Gus van Harten

The public-private distinction in the international arbitration of individual claims against the state

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SHORTER ARTICLES, COMMENTS, AND NOTES

THE PUBLIC–PRIVATE DISTINCTION IN THE INTERNATIONAL ARBITRATION OF INDIVIDUAL CLAIMS AGAINST THE STATE

Abstract Does the rise of international arbitration signify a retreat of the State from classical adjudication? In examining this question, it is important to distinguish contract-based arbitration of individual claims against the State from arbitration pursuant to investment treaties. The former is broadly limited to the private sphere of the State's activity, whereas the latter gives arbitrators a comprehensive jurisdiction over public law. An elaboration of this distinction, and the grey area within it, demonstrates that the significance of international arbitration for juridical sovereignty is its privatization of the authority to define the very concept of the public sphere.

I. INTRODUCTION

The heralded 'retreat of the State'[1]—referring to the State's withdrawal from a range of governmental functions as well as the transfer of those functions to non-State actors—poses a challenge to legal conceptions of the boundary between public and private.[2] In terms of the sovereign power finally to dispose of a legal dispute, in particular, it is said that States are increasingly prepared to accept the transfer of adjudicative authority from courts to arbitrators.[3] Teubner argues that the expansion of international commercial arbitration and lex mercatoria is reason to look beyond the State, and the positive laws of States, and to acknowledge the emergence of transnational legal orders in which private entities construct law without sovereign authorization.[4] This is an ambitious position. Even so, the rise of commercial arbitration does reveal a manner of 'retreat' from the classical model of adjudication, in that a class of disputes is no longer resolved on the merits by judges but by private adjudicators who operate in a legal market and whose decisions are insulated from court supervision on matters of law.[5]

[1] S Strange, *The Retreat of the State* (CUP, Cambridge, 1996).

[2] J Freeman, 'The Private Role in Public Governance' (2000) 75 NYU L Rev 543, 546–8.

[3] A Casella, 'On Market Integration and the Development of Institutions: The Case of International Commercial Arbitration' (1996) 40 Eur Econ Rev 155, 155–9; S Sassen, *Losing Control? Sovereignty in an Age of Globalization* (Columbia University Press, New York, 1996) 14–16; W Mattli, 'Private Justice in a Global Economy: From Litigation to Arbitration' (2001) 55 Intl Org 919, 923–6 and 944–5.

[4] G Teubner, '"Global Bukowina": Legal Pluralism in the World Society' in Teubner (ed), *Global Law Without a State* (Dartmouth, Aldershot, 1997) 10–11; id, 'Contracting Worlds: The Many Autonomies of Private Law' (2000) 9 Social & Legal Studies 399, 402.

[5] R Wai, 'Transnational Liftoff and Juridical Touchdown: The Regulatory Function of Private International Law in an Era of Globalization' (2002) 40 Col J Transnatl L 207, 215–19. Note that relevant treaties and domestic laws dealing with the recognition and enforcement of foreign arbitration awards generally limit the grounds on which a court may set aside an award to error of jurisdiction, gross procedural impropriety, or public policy; by excluding review for errors of law, therefore, disputes are left to be resolved on the merits by arbitrators. See, eg, United Nations

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However, in defence of the classical position of the State in adjudication, the authority for commercial arbitration and thus for the power to define *lex mercatoria* as a source of law is also bounded by States,[6] in that this authority originates in the State's own endorsement of an agreement of the disputing parties to withdraw a particular dispute or legal relationship from the primary jurisdiction of the courts and subject it instead to arbitration. Arbitration is thus defined or endorsed by the State as 'private' based on the State's decision to respect the autonomous decisions of non-State actors to displace the courts' competence with a mutually constructed alternative.[7] Accepting (for the moment) the validity of this public–private distinction, the rise of international commercial arbitration seems to offer a less compelling case for the State's retreat than the alternative scenario in which international arbitration is used to resolve disputes *within the public sphere*. One may pose the question, what if States went further in the delegation of adjudicative authority by allowing regulatory disputes between the State and individuals—that is, disputes arising from sovereign rather than commercial acts of the State—to be resolved by arbitrators? Given its reconfiguration of the role of the courts as the final arbiters of constitutional and administrative law, would this not be a more clear concession of sovereignty?

The claim of this paper is that States have in fact taken this additional step by establishing an international adjudicative system, based on investment treaties, that gives to arbitrators a comprehensive jurisdiction over what are essentially regulatory disputes. In particular, I shall argue that arbitrations conducted pursuant to investment treaties are distinct from international commercial arbitration—where the latter engages disputes between the State and a private individual—because States are assumed in the commercial context to be acting in a private capacity. Admittedly, it is not always possible clearly to distinguish sovereign from private acts of the State in relation to international arbitration. But, to the extent that international commercial arbitration affects regulatory concerns, its rubric is nevertheless limited to disputes arising from a specific legal relationship between individual and State. In contrast, investment treaty arbitration encompasses the full panoply of the State's regulatory relations with 'foreign investors' who are subject to the State's authority. As a result, investment treaty arbitration is a much clearer instance of the State's retreat from adjudication because it replaces courts with a private model of adjudication in matters of public law.

The first part of this article outlines an analytical framework for distinguishing public from private in international arbitration between individuals and States, based on an assessment of the character of the relevant acts of the State. Further, a definition of sovereignty is elaborated that looks to the authority of the State rather than its power as the basis for resolving whether particular State conduct could be carried out by a private party, or whether it is uniquely sovereign. This analytical framework is applied in the second part of the article, in which it is argued that investment treaty arbitration is properly viewed as public law adjudication and, as such, that it is distinguishable

Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 10 June 1958, 330 UNTS 3 (entered into force 7 June 1959), Art V [hereinafter New York Convention]; Model Law on International Commercial Arbitration, 21 June 1985, UNCITRAL, UN Doc A/40/17, Annex I, 24 ILM 1302, Art 34–6.

[6] F Snyder, 'Governing Economic Globalisation: Global Legal Pluralism and European Law' (1999) 5 Eur LJ 334, 341–2.

[7] A Redfern and M Hunter, *Law and Practice of International Commercial Arbitration* (4th edn, Sweet & Maxwell, London, 2004) 138–9 and 256.

from international commercial arbitration, given that only the latter is reciprocally consensual adjudication between juridical equals. In the third part of the article, the discussion delves into the grey areas in the public–private distinction in the international arbitration of individual claims against States. This leads to the conclusion that the key significance of the rise of international arbitration, in terms of the retreat of the State, is the granting of a generalized competence to private arbitrators to define the scope of the public sphere and, as such, the uniqueness of the juridical sovereign.

II. ANALYTICAL FRAMEWORK

A. The Public–Private Distinction

The argument begins with the premise that it is both possible and useful to distinguish between the public and private character of disputes that are resolved by adjudication. Of course, there is always grey when differentiating black from white, and so it is with the public–private distinction. But the presence of grey does not mean that black and white do not exist. When a legislature expropriates property, leading to a dispute with its private owner, the passage of the legislation is quintessentially a sovereign act and the resulting dispute quite clearly a matter of public law. Alternatively, when the Government contracts with a company to tend the lawn in front of Parliament, the Government's conclusion of the contract is a commercial act of the State—one that a private party could carry out—and its resolution by arbitration can credibly be positioned within the private domain.

As with any system of classification, it may be difficult to pinpoint the difference between public and private in specific cases. But the distinction is nevertheless drawn in all modern legal systems, including public international law, because the recognition of any unique subject—here, 'the State'—necessitates a description of that subject.[8] The distinction is present, for example, in the principle of sovereign immunity which, in absolute terms, posits that one State's authority is not subject to adjudication in another State's courts.[9] In particular, many States recognize an exception to the general principle of sovereign immunity with respect to commercial acts of the State which operates to remove the shield of sovereign immunity from the private business conduct of the State.[10] To apply this restrictive doctrine, courts and arbitrators adopt various tests to distinguish sovereign acts (*jure imperii*) from commercial acts (*jure gestionis*) but in all cases a distinction is made in order to determine the scope of sovereign immunity.[11]

One technique for drawing this public–private distinction, which is adopted in this paper, is to examine the character of relevant acts of the State and ask whether they are acts that the State alone, as the juridical sovereign, can carry out. Thus, in *I Congreso*

[8] eg International Law Commission, 'Draft Articles on Responsibility of States for Internationally Wrongful Acts' *Report of the International Law Commission on the Work of Its Fifty-Third Session*, UN GAOR, 56th Sess, Supp No 10, UN Doc A/56/10 (2001) 43, Arts 4 and 5.

[9] R Von Hennigs, 'European Convention on State Immunity and Other International Aspects of Sovereignty Immunity' (2001) 9 Willamette J Intl L & Disp Resolution 185, 186–7.

[10] *Trendtex Trading Corp v Central Bank of Nigeria* [1977] QB 529, 557–8 (CA) [hereinafter *Trendtex*]. GR Delaume, 'Sovereign Immunity and Transnational Arbitration' (1987) 3 Arbitration Intl 28, 28–9.

