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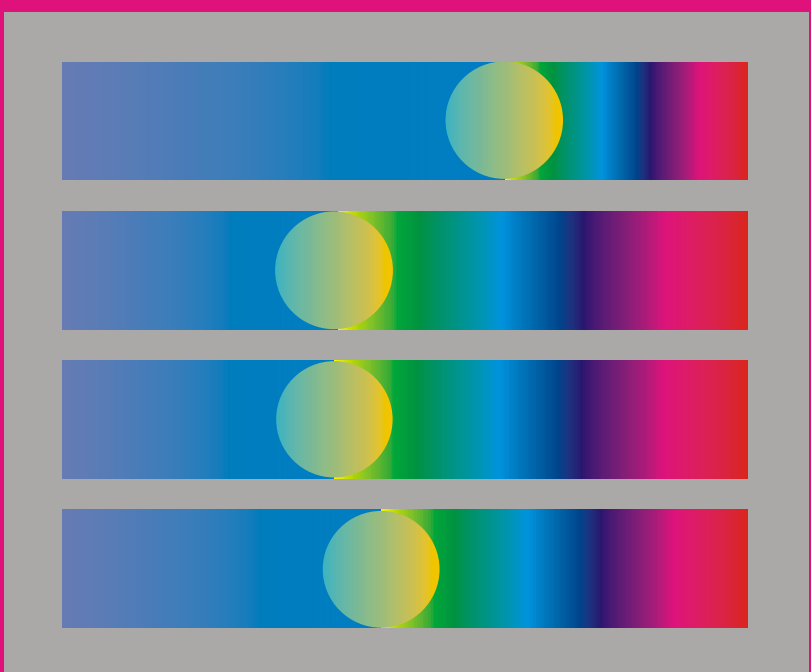
UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

DISPUTE SETTLEMENT: STATE-STATE

UNCTAD Series
on issues in international investment agreements



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UNITED NATIONS
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NOTE

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The term "country" as used in this study also refers, as appropriate, to territories or areas; the designations employed and the presentation of the material do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries. In addition, the designations of country groups are intended solely for statistical or analytical convenience and do not necessarily express a judgment about the stage of development reached by a particular country or area in the development process.

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;

A blank in a table indicates that the item is not applicable;

A slash (/) between dates representing years, e.g. 1994/95, 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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IIA Issues Paper Series

The main purpose of the UNCTAD Series on issues in international investment agreements – and other relevant instruments – is to address concepts and issues relevant to international investment agreements and to present them in a manner that is easily accessible to end-users. The series covers the following topics:

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Preface

The secretariat of the United Nations Conference on Trade and Development (UNCTAD) is implementing a work programme on international investment agreements. It seeks to help developing countries to participate as effectively as possible in international investment rule-making at the bilateral, regional, plurilateral and multilateral levels. The programme embraces capacity-building seminars, regional symposia, training courses, dialogues between negotiators and groups of civil society and the preparation of a Series of issues papers.

This paper is part of this Series. It is addressed to Government officials, corporate executives, representatives of non-governmental organizations, officials of international agencies and researchers. The Series seeks to provide balanced analyses of issues that may arise in discussions about international investment agreements. Each study may be read by itself, independently of the others. Since, however, the issues treated closely interact with one another, the studies pay particular attention to such interactions.

The Series is produced by a team led by Karl P. Sauvant and Pedro Roffe. The principal officer responsible for its production is Anna Joubin-Bret, who oversees the development of the papers at various stages. The members of the team include Helene Dufays-Budhdeo and Jörg Weber. The Series' principal advisers are Arghyrios A. Fatouros, Sanjaya Lall, Peter Muchlinski and Patrick Robinson. The present paper is based on a manuscript prepared by Amazu Asouzu and Mattheo Bushehri. The final version reflects comments received from Nils-Urban Allard, Joachim Karl, Mark Koulen, Ernst-Ulrich Petersmann, M. Sornarajah and Americo Beviglia-Zampetti.

Rubens Ricupero
Secretary-General of UNCTAD

Geneva, September 2002

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UNCTAD has carried out a number of activities related to the work programme in cooperation with other intergovernmental organizations, including the Secretariat of the Andean Community, l'Agence pour la Francophonie, the Inter-Arab Investment Guarantee Corporation, the League of Arab States, the Organization of American States and the Secretaria de Integración Económica Centroamericana. UNCTAD has also cooperated with non-governmental organizations, including the Centre for Research on Multinational Corporations, the Consumer Unity and Trust Society (India), the Dutch Foundation for Research on Multinationals (SOMO), the Economic Research Forum (Cairo), the European Roundtable of Industrialists, the Friedrich Ebert Foundation, the German Foundation for International Development, the International Confederation of Free Trade Unions, the Labour Resource and Research Institute (LaRRI), Oxfam, the Third World Network and World Wildlife Fund International.

Since 2002, a part of the work programme has been carried out jointly with the World Trade Organization (WTO).

Funds for the work programme have so far been received from Australia, Brazil, Canada, France, Japan, the Netherlands, Norway, Portugal, Sweden, Switzerland, the United Kingdom and the European Commission. China, Croatia, Egypt, Gabon, Germany, Guatemala, India, Indonesia, Jamaica, Malaysia, Morocco, Namibia, Peru, Singapore, South Africa, Sri Lanka, Thailand and Venezuela have also contributed to the work programme by hosting regional symposia, national seminars or training events.

In pursuing this programme of work, UNCTAD has also closely collaborated with a number of international, regional and national organizations, particularly with the Centro de Estudios Interdisciplinarios de Derecho Industrial y Económico (Universidad de Buenos Aires), the Indian Institute of Foreign Trade, Jawaharlal Nehru University (India), the Legon Center of Accra (Ghana), the Senghor University (Egypt), the University of Dar Es Salaam (United Republic of Tanzania), the Universidad del Pacífico (Peru), the University of Pretoria (South Africa), the National University of Singapore, the University of Tunis (Tunisia), the University of Yaoundé (Cameroon), the Shanghai WTO Affairs Consultation Center (China) and the University of the West Indies (Jamaica). All of these contributions are gratefully acknowledged.

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Executive summary

Provisions concerning the settlement of investment disputes are a central feature of international investment agreements (IIAs). The present paper deals with such provisions as they pertain to State-to-State disputes. Such disputes are relatively rare, in that the bulk of investment disputes arising under IIAs involve investor-State disputes. These are the subject of another paper in this Series.

The following principal issues raised by State-to-State dispute settlement provisions provide the focus for discussion throughout the paper and are specifically discussed in section I. First, the types of disputes that could trigger a State-to-State procedure need to be identified. State-to-State disputes can arise out of either the exercise of diplomatic protection on the part of the home State of the investor (though this is increasingly rare given the existence of investor-State dispute settlement provisions that give direct rights of action to the investor) or as a result of a dispute over the interpretation or application of the IIA. Secondly, the procedures governing dispute settlement mechanisms need to be considered. These involve: negotiations and consultations which are nearly always required as a preliminary step in the dispute settlement process; ad hoc inter-State arbitration, which is most prominently featured in IIAs; permanent arbitral or judicial arrangements for dispute settlement; and political or administrative institutions whose decisions are binding. Third, the applicable standards for the settlement of disputes need to be agreed. This issue raises the further question of which law is to govern the resolution of the dispute at hand. Fourth, the nature and scope of outcomes of dispute settlement mechanisms need to be addressed and, fifth, compliance with dispute settlement awards. The substantive provisions of IIAs that cover each area are examined in section II of this paper.

Section III of the paper considers the various interactions that exist between the present topic and others that arise in the context of IIAs. The most significant one is between State-to-State and investor-State dispute settlement. As regards other areas of interaction, two main categories of such interactions can be identified. First, there are provisions in IIAs, the

interpretation or application of which could normally be expected to be directly at issue. These include the scope of coverage and definitions of investors and investments, admission and establishment commitments and obligations concerning standards of treatment (fair and equitable treatment, most-favoured-nation treatment, and national treatment), host country transfer of funds, and the taking of property. Second, there are those interactions that would result, either directly if certain topics are expressly addressed in IIAs, or indirectly in so far as measures relating to such topics would give rise to issues with respect to the topics in the first category identified above. These include competition law and investment-related trade measures; employment, environmental and tax laws and regulations; State contracts; incentives; illicit payments; transfer of technology; and measures taken by an investor's home country with respect to the social responsibility of investors or in response to transfer pricing.

Finally, the last section of this paper considers the various options open to negotiators when drafting State-to-State dispute settlement clauses. The most basic choice is whether to include or to exclude provisions on this subject. Where the latter choice is made further alternatives exist as to how to deal with each of the issue areas identified in sections I and II. These are laid out in detail in the last section.

INTRODUCTION

A. International investment disputes and their settlement: An overview

Every foreign direct investment (FDI) transaction entails a trilateral relationship involving a host State, a foreign investor and the latter's home State. Inherent in the concept of State sovereignty lies the notion that a State has the power – which can be qualified in an IIA – to admit foreigners within its territory and to regulate their activities, as well as to protect its nationals abroad from acts contrary to international law. Thus, within the context of the regulation and protection of the investment activities of transnational corporations, disputes might arise between States or between States and investors. (Investor-State dispute settlement issues are the subject of another paper in this Series (UNCTAD, forthcoming).)

Investment-related disputes between States could arise from various governmental measures that affect cross-border economic activities, some of which are addressed in IIAs. IIAs put into place frameworks consisting of general and specific undertakings and obligations by the States party to such agreements that determine the scope, extent and manner of their involvement with the cross-border investment activities of their nationals. The genesis of State-to-State (or "inter-State") disputes in IIAs can be traced either to issues that arise directly between the signatories of IIAs, or to issues that first arise between investors and their host States, but then become inter-State disputes.

It should be noted at the outset that, by comparison with investor-State disputes, State-to-State disputes in the field of investment, which have gone to third party settlement, are few and far between. Thus, experience of such disputes is relatively limited. The present paper should be read in the light of this fact. This situation requires some clarification. It is true to say that, in a certain sense, even a dispute between an investor and a State that arises under an IIA contains an inter-State element, in that the investor is a national of another State party to the IIA, and that State

might even have been involved in attempts to negotiate an amicable settlement of the dispute. Nonetheless, such a dispute remains an investor-State dispute albeit one arising out of an IIA agreed between States.

The main explanation for the lack of State-to-State investment disputes lies in the manner in which foreign investment law has developed in recent decades. That development is marked by the move from the era of Friendship, Commerce and Navigation (FCN) treaties, and investment treaties that pre-dated the establishment of the International Centre for Settlement of Investment Disputes (ICSID), in which the investor had no right to institute proceedings against a host State, to the current era where the investor has direct rights to do so under many investment agreements. Such agreements often contain a dispute settlement clause permitting the investor to bring a claim before an international arbitral tribunal or before ICSID. Similarly, regional agreements may provide for direct rights of this type before regional dispute settlement bodies. Such agreements give ascendancy to the investor, who is the principal beneficiary of rights contained in agreements entered into between States. In this context, it is to be expected that the principal disputes will be between the investor and the host State, not between the State contracting parties to an IIA.

B. A typology of State-to-State investment disputes

A classification of the types of inter-State disputes that could arise under an IIA is difficult, as each agreement needs to be considered in the light of its scope, objectives and purposes. While any classification would therefore be, to some extent, arbitrary, it might nevertheless be useful to distinguish inter-State investment disputes as follows:

- The bulk of disputes that arise between States under IIAs are "investment disputes". Broadly speaking, they relate to investments covered under an IIA that have been subjected to adverse governmental measures by a host country.[1] To the extent that these measures run counter to the provisions of an IIA,[2] they could give rise to inter-State disputes, in that the home country of the investor may wish to bring a claim directly against the host country on the basis of its right of diplomatic protection

exercised on behalf of the investor by reason of their home country nationality. This is, however, an unlikely situation in that, where investor-State dispute settlement procedures are available, it is likely that the investor will bring a claim directly against the respondent State without the intervention of its home country. In such a case, diplomatic protection may well be excluded by agreement of the States parties to the IIA, in that the investor-State dispute settlement provisions will contain a clause to that effect, which comes into operation as soon as the investor brings a claim against the host country. It should be noted that such disputes could also include in their underlying subject matter other agreements (usually referred to as "investment agreements" or "State contracts") that grant certain entitlements to foreign investors with respect to public assets, enable foreign investors to enter into certain specific investments, or grant certain ancillary interests to foreign investors upon which they might rely to establish or acquire an investment, so long as the investors and investments are covered by an IIA. Apart from the category of investment disputes, other investment-related disputes that might arise include situations involving armed conflict or civil disturbances, in so far as a government has agreed to provide protection to covered investment in such circumstances.

- Inter-State disputes might also arise in cases that do not appertain to particular investments, such as the application of an IIA within the territory of its signatories. These types of cases would, on balance, remain exceptional. However, given that international rule-making in areas that address investment issues is on the rise in various settings, inter-State disputes could arise in relation to this diffusion concerning the hierarchy of different IIAs between the same countries that address the same investment issues.

- Furthermore, where IIAs seek to reduce government involvement, management and regulation in national economic sectors or open them to foreign investment, provisions may be

included that allow a widened scope of one country's policies and legislation affecting investments to be subject to scrutiny by other States party to those IIAs. Such provisions could be coupled with further obligations undertaken by the signatories to take or refrain from taking specified measures affecting the establishment and operations of investments. In such cases, inter-State disputes could develop on the basis of these undertakings alone, without specific reference or connection to a particular investment dispute. In these circumstances, a concrete factual situation involving an investor would no longer be necessary for a dispute to arise. The dispute is thus one between two regulators, each having promised to take or refrain from taking certain measures that are presumed to affect investments adversely, which concerns not what was done to a specific investor, but simply whether or not there has been compliance with the letter and spirit of their mutual obligations. An example of such a dispute could arise over a "no lowering of standards" clause where one State alleges that the standards contained in the regulatory laws covered by the clause have been lowered by another State contracting party to the IIA in question.

