of the Rules) have, in fact, built a sophisticated case law; and, today, States and investors argue their cases primarily in terms of this case law, accepting its precedential status.

We have also suggested that judicialization implies a move from the first to the second model of delegation (see part II above). We can give empirical content to this claim by identifying specific indicators of judicialization. In this section, we discuss four such indicators: precedent; the use of balancing and proportionality by arbitral tribunals; the admission of *amicus* briefs; and the push for appellate supervision of arbitral awards.

A. Precedent

Investment arbitral tribunals are engaged in building a *jurisprudence*: a judge-made, precedent-grounded, law of investment arbitration. They are doing so in order to stabilize (potentially explosive) strategic environments, to entrench specific frameworks of argumentation, and to legitimize their own law-making.[24] Here we focus on ICSID practice.

ICSID tribunals must give reasons, but they are not obligated to follow the past reason-giving of their colleagues. Article 53 of the ICSID Convention states that: 'the award shall be binding on the parties', which echoes, in part, Article 59 of the Statute of the International Court of Justice: '[t]he decision of the Court has no binding force except between the parties and in respect of that particular case'. In *AES v Argentina*, the tribunal developed a nuanced theory of the role of precedent in ICSID. The tribunal denied that it was strictly bound by

[24] M Shapiro and A Stone Sweet, 'Judicial Law-Making and Precedent' in *On Law, Politics and*

past decisions in any formal sense, while suggesting why arbitrators would find prior rulings, on point, of 'real interest':

> Each tribunal remains sovereign and may retain, as it is confirmed by ICSID practice, a different solution for resolving the same problem; but decisions on jurisdiction dealing with the same or very similar issues may at least indicate some lines of reasoning of real interest; this Tribunal may consider them in order to compare its own position with those already adopted by its predecessors and, if it shares the views already expressed by one or more of these tribunals on a specific point of law, it is free to adopt the same solution.[25]

More recently, some tribunals have explicitly referred to the 'duty' of arbitrators to respect precedent. Consider *Saipem SpA v Bangladesh*:

> The Tribunal considers that it is not bound by previous decisions. At the same time, it is of the opinion that it must pay due consideration to earlier decisions of international tribunals. It believes that, subject to compelling contrary grounds, it has a duty to adopt solutions established in a series of consistent cases. It also believes that, subject to the specifics of a given treaty and of the circumstances of the actual case, *it has a duty to seek to contribute to the harmonious development of investment law and thereby meet the legitimate expectations of the community of States and investors towards certainty of the rule of law*'[26] (emphasis added).

The tribunal in *Saipem SpA* justified these dicta in terms congruent with our second model, openly acknowledging that multiple forms of delegation and agency are nested within one another. In addition to resolving a discrete investment dispute, a central task of the tribunal is to enhance legal certainty for the community as a whole. It will do so through rendering something akin to formal justice – *like cases shall be decided in like fashion*. The tribunal portrays this second form of delegation as tacit, but irresistible. The social demand for precedent flows from the 'legitimate expectations' of states and investors for stability and coherence.

It is today indisputable that 'a *de facto* doctrine of precedent'[27] governs investor-State arbitration: the parties intensively argue the substance and relevance of prior ICSID rulings, which tribunals accept as persuasive authority, and then cite as supportive justification for their own rulings.[28]

[25] *AES Corp v Argentina*, ICSID Case No ARB/02/17, Award, 26 April 2005, at para 30.

[26] *Saipem SpA v Bangladesh*, ICSID Case No ARB/05/07, Decision on Jurisdiction and Recommendations on Provisional Measures, 21 March 2007, at para 67. The tribunal in *Victor Pey Casado et Fondation 'Presidente Allende' c République du Chili*, ICSID Case No ARB/98/2, Award of 8 May 2008, repeated the formula in French, at para 119.

[27] D Di Pietro, 'The Use of Precedents in ICSID Arbitration: Regularity or Certainty?' 3 (2007) International Arbitration Law Review 96.

[28] In 2006, a second sentence was added to Rule 48, which now reads: 'The Centre shall not publish the award without the consent of the parties. The Centre shall, however, promptly include in its publications excerpts of the legal reasoning of the Tribunal.'

B. Balancing and Proportionality

A second indicator of judicialization – or, the gradual entrenchment of investment arbitration as a stable system of governance in the field of international investment – is the deployment, by arbitrators, of modes of reasoning and doctrinal frameworks developed by courts. Most dramatically, tribunals are in the process of embracing balancing and proportionality.

