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The trembling legitimacy of the ICSID annulment system in the light of decisions by Ad Hoc Committees vis-à-vis the Ad Hoc Committee decisions

by V. Giraud Martinelli

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The trembling legitimacy of the ICSID annulment system in the light of decisions by Ad Hoc Committees vis-à-vis the Ad Hoc Committee decisions

by

Vanessa A. Giraud Martinelli

I. Foreword

Since 2001 there has been a considerable increase in annulment proceedings. According to the ICSID Convention, the annulment is an extraordinary remedy designed for a limited scope of review of five specific grounds provided under Article 52 of the ICSID Convention, which sets the general procedural framework for annulment proceedings. The Ad Hoc Committees are intended to review solely the arguments for annulment filed by the petitioning party and must only decide on aspects of five specific grounds of the Tribunal award. However, the extensive interpretations of Ad Hoc Committees are in some ways stretching the purposes of the ICSID system - such as legitimacy and adequacy - to the limit. For instance, one Ad Hoc Committee exceeded its mandate by criticizing the grounds for the award or the conduct of the original Tribunal and another one attempted to lecture the arbitral tribunal on law. Such behavior on the part of the Ad Hoc Committees undermines the system and threatens the enforceability of the award. Furthermore, Ad Hoc Committees have identified errors in the reasoning of the award yet the awards have not been annulled. These findings put the credibility of the ICSID system itself at risk, since, after all, the question is to what extent must the principle of finality be safeguarded?

II. Introduction

The increase in requests for annulment procedures and for resubmissions to correct "erroneous" awards has raised concerns about the legitimacy and adequacy of the ICSID system, while critics of the institution of or the functioning of Ad Hoc Committees also point to the ambiguity of the finality principle. This article will focus on analyzing the annulment procedure under the ICSID Convention, particularly its features and some of the decisions rendered by these Ad Hoc Committees.

In this regard, it is important to stress the importance of the finality principle. The ILC recognized that the finality of an award is an essential feature of arbitral practice, but also recognized that there was a need for "*exceptional remedies calculated to uphold the judicial character of the award as well as the will of the parties as a source of the jurisdiction of the tribunal*[1]." It thus "*sought to reconcile finality of the award with the need to prevent flagrant cases of excess of jurisdiction and injustice*[2]."

In order to safeguard the essence of annulment procedures under ICSID, the main contribution of this article will be to address the issues that have arisen related to certain decisions of Ad Hoc Committees and their possible solution through two main proposals, specifically: (a) the amendment of the ICSID Arbitration Rules by introducing a scrutiny of the award and (b) the creation of Guidelines for the Conduct of Ad Hoc Committees.

III. Overview of the ICSID Annulment Proceedings

The annulment proceeding is a limited review mechanism for awards rendered by ICSID arbitral tribunals in which either party may request annulment of the award by an application in writing addressed to the Secretary-General. The drafters of the ICSID Convention intended the annulment mechanism to act as an *extraordinary* remedy to void awards with unusually egregious flaws. The annulment proceedings are limited to the grounds established in Article 52 (1) of the ICSID Convention, specifically if: (a) the Tribunal was not properly constituted; (b) the Tribunal has manifestly exceeded its powers; (c) there was corruption on the part of a member of the Tribunal; (d) there has been a serious departure from a fundamental rule of procedure; or (e) the award has failed to state the reasons on which it is based.

[1] *Documents of the Fifth Session Including the Report of the Commission to the General Assembly*, 2 Yearbook of the International Law Commission 211, U.N. Doc. A/CN.4/SER.A/1953/Add.1 (hereinafter"1953 ILC Yearbook II"), Article 30 of the Draft Convention on Arbitral Procedure (1953); Aron Broches, *Observations on the Finality of ICSID Awards*, Selected Essays: World Bank, ICSID, and Other Subjects of Public and Private International Law, 299 (1995).

[2] Supra note 1, 1953 ILC Yearbook II, Article 30 of the Draft Convention on Arbitral Procedure, 202.

On receipt of the request for annulment, the Chairman must appoint an Ad Hoc Committee of three persons selected from the Panel of Arbitrators, none of whom can have served on the arbitral tribunal that rendered the award being challenged[3]. Hence, the core of the annulment proceedings is that, based on the specific grounds set forth in Article 52, the Ad Hoc Committee will render a decision on annulment (not an award) within the ICSID, which will decide whether the Ad Hoc Committee will (i) reject all grounds for annulment, meaning that the award remains intact; (ii) uphold one or more grounds for annulment in respect of a part of the award, which leads to a partial annulment; (iii) uphold one or more grounds for annulment in respect of the entire award, meaning that the whole of the award is annulled; or (iv) exercise its discretion not to annul notwithstanding the fact that an error has been identified.