C. Dispute settlement arrangements in IIAs: issues and objectives

Inter-State disputes and their settlement, arising within the context of IIAs, involve processes that are, to a large extent, addressed by dispute settlement arrangements (DSAs) therein. Such arrangements in IIAs give rise to a number of general considerations. First, while mutually agreed standards and rules in IIAs set forth the undertakings, rights and obligations of their signatories, like all other agreements, IIAs cannot be drafted in such a way as to foresee all possible contingencies and eventualities. Moreover, disagreements could develop as to the precise nature and scope of those undertakings, rights and obligations. Thus, the need might arise for their interpretation and application in specific contexts and factual situations. Indeed, it is not uncommon that the solution to a particular dispute would require the development of still more detailed criteria or ancillary rules.

Second, in national systems, compulsory procedures exist within the jurisdictions of various official fora that could be initiated to handle such matters should there be no provisions on dispute settlement in an agreement. By contrast, there is a lack of compulsory dispute settlement fora within the international system at large.[3] In these circumstances, the involved parties must ensure that they can settle the dispute amicably and peacefully.[4] Otherwise, the absence of such arrangements could lead to the settlement of a dispute on the basis of the relative power of the parties involved rather than on the merits of their claims. Equally, lack of appropriate DSAs might result in unilateral decision-making on disputed matters by the parties, thus setting off an unsound chain reaction, which could lead to the termination of mutually beneficial relations between the signatories, or perhaps even an escalation of the dispute into a higher-level political conflict.[5] DSAs provide for mutually acceptable fora that allow for certain decision-making mechanisms and procedures, which the parties agree to engage should a dispute arise within the context of an IIA, thereby reducing the scope for recourse to unilateral acts by the parties.

Third, as with many international agreements, it might not be practicable (or desirable) to put into place complex rules that set forth highly detailed provisions in certain substantive areas covered by IIAs. In those circumstances, the development and growth of a set of standards and rules in particular substantive areas covered under an IIA could be delegated to when issues arise in specific contexts, by leaving the detailed formation, interpretation and application of rules to a case-by-case review. The latter issue is of increasing significance given that IIAs increasingly involve the internationalisation of matters that have traditionally belonged within the sphere of national policy-making, including the exercise of domestic jurisdiction to regulate matters such as the environment, labour standards and the competitive structure of national markets. DSAs contribute to this rule-making process by providing the mechanisms for case-by-case reviews.

Fourth, the objectives of IIAs can be considered effective only where DSAs are incorporated into "packages" that ensure, to the extent possible, that the agreed upon rights and obligations provided for in IIAs

are realizable. DSAs complete and make effective such rule-based systems by allowing for a challenge and review process vis-à-vis measures and practices of all actors involved in the FDI relationship.

The conception of arrangements for the settlement of inter-State disputes in IIAs involves careful deliberations on certain fundamental notions concerning the purposes for which DSAs are established. In this connection, first, a primary purpose is to ensure that, when disputes arise, a pre-determined set of procedures will be available to the parties, the engagement of which will result in a final, authoritative decision that will fully settle the matter. Second, the purposes and objectives behind DSAs appertain not only to the settlement of particular disagreements concerning the interpretation, implementation or application of the provisions in IIAs, but also the avoidance of conflict. The latter implies two ideas: first, that prior to a measure being taken by a Government that might affect a foreign investment covered by an IIA, there should be a notification and discussion with regard to the proposed measure; and second, that prior to resort to particular dispute settlement mechanisms provided for in IIAs, there should be discussions intended to avoid recourse to such mechanisms.

In sum, the purposes and objectives behind the establishment of DSAs include a contribution to the avoidance, management and settlement of State-to-State disputes. In order for DSAs to achieve these objectives, effective structures – processes, mechanisms and procedures – must be agreed to and provided in IIAs. The general processes encompass two extremes: either ensuring the close control by the disputing parties of the settlement procedures and decisions that might effect the outcome; or their limited control and influence over procedures and decisions that affect the final results. The mechanisms under which States retain control are negotiations, consultations, fact-finding, good offices, conciliation and mediation, and those under which there is practically no control over the final outcome are arbitration, judicial settlement or other third party decision-making mechanisms. Third party dispute settlement procedures could still involve two decision-making models: non-binding and binding outcomes.

In the following section, the main issues that arise in the negotiation of IIAs concerning DSAs will be considered.

Notes

[1] The classic cases involve the de facto termination of the property rights of an investor in its investment, examples of which are nationalizations and direct and indirect expropriations. These measures have their history in disputes concerning diplomatic protection under customary international law, but now are the subject of specific provisions under IIAs (UNCTAD, 2000b).

[2] Governmental measures include all legislative, regulatory or administrative acts (encompassing practices) or omissions.

[3] Under current international law, no State can be compelled to engage in any dispute settlement mechanism without its consent. Furthermore, no dispute settlement structure exists that provides for the submission of all types of disputes. Thus, unlike domestic systems of governance, DSAs in international relations do not feature in the overall governance structure of international relations. Notwithstanding the foregoing, the organization of the International Court of Justice (ICJ) under the auspices of the United Nations could be regarded as a move towards the establishment of a compulsory and comprehensive DSA within the governance structure of the international system. However, it is arguable that regional dispute settlement systems, such as the European Court of Justice, are examples of a system of mandatory dispute settlement as the member States of the grouping accept that membership entails submission to the authority of the tribunal in question. Another example would be the WTO dispute settlement mechanism under the Dispute Settlement Understanding (DSU) (WTO, 1994) to which all Members of the WTO must adhere as part of their membership obligations.

[4] In these circumstances, international law requires States to attempt to settle the dispute using any means agreeable to both, so long as those means exclude measures that might endanger international peace and security.

[5] However, it should also be noted that unilateralism is not always detrimental to the relationships formed by IIAs. The legitimacy of such practices depends on the purposes and objectives of the State that resorts to unilateralism, and whether or not those purposes and objectives were anticipated within the context of the IIA. For example, a State might wish to be the sole arbiter of whether certain measures fall within the scope of an exception clause negotiated in the IIA. Equally, recourse to unilateral acts needs to be considered in terms of non-compliance of one party with the final decision that settles a dispute. Regardless of which dispute settlement mechanism renders the final decision concerning the dispute,

compliance with the final decision – be it a negotiated agreement or a tribunal award – is always an issue since the international system lacks enforcement procedures and mechanisms. To the extent that an IIA has covered these and similar issues, any attempt to act unilaterally would make a travesty of the DSAs contained therein. If, however, DSAs do not address such issues, then a State remains free to engage in unilateralism.

Section I

EXPLANATION OF THE ISSUE

State-to-State dispute settlement provisions in IIAs are textually diverse. The practical implications of arrangements on the settlement of inter-State investment disputes flow from the choices and agreements made during the negotiation of IIAs. In this connection, the main issues concerning DSAs that arise within the context of the negotiation of IIAs are the following:

- the scope of disputes that could trigger DSAs;
- the procedures governing dispute settlement mechanisms;
- the applicable standards for the settlement of disputes;
- the nature and scope of outcomes of dispute settlement mechanisms; and
- compliance with dispute settlement awards.

A. The scope of disputes that could trigger DSAs

The nature and scope of the type of disputes that could be submitted under the provisions of a DSA determine its effectiveness. At the same time, there may be a need to strike a balance between the expectation of the parties to an IIA as to how certain issues will be addressed should a dispute arise. In these circumstances, it is recognized that, on the one hand, no dispute should be left outside the scope of the DSA, while, on the other hand, not all disputes are amenable to settlement through the same dispute settlement mechanisms. This balance is particularly important in terms of emerging issues that go beyond protection afforded by IIAs in the classical instances of nationalizations and direct and indirect expropriations, and that involve the exercise of domestic jurisdiction to regulate matters such as the environment, labour standards and the competitive structure of national markets.

The determination of the nature and scope of disputes that trigger the DSA in an IIA thus first involves the task of the determination of how a dispute or matter that gives rise to a dispute is defined in DSA provisions. Second is the analysis of the extent to which a given question is to be addressed by the mechanisms included in the DSAs. In this regard, "matters" involve either the interpretation or the application of the provisions of the IIA, or both. A related issue that completes the analysis is whether or not there exist any limitations on recourse to a DSA, which will, by definition, circumscribe the types of disputes that could be submitted thereto.

The typical formulations for DSAs refer to "disputes" (other terminology used are "differences", "divergences", "matters" or "questions") concerning or arising out of IIAs, without providing a formal definition of what is meant by the terminology. Thus, the first issue that might arise in a dispute is whether or not a genuine dispute exists that would trigger the DSA, which absent a definition, would need to be defined.[1] In most instances, the term will, absent express indications to the contrary, be defined to cover as broad a range of disagreements between the parties as possible. It should be noted that a "legal dispute" could be considered as a term of art, and connotes a particular set of circumstances between States. These include first, that a claim could be formed under international law, which means that the claim should be based upon an act or omission that gives rise to State responsibility. Second, the claim must be rejected, or there must be a disagreement as to its disposition. The third element, which is not universally agreed upon, is that the subject matter of the claim must be disposable through the application of international law, as evidenced by recourse to one or more of its accepted sources. In this way, legal disputes are sometimes differentiated from "political disputes".

If they appear in an IIA, "matters" or "questions" are intended to cover a much wider set of issues than "disputes". Thus, in some IIAs, consultations may be available although there is no "dispute" between States as to the interpretation or application of a provision. A proposed measure or action could be the subject of consultations between the parties in areas of serious controversies so as to avoid or prevent a dispute from arising between the parties and to facilitate its settlement when it arises. It

has also been observed that the term "divergences" (which appears in German bilateral investment treaties (BITs)) would include, in addition to legal disputes, any questions where a gap in an agreement has to be filled by a third party (binding advice) or where facts have to be ascertained by an outsider (fact-finding commission) (Peters, 1991).

A given dispute, matter or question may relate to the "interpretation" or "application" of an IIA. The phrase "interpretation and/or application", when appearing in an IIA, is an all-encompassing formulation that mostly relates to issues or actions after the agreement has entered into force between the contracting parties. "Interpretation" is the determination of the meanings of particular provisions of an agreement in concrete or proposed situations. "Application" relates to the extent to which the actions or measures taken or proposed by the contracting parties comply with the terms of an agreement, its object and purpose. In practice, there is a large degree of overlap between the purport of "interpretation" or "application." A question of the application of an agreement will involve a question of its interpretation, and the interpretation of an agreement may be warranted by an action taken or proposed by a contracting party with respect to the subject-matter of the agreement. Assessing the effects or implications of actions or measures taken or proposed by a contracting party with respect to the subject-matter of an agreement necessarily entail an interpretation thereof.

Thus, the nature and type of issues and the particular context within which they have arisen determine the scope of issues that could trigger the DSA in an IIA. Unless particular types of disputes are intended to be left outside the purview of the DSA in an IIA, the terminology typically used provides for a relatively wide scope of subject-matter, albeit that different processes, mechanisms or procedures might be applicable to different issues.

A parallel consideration is when certain matters covered by an IIA lie outside the scope of its DSA. This arises especially either where a particular exception is provided for (for example, as to measures taken on the grounds of national security), or where alternative DSAs (such as investor-State provisions) are also included in IIAs. On the former issue,

States might be reluctant to allow for another party to challenge certain measures. As to the latter, where parallel DSAs exist, the question arises whether or not they could be simultaneously utilized. To the extent that the same issues are considered, and given the view that investor-State DSAs allow for a "de-politicization" of a dispute that would otherwise have to be resolved through inter-State channels, use of one DSA should preclude the concurrent engagement of another. There are in any event three possibilities: to allow concurrent resort to the DSAs; to restrict resort to only one DSA by requiring an election between the DSAs; or to limit resort to the DSAs, for example, by providing that only issues that are not being considered under investor-State procedures could be brought under the State-to-State DSA.

B. Dispute settlement mechanisms and their procedures

The mechanisms and procedures for the settlement of disputes determine, to a large degree, the manner and extent of control that the parties have over the outcome of the dispute settlement process. In their DSAs pertaining to inter-State issues, IIAs predominantly provide for the initiation of dispute settlement processes through bilateral means. Some IIAs require that these bilateral attempts for the settlement of disputes must be engaged in as a pre-condition of having resort to third-party decision-making processes. The types of bilateral and third-party mechanisms typically provided for in inter-State DSAs include:

- negotiations and consultations;
- *ad hoc* inter-State arbitration, which is most prominently featured in IIAs;
- permanent arbitral or judicial arrangements for dispute settlement; and;
- political or administrative institutions whose decisions are binding.

1. Negotiations and consultations

DSAs typically first provide for mechanisms that utilise bilateral decision-making processes for dispute settlement, such as negotiations and/or consultations. A prevalent formulation refers to "diplomatic channels". Other formulations refer to "negotiations", "consultations", or both. All three formulations essentially involve a negotiation process.[2] This is not surprising, since settlement of disputes through diplomatic negotiations and/or consultations have historically been the most common means of dispute settlement between States (Eyffinger, 1996). Negotiations could resolve all but the most intractable disputes and, in the more complicated cases, they can assist to narrow the issues to more manageable proportions or prepare them for resolution by the formal binding third party processes.

Consultations may appear in an IIA as distinct from negotiations. However, the former is, in a way, an integral part, if not a variety, of the latter. The distinction between them, if any, seems to be a question of degree and intensity in, and the timing of, the discussions (exchange of views) between the disputing parties. Provisions for consultations in IIAs are nevertheless useful (UNCTAD,1998; Kirgis, 1983; Sohn, 1994). At the pre-dispute stage, DSAs could create an obligation to consult on matters – not necessarily involving a dispute in the narrow sense – pertaining to an agreement. This may enable the parties to supply and exchange information and learning for the purposes of avoiding the emergence of a dispute. There are also provisions for consultations that encompass other contexts such as the review and implementation of an IIA. These have regulatory functions and could promote meaningful co-operation between the contracting parties. In this connection it is worth noting that the Dispute Settlement Understanding of the WTO requires consultations as a preliminary step in the dispute settlement process applicable to trade disputes arising between Members under the WTO Agreements (Article 4) (WTO, 1994).

Negotiations and consultations are normally conducted on an ad hoc basis, even within an institutional setting. Their inherent flexibility does not easily make these mechanisms susceptible to any rigid procedural

frameworks. Typically, the only procedural matter that is pre-determined with respect to these mechanisms is the timeframe within which they are to begin and end.

