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Is There a Better Way? Alternative Methods of Treaty-Based, Investor-State Dispute Resolution

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Jeswald W. Salacuse

Abstract

Two factors—the increase in international investment and the increase in international investment agreements—have together led to a growth in the number and severity of treaty-based disputes between host states and individual investors. An increasing number of such disputes are being settled through international arbitration. However, the large amounts of some resulting arbitration awards, the cost to host countries of the arbitral process, and the constraints imposed thereby on the ability of governments to regulate enterprises in their territories have raised questions as to whether means other than arbitration and litigation can be found to resolve treaty-based, investor-State disputes. In short, is there a better way than international arbitration to resolve at least some investor-State disputes? The purpose of this Article is to explore alternative methods for settling such conflicts.

IS THERE A BETTER WAY? ALTERNATIVE METHODS OF TREATY-BASED, INVESTOR-STATE DISPUTE RESOLUTION

*Jeswald W. Salacuse**

INTRODUCTION

The rapid growth over the last two decades in the total stock of international investment, now estimated at US\$10 trillion,¹ and the increasing number of international direct investors, at present amounting to some 77,000 transnational corporations and their 770,000 affiliates,² have quite naturally led to an increase in potential and actual conflicts between investors and host countries.³ Parallel to the growth in international investment has been the rapid increase in international investment treaties among states, which now number nearly 2500⁴ and involve some 180 different countries.⁵ These agreements, which include bilateral investment treaties (“BITs”),⁶ regional agree-

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1. See U.N. Conf. on Trade & Dev. [UNCTAD], *World Investment Report 2006: FDI from Developing and Transition Economies: Implications for Development*, 9, U.N. Doc. UNCTAD/WIR/2006 (Oct. 16, 2006), available at <http://www.unctad.org/Templates/WebFlyer.asp?intItemID=3968&lang=1> [hereinafter UNCTAD, *World Investment Report 2006*].

2. See *id.* at 10.

3. *Id.*

4. See *id.* at 26 (reporting that by the end of 2005, the total number of bilateral investment treaties (“BITs”) was 2495).

5. See UNCTAD, *Quantitative Data on Bilateral Investment Treaties and Double Taxation Treaties*, <http://www.unctad.org/Templates/WebFlyer.asp?intItemID=3150&lang=1> (last visited Sept. 15, 2007) [hereinafter UNCTAD, *Quantitative Data on BITs & DTTs*] (reporting that by the end of 2003, 176 countries had concluded bilateral investment treaties).

6. The literature and doctrinal commentary on BITs is abundant and have expanded over the years as the number of BITs has grown. See generally, e.g., RUDOLF DOLZER & MARGRETE STEVENS, *BILATERAL INVESTMENT TREATIES* (1995); M. SORNARAJAH, *THE INTERNATIONAL LAW ON FOREIGN INVESTMENT* 225-76 (1994); UNCTAD, *BILATERAL INVESTMENT TREATIES, 1959-1999*, U.N. Doc UNCTAD/ITE/IIA /2 (2000), available at

ments such as NAFTA, free trade agreements (“FTAs”),⁷ and special purpose accords such as the Energy Charter Treaty,⁸ are often concluded between industrialized countries and developing nations in order to protect and promote investment among the countries concerned. In general, these agreements do two things: (1) they subject host countries to a set of international legal rules that they must respect in dealing with foreign investors and their investments and (2) they grant investors the right to bring a claim in international arbitration autonomously and without regard to the wishes of their home country against host country governments that allegedly violate those rules.⁹ Such treaties enable investors to convert a “conflict” (i.e., a perceived difference of interests) with host governments, which might otherwise be settled through informal means or domestic courts, into a public international law “dispute” (i.e., a conflict that is activated by the parties) to be settled by an international arbitration tribunal outside the jurisdiction of the host country.

These two factors—the increase in international investment and the increase in international investment agreements—have together led to a growth in the number and severity of treaty-based disputes between host states and individual investors. An increasing number of such disputes are being settled through international arbitration; however, the large amounts of some resulting arbitration awards, the cost to host countries of the arbitral process, and the constraints imposed thereby on the ability

<http://www.unctad.org/en/docs//poiteiid2.en.pdf>; UNCTAD, *BILATERAL INVESTMENT TREATIES IN THE MID-1990s*, U.N. Doc. UNCTAD/ITE/IIT/7 (1998); K.J. VANDELDE, *UNITED STATES INVESTMENT TREATIES: POLICY AND PRACTICE* (1992); Antonio R. Parra, *The Scope of New Investment Laws and International Instruments in Economic Development*, in *ECONOMIC DEVELOPMENT, FOREIGN INVESTMENT AND LAW* 27 (R. Pritchard ed., 1996); Jeswald W. Salacuse, *BIT by BIT: The Growth of Bilateral Investment Treaties and Their Impact on Foreign Investment in Developing Countries*, 24 *INT'L LAW.* 655 (1990). In addition, see the website of the International Centre for Settlement of Investment Disputes (“ICSID”) for materials on BITs, including the texts of many BITs, arbitration awards that have interpreted and applied them, and a bibliography of books and articles commenting on BITs. See ICSID, *ICSID Bilateral Investment Treaties*, at <http://www.worldbank.org/icsid/treaties/treaties.htm> (last visited Oct. 30, 2007).

7. North American Free Trade Agreement, U.S.-Can.-Mex., Dec. 8, 1993, 32 *I.L.M.* 289 (1993).

8. THE ENERGY CHARTER TREATY, *opened for signature* Feb. 1, 1995, 34 *I.L.M.* 360 (1995).

9. See Jeswald W. Salacuse & Nicholas P. Sullivan, *Do BITs Really Work?: An Evaluation of Bilateral Investment Treaties and Their Grand Bargain*, 46 *HARV. INT'L L.J.* 67, 67 (2005) (discussing the effectiveness of bilateral investment treaties).

of governments to regulate enterprises in their territories have raised questions as to whether means other than arbitration and litigation can be found to resolve treaty-based, investor-State disputes. In short, is there a better way than international arbitration to resolve at least some investor-State disputes? The purpose of this Article is to explore alternative methods for settling such conflicts.

I. *THE NATURE, CAUSES & SIGNIFICANCE OF TREATY-BASED INVESTOR-STATE DISPUTES*

A. *The Special Nature of Investor-State Disputes*

Investor-State disputes arising under international investment treaties are not ordinary commercial disputes. Treaty-based investor-State disputes are special, and their special nature must be understood because it affects the ways in which the disputants approach their conflict and the utility and effectiveness of dispute resolution techniques employed to resolve that conflict.

First, such disputes are not a matter of simple contract claims governed by contract law. They are disputes governed by public international law in the form of treaties—instruments of international law—solemnly entered into by two or more states.¹⁰ Given the international legal nature of these disputes, unilateral attempts to deal with them through domestic laws and regulations are usually unavailing.

Second, at the heart of many investor-State conflicts is a public policy question. The host government has taken certain measures—for example, legislative or administrative acts to preserve the environment, to regulate business, or to impose a tax considered necessary in the public interest—which the investor

10. As the ICSID Annulment Committee states in the *Vivendi* case, which involved a dispute under the Argentina-France BIT:

A state may breach a treaty without breaching a contract, and vice versa . . . whether there has been a breach of the BIT and whether there has been a breach of contract are different questions. Each of these claims will be determined by reference to its own proper or applicable law – in the case of the BIT, by international law; in the case of the Concession Contract by the proper law of the contract

Compañía de Aguas del Aconquija SA and Vivendi Universal (formerly Compagnie Générale des Eaux) v. Argentine Republic, ICSID Case No. ARB/97/3, *decision on annulment* (3 July 2002) ¶¶ 95, 96.

challenges as violating its rights under a treaty. The resulting arbitration decision or other form of settlement has significant implications for the ability of sovereign governments to regulate enterprises within their territories.¹¹ If an arbitration tribunal ultimately judges such measures to be illegal under the applicable international law embodied in a treaty, the resulting arbitration award may not only require the offending host government to pay the investor substantial damages and to incur heavy arbitration costs, but it may also lead the host government to repeal or modify such measures in order to avoid similar arbitration claims from other foreign investors.

Third, because they involve public policy issues, investor-State disputes are political in nature and often become highly politicized, as political groups, non-governmental organizations, the media, and ultimately the general public come to have definite views on the dispute and how it should be settled. The political nature of the disputes, as will be seen, influences the strategies of both governments and investors in seeking to resolve them.

Fourth, underlying the dispute is an intended long-term investment relationship: A complex connection, often amounting to a state of interdependence, between the investor and the host country. In cases of privatization of public services, such as water, gas, or telecommunications, the investor and the host country are linked in a more or less permanent relationship that is very difficult to unravel, far more difficult than that arising out of a simple contract of sale of a commodity in international commerce. In such cases, the host country is dependent on the continued provision by the investor of the needed public service and at least in the short run has no other option but to continue to deal with the investor. Similarly, the investor, having committed substantial capital to the privatized enterprise, is dependent on the host country for continued revenues and at least in the short run has few options with respect to selling its investment.

Fifth, the amounts of money at stake in the dispute are large, sometimes staggeringly so, reaching in some cases to hundred of millions, even billions of dollars. As a result, in most in-

11. See Gus Van Harten, *Private Authority and Transnational Governance: The Contours of the International System of Investor Protection*, 12 REV. INT'L POL. ECON. 600, 610-11 (2005).

vestor-State, treaty-based disputes, a host country faces the risk of having to pay a substantial arbitration award in an amount that, in relation to the country's budget and financial resources, may prove onerous. Whereas the average award in an ordinary international commercial arbitration is less than a million dollars, an award in an investor-State arbitration is usually many times that.¹² For example, arbitral tribunals rendered awards of US\$355 million against the Czech Republic,¹³ US\$71 million against Ecuador,¹⁴ US\$824 million against Slovakia,¹⁵ and US\$133 million against Argentina.¹⁶

Moreover, the costs of an investor-State arbitration are usually substantially greater than those in an ordinary commercial dispute and may prove to be a significant burden for developing countries. In addition to indirect costs such as the time of government officials and corporate executives devoted to preparing and participating in the case, the direct costs usually consist of two elements: (1) the expenses of party's legal representation and (2) each party's share of the costs of administering the arbitration. The precise amount of such costs will vary depending on the complexity of the case, the amount in controversy, and the extent of time needed to resolve it. In a highly complicated

12. See Noah D. Rubins, *The Allocation of Costs and Attorney's Fees in Investor-State Arbitration*, 18 ICSID REV. - FOREIGN INV. L.J. 109, 124-25 (2003) (observing that whereas 42 percent of the commercial arbitration claims brought under the International Chamber of Commerce ("ICC") in 1999 were for less than US\$1 million, the average claim for ICSID cases in 1997 was US\$10 million).

13. See *CME v. Czech Republic*, UNCITRAL Arbitration Proceedings Final Award, 161 (Mar. 14, 2003), available at http://ita.law.uvic.ca/documents/CME-2003-Final_001.pdf (ordering that the Czech Republic pay US\$269,814,000, plus interest, and that arbitrator's fees in the amount of US\$1,351,203.44 be borne by both parties equally); Peter S. Green, *Czech Republic Pays \$355 Million to Media Concern*, N.Y. TIMES, May 16, 2003, at W1.

14. See *Occidental Exploration & Prod. Co. v. Republic of Ecuador*, Final Award in the Matter of an UNCITRAL Arbitration, London Ct. Int'l Arb. Case No. UN3467, 73-74 (July 1, 2004), available at http://ita.law.uvic.ca/documents/Oxy-EcuadorFinalAward_001.pdf (stating that Ecuador shall pay the claimant US\$71,533,649, excluding interest and arbitration costs).

