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Investor–State Disputes: Prevention and Alternatives to Arbitration

UNCTAD Series on International Investment Policies for Development

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NOTE

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The following symbols have been used in the tables:

Two dots (..) indicate that data are not available or are not separately reported.

Rows in tables have been omitted in those cases where no data are available for any of the elements in the row;

A dash (-) indicates that the item is equal to zero or its value is negligible;

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A slash (/) between dates representing years, e.g. 1994/1995, indicates a financial year;

Use of a hyphen (-) between dates representing years, e.g. 1994-1995, signifies the full period involved, including the beginning and end years.

Reference to "dollars" ($) means United States dollars, unless otherwise indicated.

Annual rates of growth or change, unless otherwise stated, refer to annual compound rates.

Details and percentages in tables do not necessarily add to totals because of rounding.

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PREFACE

The secretariat of the United Nations Conference on Trade and Development (UNCTAD) is implementing a programme on international investment arrangements. It seeks to help developing countries to participate as effectively as possible in international investment rule-making. The programme embraces policy research and development, including the preparation of a series of issues papers; human resources capacity-building and institution-building, including national seminars, regional symposia, and training courses; and support to intergovernmental consensus-building.

This paper is part of a new Series on International Investment Policies for Development. It builds on, and expands, UNCTAD's Series on Issues in International Investment Agreements. Like the previous one, this new series is addressed to Government officials, corporate executives, representatives of non-governmental organizations, officials of international agencies and researchers.

The Series seeks to provide a balanced analysis of issues that may arise in the context of international approaches to investment rule-making and their impact on development. Its purpose is to contribute to a better understanding of difficult technical issues and their interaction, and of innovative ideas that could contribute to an increase in the development dimension of international investment agreements.

The Series is produced by a team led by James Zhan. The members of the team include Bekele Amare, Anna Joubin-Bret, Hamed El-Kady, Tamas Pal Heisz, Jan Knörich, Diana Rosert, Ileana Tejada, Elisabeth Tuerk and Jörg Weber. Members of the Review Committee are Jack Coe, Susan Franck, Barton Legum, Peter Muchlinski, Jeswald W. Salacuse and Margrete Stevens.

This paper was prepared by Anna Joubin-Bret and Jan Knörich. Susan Franck, Nicolas Perrone, Elisabeth Tuerk and Jörg Weber made comments, and Tamas Pal Heisz and Diana Rosert helped finalize the paper. It benefited from comments during a peer forum on "*Investor–State Dispute Settlement*" in July 2009, which took place in Miami and was jointly organized with the University of Miami. Further comments were received from exchanges of experts in preparation for the Washington and Lee University and UNCTAD Joint Symposium on International Investment and ADR.

The paper provides a timely discussion of a crucial issue in contemporary international investment policy making, implementing UNCTAD's mandate in the area of international investment agreements emanating from the Accra Accord (paragraph 151).

Supachai Panitchpakdi
Secretary-General of UNCTAD

Geneva, May 2010

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ABBREVIATIONS

AAA	American Arbitration Association
AALCO	Asian–African Legal Consultative Organization
ADR	Alternative Methods of Dispute Resolution
BIT	bilateral investment treaty
BOT	Build–operate–transfer
CRCICA	Cairo Regional Centre for International Commercial Arbitration
DRB	dispute resolution board
DR-CAFTA	Dominican Republic–Central America Free Trade Agreement
DPP	dispute prevention policy
DSD	dispute systems design
ENE	early neutral evaluation
EPA	economic partnership agreement
FDI	foreign direct investment
FTA	free trade agreement
ICC	International Chamber of Commerce
ICDR	International Centre for Dispute Resolution
ICJ	International Court of Justice
ICSID	International Centre for Settlement of Investment Disputes
IMI	International Mediation Institute
IPA	investment promotion agency
ISDS	investor-State dispute settlement
IIA	international investment agreement
KLRCA	Kuala Lumpur Regional Centre for Arbitration
MIGA	Multilateral Investment Guarantee Agency
NAFTA	North American Free Trade Agreement
OIO	Office of the Foreign Investment Ombudsman

OPIC	Overseas Private Investment Corporation
REIA	regional economic integration agreement
SMC	Singapore Mediation Centre
UNCITRAL	United Nations Commission on International Trade Law
WIPO	World Intellectual Property Organization

GLOSSARY OF IMPORTANT TERMS

This glossary of important terms is made to provide general guidance and reference to the reader on the terms frequently used within this publication. The definitions are not meant to represent any particular scholarly thinking or perspective. Most importantly, the definitions have been adjusted to the specific context of investment treaty arbitration and investor–State dispute settlement. This glossary was compiled based on Coe (2005), Smith and Martinez (2009), specific inputs and suggestions from Susan Franck, and the website on international investment and ADR maintained by Washington & Lee University School of Law and UNCTAD in preparation for the Joint Symposium on International Investment and ADR that took place on 29 March 2010 (see http://investmentadr.wlu.edu/resources/page.asp?pageid=587, accessed 24 June 2010).

Adjudication:

Adjudication is the resolution of disputes through a neutral third party (or parties) with the authority to bind the disputing parties – in this case the investor and the State – to the terms of an award or decision in accordance with the applicable law and facts presented by them. Typical adjudicative processes are national court trials and (international) arbitration (Smith and Martinez 2009).

Alternative approach to treaty-based Investor–State dispute settlement:

An alternative approach to investor-State dispute settlement is a dispute resolution, avoidance or prevention mechanism that constitutes an alternative to international investment arbitration. There are two main categories to alternative approaches. The first category addresses already existing disputes and approaches to their resolution. The use of Alternative forms of Dispute Resolution (ADR) mechanisms is common in this context. The second category concerns the use of avoidance and prevention policies prior to the occurrence of a dispute, but in anticipation of the possibility that a dispute may emerge (at times referred to as preventative ADR).

Alternative forms of dispute resolution (ADR):

ADR is an approach to the settlement of disputes by means other than binding decisions made by courts or arbitral tribunals. In the specific context of international investor–State disputes, ADR can be understood as an international dispute resolution mechanism that is an alternative to so-called "primary methods" for resolving investment disputes. Such primary methods are adjudication through investment arbitration or in front of national courts. ADR frequently involves the intervention of a third person to assist disputants in negotiating a settlement of their conflict. The process of ADR is normally initiated with the agreement of the disputants. While they are not limited to these processes, typical methods of ADR in international disputes involve mediation and conciliation. These techniques are not necessarily mutually exclusive in any particular conflict, and can be and often are used sequentially or in a customized combination with other adjudicative methods of resolving disputes.

Conciliation:

Conciliation is a relatively formal and structured process of facilitated negotiation. It involves the assistance of a third party, namely the conciliator (or a panel of conciliators), in a dispute between the investor and the State. The conciliator's main objective is to encourage the parties to settle their dispute amicably. The role of the conciliator is not necessarily a neutral one, and the degree of authority assumed by the conciliator may also vary (Smith and Martinez, 2009). Though there are differences from dispute to dispute, conciliators usually attempt to shape a more productive process of interaction between the parties and try to improve communications between them, while addressing the substantive issues of a dispute through advisory work. Conciliation usually follows formal rules and procedures and usually terminates with a written agreement or at least written recommendations. However, these written statements remain non-binding to the parties involved. Conciliators tend to maintain substantial control over the process of conciliation, which remains very formal, structured and result oriented. For example, conciliation procedures specified by the International Centre for Settlement of Investment Disputes (ICSID) have a degree of formality that leads to a decision which is non-binding upon the parties. The process of conciliation usually focuses strongly on working out a concrete solution to a dispute rather than improving the relationship between the disputants. Hence, conciliation is often identified as a process of “non-binding arbitration”.

Direct negotiation:

Direct negotiations are negotiations between parties of a dispute by means of immediate personal contact between the disputants in order to exchange interests and proposals. They normally do not involve the assistance or facilitation of third parties in the negotiation process.

Dispute prevention and avoidance:

Dispute prevention and avoidance involve minimizing potential areas of dispute through extensive planning in order to reduce the number of conflicts that escalate or crystallize into formal disputes. Preventative ADR is an important means to achieve effective dispute prevention and avoidance. In the context of investor–State disputes, dispute prevention may involve the establishment of adequate institutional mechanisms to prevent disputes from emerging and avoid the breach of contracts and treaties on the part of government agencies. Through adequate dispute prevention policies, it can be better assured that the State and various government agencies take account of the legal obligations made under investment agreements when enacting laws and implementing policy measures. In addition, the implementation of dispute preparedness mechanisms allows governments to identify more easily potential areas where disputes with investors can arise and respond to the disputes where and when they emerge. Dispute preparedness mechanisms involve, on the one hand, the delegation of relevant authority among State agencies, e.g. by defining who is responsible for the defence of investment disputes, who trains relevant employees, and who covers the costs involved. On the other hand, dispute preparedness also necessitates an adequate coordination and communication among government entities, such as through improved channels for information sharing and better institutional cooperation. With such institutional arrangements in place, States are also better able to undertake effective dispute avoidance, addressing the concrete concerns of the investors and making attempts to solve them. Agencies involved in dispute avoidance can be investment promotion agencies through their after-care services, ombuds services, or other government agencies with direct responsibility for dealing with foreign investors (e.g. a lead agency).

Dispute resolution:

Dispute resolution involves the process of managing and resolving conflicts. It can involve parties resolving their conflicts according to their interests, their rights, or respective power. Parties focusing on interests consider factors such as needs, economics, relationships, politics and social values when resolving disputes. When there is a focus on interests, dispute resolution usually occurs through direct negotiation among parties or with the assistance of a third party neutral, such as a mediator or ombuds. When the focus is on rights, dispute resolution requires a neutral third party to adjudicate and apply agreed-upon rules to a set of facts so as to determine who prevails. Rights-based processes, including binding arbitration and traditional court trials, have limited remedies and may not address the full range of interests and needs that the parties may have. Disputes resolved on the basis of power (e.g. through gunboat diplomacy, or at the extreme, violence and war) weight the outcome in favour of the party with the most leverage, status and resources, but this may be costly on the relationships involved and may result in failure to vindicate rights.

Dispute resolution board (DRB):

A private, voluntary and confidential procedure commonly used in the context of an ongoing long-term (contractual) relationship between the parties. An informed standing group of experts is set up, usually at the time when the relationship between the parties is established, to address disputes quickly when they arise between the parties involved. Determinations by the standing group of experts may be binding on the parties or only advisory in nature, or they may be binding for the period of performance permitting review by a third party upon completion of the contract.

Dispute systems design (DSD):

Dispute systems design is the systematic process of creating a dispute resolution system that harnesses the positive aspects of conflict or at least minimizes the negative aspects. It is not a dispute resolution methodology but involves the intentional and systematic creation of an effective, efficient, and fair dispute resolution process based upon the unique needs of a particular system. The objective of DSD is to design better dispute resolution systems by (a) analysing the parties' patterns of disputing to diagnose the current system, (b) designing methods to manage conflict more effectively with practical principles, (c) approving and implementing the design architecture, and (d) testing and evaluating the new design to make appropriate revisions prior to disseminating the process to the rest of the system.

Early neutral evaluation (ENE):

Early neutral evaluation involves an evaluator, usually an attorney or other expert with specific knowledge of the subject matter of a case, who hosts an informal meeting with investors and their counsel. At such a meeting, both sides of the dispute (i.e. representatives of the investor and the State) will present their evidence and arguments, based on which the evaluator identifies areas of agreement and issues to focus on. The evaluator then writes a confidential evaluation of the prospects of a case and offers to present it to the disputants. Should parties not be successful in attempting settlement, the evaluator may assist the disputants in devising a plan for expedited exposure, assess realistic adjudication costs and explore the feasibility of a follow-up session in achieving successful settlement of a case (Smith and Martinez, 2009).

Facilitated negotiation:

Facilitated negotiations are negotiations between parties of a dispute that involve the support and assistance of a third party (also called "third-party neutral"). The main role of the third party is to remove possible barriers to a negotiated solution of a conflict that may persist when the parties attempt the settlement of a dispute through direct negotiations. Conciliation and mediation are typical forms of facilitated negotiation.

Fact-finding:

A private, voluntary, non-binding and confidential procedure in which the parties submit specific factual information (e.g. technical, scientific, accounting, or economic) to an expert for a neutral evaluation of these contested facts. The key objective of such a procedure is to gain an impartial assessment about the facts of an issue in order to prevent the escalation of disputes. ICSID has an Additional Facility for Fact-Finding (ICSID, 2006b) that serves this purpose for conflicts between investors and States. Its Fact-Finding Rules provide that an independent committee examines the disputed facts and gives an impartial assessment after oral proceedings, written submissions, evidence and witness testimony. Fact-finding proceedings end with a report that is limited to findings of fact and does not offer recommendations to the parties. The parties must then determine what legal and practical effect the report will have.

Mediation:

Mediation is a rather informal process of facilitated negotiation. It involves the assistance of a third party, namely the mediator, in a dispute between the investor and a State. At the request of the disputing parties and subject to terms and conditions specified by them, mediators intervene in the dispute in order to assist in working out a viable solution. The role of the mediator is to bring the parties of a dispute together and assist them in compromising and reaching settlement. The involvement of the mediator may vary, ranging from fostering dialogue between the parties to effectively proposing and arranging a workable settlement to the dispute. Upon request by the parties, a mediator may eventually give an opinion on the likely outcome of an adjudicated proceeding and propose optimal solutions to the settlement of the dispute. However, a mediator cannot impose a solution on the parties involved (Smith and Martinez, 2009). While mediators assume only some control over the process of settlement, they focus on assisting the parties to find a settlement while maintaining a constructive relationship between the investor and the host State. For this purpose, mediators tend to go beyond the substance of the issues, paying more attention to the nature of the negotiation process and making sure that communication between the disputants is effective. Mediators concentrate on identifying interests, reframing positions and canvassing a range of possible solutions to move the parties towards an agreement. Hence, mediation is often equated to a process of "assisted negotiation".

Negotiated settlement:

Negotiated settlement is the resolution of a dispute outside of national courts or arbitral tribunals. Such settlement can be achieved either through direct negotiations between the disputing parties, or with the support of a third party that facilitates the negotiations by means of conciliation or mediation techniques. ADR usually involves processes of negotiated settlement.

Ombudsman or "ombuds":

An ombuds is an official or institution with a mandate to remain impartial while receiving complaints or questions and making efforts to resolve conflicts between investors and the State at an early stage. To carry out this objective, the ombuds may be granted the authority to use various tools, such as directing stakeholders to other processes to resolve concerns, raising issues internally within an organization, conducting investigations for the purpose of making policy recommendations, or mediating disputes directly with interested parties.

Third-party neutral assistance:

A third-party neutral is an impartial individual or group of individuals serving as mediator, conciliator, fact-finder or arbitrator to assist parties in resolving issues in controversy between an investor and a State. A third party neutral is accepted by the parties and assists in the resolution of a dispute according to the authority granted by the parties to manage the process and/or outcome.

EXECUTIVE SUMMARY

In contemporary international investment law, international arbitration has established itself as the main option through which foreign investors can pursue claims that they have against a host State resulting from an investment dispute. Provisions on investor–State dispute settlement (ISDS) are enshrined in almost all contemporary international investment agreements (IIAs). To provide in IIAs that arbitration and not litigation in national courts should constitute the main method to resolve investment disputes is considered as an important element of investment protection.

International arbitration has long been seen as the optimal way to address and resolve disputes between investors and States, and is to some extent still considered as such today. It depoliticizes investment disputes, assures adjudicative neutrality and independence, and was often perceived as a swift, cheap, flexible and familiar procedure. Moreover, international arbitration is seen to be offering the parties a possibility to exercise a substantial amount of control over the litigation procedure. It further assures that awards are enforceable and creates a sense of legitimacy.

However, there are several disadvantages that come with international arbitration in practice, which could potentially reduce the benefits that IIAs can bring to developing economies. An important source of these disadvantages is the special nature of international investment arbitration, involving a sovereign as a defendant and challenging acts and measures taken by a sovereign State. The international arbitration procedure also differs from litigation in domestic courts in that the dispute is governed by international law and based on the violation of an international treaty, where arbitration is the main option made available to investors. Another peculiarity is that the nature of the relationship between the investor and the State involves a long-term engagement; hence a dispute resolved by international arbitration and resulting in an award of damages will generally lead to a severance of this link. Moreover, the financial amounts at stake in investor–State disputes are often very high. Resulting from these unique attributes, the disadvantages of international investment arbitration are found to be the large costs involved, the increase in the time frame for claims to be settled, the fact that ISDS cases are increasingly difficult to manage, the fears about frivolous and vexatious claims, the general concerns about the legitimacy of the system of investment arbitration as it affects measures of a sovereign State, and the fact that arbitration is focused entirely on the payment of compensation and not on maintaining a working relationship between the parties.

Given these perceived disadvantages, coupled with the realization that the amount of investor–State disputes has increased dramatically in recent years, this study seeks to explore alternatives to investment treaty arbitration. A key differentiation is made between two types of such alternative approaches or alternative means:

- Methods of alternative dispute resolution (ADR) that seek to resolve existing disputes through negotiation or amicable settlement such as international conciliation or mediation.

- Dispute prevention policies (DPPs) that attempt to prevent conflicts between investors and States from emerging and escalating into formal investment disputes, for example by establishing inter-institutional alert mechanisms within States or encouraging information sharing among government entities.

The advantages of these alternative approaches are the flexibility offered by these approaches, including the possibility to find amicable grounds for settlement between investors and States, permitting the parties to continue a working relationship. The settlement process is also faster and less costly. ADR can be without prejudice to the right of the parties to resort to other forms of dispute resolution. Finally, alternative approaches can improve good governance and other regulatory practices of States.

Nevertheless, there are also challenges to the use of alternative approaches. They are non-binding to the parties, and parties often lack familiarity and experience with the techniques involved. Alternative approaches could also be considered as a waste of time and funds if they are not conducted successfully, and they may not be suitable for all investment disputes. States with their unique attributes as parties to a dispute may face specific difficulties in using alternative approaches effectively. For example, their flexibility in finding compromise solutions is limited by the boundaries established through existing laws and regulations. Similarly, .government officials may not always be given the necessary authority and powers to use alternative approaches effectively. Moreover, some IIA provisions are by nature also not conducive to alternative approaches and do not allow for the use of ADR techniques. Finally, DPPs could potentially generate inter-institutional conflicts.