2. *Ad hoc* arbitration

Party autonomy is the basic rule in the establishment of an arbitral tribunal (which may be a single individual or a group of individuals as may be appropriate). It is essentially an adjudicative process by a tribunal, except that the procedures for the establishment of the arbitral tribunal are effected either by the agreement of the disputing parties when a dispute arises (*compromis*), or by the operation of provisions negotiated previously and incorporated into DSAs (standard rules and procedures).

These procedures normally address the following tasks:

- selection of arbitrators, the place, venue and the official language for the proceedings;
- determination of the terms of reference for the arbitral panel; and
- institution of time limits for the conduct of the arbitration proceedings and the promulgation of working rules for the panel and the parties, such as rules on the submission of case-briefs, arguments and evidence.

3. Permanent arbitral and judicial institutions

In contrast to ad hoc arbitral tribunals, governments may choose to utilise the rules, procedures and facilities of specialised institutions for the arbitration of their disputes. The only arbitral institution that provides for the settlement of State-to-State disputes under its auspices is the Permanent Court of Arbitration (PCA). Other institutional systems, for example, ICSID and the International Chamber of Commerce (ICC), are geared to the settlement of investor-State disputes. Indeed, ICSID

procedures expressly exclude State-to-State disputes from their jurisdiction, in that the ICSID Convention is limited to the settlement of disputes between a contracting State and a national of another contracting State. The resort to a permanent institution with pre-determined procedural rules for choosing the members of the arbitration panel and its proceedings might secure savings in terms of the time and resources committed to searching for potential candidates to be selected as an arbitrator, drafting an ad hoc arbitration agreement (or comparing and negotiating on proposed drafts from each involved party), looking for a convenient venue, and establishing a suitable set of procedural rules.

Although featured less frequently in IIAs, States always have the option of referring their disputes arising from such agreements to standing judicial tribunals, such as the ICJ or to standing regional judicial tribunals, if they have jurisdiction. In addition to the advantages accounted for with respect to institutional arbitration, the members that would constitute the judicial panel are known, which will dispense with the necessity of choosing the members of the panel. Moreover, the position, prestige and influence offered by standing judicial tribunals might encourage States to decide to submit their disputes to them, with the hope that those virtues will enhance the legitimacy of the awards and ensure complete and speedy compliance. It should be noted, however, that one advantage of referring disputes to arbitration would be that the members of their panels might have more of an expertise on the specific subject matters involved as compared to sitting members of the judicial tribunals, which may explain the infrequent reference of disputes in IIAs to judicial bodies.

4. Permanent political institution for dispute settlement

The third-party settlement mechanism provided for in a DSA could be a political body or an organ of an international organization. Recourse to such institutions has caused concern that their decisions may be political and incapable of achieving binding effects on the parties (Peters, 1991; Sohn, 1976). In particular cases, it is argued that political considerations might creep into what should essentially be limited to legal and commercial issues. Nevertheless, there are permanent institutions with

internal dispute settlement means that could instil finality to disputes. An example would be the Senior Economic Officials Meeting of the Association of South-East Asian Nations (ASEAN) Investment Agreement. Equally the Dispute Settlement Body of the WTO has the power to adopt a WTO Panel (or as the case may be an Appellate Body) Report within 60 days of its circulation to members unless, in the case of a Panel Report, a party to the dispute formally notifies the Dispute Settlement Body of its decision to appeal to the Appellate Body or the Dispute Settlement Body decides, by consensus, not to adopt the report (Article 16) (WTO, 1994). Thus the winning party has a right to the adoption of a Report as it can block the consensus required for its non-adoption by not adhering to the consensus reached by the other members.

C. Applicable standards for the settlement of disputes

This is an important issue concerning DSAs. Absent provisions in an applicable treaty (or a subsequent arbitration agreement), it is for the disputing parties in their negotiations or the tribunal to determine what laws, standards or principles are to be applied to the matters in dispute. To be sure, the starting point (which does not require an express reference) is having regard for the rights and obligations provided for in the IIA itself, as well as in other relevant treaties between the parties. However, IIAs do not provide for all rules, standards or principles that might be applicable to a dispute. For example, in the light of increasing recognition of the complexities involved with regulatory measures (which are typically still not expressly addressed in IIAs) that affect foreign investment and that might trigger the provisions of an IIA, what standard of discretion should the adjudicator of a dispute apply with respect to the issue of whether or not protection should be afforded to covered investments against such measures?

Where the issue is provided for, reference is typically made to rules of (international) law. In some instances, however, this indication creates rather than solves problems in that their recognition is conditioned by requiring that all parties to the dispute must accept the particular principles or rules of international law. In addition to these legal standards,

equitable principles (*ex aequo et bono*) and procedural standards might also be considered in DSAs.

When issues concerning an IIA arise between its signatories, their successful settlement turns in part on whether or not the standards that are to be applied have been considered by and between the parties involved. On the one hand, given that disputes could arise within a variety of contexts relative to IIAs, it is difficult to agree on the controlling standards before a dispute arises. On the other hand, there could be general agreement as to the applicable standards, which would provide parameters for the decision-makers as to what criteria should be applied in reaching a decision. Generally, these standards pertain to defining the nature and extent of the rights and obligations undertaken in the IIAs, which is a question of interpretation, or to the conformity of (proposed) measures undertaken by the parties thereto vis-à-vis those rights and obligations, as defined, which is an issue of application.[3]

This issue deserves careful consideration.[4] The main question is whether or not all types of disputes could (and should) be settled with reference to one standard (e.g. general rules of international law, within which vast lacunae exist). Alternatively, could the provision for, and application of, different standards to differing disputes in various contexts provide for a more appropriate means of dispute settlement? For example, when considering the issue of national treatment, what standards are to be applied to a particular programme of affirmative action designed to embrace more of the native population of a country into its cultural industries? Present national treatment standards in most IIAs would not permit such discrimination, and excluding national treatment for cultural industries might not be an acceptable solution. In addition, there need to be safeguards in relation to any exceptions clause, so that it would not be abused. Presently, there exist no rules of international law that could provide a solution. This must be considered in the context of establishing mutually acceptable standards that would be applicable should a dispute arise in relation to measures to implement and administer such programmes. This is of crucial importance in relation to the development needs and concerns of countries.

D. Nature and scope of outcomes of dispute settlement mechanisms

With respect to bilateral processes of negotiation and consultation provided for in DSAs, the outcome would normally be a settlement agreement. In most instances, this would be unproblematic. The agreement would be, by definition, binding upon the parties thereto, and its non-performance would entail State responsibility under international law. However, in a situation in which a particular regime is established by an IIA involving a number of States (such as a regional agreement), there may be certain considerations that could render the agreement unacceptable, in the light of the purposes and objectives of the regime as a whole. Other States that are members of the regime may object to an agreement that, for example, provides for a looser application of its provisions between two parties, on the grounds that such an agreement would endanger the discipline imposed by the IIA.

Awards or judgements rendered through a tribunal are, by and large, binding upon the parties. In fact, it is this very feature that provides for a final decision on the settlement of a dispute. Once a State agrees that an award shall be binding, its non-compliance with the award entails State responsibility. Thus, as with settlement agreements, inter-State arbitration is likewise unproblematic, yet the special considerations regarding particular regimes equally hold here.[5] In this connection, the finality of the awards, or recourse to an appeals process, deserves consideration.[6] Clearly, if binding arbitration is said to have the merits of final and speedy settlement of the dispute, then any review or appeals process is an anathema. However, as the reach of IIAs goes beyond the traditional issues of nationalization and expropriation, and where DSAs provide for compulsory, binding, rule-based adjudication of disputes based on legal standards and rigid rules of procedure, the possibility of a genuine error in the determination of the dispute becomes more serious, when looked at from the point of view of compliance. Thus, an appeals procedure may be required to allow for a reconsideration of the case where an error is alleged to have occurred at first instance. This approach has been adopted in relation to inter-State trade disputes arising out of the WTO Agreement and its Annexes. The Dispute Settlement Understanding (DSU) of the

WTO provides for an appeal from a WTO Panel ruling to the Appellate Body on issues of law covered in the Panel Report and legal interpretations developed by the Panel. The Appellate Body may uphold, modify or reverse the legal findings and conclusions of the Panel (DSU, Article 17 (6) and (13)) (WTO, 1994).

E. Compliance with dispute settlement awards

Compliance issues can be viewed from the standpoint of the parties to an inter-State dispute, the beneficiaries of IIAs, or the international system at large. In the final analysis, however, two factors must be considered. The first is the legitimacy of the final decision concerning the settlement of a dispute, and the ability of the parties to comply with the terms of such decision. In this respect, negotiated settlements derive their legitimacy from the fact that the disputing parties enjoy a large degree of control over claims or matters involved and the settlement process. Tribunals derive their legitimacy from the agreement of the parties, their independence and impartiality, and their focus on the rule-based system of rights and obligations that allows them to assess the merits of the claims on an objective basis.

The second factor to be considered – notwithstanding the foregoing and the fact that non-compliance is not historically an intractable feature of international relations – is how to avoid disputes that might arise in the event that a State does not comply with the final decision. In such circumstances, while the original dispute has been settled, another dispute might arise concerning the response to non-compliance, since under present international law, only unilateral decision-making structures or actions are available to respond to non-compliance with awards. In this connection, the procedures for establishing non-compliance – and the range, scope and manner of remedies – could be addressed.

In the following section, this paper will consider the foregoing issues as they have featured in different IIAs, and document and analyse how the particular DSA provisions would contribute to the attainment of their attendant objectives.

Notes

1 The interpretation of an IIA is governed by customary rules of international law concerning treaty interpretation, as codified in the 1969 Vienna Convention on the Law of Treaties (Vienna Convention on the Law of Treaties, 1969, pp. 875-905).

2 The issue could arise as to whether or not "consultations" and "negotiations" imply qualitatively different processes, especially where DSAs provide that should matters concerning the IIA develop, parties must consult, and where disputes have developed, the parties must negotiate. In this connection, while the alternative usage might imply a subtle difference in the stages within the dispute process, the basic process involved in both is an exchange. It could be noted in this regard that consultations might not involve striking a bargain, whereas negotiations do. The matter might be of philosophical interest, but remains outside the scope of this paper.

3 The issue of the application of a measure – especially where the question goes beyond whether or not a measure constitutes a well-described act that is prescribed by the IIA – may require an examination involving the characterization of the host-country's measures and their effects, and sometimes even the motives behind their initiation. In these circumstances, it could be of crucial importance that the parties to IIAs determine the applicable standards on the level of scrutiny that is afforded to the decision-maker in a dispute settlement mechanism.

4 Where DSAs are silent on this subject, it is generally accepted that, as regards the interpretation of the provisions of a treaty, the customary rules of international law, as recorded in the 1969 Vienna Convention on the Law of Treaties (Vienna Convention on the Law of Treaties, 1969), would apply. However, in connection with standards on treaty application, the parties involved in bilateral means of dispute settlement may need to reach agreement on those standards, such agreement at times being a prerequisite to reaching an acceptable solution to the dispute. In the case of third-party means of dispute settlement, it would be left for the tribunal to decide the matter, which might thereby add to the issues in dispute.

5 It should be noted that not all disputes involve questions of law. In some cases, an award might be limited by agreement to a determination of facts in controversy, after which the parties would negotiate a settlement on the basis of the tribunal's findings.

6 In the case of settlement agreements, the element of review is embodied in a request for renegotiation of the agreement.

Section II

STOCKTAKING AND ANALYSIS

This section, after providing a brief historical perspective on settlement of inter-State investment disputes, takes stock of the manner in which IIAs have dealt with the main issues enumerated in section I concerning DSAs. It furthermore analyses the individual provisions discussed in terms of the purposes and objectives behind the conclusion of IIAs, i.e. their contribution to the avoidance, management and settlement of State-to-State disputes.

As State-to-State disputes involve the principal participants in the international legal order, rules that have been shaped through time concerning dispute settlement need to be analysed in the light of both the basic expectations within that order and the realities of power and governance structures that shape the relations therein. Moreover, rules developed on dispute settlement must pass the additional test of legitimacy and validity relative to those actors that the order seeks to organize. Traditionally, inter-State investment disputes were (and in the absence of IIAs would still be) resolved under rules of customary international law, which is not without its own attendant problems relative to the subject matter. For example, the lack of international legal personality by foreign private persons under customary international law has meant that only their national States could espouse a claim on their behalf through "diplomatic protection" (Wetter, 1962; Higgins, 1994; Muchlinski, 1999; UNCTAD, 1998).[1]

In exercising diplomatic protection on behalf of its injured national, a protecting State may resort to an international claim through arbitration or before an international tribunal, should there be consent on the part of the other State involved. Otherwise, protection may involve some unilateral acts of self-help such as diplomatic protest and reprisals, though the latter raise complex questions as to their legality (see the Naulilaa case (ADPILC, 1927-1928) and the Air Services Agreement case

(RIAA, 1978); see also the United Nations Reports of International Arbitral Awards).

Attempts by States to address issues concerning the settlement of investment-related disputes through treaty practice could be traced back to the post-1945 Friendship, Commerce and Navigation (FCN) treaties. FCN treaties contained only provisions for State-to-State disputes arising out of their interpretation or application. Sometimes, provisions were also included for consultations on "matters affecting the operation" of a particular treaty. The dispute settlement arrangements in FCN agreements, despite their differing drafting patterns, lengths or scope, were substantively uniform in implications. Typically, they proceeded from bilateral mechanisms such as consultations or diplomacy, to third party mechanisms, which in their case was always submission of a dispute to the ICJ.[2] For example, article XIV of the 1966 Treaty of Amity and Economic Relations between the United States of America and the Togolese Republic provides:

> "1. Each Party shall accord sympathetic consideration to, and shall afford adequate opportunity for consultation regarding, such representations as the other Party may make with respect to any matter affecting the operation of the present Treaty.
>
> 2. Any dispute between the Parties as to the interpretation or application of the present Treaty, not satisfactorily adjusted by diplomacy shall be submitted to the International Court of Justice, unless the Parties agree to settlement by some other pacific means" (United Nations Treaty Series, 1969).

