

Protection of International Investment – The Study of Establishing Appellate Mechanisms in International Investment Arbitration

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Abstract

Tribunals of investment arbitrations have frequently rendered contradictory awards. This scenario have raised concern about the necessity of establishing appellate mechanisms to harmonize the situation so as to achieve a consistent and coherent result facilitating predictability and consistency in international investment. However, some practitioners and authors, mostly representing the interests of developing countries, objected to such mechanisms for various reasons such as contravening the principle of finality as well as political reality. This study concludes that an appellate mechanism should be incorporated into the current international investment arbitration dispute resolution system and proposed to create a stand-alone appeals facility for reviewing investor-state disputes to promote a cohesive and consistent body of law.

Key Words: *Investment Arbitration, Inconsistent Awards, ICSID, Appellate Mechanism.*

Introduction

Arbitration tribunals have occasionally rendered contradictory awards¹ in investment arbitrations. These conflicts have raised urgent concern about the necessity of establishing appellate mechanism to harmonize the situation so as to achieve a consistent and coherence result facilitating predictability and consistency in international investment disputes. Conflicting awards based upon the same facts or identical worded provision in the treaty will create a threat to the international legitimate order and the continued existence of investment treaties. It is likely that investors will be advised to structure their investments in a manner that multi-dispute resolution mechanisms can be established through multiple investment treaties.

The purpose of the paper is to review the recently proposed appellate mechanisms in international investment treaty arbitration and critically analyze the various objections to appellate mechanisms in the international investment sphere. It is the intention of this paper to argue against the objections and to demonstrate the need of a single and unified appellate mechanism in the international investment arbitrations. The paper then concludes that there is an urgent need of an appellate court in resolving international investment disputes so as to achieve predictability and coherence of awards.

¹ Compare *Société Générale de Surveillance S.A. v. Republic of Philippines*, ICSID (W. Bank) Case No. ARB/02/6, holding umbrella clause elevated contractual obligations to international law obligations, with *Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan*, ICSID (W. Bank) Case No. ARB/01/13, holding umbrella clause did not elevate contractual obligations to international law obligations.

Problems of Inconsistency

Conflicting awards based upon the same facts or identical worded provision in the treaty will create a threat to the international legitimate order and the continued existence of investment treaties. It is likely that investors will be advised to structure their investments in a manner that multi-dispute resolution mechanisms can be established through multiple investment treaties. This paper presents three sets of investment arbitration cases, namely the SGS arbitrations, the Launder arbitrations, and the two Most Favored Nation cases, to demonstrate the above inconsistencies.

The SGS arbitrations

The Swiss – Philippines Bilateral Investment Treaty (BIT) contains a clause providing that "Each Contracting Party shall observe any obligation it has assumed with regard to specific investments in its territory by investors of the other Contracting Party." - most commonly designated as "umbrella clause" because they create a separate obligation under the investment treaty, requiring the Contracting Parties to observe obligations the host State has assumed in its relations with nationals of the other Contracting Party. Until recently, little debate existed as to the construction, the scope of application, and the general effect of such clause. These provisions seek to ensure that each Party to the treaty will respect specific undertakings towards nationals of the other Party. The provision is of particular important because it protects the investor's contractual rights against any interference which might be caused by either a simple breach of contract or by administrative or legislative acts, and because it is not entirely clear under general international law whether such measures constitute breaches of an international obligation.

The umbrella clause in the Swiss – Pakistan provides "Either Contracting Party shall constantly guarantee the observance of the commitments it has entered into with respect to the investments of the investors of the other Contracting Party." Triggered by the incompatible construction of comparable clauses in the Swiss-Pakistani and the Swiss-Philippine BITs by two ICSID tribunals,² contrary views developed on the function of umbrella clauses in investment treaties.

