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State responsibility for non-enforcement of arbitral awards: revisiting Saipem two years on

Promod Nair (J. Sagar Associates) · Thursday, August 25th, 2011

In the summer of 2009, an ICSID tribunal ruled that various orders of the Bangladeshi courts that cumulatively denied Saipem (an Italian company) the benefits of an ICC award made in its favour constituted an unlawful expropriation of its investment. It held that the investor was entitled to compensation based upon the value of the ICC award.

The ruling, in many respects, could be viewed as effectively providing an insurance policy for investors potentially safeguarding them against the risks of enforcing arbitral awards in their favour in 'difficult jurisdictions'. If monies could not be obtained from a contractual counterparty by means of enforcement proceedings in the host State, 'arbitration without privity' could provide an exciting (and hitherto unavailable) alternative of seeking recoveries from the host State itself.

However, that isn't exactly how things have worked out. Since the *Saipem* decision, the issue of State responsibility for non-enforcement of arbitral awards by domestic courts has come to the fore in a number of cases, including *GEA Group Aktiengesellschaft v Ukraine* and *Frontier Petroleum Services Limited v Czech Republic*. In many respects, the *Saipem* approach has come to be considerably diluted if not avoided altogether. In the light of the ever-increasing relevance of the issue and the important questions it raises about the jurisdictional limits of investment treaty arbitration, it is apposite to revisit the *Saipem* ruling and consider its relevance today.

Judicial interference as expropriation

Faced with difficulties in enforcing an award in its favour in Bangladesh, Saipem commenced ICSID proceedings under the Italy-Bangladesh BIT. In such cases, the typical approach would have been to bring an action based on the well-established prohibition of denial of justice, which numerous tribunals have considered to be an essential component of the 'fair and equitable treatment' provision in BITs. Saipem, however, faced a potential hurdle in adopting this approach since the dispute resolution clause in the Italy-Bangladesh BIT did not expressly entitle an investor to bring a claim for breach of the fair and equitable treatment obligation by the State. The investor's claim was therefore grounded on an alleged breach of the expropriation clause in the BIT. Saipem argued that the interference by the local courts with its rights to arbitrate and its right to payment of the amounts due under the contract as determined by the award of the ICC tribunal amounted to an unlawful expropriation of its investment.

In its decision on jurisdiction, the ICSID tribunal decided it had jurisdiction. It held that a

contractual right to arbitrate was an asset having economic value and hence constituted an 'investment'. In the merits phase of the arbitration, the main issue to be decided was whether the intervention of the courts of Bangladesh amounted to an expropriation. The ICSID tribunal held that the actions of the Bangladeshi courts resulted in substantially depriving Saipem of the benefit of the ICC award and were tantamount to an expropriation of Saipem's residual contractual rights as crystallised in the ICC award.

However, the ICSID tribunal clarified that the setting aside of an award, by itself, would not automatically result in an expropriation. To be expropriatory, the court action should also be 'illegal'. Analysing the facts of the case, the ICSID tribunal decided that the actions of the Bangladeshi courts were indeed illegal since they, first of all, constituted an abuse of rights and, secondly, were in breach of the state's obligations under the New York Convention. Both bases of the tribunal's decision are however controversial.

Wrongful refusal to enforce an award as an "abuse of rights"

The *Saipem* tribunal noted that *"[i]t is generally acknowledged in international law that a State exercising a right for a purpose that is different from that for which that right was created commits an abuse of rights."* Whilst the tribunal's explanation of the meaning of the doctrine is succinct, it failed however to examine whether, or establish how, an abuse of rights is prohibited as a binding rule of customary international law.

In failing to make this enquiry, the tribunal ignored a fundamental principle laid down by the International Court of Justice in the *Asylum Case* (1950). In that case the court held that in order to rely on a custom, it must be proved that the custom *"… is established in such a manner that it has become binding … [and] that the rule invoked … is in accordance with a constant and uniform usage practised by the States in question"*.

The failure to carry out such an enquiry and establish the existence of a customary rule prohibiting an abuse of rights becomes especially pronounced when considered in the light of Prof Brownlie's conclusion that whilst the principle of abuse of rights *"is a useful agent in the progressive development of the law, […] as a general principle, it does not exist in positive law."* (See *Principles of Public International Law,* Edn. VI, p.430)

If there is in fact no binding rule of international law that would make a State responsible for committing an abuse of rights, then this aspect of the tribunal's ruling reflects a decision *ex aequo et bono.* Clearly therefore, one limb of the Saipem tribunal's reasoning is based on rather fragile foundations.

Violation of the "spirit" of the New York Convention

The second limb of the tribunal's reasoning was that the Bangladeshi courts' revocation of the ICC tribunal's authority constituted a violation of Bangladesh's obligations under the New York Convention.