Despite their substantive uniformity, the dispute settlement arrangements in FCN treaties had some drawbacks or weaknesses (Vandevelde, 1988). The FCN treaties differed from modern IIAs, as the latter are specifically directed at the protection and promotion (encouragement) of foreign investment and typically include State-to-State DSAs.

A. The scope of disputes that could trigger DSAs

The expressions used to define the types of issues or disagreements that could trigger the recourse to such mechanisms need to be analysed individually to see what definitions could be derived from the terminology used with respect to such issues or disagreements, and how they are limited not only in terms of their definitions, but also in relation to their role in resolving questions that arise from the substantive provisions of the IIA. Nevertheless, two general models may be mentioned.

The first model, an example of which is article VIII of the 1994 United States model BIT, provides in one provision that:

> "The Parties agree to consult promptly, on the request of either, to resolve any disputes in connection with the Treaty, or to discuss any matter relating to the interpretation or application of the Treaty or to the realization of the objectives of the Treaty."[3]

Thus, under this model, DSAs, at one stroke, provide for consultations with respect to "disputes" or "matters". The scope of the disputes is wide, in that they need only be "in connection with the Treaty". The scope of matters (other than disputes) is similarly wide, as all that is needed is that they relate to the interpretation or application of the BIT, or to the realization of its objectives. The three instances, put together, would cover the widest possible range of issues that might arise from the agreement. By providing for both a wide definition and scope of the types of circumstances that could trigger the DSA, this model would contribute to the avoidance of disputes, by expressly providing for a process to tackle any concerns that might arise for any of the parties.

A variation of the first model is indicated, for example, by articles 9(1) and 10 of the Chilean model BIT, which provides in two provisions that:

> "The Contracting Parties shall endeavour to resolve any difference between them regarding the interpretation or application of the provisions of this Agreement by friendly negotiations", and

> "The Contracting Parties shall consult at the request of either of them on matters concerning the interpretation or application of this Agreement."

Under this approach, there is a bifurcation of disputes and matters, both of which should be resolved through bilateral settlement processes: the scope of disputes and matters are wide, as they both relate to the interpretation or application of the agreement. The effect of this model would be, in the final analysis, the same as the first.

The second model, as illustrated in article 9(1) of the Swiss model BIT, provides simply that "Disputes between Contracting Parties regarding the interpretation or application of the provisions of this Agreement shall be settled through diplomatic channels". Here, a somewhat narrower definition exists, in that a dispute needs to have formed as to the interpretation or application of the agreement, before the DSA could be triggered.

The first model expressly addresses the issue of dispute avoidance by creating an obligation – triggered at the insistence of any one of the parties – to consult and negotiate on matters that might not be disputed at the time.[4] By contrast, in the second model, dispute avoidance would depend more on the awareness of the parties that concerns related to the IIA exist, and on their mutual goodwill to address those issues before they come to form the basis of disputes. Moreover, from an investment protection perspective, where matters have arisen within the context of IIAs – for example, on the creation of a regulatory framework affecting a particular industry – inefficiencies related to the operations of enterprises could arise if these concerns are not promptly addressed. Specifically, where goodwill is lacking, one party could engage in dilatory practices in addressing the concerns of the other, on the grounds that no dispute has arisen in connection to the IIA, as the proposed regulatory framework is not yet set in place.

The scope of disputes that could trigger a DSA in an IIA has, in some instances, been limited, either on procedural or substantive bases.

First, this issue concerns circumstances in which alternative dispute settlement procedures have been made available, and that the election to use one removes the availability of the other. In this connection, a clear example is in relation to diplomatic protection in investor-State disputes concerning those countries that are party to the 1965 Convention on the Settlement of Investment Disputes between States and Nationals of other States (ICSID Convention). Article 27(1) of the ICSID Convention states:

> "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, unless such other Contracting State shall have failed to abide by and comply with the award rendered in such dispute."

This issue is also reflected in the BIT practices of some countries. For example, the "preferred" article 8(4) of the 1991 model BIT of the United Kingdom, entitled "Reference to International Centre for Settlement of Investment Disputes", provides that:

> "Neither Contracting Party shall pursue through the diplomatic channel any dispute referred to the Centre …"

unless there is a determination that ICSID has no jurisdiction to decide the matter, or the other party has failed to comply with the decision of the arbitral panel formed under the auspices of the Centre.

Another example is provided by the NAFTA agreement, where in some areas (such as the prohibition of TRIMs) the parties have recourse to both NAFTA's State-to-State DSA under its Chapter 20, and to the procedures under the understanding on rules and procedures governing the settlement of disputes, Annex 2 to the Agreement Establishing the WTO (WTO Agreement). In such circumstances, NAFTA's Chapter 20, entitled "Institutional Arrangements and Dispute Settlement Procedures", in its Article 2005(1), provides that disputes that arise in connection to both treaties, subject to certain considerations, "may be settled in either forum at the discretion of the complaining Party" (ILM, 1993). However,

paragraph (6) of the same article restricts such election by stating that once the dispute settlement procedures have been initiated under either treaty, "the forum selected shall be used to the exclusion of the other", except that the respondent could force the recourse to NAFTA's Chapter 20 with respect to environmental and conservation agreements under Article 104 of NAFTA, and certain aspects of Sanitary and Phytosanitary Measures (NAFTA, Chapter 7) or Standards-Related Measures (NAFTA, Chapter 9) (ILM, 1993).

Second, IIA provisions sometimes provide for circumstances in which the parties cannot challenge certain measures, which but for the existence of those circumstances would have been subject to the DSA therein. One example is the reference found in United States BITs related to the non-application of the BIT to measures taken for the protection of the United States' own essential security interests. This provision would not, on its own, provide for a bar on the operation of the DSA, for a dispute might arise as to whether or not a genuine threat exists to the United States, essential security interests. However, when coupled with another provision – as evidenced by paragraph 8 of the Protocol to the 1992 United States-Russian Federation BIT, which states: "whether a measure is undertaken by a Party to protect its essential security interests is self-judging" (ILM, 1992) – the matter is then rendered as not subject to review, and hence, could not trigger the DSA (Vandevelde, 1993). The NAFTA uses a similar technique under its Chapter 11 (Investment). Article 1138 (2) provides in its relevant part that "the dispute settlement provisions of … Chapter Twenty shall not apply to the matters referred to in Annex 1138.2". Annex 1138.2 in turn provides, among other things, that the "decision by the National Commission on Foreign Investment ("Comisión Nacional de Inversiones Extranjeras") [of the Government of Mexico] following a review pursuant to Annex I, page IM4, with respect to whether or not to permit an acquisition that is subject to review, shall not be subject to the dispute settlement provisions of … Chapter Twenty", the State-to-State DSA in NAFTA.

Another example of limitations on the scope of disputes that trigger DSAs pertain to particular substantive provisions in IIAs, which have been extracted from the scope of disputes. In this connection, Article

XIII (1) of the 1994 United States model BIT provides that "No provision of this Treaty shall impose obligations with respect to tax matters …", except that with respect to expropriation, the provisions of the agreement's State-to-State DSA would still apply. Thus, the only possibility for challenging tax measures would be where a claim is made that the measure is tantamount to expropriation.

The foregoing review makes clear that the majority of IIAs provide for the coverage of a wide range of issues under their DSAs. Minimally, all disputes that arise in relation to IIAs are covered. In most cases, all matters connected with an IIA, with which the parties are concerned, could trigger its DSA. The availability of such a wide range of issues contributes not only to the settlement of inter-State disputes, but also to their avoidance. In this connection, it should however be noted that at times this wide scope has been limited, through either procedural or substantive restrictions.

B. Dispute settlement mechanisms and their procedures

DSAs typically provide first for bilateral mechanisms for dispute settlement, such as negotiations or consultations, and if they should be unsuccessful, then for third-party mechanisms like arbitration, which will provide the parties to IIAs, in most cases, with a final, binding decision.

1. Negotiations and consultations

While there is diversity in the drafting of DSAs in this respect (box 1), the significance lies in the fact that they all establish an obligation that the parties involved in a dispute must first engage in negotiations, before resorting to third-party means.

Thus, where matters have arisen in relation to an IIA, compulsory consultations or negotiations could provide for the objective of dispute avoidance. As regards a dispute that has already arisen, consultations or negotiations could clarify the disputed issues for the parties involved, and provide for a mutually acceptable solution.

Box II.1. Obligation to negotiate

"Disputes between the Contracting Parties concerning the interpretation or application of this Agreement should, if possible, be settled through the diplomatic channel."
The UK model BIT, Article 9 (1).

"The Contracting Parties shall endeavour to resolve any dispute between them connected with this Agreement by prompt and friendly consultations and negotiations."
Article 11 (1) Australia/Lao People's Democratic Republic 1994 BIT.

"Contracting Parties shall endeavour to settle disputes concerning the application or interpretation of this Treaty through diplomatic channels."
The Energy Charter Treaty, Article 27 (1) (Waelde, 1996).

"Disputes or differences between the Contracting Parties concerning interpretation or application of this agreement shall be settled through negotiations."
The Asian-African Legal Consultative Committee (ALCC) Model (A) BITs, Article 11 (1).

Box II.1 (concluded)

"B. CONSULTATION, CONCILIATION AND MEDIATION
1. Consultations

a. One or more Contracting Parties may request any other Contracting Party to enter into consultations regarding any dispute between them about the interpretation or application of the Agreement. The request shall be submitted in writing and shall provide sufficient information to understand the basis for the request, including identification of any actions at issue. The requested Party shall enter into consultations within thirty days of receipt of the request. The requesting Contracting Party shall provide the Parties Group with a copy of the request for consultation, at the time it submits the request to the other Contracting Party.

b. A Contracting Party may not initiate arbitration against another Contracting Party under Article C of this Agreement unless the former Contracting Party has requested consultation and has afforded that other Contracting Party a consultation period of no less than 60 days after the date of the receipt of the request."
Article B (1)(a) and (b), Multilateral Agreement on Investment (MAI), Draft Negotiating Text, 24 April 1998.

Source: UNCTAD.

Negotiation processes do not easily lend themselves to "proceduralization". Thus, the procedures for negotiations under DSAs are left almost entirely to the parties. An exception is evidenced by article 2006(5) of NAFTA, which provides:

> "The consulting Parties shall make every attempt to arrive at a mutually satisfactory resolution of any matter through consultations under this Article or other consultative provisions of this Agreement. To this end, the consulting Parties shall:

> (a) provide sufficient information to enable a full examination of how the actual or proposed measure or other matter might affect the operation of this Agreement;
> (b) treat any confidential or proprietary information exchanged in the course of consultations on the same basis as the Party providing the information…" (ILM, 1993).

Moreover, a few IIAs include in their DSAs that negotiations should be through ad hoc or standing institutions. For example, article 12 (1) of the 1980 BIT between the Belgo-Luxembourg Economic Union and Cameroon provides that disputes between the parties "shall, as far as possible, be settled by a mixed Commission, composed of representatives appointed by the Contracting Parties" (United Nations Treaty Series, 1982). Similarly, the Economic Partnership Agreement between Mexico and the EU of 1997 provides for a Joint Committee to which disputes shall be referred in the first instance for consultations. The Joint Committee has 30 days from the delivery of the request for consultations to arrive at a decision. However, the parties to the dispute remain free to submit the dispute to arbitration if, after 15 days from the date after the Joint Committee has been seized of the request for consultations, the legal issues arising between the parties have not been resolved (Articles 38-39). Should the parties decide upon arbitration, the procedures specified in Articles 39-43 will apply.

In some instances, IIAs provide for a timeframe within which negotiations must take place, usually six months.[5] Where no timeframes exist, DSAs provide that each party could end negotiations by requesting that the third-party settlement processes begin. Finally, it should be noted that some recent bilateral agreements between the United States and other countries concerning the development of trade and investment relations contain only a consultation clause, but do not provide for full dispute settlement procedures.[6]

2. *Ad hoc* arbitration

Where parties could not reach a mutually acceptable solution to their disputes through negotiations, most IIAs, and in particular almost all BITs, provide for recourse to ad hoc arbitration (box 2). With regard to the establishment of an arbitral tribunal, DSAs take into consideration the will and participation of the contracting parties, without allowing any of them to control unilaterally the appointment procedure, to stop or delay the establishment of a tribunal, or its operations once it is established.

Box II.2. *Ad hoc* arbitration model

"If a dispute between the Contracting Parties cannot thus [diplomatic channel] be settled within six (6) months from notification of the dispute, it shall, upon the request of either Contracting Party, be submitted to an arbitral tribunal."
Article 9 (2) Estonia/Israel 1994 BIT

"Any dispute between the Contracting Parties as to the interpretation or application of the present Agreement not satisfactorily adjusted by diplomacy, shall be referred for decision to an arbitration board..."
Article 13 (2) Japan/China 1988 BIT

Source: UNCTAD.

Thus, a typical clause can be found in the Chile model BIT (article 9.3):

> "The Arbitral Tribunal shall be formed by three members and shall be constituted as follows: within two months of the notification by a Contracting Party of its wish to settle the dispute by arbitration, each Contracting Party shall appoint one arbitrator. These two members shall then, within thirty days of the appointment of the last one, agree upon a third member who shall be a national of a third country and who shall act as the Chairman. The Contracting Parties shall appoint the Chairman within thirty days of that person's nomination."[7]

For a panel to be established, a number of issues are typically subject to the agreement of the parties, which are sometimes provided for in the DSA, in various forms and degrees of detail (box 3). The first issue is the selection of the arbitrators. Most IIAs provide for three (and in a few instances five) members, an odd number being required to prevent a deadlock. The paramount consideration concerning the make-up of the panel is the balancing required between subject matter expertise, familiarity with the particular circumstances that affect the parties involved, and the overall impartiality of the panel. Most IIAs do not provide for specific subject matter expertise. However, article 2010(1) of NAFTA states: "All panellists shall meet the qualifications set out in Article 2009(2)". The latter article requires that "Roster members shall:

> (a) have expertise or experience in law, international trade, other matters covered by this Agreement or the resolution of disputes arising under international trade agreements, and shall be chosen strictly on the basis of objectivity, reliability and sound judgment;
> (b) be independent of, and not be affiliated with or take instructions from, any Party; and
>
> (c) comply with a code of conduct to be established by the Commission" (ILM, 1993).

