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Issues related to international arrangements *

Investor--State disputes and policy implications

Note by the UNCTAD secretariat

Executive summary

International investment disputes arising from investment agreements are on the increase. The cumulative number of treaty-based cases brought before the World Bank Group´s International Centre for Settlement of Investment Disputes and other arbitration tribunals rose from five at year-end 1994 to at least 160 in November 2004, with over half (92) of the known claims filed within the past three years. Over 50 States were brought before an international tribunal, 31 of which were developing countries, 11 developed countries and 8 transitional economies. The cases cover a wide range of economic activities and various types of foreign involvement, and relate to key provisions in investment agreements. These developments raise a number of systemic and substantive issues and have serious development implications. This note sets out a number of them.

* This document was submitted on the above-mentioned date because of delays in the verification of data contained in it.

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INTRODUCTION

1. In accordance with the decision by the Commission on Investment, Technology and Related Financial Issues at its eighth session (Geneva, 26–30 January 2004),[1] the secretariat prepared this note as an input to the discussions on "Issues related to international arrangements" under agenda item 4 of the ninth session of the Commission on Investment, Technology and Related Financial Issues. The purpose of this note is to review recent developments in international investor—State dispute settlement and to set out a number of policy questions related to this issue for consideration by the Commission.[2]

2. Furthermore, the note is intended to stimulate an exchange of experiences and consensus building in this area, with a view to promoting the development dimension. This includes a review of experiences in implementing international commitments, as mandated by the eleventh Conference of UNCTAD (São Paulo Consensus, TD/410, 25 June 2004, para. 56).

A. The setting

3. The international investment policy-making efforts to attract foreign direct investment (FDI) and benefiting from it continue to intensify, and international investment agreements (IIAs) at the bilateral, sub-regional, regional and interregional levels further proliferate. The resulting intricate web of investment rules is multilayered and multifaceted, with the rules partly overlapping and partly supplementing one another. The universe of IIAs consists of over 2,300 bilateral investment treaties (BITs), over 2,300 double taxation treaties (DTTs), numerous preferential free trade and investment agreements (PTIAs), and multilateral agreements.

4. In the above context, specific procedures have been put in place with respect to the settlement of disputes between private parties and the host country arising from investment. The vast majority of BITs, as well as some regional agreements and other instruments, contain provisions for investor—State dispute-settlement.

5. The usual approach to investor—State disputes in IIAs is to specify that the parties to a dispute must seek an amicable negotiated settlement. If amicable negotiations fail to resolve a dispute, international arbitration is usually the next step—either on an ad hoc or an institutional basis (UNCTAD, 2003a, b).

6. Investor—State dispute settlement is an area of investment practice that has given rise to a broad range of legal issues, and a substantial number of approaches to tackle them. The

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[1] "In light of the discussions at the current session, UNCTAD should continue its work on investment, technology and enterprise development through research and policy analysis, technical assistance and capacity and consensus building. In particular, UNCTAD should: … Continue its work on international arrangements**,** with emphasis on the bilateral and regional dimensions, including in the context of North—South and especially South—South cooperation, and the needs of member countries in this regard. Furthermore, the secretariat should continue to facilitate an ongoing exchange of information and experiences in this area, including at the intergovernmental level", paragraph 5, fifth sub-bullet, Recommendations for the UNCTAD secretariat, TD/B/COM.2/60 & TD/B/COM.2/60/Corr.1, dated 17 February 2004.

[2] This note is based on an occasional note published by UNCTAD on 29 November 2004 (UNCTAD/WEB/ITE/IIT/2004/2), entitled "International investment disputes on the rise".

issue is of importance for both host countries and foreign investors. When a foreign investor enters the territory of a host country, that investor is usually inclined to seek protection in the form of specified treatment standards, such as most-favoured-nation treatment, national treatment and fair and equitable treatment, as well as guarantees on matters such as compensation for expropriation and the right to transfer capital, profits and income from the host State. These rights are often embodied in particular provisions of IIAs.