One line of jurisprudence, as represented by the *SGS v Philippines* case, supports a broad application of umbrella clauses allowing foreign investors to use investment treaty arbitration in order to seek relief for any breach of an investment-related promise by the host State, independent of the nature of the obligations and independent of the nature of the breach, and thus relates to commercial as well as sovereign conduct of host States. In this view, umbrella clauses go beyond customary international law by permitting foreign investors to bring claims for the breach of host State promises as a violation of the umbrella clause under the respective investment treaty without being restricted to targeting expropriatory, discriminatory or arbitrary conduct or, more generally, breaches of a sovereign nature. Umbrella clauses thus bridge the traditional distinction between municipal and international law, between contracts and treaties, by providing an international law remedy in case of any, even if "simple" or commercial, breach of an investor-State contract.

The *SGS v Pakistan* case represented the competing approach which attributes a narrower function to umbrella clauses in only restricting a State's sovereign conduct. In this view, the breach of an umbrella clause requires the breach of an investor-State contract resulting from a sovereign act of the host State. Essentially, this approach views umbrella clauses as a declaratory codification of customary international law that clarifies that rights of an investor under an investor-State contract can form the object of an expropriation and accordingly require compensation in case they are taken. Most importantly, this position excludes breaches of a purely commercial nature and reads the distinction between contract claims and

² *SGS Société Générale de Surveillance S.A. v. Republic of the Philippines*, ICSID Case No. ARB/02/6.; *SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13.

treaty claims into the interpretation of the umbrella clause. This excludes "simple" or commercial breaches of investor-State contracts from its scope of application.

The Launder arbitrations

What make the cases, *Launder v Czech Republic*³, and *CMS v Czech Republic*⁴, controversial in arbitration history is that different tribunals arrive at different decisions with essentially amounted to the same dispute. Mr. Launder, a U.S. citizen, and his Dutch investment vehicle, CME, initiated arbitral separate arbitral proceeding against the Czech Republic under the U.S.-Czech Republic BIT and the Netherlands –Czech Republic BIT in 1999 and 2000 which were held in London and Stockholm respectively. The issues before the tribunals related to expropriation, fair and equitable treatment, full protection and security and compliance with minimum obligations under international law. Both the U.S.-Czech Republic and the Netherlands –Czech Republic BITs had similar provisions in the prohibitions on the arbitrary and discriminatory treatment of investment.

The London tribunal did not find that the Czech Republic engaged in an arbitrary and discriminatory measure because the various conduct by the Czech Media Council was insufficient to rise to the level of a measure, and the initiation of administrative proceeding was neither arbitrary nor discriminatory as it constituted a normal exercise of regulatory duties of the Media Council. However, the Stockholm tribunal focused on the evisceration of the arrangements underlying the investment and perceived government coercion. It held that the Media Council was unreasonable and in violation of the treaty.

For the issues of expropriation, the London tribunal held the Czech Republic did not take any measure of, or tantamount to expropriation of Mr. Launder's property right because there was no direct or indirect interference by the Czech Republic in the use of Mr. Launder's property or with the enjoyment of its benefits. In contrast, the Stockholm tribunal held expropriation because the Czech Media Council coerced and colluded CME via overt acts and omissions to destroy the commercial value of the investment.

The two tribunals also differed on whether the Czech Republic violated its obligation to provide fair and equitable treatment despite similar obligations were stipulated in the two investment treaties. The London tribunal held there was no breach of the fair and equitable treatment obligation. It was not inconsistent for the Media Council, because of its concerns about illegal broadcasting, to enforce the Media Law absent a specific undertaking, and thus, it would not refrain from doing so. On the other hand, the Stockholm tribunal held otherwise because the Czech Republic violated its obligation to provide fair and equitable treatment to investors by evisceration of the arrangements in reliance upon which the foreign investor was induced to invest.

In spite of the similar provisions in full protections and security in the BITs, there were opposite conclusions. The London tribunal held that there was no failure to provide full protection and security to Mr. Launder's investment despite of Czech Republic's change of the Media Law where it considered that there was not a danger to the investment. The Stockholm tribunal held that the Czech Republic had not provided the protection as it is obligated to ensure that neither amendment of laws nor action of administrative bodies results in a withdrawal or devaluation of an investment.

The last major disagreement was the Czech Republic's obligation to comply with the principles of international law. The London tribunal found that the Czech Republic had not broken a particular principle of international law. Again, the Stockholm decided otherwise because the multiple breaches of the Republic were not compatible with principles of international law.