While resort to arbitration is the predominant approach in IIAs, alternative approaches have at times also been incorporated in them. IIAs usually specify a "cooling-off period" to encourage negotiation before parties can initiate formal arbitration procedures. However, the time frame of three to six months usually allocated for this purpose is rather short. Conciliation is also regularly mentioned as an option, often next to arbitration. Brief reference to non-binding third party procedures is hence common in IIAs. A few IIAs further encourage State–State cooperation to enhance communication on issues related to the implementation of the IIA, which may include the resolution of investment disputes. In practice, however, the use of arbitration to resolve investment disputes remains by far the most common approach, and alternatives such as ADR techniques could be given more prominence in IIAs if States wish to encourage their use.

Existing international rules on dispute resolution, most notably the conciliation rules of the International Centre for the Settlement of Investment Disputes (ICSID), the United Nations Commission on International Trade Law (UNCITRAL) and the International Chamber of Commerce (ICC), provide guidance on the use of ADR techniques. ICSID also maintains a set of fact-finding rules and the ICC published a set of rules detailing the establishment and function of "dispute boards". Other institutions beyond the aforementioned three also provide their own set of conciliation or mediation rules, and hence procedural guidance on the use of ADR techniques is available for the parties involved in investment disputes. Many of these dispute resolution institutions further offer necessary logistical and organizational support, for example by making a venue and facilities available to disputing parties for the purpose of undertaking the conciliation or mediation process. Despite this assistance, research today suggests that rules on ADR have been rarely used in investor–State dispute resolution, and hence more specific encouragement in IIAs towards considering the use of these rules may be an important way forward.

Though DPPs constitute a very new approach in addressing the problem of increasing investment disputes, several types of DPPs have already found application in specific countries or could be further developed:

- The sharing of information among government agencies on issues related to foreign investment in a well structured and organized way can assure that the right government agencies are alerted at an early stage about possible problems faced by investors and allow for a timely response. Information sharing will generally increase awareness among government agencies and various levels of government (e.g. at the regional or municipal level) of relevant issues in international investment law.

- Governments can target specific sensitive sectors where disputes could arise, and monitor foreign activities in this sector more closely, addressing possibly emerging problems at an early stage.

- States can provide the option of an administrative review of a measure deemed unsatisfactory by investors. The possibility of such a review has already been included in a few IIAs.

- The establishment of adequate inter-institutional arrangements among government agencies can allow States to address emerging investment disputes more effectively. Such inter-institutional mechanisms may involve the establishment of a lead agency responsible for dealing with investment disputes, with the right to obtain information from other government agencies and the authority to resolve a dispute through preferred means of settlement.

- Specific public officials can be empowered with the authority to engage with investors, embark on negotiations or pursue amicable settlement.

- Among government agencies, timely sharing of information and documents related to an investment dispute should be assured, even at a short notice.

- An ombudsman or “ombuds” office can function as an institutional interlocutor within the host country which investors can approach to have their grievances heard and addressed.

- State–State cooperation on dispute prevention could be enhanced.

- Attempts can be made to continue negotiating even while an arbitration procedure is already ongoing.

Overall, ADR and DPPs can offer promising alternatives to the settlement of investment disputes through international arbitration, and hence States, investors, legal practitioners, arbitration institutions and international organizations should be encouraged to give these methods further consideration in the context of investment disputes emerging in the future.

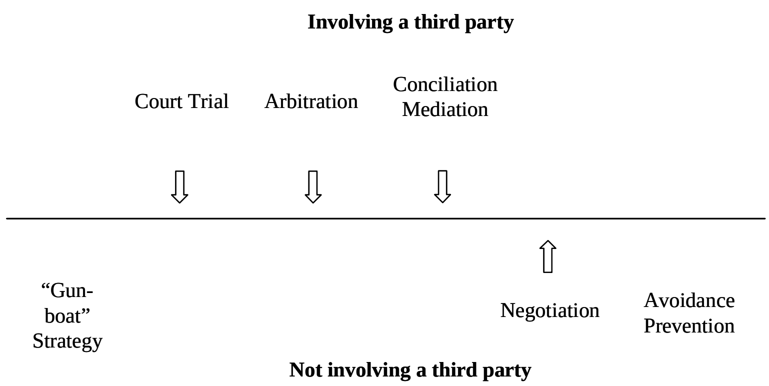
INTRODUCTION

International arbitration, next to the resort to national courts of the host State, has been the most commonly used method for the settlement of international investment disputes. The option to resolve disputes through international arbitration is included in most provisions on investor-State dispute settlement (ISDS) that usually form an integral component of contemporary international investment agreements (IIAs). The choice of international arbitration features most prominently among investors seeking compensation for damage to their investment caused by the host State due to a breach of a treaty commitment.

However, given such prominence of international arbitration as the preferred choice, other forms of dispute settlement, as well as possibilities to avoid disputes in their entirety, are to date only rarely used in practice. Taking into consideration that international arbitration, though often very effective, does have a distinct set of disadvantages and is generally costly, this paper presents alternative approaches to the settlement of investment disputes as well as approaches States can take to avoid and prevent investment disputes from arising in the first place.

In general, investors and host States are faced with a variety of different options to resolve the disputes they face, as illustrated in figure 1. At one extreme end of the spectrum is the use of a “gun-boat strategy”. Especially in highly politicized investment disputes, countries in earlier years might have used their economic or political power in an attempt to protect the rights of their foreign investors in a host State. Hence there was a need to find ways of de-politicizing the dispute and allowing cases to be heard in a neutral forum within a set framework of rules. Trials in national courts at times could fulfil this function, but they would not entirely eliminate the suspicions and mistrust on the side of investors and their home country governments that such courts lack neutrality and are biased towards the interests of the host country.

Figure 1. Forms of dispute resolution



Source: Based on Smith and Martinez, 2009.

Based on these considerations, post-Second World War investment protection was built around four pillars that each provided better security for foreign investors and their assets. The first three pillars are the granting of fair and equitable treatment (or of the minimum standard of treatment), the freedom of transfer and the protection against unlawful expropriation. In addition, the fourth pillar allows foreign investors to have their claim against a host State heard and settled by an international arbitral tribunal whenever an international commitment made by the host State has been violated. This fourth pillar hence addresses the possible mistrust of investors towards the national courts of the host country and the need to depoliticize the dispute by allowing it to be settled in a neutral forum and following international rules of procedure. While all four pillars are incorporated into most contemporary IIAs, enforcement of the fourth pillar is further guaranteed through several multilateral instruments, where the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the ICSID Convention), signed in Washington on 18 March 1965 (see ICSID, 2006a), stands out as the most important.[1]

Host States wishing to attract and promote foreign investment often seek to offer predictability to foreign investors by favouring international arbitration as the means for investors to deal with a dispute. An overwhelming majority of the more than 3000 bilateral investment treaties (BITs) and free trade agreements (FTAs) containing substantive disciplines on investment are hence offering international arbitration under the rules of the International Centre for Settlement of Investment Disputes (ICSID) or the United Nations Commission for International Trade Law (UNCITRAL).

In parallel to an increase in investment flows and the proliferation of investment treaties, investor–State disputes have also started to pick up since 1987.[2] As of end 2008, the total cumulative number of known treaty-based cases reached 317. Most of these cases were filed with ICSID or UNCITRAL. At least 77 governments – 47 of them in the developing world, 17 in developed countries and 13 in countries with economies in transition – have faced investment treaty arbitration, and more than two thirds (70 per cent) of the 317 known claims were filed within the lasts six years (UNCTAD, 2009). Overall, investor–State disputes have gained greater visibility in recent years. Their appearance on the radar screen of foreign investors and their counsel has become more pronounced, and hence they are increasingly considered as a viable means to sort out disputes with the host State. This rise in investment disputes poses particular challenges for host States and especially for developing countries.

Investment disputes usually come with a high cost, not only for host States but also for investors. Some of these costs, which for example emerge from the need to finance legal representation, arbitrators and experts, possibly during multiple years of arbitration, affect both investors and governments alike. One result is that the resort to international arbitration as a means to achieve a swift and efficient settlement of a dispute is currently being questioned not only by governments, but also by investors that spend large amounts of resources on the resolution of investment treaty conflicts. Investment arbitration is also increasingly difficult for the parties to manage. Huge disputes emerged as a result of privatization schemes or the offering of concession contracts for public utilities or natural resources exploration and exploitation. This raised political debate inside and outside the State and spurred dissatisfaction with investment arbitration.

At the same time, a very complex network of investment and investment-related treaties around the world makes it increasingly difficult for States to manage their international commitments. A recent study by UNCTAD shows a great variation in the way various core elements of investment protection and liberalization are dealt with in IIAs, including the actual wording of clauses themselves (UNCTAD, 2008b). This in turn is generating inconsistencies in the interpretation of these clauses by arbitral tribunals, resulting in a lack of predictability regarding the outcome of investment disputes. Not only does such unpredictability hold true for the substantive interpretation of a treaty, but also as far as the awarding of costs to one, the other, or both disputing parties is concerned.

Finally, the experience of investment treaty arbitration can also lead to a severance of the relationship between the investor and the State, which runs counter to the goal of many host countries to attract and promote foreign investments that provide a meaningful contribution to economic development. At the same time, a worsening of the relationship jeopardizes an investor’s prospects for a profitable long-term investment in the host country. Investors generally come with a genuine interest in a good return on their investment that may require several years of uninterrupted operation. An investor–State dispute inevitably severs this relationship and creates bad precedent for State and investor.

Given these evolving criticisms of investment arbitration, new space is emerging that allows consideration of alternatives. To the right of international arbitration, figure 1 illustrates three alternative options available to investors and States that are facing or about to encounter an investment dispute. All these options are to date not effectively used in practice, though further assessment of their viability may now be desired given the increasing dissatisfaction with investment arbitration. Firstly, both parties can seek amicable settlement through various techniques such as conciliation, mediation and fact-finding, always involving the participation of a third party for the purpose of facilitating these procedures. While only some IIAs include the option for disputants to consider such techniques, ICSID, UNCITRAL and other facilities have drafted specific rules of procedure in their investment instruments. Secondly, investors and States may consider solving their dispute through negotiations. In fact, the need for negotiations is usually included in IIAs in the form of a "cooling-off" period between the filing of a dispute and the actual commencement of arbitration procedures. All these techniques (conciliation, mediation, fact-finding and negotiation) will be referred to as methods of alternative dispute resolution (ADR) in this study, implying an alternative to both investment treaty arbitration and resort to national courts.[3] Such ADR methods have already been attempted more frequently at national level where, in addition to litigation or arbitration, judicial systems have been testing, offering and in some areas of the law even mandating the possibility for claimants to go for non-judicial or alternative means of dispute resolution.

As a third option, preferably at a relatively early stage or as an early preventative approach, States may consider administrative and policy-related steps for the purpose of improving their institutional system. Such steps, considered within this study as dispute prevention policies (DPPs), would help to prevent or efficiently deal with potential investment disputes, reducing the possibility that investment disputes may escalate into an international arbitration. DPPs may, for example, involve the establishment of adequate institutional mechanisms and inter-institutional procedures to assure that relevant government authorities are alerted in time about potential investment disputes and can take the necessary steps to address the respective problems faced by investors.[4]

In the terminology of this study, both methods of alternative dispute resolution (ADR) and dispute prevention policies (DPPs) shall be referred to as “alternative approaches”, “alternative methods” or “alternative means”.[5] This study on alternative methods of treaty-based investor–State resolution will hence not limit itself to ADR but take a broader approach by additionally considering DPPs. The structure of the study will follow closely the order set out in figure 1, beginning with the pros and cons of international arbitration and then moving rightward on the spectrum. This study will thereby examine the various stages where host State policies or IIAs can offer different ways to deal with a dispute, other than by ways of recourse to national courts or international arbitration. In conducting this analysis, the paper will frequently highlight concrete examples from existing treaty practice as well as approaches taken by individual governments in the area of dispute avoidance and prevention, and assess the present and possible future significance of such approaches. Given that the use of alternative approaches in the context of ISDS is still in its infancy, considering such examples as possible guidance for future “good practices” is important.

The paper is structured as follows. Chapter I briefly analyses the specificities of investor–State disputes and the advantages and disadvantages of ISDS through international arbitration, in order to introduce the quest for alternative approaches. As a next step, chapter II introduces alternative approaches in further detail and highlights their possible advantages and challenges. The incorporation of alternative means into IIAs is discussed in chapter III, followed by a review of existing rules and forums that support the use of alternative approaches in such agreements. While focus in these two chapters is on ADR, chapter IV particularly explores existing DPPs that States have adopted to avoid and prevent disputes. The concluding chapter is devoted to some recommendations and lays out possible ways forward.

Finally, it may be worth noting what this study does not do. It does not look into the most obvious way to sort a dispute against a State, i.e. the recourse to national courts of the host country. The requirement to exhaust local remedies before going to arbitration or the exclusive jurisdiction of local courts has given rise to numerous decisions by international courts and to doctrine and has been gradually abandoned in IIAs. The mistrust of investors in national courts and their ability to make a fair and quick decision, and the perception of bias and/or lack of competence in issues of international economic law would, however, warrant being looked at with a fresh view. This could indeed be done after over 50 years of generalizing international arbitration as the safest avenue for foreigners. However, this is arguably quite a different issue and hence it is not addressed in this study.

Notes

[1] Another important multilateral instrument is the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention), done in New York on 10 June 1958.

[2] Asian Agricultural Products Ltd. (AAPL) vs. Republic of Sri Lanka, ICSID Case No. ARB/87/3.

[3] It should be noted at the outset that the term ADR is often used with different meanings depending on the context in which it is applied. In disputes involving States and investors, recourse to arbitration itself could already be considered as an ADR method, seeking to avoid having to resort to the national courts of the host State or to a State–State mechanism.

[4] "Ignorance" or "willful ignorance" as a further, extreme case could be added on the left of avoidance in figure 1. This refers to a situation where States are not knowledgeable about the problem of an emerging dispute, or are knowledgeable but do not show interest in addressing the issue. However, ignorance will only be possible as long as the conflict does not escalate into an open dispute involving investment treaty arbitration.

[5] All alternative options depicted on the left of the arbitration option in figure 1.

I. DISPUTE RESOLUTION THROUGH INTERNATIONAL ARBITRATION

A. The special nature of investor–State dispute settlement

Investor–State disputes arising under IIAs are not ordinary international legal disputes. Rather, they exhibit specific characteristics that distinguish them from other types of disputes. This special nature of investor–State disputes is likely to affect the way the parties to a dispute handle their conflict. It will also be important in the choice of techniques used for dispute resolution (Salacuse, 2007). One can differentiate between the following specific aspects of investor–State disputes:

- An investor–State dispute will involve a *sovereign as the defendant*, either the central government itself or sub-national entities of the State (Muchlinski, 2007; Sornarajah, 2004). Hence, the nature of the parties involved is different from other types of arbitration such as commercial arbitration, where both parties are business entities. The dispute can arise from measures or acts taken at lower levels of government, or State agencies that are not signatories to the IIAs but have to abide by its provisions. This can generate inter-institutional divergences inside the government, making it difficult for the State to react timely to the problem but also for the investor to identify the appropriate interlocutor within the government.

- The foreign investor will challenge *acts and measures* (or the lack of appropriate action) *taken by the sovereign State* or a sub-entity thereof in its sovereign capacity. Hence the nature of the measures or acts being challenged is also idiosyncratic. The dispute will often involve public policy issues and challenge the ability of the State to regulate in the public interest, even when it may hurt individual interests, in this case the interests of a foreign entity. A dispute can easily turn into a political issue within the State, but also internationally – for example, when environmental or emergency measures to tackle a financial crisis are being challenged. This is even more pronounced when the amounts of public funds at stake are high. Moreover, the recent movement within IIAs and rules on ISDS towards enhancing transparency of investment policies makes it easier for civil society and other constituencies to scrutinize ISDS cases and voice their concerns.

- The nature of the applicable law is also specific, as the *dispute is governed by international law and based on the violation of an international instrument*, moreover one of the sources of international law, i.e. an investment treaty.[1]

- The nature of the available remedies is also different. Contrary to the principle of international law, when a dispute involves a sovereign State, and contrary also to ordinary legal disputes, the system established to settle investor–State disputes is based on *international arbitration as the main option* for the aggrieved foreign investor. A vast majority of IIAs offer as a central protection element for the foreign investor the possibility to resort to international arbitration under ICSID or ad hoc arbitration using the UNCITRAL rules. Sometimes, IIAs do not even require recourse to the national courts of the host country. Similar types of dispute settlement provisions can also be found in concession contracts, privatization schemes, stabilization agreements or ordinary State contracts, whereby an alleged violation will not be heard by the national courts but by an international tribunal.

- Another peculiarity of investor–State disputes refers to the fact that *the nature of the relationship between the disputants involves a long-term engagement*, sometimes requiring a complex interconnection between the two parties resulting from a situation of mutual dependence. For example, a country's population may be dependent on a private foreign investor for the provision of public services, while the investor will have committed substantial amounts of capital to the enterprise, with a return on investment only feasible after a number of years. Hence, investor and State might be obliged to maintain a functioning working relationship despite the existence of a dispute (UNCTAD, 2008a; Salacuse, 2007).

- Finally, *the amounts of money at stake in investor–State disputes are often very high*, on average many times those of commercial arbitration cases. Hence, the high awards rendered in investor–State disputes are often a major burden on the governments involved (Salacuse, 2007).