7. The existence of an effective dispute-settlement process contributes to the creation of a favourable investment climate in the host country, which is the purpose of its entering into IIAs with a view to encouraging FDI and benefiting from it. Countries wish to ensure that, in the event of a dispute with foreign investors, they will have the means of resolving the legal aspects of that dispute expeditiously. Nevertheless, there have been fears about frivolous or vexatious claims that could inhibit legitimate regulatory action by Governments, as well as concerns with regard to balancing national and international methods of dispute settlement.

B. The rapid increase in investor—State dispute settlement

8. The cumulative number of all known cases brought under bilateral, regional (e.g. NAFTA) or plurilateral (e.g. Energy Charter Treaty) agreements that contain investment clauses, or IIAs, was 160 in November 2004 (annex figures 1 and 2), up from five at year-end 1994. One hundred and six of these treaty-based cases were brought before the World Bank Group's International Centre for Settlement of Investment Disputes (ICSID), as compared to three at year-end 1994 (annex figure 3). In addition, there are at least 54 cases (cumulative) outside ICSID, as compared to two at the end of 1994. (International investment disputes can also arise from contracts between investors and Governments; a number of such disputes are (or have been) before ICSID but are not included in these data.) Well over half (92) of the 160 known claims were filed within the past three years, with virtually none of them initiated by Governments.[3] Eleven disputes were initiated by firms from developing countries. Three major factors exert a substantial influence on the number of treaty-based arbitration proceedings and what is publicly known about them. One factor, the unprecedented spate of lawsuits against Argentina, serves to inflate that number, while the other two – the confidentiality of disputes under some arbitral rules, and a decision not to include "notices of intent" as official claims in UNCTAD's count – exert downward pressure on the figures (box 1).

9. At least 50 Governments – 31 of them in the developing world, 11 in developed countries and 8 in transition economies – have faced investment treaty arbitration (annex table 1). Thirty-seven claims have been lodged against Argentina, 34 of which relate at least in part to that country's financial crisis. Mexico has the second highest number of known claims (14), most of them falling under NAFTA, and a handful under various BITs. The United States has also faced a sizeable number of claims (10), all of them under NAFTA and not the BITs concluded by that country. Poland (with seven claims), Egypt (with six claims) and Canada, Chile, the Czech Republic and Ukraine (with four claims each) also figure prominently in this list.

[3] The sole exception is a 2003 State-to-State dispute between Chile and Peru. This claim was lodged by Peru following an investor—State claim filed by a Chilean firm, Lucchetti (Lucchetti S.A. and Lucchetti Peru S.A. v. Republic of Peru, ICSID Case No. ARB/03/4). In other instances, States have set up claims commissions to deal with investor-to-State cases, such as United States and Islamic Republic of Iran Claims Tribunal.

Box 1. Factors influencing the universe of investor—State dispute settlement

There are three major factors, described below, that exert a substantial influence on the number of treaty-based arbitration proceedings and what is publicly known about them.

Argentina

The number of recent cases of investor—State disputes has been influenced by the unprecedented volume of international litigation initiated against Argentina. Since that country's 2001 financial crisis, foreign investors have claimed compensation for losses in such industries as gas and oil production, telecommunications concessions, and electricity and water distribution. In 2003 alone, 20 transnational corporations filed lawsuits against Argentina, alleging violation of investment treaty guarantees. A further eight ICSID cases had been launched as of 24 November 2004.[a] However, even excluding all the Argentine claims to date (37), the number of cases is still on the rise.

Confidentiality of disputes

The ICSID arbitration facility is the only facility to maintain a public registry of claims. A number of claims are known to be proceeding outside ICSID, however (annex figure 2).[b] What is not known is how many cases there are in addition to those shown in figure 3. The number of treaty-based investment disputes is thus likely to be higher than the available figures indicate. While considerable efforts have been made to uncover non-ICSID claims through interviews and searches of media reports and company filings, it remains the case that some investors or Governments desire confidentiality – which is why the exact number of cases is difficult to determine.

Notices of intent

A number of investment treaty claims – in the form of a notice of intent or the submission of a request to ICSID – were omitted from UNCTAD's database, either because they had not proceeded to formal arbitration or because the existence of an arbitration could not be verified.[c] ICSID claims are publicly disclosed only when they have been officially registered by the ICSID secretariat. Meanwhile, outside ICSID, notices of intent to arbitrate against a host State may or may not be publicized, but an actual arbitration will not necessarily be set in motion until a request for arbitration or a claim has been filed. For example, in the case of claims brought under NAFTA, a notice of intent to arbitrate does not set in motion an arbitration – it merely signals intent.

