FORBIDDING *DÉPEÇAGE*: LAW GOVERNING INVESTMENT TREATY ARBITRATION

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I. Introduction

The law governing international arbitration has been a field of considerable conceptual controversy. The debate goes back to the 1960's and 1970's, when distinguished scholars such as F.A. Mann, Berthold Goldman, Philippe Fouchard and others argued whether international arbitration should be considered an autonomous system of law, a new *lex mercatoria*, or whether it ultimately remained subject to the applicable local legal system.[1] As is well known, the former view was shared by many

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1. For an overview of this discussion see, e.g., Berthold Goldman, *Les conflits de lois dans l'arbitrage international de droit privé*, 109 bk. II RECUEIL DES COURS 347 (1964) [hereinafter Goldman, *Les conflits de lois*]; Berthold Goldman, *Frontières du droit et lex mercatoria*, 9 ARCHIVES DE PHILOSOPHIE DU DROIT 177 (1964) [hereinafter Goldman, *Frontières du droit et lex mercatoria*]; PHILIPPE FOUCHARD, L'ARBITRAGE COMMERCIAL INTERNATIONAL 351-457 (1965); F.A. Mann, *Lex Facit Arbitrum*, *in* INTERNATIONAL ARBITRATION LIBER AMICORUM FOR MARTIN DOMKE 157 (Pieter Sanders ed., 1967); Pierre Lalive, *Problèmes rélatifs à l'arbitrage international commercial*, 120 bk. I RECUEIL DES COURS 569, 597-663 (1968); Pieter Sanders, *Trends in the Field of International Commercial Arbitration*, 145 bk. II RECUEIL DES COURS 205, 238-65 (1976); Pierre Lalive, *Les règles de conflit de lois appliquées au fond du litige par l'arbitre international siègeant en Suisse*, 145 RECUEIL DES COURS 2 (1976) [hereinafter Lalive, *Les règles de conflit de lois appliquées*]; Harold J. Berman & Colin Kaufman, *The Law of International Commercial Transactions (Lex Mercatoria)*, 19 HARV. INT'L L.J. 221 (1978); JULIAN LEW, APPLICABLE LAW IN INTERNATIONAL COMMERCIAL ARBITRATION (1978); Berthold Goldman, *La lex mercatoria dans les contrats et l'arbitrage internationaux: réalité et perspectives*, 106 JOURNAL DU DROIT INTERNATIONAL 475 (1979); Alain Hirsch, *The Place of Arbitration and the Lex Arbitri*, 34 ARB. J. 43 (1979); Frédéric-Edouard Klein, *The Law to Be Applied by the Arbitrators to the Substance of the Dispute*, *in* THE ART OF ARBITRATION 189 (Jan C. Schultsz & Albert Jan van den Berg eds., 1982); Arthur Taylor von Mehren, *To What Extent is International Commercial Arbitration Autonomous?*, *in* LE DROIT DES RELATIONS ECONOMIQUES INTERNATIONALES – ETUDES OFFERTES A BERTHOLD GOLDMAN 215 (1982); Carlo Croff, *The Applicable Law in an International Commercial Arbitration: Is it Still a Conflict of Laws Problem?*, 16 INT'L LAW. 613 (1982); Bernardo M. Cremades & Steven L. Plehn, *The New Lex Mercatoria and the Harmonization of the Laws of International Commercial Transactions*, 2 B.U. INT'L L.J. 317 (1983-1984); Ole Lando, *The Lex Mercatoria in International Commercial Arbitration*, 34 INT'L & COMP. L.Q. 747 (1985); Arthur von Mehren, *General Principles of Law in International Commercial Arbitration*, 101 HARV. L. REV. 1816 (1988); Berthold

French arbitration scholars, whereas the latter, more "conservative" view tended to dominate in the United Kingdom and other common law jurisdictions.

