

CONTROL MECHANISMS IN INTERNATIONAL DISPUTE RESOLUTION

PROF. W. MICHAEL REISMAN*

My professor on the Law of Personal Status began one of his invariably dry lectures with the words “[m]atrimony is an institution that concludes in death or divorce.” It struck me then as a terribly unromantic way of looking at something wonderful. For all I know, the professor may have been as romantic as I was. His point was that lawyers, as designers of social relationships, must look beyond the moment of exhilarating consensus when those relationships are created to that inevitable moment—usually quite rancorous—when, in one way or another, they are undergoing stress or are ending. Domestic law provides compulsory institutions for resolving conflicts about commitments and relationships. To a large extent, international law does not. Whether an international transaction comprises a single event or a large number of events linked in complex and continuing legal and economic relationships, the responsible attorney must plan for the resolution of disputes.

Inevitably, most of the efforts of negotiators are going to be directed toward shaping the substantive transaction. By the time agreement is reached, negotiators are often exhausted and, as the champagne is uncorked, they may pay relatively little attention to dispute resolution. More often than not, negotiators will simply jam an off-the-shelf dispute resolution clause into the miscellaneous chapter at the end of the agreement. One indication of how automatic this has sometimes been is some arbitration clauses in important post-war contracts still referred to the Permanent Court of International Justice as the back-up appointment authority, despite the fact that the Permanent Court had long since ceased to exist.

In the last two decades, however, practitioners and scholars have come to give considerably more attention to the anticipatory design of dispute resolution mechanisms in international transactions. A wide range of model clauses has been developed for incorporation into different types of contracts. Supervisory authorities may be selected from many different national and supra-national institutions.

Unfortunately, one dimension of the design of transnational dispute resolution procedures still receives insufficient attention: controls.¹ Controls are techniques or mechanisms in engineered artifacts, whether phys-

* Hohfeld Professor of Jurisprudence, Yale Law School. LL.B. and LL.M., Hebrew University; J.S.D., Yale Law School. Andrew Willard read a draft of this paper and made many useful suggestions. The author acknowledges with gratitude the research assistance of Patricia L. Small, Yale Law School, J.D. 1995.

1. See generally W. MICHAEL REISMAN, SYSTEMS OF CONTROL IN INTERNATIONAL ADJUDICATION AND ARBITRATION (1992).

ical or social, whose function is to ensure that an artifact works as it was designed to work.

In social and legal arrangements in which a limited power is delegated, control systems are essential. Without them, the limited power may become absolute.

In domestic law, a sequence of appeal options within a national judicial bureaucracy provides control over judicial decision. Comparable layers of contingent controls are not available internationally, for there is no international hierarchical judicial bureaucracy. International dispute resolution procedures were traditionally single-instance affairs; facts and law were decided together in the first and only instance of decision. In smaller groups, even single-instance procedures can be controlled by informal peer controls. They may function as controls in some national settings, but are unlikely to operate in transnational settings where so many actors and so many different cultural values converge in one transaction. And this is unsatisfactory not only because human beings may err, but because granting people authority to act within certain normative guidelines, but not providing controls to enforce those guidelines, greatly increases the "moral hazards" of any enterprise.

In designing controls for international dispute resolution procedures, the alternatives to appeal are limited.

Historically, in the absence of a hierarchical institutional control, the doctrine of *excès de pouvoir* was supposed to function as a control. *Excès de pouvoir* was premised on the notion that the mechanisms parties created to resolve disputes only had the competence that the parties had assigned to them. If the mechanism—an international tribunal, for example—exceeded its power in a particular instance, the decision that resulted was null and void and could be disregarded. The injured party could invoke *excès de pouvoir* unilaterally as a justification for refusing to comply with the decision.

The doctrine of *excès de pouvoir* was elegant in theory but awkward in practice. Its operation presupposes clear criteria by which to appraise the procedures of an arbitration, no small amount of good faith in human nature, which is always perilous, and a substantial capacity for self-delusion. Not surprisingly, the doctrine of *excès de pouvoir* proved highly susceptible to abuse. This audience will surely remember the long and rancorous history of the United States repudiation of the *Chamizal Award*.²

In the inter-war period, when there was a burst of international arbitration to clear away the debris of the war, the League of Nations considered empowering the Permanent Court of International Justice to hear claims of *excès de pouvoir*.³ The proposal languished and died. It

2. *In re International Title to the Chamizal Tract (United States and Mexico) (Int'l Boundary Comm'n, June 15, 1911), reprinted in 5 AM. J. INT'L L. 782 (1911).*

3. The proposal was initially made by the government of Finland during the tenth session of the League of Nations Assembly in September 1929. The Assembly considered a report and draft

was rejected then, and again when Professor Georges Scelle tried to adapt it for the draft Convention on International Arbitration of the International Law Commission.⁴ Some commercial arbitration systems, such as the International Chamber of Commerce, provide for a limited internal review of awards prior to their certification, but the grounds are largely technical.