B. Advantages and disadvantages of international arbitration

The historical development of the ISDS system established by IIAs clearly shows that arbitration emerged over time as the preferred option for the settlement of disputes between investors and States. This is because it was generally perceived that settling investment disputes through international arbitration comes with numerous advantages, including the following:

- One of the main purposes and also advantages for negotiators of early-day IIAs was to *depoliticize the dispute* arising between the host State and the investor from another State and allow for a legal settlement. On the one hand, depoliticizing a dispute involved a departure from the "gun-boat" strategy of earlier days by judicializing economic disputes related to investment. A "small" State could now have a case against an investor from a powerful State be heard in a neutral forum within a set framework of rules. Similarly, the "small" State could offer a settlement solution that would not require the involvement of the home State of the investor. On the other hand, depoliticizing a dispute also meant that the investors did not have to approach their home States or international adjudicative bodies such as the International Court of Justice (ICJ) for assistance in a dispute with a host State, avoiding the possibility of being caught up in other geopolitical dialogues. The interaction of the investor with the host State would then be more direct, without the buffer of diplomacy in between, which could be either favourable or not in view of the investor.

- Another obvious advantage was to allow the investor to have its claim heard by an independent and qualified tribunal. This assurance of *adjudicative neutrality and independence* was an advantage when investors did not trust the independence of the domestic courts or when the judiciary of the host State had not been exposed to hearing many cases under international law. Finally, independence could be enhanced by locating the seat of the arbitration and hearings outside of the host country.

- The choice for international arbitration to hear investor–State cases was motivated mainly by the *perception that arbitration is swifter, cheaper, more flexible, and more familiar* for economic operators. International arbitration was generally perceived by foreign investors as providing an expeditious way of settling a dispute arising with the host State, thereby avoiding the dispute to linger and the costs to escalate.

- Compared to settlement by national courts, arbitration allowed the parties to exercise *more control over the litigation procedure*, as parties in dispute were able to appoint arbitrators of their choice (Salacuse, 2007; Franck 2008b). These arbitrators could be picked according to their expertise in the relevant subject area. Parties further had the possibility to demand that arbitration be held in a neutral third country and be conducted in a language familiar to all parties.

- Recourse to arbitration was considered as efficient, as it is normally ensured that the *award would be enforceable* against the other party that was generally a sovereign. IIAs and specifically multilateral conventions relating to investment disputes provided for the final and binding character of an arbitral award. This is verified by experience with the ICSID Convention. Its self-contained execution mechanism has proven successful in achieving the enforcement of arbitral awards. However, the increasing amount of annulment cases shows that not all decisions are eventually enforced. A similar rate of enforcement can be found for awards rendered under the auspices of various arbitration centres or with ad hoc arbitration using the UNCITRAL arbitration rules, as long as the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards applies.

- With the use of international arbitration to resolve international investment disputes came a *sense of legitimacy*. This was because, in past decades and even centuries, arbitration had often been effectively tested and applied to resolve various types of international disputes. Historically, arbitration has hence been perceived as a mechanism that supports adherence to the rule of law (Franck, 2005).

Despite these numerous advantages, the recent multiplication of investor–State disputes, the unpredictability of interpretations of key treaty provisions, the increase in financial amounts involved, the challenges to public policy acts and some shortcomings of international arbitration itself have raised concerns on the part of States, whether developed or developing, and of academia and civil society. Voices of dissatisfaction can also be heard among practitioners, both those representing investors and defending sovereign States in these cases. Attempts at amending some of the shortcomings have already found their way into the revision of the ICSID rules in 2006 (ICSID, 2006a) and are currently being discussed for UNCITRAL rules.

However, despite these changes, these sceptical voices and critical views of current investment arbitration are still increasingly heard, and in some cases such views have already influenced some relevant policy steps. This is evidenced by the novel positions taken by the Plurinational State of Bolivia, the Bolivarian Republic of Venezuela and Ecuador, which began to limit the access to international arbitration in sensitive sectors of the economy. The Plurinational State of Bolivia and Ecuador even denounced the ICSID Convention under article 71. Its denunciation occurred on 2 May 2007 and Ecuador's on 6 July 2009, respectively.

The origins of this dissatisfaction can be found in the inherent characteristics of international investment arbitration system itself, while it also reflects recent practice and experience with ISDS cases. Some key disadvantages of investment treaty arbitration are the following:

- Contrary to the expectations, it turns out that *costs involved in investor–State arbitration have skyrocketed* in recent years. This refers not only to the damages States must pay to foreign investors in the case of a violation of a treaty provision, but the costs for conducting arbitration procedures are extremely high, with legal fees amounting to an average of 60 per cent of the total costs of the case (see box 1). In addition to legal fees, there are arbitrator's fees, administration fees of arbitration centres and additional costs for the involvement of experts and witnesses (UNCTAD, 2008a, 2006a, 2005b).[2]

Box 1. Recent examples of legal fees in ISDS cases

In addition to the financial burden that States face due to the awards rendered against them in investor–State disputes, the costs of the actual procedures can also be very high. The following recent examples of legal fees and arbitration costs in ISDS cases illustrate this:

- In *Plama Consortium v. Bulgaria* (ICSID Case No. ARB/03/24), the legal costs to the claimant (related to both the jurisdiction and merits phases of the arbitration), amounted to $4.6 million, while the respondent's legal costs (for both phases) were $13.2 million. The claimant was required to pay all arbitration costs and half of the respondent's legal costs (UNCTAD, 2009).
- In *Pey Casado v. Chile* (ICSID Case No. ARB/98/2), the claimant's legal costs (relating to the jurisdiction and merits phases) totaled approximately $11 million, while the respondent's legal costs for both phases amounted to $4.3 million. The respondent was ordered to pay 75 per cent of the arbitration costs and $2 million in claimant's fees (UNCTAD, 2009).
- In *ADC Affiliate Limited and ADC & ADMC Management Limited v. The Republic of Hungary* (ICSID Case No. ARB/03/16), the tribunal awarded the burden of the full costs totalling $7.6 million to the defending country, which had been found to have breached its legal obligations. This included the investor's legal fees (UNCTAD, 2006a).

- In *Waguih Elie George Siag and Clorinda Vecchi v. The Arab Republic of Egypt* (ICSID Case No. ARB/05/15), the tribunal found that the claimants were entitled to receive from Egypt the amount of $6 million of legal costs, expert and other expenses.

Sources: UNCTAD, 2009; UNCTAD, 2006a.

- Equally unexpected is the *significant increase in the average time frame for claims to be settled* by a final award and executed subsequently. Parties sometimes make use of every procedural possibility to avoid enforcement of awards taken against them, thereby further extending this time frame. In recent years, the average duration of cases has increased significantly, with parties resorting to annulment and other set aside procedures, and an almost systematic recourse to bifurcation (separating jurisdiction from the merits) on the part of States and recourse to provisional measures. The average for a case to be heard and finally settled varies from three to four years. A different finding suggests that it takes 392 days on average between the hearing of the merits and the issuance of the final award, with a range from as little as 92 days to 941 days.[3] This may suggest that the amount of time required to litigate commercial cases before national courts or domestic administrative agencies is not markedly different from investment treaty arbitration.

- Investor–State cases have become increasingly *difficult to manage* for the parties and are resulting in a substantial loss of control over the procedure by the State parties to the underlying IIA and particularly by the defendant State. Beyond the decision to agree on the submission to arbitration and appoint arbitrators, parties have little influence over the arbitration procedure itself (Salacuse, 2007).

- International arbitration of a dispute between an investor and a State will, in almost all cases, *result in a severance of the links between the two parties*. This is of course exactly the opposite of what States are seeking when embarking on active investment promotion strategies to establish long-term relationships with investors and foster meaningful contributions of investments to the host State's economic development. Similarly, investors generally come with a genuine interest in a good return on their investment that may also require several years of undisturbed operation. An investor–State dispute inevitably severs this relationship and creates bad precedent for both the State and investor.

- The increase in North American Free Trade Agreement (NAFTA) cases against the United States, Mexico and Canada have also triggered *fears about frivolous and vexatious claims* that could inhibit legitimate regulatory action by governments. Similarly, NAFTA cases are often about trade measures that could be settled through State–State procedures. The investment chapter option is, however, more appealing.

- Among various circles, *concerns about the legitimacy of the ISDS system* have recently emerged and have given rise to discussions in various forums. The triggers for these concerns come from a perception of inconsistency among arbitral awards in the interpretation of core elements of protection, but also from the mere fact that an arbitral tribunal composed of only three individuals, however highly competent and respected, is looking into a national law or measure and interpreting it, as a last resort. The issue of a possible appeal mechanism has been discussed, especially after the introduction of follow-up negotiations relating to an appeal mechanism in recent FTAs concluded by the United States. There is a continuing debate over whether it is appropriate to use arbitral tribunals to rule on public policy issues without having the same levels of safeguards for accountability and transparency as are typically required from the domestic judiciary. Divergent opinions exist relating to a possible case law equivalent of *"jurisprudence constante"* (Bjorklund, 2008; Kaufmann-Kohler, 2007) emerging from consistent arbitral awards, thereby contributing to clarifying the content of principles of international law.

- The settlement of a dispute through *arbitration is focused entirely on the payment of compensation* for damages arising from the violation of a treaty provision. It does therefore not provide room for the investor and the State to strike other "deals" between themselves, e.g. ones that refer to possible changes to the measure itself or offer other forms of compensation "in kind".

These potential or perceived disadvantages could be addressed to some extent through the development of alternative approaches to disputes arising between an investor and the State. This could of course be done by taking preventive measures, avoiding disputes from arising and then from escalating, putting in place internal mediation or settlement facilities, or proposing recourse to ADR within the existing international framework for investment established by multilateral instruments on ISDS and IIAs. Several such options will be explored in further detail in the following chapters.

Notes

[1] The dispute can also arise from the violation of contract terms by the State and will follow the provisions of the contract as far as applicable law and dispute settlement are concerned and in the absence of an "umbrella clause". See UNCTAD (2004).

[2] The discovery procedure used by law firms from the Western hemisphere in international arbitration involves important fact-finding and document producing costs that have to be borne by the disputing parties directly or paid to their counsel.

[3] Web-based exchange with Anthony Sinclair on the Oil-Gas-Energy-Mining-Infrastructure Dispute Management Forum.

II. ALTERNATIVE METHODS OF DISPUTE RESOLUTION

This study identifies mainly two approaches as alternatives to investment treaty arbitration. The first is the application of ADR methods, as are now already commonplace in commercial disputes, to the context of investment disputes. Over the last three decades, ADR has evolved in many countries to settle a wide variety of disputes, including commercial disputes. It usually involves the intervention of a third party to assist the disputants in negotiating a settlement of an existing conflict. As will be shown in further detail in chapter III, reference to ADR can be found in many IIAs, though its use in ISDS cases has so far been very limited.

The second approach is the use of DPPs that aim at reducing the occurrence of investor–State disputes in their entirety. DPPs usually constitute the establishment of institutional mechanisms within the government of the host State that are conducive to preventing the emergence and escalation of conflicts between the State and investors. Their use in the context of ISDS cases is still in its infancy, and chapter IV will examine in further detail and on a case-by-case basis some approaches already taken by individual governments.

The following section will discuss the nature and process of both these forms of alternative methods in further detail. This will be followed by a section which seeks to identify advantages, but also challenges and potential obstacles to alternative methods as a tool to be used in resolving and preventing investor–State disputes.

A. Procedures followed in alternative approaches of dispute resolution

The key to both types of alternative approaches lies in *the consent and cooperation required from both parties* to what is essentially a voluntary process. For ADR to be successful, the active participation of the investor and the State parties to a dispute is required, with different degrees of involvement, throughout the ADR process. This makes for an important difference with international investment arbitration where the consent can be given in advance, for example in an IIA, and without focus on a particular situation or dispute. Once granted, this consent can not be withdrawn unilaterally by the State. In the ADR process, however, the consent is not given in advance and is required throughout the process up to the actual enforcement or compliance with the negotiated solution.

Similarly, DPPs also require that both parties actively engage in the process. Host country governments must actively institute a set of preventative measures, while investors are required to actively make use of the respective institutional mechanisms that have been put in place. Here, consent is also given in advance by the State, but it nevertheless maintains some discretion to alter the set of preventative measures if considered necessary.

Another important element is the *degree of flexibility* in dealing with the legal commitments at hand and the specific facts of a dispute. Alternative methods – both ADR and DPPs – may allow the parties to find a solution that is not based on one or the other interpretation of treaty provisions and goes beyond the identification of the existence of a violation or damage. The focus is on finding an acceptable and workable solution to the dispute even if it requires departing from the legal framework surrounding the facts of the case. Alternative solutions can even go beyond the payment of compensation to the investor and involve payment "in kind" as well as propositions by the host State to alter the actual measure being challenged by the investor.

Despite the fact that both ADR and DPPs have in common that there is a need for consent and cooperation by both parties and a high degree of flexibility, the actual nature of the two approaches is, however, substantially different. Most notably, one process aims at resolving disputes while the other seeks to prevent them. Hence, the approach taken here is to examine the nature of these processes separately, which will be done in the rest of this section.

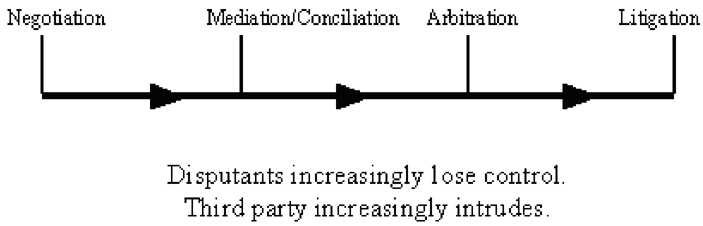
Taking first a closer look at **ADR processes**, it is possible to differentiate between several types and sub-categories of ADR (Franck, 2008b), depending on the purpose and the timing of the intervention in a dispute. ADR usually involves either conciliation or mediation, but it may also concentrate on a fact-finding exercise that makes it possible to narrow down the actual extent of the dispute. It may also be of an advisory nature, or involve a combination of all the above elements. Dispute boards, as for example established in international contracts according to rules of the International Chamber of Commerce (ICC), also constitute an ADR process, discussed in further detail below.[1]

Frequently, however, ADR is simply defined through the process that is being used to settle the dispute, i.e. through conciliation or mediation. The literature on ADR does not provide for a clear distinction between these two terms, and both of them are frequently used interchangeably. This study will suggest some criteria that allow for a distinction between the two, before looking at them in the light of investment disputes.

A first difference between conciliation and mediation lies in the degree of control the parties keep over the process of settling their dispute. Typically, in a negotiated settlement, both parties to the dispute come to an agreement entirely among themselves and work out the settlement without any outside intervention. The solution to the dispute is the result of this direct negotiation. Mediation involves a third-party neutral (the mediator) who will intervene in the dispute and, at the request of the two parties, help them work out a solution. The mediator's role can vary from helping the parties establish a dialogue to effectively proposing and arranging a workable settlement to the dispute. Although being called into the dispute by the parties, the mediator will take over the process of the settlement to a certain degree and thereby remove it to a certain extent from the control of the parties. The solution to the dispute will be the result of this intervention.

In international conciliation, the parties will give the conciliator (or the panel of conciliators) even greater control over the dispute and process. This is because the conciliator is usually entrusted with finding and proposing the actual solution that the parties will then follow. Nevertheless, throughout any type of ADR procedure, the disputants retain more control over the process as compared to arbitration and litigation, and they preserve their right to approve or refuse a proposed settlement or even to withdraw from the ADR process entirely. This is illustrated in figure 2.

Figure 2. Forms of dispute resolution and parties' control



Source: Salacuse, 2007.

Another key difference between conciliation and mediation lies in the degree of formality of the process. Conciliation, which has its historical roots in public international law, tends to provide for a relatively structured process that is replete with formal rules related to jurisdictional objections, potential pleadings, the gathering of evidence, and issuing written recommendations for settlement (Reif, 1991; O'Connell, 2003). Therefore, conciliation has been described by some as a kind of non-binding arbitration (Onwuamaegbu, 2005). On the contrary, mediation is a rather informal process, in which mediators tend to focus on identifying interests, reframing representations and canvassing a range of possible solutions to move the parties towards an agreement (Franck, 2008b). Mediation is hence often identified as “assisted negotiation” (Onwuamaegbu, 2005).

Moreover, conciliators usually do not adopt a relationship-building approach to resolving disputes between parties, nor do they seek to eliminate barriers that may obstruct negotiations. They tend to focus mostly on substance and avoid seeking solutions that go beyond the concrete issues at stake. Conciliators usually propose concrete solutions which parties may use as a basis of a negotiated settlement. Having engaged with both parties of a dispute, they draw up terms of an agreement that, in their view, represent a just compromise to a dispute (Onwuamaegbu, 2005; Redfern and Hunter, 2004; Franck, 2008b). By contrast, mediators frequently go beyond the substance of the issue, focusing also on the nature of the negotiation process and on effective communication between the disputants. The role of the mediator is to bring the parties of a dispute together and assist them in compromising and reaching a settlement (Onwuamaegbu, 2005; Frank, 2008b). One could thus suggest that mediation focuses on maintaining the relationship between the investor and the host State, whereas conciliation is more result oriented and seeks to work out a concrete solution to the dispute. Overall, there may be no clear borderline between conciliation and mediation, as some conciliators may, in the interest of achieving compromise, decide to apply some of the techniques that are more typical to the activity of mediation, provided that such a step supports the achievement of compromise.

In sum, the basic objective of the mediator or conciliator who intervenes in the dispute is to help the parties overcome the barriers to agreement. Such barriers can have many sources, including the way in which parties communicate with each other, the tactics employed in dealing with the respective other party, and a general inability or unwillingness to consider new solutions to their problem. The way in which this is accomplished may differ depending on the nature of the dispute, the history of relations between the disputants, and the individual skills and resources of the conciliator or mediator (see also box 2). No two conciliators or mediators are alike; rather, they may vary substantially in the roles, strategies and procedures that they adopt (Moore, 2003). As a result, ADR does not offer a single "magic formula" to settle a dispute. Detailed studies are available on the many forms that the processes of mediation and conciliation can assume, the techniques that can be used, the various stages involved, the degree of departure from the legal issues at stake, and the degree of flexibility to come up with various types of solutions.[2]

Box 2. The mediation and conciliation process: key features

- *Role of the mediator/conciliator:* assumes many roles simultaneously; assists, facilitates, proposes, re-formulates, convinces, finalizes; engagement ranges from strongly interventionist to a mere overseer of procedural arrangements; in many cases suggests the terms of settlement or "deal" between the parties.
- *Skills of the mediator/conciliator:* ability to assess rights and obligations of involved parties; factual understanding; authority; impartiality; possession of relevant expertise to the subject matter; must be accepted and respected by both parties and possess sufficient clout.
- *Personal background of the mediator/conciliator:* lawyer, businessman, technical expert.