³ 3 September 2001, 9 ICSID Reports 66.

⁴ Partial Award, 13 September 2001, 9 ICSID Reports 121; Final Award, 14 March 2003, 9 ICSID Reports 121.

The contradictory results of the two cases suggest that at least one of the awards was wrong or partly wrong. The injustice of the conclusion undermines the legitimacy of investment arbitration, particularly where public international law rights are at stake and the legitimate expectations of investors and Sovereigns are mismanaged. Although the Czech Republic instituted the Swedish courts to vacate the Stockholm award, the Swedish court refused to set aside the Stockholm award because its review power was narrow and should only set aside award only in exceptional circumstances⁵ and it had no jurisdiction to reconcile the two decisions. Therefore, it is appropriate to establish appellate mechanism of investment arbitration to remedy this type of legal crisis and put investment treaty arbitration back to track to provide a predictable and coherent jurisprudence.

The Most Favored Nation cases

*The case Maffezini v. Kingdom of Spain*⁶, has been controversial for expanding the scope of Most Favored Nation (“MFN”) treatment to encompass dispute settlement procedures. The *Maffezini* decision on jurisdiction raises the issue of what matters should be incorporated into the MFN treatment provisions of investment treaties. It appears that, under *Maffezini*'s reasoning, matters which do not appear to be part of the specific will of the parties may be invoked through the MFN clauses, if more favorable provisions in other investment treaties may be found. At issue in *Maffezini* was an eighteen-month waiting period in the Argentina–Spain BIT. The claimant argued that he could bypass this eighteen-month waiting period by application of the Argentina-Spain BIT's MFN clause.

The tribunal found that if a third party treaty contained dispute settlement provisions more favorable to the protection of the investor's rights and interests than those in the basic treaty, such provisions could be extended to the beneficiary of the MFN clause, as long as the third party treaty concerned the same subject matter as the basic treaty. The tribunal, in order to decide whether the omission of a reference to procedural matters was intended, or could be reasonably inferred, decided to examine the practice of Argentina and Spain (particularly Spain) in terms of their dispute settlement undertakings with other states under BITs.

The *Maffezini* tribunal's application of the MFN clause was not terribly expansive given the broad scope set forth in the ordinary language of the Argentina-Spain BIT's MFN clause itself, encompassing “all matters subject to this agreement.” Nevertheless, the notion that “treatment” of investment and/or investors could encompass dispute settlement raised fears of an explosion of cases attempting to bypass entire dispute settlement procedures by virtue of the MFN clause.

In *Salini v. Jordan*⁷, the claimants argued that other BITs between Jordan and countries such as the United Kingdom and the United States clearly allowed investors to refer contractual disputes to ICSID, and therefore invoked the MFN clause of the Italy–Jordan BIT to bypass the provision in Article 9(2) that excluded contractual disputes from ICSID arbitration. Opposite to the *Maffezini*'s approach, the tribunal distinguished the MFN clause in the Italy-Jordan BIT, finding that it was not as broad and did not refer to “all matters subject to this agreement.” The tribunal further concluded that in this case the claimants had failed to establish that it was the common intention of the parties to have the MFN clause apply to dispute settlement. Moreover, the tribunal found that the BIT clearly excluded from ICSID jurisdiction contractual disputes between an investor and an entity of a state party. Until now, there is no consistent approach to interpret whether the procedural issue can be imported by MFN clause. In light of these divergent approaches, it is considered that some coherence can be achieved for the system to retain its integrity if a single investment treaty regime with appellate mechanism is established.

⁵ Czech Republic v CME Czech Rep. B.V., Judgment of the Court of Appeal, Case No. T 8735-01

⁶ *Maffezini v. Kingdom of Spain* 16 ICSID Rev. — FLJ 212 (2001); 5 ICSID Rep. 396 (2002); 40 I.L.M. 1129 (2001).

⁷ *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Hashemite Kingdom of Jordan*, Decision on Jurisdiction, ICSID Case No. ARB/02/13 2a, November 29, 2004.