For this reason, the list of the 160 known arbitration cases excludes instances where there has been notification of intent to arbitrate under NAFTA or some other treaty (through the commencement of a mandatory waiting period under a treaty, for example) but where a request for arbitration is still awaited or could not be confirmed.

Source: UNCTAD.

/…

Box 1 (concluded)

[a] On 14 October 2004, the Government of Argentina issued a dismissal of the claims filed against it in ICSID, arguing that none of the cases was justified (Comunicado de Prensa, Ministerio de Economía y Producción).

[b] Numerous IIAs allow investors to choose between ICSID (including ICSID's Additional Facility) and ad hoc arbitration procedures, using UNCITRAL arbitration rules for example. Other institutional facilities available for use are the ICC Court of Arbitration in Paris, the Stockholm Chamber of Commerce Arbitration, the London Court of International Arbitration and various regional arbitration centres, particularly those of Singapore and Cairo. The fact that the total number of arbitration proceedings remains unknown is partly a result of this option, as only ICSID provides a list of cases. Information is not always available from these other arbitration institutions.

[c] Because claims may be filed in different manners, depending on the applicable treaty and arbitral rules, there is no obvious common standard for assessing when arbitration proceedings have been launched. NAFTA requires "notices of intent"; bilateral investment treaties (usually) do not.

10. The known investor—State arbitration proceedings concern foreign investments in both the pre-establishment and the post-establishment phase and involve all kinds and types of foreign investments, including privatization contracts and State concessions. The range of measures that are being challenged is broad, including emergency laws put into place during a financial crisis, value-added taxes, re-zoning of land from agricultural use to commercial use, measures on hazardous waste facilities, issues related to the intent to divest shareholdings of public enterprises to a foreign investor, and treatment at the hands of media regulators. Investor claims deal with issues related to fair and equitable treatment, non-discrimination, expropriation (regulatory takings or measures "tantamount to" expropriation) and the scope and definition of agreements.

11. The economic sectors that have seen treaty-based disputes include construction, water and sewage services, brewing, telecommunications concessions, banking and financial services, hotel management, television and radio broadcasting, hazardous waste management, textile production, gas and oil production, and various forms of mining.

12. Information about the level of damages being sought by investors tends to be sporadic and unreliable. Even ascertaining the amounts sought by foreign investors can be difficult, as the bulk of cases is still at a preliminary stage and under the ICSID system, claimants are not obliged to quantify their claims until after the jurisdictional stage has been completed. Claims proceeding under other rules of arbitration may also not be quantified at an early stage, and even when they are, counsel and investors tend to be reticent about disclosing such information. Some of the known awards involve large sums, however. For example, in 2003, the Czech Republic was ordered to pay some $270 million plus substantial interest to a Dutch-based broadcasting firm following a tribunal’s finding that the Republic’s media regulatory authorities had violated the terms of an investment treaty with the Netherlands. There was a similar order of magnitude in the award against Ecuador, which was ordered to pay Occidental $71 million plus interest in 2002.

13. At the same time, it should be noted that not all claims lead to the requested awards being granted. In fact, the amount awarded for a claim is not necessarily an indication of the real financial magnitude of a case, since there are no penalties for claimants filing particularly

large claims. Very large claims often end up yielding very small awards. The Metalclad vs. Mexico claim for $43 million, for example, led to an award of less than $17 million, and S.D. Myers, in its $70-to-$80 million claim against Canada, was awarded $6 million – less than 10 per cent of the amount sought. It is noteworthy in this context that not all claims brought by businesses succeed and that States have won a significant number of cases; but even defence costs money.