The tribunal acknowledged that the Bangladeshi courts had not failed to recognise the arbitration agreement and in that sense had complied with its obligations under Article II of the New York Convention. However, it considered that a revocation of the arbitral tribunal's authority violated *"at least the spirit of the Convention"*. Although there can be no quarrel with the proposition that a treaty should be interpreted consistent with its *"object and purpose"*, holding that State

responsibility could be engaged on the altogether more nebulous ground of violating its *"spirit"* would again probably be considered by many to be a step too far.

Discomfort with the Saipem ruling

As far as precedent goes, the *Saipem* decision has proved to be controversial. In its decision on jurisdiction, the tribunal was at pains to stress that it would not act as a 'supranational appellate body' sitting in judgment over local court decisions. And yet two years later, in its merits ruling, the tribunal effectively ruled that international tribunals were entitled to review the actions of state courts on the touchstone of 'legality'.

Treaty tribunals following in the footsteps of *Saipem* – in reviewing the legality of domestic judicial decisions, and inquiring into whether the judgments of municipal courts were based on legitimate grounds – have tended to tread very carefully to avoid being seen as sitting in judgment over the decisions of national courts and performing the role of a supranational appellate body.

For instance, in *GEA Group Aktiengesellschaft v Ukraine*, a German investor commenced ICSID proceedings against Ukraine pursuant to its unsuccessful efforts to enforce an ICC award in the Ukrainian domestic courts. The tribunal in that case held that an unpaid arbitral award could not "in and of itself" constitute a protected investment within the meaning of the BIT. Even if it could be considered as such, in the absence of evidence that the ruling of the Ukrainian courts was (i) discriminatory, (ii) deliberately taken to thwart GEA's ability to recover on the ICC Award, or (iii) egregious in any way, the tribunal found that the actions of the Ukrainian courts could not be considered expropriatory. It held that the mere fact that the Ukrainian courts came to a conclusion different to that which GEA had hoped could not be a reason to find a breach of the Germany-Ukraine BIT. The tribunal's approach clearly underlined its resolve not to second guess or sit in appeal over the decisions of national courts.

In *Frontier Petroleum Services Limited v Czech Republic*, an UNCITRAL tribunal held that unless a decision of the Czech municipal courts in refusing to enforce an arbitral award on public policy grounds was (i) arbitrary, (ii) discriminatory, or (iii) made in bad faith, it would not constitute a breach of the applicable BIT.

The continuing relevance of the denial of justice threshold

The *GEA* and *Frontier Group* decisions illustrate the difficulties that investors will face in establishing that a domestic court's failure to enforce an award constitutes an expropriation. These decisions also underline the reluctance of treaty tribunals to act as a de facto appellate body sitting in judgment over national court decisions.

However, this is not to say that treaty tribunals will or should desist from reviewing the conduct of national courts. In fact, the trend of arbitral decision-making post-*Saipem* underlines that State responsibility for the actions of its courts, including refusals to enforce arbitral awards, will continue to be evaluated against the threshold of the principle of denial of justice. A reminder of three fundamental principles that should guide treaty tribunals adjudicating a denial of justice claim (gleaned from Jan Paulsson's *Denial of Justice in International Law*) are:

(i) Firstly, denial of justice is almost always procedural, and does not constitute an international appellate review of national law. To quote Fitzmaurice, *"[i]f all that a judge does is to make a mistake, i.e., to arrive at a wrong conclusion of law or fact, even though it results in serious*

injustice, the state is not responsible".

(ii) The modern consensus on the point is clear to the effect that the factual circumstances must be particularly egregious if state responsibility is to arise on the grounds of denial of justice.

(iii) A claim for denial of justice will not succeed unless the victim has exhausted municipal remedies. Indeed, it is *"in the very nature of the delict that a state is judged by the final product – or at least a sufficiently final product- of its administration of justice"*. A denial of justice is not consummated by the decision of a subordinate court. If investors are allowed to bypass these mechanisms and bring international claims for denial of justice on the basis of alleged wrongdoing by courts of first instance, then *"international law would find itself intruding intolerably into internal affairs"*.

Therefore, despite *Saipem's* departure from this traditional approach, it would probably be fair to conclude that a State's responsibility for its courts' failure to enforce an arbitral award to the detriment of a foreign investor would only be engaged when there is a clear-cut denial of justice. To lower the bar any further would expose treaty tribunals to criticism of acting as an unauthorised international appellate court – and impair the legitimacy of the international investment law regime.

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This entry was posted on Thursday, August 25th, 2011 at 6:11 pm and is filed under BIT, International arbitration, Investment Arbitration
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