15. See *Ceskoslovenska obchodni banka, a.s. v. Slovak Republic*, ICSID Case No. ARB/97/4, 126 (Dec. 29, 2004), available at <http://ita.law.uvic.ca/documents/Cesk-Slovakia-AwardDec2004.pdf> (stating that the Slovak Republic shall pay the claimant 24,796,381,842 Slovak Crowns, plus interest).

16. See *CMS Gas Transmission Co. v. Argentine Republic*, ICSID Case No. ARB/01/8, 139 (May 12, 2005), available at http://ita.law.uvic.ca/documents/CMS_FinalAward.pdf (stating that Argentina shall pay the claimant US\$133,200,000 in compensation).

and lengthy case, the costs of legal representation in an arbitration proceeding can be extremely heavy. For example, in *CME v. Czech Republic* the Czech Republic reportedly spent US\$10 million on its legal defense.¹⁷ A more typical investor-State case is perhaps *Int'l Thunderbird Gaming Corp. v. United Mexican States*, a NAFTA case under United Nations Commission on International Trade Law ("UNCITRAL") rules. There, the total cost of the proceeding was US\$3,170,692, including US\$405,620 in arbitrators' fees and approximately US\$99,632 in various administrative expenses, US\$1,502,065 in Mexico's legal representation costs, and US\$1,163,375 in Thunderbird's costs of representation.¹⁸

It is possible for a host country that wins a case to recoup some of these costs from the investor who commenced the case; however, the rules on apportionment of costs among the parties vary and in any case are subject to significant discretion by the tribunal. On the other hand, a host state that loses a case may itself be required to pay a portion of the claimant investor's costs in certain circumstances.

B. *The Growth of Investor-State Disputes*

In the last ten years, one of the most significant developments in contemporary international investment law has been the growth of investor-State arbitration to settle investment disputes. During the period 1987-2005 a total of 226 investor-State treaty arbitrations had been brought,¹⁹ virtually all of which involved private investors as claimants and states as respondents.²⁰ In the realm of international investment, investor-State arbitration has become increasingly common²¹ and arbitral awards interpreting and applying investment treaty provisions have be-

17. See Luke Eric Peterson, *Czech Republic Hit with Massive Compensation Bill in Investment Treaty Dispute*, INV. L. & POL'Y WKLY NEWS BULL., Mar. 21, 2003, § 1, available at http://www.iisd.org/pdf/2003/investment_investsd_march_2003.pdf.

18. See *Int'l Thunderbird Gaming Corp. v. United Mexican States*, Arbitral Award in the Matter of NAFTA Arbitration Under the UNCITRAL Arbitration Rules, 68-72 (Jan. 26, 2006), available at http://www.naftaclaims.com/Disputes/Mexico/Thunderbird/Thunderbird_Award.pdf.

19. See UNCTAD, *World Investment Report 2006*, *supra* note 1, at 27, 29 fig.I.15.

20. See UNCTAD, *Latest Developments in Investor-State Dispute Settlement*, 2, U.N. Doc. UNCTAD/WEB/ITE/IIT/2005/2 (Jan. 16, 2006), available at http://www.unctad.org/doc/docs/webiteiit20052_en.pdf.

21. See UNCTAD, *World Investment Report 2006*, *supra* note 1, at 27.

come increasingly numerous.²² For international law firms, investor-State arbitration—once an arcane field of interest to only a few scholars and specialists—has become an established and lucrative area of legal practice.

Granting a private party the right to bring an action in an international tribunal against a sovereign state with respect to an investment dispute was once a revolutionary innovation that now seems to be taken for granted. Prior to the development of investment treaties giving aggrieved investors a right to bring an arbitration proceeding against a host country, investor-State arbitration claims were relatively rare events that required specific agreements by the parties to arbitrate disputes arising from specified investments.²³ In many (but not all) investment treaties, on the other hand, host states provide an open-ended promise to investors to arbitrate all claims relating to any investment covered by the treaty's provisions.

Although investor-State arbitration has become increasingly common, the uniqueness and power of this form of legal process should not be overlooked. There are few instances in international law where a private party may compel a sovereign state to defend the legality of that state's actions in an international forum and, if found liable, pay substantial damages for the injury caused to the private party by such action. The field of international trade law, for example, contains no similar procedure. Violations of trade law, even though they strike at the economic interests of private parties, are matters resolved directly and solely by states. The World Trade Organization ("WTO") does not give a remedy to private persons injured by trade law violations.

It should also be noted that investment treaties usually grant aggrieved investors the right to prosecute their claims autonomously, without regard to the concerns and interests of their home countries. In the view of capital-exporting states and foreign investors, it is this mechanism that gives important, practical significance to international investment agreements, a mech-

22. *See id.*

23. *See* V. V. Veeder, *The Lena Goldfields Arbitration: The Historical Roots of Three Ideas*, 47 *INT'L & COMP. L.Q.* 747, 747-48 (1998) (discussing one of the first investor-State arbitration cases).

anism that truly enables these treaties to afford protection to foreign investment.

In almost all investor-State arbitrations, it is the investor who is the claimant and the host state that is the respondent. Two reasons may explain why states rarely initiate international arbitration cases against investors. First, host states generally consider their internal legal processes, namely their domestic regulatory powers and judicial functions, sufficient to handle their claims against investors in the event of dispute. Second, bilateral investment treaties grant investors rights but rarely impose on them obligations that host states may enforce through arbitration. Thus, among the 133 concluded arbitration cases registered at the International Centre for Settlement of Investment Disputes ("ICSID") in its history,²⁴ only two as of 2006 were initiated by states,²⁵ and jurisdiction in both cases was based on contracts with the investor, not investment treaties.²⁶

C. *The Potential Significance of the Growth of Investor-State Disputes*

One may argue that the growth in treaty-based investor-State disputes in recent years is purely a function of the vast increase in international investment and the inevitability of conflict in any investment relationship and that investor-State disputes are a natural and inevitable fact of international economic life. On the other hand, one must also acknowledge that the growth of investor-State disputes has certain potential negative consequences both for the states and the investors concerned.

The costs of investor-State disputes are placing growing financial and other hardships on individual countries, particularly on poor, developing countries. The potential costs of an investor-State arbitration are basically threefold. First, as indicated

24. See ICSID, *List of Concluded Cases*, <http://worldbank.org/icsid/cases/conclude.htm> (last visited Sept. 15, 2007).

25. See *Tanz. Elec. Supply Co. v. Indep. Power Tanz. Ltd.*, 8 ICSID (W. Bank) 220, 226 (2001) (describing the claimant, the Tanzania Electric Supply Company Limited, as a public utility corporation that is entirely owned by the United Republic of Tanzania); ICSID, *List of Concluded Cases*, *supra* note 24 (listing *Gabon v. Société Serte S.A.*, ICSID Case No. ARB/76/1, and classifying a corporation, *Société Serte S.A.*, as the respondent).

26. See *Tanz. Elec. Supply Co.*, 8 ICSID (W. Bank) at 227 (stating that the arbitration arose out of a Power Purchase Agreement between the parties); William Rand, Robert N. Hornick & Paul Friedland, *ICSID's Emerging Jurisprudence: The Scope of ICSID's Jurisdiction*, 19 N.Y.U. J. INT'L L. & POL. 33, 38 n.24 (1986) (describing the *Gabon v. Société Serte S.A.* case as having arisen out of a contract for the construction of a maternity ward).

above, a host country faces the risk of having to pay awards that, in relation to its budget and financial resources, may prove extremely burdensome. Second, the host country must bear the substantial costs, both direct and indirect, of conducting the arbitration itself. Third, the “policy cost” of investor-State arbitration is that a substantial award to the investor may require the host country to repeal or modify measures that were implemented for the public good.

The growing number of investor-State disputes may impose indirect burdens on governments as well. Investment policy, like any other government policy, needs to be sustained by a degree of popular support. The public’s realization of the costs incurred by host countries as a result of investor-State, treaty-based disputes, which are often accompanied by significant publicity and media comment, may lead to declining support for foreign investment and for the policies of economic liberalization that many countries have adopted over the last two decades.²⁷ In other words, continued public support for policies favoring foreign investment is not a foregone conclusion, and increases in investor-State arbitration may contribute to additional restrictions on foreign investment in the future. Moreover, a high-profile investor-State arbitration may be seen by other foreign investors as a negative reflection on the investment climate in the host country, an indication that in reality the country concerned is not as receptive to foreign investors as its government contends. After all, the basis of any claim in a treaty-based, investor-State arbitration is that the host country has violated its international treaty commitments to investors.

In addition to the cost incurred by host countries and the investors, investor-State arbitrations may also have negative consequences for international relationships between host countries and investor home countries. A high-profile, hotly litigated arbitration between a foreign investor and a host country can negatively affect governmental and public opinion in the investor’s home country toward the host country.

27. For example, an UNCTAD study found that from 1991 to 2002, “1,551 (95%) out of 1,641 changes introduced by 165 countries in their FDI laws were in the direction of greater liberalization.” See U.N. Conf. on Trade & Dev. [UNCTAD], *World Investment Report 2003: FDI Policies for Development: National and International Perspectives*, 20, U.N. Doc. UNCTAD/WIR/2003 (Sept. 4, 2003), available at http://www.unctad.org/en/docs/wir2003_en.pdf.

Despite the examples of investors who have won large awards as a result of a treaty-based, investor-State arbitration, the idea that investor-State arbitration is a road to vast riches for investors is a gross exaggeration. Investor-State arbitration also entails significant costs for the investor—costs that may not be recouped from any eventual arbitral award. The costs to the investor have several dimensions. First are the financial costs incurred by the investor in hiring legal representation and paying its share of the arbitration's administrative costs. Second are costs incurred by having to devote significant executive time, effort, and concentration to the arbitration rather than to the investor's core business. Third are the relationship costs. A transnational corporation requires productive relationships with the host governments, business communities, and publics of the countries in which it operates. Initiating arbitration against a host government will serve to rupture those relationships and may even put in question its relationships with other countries that are sympathetic to the host country respondent. Other host countries may ask themselves: If this investor was willing to sue country X, may it not also be willing to sue us? It was perhaps an evaluation of these costs that led the former Chief Executive Officer ("CEO") of Metalclad, which ultimately won an award of US\$17 million against Mexico in a much noted case,²⁸ to state publicly that he found the whole arbitration process such a burden that he wished he had settled his company's claim through informal mechanisms, or what he called Metalclad's "political options."²⁹ Presumably, what he meant was that in hindsight informal processes of dispute resolution might have been less costly than the formal processes involved in investor-State arbitration.

D. The Causes for the Growing Number of Investor-State Disputes

If the growing numbers of investor-State arbitrations is a matter of concern that needs to be addressed, one must first understand the causes for the increase. One can identify at least six possible reasons for increased recourse by investors to investor-

28. See *Metalclad Corp. v. United Mexican States*, 5 ICSID (W. Bank) 209, 235 (2000) (determining that Mexico shall pay Metalclad US\$16,685,000, plus interest).

29. See Jack J. Coe, Jr. *Toward a Complementary Use of Conciliation in Investor-State Disputes - A Preliminary Sketch*, 12 U.C. DAVIS J. INT'L L. & POL'Y 7, 8 n.2 (2005).

State arbitration: (1) the growing availability of arbitration as a remedy; (2) the politics of investor-State disputes; (3) the occurrence of major crises; (4) the transformation of the global investment climate; (5) the development of facilitating factors; and perhaps most important of all, (6) the perceived lack of satisfactory dispute resolution alternatives to international arbitration for the settlement of investor-State disputes. Each of these reasons is examined in turn.

