Practical Issues and Perspectives of Investment Arbitration Involving Russian and CIS Parties

Presentation by
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1. Introduction

The organizers of this conference have asked me to provide some short comments on practical issues and future perspectives of investment arbitration from my experience as an arbitrator in such disputes. In the many investment arbitrations I have done in recent years, a considerable number involved parties from Russia and CIS countries, both involving the State or government or private companies in these countries. The results have been different case by case. As an example from cases which have been reported and thus are not confidential, I may refer to the three arbitrations involving Kazakhstan which I chaired in recent years: In two of them, Kazakhstan prevailed, once on jurisdiction and once on the merits. In the third of them, our Award of last December awarded the foreign investors more than 500 million US-Dollars. And, as some in this room will know, I also still chair a corporate dispute between two large Russian private enterprises.

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Within the short time I have available here, I can only address some selected topics which I find to be of specific relevance in today's discussions on investment arbitration.

2. Legal Security as a Condition for Global Investment

Both international trade and international investment are fundamental for the future prosperity of most states and their populations. Therefore, most states try to provide incentives to foreign companies to invest their capital and know-how. One of the most important incentives for foreign investors is that they need legal security for their investments, both by substantive legal protection, but also by a system they can trust in order to enforce their legal rights in case of a dispute.

Substantive legal protection is primarily provided by the domestic legal system. Obviously, in the view of investors, some states are less secure than others in providing a functioning legal protection within their domestic legal system and, what often is not the same, its actual implementation in practice. However, as a state can change its domestic law, international substantive legal protection is highly important for the foreign investor. This is provided by global instruments, such as the Energy Charter Treaty, regional instruments such as NAFTA and CAFTA and the law of the European Union, and to the greatest extent, by the network of several thousand bilateral treaties now in existence.

As everybody knows, substantive legal protection is only of any real value if rights can be enforced. This procedural protection is again primarily provided by the domestic legal system in every state. However, though the domestic courts in many countries work efficiently and are independent from the government, this is not always so and foreign investors have justified doubts in this regard in many host states. They are, therefore, only ready to invest in many countries if they have a

dispute settlement system available which is fully independent from the host state. This is obviously where international investor-state arbitration comes in.

Why do I point out these rather trivial basics of investment arbitration? This is, because, in much of the present critical discussion of this arbitration system, one seems to forget that, for international economic development and for the benefit of most countries that depend on foreign investment, an efficient system of dispute settlement is absolutely necessary. And it must be a system acceptable not only for host states, but also trustworthy for foreign investors in order to motivate them to invest in the respective countries. Host states and investors thus have a common interest in this regard.

Let us recall that, after centuries in which the only, and very unsatisfactory, protection in international law was diplomatic protection by the home state, it was considered a major achievement when finally direct access to sue states was provided by human rights treaties for individuals and by investment arbitration for investors.
I now turn to some of the presently much discussed issues of investor-state arbitration.

3. On General Criticisms Raised Presently regarding Investment Arbitration

Presently, we read a lot of rather general criticism of the investment arbitration system. Some may still recall UN Resolution 1803 of 1962 on Permanent Sovereignty over Natural Resources.[2] Given some of the recent discussions, I have the impression that certain participants have moved back 50 years to 1962 and have forgotten the development of the global economy and of international law thereafter. Not the private investors, but the greatest number of all states have decided to

[2] Permanent Sovereignty over Natural Resources, General Assembly resolution 1803 (XVII) New York, 14 December 1962

conclude the thousands of BITs, the ICSID Convention, and many also the ECT. They did so because they considered that to be in their best interest for the further development of their economies. And they did this using the ratification procedure provided in international law and in their domestic legal systems including the necessary authorization by their respective parliaments giving democratic legitimacy to these instruments.