[11] eg European Convention on State Immunity, 16 May 1972, 74 Euro TS, 11 ILM 470, Art 7(1) (entered into force 11 June 1976); Foreign Sovereign Immunities Act, 28 USC, 847 F Supp 61, s 1605(a) (1976) (US); State Immunity Act 1978, c 33, s 3 (UK).

del Partido, Lord Wilberforce relied on an assessment of the nature of State acts rather than their purpose as a basis for defining the scope of sovereign immunity, supported by this statement from the German Federal Constitutional Court in the *Claim against the Empire of Iran Case*:[12]

> As a means for determining the distinction between acts jure imperii and jure gestionis one should rather refer to the nature of the State transaction or the resulting legal relationships, and not to the motive or purpose of the State activity. It thus depends upon whether the foreign State has acted in exercise of its sovereign authority, that is in public law, or like a private person, that is in private law.

This method of distinguishing public from private is admittedly formalistic in that it makes it imperative to define the uniqueness of the State as an entity. By adopting it here, my aim is not to downplay the various critiques of the distinction between public and private power, or to deny that sovereign acts benefit some individuals and groups more than others, or to suggest that the private acts of State and non-State actors cannot hold great significance for the public at large.[13] Nor is it suggested that every dispute can be credibly classified as public or private or that the formalized distinction drawn here is appropriate in all instances as a method of inquiry.[14] The aim here is more modest. It is to show as clearly as possible that the establishment of international arbitration as an adjudicative mechanism to resolve regulatory disputes between States and private parties is a significant departure from the conventional use of international arbitration in the commercial sphere. As Feldthusen has commented, the value of categories is 'less in their logic than their utility'.[15]

In particular, I apply the public–private distinction to differentiate the use of international arbitration to resolve investor-State disputes under investment treaties (investment treaty arbitration) from its use to resolve investor-State disputes pursuant to investment contracts (international commercial arbitration). The former, it is argued, is a form of public law adjudication; the latter, a reciprocally consensual method of dispute resolution that can be approached generally as private law. I distinguish these two forms of arbitration by examining, in particular, two types of acts that are carried out by the State in any arbitration involving a claim by a private party against the State. These are: (1) the State's *act of consent* to the compulsory jurisdiction of arbitrators as an alternative to the courts; and (2) the State's *act that triggers a dispute* with the party bringing the claim. I argue that, where both of these acts are uniquely sovereign in nature—as is nearly always the case in investment treaty arbitration—the arbitration is best approached as public law. In contrast, where both of these acts of the State could be carried out by a private party, the arbitration is appropriately classified as private law.

[12] *I Congreso del Partido* [1983] 1 AC 244, 267 (HL), citing *Claim against the Empire of Iran* (1963), 45 ILR 57, 80 (Ger Fed Const Ct). See also *Republic of Argentina v Weltover*, 504 US 607, 613–14 (1992).

[13] See Freeman (n 2) 547–9; A Claire Cutler, 'Critical Reflections on the Westphalian Assumptions of International Law and Organization: A Crisis of Legitimacy' (2001) 27 Rev of Int'l Studies 133, 138; D Mullan and A Ceddia, 'The Impact on Public Law of Privatization, Deregulation, Outsourcing, and Downsizing: A Canadian Perspective' (2003) 10 Indiana J Global Legal Studies 199, 245.

[14] C Harlow, '"Public" and "Private" Law: Definition Without Distinction' (1980) 43 MLR 241.

[15] B Feldthusen, 'The Recovery of Pure Economic Loss in Canada: Proximity, Justice, Rationality and Chaos' (1996) 24 Manitoba LJ 1, 2.

This analytical framework is used in this article to demonstrate that the advent of investment treaty arbitration is a major development in both public law and international law, and that its importance would be underestimated were it collapsed into a wider debate about the emergence of transnational law or the commonalities in public and private values.[16] Indeed, the proclivity of some commentators to overlook the uniqueness of the sovereign as a juridical entity[17] tends to mask the importance of this emerging system as a rare expression of public law on the international plane.[18] Of course, with black and white there is always grey. Thus, after presenting the argument in Section III that investment treaty arbitration is a form of public law adjudication, the discussion turns in Section IV to two cases in which the public–private distinction becomes blurred. The first is where a 'stabilization clause' in a contract allows an arbitration tribunal to find that a modification of a State's regulatory regime is a breach of contract; the second, where an 'umbrella clause' in an investment treaty permits a tribunal to characterize a breach of contract by the State as a violation of the treaty. In the case of a stabilization clause, the State consents in a contract to resolve regulatory disputes arising from activity that is clearly sovereign in character; in the case of an umbrella clause, the State's treaty-based (ie sovereign) consent may be read to authorize the arbitration of disputes arising from an alleged breach of contract by the State. In each case, therefore, both of the relevant acts of the State—the act of consent and the act triggering the dispute—do not fall within either the sovereign or the commercial realm of State activity.

B. Juridical Sovereignty and the Adjudication of Regulatory Disputes

Globalization has provoked a great deal of debate about sovereignty. Yet, participants in the debate sometimes refer to the decline of sovereignty without accounting for different meanings of the term.[19] If one speaks of sovereignty only as the power of a State to control the destiny of its people and territory, then sovereignty has no doubt diminished for most if not all States through forces of globalization.[20] But is this anything new? In a society of States, the ability of any one State to effect its will over others, or over non-State actors, will vary over time. On the other hand, if one speaks of sovereignty as a juridical concept then rumours of the end of sovereignty are exaggerated.[21] Globalization has changed how power is distributed among States and the degree to which States can control the activities of individuals and

[16] Teubner (1997) (n 4) 7; D Oliver, *Common Values and the Public–Private Divide* (Butterworths, London, 1999) 1–2.

[17] eg CN Brower, CH Brower II, and JK Sharpe, 'The Coming Crisis in the Global Adjudicative System' (2003) 19 Arbitration Intl 415, 415 (characterizing all investment disputes as commercial disputes).

[18] G Van Harten and M Loughlin, 'Investment Treaty Arbitration as a Species of Global Administrative Law' (2006) 17 EJIL 121, 122.

[19] BR Roland, 'The Access of Individuals to International Trade Dispute Settlement' (1996) 13 J Intl Arb 143, 146 (arguing that '[T]he foremost goal of trade law is to surmount outdated principles of State sovereignty for the sake of individual welfare'); Cutler (n 13) 134–7.

[20] R Jackson, 'Sovereignty in World Politics: a Glance at the Conceptual and Historical Landscape' (1999) 47 Pol Studies 431, 453.

[21] R Palan, 'Trying to Have Your Cake and Eating It: How and Why the State System Has Created Offshore' (1998) 42 Intl Studies Q 625, 630; G Sorensen, 'Sovereignty: Change and Continuity in a Fundamental Institution' (1999) 47 Pol Studies 590, 604.

organizations, but it has not seriously challenged the concept of juridical sovereignty.[22]

In the juridical sense, sovereignty is a conceptual framework for understanding the representative relationship between the State and individuals within its territory, and as such for organizing the public sphere.[23] Sovereignty means that the State is treated as the entity that represents a group of people in relation to each other and in relation to other States. Sovereignty is a matter of authority, not control.[24] As an ideal, sovereignty implies external autonomy and internal control on the part of the State, but neither fully exists in reality. Rather, sovereignty is a means to conceptualize how people are organized into political entities and legal persons. In particular, as the representative of a defined political group, the State has rights and duties that can be exercised only in the State's representative capacity; that is, only on behalf of the political group.[25] So long as there are States endowed with the authority to conclude treaties, pass legislation, impose taxes, define and assign property rights, enforce judgments, assume public debt, and so on, then juridical sovereignty remains essential in the organization of international society and economy.[26]

A particular class of disputes may arise between the State and individuals who are subject to the exercise of public authority by the State. For present purposes, I refer to these disputes as 'regulatory' disputes and distinguish them from other 'public' disputes (ie between States entities or between States themselves) on the ground that they involve a claim made directly against the State by a private party. More importantly, regulatory disputes can also be distinguished from 'private' disputes that arise between individuals acting in a private capacity (although the relationship between those individuals may itself be subject to State regulation).[27] Thus, in international commercial arbitration, a party's consent to arbitrate takes place within the private sphere not because the consent is irrelevant to the public in general but because the disputing parties—acting in a private capacity—have agreed to use a particular method of dispute resolution in disputes arising between themselves.[28] They have agreed, in a manner endorsed by the

[22] I Wallerstein, 'States? Sovereignty?' in DA Smith, DJ Solinger, and SC Topik (eds), *States and Sovereignty in the Global Economy* (Routledge, London, 1999) 23; M Koskenniemi, 'What Is International Law For?' in MD Evans (ed), *International Law* (OUP, Oxford, 2004) 96; Jackson (n 20).

