An Appeal Mechanism in Investor-State Arbitration

Un mecanismo de apelación en el arbitraje entre inversores y Estados

El Sistema de Solución de Controversias Inversionista-Estado ha sido objeto de numerosas críticas. Preguntas sobre la finalidad del laudo, su coherencia, la corrección y la previsibilidad del sistema de arbitraje han sido planteadas. El componente público de este procedimiento de arbitraje internacional, el monto de dinero en riesgo y el impacto potencial de los laudos en los poderes reguladores del Estado, son motivo de controversia. El estándar de revisión de los laudos y el establecimiento de un panel de apelación permanente versus árbitros *ad-hoc* es un debate en curso. Este artículo tiene como objetivo analizar la práctica, el procedimiento y algunos de los tratados que incluyen mecanismos de apelación para así establecer si esta es una opción requerida y necesaria en esta clase de arbitraje.

Sistema de Solución de Controversias Inversionista-Estado, Centro Internacional para el Arreglo de Diferencias relativas a Inversiones (CIADI), Consistencia; Previsibilidad, Exactitud, Mecanismo de Apelación.

The Investor-State Dispute Settlement System has been subject to increasing criticism. Questions about finality of the award, consistency, correctness, and predictability of the arbitration system have been raised. The public component of this international arbitration proceeding, the substantial amounts of money at stake and the potential impact of the awards on State's regulatory powers, have been a matter of controversy. The standard of review of the awards and the establishment of a permanent appeal panel versus ad-hoc arbitrators is an on-ongoing debate. This article aims at analysing practice, procedure and some investment treaties which include an appeal mechanism in order to establish if its inclusion is required.

Investor State Disputes Settlement System (ISDS), International Centre for the Settlement of Investment Disputes (ICSID), Consistency, Predictability, Correctness, Appeal Mechanism.



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I. INTRODUCTION

The opening of the economies and the need to present a favourable climate to business and foreign investment has increased the use of arbitration in the last decade.

The combination of international arbitration procedure and the substantive obligations arising under domestic, investment and public international law (2) , has created many challenges related to the application of fundamental principles in the administration of justice. One such challenge is deciding whether there is a need for an appellate mechanism in international arbitration.

The criticism against the traditional Investor State Disputes Settlement System (hereinafter, «ISDS») encouraged the International Centre for the Settlement of Investment Disputes (hereinafter, «ICSID») Secretariat to release on 22 October 2004, the discussion paper «*Possible Improvements of the Framework for ICSID Arbitration*» for public comments, which contemplated, amongst other reforms, the creation of an appeal facility within the ICSID framework (3) .

The 2004 proposal was strongly opposed by the majority of ICSID members being discarded by the working paper «*Suggested Changes to the ICSID Rules and Regulations*», in which the ICSID Secretariat concluded that «*it would be premature to attempt to establish such an ICSID mechanism at this stage, particularly in view of the difficult technical and policy issues raised in the Discussion Paper*» (4) .

In 2017 at the United Nations Commission on International Trade Law (hereinafter, the «UNCITRAL») began discussions on potential ISDS reform, when UNCITRAL gave a working group the mandate to work on a possible reform of investor-State dispute settlement and deemed that discussions would need to be Government-led/ consensus-based, and fully transparent.

Nowadays criticism to the traditional ISDS continues. The European Union (hereinafter, the «EU») adopted a new approach including within the investment chapter of its Free Trade Agreements an appellate body. The EU has seized the opportunity to reform the traditional arbitration-based system and replace it with a permanent court system (5) .

On 26 May 2020, the EU put in place a public consultation. Concern of investors for ensure more uniform and predictable application of EU rules is part of it. A favourable intra-EU investment environment, where clear rules are implemented in a coherent way, effective remedies are ensured and measures facilitating access to investment opportunities are provided, are critical to encourage people to invest across EU Member States, the document states (6) .

The new EU approach combines elements of the traditional arbitration procedures with judicial features.

