Sovereign Immunity From Execution – Caveat Emptor

Kluwer Arbitration Blog
June 4, 2018

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Please refer to this post as: Ylli Dautaj, 'Sovereign Immunity From Execution – Caveat Emptor', Kluwer Arbitration Blog, June 4 2018, http://arbitrationblog.kluwerarbitration.com/2018/06/04/sovereign-immunity-execution-caveat-emptor/

Introduction

The issues pertaining to "sovereign immunity" in international arbitration are not new. Nevertheless, several aspects remain unresolved.[fn] Kaj Hobér, Sovereign Immunity and International Arbitration – Recent developments, Arbitrators' Insights, Essays in Honour of Neil Kaplan (Sweet & Maxwell, 2012), 91. [/fn] Sovereign immunity from execution is said to be "the last fortress, the last bastion of State immunity."[fn] ILC Commentary to Art 18, para. 1.[/fn] For example, states sometimes invoke the "sovereign immunity shield" in the execution of arbitral awards enforced against the respondent-state. The result is that an investor might be awarded compensation through an arbitration award, but still remain unpaid.

Strictly speaking, the aspiration of investment arbitration is to promote and facilitate neutrality, flexibility, efficiency, and finality. Furthermore, arbitral tribunals are under a general duty to render enforceable awards. Despite this, the last fiddle will be played by domestic courts. Unfortunately, the judicial system is not always efficient nor rational. The main reason for arbitration's widespread reception was a move away from the judicial system. Unfortunately, the independence of the courts is tainted with diplomatic "realities," e.g. international comity.

My point is simple: the law has failed to facilitate a viable solution to the issue of states hiding behind the shield of sovereign immunity. It is time to reactivate market solutions in conjunction with improving the procedure of executing awards, namely improving the "judicial architecture" of award enforcement. In this piece, I will highlight a few possible market and architectural solutions. I will not discuss any solution in relation to amending, updating, or changing domestic or international law. With the benefit of hindsight, such a discussion would be more theoretical than real.

Regulating Host-State Behavior

I argue that state behavior, just as individual behavior, is regulated by four modalities of constraint: (1) law; (2) markets; (3) architecture; and (4) norms.[fn]Lawrence Lessig, Commentaries, The Law of the Horse: What Cyberlaw Might Teach FINALHLS.DOC 12/03/99.[/fn] I argue that there is a need to move away from steering blindly towards the law. Instead, it would be wise to seek solutions in market and architectural structures. For example, third-party funding or BIT Award Risk Insurance are two possible market venues for redress. Architecture is the way in which procedural rules and legal devices (e.g. discovery tools and burden-of-proof rules) steer the legal process in a certain direction, and therefore also outcomes and behavior.

Sovereign Immunity

It is long accepted that arbitrators derive their power from the arbitration agreement. Arbitration is an entirely private dispute settlement mechanism, and therefore there is nothing to be immune from.[fn] Hobér, *supra* note 1 at 93.[/fn] Consent to arbitration constitutes an irrevocable waiver of immunity from jurisdiction. On the other hand, immunity from execution is not considered implicitly waived through an arbitration clause.

Generally speaking, there are two types of sovereign immunity: "absolute immunity" and "restrictive immunity." States have gradually shifted from the former to the latter. Restrictive immunity rests on the distinction between commercial activities and sovereign activities.[fn] *Id.* at 92.[/fn] Consequently, states cannot invoke the shield of sovereign immunity for assets stemming from commercial activities. However, rogue states can, and do from time to time, mask commercial assets with a "sovereign label." Therefore, architectural structures, e.g. lessening the burden-of-proof and broadening the pre-discovery procedure, are extremely important for an investor.

By way of legal solutions, there are none. At least none that are of satisfaction. First, there is no multilateral treaty dealing with sovereign immunity.[fn] Attempts have been made. For example, the UN General Assembly on 2 December 2004 adopted the "United Nations Convention on Jurisdictional Immunities of States and Their Property." [/fn] Even the attempts have been too narrow in scope. Second, different jurisdictions have taken different approaches and the law is not uniform.