Hence, in order to preserve the essence on which the annulment procedure is based, it is extremely important that the Ad Hoc Committee be careful not to pronounce on any aspect of the Tribunal award that is not essential[4]. In this regard, the MTD Ad Hoc Committee indicated the scope of the mandate of an Ad Hoc Committee:

> *Annulment has a limited function since a committee cannot substitute its determination on the merits for that of the Tribunal. Nor can it direct a Tribunal on a resubmission as to how it should resolve substantive issues in dispute. All it can do is annul the decision of the Tribunal: it can extinguish a res judicata but on a question of merits it cannot create a new one. A more interventionist approach by committees on the merits of disputes would risk a renewed cycle of*

[3] See: Article 52 (3) of the ICSID Convention.

[4] See: Enron Creditors Recovery Corporation (formerly Enron Corporation) and Ponderosa Assets, L.P. v. Argentine Republic, Decision on the Application for Annulment of the Argentine Republic, 30 July 2010 at para. 340; Azurix Corp. v. the Argentine Republic, Decision on the Application for Annulment of the Argentine Republic, 1 September 2009 at para. 362; CDC Group plc v. Seychelles, Decision on Application for Annulment of the Republic of Seychelles, June 29, 2005 at para. 70; Empresas Lucchetti, S.A. and Lucchetti Peru, S.A. v. The Republic of Peru, ICSID Case No. ARB/03/4 (also known as: Industria Nacional de Alimentos, A.S. and Indalsa Perú S.A. v. The Republic of Peru), Decision on Annulment, September 5, 2007, at para. 112.

tribunal and annulment proceedings of the kind observed in Klöckner and AMCO…[5]

Therefore, an annulment Ad Hoc Committee can declare an arbitral award (or part of it) to be completely or partially invalid only for such specifics grounds[6], but it cannot modify the award with its own decision on the merits. In other words, an annulment is concerned only with the basic legitimacy of the process of decision, not with its substantive correctness[7].

IV. The trembling legitimacy of the ICSID annulment system in the light of decisions by Ad Hoc Committees vis-à-vis the Ad Hoc Committee decisions

The historical context of the ICSID Convention appears to lend enormous weight to the inclusion of an annulment system in the ICSID Convention, to the extent that it would not have been ratified by so many States without the presence of its annulment system. The annulment procedure in the ICSID plays a fundamental role in the preservation of the principle of finality[8] and the legitimacy of the ICSID system. Annulment by an Ad Hoc Committee is, at the same time, a drastic and a limited remedy[9]. It is a drastic remedy in

[5] MTD Equity Sdn. Bhd. and MTD Chile S.A. v. Republic of Chile, ICSID Case No.ARB/01/7, Decision on Annulment, 21 March 2007, at. para. 57.

[6] See: Compañía de Aguas del Aconquija S.A. and Vivendi Universal (formerly Compagnie Générale des Eaux) v. Argentine Republic, ICSID Case No. ARB/97/3, Decision on Annulment, 3 July 2002, at para.68-69. In this case it was holds that where a ground for annulment is established, it is for the committee to determine whether there should be complete or partial annulment of the award.

[7] Christoph Schreuer, *ICSID Annulment Revisited*, 30 Legal Issues of Economic Integration, Issue 2 (2003). Available at: http://www.univie.ac.at/intlaw/wordpress/pdf/67.pdf

[8] See: Hussein Nuaman Soufraki v. United Arab Emirates, ICSID Case No. ARB/02/7, Decision of the Ad Hoc Committee on the Application for Annulment of Mr. Soufraki, 5 June 2007, at para. 27. In this decision it was hold that the annulment is usefully reserved for egregious violations of basic principles while preserving the finality of the decision in most other respects. In contrast with this decision see: Rumeli Telekom A.S. and Telsim Mobil Telekomunikasyon Hizmetleri A.S. v. Republic of Kazakhstan, ICSID Case No. ARB/05/16, Decision of the Ad Hoc Committee on the Application for Annulment of the Republic of Kazakhstan, 25 March 2010. In this case it was hold that an ad hoc committee should not be concerned with upholding the finality of an award or ensuring that the review of the award is as extensive as possible given that the annulment proceeding is the only possibility open to the parties, but should simply act within the confines of the tasks devolved upon it by the ICSID Convention.