1. Growing Availability of Arbitration as a Remedy

A simple explanation for the growth of investor-State arbitration is that a rapidly increasing number of investment treaties, most of which have been signed since the early 1990s, have given a growing number of investors a remedy that they never had before to deal with perceived violations of their rights. Whereas only 309 BITs had been concluded by the end of 1988,³⁰ the total number of BITs had reached nearly 2500 by the end of 2005,³¹ in addition to other important treaties, such as NAFTA and the Energy Charter Treaty, which also provide for investor-State arbitration. Moreover, various other bilateral international treaties, such as the Free Trade Agreements advanced by the United States³² and the Economic Partnership Agreements (“EPAs”) promoted by Japan,³³ contain chapters on investment that replicate the provisions of the BITs and provide for investor-State arbitration. The result of this effort has been the creation of an increasingly dense treaty network linking approximately 180 different countries.³⁴ As a result of this process, a widespread “treatification”³⁵ of international investment law has

30. See Athena J. Pappas, *References on Bilateral Investment Treaties*, 4 ICSID REV. - FOREIGN INV. L.J. 189, 194-203 (1989).

31. See UNCTAD, *World Investment Report 2006*, *supra* note 1, at 26.

32. See United States Trade Representative – Trade Agreements Home, http://www.ustr.gov/Trade_Agreements/Section_Index.html (last visited Sept. 15, 2007) (providing the texts of various free trade agreements concluded by the United States).

33. See Masaki Yasushi, *Economic Partnership Agreements and Japanese Strategy*, GAIKO F. (Japan), Fall 2006, at 53 (asserting that Japan’s bilateral trade relationships are increasingly defined by economic partnership agreements).

34. See UNCTAD, *Quantitative Data on BITs & DTTs*, *supra* note 5 (“The number of BITs has grown steadily; they numbered 385 by 1989, and 2,265 in 2003, encompassing 176 countries.”).

35. The word “treatification,” while not recognized by any standard English dictionaries, has been used on rare occasions previously. See, e.g., Jing-dong Yuan, *The MTCR and Missile Proliferation: Moving Toward the Next Phase*, at v (May 2000) (Pa-

taken place in a relatively short time. An important support for this new architecture has been ICSID, which was formally established in 1965 as an affiliate of the World Bank to resolve disputes, primarily through international arbitration, between host countries and foreign private investors.³⁶ Although ICSID did not hear its first case until 1972, it was destined to become an important institution for international investment dispute resolution.³⁷ By the end of 2005, for example, out of an estimated cumulative total of 220 investor-State arbitrations initiated since 1987, 132 cases were brought before ICSID.³⁸

Thus, one important cause of the increase in investor-State arbitration is simply the vast growth in foreign investment, the number of foreign investors, and the number of treaties granting investors recourse to international arbitration.

2. The Politics of Investor-State Disputes

Investor-State disputes are not only legal, but also political in nature. Indeed, it is the political dimension of such conflicts that primarily preoccupy host government officials. Within individual host countries, the public, political groups, and the media often take positions on such disputes, and the nature and tenacity of their views can influence how host country officials deal with the investor and the dispute. This factor, for example, may make it difficult for host country officials to negotiate a settlement of a dispute since any negotiated settlement may be challenged by political opponents and the media as “selling out to

per prepared for the International Security Research and Outreach Programme, International Security Bureau, available at http://www.dfait-maeci.gc.ca/arms/pdf/MTCR_missile-e.pdf. The origin of the word “treaty” may perhaps be found in the 1908 Nobel lecture of the Peace Prize Laureate Frederik Bajer, who urged that a treaty be established to govern the canals between the North and Baltic seas. See Fredrik Bajer, Nobel Lecture, *The Organization of the Peace Movement* (May 18, 1908), <http://nobelprize.org/peace/laureates/1908/bajer-lecture.html> (“[T]here is a need to ‘treatify’, if I may coin this expression, the waterways - the French call them ‘canaux interocéaniques’ - which connect the two seas.”); see also Jeswald W. Salacuse, *The Treatification of International Investment Law*, 13 LAW & BUS. REV. AM. 155, 155-66 (2007).”

36. See Convention on the Settlement of Investment Disputes Between States and Nationals of Other States pmbl., Mar. 18, 1965, 17 U.S.T. 1270, 575 U.N.T.S. 159.

37. See ICSID, *List of Concluded Cases*, *supra* note 24 (listing concluded cases in chronological order and identifying Jan. 13, 1972 as the date of registration of the first case brought before ICSID).

38. See U.N. CONF. ON TRADE & DEV., INVESTOR-STATE DISPUTES ARISING FROM INVESTMENT TREATIES: A REVIEW 4, U.N. Doc. UNCTAD/ITE/IIT/2005/4.

foreigners," weakness, or the product of corruption. Not only do the politics of investor-State dispute settlement inhibit negotiated settlements, they may actually encourage and prolong arbitration since host government officials can shift blame for an unfavorable result from itself to three foreign arbitrators.

This dynamic was apparently at work in the famous "Pyramids Case," which pitted a group of foreign property developers against the government of Egypt with respect to a proposed "destination resort," one of which was to be constructed near the Giza Pyramids.³⁹ The Egyptian government had initially approved the project but under public pressure ultimately cancelled it. At one point in the history of this case, which continued over fifteen years, a tentative settlement of US\$10 million was negotiated.⁴⁰ When the proposed settlement was presented to the Prime Minister for his approval, he asked what the alternative was. Upon hearing that the alternative was for Egypt to continue to defend itself in arbitration, he found that option to be preferable since an agreement to settle the case for US\$10 million would open him to attack by opponents and the media.⁴¹

In 1993, after making its way through the International Chamber of Commerce ("ICC") arbitration, the courts of France, and ICSID arbitration (resulting in an award of US\$27.6 million, plus US\$5 million in costs, which was then challenged in annulment proceeding), Egypt and the investors agreed to a negotiated settlement of US\$17.5 million.⁴² This result might have been avoided if, at an earlier stage, Egypt and the investor had agreed to the intervention of a distinguished conciliator who would have provided an expert opinion on a fair settlement of the conflict, thereby giving the Prime Minister the political cover that he felt he needed.

A similar political dynamic occurs within investor corporations. Individual corporate executives and their lawyers become so committed to "winning" the investor-State dispute and so fearful of appearing weak to their colleagues and competitors within the organization that they resist flexibility in their approach to

39. See *S. Pac. Properties Ltd. v. Arab Republic of Egypt*, 3 ICSID (W. Bank) 45, 46 (1992).

40. Reported confidentially to the author by a participant in the negotiations.

41. *Id.*

42. See *S.P.P. Settled; Annulment Proceedings Before ICSID Discontinued*, 8 MEALEY'S INT'L ARB. REP., no.1, 1993, at 1.

the host government and reject offers of settlement that do not meet their inflated expectations. In order to be effective, methods aimed at resolving investor-State disputes must accommodate the political considerations of both parties.

3. The Occurrence of Economic Crises

Domestic litigators know that economic recessions and crises provoke lawsuits as various claimants fight over their share of a shrinking pie. The same phenomenon is at work in international investment. Major financial crises often lead to disputes that ultimately find their way to arbitration tribunals. The financial crises in Argentina, Asia, and Russia have all led to increased recourse to arbitration. For example, of the approximately 200 registered cases at ICSID through March 2006, forty-one cases involved Argentina as a respondent.⁴³ Virtually all of these cases have arisen as a result of the Argentine financial crisis at the beginning of this century.

4. The Transformation of the Global Investment Climate

A more remote but nonetheless important cause for the increase in investor-State disputes has been the transformation of the global investment environment that has taken place during the last twenty years. Beginning in the post World War II period, virtually all developing countries rejected the liberal economic model and believed that their governments had the primary responsibility for bringing about national economic development. As a result, their systems were characterized by: (1) state planning and public ordering of their economies and societies; (2) reliance on state enterprises as economic actors; (3) restriction and regulation of the private sector; and (4) governmental limitation and control of international economic transactions, especially foreign investment. Indeed, many countries had serious reservations about the role of foreign direct investment in their development and therefore adopted measures to control and limit it. By the mid-1980s, this approach to development began to lose its hold on the minds and actions of policy makers, aid

43. See ICSID, *List of Concluded Cases*, *supra* note 24 (listing 130 concluded cases registered through March 2006, eleven of which involved Argentina as a respondent); ICSID, *List of Pending Cases*, <http://worldbank.org/icsid/cases/pending.htm> (last visited Sept. 15, 2007) (listing seventy-four pending cases registered through March 2006, thirty of which involve Argentina as a respondent).

agencies, and international financial institutions. Seeking to transform themselves into "emerging markets," developing countries increasingly privatized their state enterprises, engaged in deregulation, opened their economies, instituted markets to allocate resources, and began to aggressively encourage foreign direct investment.⁴⁴

These efforts at foreign investment promotion took a variety of forms including legislation to liberalize the economy, incentives to attract foreign investors, road shows to capital-exporting countries, public relations campaigns, and, of course, the conclusion of investment treaties with capital-exporting states. Thus, within a short time, the position of foreign investors in many countries was transformed from that of a dubious presence at the sufferance of the host government to that of an eagerly sought after and much courted guest. The result of this transformation may have led foreign investors to undertake their investments with high and perhaps unrealistic expectations about their importance to the country and their status in it. Having been eagerly courted by host governments, investors may have come to believe that they were investing not at the sufferance of the government but as of right. When the results of their investments did not accord with what they believed they had been promised by the host government, their disappointment led them to sue host governments in arbitration, rather than to meekly accept any losses caused by host government actions.

5. Facilitating Factors

Investor-State arbitration was once a rare and arcane international process, the province of a few experts. That is no longer the case. Indeed, the increase in investor-State arbitration has proved to be self-perpetuating. First, the growing number of cases and awards, some of which have been publicized in the media, have led to an increased understanding of this dispute settlement process and heightened ability to predict the results of future cases. Arbitral tribunals' elaboration of various international legal principles affirming the protection of investor rights, as well as the award of substantial damages and their subsequent payment by host governments, have proven useful to

44. See Jeswald W. Salacuse, *From Developing Countries to Emerging Markets: A Changing Role for Law in the Third World*, 33 *INT'L LAW.* 875, 876-88 (1999).

international investors and their lawyers as they decide whether or not to invoke arbitration in individual disputes. Second, the growth of law firms with expertise in this previously-arcaic area of the law has meant that investors have an important resource to assist them in deciding whether or not to arbitrate and then in actually carrying forward the arbitration. Having made substantial investments in developing investor-State arbitration capabilities, these law firms also have a strong incentive to encourage clients to choose this form of dispute settlement. Finally, in a relatively short time, tribunals and law firms have refined the technology and processes of investor-State arbitration, thereby facilitating the handling of cases and perhaps, as a result, encouraging other aggrieved investors to invoke this process.

6. Lack of Other Satisfactory Dispute Resolution Remedies

An investor-State arbitration is a costly, risky, time-consuming process that usually has the effect of destroying whatever business relationships remain between the aggrieved investor and the host country. One can assume, therefore, that a rational investor will not lightly resort to this dispute settlement process and will examine other options for redress of its grievance before doing so. The final and perhaps most important reason for increased recourse to investor-State arbitration may be that aggrieved investors, having undertaken that search for other options, have concluded that they have no more cost-effective, reliable remedy for the settlement of disputes than investor-State arbitration. If, on the other hand, host countries and international investors can find and develop effective alternatives to international investor-State arbitration for the settlement of treaty-based investment disputes, the costs of investment dispute settlement for both states and investors may decline while working relationships between investors and host governments may improve. The remainder of this Article will seek to identify possible alternatives and suggest how they may be shaped to meet the special needs of international investors and host governments.

