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Working Group on the Relationship between Trade and Investment

CONSULTATION AND THE SETTLEMENT OF DISPUTES BETWEEN MEMBERS

Note by the Secretariat

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EXECUTIVE SUMMARY

"Consultation and settlement of disputes between Members" is one of the seven topics listed in Paragraph 22 of the Doha Ministerial Declaration that is to be clarified by the Working Group on the Relationship between Trade and Investment.

The WTO's Understanding on Rules and Procedures for the Settlement of Disputes (DSU) establishes an integrated dispute settlement system for all matters arising from the interpretation or application of the Marrakesh Agreement Establishing the WTO and its Annexes 1 and 2. It emphasizes the importance of consultations in securing dispute resolution and, when a dispute cannot be resolved through consultations, it provides Members with the right to the establishment of a panel; it also sets out detailed procedures and deadlines for the different stages of the panel process. Where a measure is found to be inconsistent with a WTO Agreement, a panel shall recommend that the Member concerned bring the measure into conformity with WTO rules. A key feature of the DSU is the provision for an appellate review, whereby the standing Appellate Body can uphold, modify or reverse a panel's finding. The DSU establishes further provisions for multilateral surveillance of implementation of the Dispute Settlement Body's (DSB) recommendations, as well as the possibility of compensation and suspension of concessions and obligations in the event of non-implementation. Prior authorization from the DSB is required before suspension of concessions and obligations is applied against a non-complying Member, as unilateral measures are not permitted under the DSU.

International investment agreements (IIAs)[1] – bilateral, regional and multilateral- normally contain two types of dispute settlement mechanisms: (i) State-to-State, which is available only among the State parties to an agreement, and (ii) investor-State, whereby an investor can submit a claim against a host State to international arbitration. Although the Doha Declaration refers only to consultation and dispute settlement *between Members*, given that most IIAs provide for investor-State arbitration, in order to be comprehensive this Note will address both types of dispute resolution provisions. Under both mechanisms, the disputing parties are required to attempt to settle their dispute amicably (through consultations or negotiations in the case of State-to-State disputes), before instituting formal proceedings.

[1] This Note focuses on "modern" investment agreements such as bilateral investment treaties and those bilateral or regional economic integration or free trade agreements containing an investment chapter. It does not address older Friendship, Commerce and Navigation (FCN) treaties that generally provide for dispute settlement through recourse to the International Court of Justice.

Provisions relating to disputes between States normally call for settlement through *ad hoc* arbitration. Some bilateral and regional treaties provide for institutional arrangements of their own. In practice, however, these provisions are relatively standard. There is little variation in the way IIAs approach the issue of the constitution of arbitral tribunals. As regards procedural rules, aside from stipulating that decisions are to be taken by majority vote and that they shall be final and binding, most IIAs leave it up to the tribunals to determine their own procedures. There is less uniformity with respect to the applicable substantive law. While many IIAs are silent on this issue, some of them include a clause stipulating the law to be applied to the dispute. In such cases, reference is generally made to the provisions of the IIA, supplemented by other rules of international law and sometimes by other agreements concluded between the Parties. Normally, IIAs provide that arbitral awards are final and binding, but they are often silent on the issue of compliance. In addition, IIAs frequently include provisions governing the apportionment of the arbitration costs between the Parties.

While earlier bilateral investment treaties (BITs) only provided for *ad hoc* arbitration of State-to-State disputes, today virtually all IIAs contain provisions for investor-State arbitration, either through institutional or other pre-existing arbitral regimes. The vast majority of IIAs refer such disputes to arbitration under the 1966 Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) or its Additional Facility. However, a considerable number of IIAs refer to arbitration under the UNCITRAL Rules, the International Chamber of Commerce (ICC) or other private arbitration institutions. In fact, the recent trend is for IIAs to provide for a choice between different arbitral regimes. Under certain IIAs, resort to investor-State arbitration is subject to the exhaustion of local remedies, although most modern IIAs do not contain such requirement. Where recourse to local remedies is envisaged, it is normally not mandatory but is only one of several options available to the disputing parties. The choice as to whether to resort to local remedies or to international arbitration is normally final. Similarly, resort to investor-State arbitration may, under some IIAs, preclude recourse to State-to-State dispute settlement for the same dispute.

An important feature of investor-State arbitration is that it provides for the award of monetary damages. Arbitral tribunals, however, are not empowered to order a host State to revoke or modify an inconsistent measure. Arbitral awards are normally final and binding, but their validity may be challenged on several grounds before local courts, except in the case of ICSID awards which are not subject to appeal or any other remedy except those provided for under the Convention. In order to ensure enforcement by local courts of arbitral awards, many IIAs refer to certain international conventions that provide for the mandatory enforcement of foreign arbitral awards, such as the 1958 New York Convention and the ICSID Convention itself. In case of non-compliance of an award, some IIAs allow the investor's home State to bring a claim under the inter-State dispute resolution mechanism of the treaty. Under the ICSID Convention, non-compliance reactivates the right of the home State to extend diplomatic protection or to bring an international claim against the host State. Failure to abide by an arbitral award may lead to the international responsibility of the defaulting State, in which case the home State may resort to the remedies available under international law for breach of a treaty obligation.

There are a number of fundamental differences between dispute resolution under IIAs and under the WTO's DSU. With respect to State-to-State dispute resolution, one important difference relates to the applicable law: whereas the WTO dispute settlement system is limited to disputes concerning rights and obligations under the covered agreements, the scope of State-to-State dispute resolution under IIAs seems to be much broader. This is because, in addition to the provisions of the treaty, IIAs often refer to other rules of international law (both in their specific dispute settlement provisions and in their "treatment" articles) as well as to other agreements entered into by the Parties and sometimes to commitments made with respect to specific investments. Another important difference concerns the issue of compliance of dispute settlement awards, with most IIAs being silent on the issue, while the DSU establishes its own system of surveillance of compliance and remedies.

As regards investor-State arbitration, the main differences with the DSU are the following. Under IIAs the investor has direct access to an international tribunal to pursue a claim against a host State, while in the WTO access to dispute settlement is reserved to Member States. Arbitral tribunals may order the award of monetary damages, but not the revocation of an inconsistent measure, whereas WTO panels and the Appellate Body must recommend that a measure be brought into conformity with WTO rules, but it is generally understood that they may not award damages. In the event of non-compliance of an arbitral award by a host State, the investor's home State can resort to the remedies available under international law. By contrast, in case of non-implementation of a panel and/or Appellate Body decision, the prevailing WTO Member may, subject to prior authorization, avail itself of the temporary remedy of suspension of concessions or obligations as provided for under the DSU.

In discussions in the Working Group concerning the type of dispute settlement provisions that might apply to a multilateral framework on investment, the following key questions have been raised:

- Whether the WTO dispute settlement system should apply to disputes arising in the context of a multilateral framework on investment.
- If so, whether the DSU should apply as it currently stands or whether some changes would be needed for its application in this context.
- How the dispute settlement provisions of a WTO framework on investment would relate to the dispute resolution procedures contained in IIAs, including with respect to investor-State dispute settlement.

I. INTRODUCTION

1. Paragraph 22 of the Doha Declaration mandates the Working Group to clarify "consultation and the settlement of disputes between Members". This Note briefly summarises the discussions in the Working Group, describes some of the main features of the WTO dispute settlement system and the State-to-State and investor-State dispute resolution provisions contained in IIAs, and highlights some of the differences between dispute settlement in IIAs and in the WTO.

II. DISCUSSIONS IN THE WORKING GROUP [2]

2. The existence of dispute settlement provisions, including for the resolution of investor-State disputes, has been identified by Members of the Working Group as a common feature in many IIAs, notwithstanding the fact that the manner in which they are crafted is not uniform.

3. In considering what type of dispute settlement mechanism might be included in a possible WTO framework on investment, a number of questions have been raised in discussions in the Working Group. One is whether the existing WTO dispute settlement mechanism should apply to investment disputes among parties to a multilateral framework, or whether some changes would be needed for its application in this context. A further question raised by some is what standing, if any, investors should have in dispute settlement procedures.