14. Investment treaty arbitration proceedings are not inexpensive to mount. The Metalclad Corporation is reported to have spent some $4 million on lawyers' and arbitrators' fees in an arbitration against Mexico.[4] The Czech Republic reportedly spent $10 million on its defence against two major claims brought by a European-based broadcasting firm and one of its major shareholders.[5] More recently, the Government of the Czech Republic announced expected legal fees of $3.3 million in 2004, and $13.8 million next year, to deal with similar claims.[6] A cursory review of cost decisions in recent awards suggests that the average legal costs incurred by Governments are $1 to $2 million, including lawyers' fees; the costs for the tribunal about $400,000 or more; and the costs for the claimant about the same as for the defendant.[7]

C. Development implications

15. The recently increasing number of claims brought under investor—State dispute settlement provisions of IIAs appears to indicate that foreign investors may well turn increasingly to international investor—State dispute settlement procedures to challenge measures taken by authorities that they perceive as adversely affecting their investments. Even discounting the claims against Argentina, it is evident that the number of arbitration proceedings is growing steadily and is likely to continue to do so.

16. In addition, more investment may lead to more occasions for disputes – and more occasions for disputes combined with more IIAs are likely to lead to more cases.[8] The increasing prominence of complicated infrastructure projects is particularly relevant here.[9] The increase in disputes may also reflect an apparently growing tendency among foreign investors to litigate, following well-publicized claims.

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[4] See J.C. Thomas, "A reply to Professor Brower", *Columbia Journal of Transnational Law*, vol. 40 (2002), no. 3. This case was also reviewed by a Canadian court, the cost of whose review is not included in this figure.

[5] See Luke Eric Peterson, "Czech Republic hit with massive compensation bill in investment treaty dispute", *INVEST-SD News Bulletin*, 21 March 2003, available at http://www.iisd.org/pdf/2003/investment_investsd_march_2003.pdf .

[6] See Luke Eric Peterson, "Croatian firm invokes investment treaty to challenge Czech eviction notice", INVEST-SD News Bulletin, 1 October 2004, http://www.iisd.org/pdf/2004/investment_investsd_oct1_2004.pdf.

[7] Preliminary results of a CEPMLP/Dundee research project on economic analysis of transnational dispute management.

[8] For documentation of the growth of IIAs, see the various *World Investment Reports*, at www.unctad.org/wir. BITs are documented at www.unctad.org/iia, where the texts of more than 1,800 BITs can also be found. See also in this context press release UNCTAD/PRESS/PR/2004/036, on the rise of South—South investment agreements.

[9] Although not counted here, there may also be an increase in contracts between foreign investors and governments, including in the form of stabilization agreements that developing country Governments conclude with domestic and foreign private investors. (Peru alone, for example, has concluded over 400 such agreements between 1993 and 2004; see www.proinversion.gob.pe/english/convenios.) Many of these contracts, particularly those involving foreign investors, contain international investor—State dispute settlement provisions.

17. While investor—State dispute settlement is a remedy of right in contemporary IIA practice, internationalized systems of dispute settlement must guard against frivolous or vexatious claims. It is also important that the award of damages against a host country be commensurate with the actual loss. Furthermore, the development impact of disputes should be taken into account. Some recent arbitral tribunals have awarded large sums, which raise concerns about their impact on developing countries. Beyond the issue of awards, the policy implications of disputes need to be looked at.

18. International arbitration itself can demand much by way of resources and expertise, possibly putting developing countries parties at a disadvantage. Arbitrators need to be drawn from a wide pool as regards experience and origins, so as to ensure that the interests of the developing countries and of the foreign investors are represented. Perhaps more of an effort should be made to train arbitrators from developing countries.

19. Overall, the investor—State dispute-settlement system must be fair to both parties and be perceived as such. Investor—State disputes arise between a private commercial party and a State administration or agency and as such can engage public interest and contain a policy element. This has to be weighed against the commercial interests of the private party. The dispute-settlement system must be sensitive to both kinds of interests and to the claims that they might generate in the course of a dispute.

20. Given the complexity of the content of IIAs, Governments that decide to enter into IIAs need to be judicious in negotiating such agreements. They need to follow the developments of disputes in order to be sensitive to actions that could trigger litigation. Furthermore, it is important to review experiences in implementing international commitments in IIAs and to draw lessons therefrom. Indeed, some countries have revised their model BITs in view of, among other things, their recent experience in investor—State dispute settlement.