For sound strategic reasons, investment arbitrators have constructed the 'fair and equitable treatment' standard (FETS)[29] as a master tool for dealing with investment disputes. Indeed, arbitrators today use the standard as a kind of multi-purpose, umbrella principle that allows them to invoke and apply a wealth of sub-principles, including: good faith; access to justice and due process; regulatory transparency; non-arbitrariness, non-discrimination and reasonableness; and the legitimate expectations of both parties. Among other functions, the FETS allows arbitrators to consider a wider range of elements than would be normal under the tests for expropriation or regulatory takings (indirect expropriation), as well as to tailor more appropriate remedies.[30] What is important for our purposes is that the FETS organizes an approach to the kind of disputes in which we are interested here, namely, those involving tensions between (1) an investor's rights (including legitimate expectations in investment security) and (2) the State's legitimate interest in regulating for the public good (including its expectations that investors will be good corporate citizens). Using the FETS in this way pushes tribunals toward balancing.

Balancing pushes arbitrators toward proportionality. Tribunals find balancing attractive because of its scope and flexibility – it allows arbitrators to 'see' the entire contextual field and to narrow or expand their intervention as required. Proportionality analysis will determine what the investor and the State can reasonably expect from the other, and what is arbitrary or unfair. Balancing under the FETS also makes it possible for arbitrators to incorporate concerns for third-party interests. Thus, Francioni argues that 'a progressive interpretation of the FETS ... entails that the investor who seeks equity for the protection of his investment must also be accountable under principles of equity and fairness, toward the host state population affected by the investment'. Arbitrators who take this approach end up balancing the 'interests of the investor and the interests of individuals and social groups who seek judicial protection against

[29] The FETS is found in virtually every Bilateral Investment Treaty. The American and Canadian version, found in the Model BIT, provides that: 'Each party shall accord at all times to covered instruments fair and equitable treatment, in accordance with customary international law'. The standard European provision (Dutch, German, and Swedish, among others) states that: 'Investors and investments of each contracting party shall at all times be accorded fair and equitable treatment in the territory of the other contracting state.'

[30] K Yannaca-Small, 'Fair and Equitable Treatment Standard: Recent Developments' in A Reinisch (ed), *Standards of Investment Protection* (2008) 111–130.

possible adverse impacts of the investment on their life or their environment' or human rights.[31] Although the FETS enhances arbitral flexibility, its very elasticity raises anxieties about (1) the scope of arbitral authority – can it ever be constrained at the *ex ante* contractual moment? – and (2) the determinacy of rulings – can arbitrators always get to *any* decision they want? If one accepts that these worries are well founded, then one can also see why the adoption of proportionality would make sense, in so far as it would inject a measure of analytic, or procedural, determinacy to the balancing exercise. Moreover, proportionality, properly used, requires arbitrators to reduce the losses accruing to the loser as much as is legally possible, thus enhancing their legitimacy.[32]

Proportionality is an analytical framework first developed by administrative and constitutional courts in order to manage legal disputes of a particular structure, the paradigmatic example of which concerns a pleaded tension between a right on the one hand, and a constitutionally recognized public interest pursued by the State, on the other.[33] In investor-state disputes, a move toward balancing would entail both the recognition of an investor's property rights and a 'public interest' defence available to the State. In effect, the parties acknowledge that measures taken by the defendant State have infringed the investor's rights, but that hindrance may nonetheless be mitigated or justified to the extent that the measures taken were not arbitrary, and were meant to serve a proper public good. Arbitrators using the proportionality framework will deploy means-ends testing to evaluate the impact of the State's measures on the investment; they will weigh the investor's rights against the public interest being pleaded; and their conclusions will bear upon their dispositive ruling and remedies.

No arbitral tribunal referred to proportionality, even implicitly, before 2000. In that year, a NAFTA tribunal, in the case of *SD Myers v Canada*, gave a restrictive interpretation of the FETS contained in the NAFTA (Article 1105, on the authority of domestic entities to regulate matters within their borders):

> The Tribunal considers that a breach of Article 1105 occurs only when it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective. That determination must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders.[34]

[31] See ch 3 above.