[23] Jackson (n 20) 432; I Brownlie, *Principles of Public International Law* (6th edn, OUP, Oxford, 2003) 119 and 289; M Loughlin, *Public Law and Political Theory* (Clarendon Press, Oxford, 1992) 58 and 93.

[24] C Tollefson, 'Games without Frontiers: Claims and Citizen Submissions under the NAFTA Regime' (2002) 27 Yale J Intl L 141, 144.

[25] WI Jennings, *The Law and the Constitution* (University of London Press, London, 1959) 312; D Cohen and JC Smith, 'Entitlement and the Body Politic: Rethinking Negligence in Public Law' (1986) 64 Canadian Bar Rev 1, 5–6; C Harlow and R Rawlings, *Law and Administration* (Butterworths, London, 1997) 5 and 41–5; Loughlin (n 23) 6, 78, and 82.

[26] eg *Victory Transport* case, 35 ILR 110, US District Court of Appeals (characterizing as exclusively sovereign: internal administrative acts, such as the expulsion of an alien; legislative acts, such as nationalization; acts concerning the armed forces; acts concerning diplomatic activity; and public loans); *Waste Management Inc v United Mexican States* (Merits) (30 Apr 2004), 43 ILM 967, 16(4) World Trade and Arb Mat 3, para 174 ('Any private party can fail to perform its contracts, whereas nationalization and expropriation are inherently governmental acts').

[27] A Chayes, 'The Role of the Judge in Public Law Litigation' (1976) 89 Harv L Rev 1281, 1282–4.

[28] AS Rau, 'Integrity in Private Judging' (1997) 38 South Texas L Rev 455, 486–7; Redfern and Hunter (n 7) 131.

State, to insulate the adjudication of their dispute from the courts and subject it instead to arbitration. In contrast, the submission of governmental decisions to review by a particular adjudicative process is a policy choice by the State to use that method of adjudication as part of the governing apparatus.[29] Public law adjudication is distinct from reciprocally consensual adjudication in the private sphere because the State acts in a sovereign capacity when it consents to the adjudication and because the relevant dispute arises from the exercise of sovereign authority by the State. I discuss this in more detail below.

III. THE ADVENT OF INVESTMENT TREATY ARBITRATION

Contemporary investment treaties establish a novel international adjudicative regime that regulates States in order to protect the assets of foreign investors (typically, multinational firms) from various forms regulation by States in whose territory such assets are located.[30] Through hundreds of treaties concluded from the late 1960s, and above all in the 1990s,[31] investors have been given the ability to bring internationally enforceable damages claims in relation to future disputes arising from sovereign (as opposed to merely commercial) acts of the State, generally without the duty to exhaust local remedies.[32] This is a major reform given that in customary international law individuals had no such right and, to the extent that States historically provide a comparable treaty-based right to individuals, it was limited to disputes arising from a specific historical event such as a war or revolution.[33] Under the contemporary investment treaties, States give arbitrators a comprehensive (or generalized) jurisdiction[34] to resolve individual claims beyond the broad supervisory authority of domestic courts. The advent of investment treaty arbitration is thus unique because it entails a prospective consent by States to the compulsory international arbitration of disputes with investors in the regulatory sphere.

More important for present purposes is that States have incorporated a private model of adjudication—originally designed for the resolution of international commercial disputes—into the procedural design and enforcement structure of investment treaties. As a result, investment treaty arbitration is frequently analogized to international commercial arbitration.[35] The two forms of arbitration are similar in that both

[29] M Damaška, 'Activism in Perspective' (1983) 92 Yale LJ 1189, 1191–2; Loughlin (n 23) 5 and 12.

[30] See UNCTAD, *World Investment Report 2003* (United Nations, New York, 2003) c IV.

[31] Including both bilateral investment treaties and regional agreements that contain provisions on compulsory investment arbitration. See, eg, UNCTAD, *Bilateral Investment Treaties—1959–1999* (United Nations, New York, 2000); North American Free Trade Agreement, 17 Dec 1992, 32 ILM 296 and 605 (entered into force 1 Jan 1994), Arts 1116 and 1117; Energy Charter Treaty, 17 Dec 1994, 35 ILM 509, Art 26.

[32] See Van Harten and Loughlin (n 18).

[33] eg the Alabama Claims Arbitration established after the American Civil War, the Mixed Tribunals and Claims Commissions after the First World War, the Iran–United States Claims Commission after the Islamic revolution in Iran, and the UN Compensation Commission after the Gulf War of 1990–1. See J Collier and V Lowe, *The Settlement of Disputes in International Law* (OUP, Oxford, 1999) chs 1 and 3.

[34] J Paulsson, 'Arbitration without Privity' (1995) 10 ICSID Rev 232, 233, and 240.

[35] eg Mattli (n 3) 945; DF Donovan 'Introduction to Articles—Dallas Workshop on Arbitrating with Sovereigns' (2002) 18 Arbitration Intl 229, 229; GA Alvarez and WW Park, 'The New Face of Investment Arbitration: NAFTA Chapter 11' (2003) 28 Yale J Intl L 365, 393; Brower et al (n 17) 415 and 432–5. See also SJ Toope, *Mixed International Arbitration—Studies in Arbitration*

allow a private party to bring a claim before a tribunal, the members of which are appointed by the disputing parties rather than a public authority.[36] Also, the proceedings are governed by rules originating in private arbitration,[37] and the professional backgrounds of many arbitrators are in the area of commercial law. Further, the main remedy is a damages award that is enforceable under the New York Convention and other instruments of international commercial arbitration.[38] Finally, rules of arbitration and domestic laws typically call for courts to show deference to arbitration awards in order to promote stability and predictability in the use of arbitration in international commerce. Even so, in spite of these commonalities the analogy between investment treaty arbitration and commercial arbitration confuses form with substance. As discussed in the next section, in investment treaty arbitration both the State's consent to arbitration as well as the act of the State that triggers a claim by a private party are predominantly sovereign in nature, whereas in commercial arbitration they are private or commercial.

A. The Sovereign Character of Investment Treaty Arbitration[39]

The authority for international commercial arbitration is private in that it stems from the autonomy of individuals to order their affairs as they wish. Thus, although a State can consent in a contract to the arbitration of disputes that arise from a relationship with another private party, so too can any private individual. Also, like any individual a State can also enter into and breach a commercial agreement with another private party. In both circumstances, the law deems the State to have shed the cloak of sovereignty and descended into the commercial sphere.[40] In the words of Lord Denning in *Trendtex*: 'If a government department goes into the market places of the world and buys boots or cement—as a commercial transaction—that government should be subject to all the rules of the marketplace'.[41] The fundamentally unequal relationship between juridical sovereign and private individual is thus transformed into a relationship in which both parties are capable of possessing the same legal rights and duties. In turn, an arbitration arising from this relationship can be understood as private because its authority derives from the consents of the disputing parties, mutually given in the context of a reciprocal relationship between juridical equals, both acting in a private capacity.

Compare this with the State's participation as juridical sovereign in an international arbitration. Under investment treaties, the authority for the arbitration of claims against

Between States and Private Persons (Grotius Publications, Cambridge, 1990) 389 (noting the tendency to approach investment arbitration 'purely as a subcategory of international commercial arbitration and thus infused with the values of that process').

36 The presiding arbitrator is normally appointed, in the absence of agreement between the disputing parties, by a designated appointing authority.

37 eg ICSID, *Rules of Procedure for Arbitration Proceedings*, rev 26 Sept 1984 and 1 Jan 2003 (original rules 1968), reprinted in *Convention, Regulations and Rules* (ICSID, Washington, 2003) 93; *Arbitration Rules of the United Nations Commission on International Trade Law*, UNGA Res 31/98, UN GAOR, 31st Session, Supp No 17, UN Doc A/31/17, c V, s C (1976); and *Rules of Arbitration of the International Chamber of Commerce*, rev 1 Jan 1998 (original rules 1922), online: International Chamber of Commerce <http://www.iccwbo.org/court/english/arbitration/rules.asp>.

38 New York Convention (n 5).

39 For a more detailed discussion, see Van Harten and Loughlin (n 18) 139–45.

40 eg *Congreso del Partido* (n 12).

