

# Bloomberg

## Treaty Disputes Roiled by Bias Charges

By Andrew Martin - Jul 10, 2013 3:02 PM ET

When Swiss law professor Gabrielle Kaufmann-Kohler joined the board of UBS AG, she was sitting on international tribunals judging whether Vivendi Universal SA and another company whose shares UBS held were entitled to damages from [Argentina](#) in investment disputes.

After Argentina learned about her UBS role in 2007, it sought to have Kaufmann-Kohler removed from the tribunals and to overturn a \$105 million judgment in favor of Vivendi, the French media company. She was one of three arbitrators in the cases.

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Pedestrians walk by the World Bank headquarters in Washington, D.C. World Bank rules say an arbitrator must be “relied upon to exercise independent judgment,” and those issued by the UN say arbitrators should disclose circumstances that might “give rise to justifiable doubts” about their impartiality or independence. Photographer: Brendan Smialowski/AFP via Getty Images

Argentina’s efforts failed. That’s not unusual in treaty-based investor-state disputes, which are settled by arbitrators governed by rules that critics say are too tolerant of potential bias and make challenging arbitrators too difficult.

Kaufmann-Kohler declined to comment. She said at the time that she wasn’t aware of any conflicts and wouldn’t allow her UBS directorship to affect her impartiality. She still sits on arbitration panels that are weighing damages against Argentina, and is no longer on the UBS board.

Concerns about objectivity and accountability have prompted calls for tougher ethical guidelines as caseloads have exploded. The stakes are high, with some claims asking for more than \$1 billion and some attacking sovereign nations' laws and policies, even court decisions.

"It is undeniable that the typical conditions that assure impartiality in the judicial sphere are lacking in arbitration," said Sundaresh Menon, then [Singapore](#)'s attorney general and now its chief justice, in a speech last year.

### Power 'Unprecedented'

Arbitrators can keep their day jobs, even as lawyers in the kinds of cases they referee. Some write papers with opinions on issues similar to those on which they pass judgment.

"The power they have over the purse strings of countries is unprecedented," said Gus Van Harten, an associate professor at Osgoode Hall Law School in Toronto who recommends a court with tenured jurists be created to erase "lingering blemishes" left by the questions raised about arbitrators' independence. "They are kind of like the supreme court judges of the world."

The disputes they resolve rise out of clauses in treaties that allow foreign investors to challenge government actions affecting their interests. The original idea was chiefly to give a company recourse if its assets were nationalized.

Now the clauses are being interpreted to challenge public policy, including [Germany](#)'s ban on nuclear power, [Australia](#)'s attempts to limit smoking and [Canada](#)'s process for upholding drug patents. A company controlled by U.S. billionaire Ira Rennert is demanding \$800 million from [Peru](#) over what it claims are onerous demands to clean up pollution from a smelter complex in a town where children have elevated lead levels. Rennert's company has said it isn't responsible for their ailments.

### Superior System

Arbitrators have been coming under scrutiny as the treaty-based disputes have rapidly grown. The first case was in 1987, and for the next 12 years the average number brought

annually was three. A [record](#) 62 publicly disclosed actions were filed last year, bringing the total to 480 since 2000, according to the United Nations Commission on Trade and Development.

Treaty based investor-state arbitration has backers around the world. A majority of the 3,000-plus investment pacts contain arbitration clauses. Supporters, including the administration of U.S. President [Barack Obama](#), portray it as superior to the old way of settling differences: relying on local courts or diplomats to hash it out.

The arbitrations could continue to multiply, as the U.S. is negotiating trade pacts with the European Union and Pacific Rim countries that are expected to include the clause.

### Disclosing Conflicts

Investors won 70 percent of known cases last year, according to the UN. Since 1987, states have won 42 percent of the time, and investors 31 percent, with the rest settled.

Today most of the disputes are considered by three-member tribunals under procedural rules issued by the World Bank or UN, according to Luke Eric Peterson, publisher of the [Investment Arbitration Reporter](#). While the [World Bank](#) makes some information about cases public, most forums, including those governed by UN rules, leave it up to the parties to decide whether to disclose details, he said.

The warring sides pay the arbitrators -- who can earn \$3,000 a day or more, plus expenses -- and each picks one. The third, who chairs the tribunal, is selected by mutual agreement or an independent party.

There's no one code for all tribunals. World Bank rules say an arbitrator must be "relied upon to exercise independent judgment," and those issued by the UN say arbitrators should disclose circumstances that might "give rise to justifiable doubts" about their impartiality or independence.

### Exclusive Club

The requirements aren't exacting or demanding enough, according to Van Harten, the law professor. "There's too much riding on the individual sense of integrity, he said. "We need institutional safeguards like we have in courts."

Hundreds of arbitrators are available for hire around the world, some of them academics and former government officials, most of them lawyers in private practice. For critics, the exclusivity of that club is one of the main shortcomings.

