Arbitrating with Sovereigns and State-Owned Entities

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As international commerce and foreign investment have proliferated, so too have disputes between private entities and sovereign governments, their regional or local authorities, or State-owned companies. Resolving these disputes, whether arising under contracts or from administrative or regulatory action by the foreign State, can be particularly complex. Companies considering legal action against sovereign or State-owned entities must consider a range of substantive and tactical issues beyond the threshold issues common in private commercial arbitration.

First, private parties must recognize that the dispute resolution provisions in their contracts with sovereign counterparties may not represent their only, nor their best, framework for resolving the dispute. Many State contracts call for litigation of investment disputes in the national courts of the host country. Given the leverage executive authorities may exercise over local courts, or those courts' deference to administrative laws granting broad discretion to public authorities, this can raise serious concerns about the neutrality and fairness of local court proceedings. These concerns are not obviated by arbitration clauses in State contracts. If the arbitral situs is within the host State, its courts retain supervisory authority pursuant to local law. Even after an award in the investor's favor, local courts can sometimes block enforcement against overseas assets by granting annulment under local law, thereby bringing into play one of the New York Convention's rare grounds for refusing enforcement of international arbitration awards. This power of local courts to block enforcement under the Convention exists even where arbitrations are held in neutral sites, if the awards are rendered under local law.

Foreign investors can sometimes avoid these risks by proceeding under bilateral or multilateral treaties rather than contract. More than 2000 treaties now exist that articulate standards for treatment of foreign investment and provide dispute resolution procedures independent of contract. These treaties generally refer disputes to the International Centre for Settlement of Investment Disputes (ICSID), under the aegis of the World Bank. Enforcement of ICSID awards is not dependent on the New York Convention and therefore not subject to local court interference; rather, the almost 140 State signatories to the ICSID Convention are bound to enforce awards as if they were final judgments of their own highest courts. The World Bank's imprimatur, and concern over alienating further foreign investment, also help persuade sovereigns to honor adverse awards.

ICSID arbitration may be the only alternative to local court action where the investor's relationship with a sovereign is not governed by contract. The standards of treatment provided in investment treaties may be invoked to challenge regulatory or administrative acts, such as revocation of permits or imposition of onerous operating conditions, where such acts are inconsistent with local law or due process requirements or are targeted specially at, or have disproportionate impact on, one or more foreign investor. Where applicable, these standards may be invoked to claim relief in the absence of any contractual relationship between the investor and State entities, or instead of procedures provided by contract, even those purportedly "exclusive" or "mandatory."

The availability of ICSID arbitration in particular disputes raises complex questions, and companies considering proceedings against sovereigns or State entities should seek expert guidance early in the process. Not all disputes may be framed as treaty violations, and not all contractual or financial interests may qualify as covered investments. Moreover, if local court proceedings are initiated in reliance on contractual provisions or advice of local counsel, these may be found to have triggered "fork in the road" provisions in investment treaties that foreclose any later ICSID claim.

Expert advice on strategic and tactical options is also warranted for companies considering arbitration against sovereigns and State-owned entities through traditional mechanisms, such as the International Chamber of Commerce, London Court of International Arbitration or American Arbitration Association. Even in these fora, there are special considerations in sovereign arbitrations. The nationality of arbitrators is critically important, to prevent sovereigns from seeking to influence, intimidate, or even recall their nationals from overseas proceedings. If not mandated by contract, the choice of arbitral "seat" is equally important as explained above. Sovereign arbitrations also frequently present substantive issues beyond those encountered in purely private disputes, such as regulatory or public policy justifications for acts otherwise in breach of contract, or the potential immunity of sovereign assets from execution to satisfy an award, notwithstanding even explicit waivers of immunity for the arbitral process itself. Because these issues are complex, it is vital for companies weighing their options to take thorough counsel from qualified attorneys before determining their ultimate strategy.

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