IIAs almost universally provide that each party selects, within a prescribed time period, one arbitrator. In most instances, parties select an arbitrator who is their own national. This practice has been questioned, and arguments can be made as to whether or not more relevant factors, such as conflicts of interest on the basis of, for example, close personal or financial links with the parties involved in the underlying dispute, should not affect the selection process (Peters, 1991). However, it could also be argued that the selection of parties who are nationals of the disputing parties could ensure that the panel includes members who have intimate knowledge of special circumstances prevalent in those countries.

Box II.3. Establishment of arbitration tribunal

"If a dispute is not resolved by such means within six months of one Contracting Party seeking in writing such negotiations or consultations, it shall be submitted at the request of either Contracting Party to an Arbitral Tribunal established in accordance with the provisions of Annex A of this Agreement …"
Article 11 (2) Australia/Lao People's Democratic Republic 1994 BIT

"Annex A

PROVISIONS FOR THE ESTABLISHMENT OF AN ARBITRAL TRIBUNAL FOR THE SETTLEMENT OF DISPUTES BETWEEN THE CONTRACTING PARTIES

(1) The Arbitral Tribunal referred to in Article 11 shall consist of three persons appointed as follows:

(a) each Contracting Party shall appoint one arbitrator;

(b) the arbitrators appointed by the Contracting Parties shall, within sixty days of the appointment of the second of them, by agreement, select a third arbitrator who shall be a national of a third country which has diplomatic relations with both Contracting Parties;

(c) the Contracting Parties shall, within sixty days of the selection of the third arbitrator, approve the selection of that arbitrator who shall act as Chairman of the Tribunal.

(2) Arbitration proceedings shall be instituted upon notice being given through the diplomatic channel by the Contracting Party instituting such proceedings to the other Contracting Party. Such notice shall contain a statement setting forth in summary form the grounds of the claim, the nature of the relief sought, and the name of the

Box II.3. (continued)

arbitrator appointed by the Contracting Party instituting such proceedings. Within sixty days after the giving of such notice the respondent Contracting Party shall notify the Contracting Party instituting proceedings of the name of the arbitrator appointed by the respondent Contracting Party.

(3) If, within the time limits provided for in paragraph (1) (c) and paragraph (2) of this Annex, the required appointment has not been made or the required approval has not been given, either Contracting Party may request the President of the International Court of Justice to make the necessary appointment. If the President is a national of either Contracting Party or is otherwise unable to act, the Vice-President shall be invited to make the appointment. If the Vice-President is a national of either Contracting Party or is unable to act, the Member of the International Court of Justice next in seniority who is not a national of either Contracting Party shall be invited to make the appointment.

(4) In case any arbitrator appointed as provided for in this Annex shall resign or become unable to act, a successor arbitrator shall be appointed in the same manner as prescribed for the appointment of the original arbitrator and the successor shall have all the powers and duties of the original arbitrator.

(5) The Arbitral Tribunal shall convene at such time and place as shall be fixed by the Chairman of the Tribunal. Thereafter, the Arbitral Tribunal shall determine where and when it shall sit.

(6) The Arbitral Tribunal shall decide all questions relating to its competence and shall, subject to any agreement between the Contracting Parties, determine its own procedure.

Box III.3. (concluded)

(7) Before the Arbitral Tribunal makes a decision, it may at any stage of the proceedings propose to the Contracting Parties that the dispute be settled amicably. The Arbitral Tribunal shall reach its award by majority vote taking into account the provisions of this Agreement, the international agreements both Contracting Parties have concluded and the generally recognised principles of international law.

(8) Each Contracting Party shall bear the costs of its appointed arbitrator. The cost of the Chairman of the Tribunal and other expenses associated with the conduct of the arbitration shall be borne in equal parts by both Contracting Parties. The Arbitral Tribunal may decide, however, that a higher proportion of costs shall be borne by one of the Contracting Parties …"

Annex A Australia/ Lao People's Democratic Republic 1994 BIT

"2. If the Contracting Parties cannot reach an agreement within twelve months after being notified of the dispute, the latter shall upon request of either Contracting Party, subject to their relevant laws and regulations, be submitted to an arbitral tribunal of three members. Each Contracting Party shall appoint one arbitrator, and these two arbitrators shall nominate a chairman who shall be a national of a third state having diplomatic relations with both Contracting Parties at the time of nomination."
Article 12 Belarus/Iran 1994 BIT

Source: UNCTAD.

After the selection of the first two arbitrators, it is for them to nominate a third, with the proviso that the nominee be the national of a third country.[8] The almost uniform insistence that the third arbitrator be from a third country would seem to be the countervailing element in the selection process, with which the parties could ensure the panel's overall

impartiality. Furthermore, the fact that both parties involved in the dispute must then confirm the nomination also provides for a safeguard that if either party is uncomfortable with the proposed composition, they would have a chance to request a change, although, as will be further discussed below, none of the parties have the power to avoid the establishment of the panel.

In the event that any one of the parties fails to make the requisite appointments for any reason, almost all DSAs provide for an appointing authority, whose involvement could be elicited by a request from the other party to the dispute. For example, article 8(4) of the Chinese model BIT provides that "If the arbitral tribunal has not been constituted within four months from the receipt of the written notice requesting arbitration, either Contracting Party may, in the absence of any other agreement, invite the President of the International Court of Justice to make any necessary appointments. If the President is a national of either Contracting Party or is otherwise prevented from discharging the said functions, the Member of the International Court of Justice next in seniority who is not a national of either Contracting Party... shall be invited to make such necessary appointments". Again, the prestige, office and, in particular, nationality requirement of the appointing party are intended to ensure impartiality in both the process of selection and the composition of the panel.

Second, the parties need to agree on what questions the panel should decide, and the nature of, as well as the form in which it would render, its decision. These could be agreed in advance (standard terms of reference), provided for in a separate arbitration agreement when specific disputes arise (*compromis*), or left to be determined by the panel. For example, article 2012(3) of NAFTA provides that "Unless the disputing Parties otherwise agree within 20 days from the date of the delivery of the request for the establishment of the panel, the terms of reference shall be: 'To examine, in the light of the relevant provisions of the Agreement, the matter referred to the Commission (as set out in the request for a Commission meeting) and to make findings, determinations and recommendations as provided in Article 2016(2)'" (ILM, 1993).

Where provided for in the DSA or the *compromis*, the terms of reference could be general, which would give the arbitral panel a relatively high degree of latitude with respect to what issues are to be argued and determined, as well as the form in which they would render their decision. Parties could, on the other hand, mandate that only certain narrowly defined issues are considered, or that the panel should make only findings of fact or law. Several examples exist concerning terms of reference of arbitrators in inter-State disputes that, while they do not involve investment-related issues, are nonetheless instructive. For example, in the New Zealand-France arbitration arising out of the Rainbow Warrior case,[9] the United Nations Secretary-General was asked specifically not to decide whether New Zealand was justified in the detention of the French agents, although he was asked to determine the manner and length of any future detention. The significance of the issue of the terms of reference is demonstrated through the Alabama Claims case,[10] where the arbitration proceedings were almost aborted because the parties had not previously agreed on the type of damages that the panel could award, and during the proceedings, disagreed on whether it could award indirect damages, in addition to direct damages.

Third, the parties would consider the operational rules and procedures of the panel. Most IIAs leave the determination of the working rules and procedures to the panel. For example, article 8(5) of the Chinese model BIT provides, in its relevant part, that "The arbitral tribunal shall determine its own procedure."

Some DSAs provide for time frames within which the arbitral proceeding should be completed. For example, Article X (3) of the United States model BIT states: "Unless otherwise agreed, all submissions shall be made and all hearings shall be completed within six months of the date of selection of the third arbitrator, and the arbitral panel shall render its decisions within two months of the date of the final submissions or the date of the closing of the hearings, whichever is later".

An alternative to the provision of rules and procedures concerning the establishment and the operations of the ad hoc arbitral panel is for the parties to agree to refer, in part or in whole, to provisions of a

comprehensive pre-established set of rules, such as the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL rules). For example, article 27 (3) (f) of the Energy Charter Treaty provides:

> "(f) In the absence of an agreement to the contrary between the Contracting Parties, the Arbitration Rules of UNCITRAL shall govern, except to the extent modified by the Contracting Parties to the dispute or by the arbitrators. The tribunal shall take its decisions by a majority vote of its members."[11]

Another alternative would be for the States involved to submit their dispute to be settled under the auspices of specialized institutions such as an inter-State claims commission of which the Iran-United States Claims Tribunal is a leading example.

3. Permanent arbitral and judicial institutions

One of the very few inter-governmental arbitration institutions that is self-standing (i.e. is not part of the institutional arrangements of a subject-specific treaty) is the Permanent Court of Arbitration at The Hague, which was born out of the 1899 and 1907 Hague Conventions for the Pacific Settlement of International Disputes. Other specialized institutions offering arbitration services are typically geared towards private cases or government-private party cases. These include the International Court of Arbitration of the ICC and ICSID. DSAs have seldom provided for the submission of inter-State disputes to institutional arbitration, if the institutional arrangements have been outside the framework of the IIA.

In contrast, some IIAs, most of which are at the regional level, have established institutional arrangements for the settlement of inter-State disputes. An example is Chapter 20 of NAFTA, which provides for elaborate institutional arrangements for the settlement of inter-State disputes. As noted previously, the issues that are covered under these arrangements are the same as those that arise for ad hoc arbitration, but

which are pre-arranged within the rules and procedures of the institutional arrangements.

Recourse to permanent, self-standing inter-governmental judicial bodies such as the ICJ is always a possibility. In principle, where States that are parties to a dispute have accepted the jurisdiction of the ICJ, and their acceptance provides, on a reciprocal basis, subject-matter jurisdiction to the ICJ, then the matter could be adjudicated by the World Court.[12]

However, in some instances, DSAs specifically provide for the submission of the dispute to the ICJ. For example, the inter-State DSA of the ICSID Convention, in its article 64, provides that "Any dispute arising between Contracting States concerning the interpretation or application of this Convention which is not settled by negotiation shall be referred to the International Court of Justice by the application of any party to such dispute, unless the States concerned agree to another method of settlement".

Some DSAs create permanent judicial bodies that have competence over disputes that arise between the parties in connection with the specific IIA. An example is the Andean Subregional Integration Agreement (Cartagena Agreement), which provides, in its article 47, for the resolution of disputes between its member States as follows:

> "The resolution of disputes that may arise due to the application of the Andean Community Law, shall be subject to the provisions of the Charter of the Court of Justice" (OAS, 1996).

Article 42 of the Charter of the Court of Justice of the Andean Community, in turn, provides the Court with exclusive jurisdiction over inter-State disputes by stating that:

> "Member Countries shall not submit any dispute that may arise from the application of provisions comprising the legal system of the Andean Community to any court, arbitration system or proceeding whatsoever except for those stipulated in this Treaty" (Andean Community, 1996).

Perhaps the leading example of such a system is that established under the European Union (EU) Treaty, which places the European Court of Justice at the heart of State-to-State dispute settlement in relation to the provisions of that treaty. Thus, by Article 227 of the EU Treaty, a member State that considers that a member State has failed to fulfill an obligation under this treaty may bring the matter before the Court of Justice. Before that is done the complainant member State shall bring the matter before the European Commission, which shall deliver a reasoned opinion after each of the States concerned has presented its own case and its observations on the other party's case both orally and in writing. Where the Commission has not delivered an opinion within three months of the date on which the matter was brought before it, the absence of such an opinion will not prevent the matter from being brought before the Court of Justice. This procedure has been rarely invoked as member States have tended to prefer the European Commission to act against member States under its own powers to bring an action for failure to fulfill an obligation under the EU Treaty (Weatherill and Beaumont, 1999).

Similar to institutional arbitration, judicial fora have established, time-tested rules and procedures for the conduct of the proceedings. Their constitutional documents provide for their terms of reference, or as is referred to in legal terms, for their "competence" and "jurisdiction". Moreover, the members of the judiciary are pre-selected and, therefore, issues similar to the selection of arbitrators seldom arise.

4. Permanent political institution for dispute settlement

In addition to permanent judicial institutions, DSAs might provide recourse to a political organ for third-party settlement of disputes. An example was provided by article IX of the 1987 Agreement Among the Governments of Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand (member States of ASEAN) for the Promotion and Protection of Investments, which stated:

> "1) Any dispute between and among the Contracting Parties concerning the interpretation or application of this Agreement shall, as far as possible, be settled amicably between the parties to the dispute. Such settlement shall be reported to the ASEAN Economic Ministers (AEM).
>
> 2) If such a dispute cannot thus be settled it shall be submitted to the AEM for resolution."[13]

Article 4 of the 1996 Protocol replaced the preceding text of Article IX of the ASEAN Investment Agreement with the following: "The provisions of the ASEAN Dispute Settlement Mechanism shall apply to the settlement of disputes under the agreement". The ASEAN Dispute Settlement Mechanism in turn provides for panel procedures established by the Senior Economic Officials Meeting (SEOM) to assist it in ruling on the dispute.[14] Article 7 of the Dispute Settlement Mechanism states that "The SEOM shall consider the report of the panel in its deliberations and make a ruling on the dispute within thirty (30) days from the submission of the report by the panel…" (ASEAN, 1996). Thus, the permanent political body SEOM has the task of ruling on inter-State disputes that arise from the ASEAN Investment Agreement (Mohamad, 1998).[15]

Typically, political bodies do not have established rules and procedures concerning settlement of disputes. Thus, as in the case of ad hoc arbitration, the procedures and methods concerning recourse to and the functioning of political bodies are elaborated in DSAs. For example, with reference to disputes arising from the WTO Agreement on TRIMS, article IV of the Agreement Establishing the WTO provides in paragraph (2) that "There shall be a General Council composed of representatives of all the Members, which shall … carry out the functions assigned to it by this Agreement…", and further provides in its paragraph (3) that "The General Council shall convene as appropriate to discharge the responsibilities of the Dispute Settlement Body provided for in the Dispute Settlement Understanding. The Dispute Settlement Body may have its own chairman and shall establish such rules of procedure as it deems necessary for the fulfilment of those responsibilities" (GATT, 1994).[16]

This examination suggests that IIAs almost uniformly provide in their DSAs for dispute settlement first through consultation and negotiation procedures, and then through some type of third-party mechanism, such as arbitration (be it ad hoc or institutional), or permanent tribunal (be it judicial or political). The rules and procedures to be followed concerning, for example, the selection of the third-party decision-makers, their terms of reference, and their working rules and procedures – where provided for with sufficient detail and clarity – help reduce the scope of disagreements when these mechanisms are employed. This prevailing model, in principle, could provide States with the means of avoiding disputes, and contribute to the management of their relations when disputes arise, by providing a predetermined, clear and uncontroversial course of action. At the same time, it could provide the confidence that, where agreement can not be reached in a particular dispute, an impartial (and relatively quick) settlement would nonetheless be obtained through definitive rulings concerning the interpretation or application of the provisions of IIAs, which should signify a secure and predictable investment environment.