[9] Hans Van Houtte, *Article 52 of the Washington Convention A Brief Introduction.* E Gaillard and Y Banifatemi (eds), IAI Conference on Annulment of ICSID Awards. Juris Publishing, Huntington, NY,12, (2004).

that an annulment decision does not simply alter certain elements of the award, it invalidates it completely[10]. It cannot be forgotten, as was held in Burlington Resources vs. Ecuador in response to the argument that Ad Hoc Committees are not inherently superior to arbitral tribunals, that one cannot disregard the fact that the ICSID Convention entrusts Ad Hoc Committees with the power to annul awards[11]. Hence, the ICSID Convention's self-contained system of review is exclusive[12].

Despite the foregoing, the essence of the annulment procedure as an extraordinary remedy is at risk, since over recent years there has been an increase in the number of challenges of arbitral awards through the requesting of annulment proceedings[13]. In light of this increase, concerns are unquestionably raised regarding the functioning of such mechanism, especially since there has been such severe criticism of the decisions of Ad Hoc Committees, even though these Ad Hoc Committees themselves seem to very clearly understand their limitations[14].

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10 Promod Nair and Claudia Ludwig, *ICSID annulment awards*: *the fourth generation?* Global Arbitration Review, volume 5, issue 5 (October 2010). Available at: http://www.lexology.com/library/detail.aspx?g=7218cb56-7a64-426f-8cc0-8475303444e6

11. Burlington Resources Inc. v. Republic of Ecuador, ICSID Case No. ARB/08/5, Decision on Liability, 14 December 2012 at para.230.

12 RSM Production Corporation and others v. Grenada, ICSID Case No. ARB/10/16, Award, 10 December 2010 at para. 7.1.10.

13 In the recent ICSID Caseload Statistics(Issue 2013-2) in which it is establishes the outcomes in Annulment Proceedings under the ICSID Convention by decade it has been reported that from 1981 to 1990 there have been tree decisions annulling the award (in part or in full). Such statistics have increased in the last decade to eight decisions annulling the award (in part or in full) and from 2011 to the present there has been only 1 decision annulling the award (in part or in full). Available at: https://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDDocRH&actionVal=ShowDocument&CaseLoadStatistics=True&language=English42

14 See for example: *Wena Hotels LTD. v.* Arab Republic of Egypt, *ICSID* Case No. ARB/98/4, Annulment Proceeding, *5* February 2002 at para. 18. In this decision on annulment it was hold that the annulment remedy is not an appeal and that the power for review being limited to the grounds defined in Article 52, which are to be interpreted neither narrowly nor extensively.

The ICSID system is designed, however, in such a way that the principle of finality is a fundamental value, consistent with the nature of arbitration in general. The *travaux preparatoires* of the ICSID Convention make it clear that the drafters intended to: (i) assure the finality of ICSID awards; (ii) distinguish between an annulment proceeding and an appeal; and (iii) narrowly define the grounds for annulment so that this procedure remains exceptional[15].

Most of the Ad Hoc Committees have recognized the limited scope of their functions, but have nevertheless committed erred by (i) confusing the annulment procedure with an appeal[16]; (ii) reviewing the substance; (iii) not limiting themselves to reviewing the award and not keeping in mind their exceptional duties and responsibilities as outlined in the ICSID Convention; and (iv) giving lectures to those arbitrators whose awards they are reviewing.

Alan Redfern describes this situation as follows: "*three eminent arbitrators, appointed by the President of the World Bank, wiped out the decisions of three eminent arbitrators appointed by the parties in what might seem like an elaborate and expensive game of snakes and ladders*[17].

In addition, there have been grave decisions, such as in Sempra[18], where the Ad Hoc Committee annulled the award because it held that the Tribunal had failed to conduct its review since the applicable legal norm was to be found in Article XI of the BIT, and that this error of law constituted an excess of powers within the provisions of the ICSID Convention, despite the fact that it is well established that an error of law does not constitute grounds for annulment under Article 52 of the ICSID Convention and cannot amount to a manifest excess of power.