Market Solutions

First, "the World Bank solution."[fn]*See* Joseph M. Cardosi, Precluding the Treasure Hunt: How the World Bank Group Can Help Investors Circumnavigate Sovereign Immunity Obstacles to ICSID Award Execution, 41 Pepp. L. Rev. 109 (2013). [/fn] ICSID, being an organization of the World Bank could rely more heavily on utilizing the capacities of the Bank to "force" compliance with ICSID awards. The World Bank solutions are not exclusively limited to ICSID arbitration, but to any award held against a member of the World Bank. I will propose four market solutions that can be utilized through the World Bank: (1) it can withhold future loans and increase interest rates; (2) it can increase the role of the Multilateral Investment Guarantee Agency (MIGA) to be a more integral part of ICSID arbitration and then use the overall functions of the World Bank to force compliance, or structure long-term plans for repaying the outstanding credit; (3) it can essentially establish an investment bank and "purchase" unpaid awards by paying out the outstanding debts and use its platform to rein in the credit with interest; and (4) States can turn to the World Bank for a loan in order to settle with the awardee-creditor or to pay the award.

Second, third-party funding can provide an investor with expert assistance in the pursuit of realizing their assets. Third-party funders can fund the enforcement phase of arbitration (e.g. in exchange for a contingency). This can relieve the awardee-creditor. Locating commercial assets may be costly and time-consuming. Efforts to attach state-owned assets require legal and financial capacity. A funder might be more experienced, willing and prepared to over and over again re-strategize with the purpose of identifying new assets to attach that potentially fall under the commercial exception. With large awards, the investor might need to find and attach assets in various different jurisdictions in order to meet the outstanding amount. This complicates things but makes the hunt a viable business for third party funders.

Third, BIT award insurance might help secure assets in case a dispute would arise. However, BIT award insurance is not always a good deal. Insurance can prove to be costly, exposure is almost always capped, terms are adhesive, and it is not accessible to every investor.

Fourth, commercializing BIT awards; that is, "opening-up" the market of arbitral awards for investment and speculation. This would be a viable solution for awardee-creditors holding an award but lacking the desire to chase their credit at any cost. Sometimes parties are, for various reasons, willing to settle for less. That does not mean that the state does not owe the outstanding fee. In some situations, businesses might stand or fall with the credit, or some of the credit at least. However, speculators and investors might be willing to take the risk of owning an unpaid award for the potential gains. The World Bank and third-party funders have the capacity to facilitate this solution. Both have the capacity to rein in the outstanding credit, with interest, and over time.

Architectural Solutions

The courts' architectural approach will have a significant impact on whether investors will be able to realize their assets under the commercial activity exception. First, parties should include explicit waivers in BITs and contracts. Furthermore, arbitral institutions should amend their rules to this effect. Notwithstanding this, even explicit waivers are not necessarily recognized as waiving immunity from property that is used for – or partly for – sovereign functions. By analogy, in commercial transactions warranties are generally implied. In dealing with a state, a waiver for immunity from execution should be similarly included as a standard feature of business efficacy.

Second, small steps can be taken by courts in an "architectural manner." Small steps could be that the court would impose a lower burden of proof for the investor in arguing what constitutes a commercial asset. Another way is for the court to broaden its scope of pre-discovery, e.g. allowing for "general asset discovery."

Concluding Remarks

Despite the fact that sovereign immunity is one of the most traditional topics of international law, it still remains an issue in international arbitration.[fn]Hobér, *supra* note 1 at 91.[/fn] I argue that investment arbitration can only be effective and functional as long as it provides for effective remedies to private parties in their dealings with States. Effective remedies include effective asset realization. Otherwise, "caveat emptor" is as real today as in ancient unsophisticated times of sovereign dominance. Investors buying into unsophisticated markets, beware!

The law has failed investors. The shield of sovereign immunity remains the most significant barrier to automatic enforcement. It has the potential to undermine the policies that underpin the existence of arbitration clauses in BITs, MITs, and contracts.[fn] Alexis Blane, Sovereign Immunity as a Bar to the Execution of International Arbitral Awards, 41 N.Y.U.J. Int'l L. & Pol. 453 (2009) 466.[/fn]

Architectural solutions would allow for procedural changes to arbitral institutions and courts. In a similar vein, market solutions can facilitate the investors with either "selling" their awards, "securing" their awards, or hiring experts to "realize" their awards.

When international comity trumps legal rationality, the market and architectural structures are sometimes the only way out. The last bastion of sovereign immunity has *not* stood the test of time. Time is ripe for a new and more business-friendly wave. The logic of waiving sovereign immunity from jurisdiction but not from execution is cumbersome. In fact, the distinction is flawed and irrational.