[32] This will be so to the extent that the ruling is disciplined by Alexy's 'law of balancing': 'The greater the degree of non-satisfaction of, or detriment to, one principle, the greater must be the importance of satisfying the other.' R Alexy, *A Theory of Constitutional Rights* (1986, translated into English 2002) 102 and 47 on principles as 'optimization' requirements. See also A Stone Sweet and J Mathews, 'Proportionality Balancing and Global Constitutionalism' in (2008) 47 Columbia Journal of Transnational Law 73–165.

[33] Ibid.

[34] *SD Myers, Inc v Government of Canada*, UNCITRAL Partial Award, 13 November 2000, (2001) 40 ILM 1408 at para 263.

Sunsequently, in *Saluka v Czech Republic* (2006), an UNCITRAL arbitral tribunal referred to the obligation, under the FETS, to balance the interests of the parties:

> No investor may reasonably request that the circumstances prevailing at the time the investment is made remain totally unchanged. In order to determine whether frustration of the foreign investor's expectations was justified and reasonable, the host State's legitimate right subsequently to regulate domestic matters in the public interest must be taken into consideration as well. [. . .] The determination of a breach of Article 3.1 by the Czech Republic therefore requires a weighing of the Claimant's legitimate and reasonable expectations on one hand and the Respondent's legitimate regulatory interests on the other.[35]

Since 2003, ICSID arbitrators have pushed further, explicitly adopting the proportionality principle while citing the European Court of Human Rights (ECtHR) and its case law as a source. The ECtHR uses, and requires national courts to use, proportionality analysis when it adjudicates the qualified rights found in Articles 8 to 11 and 14 of the European Convention on Human Rights, and when it deals with the right to property in Protocol No 1. In the case of *Tecmed v Mexico*, an ICSID (Additional Facility) tribunal expressly referred to two ECtHR rulings in assessing the State's actions in light of the public interest they pursue, then declared that: 'There must be a reasonable relationship of proportionality between the charge or weight imposed to the foreign investor and the aim sought to be realized in any expropriatory measure.'[36] In *Azurix v Argentina* (2006), another tribunal referred to ECtHR jurisprudence, *SD Meyers* and *Tecmed v Mexico*, to justify employing 'the public purpose criterion as an additional criterion to the effect of the measures under consideration'.[37]

In 2006, a new front for proportionality was opened. In four arbitrations involving natural gas transportation and distribution concessions,[38] Argentina pleaded the 'necessity' defence offered by the US-Argentina Bilateral Investment Treaty. Article XI of that Treaty states:

> This Treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order, the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests.

[35] *Saluka Investments BV v Czech Republic*, UNCITRAL Partial Award, 17 March 2006, at paras 304–306.

[36] *Técnicas Medioambientales Tecmed SA v Mexico*, ICSID Case No ARB(AF)/00/2, Award, 29 May 2003, at para 122.

[37] *Azurix Corp v Argentina*, ICSID Case No ARB/01/12, Award, 14 July 2006, at paras 310–312.

[38] *CMS Gas Transmission Co v Argentina*, ICSID Case No ARB/01/08, Award, 12 May 2005; *LG&E Energy Corp v Argentina*, ICSID Case No ARB/02/1, Decision on Liability, 3 October

Both parties agreed that Article XI should be understood in light of Article 25 of the 2001 Draft Articles on the Responsibility of States for Internationally Wrongful Acts (International Law Commission), understood to reflect the state of customary international law. Article 25 reads, inter alia:

> 1. Necessity may not be invoked by a State as a ground for precluding the wrongfulness of an act not in conformity with an international obligation of that State unless the act:
> (a) is the only way for the State to safeguard an essential interest against a grave and imminent peril; and
> (b) does not seriously impair an essential interest of the State or States towards which the obligation exists, or of the international community as a whole . . .

Three tribunals dismissed Argentina's claim that 'necessity' justified the measures under review. Among other things, all three interpreted the 'only means' requirement as fatal to the necessity defence if *any other means* were available. All three held that the measures in question were not the only means available, while refusing to identify other means that were available. The tribunal in *LG&E v Argentina*, however, accepted the defence, but only for a specific 'crisis' period (December 2001 to April 2003). It did so in the following terms:

> With respect to the power of the State to adopt its policies, it can generally be said that the State has the right to adopt measures having a social or general welfare purpose. In such a case, the measure must be accepted without any imposition of liability, except in cases where the State's action is obviously disproportionate to the need being addressed.[39]

The Argentina gas cases raise complex interpretive questions that are beyond the scope of this chapter. What is important is that arbitrators and scholars are now actively debating whether balancing and the proportionality principle ought to govern how such 'necessity' clauses are applied.[40]

C. Third-Party Participation

The participation of *amicus curiae* in proceedings comprises a third indicator of the arbitrator as 'Agent-of-the-Community'. *Amici* briefs, by definition, represent and articulate diffuse social interests.