41 *Trendtex* (n 10) 558.

the State comes from the agreement of the State parties to the treaty to permit the use of adjudication to resolve disputes arising from their exercise of sovereign authority over each other's nationals.[42] When a State agrees by treaty to the arbitration of investment disputes *in general*, the State acts in a uniquely sovereign capacity. The consent is not limited, as in commercial arbitration, to an existing dispute that is known in advance to the consenting party or to disputes arising from a particular relationship between juridical equals. Rather, the State is unilaterally exposed to claims by a broad class of potential claimants in relation to governmental acts that affect the assets of foreign investors. The disputes that lead to individual claims under investment treaties typically arise from acts that entail the exercise of authority that is unique to the State, such as the passage of legislation, the adoption of mandatory regulations, or the issuance of judicial decisions.[43] The 'general consent' is uniquely sovereign, therefore, because it is a prospective consent to the compulsory arbitration of regulatory disputes with investors as a group.[44]

In light of the general consent, investment treaties give arbitrators a comprehensive jurisdiction to resolve a broad class of disputes arising from sovereign acts of the State, instead of a contract-specific competence to resolve disputes arising from a specific commercial relationship. But this does not itself pose a challenge to juridical sovereignty, however much it may reduce the ability of States to control the activities of multinational firms. By acting on the general consent a tribunal exercises authority that is delegated by States; only the State can grant to an individual the authority to adjudicate a regulatory dispute within its territory.[45] This authority to delegate is inherently sovereign because it stems from the representative status of the State in relation to the population and political group that is associated with its territory.[46] As such, juridical sovereignty remains fundamental to the establishment of any treaty-based adjudicative regime. Further, an arbitrator who is given comprehensive jurisdiction over a claim filed under an investment treaty is as much an official of the State as judges who are appointed for life by a government or directly elected by voters. They are differentiated

[42] Chayes (n 27) 1294–5 and 1302. See also EV Abbot, 'The Police Power and the Right to Compensation' (1889) 3 Harv L Rev 189; LL Fuller, 'Consideration and Form' (1941) 41 Col L Rev 799, 806–8.

[43] eg *SD Myers, Inc v Government of Canada* (Merits) (12 Nov 2000), 40 ILM 1408, 15(1) World Trade and Arb Mat 184 [claim arising out of a legislative prohibition on waste exports]; *CMS Gas Transmission Company v Argentine Republic* (Merits) (12 May 2005), ICSID Case No ARB/01/8, online: Investment Treaty Arbitration <http://ita.law.uvic.ca/documents/CMS_FinalAward.pdf>, para 53–6 [legislative reform of currency system]; *Metalclad Corporation v United Mexican States* (Merits) (30 Aug 2000), 40 ILM 36, 13(1) World Trade and Arb Mat 45 [State Government designation of a park]; *Occidental Exploration and Production Company v Republic of Ecuador* (Merits) (1 July 2004), London Court of International Arbitration Administered Case No UN 3467, online: Investment Treaty Arbitration <http://ita.law.uvic.ca/documents/Oxy-EcuadorFinalAward_001.pdf>, para 32 [administrative denial of value-added tax refunds]; *Loewen Group, Inc and Raymond L Loewen v USA* (Merits) (26 June 2003), 42 ILM 811, 15(5) World Trade and Arb Mat 97 [judicial conduct of a jury trial].

[44] Paulsson (n 34) 256; TW Wälde, 'Investment Arbitration Under the Energy Charter Treaty—From Dispute Settlement to Treaty Implementation' (1996) 12 Arbitration Intl 429, 434–6; A Afilalo, 'Constitutionalization Through the Back Door: A European Perspective on NAFTA's Investment Chapter' (2001) 34 NYU J Intl L & Pol 1, 4.

[45] H-L Yu and L Shore, 'Independence, Impartiality, and Immunity of Arbitrators—US and English Perspectives' (2003) 52 ICLQ 935, 965–6.

[46] AV Dicey, *An Introduction to the Study of the Law of the Constitution* [1885] (8th edn, Macmillan, London, 1915) 4, 18–19, 68–72, and 103.

not by the character of their authority but by the status of their office. Both exercise the ultimate decision-making authority of the juridical sovereign in public law.

B. The Investor's Consent

The discussion thus far has focused on the sovereign character of the State's consent in an investment treaty. However, some commentators look to the investor's consent in order to position investment treaty arbitration within the private sphere.[47] They do so by linking the investor's consent to the treaty consent of the respondent State, in order to establish a classical 'agreement to arbitrate' as understood in commercial arbitration. This conceptual approach is critically analysed here.

When an investor consents to the arbitration of a dispute with a State under a treaty, acting on the 'standing offer' made by the State's general consent, the investor invokes a governing arrangement that was originally established by an agreement between States. The investor's consent is an acceptance of a remedial opportunity provided by States to a particular class of individuals. In particular, the investor seizes an opportunity to seek damages for a State's alleged breach of international standards that regulate States. This opportunity is made available by an inter-State bargain, not a private agreement, and it relates to regulatory rather than commercial disputes. As such, the investor's consent in investment treaty arbitration differs from the consent of a private party in commercial arbitration.

To elaborate, under an investment treaty an investor must choose whether to resort to arbitration only after the relevant dispute has arisen. The investor's consent is retrospective, ie it is specific to disputes arising from the regulatory relationship with a State.[48] Unlike the respondent State, the investor does not commit to the compulsory arbitration of any future dispute with the State, at the instance of the State. Tribunals are not given general jurisdiction to award damages *against investors* for violations of standards that regulate businesses or protect the interests of host States. Generally speaking, it is States that are sanctioned and investors that are compensated.[49] Indeed, for a foreign investor to be sanctioned via compulsory international arbitration in the context of a regulatory dispute would require the consent of the investor's home State, not the investor.[50] In investment treaty arbitration, the investor's consent is always specific, just as the State's consent is always general.

In short, an investor's decision to submit a dispute to investment treaty arbitration is more like the decision of an individual to seek damages against the State under

[47] eg C Schreuer, *The ICSID Convention: A Commentary* (CUP, Cambridge, 2001) 233; Z Douglas, 'The Hybrid Foundations of Investment Treaty Arbitration' (2003) 74 BYIL 151, 221–2 and 237.

[48] The investor's consent is akin to a party's entry into an agreement to arbitrate—or *compromis*—after the dispute has arisen.

[49] This is 'generally speaking' only because some investment treaties allow counter-claims by the respondent State after an investor has made a claim under the treaty although in all cases it is the investor who triggers the use of the system.

[50] Such as in the case of the International Criminal Court whose jurisdiction is limited (but for cases referred to the court by the UN Security Council) to acts of individuals that were committed either within the territory of a State Party or by a national of a State Party: Rome Statute of the International Criminal Court, 17 July 1998, 37 ILM 999 (entered into force 1 July 2002) Art 12(2).

domestic public law than the decision to seek damages against another individual in private law. It is a consent of privilege rather than reciprocal obligation. This does not make the investor's consent insignificant. Depending on the terms of the relevant treaty, the investor's submission of a dispute to treaty arbitration can have important legal ramifications. It may require the investor to relinquish rights under domestic law. But these conditions of access to the system are based not on an agreement made by the investor but on a regime established by States.

IV. GREY AREAS IN THE PUBLIC–PRIVATE DIVIDE

The analysis presented above follows from the principle that some forms of authority are unique to the juridical entity of the State. This principle has informed my examination of the two types of State acts that are relevant to the international arbitration of individual claims against States. But it would be foolhardy to suggest that the distinction between public and private is always clear-cut. In this section, I review two forms of international arbitration which straddle the public–private divide. The first involves the use of contract-based arbitration to resolve regulatory disputes arising from sovereign acts of the State, while the second involves the treaty-based arbitration of contractual disputes arising from commercial acts of the State. Both reveal exceptional aspects of the relationship between international arbitration and the retreat of the State. On the other hand, this discussion should not be taken as an abandonment of the view that investment treaty arbitration is a form of public law adjudication, or that the significance of investment treaties lies in their delegation of the judicial function in public law to private arbitrators.

A. Contract-Based Arbitration of Regulatory Disputes

As discussed earlier, when a State consents by contract to the compulsory international arbitration of disputes arising from a contract, the State acts in a private capacity. This remains the case when a contract between a private party and a State entity—concerning an investment by the private party in the State's territory—contains an arbitration clause. The contract is an investment agreement and the arbitration of disputes arising from the agreement is contract-based investment arbitration, broadly analogous to international commercial arbitration, because the acts of the State giving rise to the dispute as well as the specific nature of the State's consent are both private acts. On this basis, contract-based investment arbitration is distinguishable from public law adjudication.

Yet, some investment contracts put obligations on the State Party to the contract that are clearly binding on the State (and only the State) in its sovereign capacity. This is the case where a contract contains a 'stabilization clause' that purports to obligate the State to maintain, for a long-term period, the regulatory framework that applies to the investment at the time the investment is made.[51] Stabilization clauses have an established history and are widespread in the context of North–South investment flows. Thus, for instance, the exploration and development of oil in Chad, which in 2003 began to pump crude for export through Cameroon, is based on a series of long-term

[51] W Peter, *Arbitration and Renegotiation of International Investment Agreements* (Kluwer Law International, The Hague, 1995) 136–42.

contracts between Chad and an international oil consortium led by Exxon Mobil.[52] Each of these contracts contains a stabilization clause, exemplified by Article 34.3 of the 2004 agreement between Chad and the consortium:[53]

> During the period of validity of this document, the State shall ensure that it shall not apply to the Consortium, without prior agreement of the Parties, any future governmental acts with the duly established effect of aggravating, directly, as a consequence, or due to their application to the shareholders of the Consortium, the obligations and charges imposed by the provisions of this Convention or with the effect of undermining the rights and economic advantages of the Consortium or its shareholders . . . Only the Consortium shall be able to cite this stability clause, which is offered to it to the exclusion of any third party to this Convention . . .