The 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards⁵ developed a different control mechanism for awards arising from disputes between private parties. The Convention uses the network of national courts in all of the States likely to be parties to an international convention.⁶ Generally, international dispute resolution mechanisms avoid national courts so as not to require either of the disputants to litigate on the other's turf. That is often the predicate of their selection of a more neutral, transnational modality. The New York Convention contained that potential danger by incorporating national court systems but severely limiting the grounds on which national courts seized of a case may review an award.

The control mechanism of the 1958 Convention has proved to be a remarkably efficient device for the specific types of arbitration for which it was designed. It is workable but rather less appropriate for cases in which one of the parties is a government and especially for cases involving matters of great importance to the political economy of one or both of the parties. Such was the situation facing the World Bank when it decided to develop a control mechanism for the special arbitral institution it was establishing for investment disputes. The bank, committed to accelerating development in the chronically poorer states by the introduction of capital that would otherwise be unavailable, yet appreciating the limited amount of public capital available for the purpose, sought to encourage the flow of private capital into direct foreign investment in developing countries.

But this was a period of new state nationalism with new claims of rights of expropriation and national jurisdiction as a means of economic

resolution in September 1931, but postponed its decision on the matter and apparently abandoned the proposal thereafter. *Report of the Committee Appointed by the Council to Study the Proposal of the Government of Finland to Confer on the Permanent Court of International Justice Jurisdiction as a Tribunal of Appeal in Respect of Arbitral Tribunals Established by States*, V LEAGUE OF NATIONS PUBLICATIONS (Legal), 1930 V.12 (1930); see also 1928-1929 LEAGUE FROM YEAR TO YEAR 68-69; 9 MONTHLY SUMMARY OF THE LEAGUE OF NATIONS 307 (1929); 1930-1931 LEAGUE FROM YEAR TO YEAR 47-48; 11 MONTHLY SUMMARY OF THE LEAGUE OF NATIONS 262, 265-66 (1931).

4. *Arbitral Procedure-Draft Convention on Arbitral Procedure Adopted by the Commission at its Fifth Session: Report by Georges Scelle, Special Rapporteur*, U.N. Doc. A/CN.4/109 (1957), reprinted in [1957] 2 Y.B. Int'l L. Comm'n 1, U.N. Doc. A/CN.4/SER.A/1957/Add.1.

5. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 38 [hereinafter New York Convention].

6. Article II(3) of the New York Convention provides:

The court of a Contracting State, when seized of an action in a matter in respect of which the parties have made an agreement within the meaning of this article, shall, at the request of one of the parties, refer the parties to arbitration, unless it finds that the said agreement is null and void, inoperative or incapable of being performed.

Id. art. II(3), 21 U.S.T. at 2519, 330 U.N.T.S. at 40.

self-determination. These trends hardly encouraged risk-averse private investment. The World Bank identified a number of obstacles that might be minimized by an appropriately structured dispute resolution mechanism. The bank created the International Convention on the Settlement of International Disputes (ICSID).⁷ Under ICSID, as it has come to be known, capital exporting states agreed not to exercise “diplomatic protection,”⁸ a euphemism for what are often rather coercive actions on behalf of nationals whose property has been taken. Developing countries committed themselves to proceeding directly to arbitration. Unless specifically indicated, they were presumed to have waived the requirement of exhaustion of domestic remedies.⁹

Designing a control mechanism for this particular form of dispute resolution was challenging. The control mechanism of the New York Convention, which has proven so successful, would not have suited this type of arbitration, for governments would have been loathe to submit to foreign courts, even for control purposes. Likewise foreign investors, who were understandably reluctant to have their disputes heard by the courts of the host state, pressed for a different approach.