[39] *LG&E v Argentina*, n 38 above, at para 195.

[40] Compare Alvarez and Khamsi (opposing balancing and proportionality) and Van Harten (supporting a proportionality approach based on the ECtHR's case law): J Alvarez and K Khamsi, 'The Argentine Crisis and Foreign Investors: A Glimpse into the Heart of the Investment Regime' in *Yearbook on International Investment Law & Policy* (forthcoming 2009), who argue that proportionality balancing is inappropriate to investor-state arbitrations; and G Van Harten, *Investment Treaty Arbitration and Public Law* (2007), 1–2, [illegible]

As recently as 2003, ICSID tribunals routinely denied third parties leave to submit briefs and to otherwise participate in proceedings. In *Aguas del Tunari v Bolivia*, the tribunal invoked the core elements of our first model of delegation in explicit terms:

> [I]t is the Tribunal's unanimous opinion that [requests to submit *amici* briefs] are beyond the power or authority of the Tribunal to grant. The interplay of the two treaties involved ... and the consensual nature of arbitration [locates] the control of [this] issue ... with the parties, not the Tribunal. [T]he Tribunal ... does not, absent the agreement of the Parties, have the power to join a non-party to the proceedings; to provide access to hearings to non-parties and, *a fortiori*, to the public generally; or to make the documents of the proceedings public.[41]

In 2006, two tribunals decided otherwise, on the basis of inherent discretion. In *Aguas Argentinas v Argentina* and *Aguas Provinciales v Argentina*,[42] arbitrators interpreted the last sentence of Article 44 of the Rules – 'If any question of procedure arises which is not covered by ... the Arbitration Rules or any rules agreed by the Parties, the tribunal shall decide the question' – as conferring 'residual power to the Tribunal to decide' to accept *amicus* briefs or not.[43] In response, the Rules were amended (new Rule 37(2)) to confer on tribunals the authority to allow/accept the submission of such briefs, and to allow external observers to attend hearings (amendment of Rule 32(2)). Rule 32(2) was the object of extensive interpretation in an order issued by the *Suez v Argentina* tribunal.[44] The order laid down an analytical process, replete with a series of tests, for determining admissibility of *amicus* briefs. Among other things, the tribunal held that briefs must address issues of substantial 'public interest' in a case that involves public goods. We will not dwell on this matter further, since Francesco Francioni assesses these developments in this volume noting, among other insights, that these changes will enable 'the emergence ... of the idea of civil society' in the arbitral world.[45]

[41] *Aguas del Tunari, SA v Republic of Bolivia*, ICSID Case No ARB/02/3, Letter from the President of the Tribunal, 23 January 2003.

[42] Art 44 of the ICSID Convention: '... If any question of procedure arises which is not covered by this Section or the Arbitration Rules or any rules agreed by the parties, the Tribunal shall decide the question.'

[43] *Aguas Argentinas, SA, Suez, Sociedad General de Aguas de Barcelona, SA and Vivendi Universal, SA v The Argentine Republic*, ICSID Case No ARB/03/19, Order in Response to a Petition for Transparency and Participation as *Amicus Curiae*, 19 May 2005, at para 10; and *Aguas Provinciales de Santa Fe SA, Suez, Sociedad General de Aguas de Barcelona SA and InterAguas Servicios Integrales del Agua SA v The Argentine Republic*, ICSID Case No ARB/03/17, Order in Response to a Petition for Participation as *Amicus Curiae*, 17 March 2006, at para 11.

[44] *Order in Response to a Petition by Five Non-Governmental Organizations for Permission to Make an Amicus Curiae Submission*, ICSID Case No ARB/03/19, 12 February 2007 (*Suez* February 2007 order/decision), laying down an analytical process and a series of tests for determining admissibility of *amicus* briefs. Among other things, the tribunal held that briefs must address issues of substantial 'public interest' in a case that involves public goods. For an excellent analysis of this order, see E Triantafilou, '*Amicus* Submissions in Investor-State Arbitration after *Suez v. Argentina*' 24 Arbitration International 571–586.