Thus, questions over finality of the award versus consistency and correctness, predictability of the arbitration system, the standard of review of the award, issues over legal certainty, the establishment of a permanent appeal panel versus *ad-hoc* arbitrators, the nomination process of its members and the costs of the appeal panel, to name a few, still raise concerns within the international field. Certainly, administrative issues are motive of concern as well.

II. PRELIMINARY COMMENTS

In 1985, the United Nations General Assembly recommended its member states the adoption of the Model Law on International Commercial Arbitration drafted by the UNCITRAL (7) . Legislation based on the UNCITRAL Model Law on International Commercial Arbitration has been enacted in more than 80 countries around the world (8) .

Under the UNCITRAL Model Law Article 34(2), the only permissible review is by a domestic court at the place of arbitration. The standard of review is limited to six grounds: (1) invalidity of the agreement to arbitrate or incapacity of a party; (2) lack of notice to a party or other inability to present the case by a party; (3) *ultra petitum*; (4) irregularity in the composition of the tribunal or the arbitral procedure; (5) non-arbitrability of the subject-matter of the dispute under the applicable law; and (6) conflict with the public policy of a State.

This type of challenge does not extend to the review of errors of law, or a review of the application of the facts to the law.

Regarding legal disputes arising out of an investment, ruled by the Convention on the Settlement of Investment Disputes between States and Nationals of other States, Article 52 establishes an internal annulment process of an award due to one or more of the followings grounds: (1) irregularity in the composition of the tribunal; (2) *ultra petitum*; (3) corruption of an arbitrator; (4) serious departure of a fundamental rule of procedure; and (5) lack of States the reasons on which the award is based.

An appeal is concerned with the substantive correctness of the decision and a Court is permitted to substitute its view, whereas an annulment erases the preclusive effect of the award and provides the parties with a second chance to arbitrate the same issues again before an entirely new tribunal.

Reviews explained above do not correspond to an appellate examination.

III. CRITICISM TO THE CURRENT ISDS

In the last years, the ISDS has been subject to an increasing volume of criticism both from host States and the civil society. The substantial amounts of money at stake and the potential impact of the awards on State's regulatory powers, have been a matter of controversy.

Criticism to the ISDS are several, among others: (1) The lack of consistency amongst the decisions; (2) The lack of predictability of the awards; (3) The desirable correctness of the awards; (4) The necessity of an appeal mechanism; (5) The lack of impartiality of the arbitrators; (6) the lack of transparency of the proceedings.

This article will only focus in the first four.

1. Finality v Consistency and Correctness

Is it more important to have an arbitration proceeding that provides finality, or consistency and correctness?

There is no doubt that one of the fundamental features and benefits of the ISDS and arbitration in general is finality. An award rendered by an arbitral tribunal is a final decision concerning facts and law. By definition, in arbitration there is no appeal to a superior body, unlike in the domestic court system.

Most of the parties which enter in an arbitration process chose arbitration seeking to remove jurisdiction from domestic courts, looking to avoid long periods of uncertainty waiting for a decision by the competent authority, as well as transaction and opportunity costs.

Those who advocate correctness, rely on the rationale that there is a need to «...*legitimize the arbitration process by creating greater consistency* [...] *and objectivity*» (9) .

Different from a national court —particularly in common law where a formal system of *stare decisis* is in place— there is no formal system of precedent in ISDS.

Moreover, most of the investment treaties have provisions concerning the non-existence of precedent or binding effect between arbitral awards (10) . For instance, the Free Trade Agreement (hereinafter, «FTA») between Chile and the United States of America (USA), Chapter Investment, Article 10.25(4) (11) states that *«an award made by a tribunal shall have no binding force except between the disputing parties and in respect of the particular case».*

Same provision can be found in the FTAs signed by the USA with Singapore (12) , Central America (13) and NAFTA (14) .

Although arbitral awards are not considered binding precedent, they are certainly viewed by arbitrators as having persuasive authority.

It is constructive to revise the available awards issued by international arbitral tribunals to determine what level of consistency has been reached.