The designers of the ICSID Convention were inspired by the efforts of Professor Georges Scelle two decades earlier. But instead of incorporating the International Court as their control mechanism, as Scelle had wished, they created, in its stead, an internal control mechanism. Briefly, the ICSID Convention allows every state party to nominate a number of potential arbitrators to an ICSID list.¹⁰ When a dispute arises, the parties may, but need not, select their arbitrators from this list.¹¹ When an award is rendered and one or more of the parties believes that the tribunal was improperly constituted; manifestly exceeded its powers; departed from a fundamental rule of procedure; failed to justify the award; or that one of the tribunal members was corrupted, the aggrieved party may lodge an application for annulment within 120 days.¹² Once the application is filed, the chairman of the ICSID Administrative Council appoints an ad hoc committee of three persons from that list of names that had been proposed by the state members. But no member of the ad hoc committee may be a national of the state party or of the country of the foreign investor involved in the dispute.¹³

Though its mandate is more circumscribed than the tribunal whose award it is reviewing, the ad hoc committee is, in effect, another tribunal following substantially the same procedures outlined in the Convention for the original tribunal. The committee may stay enforcement of the

7. Convention on the Settlement of Disputes Between States and Nationals of other States, March 18, 1965, 17 U.S.T. 1271, 575 U.N.T.S. 160 [hereinafter ICSID Convention]. For background material, see REISMAN, *supra* note 1, at 46-50.

8. ICSID Convention, *supra* note 7, art. 27, 17 U.S.T. at 1281, 575 U.N.T.S. at 176.

9. *Id.* art. 26.

10. *Id.* art. 13, 17 U.S.T. at 1276, 575 U.N.T.S. at 168.

11. *Id.* art. 40, 17 U.S.T. at 1288, 575 U.N.T.S. at 184.

12. *Id.* art. 52(1), 17 U.S.T. at 1290, 575 U.N.T.S. at 192.

13. *Id.* art. 52(3).

award during its proceedings.¹⁴ If it finds that there has been a violation of one or more of the standards, the ad hoc committee is also authorized to annul the award in whole or in part. If the award is nullified by the committee, either party may submit the dispute to a new tribunal, constituted in accordance with the Convention.¹⁵

The advantage of this control mechanism was that it provided a review of an international award, challenged by one party as violating the procedural conventions of international arbitration, while avoiding many of the well-known perils. It contained the potential for abuse in the institution of the unilateral claim of *excès de pouvoir*. It also avoided shifting the dispute to a national court, which would have been unacceptable, given the nature of the economic relationships that were involved. Nor did the control mechanism place the dispute before the International Court. That would have been structurally difficult given the fact that one of the parties was not a state. And using the court as the control mechanism would certainly have been politically unacceptable. An award could be challenged, but unlike the classic claim of *excès de pouvoir*, notoriously susceptible to abuse, a claim under ICSID was channeled within the bank arbitration process, in a procedure to which the parties had already agreed.

The ICSID review procedure was not used for the first 17 years of the institution. Finally, in 1983, the procedure got off to a rather rocky start. In *Klöckner v. Cameroon*,¹⁶ the ad hoc committee took a very technical approach. It expanded the grounds for annulment by permitting a claimant to allege any violation of the Convention in the review procedure.¹⁷ In addition, it created a hair-trigger mechanism for annulment, without regard to the materiality or gravity of a violation.¹⁸ The net result, as many scholars at the time observed, was to pressure counsel representing losing parties to challenge the award and, insofar as review became a regular feature, to transform ICSID into a two-level arbitration. Happily, in a number of subsequent decisions by ad hoc committees, the excessiveness of *Klöckner* was tempered.¹⁹ The control mechanism appears to have been repaired and the ICSID experiment seems back on track.

To their credit, the designers of the Free Trade Agreement (FTA) between the United States and Canada carefully considered the control mechanism problem when they shaped the dispute resolution procedure. I have some reservations about the wisdom of the essential design of the first-instance binational panel,²⁰ and I will comment on it in a moment.

14. *Id.* art. 52(5), 17 U.S.T. at 1291, 575 U.N.T.S. at 192.

15. *Id.* art. 52(6).

16. *Klöckner v. Cameroon*, Decision of the Ad Hoc Committee (May 3, 1985), reprinted in 1 ICSID Rev.-Foreign Investment L.J. 89 (1986).

17. *Id.* paras. 58-59.

18. *Id.* para. 179.

19. See, e.g., *Maritime Int'l Nominees Establishment (MINE) v. Guinea*, Decision of the Ad Hoc Committee (Dec. 22, 1989), reprinted in 5 ICSID Rev.-Foreign Investment L.J. 95 (1990).