Any of the corporate members of the oil consortium may resort to compulsory arbitration, pursuant to the contract, should it conclude that its rights under the stabilization clause were adversely affected by regulatory reforms adopted by Chad, whether based on new or existing laws.

The stabilization clause thus restricts the policy options available to Chad's Government, and to the people represented by the State of Chad, in relation to the oil project for a substantial period (at least 30 years in this case). The clause does so to safeguard the anticipated returns of the oil consortium, once its initial costs are sunk, from the possibility that a future government might seek to increase the State's share of the revenues generated by the project. On the other hand, such clauses are open to the criticism that the current government—in this case, with advice and financing from the World Bank—sacrificed too much on the altar of economic development. Thus, Amnesty International has campaigned against the stabilization clauses accepted by Chad in this case on the basis that they could frustrate the protection of human rights in the country.[54] And so they could, but only as part of a wider bargain to gain access to the technology, know-how, and other resources of multinational firms.[55] Chad has traded away some of its policy options in exchange for private investment in its oil sector.

The wisdom of Chad's acceptance of these stabilization clauses is an important question, although not for our present purpose. The more narrow concern here is with whether this particular use of international arbitration to constrain the State, based on a contract, is a matter of public or private law. Two questions are pertinent. The first is whether the acts of Chad that are bound by the stabilization clause, whether tied to the protection of human rights or other governmental imperatives, exist *only if* one accepts the principle of juridical sovereignty. The answer, quite clearly, is yes. The clause refers to 'governmental acts'. It applies to the passage of any law or regulation, though general in its application, which detrimentally affects the 'rights and economic advantages' of the private contracting parties. It is one-sided in that it only binds the contracting State. It is a legal mechanism to secure the economic interests of an international combine against the danger posed by the right of a self-governing people to determine their future. Juridical sovereignty in this respect serves as the framework by which the population of a territory can bind itself so as to enhance the security of foreign capital.

[52] See Amnesty International, 'Contracting out of Human Rights: The Chad–Cameroon pipeline project' (London, Sept 2005).
[53] Reproduced in ibid 46, n 67.
[54] ibid 28–33.
[55] Peter (n 51) 11–12.

It provides the conceptual foundation for the contractual constraint of sovereign acts of a State.[56]

This leads to the second question: whether Chad's consent to the compulsory arbitration of disputes arising from such acts, where they affect the rights and interests of members of the oil consortium, is also a sovereign act. Put differently, can a State—acting in a private capacity—constrain its regulatory conduct over the long term by agreeing to a contract and, in particular, to a compulsory arbitration clause? The answer might be no if one concluded that, in principle, the character of any act of consent can be defined only by examining the nature of the acts that are bound by the consent. That is, inherent to a State's consent in a private capacity is the assumption that the State can only bind itself in relation to acts that a private party could carry out. By consenting in a contract to the compulsory arbitration of disputes arising from the contract, therefore, a State acts in a private capacity only to the extent that the relevant disputes themselves arise from private acts of the State. Were the State to bind itself with respect to sovereign conduct, then the consent itself must also be viewed as a sovereign act given that no private party could refrain from amending legislation, introducing new regulations, etc. Based on this line of reasoning, the mere fact that the authority for an arbitration stems from an agreement to arbitrate in a contract, does not itself constitute the arbitration as commercial arbitration. One needs to look more closely at the acts that are purportedly bound in order to ascertain whether the contract-based consent is in fact a commercial act.

This reasoning is attractive in principle, but it poses a practical problem for the facilitation of international commerce between private parties and States. The difficulty is that if States are deemed to be unable to commit, by contract, to refrain from regulatory 'interference' with the rights and interests of private parties, they would be deprived of a legal vehicle for the promotion of their own development, particularly in the resource sector, by entering into long-term concessions with foreign firms. More to the point, international business would face greater risk when entering into transactions with State entities, thus increasing the cost of resource exploitation in much of the world. These considerations have led courts and arbitrators to adopt various mechanisms to enforce contracts that bind sovereign acts of a State party, including the restrictive doctrine of sovereign immunity; the reading of a contractual consent by a State to compulsory arbitration as an implied waiver of immunity; and (ambitiously) the characterization of international arbitration itself as a special adjudicative regime that exists 'beyond' the domestic sphere and is thus exempt from claims of sovereign immunity.[57] What these mechanisms have in common is a tendency to understate the sovereign nature of the State conduct that is bound by a contract-based consent to arbitration. Each also undergirds the use of contract-based arbitration as an international governing arrangement aimed at regulating States (mainly in the developing world) in support of international commerce and the business security of multinational firms.

[56] J McLean, 'Government to State: Globalization, Regulation, and Governments as Legal Persons' (2003) 10 Indiana J Global Legal Stud 173.

[57] See generally RY Jennings, 'State Contracts in International Law' (1961) 37 BYIL 156, 177–8; J-F Lalive, 'Contracts Between a State or a State Agency and a Foreign Company' (1964) 18 ICLQ 987, 1008–11.

Thus, in rejecting pleas of sovereign immunity by States as a bar to the jurisdiction of commercial arbitration tribunals over disputes arising from sovereign acts of the State, Wetter argues:[58]

> Acceptance of the plea would militate against one of the most fundamental notions of the international arbitral process . . . Innumerable, carefully balanced agreements are extant in the entire world to which states and state entities are parties and in which an equilibrium on the procedural level has been achieved principally by the contractual creation of mutually binding arbitration provisions. No international tribunal could deny and render nugatory the existence and effectiveness of the ultimately determinative adjudicatory element of such an immense, complex and important network of financial, trade and investment contracts, created by the desires of states and private parties in response to the needs of international commerce.

This is essentially a policy argument. The claim is that the extensive participation by States in international commerce requires arbitrators to give effect to contract-based consents of States, even where the consent purports to bind the sovereign conduct of the State. It may thus be seen as a decision to bridge the public–private divide in a way that constitutes commercial arbitration as an appendage of an international governing apparatus.

B. The Texaco *Arbitration*

A classic example of this use of contract-based arbitration to bind sovereign acts of the State is the award in the *Texaco* arbitration of 1977,[59] in which the French academic René-Jean Dupuy ordered Libya to perform specifically its obligations under a 50-year oil concession agreement dating from 1955, based on this stabilization clause:

> The Government of Libya will take all steps necessary to ensure that the company enjoys all the rights conferred by this concession. The contractual rights expressly created by this concession shall not be altered except by mutual consent of the parties.
>
> This Concession shall throughout the period of its validity be construed in accordance with the Petroleum Law and the Regulations in force on the date of execution of the agreement of amendment by which this paragraph (2) was incorporated into the concession agreement. Any amendment to or repeal of such Regulations shall not affect the contractual rights of the Company without its consent.

Following Colonel Qadhafi's overthrow of Libya's Western-backed monarchy in 1969, Libya adopted a more aggressive bargaining stance toward foreign oil companies.[60] By 1973–74, this led to the enactment of decrees nationalizing the rights, interests and property of Texaco Overseas Petroleum and the California Asiatic Oil Company as granted under the oil concession of 1955. Based on the dispute settlement provisions of the concession agreement, the oil companies resorted to international arbitration, in which the Qadhafi Government refused to participate. Proceeding under the contract, the President of the International Court of Justice appointed Mr Dupuy as sole arbitrator. In the course of interpreting the concession agreement, Dupuy examined the applicability of its stabilization clause to Libya's acts of nationalization:[61]

[58] JG Wetter, 'Pleas of Sovereign Immunity and Act of Sovereignty before International Arbitral Tribunals' (1985) 2 J Intl Arbitration 7, 14–15.

[59] *Texaco Overseas Petroleum Co & California Asiatic Oil Co v Government of the Libyan Arab Republic* (Merits) (19 Jan 1977), 17 ILM 4 [hereinafter *Texaco*].

[60] R First, *Libya—The Elusive Revolution* (Penguin, Harmondsworth, 1974) c 10.

[61] *Texaco* (n 59) paras 70–1.

> The Deeds of Concession entered into by the parties do not include any provision by which the Libyan Government limited its recourse to nationalization. However, Clause 16 of the Deeds of Concession contains a stabilization clause with respect to the rights of the concession holder . . .
>
> Such a provision, the effect of which is to stabilize the position of the contracting party, does not, in principle, impair the sovereignty of the Libyan State. Not only has the Libyan State freely undertaken commitments but also the fact that this clause stabilizes the petroleum legislation and regulations as of the date of the execution of the agreement does not affect in principle the legislative and regulatory sovereignty of Libya. Libya reserves all its prerogatives to issue laws and regulations in the field of petroleum activities in respect of national or foreign persons with which it has not undertaken such a commitment. Clause 16 only makes such acts invalid as far as contracting parties are concerned—with respect to whom this commitment has been undertaken—during the period of applicability of the Deeds of Concession.