II. *ALTERNATIVE DISPUTE RESOLUTION (ADR) AND INTERNATIONAL INVESTMENT*

A. *Dispute Resolution Processes in General*

To resolve a dispute, disputants can theoretically resort to one of four basic dispute settlement processes. These four basic processes, with numerous variations, include: (1) negotiation, whereby the parties themselves through direct discussion of their conflict agree to settle their dispute, a process that sometimes results in a renegotiation of their underlying transaction or relationship; (2) mediation (often referred to as "conciliation" in international business and investment disputes) or other forms of voluntary third-party intervention, by which a non-disputant third person assists the disputants to resolve their conflict;⁴⁵ (3) arbitration, by which the parties to the dispute agree to submit their dispute to a third person for a decision and to abide by that decision; and (4) adjudication by a court of law or some other governmental authority. As figure 1 indicates, these four dispute resolution processes form a continuum from negotiation on the one hand to adjudication on the other.

As the parties in conflict move along the continuum, they increasingly lose control of their dispute and are increasingly subject to the actions of a third party. In relying on negotiation alone, the parties retain complete control over their dispute. In mediation, they still maintain control over their dispute but the very presence of a third person changes the dynamics between them and can influence their actions. Arbitration requires an agreement by the parties to submit to the process; however, once a dispute is referred to arbitration, the arbitral panel controls the dispute and has the power to impose a decision according to the applicable law. In adjudication, the jurisdiction and procedure of the courts is based on law rather than on the parties'

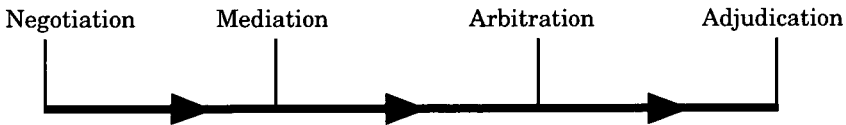
45. One scholar has defined mediation as:

[A] process of conflict management, related to but distinct from the parties' own efforts, where the disputing parties or their representatives seek the assistance, or accept an offer of help, from an individual, group, state or organization to change, affect or influence their perceptions or behavior, without resorting to physical force or invoking the authority of the law.

Jacob Bercovitch, *The Structure and Diversity of Mediation in International Relations*, in *MEDIATION IN INTERNATIONAL RELATIONS: MULTIPLE APPROACHES TO CONFLICT MANAGEMENT* 1, 7 (Jacob Bercovitch & Jeffrey Z. Rubin eds., 1992).

agreement, as is the case in arbitration.⁴⁶

Figure 1



Disputants increasingly lose control.
Third party increasingly intrudes.

The four basic processes indicated above are not as distinct from one another as the diagram might lead one to believe. Mediation is not a process separate from negotiation; rather, it is the continuation of negotiation with the help of a third party. It is part of the bargaining process. To a lesser but still important extent, one can often interpret arbitration and litigation in many cases as a continuation of negotiation by other means.

Lawyers and many executives tend to view arbitration and adjudication as the principal ways of resolving international investment disputes. These two dispute settlement processes, however, suffer from several disadvantages. They are costly, time-consuming, unpredictable, lack finality in some cases, and destroy the business relationship between the disputants in nearly all cases. Indeed, if the goal of the parties in a dispute is to preserve their economic relationship (which usually requires a significant investment of resources to create in the first place), they should rely first and foremost on negotiation and mediation to solve their problem. Arbitration and adjudication are primarily means to liquidate an economic relationship. The end result of both arbitration and adjudication is a decision as to whether or not one of the parties is entitled to a sum of money in satisfaction of its claim. Neither the aim nor the consequence of arbitration is to repair a broken business relationship. Accordingly, given the ever-present potential for conflict in international investments, the parties to international transactions, particularly in long-term arrangements, should consider the role of negotiation and mediation in resolving eventual disputes. Moreover,

46. See JESWALD W. SALACUSE, *THE GLOBAL NEGOTIATOR: MAKING, MANAGING, AND MENDING DEALS AROUND THE WORLD IN THE TWENTY-FIRST CENTURY* 225-27 (2003).

they might even build these dispute settlement processes into their transaction from the very beginning of their dealings together, before any conflict has arisen.

B. *ADR*

In the field of conflict studies, the expression Alternative Dispute Resolution (“ADR”) has become an established term of art that designates various mechanisms whereby a third party, not directly involved in the dispute, intervenes, with or without an invitation, to assist the disputants to settle their conflict. It is believed that the term ADR arose and gained currency in the United States in the mid-1970s when its courts and legal scholars, concerned about increasing judicial case loads, a “purported litigation boom,” and the questionable appropriateness of the judicial process to certain types of disputes, began a search for alternative processes of dispute resolution.⁴⁷ In that context, the meaning of “alternative dispute resolution” referred to dispute resolution processes that were alternatives to the courts. As a result, in the United States and elsewhere, there developed ADR centers to facilitate or mediate disputes among citizens, ADR practitioners to assist not only in purely private disputes but also those involving the community and government agencies, and ADR studies to further the theory and practice of this form of dispute settlement.

Over time, the application of ADR techniques has become common in a wide variety of settings, including disputes within large organizations, conflicts between neighbors and family members, public controversies over the construction of large infrastructure projects having negative effects on the environment and the surrounding community, and even governmental rule making.⁴⁸ ADR has also been extended to the realm of international political and ethnic disputes, though the courts are not a realistic alternative for those kinds of disputes. The work of for-

47. CARRIE J. MENKEL-MEADOW ET AL., *NEGOTIATION: PROCESSES FOR PROBLEM SOLVING* 624 (2006).

48. DEAN G. PRUITT & SUNG HEE KIM, *SOCIAL CONFLICT: ESCALATION, STALEMATE AND SETTLEMENT* 228 (3d ed. 2004) (citing Bertram I. Spector, *Negotiated Rulemaking: A Participative Approach to Consensus-Building for Regulatory Development and Implementation*, U.S. Agency for Int’l Development Implementing Policy Change Project, Technical Note No. 10, May 1999, at 1, available at http://www.usaid.gov/our_work/democracy_and_governance/publications/ipc/tn-10.pdf).

mer U.S. Senator George Mitchell in mediating the conflict between Catholics and Protestants in Northern Ireland,⁴⁹ of former President Jimmy Carter facilitating a settlement resulting in the 1979 Camp David Accords between Egypt and Israel,⁵⁰ and of the Norwegian foreign ministry in helping to broker a ceasefire in Sri Lanka⁵¹ are considered examples of Alternative Dispute Resolution in the international context.

While the term ADR may be relatively new in the English lexicon, its underlying processes are as ancient as human society itself. Third parties, acting as mediators, facilitators, or conciliators and even arbitrators, have intervened in the disputes of other persons since the dawn of civilization. What characterizes this intervention is that the third party is assisting the disputants to negotiate their dispute. Throughout the process, the disputants maintain control of their dispute and preserve their right to agree to or refuse a proposed settlement or even to withdraw entirely from the ADR process. For this reason, ADR is sometimes referred to as “facilitated negotiation,” recognizing that the role of the third party is to facilitate a negotiated settlement of the parties’ dispute. Methods of third-party intervention and facilitation vary widely depending on the talents and resources of the intervener, the nature of the dispute in question, and the interests and needs of the disputants. In short, ADR does not offer a single magic formula to settle all disputes.

In the domestic context, arbitration is often considered a form of ADR since it is a dispute resolution process that stands as an alternative to a court proceeding. In the international investment domain, however, where international adjudication has an extremely limited scope and where arbitration under investment treaties has become a standard form of dispute resolution, the term “alternative dispute resolution” can refer to those dispute resolution processes that stand as alternatives to both international arbitration and adjudication in domestic courts. This Article adopts that definition.

Proponents of ADR argue that it has significant advantages over the courts. ADR, it is claimed, is quicker, less costly and

49. See generally GEORGE MITCHELL, *MAKING PEACE* (2001).

50. See DAVID W. LEASCH, 1979: THE YEAR THAT SHAPED THE MODERN MIDDLE EAST 4 (2001).

51. See Dr. S. Chandrasekharan, *Sri Lanka: Cease-Fire Agreement and Prospects for Peace*, S. Asia Analysis Group, Mar. 15, 2002, available at <http://www.saag.org>.

more effective at preserving or rebuilding relationships between the parties than judicial decisions. A judicial decision, like an arbitration award, is one-dimensional—an award of money damages or denial thereof—whereas settlements arrived at through ADR are more likely to be multifaceted and take into account the disputants' interests and needs. It is also argued that ADR often results in agreements that are more optimal and stable than arrangements made by the parties alone or decisions rendered by an adjudicative body, such as a court or an arbitral tribunal.

C. *An Explanation For The Efficacy of ADR*

Despite the popularity and apparent success of ADR in many countries, one may well ask how the intervention of a third person—a mediator or conciliator—enables parties to reach a negotiated settlement when the parties, fully competent as they are, are unable to do so. With respect to investor-State disputes, the question is especially salient: What can a third person do to facilitate a negotiated solution that a state and a multinational corporation, with all their resources, cannot achieve by themselves? The question has practical as well as theoretical significance. Unless the parties believe that a third person can truly help to resolve their dispute, they are not likely to seek or accept that person's assistance.

To answer the question, one must begin with a preliminary inquiry: Why do negotiations fail? Scholars of negotiation contend that negotiations fail because of the existence of "barriers to agreement."⁵² These barriers are of various types. Some arise from the strategies and tactics of the parties, and may therefore be called "strategic barriers," including the drive to achieve a short-term gain, the refusal by the disputants to discuss their interests or to reveal information needed to arrive at agreement for fear they will be exploited by the other side, and the use of threats and aggressive behavior to intimidate the other side. Others fall into the category of "psychological barriers," that is, those that arise out of cognitive and motivational processes of human beings, including the way they interpret information, experience feelings of gain or loss, evaluate risks, and deal with

52. See Robert H. Mnookin & Lee Ross, *Introduction to KENNETH J. ARROW ET AL., BARRIERS TO CONFLICT RESOLUTION* 6 (1st ed. 1995).

biases and emotions related to their dispute. Still other barriers can be labeled as “structural” because they are based in the structure of the situation that confronts the disputants. For example, the political limitations imposed upon negotiators, the bureaucratic obstacles to agreement in their respective organizations, the existence of important constituencies seeking to obstruct any agreement, and the political constraints felt by governments involved in disputes.⁵³

One can identify such barriers in investor-State investment disputes. With respect to strategic and tactical barriers, the parties may be reluctant to put forward proposals for a negotiated agreement because they fear the other side will interpret that action as “weakness” and therefore demand even more concessions. A history of hostility between the investor’s local managers and relevant host government officials may create a psychological barrier to a negotiated settlement. And, as noted above with respect to the “Pyramids Case” in Egypt, the politics surrounding the investor-State dispute and the existence of local interest groups opposed to settlement may result in a structural barrier that makes it difficult for government officials to agree to settle the dispute with the investor. A further structural barrier in investor-State disputes is that, while many government agencies become involved in the dispute, no single agency is authorized to conduct negotiations on behalf of the government to reach a settlement.⁵⁴ As no two investor-State disputes are identical, no two investor-State disputes face the same barriers.

The basic task of the mediator who intervenes in the dispute is to help the parties overcome the barriers to agreement. The way in which a particular mediator accomplishes this task will differ depending on the nature of the dispute, the history of the relations between the parties, and the skills and resources of the individual mediator. Just as no two disputes are alike, no two mediators are alike in the way that they work. Mediators demonstrate a great variation in the roles, approaches, procedures and foci that they adopt.⁵⁵ Some are more interventionist and direc-

53. See *id.* at 6-24.

54. See Barton Legum, *The Difficulties of Conciliation in Investment Treaty Cases: A Comment on Professor Jack C. Coe's Toward a Complementary Use of Conciliation in Investor-State Disputes A Preliminary Sketch*, 21 MEALEY'S INT'L ARB. REP., no.4, 2006, at 23.