4. One view is that, since the essential function of dispute settlement is to eliminate or modify measures found to be inconsistent with agreed rules, the WTO dispute settlement system could be

[2] References to this topic in reports of the Working Group can be found in WT/WGTI/M/4, paras. 46 and 48; M/5, paras. 28, 29, 64 and 65; M/8, paras. 83, 84, 86 and 88; M/9, paras. 42 and 44; M/11, paras. 41, 47 and 49; M/12, para. 68; M/15, paras. 57 and 61; M/17, paras. 50, 89 and 140. Reference to this topic in Members' written submissions can be found in WT/WGTI/W/67 and W/68.

applied to investment disputes without the need to make major adjustments. However, if the WTO dispute settlement mechanism were to apply to a prospective framework on investment, an important question was whether its provisions on compensation and suspension of concessions (Article 22 of the DSU) should apply to investment disputes. In this regard, it has been noted that account should be taken of the fact that these provisions are already applicable to investment-related disputes under the GATS and the TRIMs Agreement.

5. It has also been suggested that attention should be given to the relationship between the application of WTO dispute settlement procedures in the context of a multilateral investment framework, on the one hand, and the application of dispute settlement provisions contained in the numerous existing bilateral and regional investment agreements, on the other hand. Some Members have pointed out that the use of WTO procedures should not preclude recourse to provisions of bilateral or regional investment agreements if the parties to a dispute so decided. In this respect, it has been suggested that there might be a need to design specific rules to avoid inefficiency and duplication.

6. The possibility to rely on the existing WTO dispute settlement mechanism has been identified by some as one of the important advantages of adopting a multilateral approach to investment rules. According to one view, as compared to bilateral treaties where the dispute settlement process may be easily influenced by the nature of the dispute or the relationship between the two countries, supervision through a multilateral system would ensure the fairness and transparency of a dispute settlement process. A different view is that one of the costs of adopting multilateral rules in this area would be the possibility of unduly favouring multinational enterprises *vis-à-vis* host countries, especially through the dispute settlement system. More generally, the point has been made that dispute settlement under WTO investment rules would benefit only home countries.

7. Regarding investor-State dispute resolution provisions, a number of delegations have indicated that possible WTO rules on investment should not provide for a right of individual investors to have recourse to international dispute settlement procedures. It was also pointed out that, given the intergovernmental nature of the WTO, the issue of investor-State dispute settlement in the WTO required careful examination. However, it was suggested that there could be rules requiring domestic judicial review.

8. In describing their individual experiences with IIAs, some Members have pointed to the existence of investor-State disputes settlement provisions in such agreements. In this context, certain limitations to the scope of the investor-State dispute mechanism have been mentioned, for example, its non-applicability to disputes involving "potential" investors.

9. The issue of dispute settlement has also been raised in connection with other elements of a possible WTO agreement on investment. For example, as regards the definition of investment, support has been expressed for a definition that is clear with respect to any prospective dispute settlement facilities. The point has also been made that the dispute settlement mechanism would have a fundamental impact on the question of coverage. In relation to transparency, it has been suggested that any WTO rules on transparency in the area of investment should be binding and subject to dispute settlement. Another view is that it is not clear how WTO dispute settlement procedures would operate in relation to transparency obligations regarding investment measures.

III. THE WTO DISPUTE SETTLEMENT SYSTEM

A. SCOPE OF APPLICATION

10. The dispute settlement system of the WTO is based on Articles XXII and XXIII of the GATT 1994, Articles XXII and XXIII of the GATS and on the Understanding on Rules and Procedures Governing the Settlement of Disputes, as set out in Annex 2 of the Marrakesh Agreement Establishing

the WTO.[3] The DSU establishes an integrated dispute settlement system applicable to the "covered agreements" defined to include the Agreement Establishing the WTO and the multilateral and plurilateral trade agreements set out in Appendix 1 of the DSU, although under some agreements special rules and procedures are applicable (Appendix 2). The DSU also covers disputes concerning rights and obligations under the DSU itself. The Dispute Settlement Body, composed of representatives of all WTO Members, is responsible for the administration of the DSU. All decisions of the DSB can only be taken by consensus.

B. CONSULTATIONS

11. The DSU emphasizes the importance of consultations in securing dispute resolution, by requiring a Member to enter into negotiations within 30 days of a request for consultations by another Member (Article 4). If consultations fail to settle a dispute within 60 days, the complaining Member may request the establishment of a panel. The DSU provides for alternative means of dispute settlement to which the parties may voluntarily agree such as good offices, conciliation and mediation (Article 5).

C. ESTABLISHMENT AND COMPOSITION OF PANELS

12. Where a dispute cannot be settled through consultations, upon request by the complaining Member a panel shall be established, at the latest, at the meeting of the DSB following that at which the request is made, unless the DSB decides by consensus not to establish the panel (Article 6). The DSU sets forth specific rules and deadlines concerning the terms of reference (Article 7) and the composition of panels (Article 8). Standard terms of reference will apply[4], unless the parties agree to special terms within 20 days of the panel's establishment. Panels normally consist of three persons proposed by the Secretariat from a roster of qualified experts and agreed upon by the parties. In the event the parties do not agree to the composition of the panel within the same 20-day period, any party may request the Director-General to appoint the panelists. The DSU sets forth detailed rules and deadlines for the different stages of the panel procedures (Article 12 and Appendix 3).

D. PANEL REPORTS

13. A panel shall submit its findings and recommendations in the form of a written report to the DSB. If a panel finds a complaint is justified, its report will normally recommend that the offending Member brings the measure into conformity with WTO rules. It may also suggest ways in which the recommendations can be implemented. Panel reports should normally be issued within six months, or in cases of urgency or for disputes involving allegations of export subsidy, within three months of the establishment of the panel. A panel report shall generally be adopted within 60 days of its issuance, unless the DSB decides by consensus not to adopt it or one of the parties notifies the DSB of its intention to appeal.

E. APPELLATE REVIEW

14. An important feature of the DSU is its provision for the appeal of panel decisions (Article 17). A standing Appellate Body composed of seven members (three of whom will serve on any one case) will hear the appeals. The appellate review is limited to issues of law covered in the panel report and legal interpretations developed by the panel. Appellate proceedings are to be completed within 60

[3] The text of the DSU is reproduced in The Results of the Uruguay Round of Multilateral Trade Negotiations. The Legal Texts, GATT, Geneva (1994).

[4] Article 7.1 of the DSU establishes the following standard terms of reference (absent agreement to the contrary): "To examine, in light of the relevant provisions in (name of the covered agreement(s) cited by the parties to the dispute), the matter referred to the DSB by (name of party) in document … and to make such findings as will assist the DSB in making recommendations or in giving the rulings provided for in that/those agreement(s)."

days and in any event they shall not exceed 90 days. The ensuing Appellate Body report, together with the related panel report as upheld, amended or reversed, is adopted by the DSB within 30 days of its circulation to Members, unless there is consensus to the contrary, and shall be unconditionally accepted by the parties.

F. IMPLEMENTATION OF ADOPTED RECOMMENDATIONS

15. After a panel report or an Appellate Body report is adopted, the respondent Member is required to notify the DSB on how it intends to implement the adopted recommendations. If immediate implementation is not practicable, the Member concerned shall be given a reasonable period of time to comply. This period may be set by agreement of the disputing parties or, in the absence of agreement, by arbitration, and it should normally not exceed 15 months (Article 21.3).

16. At the expiry of the reasonable period of time, in the event of a disagreement between the parties as to whether the measure taken by the concerned Member to implement the DSB recommendations is compatible with the WTO, the matter must be taken back to the WTO dispute settlement mechanism (Article 21.5) pursuant to an accelerated procedure before the original panel. This multilateral surveillance is such as to prohibit Members from relying on any form of unilateral determinations of WTO compliance (Articles 21, 22 and 23).

G. COMPENSATION AND SUSPENSION OF CONCESSIONS

17. In the event of non-implementation, the prevailing Member may seek compensation or the authorization to suspend concessions and obligations (Article 22), pending for the full implementation of the DSB recommendations. First, the contending parties can enter into negotiations to agree on mutually acceptable compensation. Compensation is voluntary and it will normally take the form of other trade concessions. If within the specified time-period for implementation no agreement is reached on compensation, the prevailing Member may request authorization from the DSB to suspend concessions or other obligations with respect to the non-compliant party. Such authorization will be granted within 30 days after it is requested, provided that the prior DSU requirements have been respected. Disagreements over the proposed level of suspension may be referred to arbitration. The general principle is that concessions should be suspended in the same sector as that at issue in the panel case. If this is not practical or effective, the concessions may be suspended in other sectors of the same agreement. Lastly, if this is not practical or effective, or if the circumstances are serious enough, the suspension can be made under another covered agreement. Compensation and suspension of concessions and obligations are considered as "temporary measures" and they are not to be preferred to full implementation of recommendations. During the arbitration process resort to countermeasures is strictly prohibited. Indeed, a key provision requires Members not to make determinations of violations or suspend concessions unilaterally, but to resort to the rules and procedures of the DSU (Article 23).

