Salvaging The Investor-State Arbitration System's Legitimacy

By **Phillip Euell** (May 16, 2024)

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Within the world of investor-state arbitration, it has become widely acknowledged that the very investor-state dispute settlement, or ISDS, system is vulnerable to a crisis of legitimacy. Recent developments in both Europe and Ecuador highlight the evolving landscape of international investment treaties and their implications for ISDS.

On March 1, the European Commission proposed a coordinated withdrawal from the Energy Charter Treaty, citing its incompatibility with the European Union's climate ambitions under the European Green Deal and the Paris Agreement, and reflecting broader concerns about the treaty's impact on the ability to regulate energy transitions and the high number of disputes it has engendered.

Meanwhile, Ecuador has been actively revisiting its own approach to investor-state disputes, seeking to balance investor protections with the state's right to regulate and pursue sustainable development, culminating in a referendum on April 21 ruling out a return to ISDS or "corporate courts" as the tribunals have come to be known.

If this crisis of legitimacy is not addressed soon, it may portend the end of an international dispute settlement framework that — in its inception — offered a valuable mechanism whereby the unifying goals of peace, security and abundance could be achieved on a global scale by aiding the various stakeholders in their pursuit of investment opportunity for profit on the one hand, and development of under-capitalized national economies on the other.

A solution to the ISDS crisis may be found, however, through the use of a well-known but little-understood equitable legal doctrine of Roman law known as ex aequo et bono, or EAEB.

Contemporary Understanding

In international arbitration, "ex aequo et bono" or "according to the right and good" refers to the power of arbitrators to dispense with consideration of the law, and rely instead on considerations of fairness and equity as applied to the dispute before them.

EAEB decision making is formally permitted under public international law, and it is theoretically unlimited so long as the parties consent. Article 38 of the Statute of the International Court of Justice entitles the court to decide cases EAEB, although the court is not empowered to invoke the doctrine independently.[1]

Likewise, the choice of law provision embodied in Article 33 of the United Nations Commission on International Trade Law's Arbitration Rules provides that arbitrators may apply EAEB only if they are authorized to do so by the parties' arbitral agreement.[2] This party consent rule as a precondition to adjudication by means of EAEB has similarly been adopted in many national and subnational arbitration laws.[3]

De Jure and De Facto Utilization

Turning to the implementation of EAEB in ISDS disputes, both de facto and de jure, on only one occasion has an International Centre for Settlement of Investment Disputes, or ICSID, tribunal had the opportunity to render de jure its decisions using EAEB.

That 1980 case, S.A.R.L. Benvenuti & Bonfant v. People's Republic of the Congo, involved Italian investment in the Republic of the Congo.[4] Because of acute political instability in the Republic of the Congo at the time, during the arbitration proceedings both parties directed the tribunal to render an award as quickly as possible by a decision using EAEB.[5]

The tribunal applied ICSID Article 42(3) and proceeded to hold in favor of the Italian investors; however, the decision was affected by the use of EAEB decision making solely with respect to its conclusion on liability.[6]

The tribunal ultimately restrained itself from an intemperate course, and elected to award the investors for their loss on the basis of the book value of their bottling plants when a lost-profits award assessment would not have been precluded.[7]

From this result, we may infer that, empowered with the equitable powers of EAEB, ICSID tribunals may reach their decisions in a manner consistent with principles that would favor an interpretation EAEB as analogous to natural law — namely, deciding in a manner that supersedes the narrow interests of the disputing parties for the benefit of a greater good.

Next, we consider a line of Argentine ISDS cases wherein EAEB decision making was likely employed despite the lack of express party consent. These ICSID arbitral tribunals had little choice but to decide fair-and-equitable-treatment clause disputes based on equity and fairness — thus frequently relying on an EAEB decision-making approach.[8]

In a number of these resolutions, the formalistic distinction between equity and EAEB was clearly disregarded, whereby the tribunals eschewed formalistic contractual and treaty restraints and opted for EAEB on the basis of reasonableness and proportionality.[9]

Thus, in following and embracing these restrained and considered ISDS precedents, we are calling for a more permissive attitude when considering the use of EAEB — even where party consent is not expressly given.

Natural Law and Legitimacy

In addition to the above-mentioned ICSID disputes, wherein EAEB was invoked on the basis of either party consent or through fair-and-equitable-treatment clauses, there is an alternate and perhaps more persuasive foundation for using EAEB in investor-state dispute settlement: natural law, as it has existed in the civil law traditions on the continent of Europe, as well as in the common law of England.