21. In light of this overview, the Commission may wish to consider the following issues with regard to recent trends in investor—State dispute settlement and their development dimension:

- A number of substantive treaty provisions (in particular as regards scope and definition, non-discrimination, taking of property, and dispute settlement) have given rise to investor—State dispute settlement claims. What steps could be taken to clarify these provisions in order to avoid further disputes and to clarify the meaning of certain provisions, in the interest of both host countries and foreign investors?

- A number of procedural issues in investor—State dispute settlement have given rise to concerns regarding the proper functioning of the procedures (in particular insofar as mediation, entitlement to use of investor—State dispute settlement provisions, multiplicity of forums, treaty shopping, the internationalization of domestic dispute settlement choices, standard/burden of proof, and transparency are concerned). What steps could be taken to clarify these provisions in order to avoid further disputes and to clarify the meaning of certain procedural approaches, in the interest of both host countries and foreign investors?

- Since developing countries continue to be mainly capital-importing countries, they are most likely to bear the brunt of a potential increase in investor—State dispute settlement cases. This creates a number of concerns for those countries, as they might not possess the technical expertise and institutional capacity to deal with such cases. In addition, the costs of the cases can be significant when a tribunal's costs, arbitrator fees, fees and disbursements by lawyers and the time involved in preparing the cases are all accounted for. What steps could be taken to help developing countries in this regard?

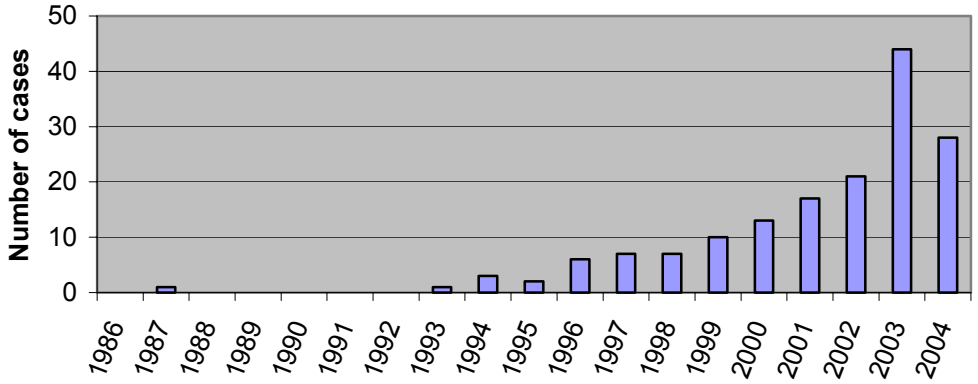
REFERENCES

United Nations Conference on Trade and Development (UNCTAD) (2003a). *World Investment Report 2003: FDI Policies for Development: National and International Perspectives* (New York and Geneva: United Nations), United Nations publication, sales no. E.03.II.D.8.

_____ (2003b). *Dispute Settlement: Investor—State* (New York and Geneva: United Nations), United Nations publication, sales no. E.03.II.D.5.