While no consensus was reached in this debate, it did not remain inconsequential in that it clarified a number of the conceptual issues at stake, including those relating to the various meanings of the term "governing law." Indeed, it turned out that at least some of the conceptual confusion was explained by the fact that the various parties to the debate were in part addressing different issues. While F.A. Mann and others who sided with him were more concerned with the *lex arbitri*, or the "curial" law governing the arbitral tribunal rather than other aspects of the concept of governing law, the proponents of *lex mercatoria* were more interested in the substantive law of international arbitration. Consequently, as a result of the debate, a distinction came to be made, perhaps more consistently than before, between the law governing the arbitral tribunal (*lex arbitri*) and the law applicable to the merits (*lex mercatoria*).[2]

While the *lex arbitri v. lex mercatoria* debate was conducted largely against the background and in the context of the quickly developing practice of international commercial arbitration, a parallel debate emerged around a related but separate issue–the law applicable to state contracts. Unlike the *lex mercatoria* debate, which was dominated by private international law scholars and international commercial arbitration practitioners, the debate about state contracts also attracted the attention of leading public international law scholars such as Robert Jennings and Prosper Weil, as well as, of course, the omnipresent F.A. Mann. The focus of this parallel debate was on the various issues raised by the participation of the state in international contracts and in international arbitration, including issues such as whether the state's agreement to arbitrate constituted a waiver of immunity, the existence of a public international law of contracts, the law

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Goldman, *The Applicable Law: General Principles of Law – The Lex Mercatoria, in* CONTEMPORARY PROBLEMS IN INTERNATIONAL ARBITRATION (Julian Lew ed., 1986); David J. Branson & Richard E. Wallace, *Choosing the Substantive Law to Apply in International Commercial Arbitration*, 27 VA. J. INT'L L. 39 (1986-87).

2. *See* Veijo Heiskanen, *Theory and Meaning of the Law Applicable to International Commercial Arbitration*, 4 FIN. Y.B. INT'L L. 98 (1993) (discussing the various theories regarding the applicable law).

governing the arbitration, and the limitations on the applicability of the host state's law on the contract.[3]

The two grand debates of the 1960's and 1970's reflected an emerging distinction between international commercial arbitration and international investment arbitration–a distinction that is now taken virtually for granted, but was nothing but obvious at the time. This should not be considered surprising since at the time foreign investment usually took the form of direct contractual arrangements between the state and the foreign investor. As a result, both commercial arbitral tribunals and investment arbitration tribunals drew their jurisdiction from contractual arbitration clauses, negotiated at arm's length between the contracting parties. This contractual thinking was incorporated into, and is still reflected in the ICSID Convention, the great intellectual product of the era of state contracts.[4] The ICSID Convention more or less implicitly assumes that foreign investment will typically take the form of an investment contract entered into between a foreign investor and the host state, or an entity controlled by the state.[5]

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3. For significant contributions see, e.g., ESA PAASIVIRTA, PARTICIPATION OF STATES IN INTERNATIONAL CONTRACTS (1990); Aron Broches, *The Convention on the Settlement of Investment Disputes between States and Nationals of Other States: Applicable Law and Default Procedure*, *in* INTERNATIONAL ARBITRATION LIBER AMICORUM FOR MARTIN DOMKE (Pieter Sanders ed., 1967); Georges Delaume, *State Contracts and Transnational Arbitration*, 75 AM. J. INT'L L. 784 (1981); Georges Delaume, *Economic Development and Sovereign Immunity*, 79 AM. J. INT'L L. 319 (1985); Andrea Giardina, *State Contracts: National versus International Law*, 5 ITAL. Y.B. INT'L L. 147 (1980-81); R.Y. Jennings, *State Contracts in International Law*, 37 BRIT. Y.B. INT'L L. 156 (1961); Jean-Flavien Lalive, *Contracts Between a State or a State Agency and a Foreign Company*, 13 INT'L & COMP. L.Q. 987 (1964); F.A. Mann, *The Proper Law of Contracts Concluded by International Persons,* 35 BRIT. Y.B. INT'L L. 34 (1959) [hereinafter *Proper Law of Contracts*]; F.A. Mann, *State Contracts and International Arbitration*, 42 BRIT. Y.B. INT'L L. 1 (1967) [hereinafter *State Contracts and International Arbitration*]; Prosper Weil, *Problèmes relatifs aux contrats passés entre un Etat et an particulier*, *in* RECUEIL DES COURS 101 (1969).

4. Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, March 18, 1965, 575 U.N.T.S. 160 [hereinafter ICSID Convention].

5. *Id.*, art. 25, para. 1 (referring to consent of parties to submit dispute to Centre, stressing that "[w]hen the parties have given their consent, no party may withdraw its consent unilaterally"). This assumes that, unlike in investment treaty arbitration, both parties have given their consent to arbitrate before the dispute has arisen. *See id.* art. 25, para. 2(b) (referring to agreement of parties, *i.e.* State and foreign investor, to treat juridical person having nationality of State party as national of another contracting State for purposes of ICSID Convention, which similarly assumes there is pre-existing contractual relationship between investor and State); *id.* art. 42, para. 1

However, while the debates of the 1960's and 1970's reflected a growing interest in international arbitration as a process of resolving cross-border commercial disputes, and the parallel interest in developing alternative methods for the resolution of investment disputes (and the corresponding displacement of diplomatic protection as a method of dealing with these disputes), it remained, in the end, less than clear which theory or position in fact "prevailed" in these debates. By the 1980's, most international arbitration lawyers, or at least international arbitration practitioners, tended to take the view that the debates about *lex mercatoria* and state contracts in particular were mainly of academic or historical interest and, as such, of limited practical relevance.

Indeed, by the 1980's, a new but analogous debate had emerged in the field of international arbitration–this time between prominent arbitration practitioners rather than academics. Now the controversy was about "a-national arbitration"–about whether parties to arbitration agreements would or should be able to "delocalize" the arbitration and have the arbitration conducted without regard to the mandatory rules of law of the seat or, in any event, have the arbitral award recognized and enforced even if it had been aside by the court of the seat of arbitration.[6] Unlike the debates in the 1960's and 1970's, the discussion about a-national or delocalized arbitration focused mainly on international commercial arbitration rather than investment arbitration. This reflected the remarkable development in the field of international commercial arbitration that took place during the 1970's and 1980's. In particular, private rules of international arbitration developed such as the rules of the International Court of Arbitration of the International Chamber of Commerce (ICC), the London Court of Ar-

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(instructing arbitral tribunal to decide dispute "in accordance with such rules of law as may be agreed between the parties").

6. *See generally* William W. Park, *The Lex Loci Arbitri and International Commercial Arbitration*, 32 INT'L & COMP. L.Q. 21 (1983); Jan Paulsson, *The Extent of Independence of International Arbitration from the Law of the Situs*, *in* CONTEMPORARY PROBLEMS IN INTERNATIONAL ARBITRATION 297 (J. Lew ed., 1986); William W. Park, *Judicial Controls in the Arbitral Process,* 5 ARB. INT'L 230 (1989); Jan Paulsson, *Arbitration Unbound: Award Detached from the Law of Its Country of Origin*, 30 INT'L & COMP. L.Q. 358 (1989); Jan Paulsson, *Delocalisation of International Commercial Arbitration: When and Why It Matters*, 32 INT'L & COMP. L.Q. 53 (1983) [hereinafter *Delocalisation of International Commercial Arbitration*]; Hans Smit, *A-National Arbitration*, 63 TUL. L. REV. 629 (1981).

bitration (LCIA) and the American Arbitration Association (AAA), as well as quasi-private rules such as those developed by the United Nations Commission on International Trade Law (UNCITRAL).[7] As a result of these developments, parties less frequently designated the procedural law of a particular country as the law governing the arbitration proceedings because of increased use of privatized international arbitration rules.[8]

But the focus on the legal framework of international commercial arbitration also belied another, parallel "development": The relative stagnation of international investment arbitration, as reflected in the statistics of ICSID. By the late 1980's, it had become increasingly clear that despite the impressive number of states parties to the ICSID Convention, state contracts would not be capable serving as the engine of foreign investment nor, it seemed, capable of generating a sufficient number of disputes to justify the continuing existence of an arbitration service provider dedicated exclusively to investment arbitration.[9]

However, beginning in the early 1990's, there were new developments that swung the pendulum of intellectual interest back to international investment arbitration. This time the debate was not about state contracts. It was, as aptly and famously captured by Jan Paulsson, about "arbitration without privity," that is, arbitration of investment disputes under investment treaties without a direct contractual relationship between the state

7. "Quasi private" in the sense that, although they were developed by UNCITRAL, a United Nations body, their actual use remains dependent on the choice of the parties.