C. Applicable standards for settlement of disputes

Where DSAs have addressed the subject of applicable standards – almost uniformly in relation to settlement through arbitration – they have typically made reference, albeit in varying formulations, to sources from which such standards could be derived, including the provisions of the IIA, other measures or agreements by the parties, and international law.

The provisions of the IIA are an indispensable source, which does not require explicit mention. However, they are sometimes referred to expressly, though not exclusively, in IIAs. For example, article 11(6) of the Argentina-El Salvador 1996 BIT provides that:

> "The tribunal shall decide on the basis of the provisions of the Agreement, legal principles recognized by the Parties and the general principles of international law" (OAS, 1997).

Box. II.4. Provisions on applicable law

"Any dispute between the Parties concerning the interpretation or application of the Treaty, that is not resolved through consultations or other diplomatic channels, shall be submitted upon the request of either Party to an arbitral tribunal for binding decision in accordance with the applicable rules of international law."
Article 10 (1) United States/Bahrain 1999 BIT.

"(5) The tribunal shall decide on the basis of this Agreement and other relevant agreements between the two Contracting Parties, rules of International Law and rules of Domestic Law. The forgoing provisions shall not prejudice the power of the tribunal to decide the dispute *ex aequo et bono* if the Parties so agree."
Article 12 (5) Netherlands-Nigeria 1992 BIT.

"(g) The tribunal shall decide the dispute in accordance with this Treaty and applicable rules and principles of international law;"
Article 27 (3) (g) Energy Charter Treaty.

Source: UNCTAD.

Generally, provisions of IIAs that establish standards are most-favoured-nation, national, and fair and equitable treatment clauses, as well as the clause on the taking of property. The various formulations of, and the issues that arise in relation to, such standards have been reviewed in separate papers in this Series (UNCTAD, 1999b, 1999c, 1999d and 2000b), and will not be repeated here. Some IIAs include a particular standard in their DSAs[17] in reference to negotiations, namely a standard of "direct and meaningful" negotiations. Here, an arbitral panel might be asked to decide whether or not negotiations were "meaningful", and perhaps even be required to rule on whether or not the arbitration could proceed, if it finds that negotiations were not meaningful. The other measures or agreements by the parties that could serve as sources from which standards are derived are often placed at issue under a separate

provision in an IIA. An example is article XI of the United States model BIT, which states:

> "This Treaty shall not derogate from any of the following that entitle covered investments to treatment more favourable than that accorded by this Treaty:
>
> (a) laws and regulations, administrative practices or procedures, or administrative or adjudicatory decisions of a Party;
>
> (b) international legal obligations; or
>
> (c) obligations assumed by a Party, including those contained in an investment authorization or an investment agreement."

Clearly, in the deliberations on applicable standards, this type of provision would require consideration of additional sources other than the IIA. In relation to applicable standards, a problem could arise with regard to the possible differing contexts within which the "more favourable" treatment is provided. The majority of favourable treatment clauses envision "like situations", whereas the exemplified article provides for an absolute standard to be applicable.

The reference to international law is, as noted previously, far from uniform. For example, while article 9(6) of the Chilean model BIT states that:

> "The arbitral tribunal shall reach its decisions taking into account the provisions of this Agreement, the principles of international law on this subject and the generally recognized principles of international law…",

article 8(5) of the Chinese model BIT requires that:

> "The tribunal shall reach its award in accordance with the provisions of this Agreement and the principles of international law recognized by both Contracting Parties."

Notwithstanding the theoretical distinction between rules and principles, the Chilean formulation seems to refer to a combination of standards to be derived from the treaty, the rules of international law on the subject applied as *lex specialis*, and generally recognized principles of international law. The Chinese formulation, however, creates a problem in that the applicable standards would need to be derived not only from the treaty provisions, in itself relatively unproblematic to the extent that such derivation is possible, but also from principles of international law recognized by both parties. Presumably, if both parties to the dispute do not recognize a particular principle of international law that the arbitral tribunal considers to be relevant, that principle must be discarded.

Still other sources of applicable standards are provided for in some Dutch BITs. For example, article 9(6) of the 1987 Netherlands/Sri Lanka BIT states that "The tribunal shall decide on the basis of respect for the law … The foregoing provisions shall not prejudice the power of the tribunal to decide the dispute *ex aequo et bono* if the Parties so agree" (United Nations Treaty Series, 1987). The first sentence provides that standards could also be derived from relevant national laws, and the second increases the scope beyond legal considerations, and concerns a balancing on equities (what is fair or reasonable) as between the parties to a dispute.

D. Nature and scope of outcomes of dispute settlement mechanisms

Successful negotiations secure settlement agreements, which are, by definition, binding upon the signatory States. This derives from a fundamental principle of international law, *pacta sunt servanda*, which in this context translates itself into an obligation on the part of a State to comply with that to which it has agreed. With regard to BITs, there are no major impediments as to the scope of negotiated settlement agreements. With regional IIAs, however, and those that establish particular integration or liberalization regimes, there might be some limitation on the scope of settlement agreements. For example, article 2006 (5) NAFTA provides:

> "The consulting Parties shall make every attempt to arrive at a mutually satisfactory resolution of any matter through consultations under this Article or other consultative provisions of this Agreement. To this end, the consulting Parties shall … (c) seek to avoid any resolution that adversely affects the interests under this Agreement of any other Party" (ILM, 1993).

Most IIAs provide in their DSAs that the decisions resulting from the engagement of third-party dispute settlement mechanisms, such as ad hoc arbitral tribunals, are to be reached by majority voting, and are binding upon the parties to the dispute. Article 11 (iv) of the AALCC Model BIT (A) provides a typical example by providing that "The arbitral tribunal shall reach its decision by majority of votes. Such decision shall be binding on both the Contracting Parties…". In some instances, however, arbitral decisions do not have a binding effect, as illustrated by article 2018(1) NAFTA: "On receipt of the final report of a panel, the disputing Parties shall agree on the resolution of the dispute, which normally shall conform with the determinations and recommendations of the panel, and shall notify their Sections of the Secretariat of any agreed resolution of any dispute" (ILM, 1993). Thus, it is up to the disputing NAFTA parties to settle their dispute; and, while the panel decision is influential, it is not necessarily conclusive of the matter and, hence, is non-binding.[18]

On the other hand, in the absence of such specific provisions, which may render the award of a panel non-binding until it is adopted by a political body, it may be presumed that any arbitral award properly made under the authority of a dispute settlement clause in an IIA will be legally binding. In this connection, it should be noted that the discretion of an arbitral panel with respect to the type of ruling or award that it could make is generally wide in BITs. Indeed, the majority of BITs are silent on the issue, thus leaving it for the panel to decide the scope of its award.

E. Compliance with dispute settlement awards

The majority of IIAs and BITs, almost uniformly, are silent on this issue. At times, however, the decision of an arbitral tribunal is immediately neither final nor binding on the disputing parties, but its implementation will be the basis upon which the dispute between the parties will be resolved or settled. Non-compliance thereafter is dealt with by sanctions in the forms of compensation to the prevailing party or the suspension of benefit of an equivalent amount as awarded by the panel (e.g. article XV (6) of the BIT between Canada and Trinidad and Tobago). Some provide for steps that monitor and report the progress made with respect to compliance. However, under both the NAFTA and the WTO, sanctions are provided for in the case of non-compliance. For example, article 2019 of NAFTA provides:

> "1. If in its final report a panel has determined that a measure is inconsistent with the obligations of this Agreement or causes nullification or impairment in the sense of Annex 2004 and the Party complained against has not reached agreement with any complaining Party on a mutually satisfactory resolution pursuant to Article 2018(1) within 30 days of receiving the final report, such complaining Party may suspend the application to the Party complained against of benefits of equivalent effect until such time as they have reached agreement on a resolution of the dispute.
>
> 2. In considering what benefits to suspend pursuant to paragraph 1:
>
> (a) a complaining Party should first seek to suspend benefits in the same sector or sectors as that affected by the measure or other matter that the panel has found to be inconsistent with the obligations of this Agreement or to have caused nullification or impairment in the sense of Annex 2004; and
>
> (b) a complaining Party that considers it is not practicable or effective to suspend benefits in the same sector or sectors may suspend benefits in other sectors.

3. On the written request of any disputing Party delivered to the other Parties and its Section of the Secretariat, the Commission shall establish a panel to determine whether the level of benefits suspended by a Party pursuant to paragraph 1 is manifestly excessive…"

* * *

On the basis of this examination of the substantive provisions in IIAs dealing with dispute settlement issues, the next section will consider the foregoing issues in their relationship with other issues arising in IIAs.

Notes

[1] Diplomatic protection is a distinct and absolute right of the claimant State to be exercised at its exclusive discretion, which absent other arrangements, could leave an investor without any remedies in relation to measures that have adversely affected its investment. Other problems related to the espousal of an investor's claim under customary international law are that the nature of the subject-matter that can be protected may be limited and the rules regulating its exercise may be cumbersome; for example, a State will not espouse a claim on behalf of its national unless requested to do so by such national, usually after the latter has exhausted the available local remedies in the State alleged to have caused the injury in question. Another example of such issues under customary international law is the need to establish the link of nationality with the claimant State and, in the case of a dual national, for that nationality to be recognized by other interested States, and the establishment of a genuine link (a dominant and effective nationality) between the private person and the State whose nationality the latter claims to possess.

[2] The contracting parties also reserved the freedom to choose any other peaceful means of dispute settlement on which they might subsequently agree.

[3] Unless otherwise noted, all instruments cited herein may be found in UNCTAD, 1996, 2000a and 2001; the texts of the BITs mentioned in this paper may be found in the collection of BITs maintained by ICSID (ICSID, 1972ff).

[4] In some cases, the duty to consult between the parties could also serve as an essential instrument of joint policy formulation, implementation and monitoring by governments. For example, article 12 of the Chinese model BIT requires that consultations take place between the representatives of the two parties on matters related to the implementation of the agreement, exchange of legal information, resolving investment disputes, investment promotion and other investment-related issues.

[5] See for example, article 9 (2) of the Chilean model BIT; article 11 (2) of the French model BIT; article 4 (a) of the United States Overseas Private Investment Corporation (OPIC) draft Investment Incentive Agreement; and article 4 (a) of the United-States-Egypt Investment Incentive Agreement. The United States-Jordan Agreement on the Establishment of a Free Trade Area of 2000 provides for a period of 90 days: article 17(c).

[6] See, for example, the agreements between the United States and: Turkey,

article 5; Egypt, article 5; Ghana, article 7; Nigeria, article 7.

7 See too the Cambodia model BIT, article IX; the Iran model BIT, article 13; and the Peru model BIT, article 9. It is interesting to note that NAFTA provides for a novel selection procedure, whereby the parties are required to create first a roster of potential panelists by appointing, through consensus, up to 30 individuals. The selection process is then reversed in that the parties are to endeavor to agree on the chairperson of the panel. If there is no agreement, one of the disputing parties (chosen by lot) will select a chairperson from the roster, with the proviso that the selecting party must select a person who is not its citizen. Thereafter, each party to the dispute is required to select two panelists who are citizens of the other disputing party from the roster (Articles 2009-2011 NAFTA) (ILM, 1993).

8 In the case of China, the nationality proviso further requires that the third country have diplomatic relations with the parties to the dispute.

9 Rainbow Warrior, 1986.

10 Wetter, 1962.

11 Another example is provided for in article X(2) of the United States model BIT.

12 The ICJ has adjudicated a limited number of investment-related cases, including the case concerning the Chorzów factory (Germany v. Poland) (PCIJ, 1928); the Nottebohm case (Liechtenstein v. Guatemala) (ICJ, 1955); the Barcelona Traction, Light and Power Company Limited (Belgium v. Spain) (ICJ, 1970); and the case concerning Elettronica Sicula S.p.A. (ELSI) (United States v. Italy) (ICJ, 1989).

13 On 12 September 1996, a Protocol to amend the 1987 agreement between the ASEAN member countries changed the name of the agreement to "The ASEAN Agreement for the Promotion and Protection of Investments" (Article 1 of the Protocol to Amend the Agreement Among the Governments of Brunei Darussalam, The Republic of Indonesia, Malaysia, The Republic of The Philippines, The Republic of Singapore, And The Kingdom of Thailand for the Promotion and Protection of Investments, hereinafter the "ASEAN Investment Agreement").

14 Articles 4 through 7 of the 1996 ASEAN Protocol on Dispute Settlement Mechanism. (ASEAN, 1996).

15 Another example of recourse to a permanent political body can be found in the Convention Establishing the Multilateral Investment Guarantee Agency (MIGA) which, in its article 56(a), provides that any question of interpretation or application of the Convention among members of MIGA shall be submitted to the Board for its decision.

[16] In the case of WTO members, Annex 2 to the WTO DSU) was negotiated inter se, which is an ample document that describes, in detail, the functions and responsibilities of the WTO General Council when it sits as the Dispute Settlement Body, and the integral rules and procedures concerning the settlement of disputes.