Proposed Appellate Mechanisms

Having recognized that the inconsistent arbitral awards have severely hammered the predictability and reliability the foreign investment environment, many developed countries have proposed and implemented various appellate mechanisms to international investment arbitrations to harmonize the inconsistency problem. Their main purpose is to protect their foreign investments.

Many recent investment treaties, particularly treaties with United States, incorporated an appeal facility which would open the possibility to review decisions thereby increasing the chances of a consistent case law. The United State Model BIT of 2004⁸ has introduced an appellate mechanism in its model clause. This idea of a bilateral appeals mechanism has found entry into the US BIT with Uruguay⁹, Singapore¹⁰ and Chile¹¹. Each of which call for further negotiations on the creation of an appeals process as a part of the agreement's dispute resolution provisions.

Similar to the Bilateral Appeal Mechanism, there were provisions of appeal mechanism in multilateral treaties such as the Central America-Dominican Republic Free Trade Agreement (CAFTA-DR thereafter)¹².

The International Centre for Settlement of Investment Disputes (ICSID) has also proposed in a Discussion Paper in October 2004¹³, a institutional change by introducing an appeals facility. In the paper, it was pointed out that a number of countries are committing themselves to an appeal mechanism. To avoid counter the objective of coherence and consistency for different appeal mechanisms to be set up under each treaty concerned, and to improve efficiency and economy, it offered the prospect of a single appeal mechanism operate under a set of ICSID Appeal Facility Rules as an alternative to multiple mechanisms. The possible features of an ICSID Appeals Facility were presented in the Annex of the paper.

Article 53(1) of the ICSID Convention expressly prohibited appeal mechanism in its awards, and amendment of the ICSID Convention requires the unanimous ratification of the Contracting States. Therefore, it was proposed in the paper that submission to the ICSID Appeals Facility would be based on the treaty between the contracting states. The legal basis is Article 41 of the 1969 Vienna Convention of the Law of Treaties¹⁴, the treaty with the submission to the Appeals Facility might also modify the ICSID Convention a between the States parties to that treaty. Both ICSID and non-ICSID awards of investor-State arbitrations would be available.

The appeal tribunal would be consisted of three members and selected for each case from a panel of 15 persons from different countries with demonstrated expertise in law, international investment and investment treaties. The appeal would have to be based on an error of law or serious error of fact or one of the five grounds of annulment set out in Article 52 of the ICSID Convention. The appeal tribunal would have the power to uphold, modify or reverse the award concerned. The party requesting appeal, unless the appeal tribunal decided otherwise, would be solely responsible for the advances to ICSID to meet the fee and expenses of the appeal tribunal members of other costs.

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⁸ Annex D, United State Model Bilateral Investment Treaty 2004.

⁹ Uruguay-US BIT, 25 October 2004, Annex E, 44 ILM 268, 296 (2005)

¹⁰ Singapore FTA, U.S.-Singapore, art. 15.19.10 (2003), available at http://www.ustr.gov/assets/Trade_Agreements/Bilateral/Singapore_FTA/Final_Texts/asset_upload_file708_4036.pdf

¹¹ Chile FTA, U.S.-Chile, art. 10.19.10 (2003) available at http://www.ustr.gov/Trade_Agreements/Bilateral/Chile_FTA/Final_Texts/Section_Index.html (last visited Mar. 29, 2007).

¹² Annex 10-F Central America-Dominican Republic Free Trade Agreement.

¹³ ICSID, 'Possible Improvements of the Framework for ICSID Arbitration', (22 October 2004).

¹⁴ <<http://un.org/law/ilc/texts/treaties.htm>>

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However, in a subsequent Working paper of May 2005¹⁵, the appellate mechanism proposal was dropped for the time being. The reason was "it would be premature to attempt to establish such an ICSID mechanism at this stage". Unfortunately, there was no detailed explanation to justify the statement.

The Cases of Appellate Mechanism

Deconstructionists have pointed out that there are many disadvantages in creating an appellate system for investor-state arbitration. Their major objection to appellate mechanism of investment arbitration is that an appeal would go against the principle of finality.¹⁶ It brings out the debate the primarily objective of international investment law. The primary purpose of the investment arbitration treaty such as the ICSID Convention is to promote foreign investment. The Report of Executive Directors¹⁷ on the Convention emphasizes the aim of promoting global economic development through private international investment. If the award is plainly wrong, whether it is erred in law or fact, it would certainly be against the aim and objective of the Convention to promote international investment by enforcing an erred award. An appellate system operates as a corrective mechanism in case an arbitration decision is wrong.