20. See United States-Canada Free Trade Agreement, arts. 1901 & 1904, annex 1901.2.

But I greatly admire the FTA's design for a control mechanism in the second instance.

The FTA control challenge was strikingly similar to that facing the designers of ICSID. The first-instance decision mechanism, largely based on the contemporary private arbitration model, plainly required a control mechanism to police moral hazard and to resolve disputes about the propriety of first instance decisions by the bi-national panels. But designing a mechanism for disputes with incredibly high stakes for two collaborating but competitive political economies was no easy task. Prior to the FTA, the control had consisted of resorting to a higher level in the judicial bureaucracies of the states concerned. But to assign control to the court systems of one of the parties would have frustrated the purpose of "denationalizing" the first instance. Hence, the FTA created an "extraordinary challenge" procedure, which permits the United States or Canadian government to seek review of a panel determination in a narrowly defined set of circumstances. Under Article 1904, section 13, a party must allege that a panel member violated the rules of conduct,²¹ that "the panel seriously departed from a fundamental rule of procedure,"²² or that the panel exceeded its powers, authority, or jurisdiction.²³ In addition, the party must demonstrate that the alleged action "materially affected the panel's decision"²⁴ and that the action "threatens the integrity of the binational review process."²⁵ Once a party invokes the extraordinary challenge procedure, a committee of three judges, rather than ad hoc arbitrators, reviews the original decision and within thirty days renders a decision to affirm, vacate, or remand.

The procedure has been invoked only twice thus far, on both occasions by the United States. The jurisprudence that has emerged under these provisions is quite interesting. The first dispute involved the importation of subsidized pork from Canada.²⁶ The United States challenged a bi-national panel ruling that limited the evidence the International Trade Commission (ITC) could consider. The panel's decision, in essence, forced the ITC to reverse its earlier determination that Canada's subsidies threatened a United States industry with material injury.²⁷ Two of three commissioners charged that the panel's ruling "'violate[d] fundamental principles' of the FTA and 'contain[ed] egregious errors under U.S. law.'"²⁸

21. U.S.-Canada Free Trade Agreement, art. 1904.13(a)(i).

22. *Id.* art. 1904.13(a)(ii).

23. *Id.* art. 1904.13(a)(iii).

24. *Id.* art. 1904.13(b).

25. *Id.*

26. *In re* Fresh, Chilled, or Frozen Pork from Canada, Panel No. ECC-91-1904-01USA, 1991 FTAPD LEXIS 7.

27. The challenged ruling was the second of two panel decisions in the dispute to remand the determination to the ITC. The Panel first remanded the determination because the ITC's findings had been based on erroneous statistics. After the first remand, the ITC reopened the record to gather new information on certain narrow aspects of its investigation. After the ITC issued its second determination, the Panel found that the ITC had erred in considering information outside those narrow aspects, and remanded the determination again.

28. *Id.* at *6.

The Extraordinary Challenge Committee (ECC) dismissed the challenge request, finding that the United States had failed to demonstrate that the alleged errors constituted departures from rules of procedure or constituted abuses of power, authority, or jurisdiction. In addition, the ECC determined that none of the alleged errors materially affected that panel's decision or threatened the integrity of the binational panel review process.²⁹ The committee noted that its role was an extremely narrow one: the ECC was not to act as a routine appeal mechanism, but to respond to "aberrant panel decisions."³⁰

The second ECC case was more controversial. The United States requested review of a decision concerning live swine, in which a binational panel had determined that certain Canadian subsidies were not "specific" and therefore not countervailable. The United States alleged that the panel had exceeded its jurisdiction by substituting its judgment for that of the Commerce Department.³¹ Although the ECC unanimously dismissed the challenge, the committee found several aspects of the panel's review disturbing. The committee acknowledged that it felt "the Panel may have erred" in overturning the Commerce Department's determination, but the committee "was not persuaded that the Panel manifestly exceeded the appropriate standard of review."³² The committee also criticized the panel's refusal to permit the Commerce Department to reopen the record in the proceeding.³³

Throughout the opinion, the ECC emphasized the extremely narrow scope of its review: "The ECC should address systemic problems and not mere legal issues that do not threaten the integrity of the FTA's dispute resolution mechanism itself."³⁴ The committee envisioned a narrow role for the binational panels as well:

Panels must follow and apply the law, not create it . . . they are not appellate courts Panels may not articulate the prevailing law and then depart from it in a clandestine attempt to change the law.³⁵

Restraint is obviously a critical feature of control mechanisms. Too little restraint transforms control into appeal. But too much restraint undermines the deterrent effect of a control system. It is, of course, too early to appraise the aggregate performance of the FTA control system, but as a student of these mechanisms, my sense—and it is tentative—is that the ECCs have shaped a role for themselves that may generate insufficient expectations of control in binational panels. The fact that, to date, no Extraordinary Challenge Committee has annulled a decision by a binational panel may, of course, testify to the high quality of the

29. *Id.* at *15-*16.