8. The conception that arbitral proceedings may be conducted under the procedural law of a selected jurisdiction other than the procedural law of the seat of the arbitral tribunal is still reflected in article 5(1)(e) of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, art. 5(1)(e), June 10, 1958, 330 U.N.T.S. 38 [hereinafter New York Convention]. The New York Convention provides that recognition and enforcement of an arbitral award may be refused if it "has been set aside or suspended by competent authority of the country in which, *or under the law of which*, that award was made." *Id.* (emphasis added).

9. During the period from its inception until the end of 1989, ICSID had only received and registered 26 cases. *See* International Centre for Settlement of Investment Disputes, List of Concluded Cases (2009) *available at* http://www.worldbank.org/icsid (click "cases" tab, then "List of Cases" tab, then "Concluded Cases" hyperlink) (listing 26 cases registered before 1989).

and the foreign investor.[10] These developments reflected the fundamental changes in the political-economic environment of international investment arbitration that had taken place in the late 1980's and early 1990's, in particular the end of the Cold War and the resulting quasi-global adoption of neoliberal economic policies. As part of these developments, which gathered momentum in the course of the 1990's, states increasingly withdrew from their role as market participants and owners or managers of business enterprises, and adopted the role of regulator–which made them indirect rather than direct market participants.[11] As a result of these developments, state contracts lost their function as the main vehicle of foreign investment and source of disputes and were replaced, to a rapidly increasing degree, by investment treaties, in particular bilateral investment treaties,[12] and to a lesser degree, foreign investment laws.[13]

Investment treaties substantially modified the legal framework within which foreign investment was undertaken. Unlike in the case of a state contract, there is no direct contractual relationship–or "privity" of contract–between the state and the foreign investor under an investment treaty. The state's consent to arbitrate is given in a treaty, to which the foreign investor is not a party, and on an anonymous basis to a class of foreign inves-

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10. *See* Jan Paulsson, *Arbitration Without Privity*, 10 ICSID REV. – FOREIGN INV. L.J. 232 (1995) (discussing rise of investment treaty arbitration and implications of arbitration agreement without privity).

11. *See* Veijo Heiskanen, *The Doctrine of Indirect Expropriation in Light of the Practice of the Iran-United States Claims Tribunal*, 8 J. WORLD INV. & TRADE 215, 215 (2007) (highlighting shift of states from market participants to regulators).

12. *See* RUDOLF DOZER & MARGRETE STEVENS, BILATERAL INVESTMENT TREATIES, xxii (1995) (discussing the radical increase in bilateral investment treaties). Rudolf Dolzer and Margrete Stevens estimate that fewer than a dozen bilateral investment treaties were concluded per year in the course of the 1970s. *Id.* In the 1980s, the number increased to an average of about 24 treaties per year, whereas in 1990 alone the figure was 55. *Id.* In 1991, 1992 and 1993, the figures were 80, 99 and 83, respectively. *Id.* By September 1994, which was the reference date of their study, the total number of bilateral investment treaties had exceeded 700. *Id.* The growth has continued since then, and by the end of 2007, some 179 countries had entered into more than 2,600 bilateral investment treaties. United Nations Conference on Trade and Development, *World Investment Report* 14, U.N. DOC. UNCTAD/WIR/2008 (Sept. 24, 2008).

13. *See* Southern Pacific Properties (Middle East) Ltd. v. Egypt, Decision on Jurisdiction, ICSID Case No. ARB/84/03, 3 ICSID Rep. 131, Decision on Jurisdiction, para. 71 (Apr. 14, 1988) (upholding tribunal's jurisdiction to hear dispute). This was the first case where the investor invoked the State's consent to arbitrate expressed in a foreign investment law.