55. See CHRISTOPHER W. MOORE, *THE MEDIATION PROCESS: PRACTICAL STRATEGIES FOR RESOLVING CONFLICTS* 43-56 (2003).

tive than others. In the field of labor mediation, for example, one scholar has categorized mediators into two groups: "orchestrators," who focus primarily on creating procedural and process arrangements to facilitate a negotiated agreement, and "deal makers," who concentrate on finding solutions to the substantive issues that divide the parties.⁵⁶

Beyond these theoretical considerations, one may well ask: What is it that mediators actually do to facilitate a settlement of a conflict between other persons? In general terms, a mediator *helps* the parties resolve their conflict, which in most cases means assisting them to negotiate a solution. A mediator, unlike an arbitrator or a judge, has no power to impose a solution. At the outset, one needs to recognize that a single, magic mediation formula does not exist. Different mediators do different things. In the international political domain, Jimmy Carter, George Mitchell, and the Norwegian Foreign Ministry, all successful mediators, each used different techniques to mediate the disputes they confronted. For one thing, mediators intrude into a conflict to different degrees, depending on the nature of the dispute, the parties, and their own skills, resources, and judgment. In general terms, there are three basic areas that mediators seek to address in their efforts to facilitate a negotiated agreement between the parties: a) process, b) communications, and c) substance.

1. Process

At the most basic level, a mediator may simply work to shape a more productive process of interaction between the parties in the dispute. For example, parties to a dispute may be unwilling to talk to one another or even to suggest a meeting for fear that such action would be interpreted as weakness. On the other hand, they may be willing to meet if the meeting is proposed, organized, and conducted by a mediator who has their respect. The site where mediation takes place can have an impact on the conflict dynamic, so the mediator's choice of a meeting site is an important decision. The site's neutrality, privacy, and security may be conducive to a settlement. It is for this reason that Camp David, the retreat of U.S. presidents, has been a favored site for conflict mediation.

56. See DEBORAH KOLB, *THE MEDIATORS* 41-43 (1983).

One process technique that many mediators use is to *caucus* individually with the disputants in order to learn of their underlying interests and concerns. In a one-on-one session with the mediator, disputants may be more frank about their interests and concerns and less confrontational and emotional, thereby giving the mediator insights into how best to resolve the conflict. Some research suggests that when hostility between the parties is high, bringing them together too soon may serve to exacerbate the conflict, rather than begin a process toward resolution.⁵⁷ In these preliminary meetings, mediators often try to develop and achieve agreement on some basic ground rules for the disputants to employ in conducting their discussions together. Mediators also work to increase the parties' motivation to solve their problem themselves. They do this by talking optimistically about the possibilities for resolution, by using their relationship with each disputant to encourage them to work sincerely to find a solution, and by seeking ways to build trust between them.

2. Communications

Merely creating a better process may not be enough to settle the dispute. Mediators also try to find ways to improve *communications* between contending parties. For example, mediators often help the two sides understand and acknowledge the legitimacy of each other's interests and needs and to avoid the use of inflammatory, emotional language in their communications with each other. One important way by which a mediator can improve communications between the parties is to help them define the precise issues in dispute and to help them stay focused on those issues during the discussion. A conflict is often exacerbated by parties' misperceptions of each other and distortions caused by hostility. By defining the issues, the mediator can move the parties toward active problem solving and away from personal recriminations. More than merely defining the issues, the mediator can facilitate settlement by reframing the issues in a way that appeals to the interests of both parties.

In addition to reframing issues, another mediation technique is to sequence issues; that is, to develop an agreed-upon agenda as to the order in which the parties will address the issues in dispute. Sometimes a mediator can create momentum toward

57. See PRUITT & KIM, *supra* note 48, at 229.

a solution and build confidence between the parties by taking up and resolving the easier issues before addressing the more difficult ones.

3. Substance

Finally, when the disputants remain locked in their positions, mediators offer *substantive* suggestions as to how the two parties might solve their problem. In working on the substance of the problem, mediators often use a variety of techniques and resources to validate the merit of their ideas, to deflate the parties' expectations and indicate the weaknesses in the parties' positions. A mediator's effectiveness in this regard will often depend on his or her reputation, expertise, relationships with the parties, and base of experience.

D. *The Potential Application Of ADR To Treaty-Based Investor-State Disputes*

For some governments and observers, the growth in the number of treaty-based, investor-State arbitrations is a new form of "litigation explosion," comparable to the litigation "boom" experienced in the United States, a situation that has provoked a search for alternative dispute resolution mechanisms. In the case of international investment disputes, the search is not for an alternative to the courts but to treaty-based international arbitration.

An initial inquiry in the search for alternatives to investor-State arbitration is to ask: What are the existing alternatives to investor-State arbitration to which an aggrieved investor may have recourse in its dispute with a host government? Aside from international arbitration, an investor aggrieved by the actions or inaction of a host government has four options: (1) recourse to the courts or other judicial institutions of the host country; (2) acceptance of governmental action by absorbing or off-setting the costs of alleged wrongful governmental action or inaction; (3) direct negotiation of a settlement of the dispute with the host government; or (4) mediation, conciliation, or other non-binding dispute resolution methods involving the help of a third party. Each of these processes is evaluated from the point of view of the investor, since it is the aggrieved investor who chooses among alternatives in selecting a particular dispute set-

tlement mechanism. Normally, the investor will make that choice by weighing and comparing the potential costs and benefits offered by each alternative.

1. Local Courts

A first alternative to investor-State arbitration for aggrieved investors is recourse to the courts of the host country. Depending on the country involved, this option, which some investment treaties require as a step preliminary to arbitration, may pose a variety of problems for foreign investors. First, depending on the country concerned, local courts may suffer from a lack of judicial independence and be subject to the political control of the host government, thus depriving the investor of a neutral forum. Second, even if the judiciary is independent, it may nonetheless harbor prejudice toward foreign investors, as the courts of the state of Mississippi demonstrated in the ICSID case of *Loewen Group, Inc. v. United States*.⁵⁸ Third, many local courts may not have the expertise to apply complex principles of international law to complicated foreign investment transactions. Fourth, even if judges have such expertise, domestic law may prohibit local courts from adjudicating on their state's international commitments and therefore deny them jurisdiction over treaty claims made by investors. And finally, local courts often strain under a heavy backlog of cases and inefficient procedures that deny expeditious justice and make the prospect of any final judicial determination of a dispute illusory. For these reasons, investors do not generally consider local courts an effective alternative to international arbitration of their disputes, and they therefore seek to avoid them. Indeed, one of the principal reasons for creating the investor-State arbitration system was to enable investors to avoid the courts of the countries in which they had invested.

On the other hand, the degree to which these factors are present varies from country to country. To the extent that efforts at judicial reform and capacity-building succeed in particular countries, the attractiveness of local courts as an alternative to international arbitration for the resolution of investor-State disputes may increase in those countries.

58. 7 ICSID (W. Bank) 421, 451-53, 468-69 (2003).

2. Acceptance And Internal Adjustment

Not all alleged violations of investment treaties result in litigation or arbitration. Depending on the costs of alleged wrongful governmental action, an investor may merely decide to absorb or find ways of off-setting the costs of that action. The investor makes that decision essentially on the basis of an evaluation of the costs and benefits of other actions in comparison to acceptance. In making that calculation, the investor will often evaluate the long-term benefits of continuing productive relations with the host country government and the local business community against the costs to be incurred by taking some other action. The decision will also be influenced by the investor's ability to absorb the additional costs or to shift those costs to other persons. In short, while a government action may provoke a conflict (i.e. a perceived divergence of interests) with the investor, the investor may choose not to convert its conflict into a dispute by activating it.

On the other hand, while host governments always assume that the investor can and should take this acceptance option, there are powerful forces driving against it. The shareholders, creditors, financing institutions and other stakeholders of corporate investors expect corporate management to maximize profits for the corporation so as to benefit those stakeholders. If, as a result of a governmental action violating an investment treaty, a corporate investor has a substantial claim under international law against the host country, corporate management may have an obligation to pursue that claim vigorously. In the abstract, the failure to do so may be viewed under the law applicable to the corporation or its contract with stakeholders as a violation by management or the board of directors of their legal duties to shareholders and other stakeholders. A substantial claim under international law against a host state is a corporate asset, and the investor therefore may have a legal obligation not to abandon it, particularly if that claim has a material impact on the operations of the investor. In evaluating the worth of that claim, corporate management will usually rely on the advice of their internal legal counsel, who in turn consults and is influenced by the company's external litigation law firm. Depending on its personnel and experience, that law firm may have a predisposition to litigate to resolve disputes and that predisposition may lead it to

recommend the initiation of arbitration. Moreover, some observers also contend that, since law firms have a financial interest in litigating claims on behalf of their corporate clients, their evaluation of potential success in arbitration may be strongly influenced by their self-interest in earning litigation fees.⁵⁹

A further argument against doing nothing in the face of an alleged investment treaty violation is that it may encourage other violations in the future. If an investor does nothing in response to a host country violation, it may consider itself to be more vulnerable to other violations in the future by the host state in question or other host states where it has other investments. If the investment treaty is truly to serve as a discipline on host government behavior, individual investors must be willing to challenge that behavior by invoking the treaty's provisions.

On the other hand, it must be acknowledged that any system of litigation entails the risk of frivolous lawsuits, and investor-State arbitrations are no exception. Investors may bring baseless arbitrations either because they honestly have miscalculated the strength of their claims, because they view the arbitration as a means to pressure a negotiated settlement from the host state, or because they believe they have relatively little to lose and the potential to gain a great deal. One way for arbitrators to dissuade such frivolous cases is to allocate all or a substantial portion of the arbitration costs to such claimants if they lose their case.

3. Negotiation

Many disputes between foreign investors and host countries are resolved through negotiation. Indeed, nearly all investment treaties provide that in the event of a dispute between an investor and the host country the two parties are to engage in consultations and negotiations, often for a specified period of time (six

59. Scholar and arbitrator Thomas W. Wälde strongly insists on this point: Essentially, managers when faced with disputes often give up and just pass them on to corporate lawyers who pass them on to specialised international law firms who pass them on to the very narrow club of international arbitrators. The sense of business, of commercial efficiency, of proactive rather than reactive assault on managerial challenges, gets lost on the way: managers simply give up. The lawyers run away with such disputes into their own playing fields.

Thomas W. Wälde, *Efficient Management of Transnational Disputes: Mutual Gain by Mediation or Joint Loss in Litigation*, 22 *ARB. INT'L* 205, 206 (2006).

months in many cases), before the investor may seek other remedies. As a result, it is safe to say that virtually all such disputes go through a period of negotiation before reaching settlement or advancing to the stage of formal investor-State arbitration. Because of the confidentiality usually surrounding such settlements, accurate, comprehensive statistics on negotiated settlements of investor-state conflicts are not available. Still, one would suppose that over the last eighteen years, such settlements vastly outnumber the estimated 229 investor-State arbitrations that have been lodged.