30. *Id.* at *9.

31. In the matter of: Live Swine from Canada, Panel No. ECC-93-1904-01USA, 1993 FTAPD LEXIS 1, at *10.

32. *Id.* at *14-*15.

33. *Id.* at *17.

34. *Id.* at *7.

35. *Id.* at *15-*16.

binational panels. But one of the consequences of a string of confirmations is the absence of guidelines of control. Uncertainty here may, in subtle ways, undermine the latent restraints of a control mechanism.

The North American Free Trade Agreement (NAFTA) sets forth the same three-pronged test for launching an extraordinary challenge.³⁶ The only substantive difference between the NAFTA and the FTA provisions is that NAFTA makes explicit what was arguably implicit in the FTA: that by failing to apply the appropriate standard of review, a panel exceeds its authority.³⁷

There are a number of important differences between the approach of ICSID and the approach of the free trade agreements to control mechanisms. First, under the free trade agreements, a party seeking an extraordinary challenge must show that the alleged action (i) *materially* affected the panel's decision and (ii) threatened the integrity of the panel system. ICSID did not prescribe a test of materiality, a *lacuna* into which the *Klöckner* ad hoc committee tumbled. Nor did ICSID prescribe the requirement that the implications for the systemic dimension be taken into account. Neither of these two requirements were fully explored in the FTA's ECC cases, because in neither case did the petitioner meet the threshold requirement of showing an abuse of power or a departure from rules of procedure. As a result, the full scope of ECC review and control is not known and may be under-appreciated.

Another distinction is that only parties to the free trade agreements, not private litigants, can seek ECC review. This is an important distinction that may be justified by the major political and economic implications of the dispute resolution mechanism itself. Yet, it inevitably has implications for the private parties' expectations of justice. The fact that the right of initiation of the control mechanism is restricted to the governments could mean that the ECC will function as a more restrained control mechanism than an ad hoc ICSID committee. It could also mean that when ECC cases are brought, they will be more politicized, with potentially greater stakes for the continuity of the FTA itself.

The FTA and NAFTA represent innovative responses to the problem of control in international dispute resolution. They take an existing model and adapt it wisely. The question now is whether the ICSID model is optimally appropriate as a dispute resolution mechanism for FTA and NAFTA type regimes.

I believe that it would be useful to consider a range of new types of institutions. I am persuaded by Professor David Caron's insightful observations in this regard. Caron notes the incongruity of adapting the private arbitration model for the resolution of disputes that have major public consequences. Perhaps it is time to fashion a new type of institution: a permanent, binational tribunal on the order of the United States-Iranian Claims Tribunal. The creation of a permanent bi-national or tri-national

36. North American Free Trade Agreement, Dec. 17, 1992, U.S.-Can.-Mex., art. 1904, § 13, H.R. Doc. No. 103-59 (effective Jan. 1, 1994).

37. *Id.* art. 1904(13)(a)(iii).

judiciary, developing a consistent jurisprudence, might be an exorbitant cost if only a few cases were contemplated. But, if a complex free trade regime between two or three great political economies is anticipated, the number of disputes would amply justify a more permanent arrangement. Such an arrangement would also reduce the temporal and financial transaction costs involved in assembling a panel in case after case. A more permanent arrangement, in turn, would provide a degree of consistency to decisions and permit the development of an *esprit de corps* among the judges.

For the present, governments could take a series of steps to create more homogeneity in the work of the panels. Workshops and seminars for those who have been nominated by their governments to be on the list could familiarize panelists with each other and with the jurisprudence and the problems that recur in this form of dispute resolution.

The lessons of the last twenty years in the construction of international dispute resolution mechanisms are clear. There is no single model available, though every model must have a control mechanism. Drawing on the wisdom and experience of the past, each new mechanism must be tailored to the special needs of the process in which it is incorporated. International lawyers, especially from the private Bar, have a unique opportunity to play an important and innovative constitutive role in this area. It is a great challenge, but it is also a great opportunity and great fun.