- *Rules and venues for the conciliation/mediation:* ICSID, UNCITRAL, ICC, AAA, WIPO, KLRCA, CRCICA etc.
- *Conciliation/mediation techniques:* caucusing individually; bridging communication gaps and facilitating understanding; narrowing down the dispute to the essential problem; removing personality clashes and resentment; aligning of disputants' expectations; reframing the issues in a manner satisfactory to both parties; working on a step-by-step approach of agreed agendas by building on small and relatively easy successes to broker a deal on the bigger issues later in the procedures, or alternatively by concentrating on the difficult issues first in order to narrow them down and work on them as a priority.
- *Role of disputing parties:* voluntary but active participation; engagement in a collaborative process; maintain much control over process and outcome.
- *Value to disputing parties:* avoidance of legal zero-sum outcomes; preserve effective relationship between disputing parties to make continuation of further work feasible.
- *Potential shortcomings:* voluntary nature; participation in good faith; uncertainty about outcome; difficulties of enforcing the results.

Source: UNCTAD, based on Coe, 2005.

Dispute prevention policies are instituted prior to the existence of an investor–State dispute or even a conflict, but in anticipation of the possibility that disagreements between the State and investors may emerge. The concept of DPPs is relatively new and unexplored, and hence, contrary to ADR, there exists very little formal literature that discusses them. An understanding of what may be the most effective DPPs is also just in the process of emerging. In this field, a lot of exploratory work will thus still be required in the future.

DPPs can take a variety of forms, some of which are reviewed within this study (chapter IV), while others may still need to be thought of. In most cases, DPPs aspire to establish effective early alert mechanisms that improve, at an early stage, the awareness among government authorities of a possibly emerging conflict with an investor. Such early alert mechanisms may be established by improving inter-institutional linkages, information sharing and channels of communication among government authorities. Links between local governments that deal with investors and the central government that concludes the IIAs could be enhanced in this way. Early alert mechanisms may also involve the establishment of an institution as a one-stop-shop to which investors can turn in case of dissatisfaction with a policy or measure enacted by the host State. A similar approach would be to offer the foreign investor a right to ask for an administrative review of a policy or measure by which it is thought to have been harmed.

In sum, DPPs are meant to give the government advance notice of a problem and enough time and flexibility to address investor concerns, either unilaterally or in coordination with the investor. DPPs ought to be considered as a very promising approach to addressing the problem of increasing ISDS cases. While ADR processes, like arbitration, still have to deal with an existing dispute that needs to be settled, the prospect of not having a dispute at all must be the preferable option in the view of governments.

B. Advantages and challenges in applying alternative approaches to ISDS

Recourse to alternative approaches comes with advantages and disadvantages that should be looked at with some scrutiny. This is particularly the case when it comes to applying alternative approaches to ISDS, which involves the unusual combination of a State and a private entity as disputing parties. Although promotion of ADR in dealing with issues such as family conflicts or labour disputes is commonplace in many national judiciaries in order to deal with, amongst other things, the problem of overflowing dockets, little experience exists so far with the use of ADR in conflicts where a measure or act of the State itself is being challenged. In order to present a viable and credible alternative to investor–State arbitration, where the recourse to international arbitration is already an exception to international law principles, alternative approaches must present at least some elements addressing the disadvantages of arbitration but at the same time not have too many inherent disadvantages themselves.

As was observed with arbitration, there are specific advantages found in the use of alternative approaches, but at the same time the use of such methods also comes with inherent disadvantages and challenges. Alternative approaches, including ADR and DPPs, commonly exhibit the following advantages:

- The *flexibility* of alternative approaches, both with respect to procedural aspects of a dispute as well as substantive results in terms of content of a direct or facilitated settlement, is a clear advantage. Whereas arbitrators are bound by the arbitration rules referred to by the parties and have relatively little flexibility (almost none under ICSID rules, slightly more under UNCITRAL rules), third-party neutrals in ADR processes have more space for taking a creative approach. The parties themselves can also be more creative in the outcome in order to work towards a win–win type of settlement based upon mutual interests and needs (Salacuse, 2007). This comes in contrast to a judge or an arbitrator who has to adjudicate the claim based on the underlying legal rights provided by the treaty/contract and international law, and with the limited choice of remedies that necessarily entails (Wälde, 2006; Franck, 2008b). In alternative approaches, there is flexibility with the legal commitments at hand and the specific facts of the dispute, where a solution is not necessarily based on the interpretation of treaty provisions, identifying the existence of a violation or damage, but focuses on finding an acceptable and workable solution even if it requires departing from the legal framework surrounding the facts of the case. For instance, where an arbitral tribunal has to decide whether a particular measure or act by the State amounts to an expropriation, follows the requirements for an expropriation to be lawful, and opens the right to monetary compensation, a negotiated settlement can be more flexible in preserving the interests of both parties to the dispute. It can focus more on the nature of the relationship between the parties than on the actual language of the contract negotiated between them or the language of the underlying IIA concluded between the relevant States at a time when none of the negotiators anticipated potential problems. More concretely, the parties can among themselves or with the help of a third party neutral come up with an alternative compensation for the denial of a permit or licence to operate a particular investment by suggesting a different location or project for the investment. Deals can be swapped for other types of investment contracts or obligations. The terms of a concession project can be re-negotiated, the return of a project can be re-evaluated and additional guarantees or sources of revenue can be proposed. Governments can be required to undertake self-assessments and reappraisals of problematic measures they have enacted. These approaches are however not applicable in cases of laws or policies of general application. But in some cases, they can produce positive effects, particularly on the on-going relationship between the host State and the foreign investor.

- ADR comes with the *possibility to strike "deals"* between the investor and the State. Much more than arbitration, ADR (and also dispute prevention policies) can include issues in the bargain that go beyond the mere payment of compensation. In many cases, other issues may be more important to the investor than financial compensation received from the State. Furthermore, ADR and especially dispute prevention policies can impact more on the measure itself compared to arbitration, and can hence lead to a solution that solves the entire problem and not only leads to the payment of compensation without any change in the problem at hand.

- Another possible advantage of alternative approaches is to provide for a *faster and less costly settlement*, the more so when the problem is tackled at an early stage and with the specific goal of avoiding escalation. Alternative approaches will also save on hours of intensive fact-finding, expert contributions, witness interrogation, sessions and document exchange.

- Another potential advantage of alternative means is that they can be *without prejudice to the right of the parties to resort to other forms of dispute resolution* and can be conducted alongside investor–State arbitration. The resulting settlement agreement could ultimately be incorporated into an award of the arbitration tribunal, a possibility expressly foreseen in ICSID Arbitration Rule 43(2). For instance, in one ICSID case, the President of the Tribunal at the request of the parties acted as mediator for a few months to assist the parties in negotiations. The parties eventually agreed on some issues and asked the Tribunal to decide on the other matters (Onwuamaegbu, 2005).

- Furthermore, foreign investors and host countries *avoid the risk of an arbitral award that might set an unsatisfactory precedent for the future* and might encourage other foreign investors to challenge the same type of governmental measure or regulation. One of the advantages of ADR is to allow for privacy and confidentiality, which may seem contradictory at first sight. However, it is understandable that numerous or lingering cases, with various challenges, annulments and other dilatory procedures, can have a negative impact on the host country's investment climate and reputation.

- Alternative means can *improve good governance and regulatory practices of States* that have to review some of their measures or laws subsequent to an ADR process or as part of a policy for dispute prevention. For example, the outcome of an ADR process may require the State to re-assess certain measures implemented in the past and improve on internal procedures, tailoring them according to a negotiated outcome. Investors may also simply appeal to a host State that certain unfavourable or problematic measures taken in the past ought to not reoccur, which may induce regulatory change.

On the other hand, alternative approaches present numerous challenges. These challenges and ways to solve them vary depending on the nature of the dispute. They are as follows:

- Most importantly, the result of a negotiation, mediation or conciliation is *not binding on the parties* and is not necessarily enforceable through any binding international rule.

- In the context of ISDS, with the exception of negotiations, both *investors and States lack familiarity and experience with the techniques involved in alternative methods*, which is one significant explanation why such methods are rarely used in practice.

- At present, it is also a challenge to *find the right neutrals* with parallel expertise in both alternative methods as well as in the area of investment law and investor–State disputes.

- Alternative approaches can result in a *waste of time and funds*. This happens when disputants embark on ADR processes only to start an arbitration procedure at a later stage when it becomes clear that one of the parties is not making good-faith commitments, not willing or able to find a negotiated outcome. Similarly, if DPPs are implemented that eventually turn out not to prevent the recourse to arbitration by an investor, then the initiation of such policies may constitute an unnecessary use of resources. Nevertheless, even if alternative means do not lead to immediate success, they can be supportive to achieving a negotiated settlement at a later stage and alerting officials of potential problems that may re-emerge with other investors.

- Alternative approaches are *not suitable for all types of investment disputes*. For example, it is not possible for a sovereign State to negotiate – and compromise – about the application or the effects of generally applicable rules or laws (e.g. environmental, social or other public interest laws which were implemented in line with democratic choices) and to make exceptions as far as foreign investors are concerned. Similarly, the application of tax measures to all investors would not be negotiable. More generally, the possibility to take alternative routes is very case- and fact-specific. Some cases involving long-term investments, for example, may lend themselves to alternative approaches to ensure that the project can continue while the solution to the dispute is being negotiated.

- Alternative methods may simply not be possible or be subjected to too many *obstacles when a sovereign State is involved*. For example, host States generally have to operate within the boundaries of existing laws and regulations. Moreover, strategic and tactical barriers can be exacerbated and approaching ADR can be considered as a weakness or be used as a pressure to obtain a settlement, thereby approaching ADR with a "wrong motivation". Political issues, involvement of pressure groups, and publicity around ADR can make it impossible for the authorities to embark on a negotiated solution.

- *The requirement of power or mandate to negotiate, or the lack thereof*, is a further deterrent to ADR. This is exacerbated when several government agencies become involved in the dispute and no single agency is authorized to conduct negotiations on behalf of the government to reach a settlement (Legum, 2006).

- The use of alternative approaches may result in the *misperception at the domestic level that foreign investors enjoy a special treatment* and that there is no equality in front of State measures or policies. Domestic investors may feel at a disadvantage compared to foreign investors.

- ADR methods and procedures may under certain circumstances be *time-consuming*. However, as will be discussed in more detail in the next chapter, existing provisions in IIAs that encourage negotiation and consultation tend to specify a time frame that does not allow for effective ADR. Frequently, States will need a substantial amount of time to discern the source of the breach and responsible institutions among a myriad of government agencies (Legum, 2006). The few months of "cooling off" allocated for this purpose in IIAs would often be too short to sufficiently assess the problem.

- The *difficulty of using ADR techniques may be related to the nature of the provision in an IIA* on the basis of which the dispute emerged. Issues that allow for more flexibility in decision-making, such as the amount of "adequate" compensation to be paid, can be effectively addressed through ADR. But other issues, such as whether expropriation has taken place or not, can only be approved or disapproved with little or no opportunity for compromise. In other words, ADR is only a viable way to resolve a dispute if the relevant IIA provisions allow for some discretion in their application.

- The confidential nature of many ADR procedures may be criticized, as it results in a *lack of transparency* regarding the way disputes involving a State party are resolved.

- DPPs can also *generate inter-institutional conflicts* involving overlapping priorities within the State. For example, disagreements may emerge whether the protection of foreign investors or the protection of the environment are to take precedence. Such examples can apply to many areas of a State's regulatory powers.

- For the host State, there is *a high political risk in seeking a negotiated settlement* and abiding by it without being forced to do so. For example, an early settlement for a case resulting in the up-front payment of a compensation to the foreign investor of several million dollars may or may not be more favourable than the outcome of an arbitral award that is most likely to be rendered in a couple of years down the line. In addition, high confidentiality of such negotiations eventually means lack of transparency, which will raise other forms of criticism.

In each individual investment dispute, the nature, degree and amount of these challenges are different. The fact that one of the parties to the dispute is a sovereign State is a multiplying factor.

Notes

[1] There are also several other forms of ADR, such as "bounded arbitration", "baseball" arbitration, early neutral evaluation and arb–med.

[2] The reader is referred to this literature for further information. See particularly Coe, 2005, for conciliation in investor-State disputes; and Kolb, 1983.

III. ALTERNATIVES TO ARBITRATION IN THE INTERNATIONAL INVESTMENT FRAMEWORK

The previous chapter reviewed available alternative methods and their possible use as alternatives to international arbitration in the context of investment disputes. As a next step, their availability has to be looked at in the context of the existing international investment framework. This chapter will therefore examine the incorporation of alternative approaches into provisions of IIAs, including BITs and FTAs. It will then discuss to what extent international rules and facilities that form part of the international investment framework, such as the ICSID Convention and the UNCITRAL rules, take alternative approaches to investment arbitration into account, promoting or simply facilitating them.

A. Available means negotiated in IIAs

The issue at stake is whether and how existing IIAs make recourse to alternative approaches available as an option for investors and to what extent these provisions are conducive to the use of alternative means. In general, recourse to means that constitute an alternative to international arbitration is frequently enshrined in IIAs. The approach is to require that parties to a dispute first seek amicable settlement through negotiations and consultations conducted seriously and in good faith, and only when such negotiations and consultations fail should international arbitration be considered as the next step (UNCTAD 2003a, 2003b). For this purpose, most IIAs include a clause that encourages or even obliges the parties involved in a dispute to engage in consultations and negotiations. The traditional formulation is that in the event of an investor–State dispute, "[…] *the parties shall initially seek to resolve the dispute by consultations and negotiations*" (e.g. Australia–Viet Nam BIT of 1991, Article 12(1)), or "[…] *the dispute shall as far as possible be settled amicably through negotiations between the parties*" (China–Singapore BIT of 1986), or "[…] *the dispute shall as much as possible be settled amicably between the parties* […]" (France–Panama BIT of 1982). Unfortunately, due to the confidentiality usually surrounding such amicable settlements, accurate and comprehensive statistics on negotiated settlements of investor–State disputes are unavailable.

IIAs usually specify a time frame for such recourse to amicable settlement, between three and six months. It is likely that such a "cooling-off period" is included in IIA provisions to make the involved parties seriously consider the desirability of international arbitration, rather than encourage them to consider the use of specific ADR techniques that go beyond simple consultations and negotiations. Moreover, the "cooling-off period" is generally too short to allow for effective ADR to take place within that time. The mere fact that this three-to-six months period is called a "cooling-off period" rather than a negotiation period speaks for itself and has to be considered in light of the objective of BITs to provide access to international arbitration for the investor without undue delay (see also box 3).

Box No. 3. ISDS cases considering the absence of an attempt to reach amicable settlement prior to arbitration

Few ISDS cases have looked into the absence of an attempt to reach an amicable settlement as a precondition for initiating a claim on the part of the investor. However, the example of two recent cases that have investigated this illustrates that decisions made on this issue can differ from case to case:

- In *Western NIS Enterprise Fund vs. Ukraine*, the tribunal issued an order stating that "proper notice is an important element of the State's consent to arbitration, as it allows the State, acting through its competent organs, to examine and possibly resolve the dispute by negotiations" (ICSID Case No. ARB/04/2, paragraph 5). Hence, the proceedings were suspended to require the investor to adhere to the appropriate proceedings by giving proper advance notice to the State. The case was later discontinued (Polasek, 2006).
- On the contrary, a different approach was taken by the tribunal in *Occidental Petroleum Corporation/Occidental Exploration and Production Company (OEPC) vs. Ecuador* (ICSID Case No. ARB/06/11). The case concerned a contract that had granted the investor specific rights to explore and drill in a particular area, where the investor had pursued arbitration only two days after revocation of the contract, despite the encouragement to use ADR and a six-month "waiting period" provided for in Article VI, paragraphs 2 and 3 of the relevant Ecuador-United States BIT. The tribunal ruled in favour of the investor, reasoning that "the *caducidad* [contract revocation] procedure at issue in this arbitration was in fact initiated in 2004. As noted earlier, for some 18 months or so prior to the issuance of the actual *Caducidad* Decree on 15 May 2006, OEPC made a number of submissions seeking to rebut the allegations on the basis of which the *caducidad* procedure was initiated, but to no avail". It was added that "albeit without prejudging the merits,

that attempts at reaching a negotiated solution were indeed futile in the circumstances" (ICSID Case No. ARB/06/11).

An explicit mention in IIAs of the possibility to use more sophisticated ADR techniques such as mediation or conciliation to settle disputes is rare. Only a few IIAs specifically propose or recognize the use of such techniques in investment disputes. They usually contain specific language allowing the use of alternative resolution techniques as part of the negotiation and consultation process. For example, Article 23 of the United States Model BIT (2004) states the following:

> *"In the event of an investment dispute the claimant and the respondent shall initially seek to resolve the dispute through consultation and negotiation,* ***which may include the use of non-binding third party procedures****"* (emphases added).

Earlier BITs concluded by the United States already incorporated provisions of this kind, as exemplified in the Poland–United States BIT of 1990. Similarly, the Turkey–United States BIT of 1985 also allows for ADR, but only after attempted negotiations have been unsuccessful:

"Article VI(2)

> *"[…] if negotiations are unsuccessful, […] the dispute may be settled through the use of non-binding, third party procedures mutually agreed upon."*

More common in IIAs is the simple reference to conciliation next to or as an alternative to arbitration, and consistently mentioned prior to arbitration in various treaty texts. One example is the China–Japan BIT of 1988, which states:

> *"If a dispute concerning the amount of compensation […] cannot be settled within six months from the date either party requested consultation for the settlement, such dispute shall, at the request of such national or company, be submitted to a* ***conciliation board*** *or an arbitration board, […]. Any dispute concerning other matters […] may be submitted by mutual agreement, to a* ***conciliation board*** *or an arbitration board as stated above"* (emphases added).