Some commentators expressed their concerned that the appeal process would cause delay to the dispute settlement process¹⁸. However, the absence of an appeal procedure creates an environment which fosters prolonged litigation after awards are issued. As pointed out by Knull and Rubin (2000)¹⁹, losing parties are forced to submit grievances to state courts and to try to neatly fit their grievances into some grounds for vacatur. They cited the example of the current Argentinean investment treaty arbitration crisis which illustrates the need for an appellate process in investor-state arbitration²⁰. The looming possibility of Argentina losing in many investment arbitrations has forced the government to construct new and creative defense strategies²¹. One such tactic has been an expansion of judicial review of arbitral awards. In a 2004 decision, the Federal Supreme Court of Argentina held that "local courts could review an arbitral award even when the parties involved have specifically agreed to waive the right of appeal" to ensure that arbitral awards comply with Argentinean public policy and are constitutional, legal and rational²². Here, the possibility for inconsistent awards seems inevitable. ICSID's annulment process is ill-equipped for reconciling any legal errors made in the nearly forty Argentinean awards, especially considering that some of these cases are outside of ICSID's jurisdiction. If parties are forced to take their claims to Argentinean courts to consider their appeals, the opportunity for justice is questionable. Not to mention the long prolonged delays it encountered.

The ICSID annulment process does not provide parties with a speedy or efficient course of action. Of the claims which have made it through the annulment process, it took an average of five years for the ICSID

¹⁵ ICSID Secretariat. 'Suggested Changes to the ICSID rules and Regulations', (12 May 2005)

¹⁶ Katia Yannaca-Small, Organisation for Economic Co-operation and Development, *Improving the System of Investor-State Settlement: An Overview* 21 (2006).

¹⁷ International Bank for Reconstruction and Development, *Report of the Executive Directors on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States* (18 March 1965), in 1 ICSID Reports 23-33 (1993).

¹⁸ Katia Yannaca-Small, Organisation for Economic Co-operation and Development, *Improving the System of Investor-State Settlement: An Overview* 21 (2006).

¹⁹ William H. Knull, III & Noah D. Rubins, 'Betting the Farm on International Arbitration: Is it Time to Offer an Appeal Option?', 11 *Am. Rev. Int'l Arb.* 531, 531 (2000) at 542.

²⁰ See Alfaro-Abogados, 'Argentina: ICSID Arbitration And BITs Challenged By the Argentine Government' (December 21, 2004).

²¹ Alfaro-Abogados, *supra* note 20.

²² *Id.*

arbitration process to finally conclude.²³ It is noted that in the Amco, Klöckner, and Wena cases and they took ten, seven and six years to be concluded respectively since they were registered. Furthermore, parties are not limited to one request for annulment, heightening the inefficiency of the arbitration process²⁴. The Secretary General of ICSID is permitted to consider any request for an annulment if it is made, in accordance with Article 52(2) of the Convention, "within 120 days after the date on which the award was rendered (or any subsequent decision or correction)" or "in the case of corruption on the part of a member of the Tribunal, within 120 days after discovery thereof, and in any event within three years after the date on which the award was rendered (or any subsequent decision or correction)."²⁵ The ICSID Annulment process theoretically could last an eternity.

Fears that an appeals procedure would result in added costs and setbacks in the arbitral process are unfounded. The average time period for annulling an ICSID award is approximately five years²⁶, whereas, the average time for an appeal before the WTO Appellate Body is three months²⁷. Forcing parties to continue within the current ICSID annulment process, or to take their objections to state courts, has not cut costs or engendered a more efficient practice. An appeals mechanism would remedy the inefficiencies of the current process.