[17] See Turkey's BITs with Austria, the Netherlands, Switzerland, and the United States.

[18] It will be noted (and more fully discussed below) that non-compliance with non-binding decisions might nevertheless lay the basis for suspension of benefits or other authorized remedial measures in an IIA.

Section III

INTERACTION WITH OTHER ISSUES AND CONCEPTS

Of the various interactions that exist between the present topic and others that arise in the context of IIAs, a significant one is between State-to-State and investor-State dispute settlement. IIAs are agreements between States, and any commitments entered into are, in the final analysis, opposable only by their signatories. Under this perspective, inter-State DSAs provide for the general and final methods of the settlement of international investment disputes. The foregoing notwithstanding, IIAs increasingly establish rights for foreign investors to challenge directly the measures of their host countries through a variety of dispute settlement mechanisms. Investor-State dispute settlement arrangements therefore provide for alternative means of settling particular investment disputes, a topic covered in a separate paper in this Series (UNCTAD, forthcoming). This section will, however, highlight some of the interactions with respect to the topic of investor-State dispute settlement.

As regards other areas of interaction, State-to-State dispute settlement arrangements provided for in IIAs make effective the rights and obligations contained in such agreements. As such, the topic of dispute settlement can potentially interact with all other substantive and procedural matters covered in an IIA that might give rise to a question or disagreement. To some extent, therefore, the degrees of interaction with other issues are determined by the matters that are typically covered by IIAs, as well as by their substantive nature. For purposes of analysis, it is useful to classify individual topics within relevant groupings, and to consider the interactions in terms of groups of issues, rather than by an item-by-item analysis.

In relation to relevant groupings of issues, two main categories can be identified. First, there are topics that are typically included as provisions in IIAs, the interpretation or application of which could

normally be expected to be directly at issue. These include the scope of coverage and definitions of investors and investments; admission and establishment commitments and obligations concerning standards of treatment (fair and equitable treatment, most-favoured-nation treatment, and national treatment), host country operational measures, transfer of funds, and the taking of property.

Second, there are those interactions that would result, either directly if certain topics are expressly addressed in IIAs, or indirectly in so far as measures relating to such topics would give rise to issues with respect to the topics in the first category identified above. These include competition law and investment related trade measures; employment, environmental and tax laws and regulations; State contracts; incentives; illicit payments; transfer of technology; and measures taken by an investor's home country, with respect to the social responsibility of investors, or in response to transfer pricing. It should be noted that, while these topics are not currently principal, recurring features of IIAs, some of them (such as environmental measures) could be considered as emerging issues, which could indirectly interact with DSAs in IIAs.

- **Investor-State dispute settlement arrangements.** Where both State-to-State and investor-State DSAs are present in IIAs, together they can provide a framework to ensure the fullest implementation of an IIA. However, whilst most State-to-State dispute procedures in IIAs refer to ad hoc processes to which both parties have equal access, in the investor-State arrangements, there are mixtures of both ad hoc and institutional processes, access to which may be had either equally or at the preference of the investor.

  Once the national of either contracting party validly submits a dispute to an investor-State procedure, such election could be, in some cases, exclusive. Thus, no other national or international procedures remain open to the disputing parties (either the State or the investor), including either arbitration under any other system or regime, or, the State-to-State dispute settlement procedures

under the particular IIA. For example, the draft MAI, Part V, C1b (on State-to-State Dispute Settlement Procedures) provides:

"A Contracting Party may not initiate proceedings under this Article for a dispute which its investor has submitted, or consented to submit, to arbitration under Article D [dealing with investor-to-State dispute settlement procedures], unless the other Contracting Party has failed to abide by and comply with the award rendered in that dispute or those proceedings have terminated without resolution by an arbitral tribunal of the investor's claim."

Table III.1. Interaction across issues and concepts

Concepts in other papers	State-to-State dispute settlement
Admission and establishment	++
Competition	+
Dispute settlement: investor-State	++
Employment	+
Environment	+
Fair and equitable treatment	++
Funds transfer	++
Home country measures	+
Host country operational measures	++
Illicit payments	+
Incentives	+
Investment-related trade measures	+
Most-favoured-nation treatment	++
National treatment	++
Scope and definition	++
Social responsibility	+
State contracts	+
Taking of property	++
Taxation	+
Transfer of technology	+
Transfer pricing	+
Transparency	0

Source: UNCTAD.
Key: 0 = negligible or no interaction
+ = moderate interaction
++ = extensive interaction

The interconnection between investor-State arbitration and State-to-State dispute settlement is also manifest where the range of disputes that could be submitted to either mode of dispute settlement do not overlap. For example, under Article 64 of the ICSID Convention, the scope of inter-State disagreements extends to any dispute arising between contracting States concerning the interpretation or application of the ICSID Convention, while Article 25, its counterpart concerning investor-State issues, includes only a legal dispute arising directly out of an investment. This makes clear that contracting States cannot enter into disputes with each other under the ICSID Convention over specific investor-State disputes that have been brought under Article 25. They may only enter into disputes concerning the interpretation or application of the Convention itself, whereupon they are required to reach a negotiated settlement. Failure to do so will open the possibility of a referral of the dispute to the International Court of Justice, or to another method of settlement agreed to by the parties. Thus Article 64 ensures that the ICJ will not be used by contracting States as an appellate body against decisions of ICSID tribunals, or to challenge the competence of such a tribunal to hear the case before it.

- **Scope and definition.** The scope of the coverage of an IIA is established by the interaction between all its provisions in light of the definitions clause (UNCTAD, 1999a). The wider the definitions of certain concepts and issues in an IIA, for example, "nationals", "investments", "investor", the more susceptible it is to disagreements as to the inclusion of particular instances of such concepts or issues. Far-reaching definitions would constitute a limitation on a host country's investment-related measures. Such measures might be incompatible with treaty commitments; but, more importantly, the threat of challenges to these measures under DSAs might prove to have a chilling effect on legitimate governmental regulation. On the other hand, a more detailed, carefully considered set of definitions of those concepts or issues would ensure predictability for both States and investors as to

particular issues that are covered by IIAs, and those that fall outside their respective coverage, and hence, also outside of the scope of DSAs (UNCTAD, 1999a).

This is more prominent in those models that define "investment disputes" as a dispute between a party and a national or company of the other party arising out of or relating to:

(a) an investment agreement between that party and a national or company;

(b) an investment authorization granted by that party's foreign investment authority to such national or company; or

(c) an alleged breach of any right conferred or created by the treaty with respect to an investment.

Ordinarily, in the first instance, the dispute may involve a host country and an investor. The home country might only become engaged if the investor is unjustifiably denied the remedy available under the investor-State dispute settlement procedure; if the tribunal under the investor-State dispute settlement procedure declines jurisdiction for one reason or another (for example, because the investment does not come within the definition of protected investment although the concerned investor is a national of one contracting State); or when the right violated is also a breach of the IIA (for example, a State purporting to withdraw its unilateral consent to submit to arbitration expressed in the IIA after a covered investment was made on the basis of the subsistence of that consent or to pre-empt a pending claim by an investor).

Any of the above could amount to or lead to "a dispute" between the host country party and the home country party concerning the interpretation or application of the IIA.

- **Admission and establishment.** Where an IIA guarantees rights of entry and establishment by the respective nationals of the contracting parties, an action of a State restricting such admission in violation of such rights may lead to a dispute concerning the interpretation or application of the IIA between the host country and the home country of the covered investors, though it is more likely that the investor will bring a claim against the host country if the IIA provides for investor-State dispute settlement. On the other hand, where an IIA does not provide such a positive guarantee, the refusal to grant a right of entry and establishment to an investor from another contracting State cannot be the basis of any dispute, whether between the contracting parties themselves, or between the investor and the State refusing entry and establishment.

  An IIA that applies to investments made in the host country before it entered into force would cover all investments in the host country of the nationals of the treaty partner. An action taken by the host country may not only be a violation of a right assured to the private investor by the IIA but would also amount to its violation therefore leading to a dispute under the State-to-State dispute settlement provision of the IIA.

- **Standards of treatment**. The standard of fair and equitable treatment in an IIA contained in a State-to-State dispute settlement arrangement would give negotiators or adjudicators the opportunity to assess whether an impugned action against an investor would withstand the commitments undertaken by a State in that respect (e.g. compensation for expropriation). The availability of, or access to, an independent and neutral binding third party procedure enhances the value and potency of this standard in a dispute situation (UNCTAD, 1999b). If a State action is below the fair and equitable standard, it could constitute a breach of the IIA in that specific area, thereby justifying a finding of responsibility against the concerned contracting State.

  The interaction with national treatment provisions in an IIA would

be relevant in those countries that do not have relatively adequate provisions on a particular subject in their treaties with the home country of the investor when compared with what is obtainable within the national legal system. The national treatment standard expects a host country to extend to foreign investors treatment that is at least as favourable as the treatment that it accords to national investors in like circumstances (UNCTAD, 1999c). In that case, a foreign investor might expect a treatment as favourable as compared with what is obtainable nationally and, in the process of using the available national treatment standard, might implicate the international responsibility of the host country. For example, if there is no provision in an IIA for the settlement of investor-State disputes as in the 1988 BIT between Bangladesh and Thailand, an investor could insist on using the national procedure in that instance as it is the more favourable and effective in obtaining redress from an injury in the host country. If, in the course of utilising the national procedure, an investor suffers a denial of justice below the fair and equitable standard, the treaty-based remedy of diplomatic protection through the State-to-State dispute settlement procedure in an IIA could be availed automatically. The fair and equitable treatment and the national treatment standards could complement each other in this way (UNCTAD, 1999b).

The national treatment standard could merge with the most-favoured-nation (MFN) standard to implicate the State-to-State dispute settlement arrangement in an IIA. Both standards have a very strong link and interaction in avoiding discrimination against foreign investors (UNCTAD, 1999c; UNCTAD,1999d). The MFN standard involves comparability of favourable rights with respect to third countries with which a particular country has concluded an IIA containing a more favourable standard (UNCTAD, 1999d). If a country has both the national and the MFN standards in its IIA, the MFN standard might be relied upon to call in a more effective State-to-State dispute settlement regime where a denial of justice at the national level below the fair and equitable standard has occurred. Assuming that the BIT with the claimant

State has only the primary stage of dispute settlement procedure in it, as in the BIT between Egypt and Indonesia, the MFN clause might enable the more favourable of the dispute settlement arrangements in the BITs to which the host country is a party with other countries to be invoked in the circumstance.

- **Taking of property**. The taking of property (assuming that it qualifies as a covered investment under an IIA), contrary to the conditions stipulated in the provision covering such takings, could constitute a breach of the IIA and thus lead to a dispute concerning the interpretation or application of the obligation of the State taking the action under the IIA to pay compensation as stipulated. The interaction between this issue and State-to-State dispute settlement is more fully discussed in the paper on taking of property in this Series, and will not be further considered here (UNCTAD, 2000b).

CONCLUSION:

ECONOMIC AND DEVELOPMENT IMPLICATIONS AND POLICY OPTIONS

The process of foreign investment can create disagreements and disputes between the various actors involved. There is, therefore, little doubt for the need to have in place procedures for the settlement of investment disputes. This is so regardless of the level of development of the host country in question. Equally, it is clear that disputes will arise not only over specific investments between investors and host countries, but that the wider implications of such disputes, on the evolution of the treaty-based framework for investment that IIAs are seeking to create and develop, can, in their turn, create questions and differences that might need some kind of formal resolution. This is particularly true of issues pertaining to the general interpretation and application of the substantive provisions and procedures established by IIAs. Such disputes are of the type that are more likely to be dealt with at the State-to-State level.

A further issue to be borne in mind, when considering the development implications of dispute settlement mechanisms, is the paramount need to ensure the primacy of swift, efficient and amicable methods of dispute settlement. This is the best guarantee of long-term stability in investment relations. Therefore, the majority of dispute settlement clauses and systems that are found in IIAs stress the value of this type of approach, and expect informal means of settlement to be used in the first instance. Indeed, dispute settlement clauses and systems are there to deal with the generally rare disputes that cannot be easily disposed of through amicable means. On the other hand, major disagreements can and do occur. Thus, the proper conduct of more serious investment disputes must be ensured.

The system of dispute settlement to be chosen must provide effective means for the resolution of differences between the parties and, crucially, it must be fair to both parties, and to be perceived as such. In this

connection, State-to-State disputes concerning investment issues bring with them many development implications. In particular, the way in which an IIA is interpreted and applied may have significant implications for the conduct of investment policies on the part of developing host countries. Thus it is essential that State-to-State dispute settlement systems offer sufficient flexibility to be sensitive to development concerns. This may require procedures that ensure adequate coverage for the development implications of the various positions taken by the States party to the dispute in question. Equally, such procedures must provide for full "equality of arms" as between developed and developing countries parties to a dispute so that superior resources or experience do not, in themselves, result in the development dimension of the dispute being incompletely heard and analysed.

Equally, State-to-State investment disputes arise in the context of investment relationships between a private commercial party and a State administration or agency. Thus, a public interest and policy element is present. This cannot be wholly disregarded as against the commercial interests of the private party, nor, indeed, can the legitimate interests and expectations of the commercial party always take second place to the public interest. This may be especially the case where private property rights are protected as fundamental individual rights (as for example under the European Community Treaty) or human rights (as for example under Article 1 of the First Protocol to the European Convention on Human Rights) against a "taking" by a government through administrative action. The dispute settlement system must therefore be sensitive to both kinds of interests and to the claims that they might generate in the course of a dispute.

Against this background, and in the light of the preceding discussion, a number of policy options present themselves for consideration in the drafting of State-to-State dispute settlement clauses in IIAs.

A. No Reference to State-to-State dispute settlement

At the most basic level it is possible to decide not to include any reference to dispute settlement in an IIA. This option is not usually found in practice. A central purpose of many IIAs is to place a guarantee of dispute settlement into legally binding terms through the use of such an agreement. The effect is to create an international legal obligation to settle disputes between a host country and other countries parties to an IIA in accordance with the procedures laid down in that agreement.