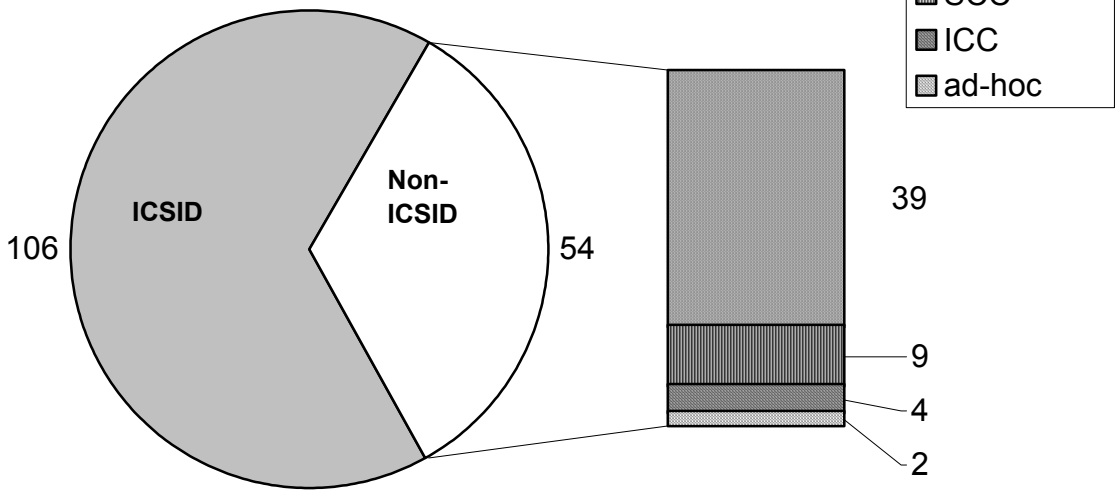
ANNEX

Annex figure 1. Known investment treaty arbitrations, November 2004

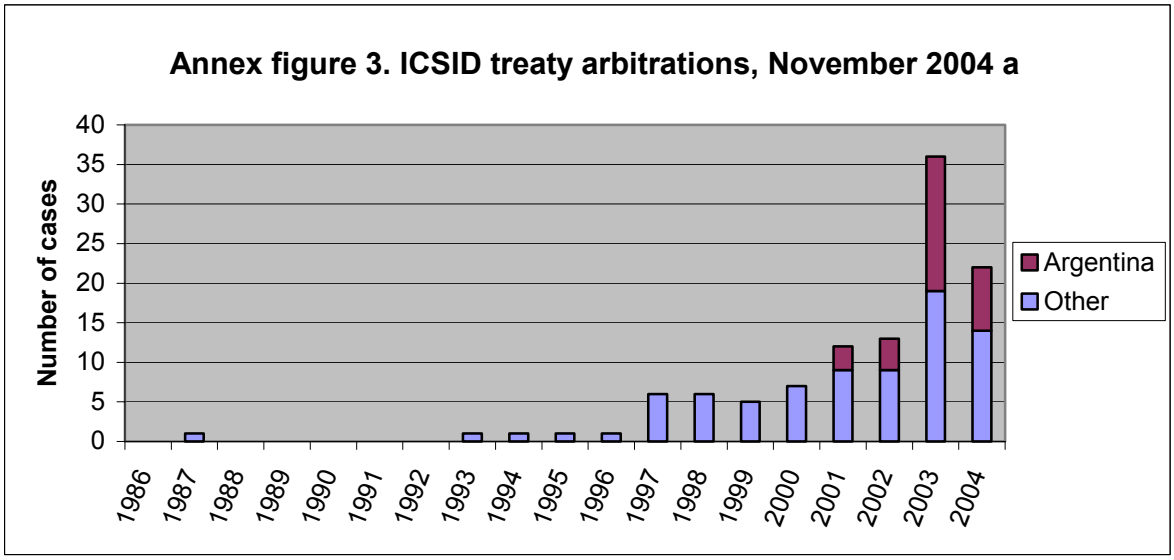


Source: UNCTAD.

Annex figure 2. Disputes by rules of arbitration, November 2004



Source: UNCTAD.



Source: UNCTAD.

[a] Argentina since 2001.

Annex table 1. Known investment treaty claims filed against a given country [a]

Respondent	Number of claims
Argentina	37
Mexico	15
United States of America	10
Poland	7
Egypt	6
Canada	4
Chile	4
Czech Republic	4
Ukraine	4
Democratic Republic of the Congo	3
Ecuador	3
Hungary	3
Kazakhstan	3
Pakistan	3
Russian Federation	3
Burundi	2
Estonia	2
Jordan	2
Latvia	2
Morocco	2
Philippines	2
Romania	2
Sri Lanka	2
United Arab Emirates	2
Venezuela	2
Albania	1
Algeria	1
Barbados	1
Bolivia	1
Bulgaria	1
El Salvador	1
Germany	1
Ghana	1
Guyana	1
India	1
Indonesia	1
Kyrgyzstan	1
Lebanon	1
Mongolia	1

Myanmar	1
Paraguay	1
Peru	1
Republic of Moldova	1
Saudi Arabia	1
Slovakia	1
Spain	1
Trinidad and Tobago	1
Tunisia	1
Turkey	1
Viet Nam	1
Undisclosed	6
Total	**160**

Source: UNCTAD.

[a] The information provided in this table is still preliminary and subject to ongoing verification.