On 3 October 2013, the **European Commission** released a paper titled **"Incorrect claims about investor-state dispute settlement"** [3] It addressed the following claims (I quote what the EC mentions as "incorrect claims"):

- Claim: Investor-state dispute settlement subverts democracy by allowing companies to go outside national legal systems
- Claim: Investor-state dispute settlement gives too many rights to companies.
- Claim: Investor-state allows companies to sue just because they might lose profits
- Claim: Investor-state dispute settlement cases take place behind closed doors
- Claim: Investor-state dispute settlement undermines public choices (e.g. Vattenfall challenging the German moratorium on nuclear power, Philip Morris challenging Australia's plain packaging regime for cigarettes)
- Claim: Investor-state dispute settlement is biased in favour of investors – they can threaten to bring expensive cases against governments and so scare them away from policies that the investors do not like

I am afraid, I do not have the time available here to also quote or summarize the answers given by the EU to each of these claims. They can be found in the paper under the website(http://trade.ec.europa.eu/doclib/docs/2013/october/tradoc_151790.pdf). Let

[3] http://trade.ec.europa.eu/doclib/docs/2013/october/tradoc_151790.pdf.

me only say that I agree with most of these answers. But though the above claims involve policy and not legal evaluation, as a precaution and to avoid any misunderstanding, I add one caveat: I abstain from any opinion on any policy or legal considerations related to the pending arbitration case between Philip Morris and Australia regarding the plain packaging regime for cigarettes, because I chair the tribunal in that case.

The instruments of international law on investment protection do not mean that the sovereignty over natural resources, or sovereignty over the national infrastructure, which nowadays has attained similar importance for states, should not be respected. This does also not mean that there is no room for improvement regarding the respective dispute settlement mechanisms. What we have to search in policy is a balance between this sovereignty and legal protection for investors that they trust. And whatever opinion one has regarding these policy issues, there should be no doubt that arbitral tribunals have a mandate to apply the law and not policies.

There may be good reasons for a state to reconsider its position in this context. Some have had fundamental changes in their political system and in their approach to sustainable development and private investment. Some have simply lost some of their investment arbitration cases and now wish to discontinue with the system. Some have joined regional systems such as the EU which, as we know, is presently re-examining the approach to BITs of its member states between themselves, with non-EU states, and in the future of the EU itself. Treaties are not concluded forever. They can be terminated or re-negotiated. China, which originally hesitated to accept full-fledged arbitration clauses, after becoming more an investment exporting country, has renegotiated some of its BITs. Russia, originally with a similar hesitation, has concluded a BIT with China with full-fledged arbitration. Canada, after many years, has just recently ratified the ICSID Convention.

But let me insist: These reconsiderations concern policy decisions. They are not by themselves due to a failure of the system of investor-state arbitration. The thousands of BITs and the ECT, as well as the provisions for today's investor-state arbitration, are an important part of the international rule of law. Applying and enforcing that rule of law is exactly what arbitrators have been appointed to do. Obviously, one may disagree with their decisions in individual cases, just as we sometimes disagree with judgments of our national courts.

Let me add a short note on a trend in recent years that sometimes hedge funds or similar entities try to abuse investment arbitration for speculative purposes. As far as I can see, arbitral tribunals have shown that they can prevent such abuse by strict application of their jurisdictional limits, and by applying strict standards for the evaluation of damages, as we did in the Rosinvest Award involving Russia in the first decision in one of the YUKOS cases, as some readers may know from the publications of and on that Award.

4. Criticisms of Specific Aspects of the System

However, all this does not mean that the present system could not be either improved or better adapted to what has turned out to be demands from its implementation in practice. Hereafter, I address some of the challenges raised recently.

a. Procedures Too Complex and Too Long

It has often been said that investor-state arbitration procedures have become too complex and too long. This is, to some extent, correct. The reason is partly implied in this kind of dispute, which, more than commercial arbitration, often involves higher amounts in dispute; a mixture of contractual, administrative, legislative, and court decisions; and the application of domestic and many sources of international law.

When I start a new arbitration of this kind, I am often surprised at how much time counsel for both sides request for the submission of their memorials and possibly a procedure for document disclosure. But most of the time, after further explanation, I must agree that long periods are needed for a thorough preparation before the hearing. Effective case management from the very beginning, in consultation with counsel of the parties, becomes very important in this context and, as some readers will know, in cases I chair, I usually insist on particular efforts in this regard.

b. Arbitration Too Costly

This complexity and length then makes the procedure often much more costly**.** Large teams of lawyers with support staff on both sides, together with the expenses for many witnesses and experts, court reporters, and interpreters have to be paid. I have had hearings attended by up to 100 persons from the parties' sides. We all know the battles of thousands of documents submitted in many cases. Their selection, processing and submission obviously leads to large expenses.