Just 15 people -- all but one from the U.S., Canada or Western Europe -- have served on 55 percent of known investor-state tribunals, according to a November 2012 [report](#) by two nonprofits, the Brussels-based Corporate Europe Observatory and the Transnational Institute in Amsterdam. The report called arbitrators "the epitome of a close-knit community."

While only 6 percent of cases adjudicated to date under World Bank rules have been against countries in Western Europe and [North America](#), about 68 percent of panel members came from those regions, according to data from the bank's International Center for Settlement of Investment Disputes. About three quarters of those cases were treaty based investor-state disputes, and the rest were over laws or contracts.

### Lawyers' Ties

Guido Santiago Tawil, a Buenos Aires lawyer who had worked for years with attorneys at U.S. law firm King & Spalding LLP, was picked by one of the firm's clients in 2010 to sit on a tribunal to decide whether [Venezuela](#) should pay the client for property the government seized from it.

Venezuela's lawyers objected to Tawil's selection by Universal Compression International Holdings, a Spanish subsidiary of U.S. oil and gas services supplier [Exterran Holdings Inc. \(EXH\)](#) They said that Tawil had recently worked with King & Spalding as co-counsel on two major cases. They questioned whether he could be impartial because of his ties to the U.S. firm, noting that one of the attorneys arguing for the company used to work for him. None of it disqualified Tawil.

### Two Hats

Universal Compression had brought the case after Venezuela expropriated foreign energy assets in a drive to bring the economy under state control. The case was suspended last year after Venezuela agreed to compensate the company.

Tawil said in an e-mail that the objection to his serving on the panel didn't have any grounds. He declined to elaborate.

What many critics -- and some arbitrators -- zero in on is that they may wear two hats, as lawyers arguing cases and as tribunal panelists deciding them.

"Has one ever seen a referee in a soccer game entering the playing field" as a member of one of the teams, asked Brigitte Stern, a French law professor, in a recent issue of the [Arbitration Trends](#) newsletter. "This problem has not yet been seriously dealt with by the investment arbitration community."

Stern's neutrality has been questioned as well, after Venezuela selected her as an arbitrator in the Universal Compression complaint.

Not Compatible

Even as Venezuela sought to disqualify Tawil, the company objected to Stern because the country had picked her as an arbitrator in three other previous cases; Venezuela had won two of them, with the third not yet resolved. The challenge was rejected. Stern didn't respond to requests for comment.

Even as it ruled against Argentina's attempt to unseat Kaufmann-Kohler because of ties to UBS, a committee appointed by the World Bank's International Center for Settlement of Investment Disputes mentioned the conflict created by arbitrators' varying roles.

"The positions of a director of such a bank, and that of an international arbitrator, may not be compatible," the ruling said.

Argentina tried to remove Kaufmann-Kohler from other tribunals as well as the Vivendi case; she wasn't disqualified in either. The companies prevailed, with Argentina ordered to pay more than \$200 million in one; damages haven't been assessed yet in two others.

## 'Idiotic' Criticism

U.S. lawyer Stephen M. Schwebel was a co-counsel for Vivendi in its Argentina complaint -- which was being adjudicated at the same time as an action Dutch insurer Eureko BV filed against [Poland](#) in which Schwebel was an arbitrator.

Both countries challenged his neutrality: He co-authored a decision in favor of Eureko and against Poland while he was working for Vivendi, and then cited the decision to bolster his arguments for Vivendi in its case against Argentina.

Schwebel, former president of the UN's International Court of Justice, said attacks on the investor-state arbitration system are being driven by anti-business academics and activists, and that most conflict-of-interest allegations are "flimsy or tactical." He called those lodged against him, which weren't successful, "defamatory and idiotic."

The decision he helped write in granting Eureko an award against Poland "was in the public domain" and one of dozens of arbitral rulings mentioned in pleadings, Schwebel said. "I would have been lax in not citing the award."

## 'Problematic' Proceedings

According to World Bank data, of 63 proposals to disqualify arbitrators to date, one has been upheld; 42 were rejected, and in 16 instances the arbitrators resigned before rulings were made. Two were withdrawn and two haven't been decided.

In cases heard under World Bank rules, the two others on the panel usually determine whether objections about a colleague have merit. That's "problematic" because "not only do they know each other from that proceeding, but because it's a small club, they also know each other from the other proceedings they have done together," said Karel Daele, a London-based arbitration attorney who wrote a 2012 book on challenges.

Daele recommends that a third party, rather than two arbitrators, decide whether a challenge is valid. That's how it works under UN rule and at the [International Chamber of Commerce's](#) International Court of Arbitration, where Daele said objections tend to have a higher success rate.

In arbitrations carried out under UN rules, the suitability of at least 21 arbitrators has been challenged to date, with six disqualified and three others agreeing to end their conflicts so they could remain on the tribunal, according to Daele, who compiled the statistics.

Peterson, the arbitration newsletter publisher, said governments that include investor-state arbitration in treaties could force higher ethical standards.

“Self-policing and peer review are not enough to eliminate some of the key ethical problems,” he said.