The BIT between Georgia and the Netherlands of 1998 similarly mentions conciliation next to arbitration:

> *"Each Contracting Party hereby consents to submit any legal dispute arising between that Contracting Party and a national of the other Contracting Party concerning an investment of that national in the territory of the former Contracting Party to the International Centre for Settlement of Investment Disputes for settlement* ***by conciliation*** *or arbitration under the Convention on the Settlement of Investment Disputes between States and Nationals of other States opened for signature at Washington on 18 March 1965."* (Emphasis added.)

A more recent example can be found in the investment chapter of the Economic Partnership Agreement (EPA) between Japan and the Republic of Indonesia of 2007. Chapter five, article 69 on investor-State dispute settlement includes detailed provisions on the use of conciliation or arbitration:

> *"4. If the investment dispute cannot be settled through consultation or negotiation […], the disputing investor may submit the investment dispute to one of the following international conciliations or arbitrations:*
>
> *"(a) conciliation or arbitration in accordance with the Convention on the Settlement of Investment Dispute between States and Nationals of Other States […]*
>
> *"(b) conciliation or arbitration under the Additional Facility Rules of the International Centre for the Settlement of Investment Disputes […]"*

Only a few treaties suggest conciliation procedures as a precondition for the investor's right to submit the dispute to international arbitration. One example is Article 9 of the BIT between India and Sweden of 2000, which states the following:

> *"2. If such a dispute has not been amicably settled within a period of six months the Investor that is a party to the dispute may submit the*

> *dispute for resolution according to the following provisions:*
>
> *"(a) to the courts or administrative tribunals of the Contracting Party that is a party to the dispute; or*
>
> *"(b) in accordance with any applicable, previously agreed dispute settlement procedure; or*
>
> *"(c) to* ***international conciliation under the Rules of the United Nations Commission on International Trade Law (hereinafter referred to as "UNCITRAL")****.*
>
> *"3. Should the investor fail to exercise the options in paragraph 2(a) and (b) of this Article or* ***where the conciliation proceedings under Article 2 (c) of the paragraph are terminated other than by the signing of a settlement agreement****, the dispute shall be referred to binding international arbitration according to the following provisions* […]" (emphases added).

Although ADR beyond the aspect of negotiations and consultations is rarely mentioned explicitly in IIAs, it is worth considering that IIAs also do not prohibit its use. Moreover, since treaty provisions do not specify how these consultations and negotiations are to be conducted, they also do not prevent the disputing parties from seeking the assistance of third persons to help them resolve their quarrel. On the other hand, more specific language encouraging or authorizing the use of ADR beyond consultations and negotiations would be an additional signal to both parties that this kind of ADR is a viable option worth much consideration. It is generally not clear to what extent the failure to expressly provide for ADR in IIAs has inhibited a more frequent usage of such techniques.

Beyond the realm of ADR, a further possibility of introducing alternatives to investment treaty arbitration in IIAs is to enhance the role of State–State cooperation in the prevention and handling of disputes. Renewed interest in State–State procedures can be discerned from several more recent IIAs. The general approach is to reinforce communication and share information between the governments of the investor and the country where the investment has taken place on emerging and existing investment disputes, with the goal of resolving such disputes. In other words, a potentially larger role of the home State may be thought of in the context of the settlement of investment disputes, and respective provisions could be incorporated more frequently in future IIAs. Although this constitutes in essence a "re-politicization", the nature of the relationship between the States involved is in this case one of cooperation rather than confrontation.

A significant example of shared concern between the two contracting parties of an IIA is the recently concluded FTA between Canada and Colombia, in the article 815 establishing the Committee on Investment:

> *"3. The Committee shall meet at such times as agreed by the Parties and should work to promote cooperation and facilitate joint initiatives, which may address issues such as:*

> *"(a) capacity building, to the extent resources are available, in legal expertise on investor-State dispute settlement, investment negotiations and related advisory matters;*
> *"(b) promoting corporate social responsibility; and*
> *"(c) other investment-related issues identified as a priority by the Parties."*

In addition to strengthening the cooperation between the contracting parties, joint commissions or other bilaterally established mechanisms between the States can also get involved in sharing information, taking preventive action or even facilitating settlement of investment disputes.

Several examples from recent IIA practice that could allow such an approach are worth considering. While these provisions refer to State–State cooperation in a more general sense, expansion and clarification of these provisions to incorporate the handling of investment disputes could be a way forward in the future. Chinese BITs for instance frequently include the following type of provision, as exemplified in article 13 of the BIT between China and Latvia of 2004:

> *"1. The representatives of the Contracting Parties shall hold meetings from time to time for the purpose of:*
> *"(a) reviewing the implementation of this agreement*
> *"(b) exchanging legal information and investment opportunities*
> *"(c)* ***resolving disputes*** *arising out of investments*

[…]

"2. Where either Contracting Party requests consultation on any matter of Paragraph 1 of this Article, the other Contracting Party shall give prompt response […]" (Emphasis added.)

The establishment of a "joint committee" or "subcommittee" on investment, as is found in investment chapters of Japanese EPAs, also constitutes a viable approach. Examples of such provisions are chapter 7, article 93 of the EPA between Japan and Malaysia of 2005, and chapter 8, article 88 of the EPA between Japan and Singapore. These committees are composed of representatives of both governments of the agreement and meet on mutually agreed occasions. They are assigned various functions, including the exchange of information, the monitoring of appropriate implementation of the agreement, the review of possibilities to cooperate in investment promotion and facilitation efforts, and other responsibilities as required. Such joint commissions can also fulfil the function of enhancing State–State cooperation in the area of dispute management and avoidance.

Similarly, regional economic integration agreements (REIAs) also provide for the establishment of Committees to supervise and handle various matters relevant to the agreement. For example, the North American Free Trade Agreement (NAFTA) of 1992 provides for the establishment of the Free Trade Commission in its article 2001 which, among other things, is responsible for supervising the implementation of NAFTA, resolving disputes arising from the interpretation or application of the agreement and considering other issues relevant to the operation of the agreement. The Commission meets at least once per year. It also supervises the work of all subcommittees and working groups that are being implemented under the NAFTA. The handling of matters related to investment disputes, or simply reviewing or consulting on these issues, could potentially fall under the responsibility of such a committee or one of the subcommittees within the NAFTA agreement or other similar REIAs.

Another example of such an approach in an REIA that has more concretely addressed the issue of dispute settlement involving private entities at the State–to–State level can be found in *The Olivos Protocol for the Settlement of Disputes in Mercosur* of 2002. In chapter XI, articles 39 to 44 of the agreement, dealing with claims by private persons, a two-step approach is introduced, requiring a first stage of consultations and reviews that may already put an end to the dispute. If this is not successful, then State–State procedures will be initiated as a second step. The respective articles include the following content:

> *"Article 39. Scope of application*
>
> *"The procedure established in this Chapter shall apply to claims filed by private persons (individuals or corporations) in connection with the adoption or application, by any of the State Parties, of legal or administrative measures having a restrictive, discriminatory or unfair competition effect […].*

"Article 40. Initiation of actions

"1. The private persons concerned shall file their claims with the National Chapter of the Common Market Group of the State Party where they have their usual residence or place of business.
"2. […]

"Article 41. Procedure

"1. […] the National Chapter of the Common Market Group that has admitted the claim pursuant to Article 40 of this Chapter shall engage in consultations with the National Chapter of the Common Market Group of the State Party charged with the violation, with the aim of finding an immediate solution to the matter raised. […]
"2. If consultations end without reaching a solution, the National Chapter of the Common Market Group shall forward the claim directly to the Common Market Group.

"Article 42. Intervention of the Common Market Group

[…]
"2. Should the Common Market Group not reject the claim, the claim will be deemed accepted. In this case, the Common Market Group shall immediately call upon a group of experts […]

"Article 43. Group of Experts

"1. The Group of experts referred to in Article 42.2 shall be formed by three (3) members designated by the Common Market Group […]

"Article 44. Opinion of the group of experts

"1. The group of experts shall submit its op to the Common Market Group.
*"i) If a [*sic*] unanimous opinion were to declare the admissibility of the claim filed against a State Party, any other State Party may request the adoption of corrective measures or annulment by reverse [*sic*] the challenged measures. If this request is not complied within fifteen (15) days, the claiming State Party may resort directly to the arbitration procedure, as provided for in Chapter VI of this Protocol."* [1]

Interesting in these provisions is the procedure of transferring a claim by a private entity such as an investor into a State–State procedure. After a first requirement for consultations with the goal of encouraging quick solutions to a dispute, the Common Market Group has to review the admissibility of the claim from a procedural point of view, before appointing a group of experts comprised of individuals with expertise in the subject area of the dispute. This group then decides on the admissibility of the subject matter before referring it to the State–State arbitration procedure. This approach resembles a two-stage process.

What the above approaches have in common is that problems are addressed upfront and attempts are made to solve them before the investor goes to the ISDS procedure available under a treaty. ISDS mechanisms have been put in place to avoid diplomatic protection for one side or pressure on the other. In practice, however, when a dispute is looming, the ambassador of the home State of the investor will generally knock at the door of the authorities and request to have the matter looked at in detail. The inclusion of specific wording in an IIA in order to involve the home State of the investor into ISDS could be seen as a step back towards politicizing disputes, when depoliticizing has been the guiding concern for all parties in recent years. The issue could, however, be approached from the angle of closer cooperation between the State parties, both of which share the concern that possible disputes could arise for either of them with investors of the other State. Such cooperation could prevent a conflict, avoid escalation into a dispute or settle a problem at an early stage.

B. Available international rules and dispute resolution institutions referred to in IIAs

Similar to arbitration, it may be helpful to have rules that guide the parties and third party neutral smoothly and effectively through an ADR process. Such rules allow the initiating party to make an informed choice and to guarantee predictability around the process, the more so when a sovereign State is involved in the dispute. A defendant State may also rely on these rules to make an informed decision on whether to go ahead with mediation or conciliation. The international investment framework includes at least three sets of rules that can be referred to or used to conduct ADR. These are the rules set up under the ICSID Convention, the UNCITRAL conciliation rules and the ICC conciliation rules. The first part of this section will look into these and some other rules and assess their use in investor–State disputes.

In addition to rules that deal with the ADR process itself, this section will also look at the availability of an institutional framework that provides the necessary support and services to investors and States willing to engage in ADR. Several institutions offer services such as the proposition of a neutral third party for the purpose of conciliation, or making a venue available where relevant meetings among the disputing parties can be held. In addition to the ICSID secretariat and the ICC, several other arbitration institutions or centres, whether regional or national, have embarked on providing such services.

The **ICSID Convention** contains the main body of rules referred to by IIAs and used by parties involved in investor–State disputes. These include the *Rules of Procedure for Arbitration Proceedings (Arbitration Rules)*, providing the procedural framework for the commonly used investor–State dispute settlement by arbitration, and also the *Rules of Procedure for Conciliation Proceedings (Conciliation Rules)* that include rules on how to undertake conciliation (ICSID, 2006a). The ICSID Conciliation Rules were adopted as early as 1967, together with the ICSID Arbitration Rules, to be used to solve disputes involving ICSID member States themselves and investors from ICSID member States. In 1978, the ICSID Conciliation (Additional Facility) Rules were adopted for use in cases where either party to the dispute is not a member of ICSID or where the issue at stake is not entirely related to investment (Onwuamaegbu, 2005). ICSID has also recently considered promoting mediation, although this approach seems to have been abandoned lately, probably under the pressure of the increase in arbitration cases on human and financial resources of the centre.

The *Report of the Executive Directors on the Convention* describes the main difference between arbitration and conciliation under the ICSID rules. It states that "the differences between the two sets of provisions reflect the basic distinction between the process of conciliation which seeks to bring the parties to agreement and that of arbitration which aims at a binding determination of the dispute by the Tribunal" (ICSID, 2006a).

Although focused on dispute settlement through arbitration, the ICSID Arbitration Rules nevertheless provide for a possibility to consider amicable settlement as an alternative to arbitration. They include an option available to the parties to request the convening of a pre-hearing conference between the Tribunal and the parties. Chapter III, rule 21 of the arbitration rules states:

> "*(2) At the request of the parties, a pre-hearing conference between the Tribunal and the parties, duly represented by their authorized representatives, may be held to consider the issues in dispute with a view to reaching an amicable settlement.*"

Focused entirely on conciliation, the ICSID Conciliation Rules specify how the parties involved in a dispute shall select the conciliators and explain in detail how the Conciliation Commission should be formed. The rules further regulate how the Commission, which is comprised of the conciliators, shall operate and fulfil its mandate. They finally outline various procedures to be followed by the commission and the parties involved during the conciliation process, and specify how the proceedings shall be terminated (ICSID, 2006a). The ICSID Conciliation Rules hence provide for a relatively formal set of procedures, and a substantial amount of power is given to the Conciliation Commission. For example, the Conciliation Commission has certain powers under which it can: (a) at any time, "*recommend that the parties accept specific terms of settlement or that they refrain* […] *from specific acts that might aggravate the dispute* [… and] *point out to the parties the arguments in favor of its recommendations*" (ICSID, 2006a); (b) request written statements from the parties; (c) rule on its own jurisdiction; (d) rule on requests to disqualify conciliators; (e) hold hearings and take evidence in the form of documents or witness testimony; and (f) issue a report at the closure of the proceedings. ICSID's current conciliation rules resemble a process of non-binding arbitration which may actually be one of the factors for the lack of attractiveness of conciliation under ICSID for parties, discussed in further detail below.

Finally, ICSID also maintains a set of Fact-finding Rules (Schedule A) under its Additional Facility Rules. These fact-finding rules are set up for the purpose of preventing disputes, as the result of a fact-finding procedure would provide the disputing sides with an impartial assessment of an issue (Onwuamaegbu, 2005). These proceedings require the setting up of a Committee for the investigation, and, upon conclusion of the proceedings, a report on the outcome will be issued (ICSID, 2006b).

A similar example of a set of rules, applicable to ad hoc conciliation, can be found in the **UNCITRAL Model Law on International Commercial Conciliation of 2002** (UNCITRAL, 2004), which works together with the UNCITRAL Conciliation Rules of 1980 (UNCITRAL, 1980). The Model Law provides a good example of a codified approach towards conciliation. The procedure is – in brief terms – as follows:

A party to a dispute addresses a request for conciliation to the institution offering conciliation services. If the institution concerned secures the agreement of the other disputant, it will appoint a conciliator. While conciliators have broad discretion to conduct the process, they will invite both sides to state their views on the dispute, and will then make a report proposing a settlement. The parties may accept or reject this proposal; in the latter case, either party may proceed to arbitration. The disputing parties may also use the conciliator's proposal as the basis for further negotiations between them. The conciliation process is confidential and voluntary. Either party may withdraw from conciliation at any time.

The **International Chamber of Commerce (ICC)** also provides a set of rules on ADR which are applicable to all business disputes (ICC, 2001). The extent to which these *ADR Rules* can be applied to investor–State disputes, however, still needs to be determined. The basic content of the ICC rules is similar to the examples outlined above, specifying the process how a disputing party initiates the conciliation procedures, the selection of a third-party neutral, the coverage of necessary fees and costs, the details of the actual ADR procedure, and the steps necessary to conclude the procedures.

In addition to its rules on ADR, the ICC also supports the establishment of so-called "dispute boards", which are set up at the time when a medium- to long-term contract between two parties is being concluded. These dispute boards then remain in existence throughout the contract's duration and can be approached by either party in case a conflict emerges. Dispute boards usually comprise one to three people who are very familiar with the contract at hand. Their mandate is to help the parties in resolving conflicts that emerge in the course of the fulfilment of the contract, making recommendations or even advocating specific decisions. As with rules on conciliation, the ICC has published a set of *Dispute Board Rules* that specify how a dispute board has to function. The ICC also supports the setting up of such dispute boards through its Dispute Board Centre. As with conciliation, the dispute board rules do specify that formal arbitration can follow an unsuccessful attempt at dispute resolution through the dispute board (ICC, 2004). In terms of timing, such a dispute board can be understood as an attempt to anticipate potential disputes already when contracts come into existence. The advantage may be that contracting parties agreeing on the establishment of a dispute board are relatively aware of the fact that disagreements may emerge, and are prepared to first attempt resolution through alternative methods, potentially avoiding arbitration entirely. Given such potential advantages, it is worth further exploring the applicability of dispute boards to the investor–State scenario and maybe even the formal inclusion of respective provisions in IIAs. For example, a dispute board could be set up for any larger investor entering a host country or upon conclusion of state contracts with foreign investors.

Another leading institution in the area of ADR is the **International Centre for Dispute Resolution (ICDR)** established under the American Arbitration Association (AAA). Its *International Dispute Resolution Procedures* are similar to the conciliation rules of the institutions outlined above and cover the same kind of issues, such as initiation of mediation, appointment and duties of a mediator, confidentiality, termination of the mediation, and coverage of expenses. Again, these rules primarily refer to commercial disputes and their applicability to ISDS needs to be explored (AAA, 2007). But there are likely to be interested bodies beyond the realm of commercial disputes that would consider using these rules.

The **World Intellectual Property Organization (WIPO)** also maintains rules on arbitration and mediation. Similar to the previously introduced conciliation or mediation rules, the *WIPO Mediation Rules* (effective from 1 October 2002) incorporate guidelines on the appointment and role of the mediator, the representation and participation of the parties in the process, the actual process of mediation, confidentiality, financial issues and termination of the mediation process. The WIPO rules are particularly relevant to commercial arbitration on issues related to intellectual property at a cross-border level (WIPO, 2006).