As such, it was concluded that an earlier Libyan government could validly undertake contractual obligations that bound sovereign acts of Libya for the long term, including in particular the acts of nationalization taken by the post-revolutionary government. In addition, Dupuy took the additional step of justifying the imposition of this contract-based constraint on Libya's sovereign conduct by characterizing the concessionary agreement as an 'internationalized' agreement, ie as a special type of contract that is separated from the domestic law of any State.[62] He concluded:[63]

> Thus, in respect of the international law of contracts, a nationalization cannot prevail over an internationalized contract, containing stabilization clauses, entered into between a State and foreign private company. The situation could be different only if one were to conclude that the exercise by a State of its right to nationalize places that State on a level outside of and superior to the contract and also to the international legal order itself, and constitutes an 'act of government' which is beyond the scope of any judicial redress or any criticism.

Dupuy's interpretation of the contract can be summarized in this way: the long-term concession entered into by Libya, because it contained both a stabilization clause and an arbitration clause, was an internationalized agreement that authorized arbitrators to rule on the legality of Libya's nationalization, regardless of its domestic law. Based on this finding, Dupuy ordered specific performance by Libya in favour of the oil companies, which later settled for monetary compensation.

Dupuy's decision was no doubt motivated by the same considerations that underlie the stabilization clauses entered into by Chad; that is, it puts aside sovereign prerogatives in order to facilitate the State's participation in international commerce and, in particular, to provide a stable legal framework for international business. One can apply various criticisms to this justification, in addition to the human rights critique of Amnesty International. For example, the policy only follows from the assumption of a capitalist global economy in which capital flows are organized, technology transferred,

[62] R Lillich, 'The Law Governing Disputes Under Economic Development Agreements: Reexamining the Concept of "Internationalization"' in R Lillich and CN Brower (eds), *International Arbitration in the 21st Century* (Transnational Publishers, New York, 1994) 68–9. For a contrary view see, eg, Bowett, 'State Contracts With Aliens' (1988) 59 BYIL 49.

[63] *Texaco* (n 59) para 73. See also *AGIP SpA v People's Republic of Congo* (Merits) (30 Nov 1979) 1 ICSID Rep 306, 21 ILM 726, para 85 ('The unilaterally-decided dissolution which took place under Order No 6/75 represented a repudiation of these stability clauses, whose application results not from the automatic play of the sovereignty of the contracting State but from the common will of the parties expressed at the level of international juridical order').

and markets opened up mainly by profit-based decision-making in a small number of private firms based, for the most part, in industrialized countries.[64] From this perspective, contractual constraints on sovereign decision-making operate as a mechanism to control nationalist or socialist challenges from the periphery. Alternatively, as argued by Asante and Sornarajah, long-term concessions that impact on fundamental aspects of a State's economy could be characterized as public law instruments.[65] From this point of view, the economic uncertainty underlying such long-term contracts means that a degree of conflict between investor and government is bound to arise, and that it should be managed by structured renegotiation rather than private law adjudication. Rejecting this approach to State contracts in *Texaco*,[66] Dupuy prioritized the binding nature of a State's contractual obligations over the special considerations that flow from the uniqueness of the State as juridical entity.[67]

Even so, the impact of the *Texaco* award on Libya's freedom of governmental action does not in itself amount to a full-scale retreat of the State because the framework of juridical sovereignty remains intact. If one restricts the meaning of sovereignty to that of formal status rather than actual power, then Dupuy's interpretation of the stabilization clause, as he noted, 'does not affect in principle the legislative and regulatory sovereignty of Libya'. Closer to the mark for our purposes is Dupuy's construction of an 'international legal order' based on the theory of internationalized contracts. In the case of either finding, to maintain the reciprocity of the private law relationship the underlying theory of the decision either equates the juridical position of the sovereign to that of a private party, or it elevates private firms to a formal sovereign status alongside the State.[68] Neither is very satisfying in its definition of the public sphere based on the uniqueness of the State. But this is not the key issue. The crucial significance of *Texaco*—and other arbitrations involving the interpretation of stabilization clauses—is not so much how the grey area between public and private is resolved but by whom. The definition by arbitrators of the uniqueness of the State in these cases supports *in relation to matters of public law* the wider claim that international arbitration is part of a legal order in which private actors formulate bodies of law without direct supervision by the State.

Yet, regardless of whether the priorities of the global market require the use of international commercial arbitration (rather than courts) to control juridical sovereigns, there is an important mitigating factor in contract-based arbitration that is absent from treaty arbitration in relation to any retreat of the State from the field of

[64] Y Ghai, 'Management Contracts' in Y Ghai, R Luckham, and F Snyder (eds), *The Political Economy of Law* (OUP, Dehli, 1987) 389–98.

[65] SKB Asante, 'Stability or Contractual Relations in the Transnational Investment Process' (1979) 28 ICLQ 401, 403–4; M Sornarajah, *The Settlement of Foreign Investment Disputes* (Kluwer, Boston, 2001). See also UNCTAD, *State Contracts*, UNCTAD Series on Issues in International Investment Agreements (United Nations, New York, 2004) 3–5.

[66] *Texaco* (n 59) paras 54–7.

[67] Such as the principle that one elected government may not bind another, so as to maintain the ability of the sovereign 'to change its policies in order to reflect the will of the people (particularly after a change of government) or to reflect new circumstances (such as evidence of a new risk to public health)': ACL Davies, 'Ultra Vires Problems in Government Contracts' (2006) 122 LQR 98, 105.

[68] N Nassar, 'Internationalization of State Contracts: ICSID, The Last Citadel' (1997) 14 J Intl Arbitration 185, 192; AFM Maniruzzaman, 'State Contracts in Contemporary International Law: Monist versus Dualist Controversies' (2001) 12 EJIL 309, 315.

adjudication. This is the specificity of the State's consent. As noted, in commercial arbitration, the State decides to submit to the authority of arbitrators in the context of a particular transaction or relationship with a private party. The consent is not generalized to a broad class of individuals who are affected by regulatory acts of the State. This limits the scope of contract-based arbitration and the degree to which it impinges on sovereign discretion, relative to a treaty-based consent that encompasses the full range of the State's regulatory relations with investors as a group. Thus, while international commercial arbitration may engage regulatory disputes, it is less firmly entrenched in the public sphere than its investment treaty counterpart.

C. Investment Treaty Arbitration of Contractual Disputes

The view that investment treaty arbitration is a form of public law adjudication was outlined above. In this section, the discussion focuses on a particular class of disputes that come before tribunals established under investment treaties and that complicate the characterization of investment treaty arbitration as public law. This challenge arises, in particular, where investment treaties authorize the compulsory arbitration of disputes arising from an alleged breach of contract by the State.

It is important to emphasize that most contract-related claims submitted to investment treaty arbitration remain quite clearly a matter of public law. The mere fact that an investment treaty tribunal rules on a dispute that originates in a contract between an investor and a State entity does not alter the public character of the arbitration. This is because the obligations by which States are bound under the treaties, in their treatment of investors, are intertwined with the sovereign authority of the State. Further, the acts of the State that trigger such disputes are sovereign acts. Thus, a treaty may bind the State as the sovereign in relation to contracts that it has entered into as a private party.

In most treaty arbitrations relating to a contract, the categories of sovereign and commercial are relatively easy to make out. This is illustrated by the *Wena Hotels* arbitration.[69] In that case, the tribunal concluded that the conduct of an Egyptian State company (EHC: the Egyptian Hotels Company) that had entered into a hotel lease with a foreign company—and the delayed and inadequate response of the Egyptian authorities to that conduct—amounted to a violation of a bilateral investment treaty between Egypt and the investor's home State, the UK. As the tribunal found, in the course of a disagreement between EHC and the investor, EHC encouraged and took part in the seizure of the investor's hotels. Buildings and furniture were ruined; agents and employees of the investor were roughed up. In response, the Egyptian authorities neglected to compel EHC to return the hotel property and compensate the investor for its losses. This, the tribunal concluded, violated Egypt's obligations under the treaty, including its duties to ensure fair and equitable treatment, as well as full protection and security, for investors. On this basis, Egypt was ordered to pay (US) $20 million in damages.

The key here is that, although the dispute originated in a contract, this arbitration revolved around matters of public law. It is true that the Egyptian State, via EHC, may be seen to have acted in a private capacity when it entered into a hotel lease with the

[69] *Wena Hotels Ltd v Egypt* (Merits) (8 Dec 2000), 41 ILM 896 [hereinafter *Wena Hotels*]. See also *Compañía de Aguas del Aconquija SA & Vivendi Universal v Argentine Republic* (Annulment) (3 July 2002), 6 ICSID Rep 340, paras 95–6.

investor. But the liability of Egypt itself arose not from the acts of EHC per se but from the failure of the Egyptian authorities to protect the investor from abuse. According to the tribunal:[70]

> there is substantial evidence that Egypt was aware of EHC's intentions to seize the hotels and took no actions to prevent EHC from doing so. Moreover, once the seizures occurred, both the police and the Ministry of Tourism took no immediate action to restore the hotels promptly to Wena's control. Finally, Egypt never imposed substantial sanctions on EHC or its senior officials, suggesting Egypt's approval of EHC's actions.