H. DEVELOPING COUNTRIES

18. The DSU includes a number of provisions on special and differential treatment for developing and least-developed countries. Generally speaking, these provisions call for attention to be paid to the specific interests of developing-country Members in various stages of the dispute settlement process (i.e., consultation, implementation of recommendations), to the impact of the measures complained of on their economies, and to the need to provide extended time-frames and technical assistance to developing countries involved in a dispute. In addition, particular consideration is to be given to the special situation of least-developed country Members.

I. OTHER PROVISIONS

19. The DSU contains special rules for the settlement of disputes which do not involve a violation of the covered agreements but where a Member believes, nevertheless, that benefits are being nullified or impaired (Article 26). It also provides for arbitration as an alternative means of dispute settlement, subject to the mutual agreement of the disputing parties, which shall also agree to abide by the arbitration award (Article 25).

20. In accordance with the Doha Ministerial Declaration (WT/MIN(01)/DEC/W/1), negotiations are currently taking place on improvements and clarifications on a number of provisions of the DSU. The negotiations are expected to conclude by May 2003 with the view to giving effect to the results as soon as possible (Doha Declaration, para. 30).

21. Two other features of the DSU are worth mentioning here because they are relevant to the comparison between dispute settlement in the WTO and in IIAs. One is that under the DSU there is no requirement to exhaust local remedies before instituting dispute settlement proceedings. The other is that resort to the WTO dispute settlement process is free of charge, albeit each party must cover its own representation costs.

IV. CONSULTATION AND DISPUTE SETTLEMENT PROVISIONS IN INTERNATIONAL INVESTMENT AGREEMENTS[5]

22. Virtually all IIAs – bilateral, regional or multilateral – contain provisions for the settlement of disputes. The basic purpose of these provisions is to ensure that the IIA's substantive obligations are effectively implemented and enforced, thus contributing to secure and stable international investment relations. There are two main types of dispute settlement provisions in IIAs: those regulating disputes between the State contracting parties (State-to-State dispute resolution), and those governing disputes between a State party and an investor of another State party (investor-State dispute settlement).[6] Most modern IIAs incorporate both types of provisions, albeit in separate articles, as they have different purposes and functions. It should be noted that, in the context of bilateral/regional free trade or economic integration agreements containing an investment chapter, disputes between States over investment matters are normally covered under the general inter-State dispute settlement provisions of such agreements, while disputes between private investors and host States are dealt with under the provisions for investor-State arbitration usually set out in the investment chapter.

A. STATE-TO-STATE DISPUTE RESOLUTION

23. Most IIAs, in particular almost all BITs, provide for the settlement of inter-State disputes through *ad hoc* arbitration (i.e. non-institutional arbitration) under a set of rules specially designed for that purpose and set forth in the agreement. These provisions are relatively standard in treaty practice. In the case of investment chapters included in bilateral or regional economic integration agreements, the common practice is to provide for institutional arrangements for the settlement of inter-State disputes.

1. Scope of application

24. State-to-State dispute settlement provisions in IIAs typically contain a clause stipulating that they apply to disputes between the contracting parties over the interpretation or application of the

[5] This section draws partly on UNCTAD, Bilateral Investment Treaties in the Mid-1990s, United Nations, New York and Geneva (1998), and on R. Dolzer and M. Stevens, Bilateral Investment Treaties, The Hague, Boston, London, Martinus Nijhoff Publishers, (1995).

[6] Investment disputes may also arise between private investors. These disputes are usually settled through the local courts of the State that has jurisdiction in accordance with private international law rules or through international commercial arbitration (this type of disputes will not be discussed in this note).

IIA.[7] Inter-State disputes may also develop from concrete situations involving investments or investors covered under an IIA that have been affected by a measure taken by the host country. To the extent that such measure is inconsistent with the provisions of an IIA, it can give rise to a State-to-State dispute, where provisions for the settlement of investor-State disputes are not available.

25. It should be noted that in some IIAs, the submission of a dispute under the Investor-State dispute settlement mechanism precludes its submission to the State-to-State dispute resolution provision, subject to certain exceptions. One such exception is where the arbitral tribunal determines that it has no jurisdiction over the dispute; another is where the host State refuses to comply with the award.

26. It should also be pointed out that State-to-State dispute settlement clauses in IIAs generally do not explicitly require exhaustion of local remedies as a condition of resort to arbitration.[8]

2. Consultations and negotiations

27. As a first step in State-to-State dispute resolution, most IIAs require that the parties seek to resolve the matter amicably through consultations, negotiations or other diplomatic channels. The intention is to provide the disputing parties with an opportunity to reach agreement before instituting arbitral proceedings. Relevant clauses may stipulate that a certain time-period must elapse between the date on which a dispute arises and the date on which it may be submitted to arbitration. Usually, the prescribed period is six months[9], but it can be as short as three months or as long as one year. In some instances, IIAs do not specify the length of the time-period but merely stipulate that diplomatic negotiations should take place within a "reasonable lapse of time".[10] Other IIAs omit any reference to a time-period, although they do encourage negotiations between the disputing parties as a first step.[11] Where negotiations fail, most IIAs allow for the submission of the dispute to third-party arbitration, at the request of either contracting party.

3. Arbitration

(a) Composition of tribunals

28. As noted, State-to-State disputes are normally submitted to arbitration by *ad hoc* tribunals, that is, tribunals specifically constituted to hear the dispute in question. Most IIAs provide for a standard procedure for the constitution of arbitral tribunals: each party selects one arbitrator and a third, presiding arbitrator is appointed by agreement of the parties or by the two-appointed arbitrators. In the absence of agreement, the responsibility for appointing the presiding arbitrator is often

[7] This is the case, for example, of the Model investment agreements of Chile, China, France, Germany, Mauritius, Peru, South Africa, Switzerland, the United Kingdom and the United States (as revised in 1998). These agreements are reproduced in UNCTAD, International Investment Instruments: A Compendium, (1996-2002), Vol. III, pp. 143-206, Vol. VI, pp. 493-511, Vol. VIII, pp. 273-280, and Vol. IX, pp. 295-302.

[8] A leading interpretation of the International Court of Justice concerning the exhaustion of local remedies is found in the 1989 *Elettronica Sicula S.p.A*. (*ELSI*) case between the United States and Italy. The question was whether local remedies had to be exhausted in the context of a bilateral treaty that provided for State-to-State arbitration but made no mention to the need to exhaust local remedies. The Court held that the exhaustion of remedies was such an important principle of international law that it would apply even where a treaty did not expressly refer to it. *ELSI* (Elettronica Sicula S.p.A.) Case (US v. Italy), ICJ Rep. 1989, 15.

[9] See, for example, the Model investment agreements of Chile, China, France, Mauritius, Peru, South Africa, Switzerland and Turkey, *Ibid*., Vol. III, pp. 148, 154, 163, 181; Vol. VI, p. 498; Vol. VIII, pp. 277 and 284; and Vol. IX, p. 300.

[10] This is the formulation used in the Model investment agreement of the Netherlands (as revised in 1997), *Ibid.*, Vol. V, pp. 333-338 (337).

[11] See the Model investment agreements of the United Kingdom and the United States, *Ibid.*, Vol. III, p. 191 and Vol. VI, p. 508.

conferred to a designated appointing authority, such as the President of the International Court of Justice, the Secretary-General of the United Nations or the Secretary-General of the International Centre for Settlement of Investment Disputes (ICSID). It is usually required that the presiding arbitrator not be a national of either of the two disputing parties. Most IIAs establish deadlines for the constitution of arbitral tribunals. Two months generally are allowed for the selection of the party-appointed arbitrators and an additional two months for the selection of the president of the tribunal.[12] However, some IIAs provide for longer time-limits for one or both of these periods, which may range from three to six months.