Despite the fact that some authors state that the system of soft precedent has actually resulted in consistency among these tribunal decisions —and often the awards involving claims against Argentina are cited (15) as an argument to show a high degree of consistency— after revising these awards it looks like there is certain lack of consistency among the different panels (16) .

Thus, arguments addressed by the ICSID Secretariat in 2004, fostering for coherence and consistency in case law generated in ICSID and other investor-State arbitrations initiated under investment treaties (17) , and the current concerns of the UE Members, it seems valid.

> It is indispensable to ensure an effective and independent dispute settlement mechanism, in order to achieve predictability

The balancing between finality and consistency and correctness hits the wall at this point. Is justice being met when there is no second opinion concerning law in arbitration? Are other values, such as correctness and consistency, in conflict with the benefits of finality?

2. Predictability

Every time an arbitral tribunal has the final word on the facts and the law, in a case before it, it provides a great deal of predictability to the process.

Parties resort to arbitration to avoid the technicalities of national procedures and substantive rules, which are, for the most part, unsuitable in an international business environment. These fundamental expectations from the parties can only be fulfilled if control over awards is kept to a minimum so setting aside and refusal of enforcement are permitted only in truly exceptional circumstances (18) .

The finality of awards is not only an essential expectation of the parties, it is indispensable to ensure an effective and independent dispute settlement mechanism (19) , in order to achieve predictability.

Predictability derives from consistency, being the former a fundamental hallmark of any given legal system. The lack of a review of the merits in cases where inconsistent decisions clash increases the sense of unpredictability, as there is no certain binding interpretation of reference. In this sense, critics have argued that «*[t]he mantra of one case not being binding on any other, each one being an individual, one-off, ad-hoc process, has no place in a legal system that passes judgment on a vast range of government measures affecting international investments*» (20) . Consequently, a review-tier body is envisaged to play a role in consolidating predictable decisions.

However, the question remains the same. Will an appellate mechanism help the achievement of predictability? Is there really a lack of consistency which justifies the creation of an appellate body? Do some inconsistencies or contradictory decisions prove that there is a need for revision of facts and law by a different tribunal and, consequently diminish predictability to the current system?

3. Necessity

Since to appellate an award issued by an arbitral tribunal is not possible, it is worth asking if, where a remedy is possible there has been a significant number of applications, in order to realize the degree of arbitral fallibility and which would indicate whether the community should envisage permitting appeals.

It is a fact that investment tribunals are as capable of falling into error as domestic courts. Many international decisions involve questionable and appealable positions; thus, every opportunity should be taken to reduce the risk of perpetuating judicial or arbitral errors. Some states that a system which provides such an opportunity should be preferred to one that does not. As Warren Burger, who later became Chief of Justice of the United States of America, said in 1968 when he was still a Judge of the Circuit Court of Appeals:

> *«A court which is the final and unreviewable needs more careful scrutiny than any other. Unreviewable power is most likely to self-indulge itself and the least likely to engage in dispassionate self-analysis» (21) .*

Available information about annulment procedures can be found in the ICSID website (22) . From the information existing at 23 June 2020, in the past decade 181 cases were concluded, 44 of them were reviewed, corresponding to a 24% of the total.

Looking at the figures, it seems that users of ICSID tribunals are more or less confident in the decisions issued by those tribunals.

Therefore, is there a real need to create an instance or a high body to revise awards? Are the principles of finality and predictability more important than correctness and consistency?

Maybe there are other issues that produces uncertainties and distrust besides predictability, correctness and consistency, but those are beyond the scope of this article (23) .

4. Practice. Treaties which allow appeals

There are examples of intentions by the States to establish an Appellate Body.

The FTA between Chile and USA includes the following provision:

> *«Within three years after the date of entry into force of this Agreement, the Parties shall consider whether to establish a bilateral appellate body or similar mechanism to review awards rendered under Article 10.25 in arbitrations commenced after they establish the appellate body or similar mechanism» (24) .*

The FTAs signed by the USA with Colombia (25) , Peru (26) , Singapore (27) , Morocco (28) , and Panama (29) , contain the same provision, as well as in the Treaty between the United States and the Republic of Uruguay Concerning the Encouragement and Reciprocal Protection of Investment (30) .