The duties of Egypt to protect private property, and to condemn and punish the perpetrators of harm to private individuals, are sovereign duties flowing from the State's monopoly over the lawful use of force to maintain order. In the same vein, the treaty obligations of a State to refrain from adopting regulatory measures that discriminate against foreign investors, or to pay compensation for an expropriation of assets, are quintessentially sovereign. In *Wena Hotels*, the terms of the contract between EHC and the investor were a vital factual element in the dispute. But Egypt's consent to arbitrate remained a sovereign act just as Egypt's failure to adequately protect the investor in its dispute with ECH followed from Egypt's unique status as the sovereign.

That said, there is a distinct class of investment treaty arbitrations in which the dispute itself arises directly from an alleged breach of contract by the State. They involve claims by investors pursuant to 'umbrella clauses' contained in investment treaties.[71] Many investment treaties contain such clauses, which typically provide for the States Parties to 'respect' or 'observe' or 'abide by' all of their obligations and commitments to foreign investors.[72] A broad reading of such clauses is that they establish a general, overarching guarantee on the part of the State to any foreign investor that has entered into a specific agreement with the State. On this interpretation, an umbrella clause transforms a breach of contract by the State into an outright violation of the treaty.[73]

Umbrella clauses put investment treaties into a potentially precarious position relative to domestic legal orders because they provide an additional avenue by which private parties can seek redress for alleged breaches of contract by a State. Since the umbrella clause is subject to dispute settlement under the treaty it may enable an investor to bring a treaty claim alongside the causes of action available under the contract. A treaty claim based on an umbrella clause may supplement contractual (or other domestic) remedies. Besides certain complications that this creates for investment treaty provisions regarding the customary duty of foreign nationals to exhaust local remedies before bringing an international claim, umbrella clauses introduce a grey area in the classification of arbitration as public law. That is, is investment treaty arbitration really a form of public law adjudication, one may ask, where the dispute has arisen from an alleged breach of contract by the State but the State's consent to arbitrate is contained in a treaty? Or does the fact that the dispute originates in a commercial act of the State make this category of treaty arbitration a matter of private law?

[70] *Wena Hotels*, ibid para 84.

[71] UNCTAD (n 65) 19–23.

[72] AC Sinclair, 'The Origins of the Umbrella Clause in the International Law of Investment Protection' (2004) 20 Arbitration Intl 411, 412–13.

[73] J Karl, 'The Promotion and Protection of German Foreign Investment Abroad' (1996) 11 ICSID Rev—FILJ 1, 23; C Schreuer, 'Travelling the BIT route: of waiting periods, umbrella clauses and forks in the road' (2004) 5 J World Investment and Trade 231, 250; FO Vicuña, 'Of Contracts and Treaties in the Global Market' (2004) 8 Max Planck Ybk UN Law 341.

D. The SGS *Arbitrations*

These questions were relevant to two arbitrations against Pakistan and the Philippines, respectively, under separate investment treaties, initiated by the same Swiss investor, Société Générale de Surveillance SA (SGS).[74] In both cases, the State's treaty-based consent to the jurisdiction of the tribunal and to the umbrella clause in the treaty was a sovereign act, while the act triggering the dispute was an alleged breach of contract by the State, ie a commercial act.

In *SGS v Pakistan*, SGS claimed that Pakistan had violated an umbrella clause in its bilateral investment treaty with Switzerland, which obliged Pakistan to 'constantly guarantee the observance' of its commitments to Swiss investors. SGS had concluded a contract with the Government of Pakistan to provide pre-inspection services for customs control. The contractual relationship broke down, prompting an (unsuccessful) action by SGS in the Swiss courts, and the initiation by Pakistan of arbitration in Pakistan in accordance with the dispute settlement clause of the contract. SGS countered with an international claim of breach of contract pursuant to the treaty's umbrella clause. After assessing the claim, the tribunal in *SGS v Pakistan* declined to assert jurisdiction, finding that the wording of the umbrella clause was not sufficiently clear and specific to convert Pakistan's contractual duties into treaty obligations.[75] As discussed below, this reading effectively limited the potential encroachment of treaty arbitration into the private sphere of contractual disputes out of respect for the integrity of the domestic legal order.[76]

We may compare this to the arbitration in *SGS v Philippines*, in which another tribunal reached a very different conclusion as to whether umbrella clauses can found the jurisdiction of a treaty tribunal over investor claims of breach of contract by the State. In this case, SGS had entered into a contract with the Government of the Philippines for the provision of import supervision services. SGS claimed inter alia that the Philippines breached the contract and filed a claim under a Swiss–Philippines investment treaty. The treaty contained an umbrella clause that required the Philippines 'to observe any obligation' it assumed with respect to investments of Swiss investors within its territory. The tribunal took note of, and rejected in strong language, the reasoning of the award in *SGS v Pakistan*, stating that the earlier tribunal had 'failed to give any clear meaning to the "umbrella clause" ' in the Swiss–Pakistan treaty. The *SGS v Philippines* tribunal then concluded that the applicable umbrella clause made it a violation of the treaty for the Philippines to breach a binding contractual commitment to a Swiss investor. On this basis, the tribunal assumed jurisdiction over SGS's claims of breach of contract by the Philippines, although it declined to exercise that jurisdiction until after

[74] *SGS Société Générale de Surveillance v Pakistan* (Jurisdiction) (6 Aug 2003), 18 ICSID Rev 307, 16(2) World Trade and Arb Mat 167 [hereinafter *SGS v Pakistan*]; *SGS Société Générale de Surveillance v Philippines* (Jurisdiction) (29 Jan 2004), 16 World Trade and Arb Mat 91 [hereinafter *SGS v Philippines*]. See SD Franck, 'The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions' (2005) 73 Fordham L Rev 1521, 1569–74; T-H Cheng, 'Power, Authority and International Investment Law' (2005) 20 Am U Intl L Rev 465, 473–4.

[75] *SGS v Pakistan*, ibid para 171.

[76] Although the tribunal also reserved the possibility that a contractual breach by the State could violate the umbrella clause in exceptional circumstances, such as where the State impeded the ability of an investor to prosecute its claims before an international arbitration tribunal, having previously agreed to such arbitration in a contract with the investor: ibid para 172.

claims made by the contracting parties—pursuant to the dispute settlement mechanism of the contract—were themselves resolved.

There are various explanations for why these two tribunals arrived at different conclusions, most of which are not directly relevant to the public–private dimension at the heart of this paper. For one, the wording of the respective umbrella clauses was different. In *SGS v Pakistan*, the States Parties were obliged to 'constantly guarantee the observance of commitments', whereas in *SGS v Philippines* each was required to 'observe any obligation it has assumed'. The latter phrase, as noted by the *SGS v Philippines* tribunal, is a bit more categorical.[77] On the other hand, both clauses also raise the possibility that the State's general consent to treaty arbitration encapsulated a consent to arbitrate disputes arising from breach of contract by the State.

More important for the present inquiry are divergences in the tribunals' characterization of the purpose of investment treaties. In *SGS v Pakistan*, the tribunal expressed its aim to avoid a clash between what it regarded as distinct bodies of law; that is, between treaty and contract. The tribunal reasoned that umbrella clauses 'should be read in such a way as to enhance mutuality and balance of benefits in the inter-relation of different agreements located in differing legal orders'. The danger, for the tribunal, was that an expansive reading of the umbrella clause 'would amount to incorporating by reference an unlimited number of State commitments including unilateral commitments to an investor of the other Contracting Party . . .'.[78] In showing restraint in this fashion, the tribunal drew on a distinction between the domestic and international sphere. However, given the facts, its rationale also differentiated sovereign acts from private acts of the State. In doing so, the tribunal indirectly preserved the integrity of treaty arbitration as a 'public law' adjudicative system by limiting the ability of investors to bring treaty claims based on breach of contract. The umbrella clause, in effect, simply did not permit tribunals to rule on commercial acts of the State.