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[15] R. Doak Bishop and Silvia M. Marchili, *Annulment Under The ICSID Convention.* Oxford International Arbitration Series, at 3.09, 20 (2012).
[16] See: Amco Asia Corp. v. Indonesia (Case No. ARB/81/i). Annulment Decision of May 16, 1986, 1 INT'L ARB. REP. 649, 649 (1986); Klockner Industrie-Anlagen GmbH v. United Republic of Cameroon (Case No. ARB/81/2), Annulment Decision of May 3, 1985, excerpts translated in 1 ICSID Rev. Foreign Inv. L.J. 89, 89 (1986).
[17] D. Alan Redfern, *ICSID-Losing its appeal?* Arbitration International, volume 3, Issue 2, 98-99 (1987).
[18] Sempra Energy International. v. Argentina (ICSID Case No.ARB/02/16) Decision on Annulment.

The Patrick Mitchell Ad Hoc Committee annulled the award, establishing that the Tribunal forced the concept of investment […] in order to affirm its jurisdiction: "*Moreover, it determined that the Tribunal failed to state reasons*" that led the committee to conclude that there was a "*manifest excess of power*"[19]. The aforesaid, even though the applicant was seeking annulment of the award on entirely different grounds.

All these situations are of concern since the nature of the mechanism itself is shaky An important decision of the International Court of Justice defines the annulment procedures as follows:

> *[that]...the award is not subject to appeal and that the Court cannot approach the considerations of the objections raised by Nicaragua to the validity of the Award as a Court of Appeal. The Court is not called upon to pronounce on whether the arbitrator's decision was right or wrong. These and cognate considerations have no relevance to the function that the Court is called upon to discharge in the proceedings, which is to decide whether the Award is proved to be null and void*[20].

In this regard, the ICSID Secretary General proposed an amendment to the Arbitration rules in 1986 by stating that:

> *The danger thus exists that if parties, dissatisfied with an award, make it practice to seek annulment, the effectiveness of the ICSID machinery might become questionable and both investors and Contracting States might be deterred from making use of ICSID arbitration*[21]

In sum, the situations described above raise serious issues that threaten ICSID's legitimacy and the perception of the international arbitration community.

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[19] See: Mr. Patrick Mitchell v. Democratic Republic of the Congo, ICSID Case No. ARB/99/7, Decision on the Application for Annulment of the Democratic Republic of Congo, 9 February 2004 at 67.

[20]. Case concerning the Arbitral Award made by the King of Spain on 23 December 1906 (Honduras v. Nicaragua), Judgment of Nov 18, 1960, ICJ Reports 1960, 214.

[21] Report of the Secretary General to the Administrative Council, ICSID doc No. AC 86 Annex A, 2, Oct 2, 1986.

V. Proposals

Ad Hoc Committees are generally clear as to their duties, nonetheless there have been cases where they themselves have exceeded their power and these situations are of great concern when the adequacy of the ICSID system itself may be at stake. The ICSID Arbitration Rules do not provide any guidelines for the conduct of Ad Hoc Committees and the grounds for annulment are very limited. Thus, their approach to their decisions has not been uniform.

Therefore actions need to be taken either at the annulment stage or, preferably, at the level of the arbitration itself. In order to preserve the wish of the drafters of the ICSID Convention and the main purpose of the ICSID annulment mechanism, which is to guarantee the fundamental integrity of the process, we would like to make two proposals regarding the ICSID annulment system: (a) the scrutiny of ICSID Awards; and (b) the creation of guidelines for the conduct of the ICSID Ad Hoc Committees.

(A) Scrutiny of the Award

Our first proposal is to introduce a quality control of the award before the final award has been issued. This could be done by amending the Arbitration Rules to introduce such procedure and creating an experienced permanent body that will be in charge of reviewing the ICSID awards.

A scrutiny of the drafts of the awards could be a solution that would (a) reduce the amount of requests for annulment proceedings; (b) lend more certainty to the ICSID arbitration procedure by safeguarding the principle of finality; and (c) reduce the time and costs of the annulment procedure. Alan Redfern and Martin Hunter stressed how this internal review of awards has allowed, for example, the International Chamber of Commerce Court of Arbitration ("ICC") to pride itself on the overall quality of the ICC awards:

> "The advantages and disadvantages of the ICCs scrutiny process were subject to extensive consultation and debate in the period running up to the formulation of the ICCs 1998 Rules. Overall, it was found that a substantial majority of arbitrators and other arbitral practitioners

> considered the scrutiny process to be valuable, and that the advantages outweighed the disadvantages. It is important that, with such a wide range of arbitrators being called on to act in ICC cases, there should be a degree of control over the form of awards, and over their enforceability[22]."