When we see the cost claims of the parties at the end of a procedure, they are indeed often quite exorbitant. This is true for cost claims of both the state and the investor. I have seen cost claims in the range of up to US$50 million from each side. And I also have a pending investment arbitration case in which, after we decided that we had jurisdiction, the group of small investors now has difficulties financing the deposits to continue with the procedure on the merits. In such scenarios, the growing relevance of third party financing is not surprising.

Nevertheless, the usual complaint that international arbitration has become too expensive is on one hand correct, but on the other hand, too simple. Though efficient case management may help, if counsel is expected to do the best job possible for the client and leave no stone unturned, it is not easy for counsel to eliminate certain options for cost reasons or for a tribunal to exclude certain procedural steps without

limiting due process. At a recent conference of the International Federation of Commercial Arbitration Institutions (IFCAI), statistics were presented, and confirmed by later studies, that of the cost of a particular arbitration case, usually more than 90% are costs accumulated for the parties, and only the rest were costs in the range of 3 to 5% for the arbitral institution and for the arbitrators. Regarding these latter costs, one has to realize that they may vary depending on the arbitration rules the parties have selected for their dispute, since some arbitral institutions calculate their and the arbitrators' fees on the bases of hourly rates and others on the basis of the amount in dispute.

c. Transparency

Transparency is a further critical issue. While confidentiality is still an important reason why private parties chose arbitration for the settlement of their disputes, in investment arbitration, there is a strong trend to provide for more transparency. Indeed, the high relevance of a country's natural resources and infrastructure for its economy and population lead to the conclusion that public interests are involved, if investment arbitrations deal with and decide on these.

For these reasons, many of the modern instruments expressly provide for much greater transparency or the parties agree at the beginning of the proceeding in this regard. I remember when I chaired the very first NAFTA arbitration many years ago, it was still conducted in a rather confidential manner though the media reported on the case and later on our award. In my most recent NAFTA procedure, the hearing in Washington was open to the public and indeed transmitted live to Canada.

Later instruments such as the CAFTA Treaty provide expressly on such transparency. A more recent step in this direction is the new US Model BIT. While it gives the parties of the arbitration the choice between ICSID, its Additional Facility Rules, and the UNCITRAL Rules or the rules of any other arbitral institution on which the parties agree, for all of these it provides in its Art. 29 that all memorials, minutes, orders, hearings, and awards of the tribunal shall be open to the public. And just

recently, UNCITRAL has adopted new transparency rules to be applied in investment treaty arbitrations conducted after 1 April 2014. As an example for case-related transparency, I may point out that, as some readers may know, in the arbitration I presently chair between Philip Morris and Australia regarding that country's cigarette legislation, it was agreed that, after a prior redaction to exclude any confidential information, all awards, decisions, and orders of the Tribunal would be published on the website of the Permanent Court of Arbitration (PCA).

Permit me one personal comment in this context: While I do understand the good reasons for the increased transparency, in my experience it does not make the procedure more efficient. If they are open to the public, the parties' written submissions, and perhaps even more their oral presentations in the hearing, tend to be less focused on the professional exchange with the tribunal, but rather tend to be become public statements. And also as an arbitrator in such public hearings, I noticed that my remarks would go beyond what I would normally say in addressing counsel, just to make sure that those in the audience less familiar with the details of the case and the media would not misunderstand. Finally, let me add that the procedures may become more costly if they include the admission of amicus curiae briefs of non-governmental organizations or perhaps of the EU in intra-European BIT disputes.

5. Perspectives for the Future

Finally, permit me a short note on perspectives for the future.

I would expect that some of the criticism in recent years will continue and change the scenario. Changes of government or of the political structures in states will, for understandable reasons, lead to conflicts with foreign investors and then to disputes and arbitrations. States will continue to need and try to attract foreign investment. They will only be successful in such efforts if they provide some legal security for such investments including the option for the settlement of disputes. But, on the other hand, as in commercial arbitration, parties, both states and private companies, who

have been on the losing side in a number of arbitrations may see the fault in the system rather than in their own conduct.

Nevertheless, as a result of the continuing growth of worldwide investments, I would expect investor-state arbitration to grow as well. But perhaps parties will choose a greater variety of arbitration rules and institutions. And more transparency of investment arbitration procedures may be included expressly in new instruments or agreed by the parties in particular cases.

My conclusion would be that it is a bit like with democracy: investor-state arbitration is not perfect, but still better than all other systems yet proposed.