The most prominent among contemporary proponents of natural law, or the classical legal tradition, is constitutional scholar Adrian Vermeule. Through the application of these ancient principles, Vermeule promises to expand and fulfill commitments to promote general welfare and human dignity.[10]

In developing his "common good constitutionalism" doctrine, Vermeule draws inspiration from the early modern European theory of ragion di stato, or "reason of state," which elaborates a set of principles for the just exercise of authority — including peace, justice and abundance, as well as health, safety and economic security,[11] positing that, historically, every act of public-regarding government has been founded on such a

vision.[12]

Accordingly, in Vermeule's vision, law ought not be constrained to particular written instruments of civil law or legislative will, but instead must embody rational determinations of the common good, and it is those determinations, including the natural law background against which they are made, that constitute the law.[13]

Next, to set the foundation for our proposed heterodox use of a natural law EAEB approach to ISDS, we turn to controversial Weimar-era jurist Carl Schmitt.[14] Schmitt's theories explore the dangers to constitutional structures — in our case bilateral and multilateral treaty obligations — of the continued and stubborn use of legal formalism, which results in legitimacy-undermining outcomes.

As a remedy, Schmitt sets out a constitutionally-permissible exception for extraordinary executive authority — in this case natural-law imbued EAEB tribunal decision making — to aid in an effort to sustain and strengthen the constitutional system itself through legitimacy-building, with, in our case, the ultimate goal of bringing reason-of-state principles to ISDS decision making.

Schmitt developed a framework for diagnosing the acute failure of the legalist approach, as well as a solution to the foreboding existential problems that Weimar was confronting,[15] offering a model based on legitimacy and also a method by which to connect legitimacy to constitutional legality in those crisis moments when the two concepts are unsustainably divergent.[16]

In our case, a supranational framework of bilateral and multinational ISDS treaty obligations — rather than a constitution — is legitimate when it has foundations in the preferences, beliefs and choices of all relevant parties involved, i.e., investors, developed states, developing states, and the constituent populations of developing and developed states together.[17]

Accordingly, legality by itself is often insufficient to create legitimacy. Treaty obligations written on a piece of paper often fail to make those treaty commitments compatible with the divergent incentives of the interested parties.[18]

However, somewhat paradoxically, even while superseding legal formalism, legality can play an indirect role in securing legitimacy as balance of stakeholder interest through a written constitution — or, in our case, fair-and-equitable-treatment treaty standards — wherein there exists an extraordinary tribunal empowered to act in crisis situations.[19]

Thus, the proposed treaty standards enumerating the express authority of arbitral tribunal adjudicators to render decisions derived from fair and equitable treatment, and imbued with EAEB, with the very balance of stakeholder interest at the center of their decision making, offers a method by which the dual aims of rendering justice to the dispute's concerned parties while perpetuating and augmenting the legitimacy of the ISDS system can be achieved.

Conclusion

At a time when the future of ISDS is in increasing doubt, the emphatic legal formalism all to often found in ISDS decision making endangers the essential supra-national web of bilateral and multilateral treaty obligations, which have served the global community in furtherance of the universal, natural-law-consistent goals of promoting peace, security and abundance.

Therefore, the time is ripe to embrace an explicit empowering of ISDS tribunals with extraordinary equity-derived and natural-law-shaped powers of EAEB to achieve more just outcomes for the respective parties to individual disputes, and to strengthen the ISDS system as a whole.

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[1] Trakman, Leon "Ex Aequo et Bono: Demystifying an Ancient Concept" Chicago Journal of International Law, Volume 8 Number 2, P. 626, Article 11, (Jan. 1, 2008).

[2] "Article 33 – Applicable law, amiable compositeur"; United Nations Commission on International Trade Law Arbitration Rules (1976) United Nations.

[3]
See https://uncitral.un.org/en/texts/arbitration/modellaw/commercial_arbitration/status accessed Dec. 15, 2022.

[4] S.A.R.L. Benvenuti & Bonfant v. People's Republic of the Congo, ICSID Case No. ARB/77/2, Award (Aug. 15 1980), 21 I.L.M. 74o (1982), at Section II.

[5] Id.

[6] Id.

[7] Perera, Srilal "Equity-Based Decision-Making and the Fair and Equitable Treatment Standard: Lessons From the Argentine Investment Disputes - Part I" 13 Journal of World Investment & Trade 210 (2012) at 222.

[8] Perera at pp. 253, 254.

[9] Perera at p. 215.

[10] See Vermeule, Adrian, "Beyond Originalism" Atlantic Magazine (March 31, 2020) accessed on Dec. 15, 2022
at https://www.theatlantic.com/ideas/archive/2020/03/common-good-constitutionalism/609037/

[11] See generally, Vermeule, Adrian, "Common Good Constitutionalism," Polity Books (2022) at pp. 1–21.

[12] Id.

[13] Id.

[14] For an indispensable discussion of the contemporary relevance of Schmitt's work, see

generally Telman, Jeremy, "Should We Read Carl Schmitt Today?" Berkeley Journal of International Law 19 Berkeley J. Int'l L. 127 (Jan 01, 2001).

[15] See generally Schmitt, Carl "Legality and Legitimacy" Duke University Press (2004). See also Posner, Eric and Vermeule, Adrian, "Demystifying Schmitt" Chicago Unbound Public Law and Legal Theory Working Papers (2011) accessed on Dec. 15, 2022 at http://www.law.uchicago.edu/academics/publiclaw/index.html.

[16] Id. at pp. 13–14.

[17] Schmitt at pp. 1–14.

[18] Id.

[19] Id.