(b) The tribunal procedure

29. The majority of IIAs do not establish detailed procedural rules for the conduct of proceedings in State-to-State arbitration. Thus, aside from setting forth the fundamental rules that decisions are to be taken by majority vote and that they shall be binding, most IIAs provide for the tribunal to determine its own procedure.[13] Some IIAs, however, stipulate that a specific set of rules be adopted. For example, the 1994 U.S. Model BIT (as revised in 1998) requires that in the absence of an agreement by the disputing parties to the contrary, the arbitration rules of the United Nations Commission on International Trade Law (UNCITRAL) shall apply, except to the extent these rules are modified by the Parties or the arbitrators and neither Party objects to the modification.[14] In certain IIAs, the tribunal's ability to determine its own procedure is conditioned upon the agreement of the disputing parties.[15] In a few instances, IIAs stipulate a time-period for the completion of the arbitral proceedings.[16]

(c) The applicable substantive law

30. Many IIAs do not stipulate the law to be applied by the arbitral tribunal to the merits of inter-State disputes, i.e., the applicable substantive law. However, some IIAs do contain a clause establishing that the tribunal shall apply the provisions of the agreement and the rules and/or principles of international law.[17] In certain cases, reference to other agreements concluded between the contracting parties is also made.[18] In U.S. treaty practice, State-to-State investment disputes submitted to arbitration are to be decided "in accordance with applicable rules of international law".[19] A few IIAs take a different approach as regards the applicable law. For example, it may be provided that the law of the host country be taken into account, or even that the dispute be decided ex aequo et bono (i.e., according to extra-legal principles of justice and fairness), if the parties so agree.[20] The fact that many IIAs do not contain a provision on the applicable law for the arbitration of State-to-

[12] See, for example, the Model investment agreements of Mauritius, South Africa, Switzerland, Turkey and the U.K., *Ibid*., Vol. III, pp. 181-182 and 191; Vol. VIII, pp. 277 and 285; and Vol. IX, p. 300.

[13] This approach is followed in the Model BITs of Chile, China, France, Germany, Mauritius, Switzerland, the U.K and South Africa, see *Ibid*., Vol. III, pp. 148, 154, 164, 172, 182 and 191; Vol. VIII, p. 277; and Vol. IX, p. 300.

[14] See U.S. Model investment agreement, *Ibid*., Vol. VI, p. 508.

[15] Such is the case in the BITs between Chile and Denmark and between Ghana and Switzerland, cited in UNCTAD, Bilateral Investment Treaties in the Mid-1990s, (1998), p. 101.

[16] For example, the U.S. Model BIT requires that all submissions be made and hearing completed within six months of the date of the selection of the third arbitrator and that the arbitral decision be rendered within two months of the date of the final submission or the date of the closing of hearings, whichever is later. UNCTAD, International Investment Instruments: A Compendium, (1996-2002), Vol. VI, p. 508.

[17] See, for example, the South African Model BIT, *Ibid.*, Vol. VIII, p. 277. The Chinese Model BIT requires that the principles of international law be recognized by both Contracting Parties, *Ibid*., Vol. III, p. 155.

[18] This is the case in the 1992 Norway-Lithuania BIT, cited in Dolzer and Stevens (1995), p. 128.

[19] An example is provided by Art. VIII (1) of the U.S.-Argentina BIT, cited in *Ibid.*, p. 129.

[20] For example, Article 12.5 of the Model investment agreement of the Netherlands allows for the settlement of the dispute *ex aequo et bono* if the Parties so agree. UNCTAD, International Investment Instruments: A Compendium, (1996-2002), Vol. V, p. 337.

State disputes may be partly explained by the generally recognized assumption that international agreements are governed by international law. In any event, since most IIAs require that investments be accorded treatment consistent with that accorded under international law, they implicitly require tribunals to apply international law to State-to-State disputes concerning the treatment of investments.[21] Thus, the scope of State-to-State arbitration under IIAs seems to be considerably broadened, as a result not only of references to rules of international law in the specific dispute settlement provisions but also of references to international law rules in the "treatment" clauses.

(d) Nature and effect of the arbitral decision

31. The majority of IIAs provide that the decisions of ad hoc arbitral tribunals shall be taken by majority vote and that they shall be final and binding upon the parties to the dispute.[22] Nevertheless, it should be noted that most IIAs are silent with respect to the nature of the steps to be taken by the defaulting State to conform with an arbitral award. Similarly, they often omit reference to the possibility of the prevailing State of applying countermeasures in the event on non-compliance. Some IIAs do, however, address this issue. For example, Chapter 20 of the NAFTA provides for compensation or suspension of equivalent benefits in case of non-implementation of a panel report.[23]

(e) The costs of arbitration

32. IIAs frequently include provisions concerning the apportionment of the arbitration costs between the disputing State parties. The standard approach is to establish that each contracting party shall bear the costs of the arbitrator it appoints and of its representation in the arbitral proceedings. The costs of the presiding arbitrator and the remaining expenses of the tribunal are to be divided in equal parts between the contracting parties.[24] Another approach is to provide that each contracting party bear the cost of its own representation and that all the tribunal's costs, including those of the arbitrators, be paid for equally by the contracting parties.[25] Presumably, the latter formula would best ensure the neutrality of the proceedings, since there would be no direct financial connection between a contracting party and the arbitrator whom it appoints. Notwithstanding the arrangements mentioned above, most IIAs allow the tribunal discretion to determine the apportionment of costs between the disputing parties according to any other formula or to decide that a higher proportion of the costs be paid by one of the parties.[26]

B. INVESTOR-STATE DISPUTE SETTLEMENT

33. Before the inclusion of investor-State dispute settlement provisions in IIAs became a widely accepted practice, a foreign investor who felt that his legal rights under an investment agreement had been infringed had two remedies available: (i) to submit a claim before the local courts of the host State, or (ii) to request the diplomatic protection of his home State. However, under customary international law a home country generally may not exercise diplomatic protection unless the investor

[21] UNCTAD, Bilateral Investment Treaties in the Mid-1990s, (1998), p. 102.

[22] See the Revised Draft of Model Agreements for the Promotion and Protection of Investments of the Asian-African Legal Consultative Committee, and the Model investment agreements of Chile, China, France, Germany, Mauritius, Switzerland, the U.K. and the U.S. UNCTAD, International Investment Instruments: A Compendium, (1996-2002), Vol. III, pp. 122, 148, 155, 164, 172, 182, 191; Vol. VI, p. 508; and Vol. IX, p. 300.

[23] See Articles 2018 and 2019 of the North American Free Trade Agreement (NAFTA). The full text of the agreement is reproduced in 32 *ILM* 605 (1993).

[24] See, for example, the Model investment agreements of Chile, China and Mauritius, UNCTAD, International Investment Instruments: A Compendium, (1996-2002), Vol. III, pp. 148 and 155; Vol. IX, p. 301.

[25] An example of this approach is found in the Model investment agreements of Peru and the United States, *Ibid*., Vol. VI, pp. 498 and 508.

[26] See the Model investment agreements of France, Germany, the U.K. and the United States, *Ibid*., Vol. III, pp. 164, 172 and 191, and Vol. VI, p. 508.

has first exhausted the local remedies available in the host State.[27] Therefore, at least in a first stage, domestic courts were the only forum at which an investor could seek redress.

34. Foreign investors, however, might not fully trust the impartiality of the host State's courts or the diligence with which they proceed. Moreover, local courts may deny jurisdiction over the dispute on the grounds of sovereign immunity.[28] In such cases, or where the investor received no adequate remedy from local courts, he could invoke the diplomatic protection of his own State, that is, he could request his home country to espouse his claim against the host State.[29] This avenue, however, also presented certain deficiencies from the point of view of the investor. First, no home State is under the obligation to espouse a claim from an aggrieved national. It may choose not to do so if, for example, espousing the claim could undermine its international relations with the host State. Second, if it decides to espouse the claim, the home State may settle it at less than its true value, or it may simply choose not to return any compensation paid to its national.

35. To address these problems, today virtually all modern IIAs contain provisions allowing foreign investors direct access to international tribunals to settle their disputes with host States, either by reference to institutional arbitration or to other pre-existing arbitration rules. The vast majority of IIAs call for the submission of disputes to the International Centre for Settlement of Investment Disputes, but a considerable number refers to arbitration under the UNCITRAL Rules, the International Chamber of Commerce or other private arbitration institutions. Furthermore, many recent IIAs give investors the freedom to choose between different arbitral regimes.