[45] See ch 3 above.

D. Appeal

A fourth indicator of judicialization is the demand for appellate supervision. Traditional features of arbitration, including the *inter partes* nature of the contract and the controlling law, the *ad hoc* scope of a tribunal's jurisdiction and composition, and the final character of decisions, militate against appeal. The first model of arbitral agency forcefully denies the need for a 'vertical system of control'[46] of arbitral awards. As a former Chief Justice of the United States has stressed, one important 'advantage of arbitration is that [the] process usually need not produce a body of decisional law which will guide lawyers and clients as to what their future conduct ought to be'.[47] As we have seen, however, ICSID tribunals are behaving increasingly like courts, building and using precedent, balancing, and considering wider collective interests of various sorts in their rulings. Cast in the light of the second model of delegation, the issue of appeal is inevitably raised.

Judicial bodies find appeal useful for two basic reasons.[48] First, it provides losing parties with cathartic opportunities to defend their interests, thereby enhancing the overall legitimacy of the system. Second, systems of appeal serve the goal of achieving legal certainty and doctrinal coherence, to the extent that hierarchy and supervision increase the consistency of decisions at first instance.

In the ICSID context, appeal may be attractive for further reasons. Investor-State arbitration is of huge significance in today's globalized world; the monetary stakes involved are typically high; the good reputations of large multi-national firms and States are at risk; and important disputes will always involve significant social interests. It may be, as a renowned practitioner has argued, that the investment community needs courageous arbitrators who are willing to think and to make law creatively, in the interest of the community, and in light of social and economic change. Brave judges 'will inevitably make mistakes', Van Vechten Veeder writes, and, given the inevitability of mistakes, '[one] needs an appellate system'.[49]

As judicialization proceeds, the demand for appeal will grow. At present, there is no shortage of proposals on the table, three of which deserve mention. A first consists in the creation of a standing court of appeal, an 'ICSID Appeals Facility',[50] or a chamber of the International Court of Justice acting as a 'Supreme Investment Court'.[51] A second aims at building on existing

[46] K-P Berger, *The Creeping Codification of the Lex Mercatoria* (1999) 73.

[47] W Rehnquist, 'A Jurist's View of Arbitration' (1977) 32 *Arbitration Journal* 5.

[48] M Shapiro, 'Appeal' (1980) 14 Law and Society Review 629, 631.

[49] V Van Vechten, 'The Necessary Safeguards of an Appellate System' (2005) 2 *Transnational Dispute Management* 7.

[50] ICSID Secretariat, 'Possible Improvements of the Framework for ICSID Arbitration' (22 October 2004) 14 ff.

[51] A Qureshi, 'An Appellate System in International Investment Arbitration' in P Muchlinski, F Ortino, and C Schreuer (eds), *The Oxford Handbook of International Investment Law* (2008) 1154, 1165 ff.

arrangements, modelling an appellate jurisdiction on the ICSID ad hoc annulment committees.[52] A third proposal would create a permanent body that would answer preliminary questions raised on an issue-by-issue basis by arbitrators, as the European Court of Justice does under Article 234 of the Rome Treaty.[53]

IV. Conclusions

In this chapter, we have argued that two models of arbitration are in deep tension, and that this tension is gradually being resolved in ways that will make the first model obsolete. Viewed institutionally, arbitrators now preside over the process through which the rules and principles that govern investor-State relations are elaborated and defended. This volume focuses on human rights. The development of investment arbitration is itself a powerful move to recognize certain rights, attaching to the investor, including property rights, access to justice, due process, and so on. With judicialization, arbitrators increasingly behave as courts do. Most importantly, they are now finding themselves weighing the rights of investors against the public purposes being pursued by States, which may include the various ways in which States may act to protect health, the environment, and other basic human rights. They have even begun to use some of the same techniques and procedures that administrative and constitutional judges have evolved in order to enhance legal effectiveness and political legitimacy. These facts deserve wider scholarly attention than they have received.

[52] B Legum, 'The Introduction of an Appellate Mechanism: the U.S. Trade Act of 2002' in E Gaillard and Y Banifatemi (eds), *Annulment of ICSID Awards* (2004) 289, 295–296.
[53] CJ Tams reviews this and other proposals in 'An Appealing Option? The Debate About ICSID Appellate Structure' (2006) *Essays in Transnational Economic Law*, No 57.