In addition to the provision of rules guiding the procedures for conciliation and mediation, many institutions also provide the necessary facilities for the disputing parties to utilize while engaging in the conciliation or mediation process, hence assuming the role of a supportive organization in the proceedings. The reason why these institutions provide such facilities is to offer organizational, administrative and logistical support to the disputing parties and third party neutral throughout the conciliation or mediation process, and offer a neutral forum and space for the proceedings to go forward effectively. For example, the parties of a dispute may be offered relevant information, such as a list of accredited conciliators and mediators, or will be allowed to use the supportive organization's facilities while conducting the conciliation or mediation procedures. The organization may also make meeting rooms and venues available to the disputants.

A wide range of such institutions currently exist, so that no exhaustive list but only a few examples can be mentioned here. Among the aforementioned institutions, ICSID, ICC, AAA and WIPO provide such facilities and support to parties involved in conciliation or mediation. In addition, various regional and national centres currently also assume this function. For example, several regional arbitration centres were established under the Asian–African Legal Consultative Organization (AALCO), an intergovernmental organization founded, among other things, for the purpose of advising member States on various matters in international law. The Kuala Lumpur Regional Centre for Arbitration (KLRCA) and the Cairo Regional Centre for International Commercial Arbitration (CRCICA) are both among these centres established under AALCO. Both provide rules and facilities on conciliation and mediation. The KLRCA offers facilities and assistance in conciliation and mediation procedures, while the CRCICA provides administrative support.[2] In addition, several national arbitration institutions also offer ADR facilities and rules.

Despite the existence of rules and facilities dealing with conciliation and mediation procedures, their application in the investor–State context has to date been minimal. For example, even though the ICSID arbitration and conciliation rules were concluded simultaneously in 1967, the practice at ICSID to date is strongly tilted towards use of the arbitration rules. For example, out of the 280 cases registered at ICSID until the end of 2008, the ICSID website reports only six cases for conciliation.[3] None have been registered under the Additional Facility Rules. No cases have been brought to the ICSID Centre under the Fact-Finding Rules, after nearly thirty years of their being in existence.

Although the aim of conciliation is agreement, the non-binding nature of the report upon conclusion of proceedings has often been cited as one of the reasons why parties have tended to shy away from ICSID conciliation in particular. The reason is that the process could cost as much time and, possibly, involve similar costs as an arbitral proceeding which would conclude with a binding award.

Furthermore, it is felt that the conciliation rules do not differ significantly from the arbitration rules and do not have the incentive of being simple and swift. In addition, absence of transparency and the confidentiality or privacy of a non-binding process that can result in the voluntary payment of huge amounts can also be seen as a deterrent.

Another reason that has been cited for the limited use made of ICSID conciliation is that potential users are not aware of its existence. The ICSID Centre has at times tried to address this lack of interest for its conciliation and fact-finding rules. It has further looked into the possibility to propose a mediation mechanism. In a joint effort with the Multilateral Investment Guarantee Agency (MIGA), several disputes involving MIGA as the political risk insurer have been solved through recourse to mediation or settlement. Recently however, these efforts have not been pursued. Similarly, from 1988 to 1993, the ICC dealt with more than 2,000 arbitration cases, but only with 54 requests for conciliation. Out of that number, conciliation was actually agreed upon in only 16 cases, and only 10 conciliators were appointed, because in the remaining six cases the parties settled the dispute otherwise or the request for conciliation was withdrawn. Of the 10 conciliations, 9 had been completed by 1994 – 5 resulting in complete settlement (Schwartz, 1995). Out of these 10 conciliation cases, none involved a sovereign as one of the parties to the dispute.

In light of this lack of effective use of existing rules on conciliation, even when these rules have been specifically designed to involve a State as one of the parties to the conciliation process, one might conclude that the conciliation mechanism is not suited to cases involving States. While this may not necessarily be the case, the rules themselves may be a strong deterrent to their own use due to their complexity – almost as complex as arbitration rules – without having the binding effect that arbitration has and without making the process swifter and necessarily less costly. It has been argued that a set of simple, basic rules could be applied by parties wanting to avoid arbitration, achieving simplification while recognizing the need for an organized process.

Since conciliation is confidential, public information is scant. It seems that it in general has not been widely used in investor-State disputes, as illustrated by the experience with the ICSID Conciliation Rules. One should, however, not conclude that the intervention of a third-party as conciliator or mediator is rarely used in international business and investment disputes. It is highly possible that third persons – without being formally designated as "conciliators" – have played an important role in helping the disputing parties solve their conflict.

This chapter demonstrated various ways how alternative means – especially ADR – have been incorporated into IIAs of various kinds and further illustrated their limited use. The main finding was that, despite the fact that ADR has been included in IIAs and that existing rules provide for conciliation as one option, recourse to arbitration is still the path commonly taken by investors and States. However, given the many deficiencies of arbitration outlined in chapter I, it may be worth considering, for the future, to include provisions on ADR in a more detailed and possibly binding fashion in IIAs, and to consider resort to existing rules on conciliation more frequently.

Notes

[1] Translated version of the agreement. The language of the original is Spanish.

[2] See: AALCO website at http://www.aalco.int/; KLRCA website at http://www.rcakl.org.my/conciliation-mediation/; and CRCICA website at http://www.crcica.org.eg/adr_rules.html.

[3] See ICSID Website. The six conciliation cases are: (a) *SEDITEX Engineering Beratungsgesellschaft für die Textilindustrie m.b.H. v. Madagascar* (Case No. CONC/82/1); (b) *Tesoro Petroleum Corp. v. Trinidad and Tobago* (Case No. CONC/83/1); (c) *SEDITEX Engineering Beratungsgesellschaft für die Textilindustrie m.b.H. v. Madagascar* (Case No. CONC/94/1); (d) *TG World Petroleum Ltd. v. Niger* (Case No. CONC/03/1); (e) *Togo Electricité v. Republic of Togo* (Case No. CONC/05/1); and (f) *Shareholders of SESAM v. Central African Republic* (Case No. CONC/07/1.

IV. DISPUTE PREVENTION POLICIES: EXPERIENCES AND GOOD-PRACTICE APPROACHES

Despite the importance that ADR, its inclusion in IIAs and use in international rules can have for finding ways to solve existing disputes amicably, the simple fact that there has been an incidence of an investor–State dispute in the first place could be considered as evidence of failure. In other words, there is an element of false timing when action is taken only after damage has already been done and disputes that are hard to solve have arisen. Rather, States would be better off anticipating possible sources of investor–State disputes in advance and taking necessary action much earlier. In doing so, the difficulties and costs, including political costs, involved by resorting to international arbitration or ADR could be avoided entirely.

In fact, the best chance to resolve a dispute between a foreign investor and a government agency is likely *before* the investment dispute becomes a dispute under an investment *treaty* (Legum, 2006). The best way forward for the host State to avoid and prevent disputes and/or achieve early settlement is by putting in place several policies of information provision, prevention and institutional cooperation. Offering early and/or alternative effective speaking partners within government to the aggrieved investor is also an important approach. Several countries have started putting in place such measures and policies, and this section will look into relevant experiences and “good practices” in several regions. “Good practices”, it should be noted, does not imply that a State will be totally immune to any disputes from occurring, but rather that it has taken concrete and positive steps towards preventing conflict from arising and crystallizing into fully formed disputes under a treaty. In practice, several States have embarked on designing comprehensive dispute prevention programs or have put in place institutional or legal frameworks addressing a more limited scope. The UNCTAD secretariat has been actively providing technical assistance to States on the implementation of DPPs and is contributing to the sharing of experiences and practices, involving various actors of the international investment community.

A. Information sharing

A first set of policies relates to the prevention of measures, decisions or actions by the State, particularly at sub-national levels or by State agencies, which could violate commitments otherwise taken by the State at the international level and create damage to a foreign investor. A review of recent cases shows that about half relate to decisions taken by municipal or provincial governments or by State agencies in charge of specific sectors of the economy. For instance, most of the cases that have arisen from public utilities concessions or privatization schemes are based on alleged violations by a sub-national entity, such as a municipality or province. Often, these entities will act without being aware of these international commitments, not fully appreciating the consequences of their decisions or refusing to make a decision in favour of a foreign investor. International investment treaties are usually negotiated by the upper level of government and their content and the level of obligations they entail are often not made available or communicated to authorities that are in contact with foreign investors in the day-to-day operation of the investor. Whereas governments have made great efforts to inform foreign investors of their commitments towards investment promotion, protection or liberalization through their investment promotion agencies, very little has been done to inform other State actors of the dos and don’ts when dealing with foreign investors.

An interesting example of information provision at the level of federal states can be found in NAFTA. The member countries of NAFTA had understood the need for information provision at the federal state or provincial level and organized meetings to inform stakeholders in states and provinces of the benefits that the commitments to liberalize trade and investment would bring for various economic actors. These information meetings were however not originally meant to brief state or provincial authorities about the consequences of a violation of treaty provisions and about possible implications that decisions relating to permits, authorizations and investment contracts could have on investor rights. As ISDS cases against the United States became public knowledge, the lead agency in charge of handling disputes was consulted frequently by Government agencies in order to assess possible implications of legislation or regulations.

Since the early NAFTA days, several countries have organized decentralized meetings with various stakeholders at various levels of government in order to inform them about treaty commitments. In addition to the authorities at the central government level that are usually in contact with foreign investors, it is recommendable to specifically target those government agencies that are in charge of specific sectors or may potentially enact measures that could violate treaty provisions. This approach was taken recently by several Latin American countries after the conclusion of the Dominican Republic – Central America Free Trade Agreement (DR-CAFTA).[1] Peru has also organized similar information sharing events after the conclusion of the Free Trade Agreement (FTA) between Peru and the United States.

In order to enhance information sharing at the early stage of treaty negotiation, several countries have involved a representative of the attorney general's chambers or offices in the negotiation team. This is for example the case in Malaysia or in the Philippines. In addition, broad consultations among government agencies already during the negotiation phase can significantly reduce the risk of agencies and ministries taking measures or acts that can violate treaty provisions at a later stage.

Recently, the Government of Peru has enacted a law and set up a sophisticated information system that is intended to serve three purposes:

- First, to inform the provincial and municipal authorities as well as State agencies about the international commitments undertaken by the central government, for example, providing details on the content of the FTA signed with the United States or on recently signed BITs.

- In addition, the information system is also available for these sub-national levels of government to inform the central government about difficulties or problems with foreign investors and seek their involvement. This system is available through a website put in place and operated by the Ministry of Economy on their homepage. In addition to making the site and the information available, various meetings have been organized at the provincial level. The information system created by Peru has an early alert function to enable the inter-ministerial Commission in charge of State response to get involved at an early stage of a dispute and to take appropriate action.

- Thirdly, the system also serves as a gateway for the foreign investor to the central authorities and more specifically to the inter-ministerial commission in charge, allowing the investor to better signal its problem or seek a solution of its claim.

Peru experienced its first investor–State dispute in 2003 and has since then received several claims, either based on investment treaties or contracts concluded between the Peruvian State and investors, such as stabilization contracts of which Peru has concluded over 300 with individual companies. In December 2006, the law No. 28933 was enacted, establishing the "coordination and response system of the State on investment-related disputes".[2] The main purpose of the law is to optimize the defence of the State with respect to international investment disputes, centralize information on IIAs concluded by Peru, set up an alert mechanism to warn of possibly emerging investment disputes, centralize information on international investment disputes, better coordinate procedures among public entities involved in a dispute, and achieve further standardization of the ISDS provision in Peru's IIAs. The public entities subject to the Law include all levels of national, regional and local government as well as state-owned enterprises and other public funds. Hence the Law is of broad application throughout the levels of government.

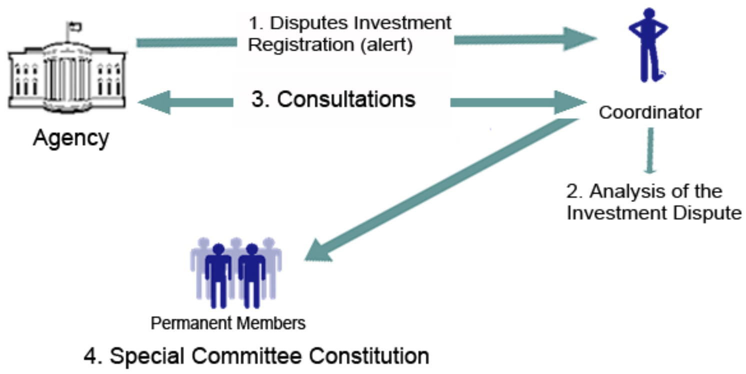
The Law establishes the Ministry of Economy and Finance as the Coordinator to which information on IIAs and other relevant agreements must be communicated. Similarly, public entities are also required to pass on information they receive about emerging disputes to the Coordinator. The Law further sets up a Special Commission assigned to the Ministry of Economy and Finance to represent the State in ISDS cases. This Commission is chaired by a representative of the Ministry of Economy and Finance, and is further composed of representatives from the Ministry of Foreign Affairs, the Ministry of Justice and Proinversión, Peru's Investment Promotion Agency (IPA). Up to two non-permanent members can also be required to join the Commission depending on the nature of the case. These include a representative of the Public Entity involved in the dispute, with the representative of the Ministry of Foreign Trade and Tourism joining if the dispute arose from an FTA. The Special Commission is, among other things, responsible for strategically assessing possibilities for reaching amicable settlement, obtaining technical reports and information from public entities involved in a dispute, taking part in the settlement negotiations, proposing the hiring of legal practitioners, designating arbitrators, assisting in the work of outside counsel hired for the defence of the State, approving the availability of funds for conciliation or arbitration, and determining the liability of the pubic entity involved in the dispute for the payment of relevant costs and awards.

The Law further provides guidelines for the negotiation of dispute settlement provisions and sets some requirements for provisions to be included in IIAs. Among these are the need for a six month period of amicable settlement, the definition of possibilities for recourse to neutral dispute settlement systems, the specification of how the costs of arbitration and conciliation procedures are distributed among the parties, and the obligation of the investor to notify the Coordinator of the system.

This framework established by Peru for the response to disputes arising from IIAs has two interesting characteristics as far as the early sharing of information is concerned. First of all, the Law provides for an obligation to report and notify to one identified central agency, the conclusion of any agreement with an investor or any IIA that includes an ISDS provision. One purpose of collecting this information in a single place is to consolidate a database of agreements and to keep track of commitments made by the State. An additional advantage is that information about these commitments is available to all relevant State entities from one central source. Parallel to that, the law also provides for an early alert system that allows the State of Peru to obtain early information about problems involving foreign investors that may trigger the use of international arbitration. Early warning on potential disputes to central authorities responsible for handling ISDS cases allows for early and coordinated action to be taken. More time will be available to prepare for the case, and more effective conduct of the amicable settlement phase will be possible in order to seek settlement before arbitration begins.

The Peruvian authorities have taken a bold and strong decision when deciding to organize the coordination and defence of cases by means of a law of mandatory application. The main goal was to ensure that coordinated action is taken and information is available without delay. Budgetary matters and allocation of payments are also better handled within a law. However, a possible structural deficiency in the system is that the collection of information and the handling of disputes are not in the hands of the same agency. Such a collegial coordination among agencies rather than the empowerment of one single agency may also impede effective decision-making at the negotiation stage and may lead to difficulties in building focused internal capacity for dealing with ISDS cases within one agency.

Figure 3. Alert system of Peru



Source: Government of Peru.

Practice within States shows that there are various ways of setting up information sharing tools. Several countries have committed to transparency and information obligations in the investment chapters of recent FTAs (such as the provisions on Transparency of Arbitral Proceedings in the DR-CAFTA and in the FTAs between the United States and Peru, Singapore and Chile) and are providing information on treaties and ISDS cases on their official websites. Dedicated web pages containing information relevant for investors (such as, for example, the full coordinates of the lead agency or possible steps to be taken in case of a dispute) are also frequently set up (e.g. Peru). Most of these web pages are, however, not directly targeting the various State actors and could be improved through the provision of some detailed guidance, contact point lists, guidelines in dealing with an investor in the case of a problem or even by giving some indications on dos and don'ts.

Another frequently used tool to raise awareness is the organization of targeted workshops. Several countries have used this approach to sensitize sectors or agencies within the government, but also more pragmatically, to train their own officials in dealing with treaty implementation and investor–State disputes (e.g. Colombia and Morocco).

An important issue here is to ensure the continuity of the information flows, particularly within ministries where the officials change every so often and where information channels can get lost. Workshops to update, follow-up activities, updating of contact points are steps that could usefully be included in an information-sharing programme.

Finally, the nature of the information-sharing programme, whether voluntary or mandatory, whether based on assistance, dialogue or on making reporting and informing mandatory for all the identified actors, needs also to be defined in order to achieve the goal of preventing disputes from arising or escalating.

B. Targeting sensitive sectors

Empirical evidence based on the bulk of investment disputes shows that foreign investments in some sectors and economic activities are more “prone” to disputes between the investor and the host State. Similarly, some forms of legal commitments, such as for example complex State contracts involving public utility concessions, build–operate–transfer (BOT) contracts or privatization schemes are more often at the origin of disputes than other types of investment instruments, depending also on the extent of the obligations of the State.

Numerous disputes have arisen in connection with concession agreements for public services such as water distribution or waste collection. Mining and petroleum extraction projects are also more often at the origin of disputes than foreign investment in other sectors of the economy.

Countries’ experience in dealing with dispute prevention policies shows that an important step in setting up these policies is the identification of so-called sensitive sectors of the economy or sensitive contractual arrangements. These contractual arrangements could be on the basis of national laws, regulations, contractual practice and of course the commitments made under investment treaties, for example pre-establishment commitments. Experience from other countries can also be useful in identifying sectors and activities that are more sensitive to regulatory intervention by the host State.

Once identified, listed, surveyed and monitored closely, preventive measures can be targeted at these sectors in order to avoid getting into violations of commitments or generating other types of disputes. Information, prevention, specific coordination to encourage good practice can be used more efficiently when the potential issues have been identified.

An example at hand is the survey of investors complaints carried out currently by the investment promotion agency of the Dominican Republic in the implementation of the DR–CAFTA. Investment policy reviews carried out by UNCTAD at the request of member countries can also provide useful guidance to focus the efforts and resources for more efficient dispute prevention policies.