1. Scope of application

36. In the majority of IIAs, the scope of application of the investor-State dispute settlement provision is defined in quite broad terms, requiring only that the dispute be related to an investment, regardless of whether there is an alleged breach of a specific provision of the IIA. Formulations commonly used stipulate that such provision applies to disputes "in connection with", "concerning" or "relating to" an investment. This approach has been followed in several European bilateral investment treaties.[30]

37. Some IIAs define the scope of application of the investor-State dispute mechanism in narrower terms, stipulating that the dispute involve a provision of the agreement. For example, an IIA may provide that the investor-State dispute mechanism applies to disputes relating to the provisions of the agreement (e.g., the MERCOSUR Colonia Protocol)[31], or concerning an obligation of the host State under the agreement (UK Model BIT).[32] In a few instances, the scope of application is limited to disputes relating only to certain provisions of the IIA. For example, the Chinese Model BIT limits resort to investor-State arbitration to disputes involving the amount of compensation to be paid for expropriation.[33]

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[27] Peter Malanczuk, Akehurst's Modern Introduction to International Law, (seventh edition), Routledge, London and New York, (1997), pp. xxii-449 (267-268).

[28] According to the international law doctrine of sovereign immunity, the courts of one State, as a principle, may not assume jurisdiction over the acts of another State. Malanczuk (1997), pp. 118-121.

[29] Under customary international law, a State may exercise its right of "diplomatic protection" to assert a claim against another State which has caused injury to one of its nationals in order to obtain compensation or some other form of redress. Malanczuk (1997), pp. 256-257.

[30] See, for example, the Model investment agreements of France, Germany, Switzerland and the Netherlands. UNCTAD, International Investment Instruments: A Compendium, (1996-2002), Vol. III, pp. 163, 172 and 181, and Vol. V, p. 336.

[31] The 1994 Colonia Protocol on Reciprocal Promotion and Protection of Investments within MERCOSUR was concluded by Argentina, Brazil, Uruguay and Paraguay, *Ibid.*, Vol. II, pp. 513-521 (518).

[32] *Ibid.*, Vol. III, p. 190.

[33] *Ibid*., Vol. III, p. 155.

38. A third, alternative formulation is found in US BITs. In these treaties, the investor-State dispute settlement mechanism applies to disputes relating to an investment authorization or agreement, or an alleged breach of a treaty obligation.[34] While this formulation requires that the dispute should involve some kind of legal obligation, it does not only refer to obligations under the BIT but also to those under any investment agreement concluded between the investor and the host State. A further formulation requires that the investor or his investment must have incurred loss or damage by reason of the alleged breach in order to be able to submit a claim to arbitration. Examples of this approach are found in the investment chapters of several regional/bilateral free trade agreements.[35]

39. It should be noted that the scope of the investor-State dispute resolution mechanism in an IIA is largely determined by the definitions of key concepts in the agreement such as "investment" and "investor". The definition of "investment" will necessarily circumscribe the subject matters that may be submitted to arbitration under such mechanism. Equally important are the provisions defining who may be considered as an "investor" and thus as a potential claimant.[36] Clearly, the investments and investors not included in those definitions will fall outside the scope of the respective investor-State dispute resolution mechanism.

40. Some IIAs set forth exclusions or exceptions from the application of the investor-State dispute settlement provisions. Aside from the usual exceptions on national security grounds, specific exclusions from dispute settlement for reserved sectors or measures may be established in the text of the agreement or in its annexes. In some instances, the decisions by the competent authorities of the host State whether or not to permit the acquisition of certain investments subject to review procedures are also excluded from dispute settlement.[37] In other cases, the dispute resolution provisions are not applicable to potential investors or investments, i.e., they only apply to actual investments.[38]

2. Consultations/Negotiations

41. As with State-to-State disputes, virtually all IIAs require the investor and the host State to seek to settle the dispute amicably through consultations or negotiations before resorting to international arbitration or any other means of dispute resolution envisaged in the agreement. In order to provide an opportunity for negotiations to take place, a substantial number of IIAs establish that a dispute may only be submitted to arbitration after a certain period of time has elapsed since the

[34] The relevant provision of the U.S. Model investment treaty reads as follows: "For purposes of this Treaty, an investment dispute is a dispute between a Party and a national or company of the other Party arising out of or relating to an investment authorization, an investment agreement or an alleged breach of any right conferred, created or recognized by this Treaty with respect to a covered investment." *Ibid*., Vol. VI, p. 506.

[35] Some examples include the investment chapters of the NAFTA, the Free Trade Agreement between Mexico and Costa Rica, The Treaty on Free Trade between Colombia, Venezuela and Mexico (the "G-3 Treaty") and the Canada-Chile Free Trade Agreement. NAFTA's Chapter 11 is reproduced in UNCTAD, International Investment Instruments: A Compendium, (1996-2002), Vol. III, pp. 73-99. The relevant excerpts of the other agreements can be found in *Ibid*., Vol. V, pp. 43-105.

[36] Many IIAs contain a provision dealing with the status of enterprises that are owned or controlled by investors of one Party but which are incorporated under the laws of the host State, in order to ensure that such enterprises have standing under the investor-State arbitration mechanism. See also *infra*, para. 51.

[37] See, for example, NAFTA Article 1138 and Annex 1138.2, and Article G-39 and Annex G-39.2 of the Canada-Chile Free Trade Agreement.

[38] E.g., under the Revised Draft of Model Agreements for the Promotion and Protection of Investments of the Asian-African Legal Consultative Committee, investor-State arbitration is available only with respect to "investments made". Potential investors are also excluded from the investor-State dispute settlement procedure of the FTA between Mexico and Costa Rica (WT/WGTI/W/68).

dispute arose. In most cases the specified time-period is six months, but its length may vary. For example, the Energy Charter Treaty provides for a period of only three months.[39]

3. Exhaustion of local remedies

42. In certain cases, resort to investor-State arbitration may be subject to the exhaustion of local remedies. For example, a number of the earlier BITs only permitted recourse to arbitration after the investor had exhausted any remedies available before the courts or administrative tribunals of the host State. Some of these treaties prescribed that the investor should seek redress before domestic courts for a specified period of time, which could range from three to two years.[40] Should the result obtained through a court decision not be satisfactory to the investor or should the local proceedings not be concluded within the prescribed time-period, the investor would then be allowed to submit the claim to arbitration under the investor-State dispute settlement mechanism.

43. Today, many IIAs omit any reference to the exhaustion of local remedies, since this requirement is implicitly waived by virtue of the State Parties' advance consent to submit disputes with foreign investors to international arbitration.[41] Where IIAs envisage recourse to the competent courts of the host State, such recourse is usually not mandatory but is only one of several options of dispute resolution available to the investor.[42] In a few cases, resort to domestic tribunals is the only option available, except for disputes concerning the amount of compensation to be paid for expropriation which can be submitted to *ad hoc* international arbitration, provided that no recourse to local courts has been made.[43]

44. Normally, the investor's choice to use the local remedies or to submit to international arbitration is final, i.e. it precludes resort to the excluded option at a later stage. For example, under the Energy Charter Treaty and the Mercosur Colonia Protocol recourse to other remedies precludes the right to submit a claim to arbitration.[44] Under the ICSID Convention, consent to arbitration is deemed consent to the exclusion of any other remedy, unless otherwise stated.[45] Sometimes, the options available do not exclude each other entirely. For example, under Chapter 11 of the NAFTA, while resorting to arbitration requires the investor to waive the right to initiate or continue domestic legal proceedings, it does not prevent him from seeking injunctive declaratory or other relief not involving the payment of damages before a local administrative tribunal or court. Besides, prior recourse to local remedies does not exclude resort to NAFTA arbitration, provided that the investor surrenders the right to continue such proceedings.

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[39] Relevant excerpts of the Energy Charter Treaty are reproduced in UNCTAD, International Investment Instruments: A Compendium, (1996-2002), Vol. II, pp. 539-577 (568).

[40] For example, earlier BITs signed by Argentina with Germany and the U.K. provide for an eighteen-month period during which the investor must seek redress before the local courts. See Horacio A. Grigera Naón, The Settlement of Investment Disputes between States and Private Parties – An Overview from the Perspective of the ICC, 1 *The Journal of World Investment* 1, July 2000, pp. 59-103 (65).