Negotiations may be conducted before or after the investor has begun arbitration. For example, in 2006 an ICSID case brought by the Western NIS Enterprise Fund (the "Fund") against Ukraine⁶⁰ was terminated when the two disputants agreed to a settlement whereby the Fund was reimbursed by Ukraine for certain loans that it had made.⁶¹ It is estimated that thirty percent of all cases registered at ICSID are settled through negotiations, rather than by a binding award of an arbitral tribunal.⁶² Approximately two-thirds of all arbitration cases filed with the International Chamber of Commerce Court of Arbitration are settled by negotiation before an arbitral award is made.⁶³

Since direct, unassisted investor-State negotiation is an alternative to investor-State arbitration, policy makers need to seek ways to make this alternative more attractive to investors and more efficient for arriving at settlements that are satisfactory to the parties. A first step in this direction would be for governments to designate and authorize a specific government agency to have responsibility for managing investor-State disputes when they arise and for negotiating settlements of such conflicts. A second step involves the central government's coordination with sub-national units of states. Many investor-State disputes arise, not because of actions taken against investor interests by central governments, but because of actions taken by various sub-na-

60. *W. NIS Enter. Fund v. Ukraine*, ICSID (W. Bank) Case No. ARB/04/2 (Jan. 26, 2004).

61. See Luke Eric Peterson, *Ukraine Reaches Settlement in BIT Claim by US-Gov't Venture Capital Fund*, *INV. TREATY NEWS*, July 4, 2006, available at http://www.iisd.org/pdf/2006/itm_july4_2006.pdf.

62. See Coe, *supra* note 29, at 35.

63. See Eric Schwartz, *International Conciliation and the ICC*, 10 *ICSID REV. - FOREIGN INV. L.J.* 98, 99 (1995).

tional officials and agencies such as governors, state assemblies, and town councils. In many cases, such actions are taken by local officials without any knowledge of applicable treaties and the rights they confer on investors. Moreover, such local officials and agencies may exacerbate resulting conflicts and take actions that tend to politicize them. This suggests that one possible avenue of reducing the likelihood of investor-State disputes is to better inform such local officials of the state's treaty obligations and their impact on sub-national units and to develop better means of detecting the development of conflicts so that the central government might be able to play a role in settling them at an early stage.

In the long run, an improvement in the use of negotiation as an alternative dispute settlement process requires a better understanding of how investor-State negotiations take place. Although it is difficult to generalize in the absence of systematic evidence, individual cases highlight factors that can contribute to the success or failure of a negotiation. For example, in 1993, Enron, a U.S. corporation, and the Maharashtra State Electricity Board ("MSEB") in India signed a contract whereby a consortium led by Enron would build the Dabhol Power Project, a US\$2 billion investment. The MSEB signed an agreement to buy all the electricity produced by the Project over the following twenty years. When a new government came to power in Maharashtra as a result of elections, it cancelled the contract, alleging that the power tariff was too high and that the contract was not in the State of Maharashtra's best interests. Negotiations between the State of Maharashtra and Enron succeeded, resulting in modification of the contract, a reduction in power tariffs, and the continuation of the project. One factor that led to this result was that Enron's business strategy in India at the time contemplated undertaking numerous energy projects throughout India in the years to come. Enron judged those potential future investment relationships to be worth more than winning an arbitration award in a case that would certainly be a protracted struggle and that might ultimately destroy its opportunities to undertake other power projects in the country. It therefore constantly remained open to a negotiated settlement throughout its conflict with the State of Maharashtra.

Maharashtra's subsequent reevaluation of its own interests also led it to become more open to a negotiated settlement.

When the Maharashtra government cancelled the electricity supply agreement, it assumed that its action would entail relatively little cost. It also assumed that other investors would be willing to step into the shoes vacated by Enron or that the State would be able to find indigenous solutions to its power shortage. Once those assumptions proved false and once Enron had begun an arbitration case in London with a claim of US\$300 million, the State of Maharashtra became considerably more open to renegotiation than it was at the time it cancelled the contract.⁶⁴ Thus, it appears that at least in some cases, the existence of an investor-State arbitration remedy for the investor may encourage disputant flexibility and create an incentive for host governments to negotiate a settlement. It may well be, when examining the totality of investor-State negotiations, that the prospect of investor-State arbitrations is a factor inducing negotiated settlements of investor-State disputes.

The initiation of an arbitration may both favor and discourage negotiated settlements, depending on the circumstances. On the one hand, faced with the hard realities of the costs, slow pace, and unpredictability of arbitration, some parties may be encouraged to negotiate a settlement of their dispute rather than to incur more expense and delay. On the other hand, the initiation of arbitration may itself create a psychological barrier to settlement because it causes the parties to harden their position and reject flexibility in their approach to one another.

A variety of factors can prevent the achievement of a negotiated settlement. The host government's belief that vital national interests are at stake, the investor's perception that its crucial economic interests are in play, the political dynamics of the host country, the inability of the investor to mitigate its loss by other means, and the appointment by the parties of incompetent or dysfunctional negotiators to represent them are just some of the factors that can inhibit or halt the negotiation process.

Unrealistic expectations of the parties are a further obstacle to successful negotiations. The alternative to a successful negotiation in most cases is arbitration in which the investor will be the claimant and the state refusing that claim the respondent. International investor-State arbitration has risks and costs for both sides, and it is important that both sides understand them thor-

64. See SALACUSE, *supra* note 46, at 236-47.

oughly as they approach the negotiation process so they can accurately evaluate the worth of a settlement proposal advanced by the other side. Not surprisingly, parties to a dispute, influenced by psychological and political factors, tend to view their conflict from their own points of view, leading them to overestimate their chances of success in any eventual litigation. When the investor overvalues the strength of its treaty claim and the host state undervalues the worth of the claimant's case, opportunities for a successful negotiated settlement decline. Various factors may lead to this miscalculation, including the failure of their lawyers to give their clients a realistic and brutally frank assessment of the strength of their respective cases and the likelihood of prevailing in arbitration. One possible means of overcoming these various barriers to a negotiated settlement is through the intervention into the dispute of a skillful, well-intentioned third party who can provide the disputants with a neutral, disinterested evaluation of their respective cases.

4. Mediation, Conciliation, And Other Forms Of Voluntary Third-Party Intervention

In theory and in law, there is no reason why mediation and other forms of ADR, as previously described, could not be applied to resolve investor-State disputes just as they are successfully applied in a wide variety of other contexts. Certainly, nothing in any international investment treaty prohibits recourse by the parties to mediation or other alternative dispute resolution processes to settle potential treaty claims. On the other hand, few investment treaties specifically authorize or recognize the applicability of ADR to investor-State disputes. Those that do only tend to make reference to conciliation, which is a form of ADR but does not necessarily encompass the range of techniques and approaches traditionally associated with ADR.

With respect to non-adjudicative methods for the resolution of investor-State disputes, the traditional formulation found in many, if not most, investment treaties is that in the event of an investor-State dispute, "the parties to the dispute shall initially seek to resolve the dispute by consultations and negotiations,"⁶⁵

65. Agreement on the Reciprocal Promotion and Protection of Investments, Austl.-Vietnam, art. 12(1), Mar. 5 1991, Austl. T.S. No. 36, available at http://www.unctad.org/sections/dite/iaa/docs/bits/australia_vietnam.pdf.

“the dispute shall, as far as possible, be settled amicably through negotiations between the parties,”⁶⁶ or “the dispute shall . . . as much as possible be settled amicably between the parties.”⁶⁷

Although these treaty provisions requiring the parties to engage in negotiations and consultations before initiating arbitration do not specify how those negotiations and consultations are to be conducted, they certainly do not prevent the parties from seeking the assistance of third parties such as mediators, conciliators, or facilitators, to help them in their negotiations and consultations. On the other hand, specific language encouraging or authorizing the use of ADR might serve as an important signal to both governments and investors that the states in question intended to encourage disputants to have recourse to ADR and that they should approach the resolution of their dispute accordingly. Although no supporting evidence exists, it is possible that a treaty’s failure to authorize ADR has inhibited disputants from using it in individual cases.

Some treaties specifically authorize the use of conciliation, which is the only form of non-binding third party procedure that they recognize. For example, the Japan-P.R.C. BIT (1988) gives the investor the option of resorting either to conciliation or arbitration.⁶⁸ However, no treaty requires its use.

Other treaties contain specific language expressly authorizing the use of alternative resolution techniques as part of the negotiation and consultation process. For instance, the United States-Poland BIT (1990) states: “In the event of an investment dispute . . . the parties to the dispute shall initially seek to resolve the dispute by consultation and negotiation, which may include

66. Agreement Between the Government of the People’s Republic of China and the Government of the Republic of Singapore on the Promotion and Protection of Investments, P.R.C.-Sing., art. 13(1), Nov. 21, 1985, *available at* <http://www.fmprc.gov.cn/eng/wjzb/zjzg/yzs/gjlb/2777/2778/t16194.htm>.

67. “Tout différend relatif aux investissements entre l’une des Parties contractantes et un national ou une société de l’autre Partie contractante est autant que possible réglé à l’amiable entre les deux Parties concernées.” L’accord entre le Gouvernement de la République Française et le Gouvernement de la République de Panama sur le traitement et la protection des investissements, Fr.-Pan., art. 8, ¶ 1, Nov. 5, 1982, *Journal Officiel de la République Française* [J.O.][Official Gazette of France], October 17, 1985, p. 12067.

68. Agreement Between the People’s Republic of China and Japan Concerning the Encouragement and Reciprocal Protection of Investment, Japan-P.R.C., art. 11(2), Aug. 27, 1988, 1555 U.N.T.S. 238.

the use of non-binding, third-party procedures.”⁶⁹ Article 6(2) of the United States-Turkey BIT (1985) provides that if negotiations are unsuccessful, “the dispute may be settled through the use of non-binding, third party procedures upon which [the parties] mutually agree.”⁷⁰ And Article 23 of the United States Model BIT (2004) also provides: “In the event of an investment dispute, the claimant and the respondent shall initially seek to resolve the dispute through consultation and negotiation, which may include the use of non-binding, third party procedures.”⁷¹ This language appears to represent an attempt by states to underscore the importance of alternative dispute resolution techniques and to introduce them into the investor-State dispute resolution process.

It is difficult to determine exactly the extent to which such third-party intervention actually takes place in investor-State disputes. It may well be that third parties such as local business leaders, diplomats, politicians and others, play a role in facilitating the investor-State disputes that are successfully settled through negotiation. While these third parties may not be designated formally as mediators, they may nevertheless exercise mediation functions.

The willingness of disputants to resort to mediation or other ADR techniques depends among other factors on their knowledge of and experience with these processes.

Traditionally, companies engaged in an international business dispute have not actively sought the help of mediators. They have first tried to resolve the matter themselves through negotiation, but when they judged that to have failed, they have immediately proceeded to arbitration. Various factors explain their failure to try mediation: their lack of knowledge about mediation and the availability of mediation services, the fact that companies tend to give control of their disputes to lawyers whose professional inclination is to litigate, and the belief that mediation is merely a stalling tactic that only delays the inevitability of an arbitration proceed-

69. Treaty Concerning Business and Economic Relations, U.S.-Pol., art. 9(2), Mar. 21, 1990, S. Treaty Doc. No. 101-18 (1990).

70. Treaty Concerning the Reciprocal Encouragement and Protection of Investments, U.S.-Turk., art. 6(2), Dec. 3, 1985, S. Treaty Doc. No. 99-19 (1986).

71. US Model Bilateral Investment Treaty, art. 23 (2004), available at <http://www.state.gov/e/eeb/rls/othr/38602.htm>.

ing.⁷²

With increasing recognition of the disadvantages of arbitration, some companies are beginning to turn to more explicit forms of mediation to resolve business disputes.⁷³ Increasingly, when a dispute can be quantified (for example the extent of damage to an asset by a partner's action or the amount of a royalty fee owed to a licensor), the parties will engage an independent third party such as an international accounting or consulting firm to examine the matter and give an opinion. The opinion is not binding on the parties but it has the effect of allowing them to make a more realistic prediction of what may happen in an arbitration proceeding.