C. Reinforcing institutional and amicable procedures - administrative review

An additional way forward to prevent disputes from escalating is by putting institutional mechanisms in place that allow aggrieved investors to initiate procedures in the host State for the undertaking of an administrative review of the law or measure that the investor considers to be in violation of the treaty. Such an administrative review has the advantage that it may allow for an easy fixing of a problem initially not recognized by domestic central or local governments. Resulting from an administrative review, the host State may recognize the controversy of a measure and may hence decide to alter or reverse it at least to the extent it is willing to do so and within a set time frame to avoid delay. Alternatively, the State may take some appropriate measures to address the negative impact of a measure. By adopting such approaches, the State may eventually avoid a lengthy arbitration procedure and the payment of compensation to an investor. This approach may thus not always constitute a delay of the proceedings before arbitration can be initiated, but may in many cases substantially shorten the process of finding a solution to the entire problem. Such recourse to an institutional or amicable administrative procedure could benefit both the governments and investors involved. Governments could achieve improvements of their legal and administrative framework, while the investor would be content with the speed at which its complaint has been addressed by the host country government.

Some recent IIAs provide for the recourse to domestic administrative review procedures prior to seeking arbitration. For example, the protocol of the BIT between China and Latvia of 2004 requires the following:

> *"The Republic of Latvia takes note of the statement that the People's Republic of China requires that the investor concerned* ***exhausts the domestic administrative review procedure*** *specified by the*

laws and regulations of the People's Republic of China, before submission of the dispute to ICSID under Article 9, paragraph 2." [Emphasis added.]

Similarly, the provision on ISDS of the BIT between Belgium–Luxembourg and Colombia of 2009 states the following:

> *"With regard to acts of a governmental authority, in order to submit a claim to arbitration under this Article or to a local court or administrative tribunal, **local administrative remedies shall be exhausted**, should it be required by the law of the Contracting Party. Such procedure shall in no case exceed six months from the date of its initiation by the investor…"* [Emphasis added.]

D. Implementation of ISDS commitments: access to information, inter-institutional arrangements and authority to settle

Another set of preventive steps can be taken by governments together with the signature of investment treaties, particularly FTAs, and upon the conclusion of these treaties. In a vast majority of investment protection treaties, States make commitments on ISDS and give the choice to the investor to resort to international arbitration should a dispute arise. Upon signature of the treaty, States will normally take steps to eliminate non-conforming measures and put laws and regulations into conformity with core investment treaty provisions such as national treatment, performance requirements, access to incentives etc. Similarly, ISDS provisions could be subject to specific implementation measures, in order to allow the State to be ready and fully prepared to comply with the provisions should any investor choose to start an arbitration procedure. This approach has an impact on governance, since it increases the predictability for the State entering into investment agreements and enables it to abide by its commitments.

Such an approach has been taken by the Government of Colombia in parallel to its investment treaty negotiations. Colombia has recently started the conclusion of IIAs and has in recent months negotiated FTAs with the United States and Canada both of which include an investment chapter. Almost simultaneously, the Ministry of Commerce has launched a programme with the support of the United States Agency for International Development, aiming at getting prepared to deal with investor–State cases through the identification of a lead agency and other institutional arrangements to avoid disputes and be better prepared for them. A specific decree – yet to enter into force – will grant the lead agency the authority to collect and produce evidence from all relevant sources within the Colombian Government.

The lead agency will constitute the core of Colombia's institutional arrangements to implement its ISDS commitments and ensure the defence of the State in investor–State arbitration. It will be involved in the handling of all issues related to the investor's interaction with the State in the context of investment disputes, including the receipt of notifications about emerging disputes, the coordination of consultations between the investor, the specific agency involved in the dispute at hand and other relevant agencies, and the management of the arbitral proceedings themselves. In other words, the lead agency will be the centralized authority to be approached for all matters related to investor–State disputes, and all information regarding such disputes is gathered within this agency. Such an approach drastically simplifies the authority structure among government agencies, thereby increasing overall transparency.

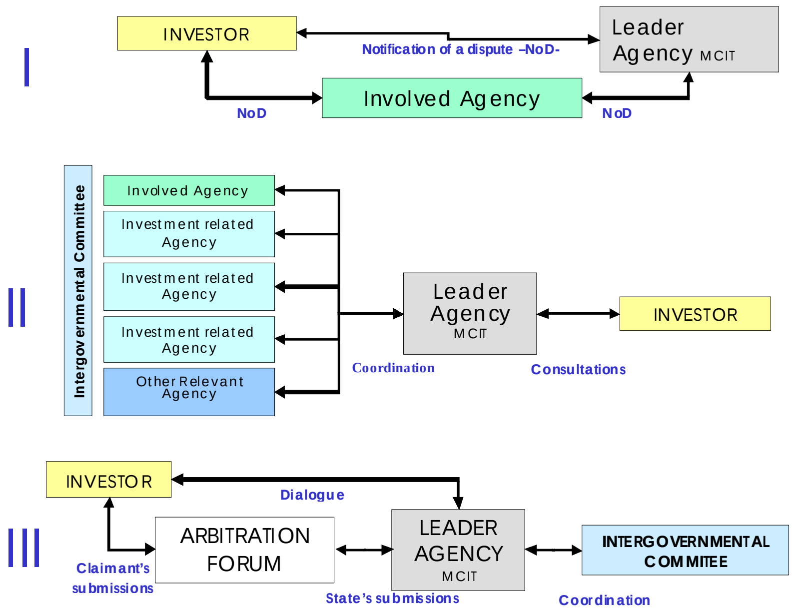
Figure 4 illustrates the role of the lead agency in further detail, particularly in relation to the investor and the involved agency as the two other most relevant actors. The involved agency is the government authority which is responsible for implementing the measure that triggered the dispute between the investor and the State. The figure illustrates three different roles of the lead agency, firstly as a recipient of information about disputes, secondly as a coordinating body during the consultations process, and thirdly as a key agency involved in arbitral proceedings.

The first role of the lead agency, namely as a recipient of information about disputes, addresses the challenge faced by governments in assuring that the right government agencies receive information about existing grievances by investors potentially resulting from breaches of IIA commitments. In many cases, the involved agency – which may often be a local or even remote government authority – will be approached by the investor seeking to communicate areas of dissatisfaction. Hence it is important to make it known to the agency involved how to react to complaints it receives from foreign investors.

Designating a lead agency as a focal point and making this known to all agencies that may become involved in investment disputes will guarantee that information about potential disputes will be channelled from the agency involved to the right place within the national government. The lead agency will then be in charge of coordinating the involvement of all relevant authorities. In addition, investors can also be informed directly about the existence of the lead agency, which they may approach in situations when a dispute seems imminent.

During the phase of active consultations, the State is likely to have some interest in settling a dispute before it is submitted to arbitration. The lead agency can play a role in making this possible by acting as an intermediary between the investor and relevant government authorities. First of all, the lead agency will act as the main body engaging in the consultations with the investor, irrespective of which specific government authority is involved in a particular dispute. Within the lead agency, specifically trained personnel can be designated to engage in all the existing consultations with investors, who will as a result be able to accumulate valuable experience over time on how to handle such consultations most effectively. The lead agency will pool all the information about a dispute received by the involved agency and other agencies of relevance to the particular case and utilize it for the consultations process. Such a pooling of knowledge will increase the effectiveness of the responding government to handle the consultations in an informed and competent manner.

Figure 4. Getting prepared: the institutional system of Colombia



Source: Government of Colombia.
Note: Part I: knowing the investment related dispute – there must be a lead agency centralizing notifications and coordinating any response; part II: consultations investor–State – the lead agency must be in charge of coordinating the other governmental agencies involved in the dispute, and it also must be the front desk for contacts between the investor and the administration; part III: arbitral proceedings – even during arbitration, the above stated roles of the lead agency must be maintained and any non-judicial solution must be approved by the Committee.

Thirdly, if a case is nevertheless eventually submitted to arbitration, the lead agency will maintain its involvement in the case. It will, on the one hand, further coordinate with the involved and relevant government agencies, while sustaining the dialogue with the investor. It will also provide the information it has collected on the case to the lawyers who support the State's defence.

Colombia has already taken several steps in establishing this system. For example, it made efforts to identify all relevant regulatory authorities that may happen to get involved in a dispute. To facilitate inter-agency communication, specific contact points (officials in charge) in various agencies were designated to deal with issues related to investment. The lead agency will be given clear authority to collect and produce evidence from all relevant sources within the Colombian Government.

Guatemala is also considering new institutional approaches in dealing with investment disputes, with the ad hoc decree No. 128-2009 of 5 May 2009 illustrating this step. The decree temporarily sets up an institutional mechanism for dealing with two recent cases against the country, by establishing an inter-institutional Commission to handle these two pending cases. The Ministry of Economy was designated by the decree as the coordinating agency.

Although primarily targeted towards preparation to defend the State in ISDS cases, the programme also has other functions related directly to dispute prevention and early settlement of investor claims. The identification and empowerment of a lead agency contributes to allowing discussions with the aggrieved investor early on, to securing the required cooperation and support from the government agency or sub-national entity that has taken the aggrieving measure at an early stage, and to vesting it with the necessary authority to negotiate and settle a claim when possible. On this particular issue, it should be noted that government officials have generally less authority and flexibility to engage in settlement discussions and to agree to a settlement than executives from the private sector. Particularly when another agency or sub-national entity is involved, it will be difficult to take these steps without having been given the authority upfront and possibly by law.

E. Securing authority to negotiate and settle – budgetary authority

At the heart of the State's policies to avoid conflict with foreign investors and as an immediate consequence of identifying a lead agency or coordinating commission is the empowerment of public officials to conduct discussions with investors, to propose or to respond to proposals for direct contacts, and to embark on negotiations either directly or with the help of third party neutrals.

Some countries have internal rules relating to the liability of public officials in the conduct of their responsibilities that can include personal and monetary liability. Public officials entrusted with the implementation of investment treaty commitments or dispute prevention programmes need therefore be given not only the necessary authority but also reassurance as regards possible charges that could be brought against them. Ideally, this would form an integral part of the dispute prevention programme and would provide strict guidance and rules to be used by the public officials conducting a settlement negotiation or participating in a mediation process that could lead to a decision.

As implied by Legum (2006), in addition to the identification of a lead agency and the authority and power of attorney to negotiate and possibly settle, the lead agency will require some form of statutory or specific budgetary authorization before officials can reach into the public coffers. Such authorization commonly exists where judgements by domestic courts are made against the State, but this is not necessarily the case with respect to claims resulting from international arbitration. When such authorization is lacking, the legislature will be required to issue a specific authorization that allows payment to proceed. A sense of uncertainty on whether the settlement of claims from investor–State disputes is formally authorized would often suffice to discourage government officials from looking into conciliation as a viable option.

An additional uncertainty could emerge from a lack of clarity regarding which agency will have to shoulder the financial burden from the settlement. As claims from investment treaties are still a relatively new occurrence in most States, governments may be uncertain as to whether the agency responsible for the breach of a treaty or contract, the agency responsible for the IIA negotiations, the agency responsible for defending the State, or some other agency will be charged with the payment. This question is not unimportant, as the payment may require an agency to cut back on other expenses that it would have usually included within its annual budget. Such uncertainty on who will shoulder the financial burden will increase the challenge that government officials face when authorizing a settlement (Legum, 2006).

F. Assessing the claim: making all relevant documents available to the lead agency at short notice

It has been noted by Professor Coe that "at an early stage the [newly engaged agencies] ha[ve] too little information with which responsibly to assess the merits" of a dispute (Coe, 2005: 41). It is essential for the lead agency or the commission in charge to receive all the documentary evidence of facts and legal documents soonest in order to get a clear picture of the problem at hand, to assess the risk of escalation, to monitor the available time frame and to undertake the steps and procedures set forth by the investment treaty or the contract. Information pertaining to the potential magnitude of the case, to the risk involved, and to possible implications of an early settlement is not only based on the legal issues where advice can be given by outside counsel but also on a more political assessment related to making the right decision at the right time.

The flow of information at the beginning of a case is slow in most governments. Requests for information by the lead agency or commission in charge of the defence of the case or vested with the authority to settle the case amicably must go through an official and mandatory channel. Officials in charge of the case will often face reluctance if not dissimulation of facts and documents on the part of the implicated government agency or entity. A lack of cooperation will create tensions and make it impossible to have a clear assessment of the case that would then lead to an amicable settlement or negotiation with the investor.

Inter-institutional arrangements made by law or established as a system inside the host government, such as the Commission set up by the Peruvian law or the system organized by Colombia, are meant to facilitate early settlement decisions based on early and complete information, appropriate power and budgetary authority. They will also make it easier for an aggrieved investor to identify early on the proper procedure to start an amicable discussion in view of a settlement. The investor can do so before the parties have started investing important amounts in preparing their defence, thereby avoiding loss of time and the conflict to escalate. Establishing such a system by law will also enhance transparency and accountability on the part of the government actors.

Several governments in Latin America have recently embarked on comprehensive ISDS implementation policies. The UNCTAD secretariat has assisted the Government of Peru in the preparation of Law 28933 and is currently assisting the governments of Guatemala, Panama and the Dominican Republic for a similar set-up. Exchange of experience in this field is part of UNCTAD's technical assistance and a salient feature of the yearly courses on *Managing Investment Disputes*.[3]

G. Institutional response: ombuds and mediation services

In addition to more classic investor after-care services that include the continued assistance by investment promotion agencies to foreign investors once the investment is up and running (UNCTAD, 2007a), several host countries are providing an institutional response to problems encountered by investors by offering ombuds and mediation services. Setting up an ombuds office or appointing an ombudsman to serve as a one-stop-shop for complaints can bear fruitful results. In its usual definition, an ombud is an "officer appointed by the legislature to handle complaints against administrative and judicial action," serving as a "watchdog" over those actions while exercising independence, expertise, impartiality, accessibility and powers of persuasion rather than control (Wiegand, 1996: 98).

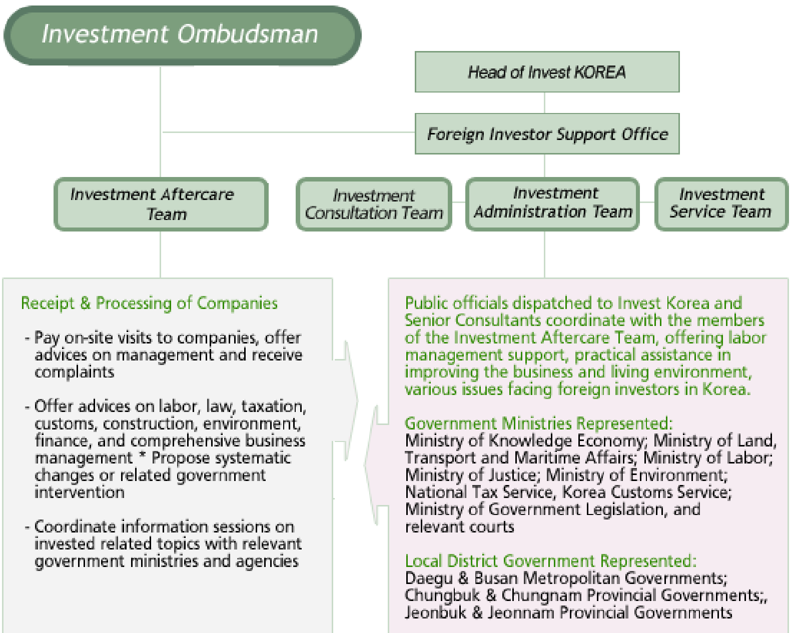
For investors, an ombuds office provides an institutional interlocutor to turn to, an official channel to address issues and problems at an early stage. It can remain at the informal level but can also constitute a formal approach to the host government and a request to resolve the issue. It can constitute a mandatory channel or be available to the investor as an additional choice. It may operate according to strict procedures or be available in a more flexible manner. In any event, the ombuds office can constitute a way for the investor to attempt a prompt, early, potentially cheap and amicable resolution of a problem relating to its investment.

For host States, an ombudsman or ombuds office constitutes a first contact point or gateway to deal with a problem encountered by a foreign investor. The ombuds office can provide early information to the authorities and enable them to assess the problem. It may also facilitate early action, if required, allowing the authorities to correct the problem before it worsens.

The ability of the ombudsman or ombuds office to take corrective action or to request that corrective action be taken by another agency or sub-national authority of the government will depend of its institutional location inside the government. In practice, the ombuds office can be found in investment promotion agencies, at the central or regional level, within a Ministry or as a separate entity directly under the Prime Minister or the President. It can take the form of a single authority or of a commission comprising various agencies. It can also be set up under a treaty in the form of a joint commission comprising representatives of the States members of the treaty. For instance, the Commission for Environmental Cooperation helps prevent potential trade and environmental conflicts related to NAFTA and may be adapted to potential investment disputes. To some extent, joint commissions entrusted with a preventive role can be found in several BITs concluded by China, as was discussed in the previous chapter.

An illustrative example of such an ombuds office is the approach taken by the Republic of Korea. Here, an ombuds office has been strategically located within KOTRA, the Republic of Korea investment promotion agency, but is totally independent from it, accountable solely and directly to the Prime Minister. The Office of the Foreign Investment Ombudsman (OIO) was established in October 1999 following the passing of the Foreign Investment Promotion Act a year earlier. The OIO is set up as a non-profit organization hosted by KOTRA. Its main purpose is to support foreign investors facing difficulties in managing their business within the Republic of Korea, tracking problems and solving them, as well as continuously working towards improving the overall investment environment in the country (fig. 5).

Figure 5. The Republic of Korea Office of the Foreign Investment Ombudsman



Source: Office of the Investment Ombudsman website.

In addition, the OIO includes an investment aftercare team that consists of so-called “home doctors” who are experts on various industrial sectors in the Republic of Korea. They provide individualized support to foreign investors in the Republic of Korea who face grievances of any kind. In addition, an investment service team within the OIO makes sure that the investment environment for foreign investors is generally favourable, by addressing, among other things, the daily concerns of foreign managers and other individuals at a personal level.