[41] This approach is used in the modern prototype BITs of several developed countries, such as France, Germany, the Netherlands, Switzerland, Sweden and the U.K. It is also found in regional free trade agreements such as NAFTA, the G-3 Treaty, and the Agreement on Investment and Trade in Services among Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua, UNCTAD, International Investment Instruments: A Compendium, (1996-2002), Vol. III, pp. 163, 172, 181, 190; Vol. V. pp. 69, 336; and Vol. IX, pp. 46, 113.

[42] See, the Model investment agreements of Chile and Peru, *Ibid.*, Vol. III, p. 147 and Vol. VI, p. 497. See also the Mercosur Colonia Protocol and the Energy Charter Treaty, *Ibid.*, Vol. II, pp. 518 and 568-569.

[43] See Model investment agreements of China and Mauritius, *Ibid.* Vol. III, p. 155 and Vol. IX, p. 299.

[44] *Ibid*. Vol. II, pp. 518 and 568-569.

[45] Article 26 of the ICSID Convention, see *infra*, note 46.

4. ICSID arbitration clauses

45. The Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) came into force in 1966 under the aegis of the World Bank.[46] It provides facilities for the conciliation and arbitration of investment disputes between foreign investors and host States. In addition, the International Centre for the Settlement of Investment Disputes, established under the Convention, offers the disputing parties a range of administrative services for the conduct of the proceedings.

46. By providing an independent arbitration mechanism, whereby an investor could pursue a claim against a host State before an international tribunal without the intervention of his home State, the ICSID Convention set the basis for future IIAs to include a clause referring to ICSID arbitration.[47] Today, the overwhelming majority of IIAs contain such a clause, while many States have adhered to the ICSID Convention.[48]

47. ICSID's jurisdiction, as defined in Article 25(1) of the Convention, extends to legal disputes arising directly out of an investment between a Contracting State and a national of another Contracting State, where both the investor and the host country have consented to submit to ICSID's arbitration. The written consent of both disputing parties is a fundamental condition for ICSID's jurisdiction. It need not be expressed in a single instrument: the host State may include its advance consent in an IIA or in its national law, and the investor can give its consent by simply instituting the arbitral proceedings.

48. Many modern IIAs clearly set forth the advance consent of the State parties to submit to arbitration under the ICSID Convention (or under any other arbitral regime). An example of this approach is provided by the Model BIT of the Netherlands, which in the relevant provision reads as follows:

> *"Each Contracting party hereby consents to submit any legal dispute arising between that Contracting party and a national of the other Contracting Party concerning an investment of that national in the territory of the former Contracting Party to the International Centre for Settlement of Investment Disputes for settlement by conciliation or arbitration under the Convention on the Settlement of Investment Disputes between States and Nationals of other States, open for signature at Washington on 18 March 1965 [...]"* [49]

49. In some IIAs the consent of the host State is given in an implicit manner by leaving it up to the investor to submit a dispute to ICSID arbitration if no amicable solution can be reached within a specified period of time.[50] However, not every clause in an IIA referring to ICSID necessarily constitutes an advance consent of the State parties to submit to arbitration. For example, some IIAs provide that resort to arbitration be subject to the "agreement" of the disputing parties, which means that the host State may or may not give its consent. Other IIAs stipulate that the host State "shall

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[46] The text of the ICSID Convention and its rules and regulations are reproduced in *ICSID Basic Documents*, ICSID/15 (1985). For an in-depth analysis of the ICSID Convention see Aaron Broches, "The Convention on the Settlement of Investment Disputes between States and Nationals of Other States" in Aaron Broches, Selected Essays, World Bank, ICSID and other Subjects of Public and Private International Law, Martinus Nijhoff Publishers (1995), pp. 188-239. See also I.F.I. Shihata and A. Parra, "The Experience of the International Centre for the Settlement of Investment Disputes", 14 *ICSID Review* FILJ 299 (1999).

[47] The first bilateral investment treaty to incorporate an ICSID clause was the BIT signed between the Netherlands and Indonesia in 1968. Dolzer and Stevens (1995), p. 130.

[48] As of June 2002, 134 countries were Contracting States to the ICSID Convention.

[49] UNCTAD, International Investment Instruments: A Compendium, Vol. V, p. 336. See also the preferred alternative for the investor-State dispute provision of the U.K. Model BIT, *Ibid*., Vol. III, p. 189.

[50] See the Model investment agreements of Chile and Germany, *Ibid.*, Vol. III, pp. 147 and 172.

consent" to ICSID arbitration, or that it "shall assent" to any such demand by the investor, suggesting that the host State's consent would need to be obtained in respect of each dispute. While none of these formulations implies an automatic right for the investor to submit a dispute to arbitration, a failure by the host State to give its consent would presumably constitute a breach of the IIA, which would in turn need to be settled through the State-to-State dispute settlement provisions of the agreement.

50. Certain IIAs include consents to submit to ICSID arbitration even where one or more of the contracting parties are not signatories to the ICSID Convention. In such cases, the consent can only take effect until both the host State and the home State of the investor become parties to the Convention.[51] In order to address these situations, in 1978 ICSID adopted a set of alternative rules called the "Additional Facility", providing for arbitration and conciliation of investment disputes where either the host country or the investor's home country, but not both, is not an ICSID Contracting State.[52] Taking advantage of this, recent IIAs usually combine consents to arbitration under the Additional Facility with consents to arbitration under the ICSID Convention in anticipation of an eventual accession of the States concerned to the Convention. Many bilateral and regional investment treaties have followed this approach.

51. Another important aspect of ICSID's jurisdiction concerns the nationality of the investor, in particular where the investor is a juridical person. The basic assumption under the Convention is that the nationality of a company is to be determined according to the place of its incorporation or the location of its seat.[53] Therefore, a company that is incorporated under the law of the host State would technically be considered as a national of that State even though it is owned by individuals of another Contracting State. This situation would prevent that company from submitting a claim to arbitration since ICSID's jurisdiction does not extend to disputes between a host State and its own nationals. Article 25(2)(b) of the Convention addresses this problem by providing that the parties may agree to treat a company that has the nationality of the host State as "a national of another Contracting State" if, prior to the dispute[54], that company was owned or controlled by nationals of that other State. Many IIAs, particularly bilateral investment treaties, include a similar clause to ensure that foreign-owned locally incorporated firms fall within the scope of Article 25(2) (b) of the ICSID Convention.[55]

52. A key provision of the ICSID Convention is that once a dispute has been submitted to ICSID arbitration, the investor's home State may not extend diplomatic protection or bring an international claim in respect of that dispute, unless the host State fails to comply with the award rendered under the Convention (Article 27(1)). However, it has been suggested that this provision does not preclude a State-to-Sate arbitration on issues of treaty implementation or application which are related to the investor-State dispute, so long as this does not amount to the espousal of the investor's claim by the home State.[56]

5. The choice of alternative arbitration rules

53. While in the past IIAs referred almost exclusively to ICSID arbitration, nowadays many investment treaties provide for a choice among several arbitration mechanisms. In addition to

[51] This approach was used in NAFTA's Chapter 11, where the option to resort to arbitration under the ICSID Convention will not be available until either Canada, or Mexico, or both adhere to ICSID.

[52] ICSID's Additional Facility Rules can be found in *ICSID Basic Documents*, ICSID/11 (1979).

[53] A. Broches, (1995), p. 206.

[54] The foreign control or ownership is to be appraised prior to the event giving rise to the dispute, so that if an act of expropriation is at the origin of the dispute, this will not prevent the expropriated company from submitting a claim to arbitration.

[55] Such a proposition is included, for example, in the Model investment agreements of Chile, Switzerland, the U.K. (preferred alternative) and the United States. UNCTAD, International Investment Instruments: A Compendium, (1996-2002), Vol. III, pp. 147, 181, 189 and Vol. VI, p. 508.

[56] Peter Malanczuk, State-State and investor-State Dispute Settlement in the OECD Draft Multilateral Investment Agreement, *Journal of International Economic Law* (2000), pp. 417-439 (436).

references to the ICSID Convention and its Additional Facility, they also refer to other arbitration rules or institutions. The rules most frequently referred to are the Arbitration Rules of the United Nations Commission on International Trade Law.[57] As for the institutions, references to arbitration under the International Chamber of Commerce and the Stockholm Chamber of Commerce are the most common.[58] Sometimes, reference to regional arbitration institutions is also made.[59] The choice of alternative arbitration regimes may prove to be particularly useful in situations where the requirements of ICSID's jurisdiction prevent the application of this system.