The Free Trade Area of the Americas Agreement and the Dominican Republic-Central America-United States Free Trade Agreement includes a stronger obligation, as follows:

> *«Within three months of the date of entry into force of this Agreement, the Commission shall establish a Negotiating Group to develop an appellate body or similar mechanism to review awards rendered by tribunals under this Chapter» (31) .*

Based on the mandate given to it by the UNCITRAL in 2017 (32) , a working group was created in order to draw up a possible reform of the ISDS.

The working group concluded that the development of reforms by UNCITRAL was desirable to address the concerns related, among others, to lack of consistency, coherence, predictability and correctness of arbitral decisions by ISDS tribunals, which results in: (i) Unjustifiably inconsistent interpretations of investment treaty provisions and other relevant principles of international law by

ISDS tribunals; (ii) Lack of a framework for multiple proceedings that are brought pursuant to investment treaties, laws, instruments and agreements that provide access to international dispute settlement mechanisms and; (iii) Absence of, or limited mechanisms in many existing treaties to address inconsistency and incorrectness of decisions (33) .

Finally, in 2009, with the entry into force of the Lisbon Treaty, the Member States of the EU added «foreign direct investment» to the terms of article 207(1) of the Treaty on the Functioning of the European Union and, consequently, gave the competence to the EU —as a unit— for negotiating and concluding agreements protecting foreign direct investments in all sectors (34) .

This arrangement constituted a significant transformation in the EU´s investment policy in many ways, setting the ground for the adoption of a single and comprehensive approach to the foreign investment regime. The EU´s new investment policy aims at a more consistent, impartial and transparent system achievable —in its view— by the introduction of an Investment Court System (hereinafter, the «ICS») for the resolution of investment-related disputes merging features of arbitration and judicial settlement.

The ICS establishing a first instance permanent tribunal with publicly appointed members, as opposed to the traditional panel of arbitrators selected by the parties. Introduces an appellate tribunal, as opposed to the annulment committee with limited grounds under the ICSID Convention or the setting aside procedure before national courts in non-ICSID cases.

To this date, the ICS has been already included in most recent FTAs entered into by the EU (35) , and suggested in others currently in negotiation (36) .

5. Waiving the right to seek revision

If an appellate body were established, could parties wishing instead to provide for arbitration without recourse under an appellate body simply omit them from the consent to arbitration? In other words, would this mechanism be applied by default?

The consensual nature of the arbitration process cannot be at risk. An appeal facility must be flexible and subject to adjustment in the underlying consent document.

Parties that wish to avoid the uncertainty created by the prospect of an appellate mechanism should be authorized to waive the right to appeal in the arbitration agreement.

Nonetheless, the validity of such waivers must be considered. Some commentators contend that Convention Article 52 is not subject to modification by the parties and that such waivers could be challenged before an ad-hoc committee. Therefore, the parties involved in the development of an appeal mechanism must be aware and consider not only substantive matters, but procedural and administrative ones as well in order to avoid, including article 40 of the Vienna Convention in the Law of Treaties.

6. Advantages and disadvantages

Some of the advantages and disadvantages have been stated earlier. However, a discussion addressing the factors driving the creation of an appellate mechanism would not be complete without exploring some of the key issues about the desirability of having one.

If we add an entire full appeal step to the overall process, the finality benefit of arbitration is severely undermined (37) .

Arbitrations could become much longer and more expensive and the benefit of lengthening the process will go to large, well-resourced governments and corporations. Claims by smaller investors, and defences by developing countries, will correspondingly become much more difficult, and that it is not desirable.

The proposal for amendment of the ICSID rules which includes a new section to the Arbitration Rules including the option of appoints a sole arbitrator for expedited arbitration it is a great achievement in order to avoid greater expenses and administrative cost (38) .

Subjecting arbitral tribunals awards to an appeal mechanism might not just detract from the finality of the awards, but also could open opportunities for delays in their enforcement.