Host countries' lack of experience with and detailed knowledge of ADR in its application to investor-State disputes may also explain why they have not resorted to these means more often. The politics of investor-State disputes may also be a complicating factor in this regard since resorting to ADR might be viewed as weakness or as compromising national interests, particularly once the investor has initiated international arbitration. Specific authorization in an investment treaty to use ADR techniques might counter this reaction to some extent.

One type of voluntary third-party intervention that has particular relevance for investor-State conflicts is *conciliation*. Many arbitration institutions, such as ICSID and the International Chamber of Commerce, offer a service known as conciliation, which is normally governed by a set of rules.⁷⁴ Indeed, certain investment treaties specially provide for conciliation as an option in investor-State disputes. Generally, in institutional conciliation, a party to a dispute addresses a request for conciliation to the institution offering conciliation services. If the institution concerned secures the agreement of the other disputant, it will appoint a conciliator. While the conciliator has broad discretion

72. Jeswald W. Salacuse, *Mediation in International Business*, in *STUDIES IN INTERNATIONAL MEDIATION* 213, 222 (2002).

73. For example, General Electric Corporation has developed a program known as the Early Dispute Resolution Initiative that seeks to save money and time through the effective use of dispute resolution techniques outside of formal litigation and arbitration, often with external mediators. See Michael Wheeler & Gillian Morris, *GE's Early Dispute Resolution Initiative (A)*, Harvard Business School Case No. 9-801-395 (2001).

74. See, e.g., ICSID, *Rules of Procedure for Conciliation Proceedings*, in *ICSID CONVENTION, REGULATIONS AND RULES* (2006), available at <http://www.worldbank.org/icsid/basicdoc/basicdoc.htm>.

to conduct the process, in practice he or she will invite both sides to state their views of the dispute and will then make a report proposing an appropriate settlement. The parties may reject the report and proceed to arbitration, or they may accept it. In many cases, they will use it as a basis for a negotiated settlement.

Conciliation is thus a kind of non-binding arbitration.⁷⁵ Its function is predictive. It tends to be rights-based in its approach, affording the parties a third person's evaluation of their respective rights and obligations. If, as indicated above, mediators work on process, communications, and substance of disputes, conciliators focus almost exclusively on the substance of the dispute. They do not usually adopt a problem-solving or relationship-building approach to resolving the dispute between the parties, nor do they seek to eliminate the various psychological, strategic, and structural barriers that obstruct negotiations. The conciliation process is confidential and completely voluntary. Either party may withdraw from conciliation at any time.

One theoretical question that is sometimes raised is how to categorize conciliation. It has been argued that it is a process separate and distinct from mediation; however, if one defines mediation as a voluntary process by which a third person assists the disputants to negotiate a settlement of their dispute, then conciliation clearly falls within the category of mediation.⁷⁶ Conciliation as it is currently practiced would appear to be a form of mediation, albeit narrower in scope: Its primary focus is to propose a solution that the parties may use as a basis of a negotiated settlement rather than to work on process and communications and seek to eliminate the various other barriers to agreement. The conciliator has no power to impose a decision. The primary function of the conciliator's report is to help the parties negotiate a settlement.

Since conciliation is confidential, public information on the process itself is scant. One of the few published accounts concerns the first conciliation conducted under ICSID auspices in which a retired English judge, Lord Wilberforce, successfully acted as a conciliator to help resolve a dispute involving the distri-

75. See Ucheora Onwuamaegbu, *The Role of ADR in Investor-State Dispute Settlement: The ICSID Experience*, 22 NEWS FROM ICSID 12-14 (2005).

76. See Coe, *supra* note 29, at 14.

bution of US\$143 million in profits between Tesoro Petroleum Corporation and the State of Trinidad and Tobago. The conciliation, which started in 1984, took less than two years and cost a mere US\$11,000.⁷⁷ Despite the success of ICSID's first conciliation and despite the reference to conciliation in some investment treaties, this form of dispute settlement has not become widely used to resolve investor-State disputes. For example, by 2006, ICSID had received 196 requests for arbitration since its creation and only five requests for conciliation.⁷⁸ Similarly, from 1988 to 1993, a period in which over 2,000 arbitration cases were filed at the International Chamber of Commerce, it received only fifty-four requests for conciliation. Of that number, the other party in the dispute agreed to conciliation in only sixteen cases; however, the ICC appointed only ten conciliators, since the parties in six cases settled their dispute or withdrew their request. Of the ten conciliations, nine had been completed by 1994, with five resulting in complete settlement.⁷⁹ These figures do not mean that mediation is not frequently used in settling international business and investment disputes. It is quite possible that third parties, other than formally designated "mediators," "conciliators," or "facilitators" have played a role in helping the parties in investment disputes negotiate a settlement.

In considering the applicability of ADR to investor-State disputes, it must be stressed that conciliation as it is currently practiced and generally conceived of by many lawyers is only one rather limited form of mediation. In contrast to the rather passive and restricted role played by Lord Wilberforce in ICSID's first conciliation case is the very different approach adopted by a multidisciplinary team of mediators in successfully mediating an investment dispute between Vattenfall, a Swedish state-owned electricity company, and Polskie Sieci Elektroenergetyczne ("PSE"), a Polish integrated electricity company.⁸⁰ In the mid-

77. Lester Nurick & Stephen J. Schnably, *The First ICSID Conciliation: Tesoro Petroleum Corporation v. Trinidad and Tobago*, 1 ICSID REV. - FOREIGN INV. L.J. 343-48 (1986).

78. See ICSID, *List of Concluded Cases*, *supra* note 24; ICSID, *List of Pending Cases*, *supra* note 43 (listing all concluded and pending ICSID cases and distinguishing between arbitration and conciliation cases within the case numbers).

79. See Schwartz, *supra* note 63, at 107.

80. See Wälde, *supra* note 59, at 218-31 (discussing the conciliation case between Vattenfall and Polskie Sieci Elektroenergetyczne).

1990s, Vattenfall, seeking to develop an export market for its electricity, and PSE, fearing a future scarcity of electricity, entered into a twenty-year contract whereby Vattenfall would build and finance a US\$300 million undersea interconnector linking the two countries. PSE committed itself to purchase Vattenfall's electricity at fixed mid-1990s prices for a period of twenty years.

By the turn of the century, the energy environment of the two companies and their respective countries had changed dramatically. PSE now had an oversupply of electricity and electricity prices in Poland had dropped considerably from what they had been in the mid-1990s. As a result, PSE's long-term commitment to purchase Vattenfall's electricity became financially onerous. It therefore began negotiations with Vattenfall to reduce its price obligations and also to gain the right to sell its electricity to Sweden, using the undersea interconnector. When these negotiations failed, PSE refused to take and pay for Vattenfall's electricity under the contract, and Vattenfall, in response, threatened to take their dispute to international arbitration.

Rather than turn the dispute over to the two companies' litigators, the negotiators for the two sides decided to seek the help of a mediator in hopes of arriving at a negotiated settlement. Using a tender process, it secured the assistance of a mediation team consisting of a chief mediator and a few technical experts. Instead of merely hearing the legal arguments made by each side, the mediator actively worked to identify and eliminate the various barriers (the chief mediator referred to them as "blockages") that had to that point obstructed negotiations. Moreover, he also sought to find ways to improve three essential aspects of their negotiations: process, communications, and substance. Over a period of seventy-five days, which first involved intense individual consultations with the parties (a form of shuttle diplomacy between Stockholm and Warsaw) and then joint mediation meetings with the company's negotiators, the mediator was able to create a process that ultimately led to creative problem solving. The mediator understood that the dispute was not purely legal and technical. Various psychological and emotional factors on both sides had to be dealt with to create a "positive current" favoring a settlement. In addition, the mediator had to consult and mobilize various outside forces, such as European Commission officials and country regulators, so that they might contribute to a successful settlement of the dispute. In

the end, mediation enabled the two companies to negotiate, over an additional 100 days, a new contractual regime for the interconnector that allowed both sides to generate new revenues. The two companies thus achieved a win-win solution that created value for both and allowed them to avoid the costs and uncertainties of an international arbitration.

III. A *CONSIDERATION OF THE ADVANTAGES AND DISADVANTAGES OF ADR IN INVESTOR-STATE DISPUTES*

While mediation is not likely to replace arbitration and negotiation as basic means for settling investor-State disputes, its enhanced use as an *additional* dispute settlement process would seem to offer advantages to both investors and states. First, successful mediations are usually cheaper and less time-consuming than arbitrations. As indicated above, the average investor-State arbitration often extends over several years and consumes millions of dollars in litigation costs alone. For example, had Vattenfall and PSE gone to arbitration the two companies would easily have spent US\$5 million in litigation costs alone.⁸¹

Second, a successful mediation is more often likely to preserve working relations between the investor and the host government and be less disruptive of the underlying investment enterprise, avoiding the negative effect on the lives of people in the host country that may accompany such disruptions. In some cases, as in the Vattenfall-PSE dispute, mediation creates new value and allows the parties to derive revenues that would never have been possible as the result of arbitration. Whereas an arbitration award is a one-dimensional solution to a problem involving the granting or denial of money, a mediated solution to a conflict is often multidimensional and seeks to take account of the interests of both sides so as to arrive at a win-win solution. For example, if a host government has restricted the use of or seized land owned by the investor for reasons of public interest or public health, an arbitration would determine whether or not an illegal expropriation had taken place and, if so, how much the investor is to be compensated. A mediated solution to the

81. *See id.* at 232 (“In the Vattenfall-PSE dispute, arbitration would probably have meant significant costs (say US\$5m), but moreover the loss of profit which might by now have amounted to several hundreds of million of Euros, shared by both parties.”).

same problem might involve a complex arrangement whereby the government provides other land for the investor's use, the investor agrees to change its manner of using the land to meet government regulations, and the government modifies certain regulations. It is possible that such a mediated solution would allow the host state to meet its public interest concerns and for the investor to derive profits, while continuing to employ local citizens and pay local taxes.

An additional advantage of mediation over arbitration is the confidentiality of the proceedings and the outcome. Parties involved in arbitration run the risk of an arbitral decision that may stand as an unsatisfactory precedent in future cases concerning challenges by other investors to the same governmental actions or regulations contested in the arbitration in question. While arbitral decisions do not have the effect of legal precedent, they are nevertheless cited by lawyers in arguing cases and are consulted by arbitrators in making their decision. Mediations, on the other hand, do not create such precedents since they are confidential. Moreover, a litigated dispute over many years with a major investor can have negative consequences for international perceptions of the investment climate in the host country and can negatively affect the business reputation and relationships of the investor. Finally, a negotiated solution worked out under the auspices of a mediator with a distinguished reputation can reduce some of the political onus and risk on both government officials and investors in agreeing to a settlement of a dispute that may have political overtones and attract media attention.

Despite these potential advantages, mediation of investor-State disputes has been little used. The precise reasons that disputants have rarely resorted to conciliation or other forms of mediation in their disputes with host countries are not clear, but this is certainly a subject of study that institutions such as ICSID, the ICC, the United Nations Conference on Trade and Development ("UNCTAD"), and other organizations concerned about the increase in investor-State arbitration should address. Nonetheless, one can speculate on various reasons for this disinclination to mediate.

First, because mediation is little used in investor-State disputes, government officials, corporate executives, and lawyers are not often deeply knowledgeable about this process and how

they can initiate it. Since they are unfamiliar with mediation, they are not likely to employ it in resolving disputes.

Second, even if they are familiar with the process in theory, they may not know how to find persons who have the requisite experience and skills to mediate an investor-State dispute. While it is true that ICSID and other institutions have established lists of conciliators, it is unclear that such persons, despite their general professional standing, are suited to mediate particular investment disputes. An effective mediator needs much more than knowledge of international law. He or she must have the skills to understand and deal with a wide variety of emotional, psychological, organizational, political, and process issues that obstruct understanding between the parties. Indeed, the resources and experience of a deal-making investment banker are probably much more germane to the mediation of an investor-State dispute than are the talents of a litigator. In any event, the tender process used in the *Vattenfall-PSE* case is worthy of consideration as a way to find a mediator.