The mandate of the OIO is enshrined in Republic of Korea law, which requires all relevant agencies within the Republic of Korea Government to cooperate promptly with the OIO. Article 21-3, Paragraph 3 of the Enforcement Decree of the Foreign Investment Promotion Act specifies:

> *“The Ombudsman may request the relevant administrative agency or the foreign investment-related agency to cooperate for the purpose of solving problems experienced by foreign capital-invested companies and performing duties related thereto. In this case, the agency thus requested to cooperate shall notify its opinion on the matter under consideration within seven days after the date on which the request has been made.”* [4]

The OIO is also a member of two agencies within the Republic of Korea Government that have relevance to investment. These are the Foreign Investment Committee, which is the key responsible authority for policymaking on investment, and the Regulatory Reform Committee in charge of conducting regulatory reform. As a member of these two agencies, the OIO can provide effective advocacy on legal and regulatory issues that affect foreign investors in the Republic of Korea or give advice on the Republic of Korea investment environment as a whole.

Existing statistics show that the services of the OIO are used frequently by foreign investors. From the years 2000 to 2007, more than 3,200 grievances of foreign investors in the Republic of Korea were received by the OIO, covering an array of issues pertaining to various industrial sectors. In 2007, 370 grievances were filed, of which 298 were resolved by the "home doctors", constituting 80.5 per cent of all grievances in that year.

The OIO usually follows two specific procedures in addressing grievances notified to it by foreign investors, depending on the nature of the grievance. On the one hand, the problem may be resolved through general business counseling, involving the provision of advisory and supporting services to the foreign investor on how to handle domestic laws, management difficulties, etc., in order to help the investor overcome the problems faced within the Republic of Korea investment environment. On the other hand, if the grievance results from inadequate laws or administrative hindrances on the part of the Republic of Korea Government, then the OIO may venture beyond advising the investor by addressing the relevant Republic of Korea Government authorities and agencies directly to advocate improvements in investment policy, administrative procedures or laws and regulations. In these particular cases, the role of the investment ombudsman is crucial, as is his independence. Competence and personal values also seem to be playing an important role in the success of the Republic of Korea experience.[5]

A similar approach as above can be found in the setting up of an investment mediation service. This approach can be taken by the host government by instituting a mediation service available for foreign investors or designating a mediator whose function will be to hear the complaints, bring the parties together, facilitate the dialogue and possibly resolve the problem before it turns into a dispute that can only be settled by courts or international arbitration. The idea is similar to that of an ombudsman. An investment mediator would be "above" the dispute (or potential dispute). The functions of a mediation service would be those of a communicator, adviser, facilitator – not those of an administrator or judge – and it can, in theory, respond to requests from the government as well as investors.

In practice, several States have set up institutions to provide internal mediation services or designate official mediators available for foreign investors. Here again, the role can be played by a commission or by an individual. A case at hand is the mediation services made available by the Kingdom of Morocco to investors both at the regional level through the decentralized Regional Investment Centres and at the central Government level by a Commission on Investment. The Commission, in which the key ministers are participating or represented, is chaired once a month by the Prime Minister himself. The secretariat for this commission is entrusted to the Directorate of Investment, a Government entity in charge of investment projects and investment policies. The Directorate of Investment will bring the problems and cases to the attention of the commission and is then entrusted with the implementation of the decision taken by the commission.

Impartiality, competence and trustworthiness, as well as actual ability to resolve the issues, will be a guarantee for the investor and the Government.

H. State–State cooperation in dispute prevention

Another way of preventing disputes from emerging and reaching the international arbitration phase is by enhancing State–State cooperation on relevant matters. To a certain extent, communication and interaction among States on issues related to investment agreements and investor–State disputes have constituted common practice in the past, offering important lessons when considering approaches to making such practice more formal. At the same time, new previously non-existent channels of State–State cooperation can be thought of, in order to avoid the perception of going back to diplomatic protection of earlier days.

It is important to note that not only predominantly capital-importing countries have been found to show interest in finding ways of preventing disputes from escalating into international arbitration. Equally, capital-exporting countries at times also engage in activities on behalf of their investors to prevent disputes from escalating. Generally, the interest of the investor in having its complaint addressed and grievance removed in a quick and uncomplicated matter is likely to be large, and preferable to costly and time-consuming ISDS procedures.

The current construct of international arbitration to settle investor–State disputes under the ICSID Convention has been set up in order to remove investor–State disputes from political pressure and to settle these cases in a legal framework. However, as mentioned before, common practice among States has been the issuance of complaints by diplomats of the home country towards the government of the host country on behalf of an aggrieved investor - the "ambassador knocking on the door of the host country government ministry". Article 27 of the ICSID Convention (ICSID, 2006a) explicitly allows such involvement by diplomats to take place, but defines clear limitations:

> *"(1) No Contracting State shall give diplomatic protection, or bring an international claim, in respect of a dispute which one of its nationals and another Contracting State shall have consented to submit or shall have submitted to arbitration under this Convention […]*
>
> *"(2) Diplomatic protection, for the purpose of paragraph (1), shall not include informal diplomatic exchanges for the sole purpose of facilitating the settlement of a dispute."*

Nevertheless, diplomatic exchanges on investment disputes by and large resemble ad hoc processes without any basis in existing law or international agreements. While diplomatic contacts and an engagement by prominent diplomats on behalf of an investor offering "good offices" may have some impact on the host government, this approach is likely to face limitations as it creates a sense of diplomatic pressure exerted on the host country government akin to the politicization and "gunboat" diplomacy described earlier. Moreover, such diplomatic efforts lack the nature of a more formal institutional process between States where defined channels of action in response to a complaint are specified. Hence, if diplomatic channels are used to address potential disputes between investors and the host State, attention should be paid that this happens through previously agreed-upon procedures that establish a mentality of cooperation rather than confrontation.

It may be worth adding that the goal of depoliticizing investment disputes by use of ISDS mechanisms may not work in all kinds of disputes. Some are political by nature, where their political dimension will be impossible to ignore. Among these disputes are those arising from transactions that are based on intergovernmental arrangements between the States involved. Such disputes may be better dealt with at a State–to–State level, and may require avoidance of purely win–lose situations as is the nature of arbitral decisions.

Moreover, capital-exporting developed countries also advocate in favor of the interests of their investors through means other than diplomatic channels. For example, the German Government, through its insurance scheme for foreign investors (Hermes), provides respective assistance to all insured German firms investing in host States with which the German Government has concluded an IIA. A similar approach is also used by the government of the United States on behalf of investments insured by the Overseas Private Investment Corporation (OPIC). Apparently this involves various kinds of advocacy work vis-à-vis the host country government. As accounts of such cases mostly do not enter the public domain, an assessment of their frequency is not possible. However, they are likely not too uncommon.

Possibly more promising is the role of State–State joint commissions or similar kinds of institutions set up for the purpose of handling complaints of investors and channeling them to the right government agencies for further review. As discussed above, the purpose and responsibilities of the joint commissions can even be specified in IIAs. Investors could approach the representative of the joint commission in their home country, who would then engage in respective consultations with its counterpart in the host State to attempt an early settlement of the emerging dispute. The whole procedure would hence constitute yet another type of early alert mechanism, in this case not only among domestic institutions but more international in nature.

I. The ability to settle during an arbitration procedure

In view of the confidentiality usually surrounding such settlements, accurate, comprehensive statistics on negotiated settlements of investor–State conflicts are not available. Nevertheless, estimates are that, over the last two decades, such settlements vastly outnumbered the 317 known investor–State arbitration cases lodged until the end of 2008. Of these cases, 48 were discontinued following settlement, implying that the tribunal did not have to impose a binding solution on the parties (UNCTAD, 2009). It is believed that 30 per cent of all cases registered at ICSID are settled through negotiations, rather than by a binding award of an arbitral tribunal (Coe, 2005). Approximately two thirds of all arbitration cases filed with the Court of Arbitration of the International Chamber of Commerce are settled by negotiation before an arbitral award is rendered (Schwartz, 1995).

Negotiations may even continue after arbitration has started. For example, in 2006, an ICSID case brought by the Western NIS Enterprise Fund against Ukraine was terminated when the two disputants agreed to a settlement whereby Ukraine reimbursed the Fund for certain loans that it had made. Several cases against Argentina, the Plurinational State of Bolivia, the Bolivarian Republic of Venezuela and Ecuador have been settled during the arbitration procedure, directly between the parties, without having recourse to a parallel mediation or conciliation procedure. Recent research suggests that there may be a transnational standard emerging on this issue, where an arbitrator seeks the informed consent to the process from both disputants and ensures, as an impartial actor, that due process and equal treatment of the disputants is guaranteed (Kaufmann–Kohler, 2009).

Notes

1 This approach was taken by Costa Rica, the Dominican Republic and Guatemala.

2 The Law is complemented by Supreme Decree No. 125-2008-EF, further clarifying the exact procedures to be followed in relation to the Law.

3 See UNCTAD website: www.unctad.org/iia.

4 See http://www.investkorea.org/InvestKoreaWar/work/ombsman/eng/au/index.jsp?num=3; accessed 28 June 2010.

5 Ibid.; UNCTAD 2002.

V. CONCLUSION

This study highlighted some shortcomings and problems arising for parties involved in investment treaty arbitration, thereby putting forward the need to explore and develop alternative approaches to settle or even prevent investment disputes. It subsequently introduced and explored various such alternatives available to States and investors to resolve their disputes. A distinction was made between alternatives to investment arbitration that can be used to resolve already existing disputes (ADR techniques such as mediation and conciliation) and innovative approaches to prevent disputes from arising in the first place (introduced in this study as DPPs). While all actors in the area of international investment should be encouraged to give these alternative approaches more intensive consideration in the future, their nature of involvement in this area will differ in many ways. In the following paragraphs, possible approaches and options for the various actors will therefore be identified.

State parties to IIAs that have been or may be affected by disputes with investors have various policy options at their disposal to respond to the challenges these disputes pose to them, while remaining outside the realm of common investment arbitration:

- States could pay more attention to ADR techniques as alternatives to conventional investment treaty arbitration by making them available and building the necessary capacity and authority within the government to enable the appropriate application of such techniques. This includes the delegation of authority, including budgetary authority, to the relevant government officials or authorities at the appropriate level of the government, allowing them to settle a claim through amicable settlement, conciliation, mediation, or other relevant techniques, and providing them with the necessary protection and safeguards under law. Such an approach by a government would implicitly communicate to investors that mediation or conciliation are viable options to be considered as alternatives to arbitration and not merely additional bureaucratic hurdles preventing a swift response to a problem arising with State authorities.

- States could consider the inclusion of more conducive wording into the texts of their IIAs that facilitates amicable settlement and encourages mediation or conciliation. In addition, including such language into a model agreement will already signal respective intentions to a prospective treaty partner during the negotiation stage. Appropriate time frames prior to the commencement of an arbitration procedure that allow for meaningful contact between the investor and the authorized decision makers from the State could also be worked into the IIAs. Provisions encouraging greater cooperation between the State parties in informing, discussing or finding appropriate solutions to problems arising from the application of the treaty may also be included into the IIAs.

- Developing countries entering into IIAs would benefit from the inclusion of active DPPs into the implementation commitments they make when concluding IIAs or into the cooperation packages that form part of the negotiated outcome of an investment treaty. The inclusion of such provisions would facilitate the taking of appropriate action by the State, and possibly enhance the other contracting party's (or parties') support in designing and implementing these policies. This could happen through the sharing of experiences or by making funding available for the endeavour.

- States entering into IIAs, whether developing or developed, could engage in international cooperation in the area of dispute prevention. This applies particularly to any country that has an interest in enhancing the development benefits of these agreements. While the role that IIAs play in the development of a host country has often been discussed and debated, it is unquestionable that a multiplication of investment disputes can only result in a negative impact on a country's economic development. This is because the occurrence of multiple investment disputes in a country will portray a negative image on this country's investment climate, potentially reducing the inflow of FDI that the country is seeking to attract in line with its development objectives. Furthermore, one could assert that, in the long run, the balance between the costs incurred as a result of ISDS cases and the capital inflows received through major investment projects, possibly as a result of the conclusion of IIAs, may not remain positive in many States. Indeed, the high amounts of compensation awarded to investors and the costs involved in the defence of ISDS cases are taking a toll on the budget of States. These funds could be better spent on economic development projects and the improvement of human capital in developing countries. An appropriate preventative action by the host State, preferably with the support of the treaty partner to an IIA, would have very positive implications in this context.

- The host State to foreign investments could establish a comprehensive dispute prevention programme that includes measures to prevent the generation of problems with investors and their escalation into a formal investment dispute. Measures establishing an appropriate institutional mechanism for dealing with investment disputes may also form part of this dispute prevention programme. As this study has illustrated, the first step in the active prevention of investment disputes is the creation of awareness of the commitments contained in IIAs among all actors within the State that are in contact with investors. All these actors must be made aware of the possible impact that their decisions, measures and acts, or the absence thereof, has on these commitments. It should hence be a priority to ensure that appropriate information channels exist for reaching out to all involved government offices and agencies. This study has also demonstrated the positive aspects of establishing an adequate institutional organization, as it can facilitate the flow of information, provide the framework for setting up early alert mechanisms and put in place a designated counterpart that investors can approach when they encounter problems with the host State.

- The State could inform investors, more directly and at the time when they make their investment, about the existing alternative means put in place by the government. This is particularly important with respect to DPPs. Investors need to be aware that institutions such as ombuds services, a lead agency or provisions on ADR in IIAs actually exist. Only then will they be encouraged to make use of these means with the result that solutions to conflicts will be found amicably and at an early stage. IPAs could for instance take up this function of informing investors about the existence of such policies and institutions.

- IPAs could be given a strong role in the prevention of investment disputes. Many IPAs today are not only involved with the attraction and support of newly incoming investors, but also provide investment aftercare services to make sure that established investors and foreign managers are satisfied with the investment environment (UNCTAD, 2007a). Such an investment aftercare package could include support for investors that are dissatisfied with the investment environment or face grievances of any kind. Investors could be given the option to approach the IPA when they have specific concerns, so that the IPA can deal with these matters at an early stage by involving relevant government agencies. This could effectively prevent conflicts between the State and investor to escalate into formal disputes. In addition, IPAs could also provide advice and information on ADR options to investors who are already involved in concrete investment disputes.

However, active policymaking on alternative approaches by the State will not be sufficient. **Investors** will also have to take an active role:

- This study has put forward several reasons why investors would benefit from the use of alternative approaches. Hence, investors involved in an investment dispute or those having complaints about government policy could give more consideration to alternative means. In particular, small- and medium-sized enterprises that could not afford international arbitration may be able to have their concerns heard and addressed through the institutions put in place for dispute prevention.

- Active participation of investors in the use of institutions for dispute prevention put in place by the host country government would be important to make DPPs a successful means in lowering the amount of ISDS cases. Investors should actively approach IPAs, ombuds services, lead agencies and other available institutions whenever they have concerns about government policies. Even minor concerns may eventually evolve into more complex problems, and their resolution at an early stage should be preferred by both the investor and the government.

Legal practitioners in the field of international investment law, i.e. those advising investors or undertaking the defence of the State, as well as arbitrators, can also play an important role in exploring the use of alternative approaches. As the legal community of practitioners sits at the interface between both parties of an investment dispute, advising both investors and the State and providing for settlement between the two, their involvement in the process may be of particular significance:

- Legal practitioners can create awareness among investors and States of the available alternatives to investment treaty arbitration, especially when both parties are not aware of all the institutions and rules that exist in this area. Practitioners may even encourage the use of alternative approaches in cases where it seems particularly viable. More frequent advocacy for the use of alternative approaches, combined with some possible success stories of cases that have effectively gone through mediation, conciliation or dispute prevention, may eventually change mentalities within the entire investment law community towards a more favourable attitude to alternative approaches.

- The community of practitioners would need to enhance its capacity to handle an increase in the use of alternative means, especially when it comes to ADR techniques. This requires that lawyers become more acquainted to the specifics of using mediation, conciliation and other methods to resolve investment disputes. In addition to the existing community of arbitrators, new practitioners need to emerge that have both expertise in international investment law and substantive experience in the use of ADR techniques.

Arbitration institutions[1] will also have a role to play in making the resort to alternative means more commonplace within the international investment law community:

- Arbitration institutions could propose simplified rules for ADR or provide for more flexibility in rules on conciliation, mediation and fact-finding, so as to make them more attractive to those wishing to use them in legal proceedings on investment matters.

- Arbitration institutions could also facilitate the access to ADR procedures by developing capacity or encouraging the inclusion of experts on ADR techniques in their lists. In addition to such experts, these lists could also include personalities of high profile who could play a role in the mediation of disputes.

- Arbitration institutions could also further develop their support to parties wishing to go for an ADR procedure. Among other things, such support could be logistical, secretarial, or a roster could be made available.

Finally, **international organizations** could play an important role in building awareness within the international law community and especially among States of the possible advantages that alternative approaches to investment treaty arbitration could bring. This could be done through capacity-building and an intensification of technical assistance activities in this area:

- Such technical assistance may involve the provision of instructions on the appropriate use of ADR techniques in the resolution of investment disputes.

- Advice on the design, establishment and implementation of adequate policies for dispute prevention and avoidance could also form part of such technical assistance. This will allow States to strengthen their institutional frameworks for the prevention of investment disputes.

* * *

This study has shown that the current international investment law community finds itself at a crossroads concerning the use of appropriate methods to the resolution of international investment disputes. Two main directions can be imagined that the investment community may take in the future. On the one hand, the use of international arbitration may manifest itself as the predominant approach to resolving investment disputes, where consideration of other possibilities remains only on the margin. But on the other hand, an environment and general mentality may emerge where multiple possibilities for resolution are considered simultaneously and already at the outset of any conflict between an investor and a State, including both arbitration as well as the use of ADR techniques or DPPs. It is in the hands of all the various stakeholders within the investment law community to determine which path will be taken in the future. With the current significant increase in ISDS cases, the second one may however be more economical and in favour of the development objectives of developing countries that welcome foreign investors and for this purpose engage actively in the conclusion of IIAs.

Notes

[1] Mediation institutions, such as the International Mediation Institute (IMI) can play similar roles.

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