It was argued that the jurisprudence is still in its early day because the number of investment dispute is very much less than those cases handled by domestic courts. We cannot agree with this argument because investment disputes are hardly comparable with those of the normal civil dispute cases. Firstly, the monetary amounts of the investment are much more than those of civil cases. Secondly, investment dispute normally involves public interest as one of the parties is a state. There is an urgent need that consistent and coherence to the investors such that accurate rules of laws in investment treaties are established to protect investors' interest. Besides, it would also be the interest of the contracting states that a jurisprudence state be established as they are answerable to their citizens.

It was argued by deconstructionists that an appeal mechanism proposed by the 2004 ICSID Discussion paper could fragment the arbitral regimes²⁸. ICSID arbitrations would in some instances be subject to the mechanism where the BITs between the Contracting States have subjects their dispute to appellate mechanism and in other cases remain free of the mechanism because the BITs between the Contracting States do not have such provision.

The consistency of award is severely limited by the differences in the provision of different international agreements. However, One should not be too concerned with the hardware of the appellate mechanism. It is more important that the software of an appellate mechanism be established. To achieve consistency and coherence of awards, it is most important that the legal reasoning of how the tribunals to decide certain legal issues are established. Although a legal reasoning of an appellate tribunal established under one arbitral institution may not be binding on subsequent disputes under different arbitral institution, it would definitely be highly persuasive. In fact, the current practice of investment treaty arbitrators do take into account of the decisions of other precedent cases established under different institution. For example, an ICSID appellate tribunal's decision would be highly persuasive to subsequent NAFTA cases. Consistency and coherence of award can still be maintained.

²³ See ICSID, List of Concluded Cases, at <http://www.worldbank.org/icsid/cases/conclude.htm>.

²⁴ See Amco Asia Corp.v. Indonesia, ICSID (W. Bank) ARB/81/1(1990) The Amco arbitration proceedings lasted just short of a decade, after the second annulment award was issued. Klöckner was not concluded until a third tribunal decided a second annulment application seven years after the original proceeding was registered with ICSID. Klöckner Industrie-Anlagen GmbH v. Cameroon, ICSID (W. Bank) ARB/81/2 (1985).

²⁵ ICSID Rules of Procedure for Arbitration Proceedings, Chapter VII, Rule 50.

²⁶ ICSID, List of Concluded Cases, supra note 20

²⁷ WTO, Appellate Body Annual Report (2005), available at http://www.wto.org/english/tratop_e/dispu_e/stats_e.htm.

²⁸ South Centre, 'Developments of Discussions for the Improvement of the Framework for ICSID Arbitration and the Participation of Developing Countries', South Centre Analytical Note, February 2005 http://www.southcentre.org/index.php?option=com_docman&task=doc_download&gid=245&Itemid= last seen on 21.2.2009

It was also argued that it would be difficult to establish legal reasoning because the provisions and wordings of different treaty may hardly applicable to other. However, we are concerned with the legal reasoning. It is the legal rationale that is important to established precedent. For example, under the common law system, the same *ratio decidendi* may be applicable to different contracts which have similar contractual provisions although their wording may not be exactly the same.

We disagree that the appeal mechanism would not harmonize the coherence of inconsistent cases. It is no doubt that the decision of the tribunal under the bilateral appeals mechanism may not be binding on subsequent cases. However, being an appeal tribunal the legal reasoning, or ratio decidendi, used in the decision is highly valuable, persuasive and authoritative. Similar to court decisions among common law countries where the decisions of higher court of a common law country are persuasive to courts of other common law countries, the decisions of a bilateral appellate tribunal are persuasive to subsequent cases of other similar bilateral treaty cases. Their decisions are definitely beneficial to resolve or harmonize the inconsistent decision problems so as to provide coherence of interpretation of various provisions of investment treaties.

Conclusion

Current methods for review of both investor-state and international commercial arbitral awards are inadequate for providing parties with effective review mechanisms for faulty awards. An appellate system should be readily available to parties who opt to participate in this process. The creation of a stand-alone appeals facility for reviewing investor-state disputes would aid in promoting a cohesive and consistent body of law. Further, the adoption of appeals procedures for international commercial disputes at an institutional level would enhance the efficiency of international commercial arbitration. To encourage the finality, efficiency and enforceability of international arbitral awards, such appellate processes must be recognized.

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