54. A number of IIAs provide for purely *ad hoc* arbitration for investor-State disputes.[60] In such cases, they stipulate the rules that will apply for the appointment of arbitrators and often include a provision entrusting the Secretary-General of ICSID with the responsibility to appoint the arbitrators where the disputing parties fail to agree on the composition of the tribunal after a specified period of time.

55. Normally, IIAs setting forth several alternative arbitration forms also provide for the State parties' consent to each of those forms, by explicitly authorizing the investor to choose the mechanism to which the dispute will be submitted. Some IIAs use a different formulation stating that the disputing parties may agree on the arbitration mechanism to be used, provided that if no agreement is reached, the dispute shall be submitted to one of the arbitration forms mentioned in the agreement. Even when an IIA omits to mention how the arbitral regime is to be chosen, in practice, the investor will still retain the power to decide the matter by selectively withholding his consent. This is because in order to initiate an investor-State arbitral proceeding the consent of both disputing parties is required.[61]

6. The applicable substantive law

56. Arbitral tribunals normally give effect to the parties' own choice regarding the substantive law to be applied to their dispute, whenever this choice is clear. For example**,** a clause designating the applicable law may be included in an investment contract concluded between the investor and the host State. Where the applicable law is not specified, the tribunals are left with the task of determining whether national law or international law will apply, or even whether either of them will be applicable to specific issues of the dispute.

57. IIAs often contain an applicable law clause in the investor-State dispute settlement provisions. A number of them indicate that the IIA's provisions, the laws of the host State, the provisions of the investment contract and the principles of international law shall apply. For example, the Chinese Model BIT provides that the tribunal shall adjudicate in accordance with the law of the host State, including its rules on the conflict-of-law, the provisions of the BIT and the generally recognized principles of international law accepted by both State Parties.[62] In other cases, preference is given to the provisions of the IIA and the principles of international law, while the law of the host State is to be

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[57] The UNCITRAL Arbitration Rules are reprinted in UNCTAD, International Investment Instruments: A Compendium, (1996-2002), Vol. I, pp. 71-87. See also 15 I.L.M. 701 (1976).

[58] An example of this approach is found in the second alternative of the investor-State dispute provision of the U.K. Model BIT, which provides that the parties may agree to refer the dispute to: (a) the ICSID or its Additional Facility, (b) the ICC, or (c) an *ad hoc* tribunal under UNCITRAL Arbitration Rules. See *Ibid*., Vol. III, p. 190.

[59] For example, the ASEAN Agreement for the Promotion and Protection of Investments, refers to the Regional Centre for Arbitration in Kuala Lumpur or any other regional centre for arbitration in ASEAN, in addition to ICSID and UNCITRAL arbitration, *Ibid*., Vol. II, p. 297-298.

[60] For example, the Chinese Model investment agreement provides only for *ad hoc* arbitration and that exclusively with respect to disputes involving the amount to be paid for compensation. *Ibid*., Vol. III, p. 155.

[61] UNCTAD, Bilateral Investment Treaties in the Mid-1990s, (1998), p. 96.

[62] UNCTAD, International Investment Instruments: A Compendium, (1996-2002), Vol. III, pp. 155-156.

applied only in a suppletory manner.[63] Other IIAs refer exclusively to the provisions of the treaty and to the applicable rules of international law, omitting any reference to the law of the State party. This approach is followed, for example, in NAFTA's Chapter 11 and in the Energy Charter Treaty.[64]

58. Where a dispute is referred to ICSID, Article 42 of the Convention provides that in the absence of agreement by the parties on the applicable law, the tribunal shall decide the dispute in accordance with the law of the host State and such rules of international law as may be applicable. This provision accords primacy to the parties freedom to agree on the applicable law, while also providing guidance to the tribunal as to how this law should be chosen in the absence of agreement by the parties.

59. The arbitration rules of UNCITRAL and the ICC also recognize the autonomy of the parties to choose the applicable law. The UNCITRAL Rules, for example, provide that the arbitral tribunal shall apply the law designated by the parties and, failing such designation, the law determined by the conflict-of-law rules which it considers applicable. In line with commercial arbitration practice, the UNCITRAL rules emphasize the governing force of the investment agreement between the parties, by requiring that, in all cases, the tribunal shall decide the dispute in accordance with the terms of the contract and shall take into account the usages of trade applicable to the transaction.[65]

7. The nature and effect of the arbitral award

60. An important feature of the investor-State dispute settlement mechanism is that it provides for the award of damages. Thus, if a host State is found to be in breach of an obligation, the tribunal may order that the investor be awarded monetary damages, including applicable interest. It may also order restitution in kind, in which case monetary awards may normally be paid in lieu of restitution.[66] Arbitral tribunals, however, are not empowered to order a host State to revoke or modify an inconsistent measure or policy. The underlying rationale for this limitation is to avoid situations in which a host State would be bound to change its legislation or to adopt measures contrary to its courts decisions in order not to incur international responsibility should it not abide by the award.

61. In accordance with the general rule of international arbitration, awards rendered under the investor-State mechanism are binding and final. However, if an international arbitral award does not comply with the fundamental requirements of due process and fairness, its validity may be challenged before the courts of the place of arbitration and thus be denied recognition by the courts of the State where enforcement is sought.

62. The ICSID Convention differs from other arbitration regimes in that it prevents the parties from challenging an award rendered by an ICSID tribunal before municipal courts. Instead, the Convention provides for several alternative remedies of its own: either party can request the interpretation, the revision or the annulment of an arbitral award.[67] Requests for annulment can be made on several grounds, *inter alia*, that the tribunal manifestly exceeded its powers; that there was a serious departure from a fundamental rule of procedure; or that the tribunal failed to state the reasons on which the award was based. Such requests are heard by an *Ad hoc* Committee appointed by the Chairman of ICSID's Administrative Council.

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[63] See, for example, the FTA between Mexico and Costa Rica and the Agreement on Investment and Trade in Services among Central American countries. *Ibid.*, Vol. V, p. 58 and Vol. IX, p. 53.

[64] NAFTA Article 1131(1). See also Article 26(6) of the Energy Charter Treaty, *Ibid.*, Vol. II, p. 570.

[65] Article 33 of the UNCITRAL Arbitration Rules, *Ibid.*, Vol. I, p. 84.

[66] See, for example, NAFTA Article 1135(1).

[67] See Articles 50-52 of the ICSID Convention.

8. Enforcement and recognition of an arbitral award

63. Since, under customary international law, States are not required to enforce foreign arbitral awards, many IIAs contain provisions aimed at ensuring the enforcement by local courts of the awards rendered under their investor-State arbitration provisions. This is normally done by reference to certain international conventions that provide for the mandatory enforcement of arbitral awards. The most important convention of this kind is the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards[68], concluded under the aegis of the United Nations, and to which many countries have adhered. One regional example is the 1975 Inter-American Convention on International Commercial Arbitration. Nevertheless, even under these treaties, a State may still refuse enforcement of a foreign award on a number of grounds, notably, where the matter of the difference is not capable of settlement by arbitration under that State's domestic law, or if the award is contrary to its public policy.[69]

64. Another limitation to enforcement is the fact that under New York Convention the State parties are entitled to refuse to enforce arbitral awards made in the territory of a State not party to the Convention. So, in order to ensure that this does not preclude enforcement of awards rendered under the investor-State dispute resolution provisions, a number of IIAs require that awards be made in the territory of a country that is a party to the New York Convention.

65. The above problems do not arise in the context of the ICSID Convention, which requires every Contracting State (not only those concerned by the dispute) to recognize the arbitral awards rendered by ICSID's tribunals and to enforce them as if they were final decisions of a local court (Article 54(1)). Here, again, ICSID arbitration differs from other arbitral regimes, such as UNCITRAL and ICC arbitration, which rely on the above-mentioned conventions to ensure effective enforcement of arbitral awards. It should be noted, however, that under the ICSID Convention as well as under the New York Convention, enforcement against the respondent State may still be refused on the basis of the principle of "sovereign immunity from execution" or the Act-of-State doctrine, both of which are preserved in these instruments.[70]

66. Where a State party to an IIA is not a signatory to any treaty such as the New York Convention or the ICSID Convention, then, it is not legally bound to enforce a foreign arbitral award. That is why some IIAs stipulate that each State party shall enforce or provide for the enforcement in its territory of awards rendered under the investor-State dispute settlement provisions of the IIA. An example of this formulation is provided by the 1992 BIT between the Russian Federation and the United States.[71]

67. In case of non-compliance by a host State of an arbitral award, some IIAs provide that the investor's home State may bring the claim under the inter-State dispute settlement procedures of the agreement.[72] Under NAFTA, for example, if a disputing State fails to comply with a final award, the home State of the investor may request the NAFTA Free Trade Commission to establish a panel under the inter-State procedures of the agreement. In such proceedings, the requesting State may seek a determination that the failure to comply with the award is inconsistent with NAFTA obligations and a

[68]The text of the 1958 New York Convention is available at UNCITRAL's website: www.uncitral.org/english/texts/arbconc/58conv.