From our perspective, in order to get true consistency among arbitral awards, it might be expected some kind of formal system of precedence to be adopted, otherwise the goal of consistency would be difficult to achieve.

When addressing the question of correctness, the standard of review of any appeal mechanism becomes important. The standard of review can be placed on a continuum with the limited review incorporated into judicial review under the UNICTRAL Model Law or the New York Convention, on one hand, or a full appeal on fact and law, with the right of the court to substitute its decision, on the other.

Finally, costs must be taken into consideration. If a full appeal is allowed, the arbitration process could become more expensive.

IV. CONCLUSION

The constant growing of trade and the proliferation of disputes settled before international arbitral tribunals urge us to study the possibility of the implementation of an appeal mechanism.

Questions about finality and consistency of the awards are cornerstones of this debate.

There is no doubt that scholars, practitioners and main institutions should participate in the discussion and improvement of the present arbitration system.

The public process initiated by ICSID and currently ongoing, it is certainly an appropriate method for moving forward on a number of important issues of process.

The amendments proposed by the Working group III under UNCITRAL in order to draw up a possible reform of the ISDS, and the EU´s new investment policy by the introduction of an Investment Court System for the resolution of investment-related disputes merging features of arbitration and judicial settlement, must be followed closely.

The debate is open, and the chances for development and improvement of the system clearly exists. Maybe, it is not premature to attempt the establishment of an appeal mechanism. However, technical and administrative issues must be resolved. In any case, enriching the debate at an academic and practitioner level, is necessary.

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(5) W. Koeth, «*Can the Investment Court System (ICS) Save TTIP and CETA,* European Institute of Public Administration, working paper 2016/W/01, p. 6.

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(6) Investment protection and facilitation framework at [https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12403-Investment-protection-and-facilitation-framework] at 22 June 2020.

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(7) K.P. Berger, «Understanding Commercial Arbitration», *Understanding Transnational Commercial Arbitration* , 2000 5, pp. 11 ss.

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(8) According to information provided by UNCITRAL at [https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/overview-status-table.pdf] at 19 June 2020.

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(9) Above n2, 294.

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(10) A similar provision exists in Article 59 of the Statute of the International Court of Justice. «The decision of the Court has no binding force except between the parties and in respect of that particular case.» *Statute of the International Court of Justice*, available at [http://www.icj-cij.org/documents/index.php?p1=4&p2=2&p3=0] at 17 June 2020.

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(11) *Chile and The United States of America Free Trade Agreement* (entered into force 01 January 2004) [https://ustr.gov/sites/default/files/uploads/agreements/fta/chile/asset_upload_file1_4004.pdf] at 23 June 2020.

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(12) *Singapore and The United States of America Free Trade Agreement*, Chapter 15, Article 15.25(4) (entered into force 01 January 2004) [https://ustr.gov/sites/default/files/uploads/agreements/fta/singapore/asset_upload_file708_4036.pdf] at 23 June 2020.

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(13) *The Central American-Dominican Republic-United States Free Trade Agreement*, Chapter 10, Article 10. 26(4) (signed on5 August 2004) [https://ustr.gov/sites/default/files/uploads/agreements/cafta/asset_upload_file328_4718.pdf] at 23 June 2020.

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(14) *North America Free Trade Agreement*, Chapter 11, Article 1136(1) (entered into force 1 January 1994) [http://www.sice.oas.org/Trade/NAFTA/chap-111.asp#Chap.XI] at 23 June 2020.

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(15) Above n1, 301.

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(16) See *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan* (Case No. ARB/01/13) and *SGS Société Générale de Surveillance S.A. v. Republic of the Philippines* (Case No. ARB/02/6), where the tribunals adopted two different opinions interpreting an umbrella clause included in a contract; and *Emilio Agustín Maffezini v. Kingdom of Spain* (Case No. ARB/97/7) and *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Kingdom of Morocco* (Case No. ARB/00/4), where the tribunals adopted a different approach in the application of the Most Favoured Nation Treatment clause of a Bilateral Investment Treaty, with respect to provisions concerning dispute settlements.