In relation to investor-State disputes, when the host country has a well-structured and generally accepted internal legal order, a reference to dispute settlement in an IIA could be thought of as unnecessary. The internal laws and practices of a host country may be seen as sufficiently protective of the rights and obligations of both a private investor and a host country, so as not to need further determination in an international agreement (UNCTAD, forthcoming). By contrast, where State-to-State disputes are concerned, the particular features of the internal legal order of the host or, indeed, home country are unlikely to influence the need for some type of dispute settlement system to be used by the contracting State parties to an IIA.

In such cases, silence on State-to-State dispute settlement would mean that the parties will rely on traditional methods of international dispute settlement to deal with any disputes that might arise. This may give rise to uncertainty over the applicable method of dispute settlement to be used and will require further negotiation between the State parties to a dispute as to how to deal with that eventuality. The main advantage of including a clause on State-to-State dispute settlement in an IIA is that the contracting parties will know ex ante what types of dispute settlement methods are open to them and how they should be activated and pursued, though the degree of coverage and procedural detail may vary from agreement to agreement, as will be shown below.

B. Reference to State-to-State dispute settlement

In the light of the practice detailed in section II, a number of options arise in relation to how the principal issues identified in section I should be dealt with by the terms of the State-to-State dispute settlement clause in an IIA.

(a) The scope of disputes that could trigger State-to-State dispute settlement procedures

Option 1: General formulations as to scope

There appears to be little practical difference in the effects of the various formulations that have been used to delineate the scope of disputes that could be covered under State-to-State dispute settlement provisions. As noted in section II, some agreements refer to prompt consultations on any dispute or matter arising from an agreement. It is a formulation aimed at dispute avoidance and possesses the advantage of informality and flexibility as to the subjet-matter of the dispute that may be dealt with through this procedure. This may be particularly useful for a developing country party that may not have the resources to engage in extensive formal dispute settlement procedures.

Other agreements provide dispute settlement procedures only in relation to the interpretation and application of the substantive and procedural provisions of the agreements. This formulation would appear to restrict disputes that come within the State-to-State dispute settlement provisions to those arising directly out of the agreements themselves. In practice, however, the range and scope of disputes that could be fairly described as arising out of the interpretation and application of the provisions of IIAs is quite wide. Equally, such a formulation will not rule out the primacy of informal, negotiated methods of dispute settlement.

Option 2: Removal of certain substantive measures from the State-to-State dispute settlement provisions

A variant of this approach is to remove certain substantive measures from review under the State-to-State dispute settlement provisions, for example national security issues, national FDI screening decisions or tax measures that do not amount to expropriatory measures. Such an approach can offer a degree of flexibility over which areas of an IIA should be excluded from the dispute settlement system in the agreement. These may reflect vital national public policy issues. Indeed, this approach could be adapted to exclude specific industries or sectors as well, where a State feels this to be necessary.

Option 3: The avoidance of concurrent proceedings

As noted in section II, certain IIAs have added a specialized clause to their State-to-State dispute settlement provisions which ensures that there will be no concurrent proceedings before other fora where the State-to-State dispute settlement procedure has been instituted. Usually, such provisions prevent States from commencing State-to-State dispute proceedings over a matter that is already subject to investor-State proceedings under the investor-State dispute settlement provisions of the agreement in question. In addition such clauses may provide rules for determining which of more than one available forum should take precedence in State-to-State proceedings.

(b) Dispute settlement mechanisms and their procedures

(i) Treatment of negotiations

Here a number of options arise in relation to the extent to which the States parties to the dispute are obliged to pursue a negotiated settlement.

Option 1: Hortatory provision

The parties may exhort the use of negotiated settlement techniques without making these mandatory. The formulation in this case would use wording such as "shall endeavour to" or "should" when referring to the use of negotiated informal methods of dispute settlement. Such a formulation does not, however, absolve a State from undertaking negotiations prior to moving on to third-party methods of dispute settlement. It requires that States make a genuine effort to negotiate or consult. Where this is a pre-condition to binding third-party settlement, failure to negotiate or consult will mean that the pre-condition would not have been met, even though the language used is hortatory in nature.[1]

Option 2: Mandatory provision

Here the parties are obliged to use negotiated settlement techniques before proceeding to more formal means of dispute settlement. Such clauses typically use mandatory language in that the parties "shall" or "must" use informal methods.

Option 3: Specific procedural requirements

In addition to the issue of whether the parties are obliged to use informal methods first, other requirements by which the dispute should be handled can be included in the relevant provision. For example, as noted in section II, there may be information requirements pertaining to the exchange of relevant information between the parties to a dispute, rules regarding permissible time limits or requirements to use ad hoc or specific standing institutions for the purposes of mediation, good offices or conciliation.

(ii) Mode of dispute settlement

Under this heading the parties to an IIA must decide on the types of procedures that will be made available to disputing State parties to the agreement and on the effects of the parties making a choice of a particular

mode of dispute settlement, where such choice is available.

Option 1: Ad hoc arbitration

As shown in section II, the majority of agreements opt for mandatory ad hoc arbitration between the State parties to a dispute upon the failure of an informal negotiated settlement of the dispute. There is a wide discretion on the part of negotiators as to the amount of detail to be inserted as concerns the procedures to be followed. However, as indicated in section II, a number of issues can be addressed with varying degrees of specificity:

- Appointment of arbitrators and arbitral panels.
- Determination of the subject-matter of the arbitration which can be done, in part by the general provisions of the agreement, as described in (a) above, but which also needs more specific determination in relation to the dispute at hand either by the parties themselves or by the arbitral panel.
- Operational rules and procedures to be used by the arbitral panel. These issues are mostly left to the panel's discretion but may include mandatory provisions such as, for example, rules on time limits applicable to the stages of the proceeding or references to the use of pre-established arbitral rules such as the UNCITRAL Arbitration Rules.

Option 2: Reference to the Permanent Court of Arbitration

In the alternative to ad hoc international arbitration, an IIA could refer to the Permanent Court of Arbitration as the forum before which the State parties to a dispute could present their case. This is not a common approach.

Option 3: Reference to specific institutional procedure under the IIA

As discussed in section II, certain regional agreements have

included specialized institutional arrangements for the settlement of disputes for both investor-State and State-to-State disputes. These could be used as an exclusive mode of dispute settlement. They offer the advantages of a predictable and specialized organ that is devoted to settling disputes under an agreement. This is particularly useful in relation to newly established investment regimes in regions in which no precedent exists for this type of arrangement, or as between State parties that are at different levels of development and which might require a degree of specialized understanding of the particular issues raised by the investment regime in question for their national policies and practices. This is also the approach used in relation to the multilateral trade arrangements before the WTO.

Option 4: Recourse to international judicial bodies

In the absence of ad hoc arbitration or specific institutions dealing with dispute settlement, the parties may seek recourse to the established international judicial forum of the ICJ for the settlement of disputes under an IIA. This approach has the advantage of involving the main expert international judicial body, set up specifically to adjudicate upon inter-State disputes, in the settlement of disputes arising under the IIA in question.

The most significant drawback of this approach may be the fact that the ICJ is a general court of international law and does not, as such, specialize in disputes such as those arising out of the interpretation or application of investment agreements. That is not to say that the ICJ could not discharge this task. Indeed, that would be not only incorrect as a matter of history, in that disputes between States over the terms of international economic agreements have been brought before the Court, but also a slight on the legal expertise available on the bench of the ICJ in such matters. On the other hand, the procedure before the ICJ is that of a full judicial, as opposed to a more informal arbitral, tribunal and proceedings may take too much time in relation to the nature of the dispute arising under the agreement.

Option 5: Recourse to regional judicial bodies

In the case of regional economic groupings, State-to-State disputes concerning the application of regional treaty provisions to investment issues may be taken to a specialized regional court set up to deal with such disputes. Unlike the more general ICJ, such judicial tribunals may be set up as specialized courts with a primary jurisdiction over economic issues arising out of regional economic agreements. They may also be tasked with the development of a coherent and consistent jurisprudence concerning the interpretation and application of the agreement in question. Therefore recourse to such a tribunal may form an essential part of the economic policy aims of the States parties to the agreement, making recourse to such a tribunal a necessary element of the economic order sought to be created. On the other hand, in common with other judicial tribunals, their procedure is likely to be more time consuming and expensive than informal arbitration. Accordingly this option is not likely to be used in relation to more informal investment agreements that do not constitute a part of a wider-ranging regional economic integration arrangement.

Option 6: Recourse to a permanent political institution

This option allows for an institutionalized political approach to State-to-State dispute settlement. The advantage here is of a more discretionary mode of dispute settlement, not bound by the formalities of third party adjudication, but offering third party decision-making. The major disadvantage is that such a system is not predictable or certain in the outcome of disputes, as each dispute is treated on its own merits in the light of the overall objectives of the parties to the agreement. Thus, decisions are not made in accordance with the usual rules and practices of due process that third party arbitral and judicial bodies must adhere to, nor are they necessarily limited to the issues raised by the disputing parties, as the wider interests of the parties as a whole are on the minds of the decision-makers.

Certain further qualifications may be placed upon the use of the above options:

- The agreement in question may mandate the use of only one of the above. Indeed, as already pointed out, most IIAs opt for mandatory ad hoc arbitration on the failure of informal dispute settlement methods.
- An agreement may offer a choice of dispute settlement mode from among a range of alternatives based on the above six options.
- In the latter case, the parties may wish to insert a clause ensuring that the chosen mode becomes exclusive, so as to avoid duplication of proceedings and procedures and so as to allow for a degree of finality based on the outcome of the selected mode of dispute settlement.
- The parties may consider whether to offer another mode of dispute settlement upon the outcome of the application of another mode. For example, the award of an ad hoc arbitral tribunal might be subjected to review for error, or even to full appeal, by a judicial body specified in the agreement; in specialized institutional arrangements an initial decision could be subjected to an appeal process by an appellate body established under that system.

(c) Applicable law for dispute settlement

In this connection, as shown in section II, the majority of IIAs refer to standards recognized by various sources of law, including national laws, regulations and administrative practices, international law, the provisions of the IIAs themselves and other measures or agreements to which the parties adhere. There are no hard and fast alternatives in this context. It is therefore difficult to provide clear alternative options. However, in principle, the following options could be developed:

Option 1: Silence on applicable law

This approach would require the arbitral tribunal itself to determine the applicable standards. This is not usual practice. If the arbitral tribunal is to decide on this issue then an express provision making this clear would be preferable to silence, as this could create space for further disagreement between the disputing States as to precisely which standards apply, thereby adding fuel to the underlying dispute and thereby increasing its scope. In the absence of any provision on this matter, it is

safe to say that applicable principles of international law, which bind States regardless of any treaty provisions between them, will apply to the dispute. This is particularly important in relation to the interpretation of the IIA provisions, which should conform to the requirements of Articles 31 and 32 of the Vienna Convention on the Law of Treaties, which deal with the rules of treaty interpretation and which have been uniformly and generally held to represent customary international law in this field by successive WTO Panels and Appellate Bodies (Cameron and Gray, 2001).

Option 2: Reference to specific sources of standards

As shown in section II, a number of variations are possible though in the majority of cases a reference to international law appears almost ubiquitous. No examples have been found in IIAs where national law alone is referred to as the sole source of standards. Any such reference will usually be qualified by reference to applicable principles of international law.

From the examples in section II the following variants have been identified:

- Reference to international law alone.
- Reference to the IIA itself and to international law.
- Reference to the IIA, international law and to rules of domestic law.
- Reference to the IIA, international law and to "principles of law recognized by the Parties".

The reference to international law may take numerous forms and may not always show full agreement between the parties as to what the content of the international law applicable to the issue should be. The examples of the Chilean and Chinese BITs mentioned in section II illustrate that problem.

Some further variations are also possible:

- A reference to sources, such as other international agreements

or investment contracts, that contain more favourable treatment standards for investors.

- A reference to settlement *ex aequo et bono*.

The arrangements for the settlement of inter-State disputes would contribute to the management of investment relations between countries, and to investor expectations with regard to a secure and predictable investment environment in those countries, only to the extent that the applicable standards are carefully considered and to some extent foreseeable by the parties concerned. In this connection, it should be mentioned that use of concepts and standards, such as national treatment, for which established jurisprudence exist, could be useful. Conversely, the inclusion of general or vague standards, such as fair and equitable treatment, which are themselves capable of creating disputes as to their meaning, scope and coverage, should be considered together with explanatory notes that set out clear guidelines for decision-makers in case of disputes.

(d) Nature and scope of outcomes of dispute settlement

Here at least two options present themselves:

Option 1: Silence on the issue

This is the usual approach in BITs. It gives wide discretion on these matters to the arbitral tribunal itself.

Option 2: Specific provisions

Such provisions usually assert that the award of the arbitral tribunal shall be binding on the parties. In regional or multilateral arrangements, a specific provision detailing the force of the panel award and its effect on third party States may be necessary so as to determine whether the latter are subjected to any legal effects arising out of the award, for example to treat it as a binding precedent.

(e) Compliance with awards

Here there are two possible approaches: the first is to leave the issue of how to exact compliance to the parties, while the second is to provide expressly for sanctions in the event of non-compliance with the award by the losing party. This may take the form of compensation for loss and/or the right to take counter-measures by the winning State party to the dispute.

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The foregoing discussion has shown the significant choices that arise in relation to the development of an effective State-to-State dispute settlement mechanism in IIAs. While raising many intricate technical issues, it should not be thought that such a system is always at the centre of the dispute settlement provisions of an IIA. Current practice has tended to extend dispute settlement provisions to cover investor-State disputes, and it is likely that this type of dispute will become more common in relation to the application and interpretation of IIA provisions. In that sense, State-to-State procedures may become secondary to investor-State procedures in agreements in which both types of dispute settlement are foreseen. On the other hand, some IIAs may only provide for State-to-State dispute settlement, especially where the main aim behind the agreements is the development of an inter-State order for the regulation of FDI in which investor protection rights may be of a "soft law" or hortatory character. In such cases, the main types of disputes will relate to the interpretation and application of general provisions in the agreements, without reference to specific disputes involving actual investors. Thus, State-to-State dispute settlement provisions may be ubiquitous in all IIAs, even though their actual significance may vary between agreements.

Note

[1] For a discussion see ICSID, 1999.

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