[69] See, for example, Article V of the 1958 New York Convention.

[70] Simply put, under international law, sovereign immunity from execution concerns the exemption of a foreign State from enforcement measures against its state property resulting from a municipal court decision or an arbitral award. Under the Act-of-State doctrine, closely related to the principle of sovereign immunity, the acts of a State carried out within its own territory cannot be challenged in the courts of other States. Consequently if a municipal court considers that the award for which enforcement is sought is contrary to the above-mentioned principles, it may refuse to enforce the award. Malanczuk (1997), pp. 118-123.

[71] Cited in UNCTAD, Bilateral Investment treaties in the Mid-1990s, (1998), p. 98.

[72] See for example the NAFTA, the FTA between Mexico and Costa Rica and the G-3 Treaty.

recommendation that the defaulting State complies with the award.[73] Failure to do so may lead to the international responsibility of the defaulting State under public international law. Under the ICSID Convention, non-compliance with an arbitral award reactivates the right of the home State to extend diplomatic protection to the investor.[74] The home State may also bring a claim against the non-compliant State at the International Court of Justice in accordance with the provisions of the ICSID Convention. Moreover, the home State of the investor may have recourse to all the other remedies available under public international law for breach of an international treaty obligation.[75]

9. The costs of arbitration

68. As is the case with State-to-State arbitration, IIAs normally contain provisions concerning how the costs of the arbitral proceedings are to be determined. There is no standard practice on how to approach this, however, the possible options include: equal sharing of costs among the parties, the "loser pays" formulation, or else, the determination is left to the tribunal's discretion.

V. MAIN DIFFERENCES BETWEEN THE DISPUTE SETTLEMENT PROVISIONS IN IIAS AND THE DISPUTE SETTLEMENT SYSTEM OF THE WTO

69. There are a number of important differences between the dispute resolution mechanisms provided for in IIAs and the WTO dispute settlement system.

70. With respect to State-to-State dispute resolution, as noted before, IIAs normally provide for *ad hoc* arbitration, i.e., through a mechanism that does not automatically provide specific procedural rules and where it is usually left to the tribunals to determine their own procedures. In contrast, the WTO provides for an institutional dispute resolution system with *ad hoc* panelists for each dispute and a quasi-permanent Appellate Body, and with detailed procedural rules for the different phases of the settlement process. It should be recalled, however, that some IIAs, particularly at the regional level, do establish institutional arrangements for the settlement of inter-State disputes.

71. A significant difference between State-to-State dispute settlement in IIAs and in the WTO relates to the applicable law. Whereas the scope of WTO dispute settlement is circumscribed to disputes involving rights and obligations under the covered agreements, the scope of State-to-State dispute settlement under IIAs seems to be much broader. This is because, in addition to their own provisions, IIAs often refer to other rules of international law not only in the specific dispute settlement articles but also in the "treatment" articles. Besides, they also include references to other agreements concluded by the parties as well as to commitments entered into with respect to specific investments.

72. Probably one of the most important differences between State-to-State dispute resolution in IIAs and in the DSU concerns the issue of compliance with dispute settlement awards. On the one hand, most IIAs, and almost all BITs, do not deal with the issue, but in case of non-compliance, the prevailing State is free to resort to the remedies available under the customary law of State responsibility (including unilateral countermeasures and the suspension of the operation of the treaty). It should be noted, however, that some IIAs, namely bilateral and regional economic integration agreements, do contain their own systems of sanctions in case of non-compliance. On the other hand, the DSU establishes a self-contained system of remedies in the event of non-compliance, which can take the form of temporary compensation or suspension of concessions or obligations. The adoption

[73] NAFTA Article 1136(5).

[74] It is recalled that the ICSID Convention prevents a home State from extending diplomatic protection or bring an international claim in respect of a dispute which one of its nationals and a host State have consented to submit to ICSID arbitration, unless the host State fails to comply with the tribunal's award (Article 27(1)).

[75] See for example Article 60 of the 1969 Vienna Convention on the Law of Treaties, which allows for termination or suspension of a treaty as a consequence of its breach.

of countermeasures by the prevailing Member is only permitted on the basis of prior authorization and under certain conditions. Unilateral action is not allowed under the WTO system.

73. There are also fundamental differences between the investor-State dispute settlement provisions contained in IIAs and the WTO dispute settlement system. Some of these differences, which reflect the diverse purposes and functions of these two types of mechanisms, are the following.

74. First, as noted before, an outstanding feature of the investor-State mechanism is that it allows the private investor direct access to an international tribunal to pursue a claim against the host State without requiring the diplomatic protection or the intervention of his home State. Investor-State arbitration is considered as one of the most important means of investor protection in IIAs, particularly in those whose main purpose is to protect the investor's rights against unlawful expropriation or discriminatory treatment. Clearly, this represents a fundamental difference with respect to the WTO dispute settlement system, where non-governmental actors are prevented from submitting disputes under the DSU and where only Member States, if they wish to espouse the claims of their nationals, can initiate the dispute settlement process against other Member States.

75. A second important difference relates to the kind of legal remedies available under each of these types of dispute settlement. It is recalled that under investor-State arbitration, if a host State is found to be in breach, the tribunal is generally empowered to order that the investor be awarded monetary damages and/or restitution of property with applicable interest. The arbitral tribunal cannot, however, order a host State to revoke or modify an inconsistent measure or policy. Again, this situation differs fundamentally from the WTO dispute settlement system, where it is generally understood that neither the panels nor the Appellate Body can recommend the payment of monetary damages. Instead, if a violation of a WTO Agreement is found, the Dispute Settlement Body shall recommend that the offending Member bring the inconsistent measure into conformity with its WTO obligations.

76. There is also a significant difference as regards review procedures. Under *ad hoc* investor-State arbitration, the arbitral awards are normally final, although a losing State may request that an award be set aside or annulled on procedural grounds before municipal courts. The ICSID Convention goes beyond *ad hoc* regimes, by requiring that ICSID awards not be subject to any appeal or to any other remedy except those provided for in the Convention. Under the WTO system, on the other hand, the DSU allows the disputing Members to request for an appellate review of the panel report concerning issues of law and the legal interpretations made by the panel.[76] The main difference between ICSID's annulment procedures and the WTO appellate review is that, while under the former an award can only be annulled on the narrow procedural grounds set forth in the Convention and the parties are thus free to submit the dispute to a new tribunal, the WTO's Appellate Body can not only nullify a panel decision for procedural defects, but it can also modify or reverse the legal findings and conclusions of a panel and substitute its own decision for the panel's recommendations.[77]

77. Another important difference between the two types of systems concerns the issue of enforcement. Under investor-State arbitration the enforcement of arbitral awards is normally achieved by reference to certain international conventions providing for the enforcement of foreign arbitral awards, such as the 1958 New York Convention and the ICSID Convention. Where a State fails to comply with an arbitral award, under some IIAs the investor's home State may bring the claim under the State-to-Sate dispute settlement procedures of the agreement, or, if it is an ICSID award, under the relevant provisions of the ICSID Convention. As a last resort, the investor's home State may use the remedies available under customary international law of State responsibility for breaches

[76] It should be noted, however, that if the arbitration procedure of Article 25 of the DSU is used, the arbitration report cannot be appealed.

[77] UNCTAD, Dispute Settlement (Investor-State), UNCTAD Series on issues in international investment agreements (forthcoming).

of an international treaty. On the other hand, as noted above, under the dispute settlement system of the WTO, in case of non-compliance, the affected Member is entitled to seek compensation or, if this is not possible, the authorization to suspend equivalent concessions to the non-compliant Member.

78. Finally, it should be mentioned that, while under the investor-State dispute settlement mechanism the costs of arbitration are to be borne directly by the disputing parties, this is not the case under the WTO dispute settlement system.