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(19) *Ibid*.

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(22) Information about concluded and pending cases available at [https://icsid.worldbank.org/en/Pages/cases/AdvancedSearch.aspx] at 17 June 2020.

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(23) See [https://ciarglobal.com/anulado-laudo-de-128me-contra-espana-en-arbitraje-con-eiser/] at 22 June 2020.

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(24) Above n11, Annex 10-E.

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(25) *Colombia and The United States of America Free Trade Agreement*, Annex 10-D (signed 22 November 2006) [https://ustr.gov/sites/default/files/uploads/agreements/fta/colombia/asset_upload_file630_10143.pdf] at 17 June 2020.

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(26) *Peru and The United States of America Trade Promotion Agreement*, Annex 10-D (signed 4 December 2007) [https://ustr.gov/sites/default/files/uploads/agreements/fta/peru/asset_upload_file78_9547.pdf] at 23 June 2020.

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(27) Above n12, Side letter.

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(28) *Morocco and The United States Of America Free Trade Agreement*, Annex 10-D (entered into force 01

January 2006) [https://ustr.gov/sites/default/files/uploads/agreements/fta /morocco/asset_upload_file651_3838.pdf] at 23 June 2020.

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(29) *Panama and The United States of America Free Trade Agreement*, Annex 10-D [http://www.sice.oas.org/Trade/PAN_USA_TPA_Texto607 _e/agreement_text_TPA_e.asp#c10] at 23 June 2020.

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(30) *Treaty between the United States and the Republic of Uruguay Concerning the Encouragement and Reciprocal Protection of Investment*, Annex 10-E (signed 25 October 2004) [https://tcc.export.gov/static/Uruguay-11.4.05.pdf] at 23 June 2020.

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(31) Above n 13 *Dominican Republic-Central America-United States Free Trade Agreement*, Annex 10-F.

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(32) *Official Records of the General Assembly, Seventy-second Session, Supplement No. 17* (A/72/17), paras. 263 and 264. (The Commission entrusted Working Group III with a broad mandate to work on the possible reform of investor-State dispute settlement (ISDS). In line with the UNCITRAL process, Working Group III would, in discharging that mandate, ensure that the deliberations, while benefiting from the widest possible breadth of available expertise from all stakeholders, would be government-led with high-level input from all governments, consensus-based and be fully transparent. The Working Group would proceed to: (i) first, identify and consider concerns regarding ISDS; (ii) second, consider whether reform was desirable in light of any identified concerns; and (iii) third, if the Working Group were to conclude that reform was desirable, develop any relevant solutions to be recommended to the Commission. The Commission agreed that broad discretion should be left to the Working Group in discharging its mandate, and that any solutions devised would be designed considering the ongoing work of relevant international organizations and with a view of allowing each State the choice of whether and to what extent it wishes to adopt the relevant solution(s)).

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(34) J.P. Charris-Benedetti, «The proposed Investment Court System: does it really solve the problems?», *Revista Derecho del Estado*, vol. 42, 2019, pp. 83-115 [https://dx.doi .org/10.18601/01229893.n42.04] at 22 June 2020.

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(35) The European Commission's draft text of the Transatlantic Trade and Investment Partnership (TTIP), complemented in November 2015, was the first IIA to include the ICS as the mechanism of dispute settlement. The ICS was implemented in the EU-Vietnam FTA (2016), followed by the EU-Canada Comprehensive Economic and Trade Agreement (CETA), the EU-Singapore Investment Protection Agreement and the EU-Mexico Trade Agreement (2018).

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(36) The EU and Chile started the negotiation process for the modernisation of the EU - Chile Association Agreement in 2017. Due to COVID-19 the seventh round took place by videoconference finishing on 29 May 2020.

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(37) Above n 2, 298.

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(38) Proposal for amendment of the ICSID rules, Arbitration Rules, Rules 77 at [https://icsid.worldbank.org/en/Documents/WP_4_Vol_1_En.pdf] at 22 June 2020.]

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