The creation of a permanent ICSID body in charge of scrutinizing all the awards could well be a way of avoiding most of the flaws in the awards. The award scrutiny procedure would involve having the arbitral tribunal deliver a draft of the award to this new permanent and experienced body for prior screening of all ICSID awards. In doing so, it will verify (without affecting the Arbitral Tribunal's decision) the form and the substance of the award, such as whether there are any possible grounds for annulment as provided in the ICSID Arbitration Rules.

This procedure will ensure that the ICSID arbitral awards are of the highest possible standard and thus less susceptible to annulment. In addition, the recommendations made by the permanent body would save the parties time and money since they would reduce or avoid the delays that could result from one party seeking the annulment of the Award.

(B) Guidelines for the Conduct of the ICSID Ad Hoc Committee

According to Hans Van Houtte, an Ad Hoc Committee must avoid the risk of wrecking the annulment proceedings by (among other situations): (i) upholding the award in solidarity with its fellow ICSID arbitrators; and (ii) giving the impression that it has a better brain than the arbitrators whose work it has to review. Such situations have arisen, as has been established in this article as well as by the critics of the Ad Hoc Committees and thus of the ICSID annulment proceedings[23].

Furthermore, it should be taken into account that the grounds for annulment do not formally distinguish the role of the Ad Hoc Committees within the ICSID. We believe that it is

[22] Alan Redfern and Martin Hunter, *Law and Practice of International Commercial Arbitration*, Sweet & Maxwell, 4th edition, 477,478 (2004).
[23] Supra note 8, 14.

necessary to reinforce the scope of the quality control of the Ad Hoc Committee, and one way of avoiding the need for overseeing the Ad Hoc Committees when delivering their decisions would be to create some clear Guidelines for the Conduct of the Ad Hoc Committee ("Guidelines") in order to safeguard the essence of the annulment procedures, the principle of *ultra petita* and the possible conflicting findings of the arbitral tribunal award and the decision of the Ad Hoc Committee. The Guidelines could be introduced separately to the ICSID and be adopted by a Resolution of a Committee especially created to prepare The Guidelines. The parties may adopt it in whole or in part, at the commencement of the annulment proceedings, or at any time thereafter. The enactment of The Guidelines will have as main purpose to regulate the scope of the mandate of the Ad Hoc Committees. .

The primary function of the Guidelines will be to promote the effectiveness of the ICSID annulment procedure and help to achieve the best decisions of the Ad Hoc Committees. They would represent a comprehensive work that would define the framework of the Ad Hoc Committee, procuring a proper balance and at the same time ensuring the effectiveness of eventual (and less frequent) annulment proceedings.

VI. Concluding Observations

The increase in annulment proceedings has almost led to a practical routine where the losing party requests annulment of the arbitral award as part of its due diligence, yet this problem would not exist if the Ad Hoc Committee were strictly limited to deciding within the limited grounds of Article 52 of the ICSID Arbitration Rules.

The issue is that this has not been so in practice, thus leading to severe criticism of certain decisions by Ad Hoc Committees. If, in addition, there are no uniform guidelines as to the scope of the mandate of Ad Hoc Committees, these situations will likely become more familiar. Such behavior of Ad Hoc Committees threatens the system and the enforceability of the award. Furthermore, these findings put the credibility of the ICSID system itself at risk, since there is a limit to how far this situation can be tolerated.

Hence the possibility of reforming the ICSID Arbitration Rules would seem to be an ideal and coherent option for preventing the undermining of confidence in the system and the effectiveness of the ICSID annulment proceedings. With a view to finding a solution, we have attempted with this contribution to examine the problem and offer two proposals for the ICSID annulment system, specifically the introduction of: (a) the prior scrutiny of all ICSID Awards; and (b) the creation of clear Guidelines for the conduct of the ICSID Ad Hoc Committees.

To conclude, we believe that there is an urgent need to improve the framework of the ICSID Convention since in order to balance the ICSID system any problems that produce uncertainty should be carefully and promptly addressed. The consequence of not dealing with these issues now is that they are, sooner or later, likely to affect the general ability to efficiently reach a final decision in a timely and cost-effective manner. The implementation of our two suggestions will reestablish the solid confidence that has been placed in the ICSID system throughout it's almost 50 years as the institution to go to when seeking fair and balanced solutions to international investment disputes.