These concerns were rejected in *SGS v Philippines*, where the tribunal roundly dismissed the apprehension that a broad interpretation of an umbrella clause entailed the 'full-scale internationalisation of domestic contracts'.[79] Instead, the tribunal distinguished the issues of the *scope and content* of a State's contractual obligations from the *performance* of those obligations, once ascertained. The issue of performance was found to be subject to treaty arbitration, while the former issues were not. Thus, the umbrella clause allowed the tribunal to rule on a claim that the Philippines had not performed its contractual obligations, although the scope and content of those obligations remained subject to the contract. This prompted the tribunal to refrain from ruling on the treaty claim until the applicable contractual remedies ran their course. In this case, the contract provided that its provisions were governed 'in all respects' by the laws of the Philippines, and that any disputes under the contract were to be filed in the courts of the Philippines.[80]

Whether this distinction between the scope and the performance of an obligation ultimately addresses the concerns of the *SGS v Pakistan* tribunal is difficult to say in

[77] ibid para 119.
[78] ibid para 168. The tribunal also found that a broad reading would make superfluous the other substantive obligations of the States Parties, that the language of the umbrella clause did not expressly refer to 'contractual' commitments, and that the location of the umbrella clause in the treaty text indicated that it was not meant to be a substantive obligation: paras 168–9.
[79] *SGS v Philippines* (n 74) para 126.
[80] ibid para 22.

the absence of an award on the merits in *SGS v Philippines*. Of primary interest here is that it is not possible to limit issues of a State's performance of a contract to the public realm in light of the uniqueness of juridical sovereign. Any private party is capable of 'performing' a contract. As such, the approach in *SGS v Philippines* constitutes treaty arbitration more clearly as a form of adjudication in the private sphere, by allowing an investor's claim of breach of contract to proceed against the State. In contrast, in *SGS v Pakistan*, the tribunal rejected this outcome in order to maintain the autonomies of the worlds of treaty and contract.

A practical difficulty with reading umbrella clauses to allow the treaty arbitration of private law claims against the State is that umbrella clauses may require States to abide by contractual commitments regardless of the agreed choice of forum, as determined by the contract itself. This returns us to the question of whether an umbrella clause, given its generality, simply aggregates and internationalizes the contractual duties of the State. If so, then a breach of the umbrella clause surely depends on an interpretation of *all* of the terms and conditions of the contract, including its provisions on dispute settlement. As intimated by the *SGS v Philippines* tribunal, how can a State fail to perform a contractual commitment, and violate an umbrella clause, unless the investor had already impugned the State by successfully bringing a claim under the dispute settlement mechanism of the contract? To permit investor claims to proceed based on an umbrella clause in the treaty, independent of previously agreed dispute settlement provisions in the contract, fails to interpret the commitments of the State based on the contract as a whole. It is a selective approach to the incorporation of disputes arising from commercial acts of the State into the realm of treaty arbitration.

This leads us to the underlying public–private concern with respect to an interpretation of umbrella clauses that allows treaty-based arbitration of private law claims against the State. With an umbrella clause in a treaty, the State's consent is not limited to a single relationship or transaction with another private party. Rather, it extends in principle to any claim by an investor of alleged breach of contract by the State. The generality of the State's consent may indeed suffice to constitute an adjudication based on that consent as public law in light of the intimate connection between the consent itself and the uniqueness of the State as a representative entity. That is, it is difficult to conceive of a private party giving consent to abide by all of its commitments with respect to other private parties within its jurisdiction in the manner of a State.

This application of the public–private distinction does not mean that an umbrella clause should be read as imposing no obligation whatsoever on the State. It means simply that an obligation assumed in an investment treaty should be read in light of the generality of the State's commitment. One might, for instance, interpret umbrella clauses as imposing obligations which are distinguishable as *sovereign* duties from the contractual obligations to which they relate, as well as from other sovereign obligations under the treaty (ie to ensure full protection and security or to refrain from expropriation without compensation). On this reading, a breach of contract by the State would violate the treaty only to the extent that the State's compliance with the contract flowed from a duty of the State that could not attach to any private party. This would extend the scope of investment treaty arbitration into the realm of contract-based adjudication, but only to the extent that commercial arbitration is itself used to resolve regulatory disputes, as in the case of a stabilization clause in a contract.[81] Thus, the range of

[81] See UNCTAD (n 65) 27–31.

disputes that would be arbitrable under an umbrella clause would broadly coincide with the State's capability to use international commercial arbitration as a governing arrangement in itself. The main difference between the two would continue to be the degree of specificity of the State's consent to abide by its 'public law' obligations, as governed by the contract. But, by limiting the encroachment of treaty arbitration on the private sphere, its integrity as public law adjudication would be preserved, with a corresponding limit on the generalized liability of States for commercial acts.

Of course, there are other interpretive options; one need not equate the duties imposed by umbrella clauses to contractual obligations that are themselves sovereign in character. The idea is to interpret a treaty obligation of a State to abide by its contractual commitments in light of the wide-ranging nature of such an obligation. Another way to do so is to interpret umbrella clauses as simply imposing an obligation of sovereign non-interference with the resort by investors to the dispute settlement mechanisms of their contracts with the State.[82] On this basis, the obligation would link the duty of States to refrain from denying justice to foreign nationals to the terms of specifically agreed dispute settlement provisions. Alternatively, establishing a breach of the treaty obligation by the State might require evidence of malicious interference with a specific contract by the State, or intentional breach of statutory or prerogative powers, consistent with elements of the common law tort of misfeasance in a public office.[83] In either case, the obligations imposed by umbrella clauses are conceived of in terms of a regulatory duty of the State to observe its obligations in general, rather than an all-encompassing obligation to respect every single commitment entered into by the State in a private capacity. The duty of States is to refrain from 'using their sovereign powers to escape from contractual commitments'.[84]

V. CONCLUSION

The rise of international arbitration in the resolution of individual claims against States does not alter the fact that adjudication goes to the core of juridical sovereignty. For the same reason, though, the claim that the rise of international *commercial* arbitration signals a retreat of the State from its classical role in relation to adjudication is exaggerated. Where the courts' endorsement of arbitration is limited to commercial disputes between private parties, even if one party happens to be a State entity, the State nevertheless retains its control over the recognition of party autonomy and of the right of individuals to eschew the courts in favour of arbitration. An exception arises in international commercial arbitration when the State agrees to contractual provisions that purport to bind the State in a sovereign capacity. In particular, the interpretation of stabilization clauses permits arbitrators to resolve the conundrum of how a private act of the State can operate to bind sovereign conduct, and thus to delineate the legal scope of the public sphere.

Even so, the State retains significant control over the delegation of this public law competence to arbitrators by the State's consideration of whether to enter into specific contracts with foreign firms. Investment treaties alter this dynamic. As I have argued,

[82] As suggested in *SGS v Pakistan* (n 74).

[83] PW Hogg and PJ Monahan, *Liability of the Crown* (3rd edn, Carswell, Toronto, 2000) 143–4.

[84] UNCTAD (n 65) 35, n 15.

investment treaty arbitration is a type of public law adjudication, both because it is established by a sovereign act of the State and because it is used to resolve regulatory disputes. Thus, the rulings of arbitrators pursuant to investment treaties are unlike conventional awards issued in the arbitration of disputes between juridical equals. They involve governmental choices that are akin to the judicial determination of individual property and economic rights in domestic public law. To reduce investment treaty arbitration to a category of international commercial arbitration is to understate its transformative impact.

The importance of the public–private distinction in international arbitration is not what it tells us about sovereignty in general, but what it reveals about the role played by arbitrators in interpreting questions of public law that were previously determined by the courts. The lesson of *Texaco* is that an arbitrator may interpret a stabilization clause in a contract broadly so as to constitute arbitration as a method of government. Likewise, the *SGS* arbitrations show that arbitrators may read umbrella clauses in an investment treaty in a manner that converts a contractual breach by the State into an international wrong. The former extends the reach of private law adjudication into the public sphere; the latter does essentially the opposite. In both cases, though, the end result is the same: arbitrators exercise the authority to expand their competence over individual claims against the State, in the foggy borderland between the worlds of public and private. The tension and uncertainty generated by the public–private distinction is nothing new in adjudication.[85] What is exceptional is that private contractors rather than tenured judges are left to manage the legal construction of the public sphere, without rigorous supervision by courts. The ultimate authority to determine what juridical sovereignty means is itself privatized.

Under investment treaties, as noted, States delegate to arbitrators a *comprehensive* jurisdiction over individual claims against the State, thus relinquishing the ability of the State to limit the use of arbitration in public law to specific contracts and legal relationships. For this reason, the retreat of the State from classical adjudication is more decisive and wide-ranging in the case of investment treaty arbitration than in international commercial arbitration. With the former, States have delegated comprehensive jurisdiction over public law to a small group of legal service providers who operate in an international market for private adjudication.[86] The appropriateness of this development has not been the focus of this article. Yet, it is important to note that the security of tenure of judges is a key pillar of their independence from both executive government and wealthy litigants. Further, because in international treaty arbitration it is exclusively private parties who bring the claims and who activate the system as an alternative to the courts, *all* arbitrators may be seen to have a commercial interest in expanding the scope and remedial power of the system so that arbitration may thrive as a business. More than anything, then, the significance of international arbitration in the retreat of the State is its institutional entrenchment of an uncomfortable union between adjudication-as-business and public law.

GUS VAN HARTEN*

[85] See C Harlow, *State Liability—Tort Law and Beyond* (OUP, Oxford, 2004) 31.

[86] Y Dezaley, 'Between the State, Law, and the Market: The Social and Professional Stakes in the Construction and Definition of a Regulatory Arena' in WW Bratton et al (eds), *International Regulatory Competition and Coordination* (Clarendon Press, Oxford, 1996) 84–6; Rau (n 28) 455, 488, 496–7 and 521.

* Law Department, London School of Economics.