Third, in the case of governments, officials may feel that legally or politically they may not have resort to ADR techniques in handling a dispute with an investor. Since no law or regulation specifically authorizes the use of ADR methods, such officials may be reluctant to take a course of action that will later be challenged by higher authority or particular groups within the country. Lack of a specific budget allocation to pay for ADR services may also be a constraint.

A fourth reason for the lack of recourse to mediation is the perception, particularly among lawyers, that it is not effective in settling disputes, that states will use it as a delaying tactic, thereby merely adding to the time and expense of an inevitable arbitration. Lawyers who make this argument may be driven by professional disposition or self-interest rather than by a measured and scientific evaluation of mediation itself.

Fifth, in the case of investment disputes that have political overtones and have attracted significant media and popular attention, government officials are reluctant to agree to a mediated settlement reached in confidential circumstances for fear of being accused of weakness in defending national interests against foreigners, or worse, corruption.

In addition to these pragmatic considerations, two addi-

tional, more general and somewhat theoretical arguments have been raised against mediation. First, mediation, which does not result in a formal decision or award, does not contribute to the development of a jurisprudence in the emerging field of international investment law. Arbitration awards not only decide individual disputes, they also contribute to developing the fabric of this increasingly important area of international economic law.⁸² Widespread application of mediation would retard that development. Mediation may allow investors and host country governments to avoid the burdens of unfavorable precedents, but viewed from a more comprehensive perspective, this may not be the best outcome.

Second, mediation of legitimate claims reduces the inhibiting effect of adverse arbitration awards on potentially illegal governmental behavior. One of the purposes of signing international investment agreements, it is said, is to impose a discipline on governmental behavior and thereby foster a heightened rule of law. A principal deterrent to such behavior is an international arbitral award formally determining such behavior to be illegal and imposing a significant sanction in the form of substantial monetary damages. Mediating claims of illegality, rather than adjudicating them in arbitration, could reduce the deterrent effect and thereby lessen respect for treaty provisions.

While these two reasons may have a certain theoretical justification, the same types of arguments can be made against ADR in any domain affected by any branch of law. The primary purpose of any dispute resolution system is to satisfy the needs of the disputants. System development can only be a distant, secondary aim. Just as mediation of domestic disputes will never replace domestic courts, the application of ADR in investor-State disputes will never replace arbitration. Some disputes, however, are appropriate for resolution by ADR techniques. In those cases, the advantages to the potential litigants and to the society at large outweigh any theoretical disadvantages caused by the resulting loss of a supposed useful precedent.

82. See Coe, *supra* note 29, at 25 ("Each new investor-state award becomes a part, de facto, of a primitive system of precedent under which tribunals consult and give various degrees of persuasive weight to the awards of other arbitrators.").

*CONCLUSIONS: ENHANCING THE ALTERNATIVES TO
INVESTOR-STATE ARBITRATION*

If the number and cost of investor-State arbitrations have become excessive, it is quite natural to ask how ADR processes—namely, direct negotiations and mediation—might be enhanced so as to attract aggrieved investors and host governments to use them in lieu of international arbitration. While ADR is not likely to replace international arbitration of investment disputes, it is suggested that certain cases that now find their way to arbitration might be settled more efficiently, effectively, and cheaply through the application of ADR techniques. The following proposals are offered as possible ways of enhancing ADR as a method of investor-State dispute settlement.

*A. Improved Education And Research About ADR
Applications To Investor-State Disputes*

One reason why litigants have not had recourse to ADR in investor-State disputes is that corporate executives, government officials, and lawyers have not been educated about ADR techniques and their potential application to investor-State disputes. Accordingly, organizations concerned about investor-State disputes, such as ICSID, UNCTAD, the ICC, and the Multilateral Investment Guarantee Agency (“MIGA”), should make a concerted effort to undertake such an educational campaign. Unfortunately, these organizations do not yet possess the knowledge and experience with ADR to offer such education on a credible basis. It may therefore be useful to join forces with established ADR centers to develop and carry out such educational campaigns.

As a basis for any educational campaign, these institutions, with appropriate academic support, should first conduct research on the resolution of investor-State disputes through negotiation and mediation. A better understanding of the anatomy of investor-State disputes is needed: how they arise and evolve, what actions tend to exacerbate the conflicts, at what point third parties are best suited to intervene, and what kind of experience, skills and resources are best suited to help resolve particular types of investor-State disputes. In addition, finding and publishing “success stories” in which ADR has proved effective will not only enlighten executives, officials, and lawyers about the nature

and use of these processes but will also encourage them to consider the application of ADR to cases in which they are involved. Appropriate institutions might also organize formal courses to provide mediator training, so as to develop a corps of trained professional mediators. As noted above, institutions engaged in this educational process should avoid the bias that only lawyers can be competent mediators.

B. *Pro-Active Approach By Institutions*

Institutions such as ICSID and the ICC that are engaged in providing dispute resolution services should take a proactive approach in advancing the option of ADR techniques to litigants who seek to have their cases resolved by international arbitration. This means that such institutions should do more than provide a perfunctory notification of the possibility of mediation to litigants at the time a case is registered. Officials of the institution should explore in depth with individual litigants the option of mediation and advance various practical possibilities in this regard. Moreover, once the tribunal in an arbitration case has been constituted, it should, in the organizational phase of the proceeding, explore the option of mediation with the parties. Many courts in the United States have created annexed mediation services and have developed the concept of the "multi-door court house;" that is, a court house that offers litigants a door to mediation as well as to adjudication. ICSID and other arbitral institutions might develop a similar "multi-door approach."

C. *Early Intervention In Conflicts*

It is generally believed that it is easier to effect a negotiated settlement of a dispute if a mediator intervenes earlier rather than later in the conflict. Once a dispute has been submitted to international arbitration, the difficulties of its settlement increase because of the dispute's resulting politicization, the hardening of the disputants' positions, and the entry into the fray of other government agencies who must now become part of any settlement.⁸³ As a result, host countries as well as investors should develop policies that facilitate early intervention by mediators, and dispute settlement institutions themselves might

83. See Legum, *supra* note 54, at 1.

also seek to intervene in a dispute at an early stage. For example, host country investment promotion agencies might see as one of their functions the mediation of incipient disputes between foreign investors and host government departments and create an office staffed by trained mediators to carry out this function. It would seek to intervene in situations of potential conflict between international investors and the host government that risk developing into full blown investor-State disputes.

One of the obstacles to early intervention by central government authorities is lack of knowledge by such authorities that an action has taken place that potentially violates a treaty obligation and may become the basis for an investor-state conflict. As indicated earlier, many such actions are done by sub-national units without the knowledge of the central government; consequently, states should seek to develop systems that will keep relevant central government agencies informed of sub-national actions affecting foreign investors.

In addition, investment contracts between multinational corporations and host governments might provide for specific alternative dispute settlement in the event that conflict arises. Such contracts might stipulate, for example, that no arbitration may be launched until corporate executives and government officials have attempted and failed to negotiate or mediate disputes.

D. Creation Of An International Investment Mediation Service

International institutions such as ICSID, MIGA, the United Nations, and other respected organizations concerned with international investment should consider the creation of an international mediation service consisting of a corps of experienced international mediators who could be called upon to offer their assistance in cases of disputes between investors and states. This service might seek to intervene in disputes both before and after they have been submitted to arbitration. It also might seek to develop an early warning system that would keep the mediation service informed of potential conflicts that might be amenable to the application of ADR techniques.

E. Search For Ways To Associate ADR More With Arbitration

Efforts should be made to find ways to associate ADR more

closely with the arbitration of investor-State disputes. Initially, one may ask whether arbitrators themselves can and should seek to facilitate a negotiated settlement of a dispute. On this question, practice seems to vary considerably among countries. Generally, Americans and some Europeans consider it improper for an arbitrator to facilitate a settlement of the dispute.⁸⁴ In their view, arbitrators should do no more than to suggest the possibility of settlement but should not actively engage in mediating efforts. The reason for this reluctance is their fear that if arbitrators' mediation efforts fail, they will have compromised their ability to act as arbitrators because of the information gained from contact made with the individual disputants, often in private meetings.⁸⁵ In Germany, however, arbitrators often take a more active role by proposing possible formulas for settlement at the parties' request, participating in settlement negotiations, and even meeting separately with the parties with their consent.⁸⁶ In Asian cultures, which have a particular aversion to adversarial procedures, arbitrators are even more energetic than their European and American counterparts in seeking to facilitate agreement among the disputants rather than merely imposing a decision.⁸⁷ Dispute settlement institutions should consider the question of arbitrators acting as mediators. They might also adopt rules that allow arbitrators to attempt to mediate investor-State disputes in appropriate cases and with the full consent of the parties.

In addition, arbitrators with the parties' consent in appropriate cases should encourage the appointment of a mediator even while the arbitration is proceeding. Arbitrators should be willing to cooperate with the mediator and facilitate his or her task, for example, by allowing the mediator access to arbitration documents and permitting the mediator to attend arbitration hearings and sessions.

F. *Enact Legislation Authorizing Host Country Officials To Use ADR*

Since political considerations sometimes inhibit the use by

84. See CHRISTIAN BÜHRING-UHLE, *ARBITRATION AND MEDIATION IN INTERNATIONAL BUSINESS: DESIGNING PROCEDURES FOR EFFECTIVE CONFLICT MANAGEMENT* 193-95 (1996).

85. See *id.* at 203-08.

86. See *id.*

87. See *id.* at 198-99, 199 n.135 (providing more details on dispute resolution in China).

host country officials of ADR in investor-State disputes, host governments should consider enacting legislation that specifically authorizes, if not encourages, government officials to employ ADR techniques in resolving such disputes. Appropriate budgetary line items for this purpose might also be developed to give officials an incentive to use mediation and alternative methods of dispute settlement in appropriate cases. In addition, to facilitate the management of investor-State disputes and the effective application of ADR techniques to resolve them, legislation might also specify the government agency that is to take charge of managing investor disputes, negotiating settlements, employing ADR specialists, and recommending negotiated settlements to the government for final approval.

*G. Revise Treaty Language To Encourage ADR
In Investor-State Disputes*

Contracting States might seek to revise their existing investment treaties, as well as the treaty models they use in negotiations, to incorporate specific language authorizing and encouraging disputants to employ ADR techniques to the maximum extent possible and making it clear that their intention in the treaty is that disputants should resort to international arbitration only after they are convinced that negotiations and various forms of alternative disputes settlement would be unavailing. Such treaty language might be as follows:

The Contracting States hereby authorize and encourage the parties in the event of dispute to make maximum resort to negotiation, voluntary third party procedures, and other forms of non-binding alternative dispute resolution to settle their dispute.

It is the intent of the Contracting States that parties to a dispute with regard to the interpretation and application of the present Treaty shall not resort to international arbitration as provided under this Treaty unless they are both convinced that negotiations, voluntary third party procedures, and other forms of non-binding alternative dispute resolution would be unavailing in reaching a settlement of their dispute.

If amending existing treaty language is not feasible, an exchange of letters between Contracting States to the effect that the phrase "negotiations and consultation" includes the use of ADR techniques might be considered. Under Article 31(3) of

the Vienna Convention on the Law of Treaties, such subsequent agreement may be taken into account in the interpretation of the treaty or the application of its provisions.⁸⁸

88. *See* Vienna Convention on the Law of Treaties, Mar. 21, 1986, art. 31(3), U.N. Doc. A/CONF.129/15, reprinted in 25 I.L.M. 543 (1986).