



Negotiating Group on the Multilateral Agreement on Investment (MAI)

DISPUTE SETTLEMENT

(Note by the Chairman)

DISPUTE SETTLEMENT

(Note by the Chairman)

1. The objective of the MAI negotiations is to obtain an agreement providing high standards of treatment and protection for foreign investors. An effective system of dispute settlement is necessary to the implementation in practice of such high standards. Dispute settlement procedures incorporating binding third party mechanisms -- both state-to-state and investor-to-state -- have been an integral feature of both bilateral investment treaties (BIT's) and multilateral investment protection agreements such as the North American Free Trade Agreement (NAFTA) and the European Energy Charter Treaty (ECT).

2. A binding dispute settlement mechanism encourages early resolution of disputes between investors and host states. If consultation fails to provide a satisfactory resolution of a dispute, the ensuing phases of the dispute settlement process needs to be simple and efficient. In addition to a state-to-state mechanism, investors generally wish to have at their disposal an investor-state mechanism activated by the investor himself. Governments also see advantages in dispute settlement actions to which they do not need to become a party.

3. The dispute settlement mechanisms currently in force in the investment field have a number of standard features.

- In state-to-state dispute settlement, arbitration is generally provided for disputes about the interpretation and application of the treaty. There is no obligation to exhaust local legal remedies before invoking the state-to-state mechanism; there is almost always a requirement to seek an amicable solution to the controversy by diplomacy or consultations before resort to arbitration; existing arbitral systems (such as UNCITRAL) or ad hoc arbitral rules are often specified as being applicable and the arbitral awards are final and binding on the disputants.
- In investor-state mechanisms, there are generally obligations to enter into preliminary consultations or other initiatives to reach an amicable settlement before commencing formal arbitral proceedings. Such mechanisms typically provide prior consent to one or more existing arbitral systems (such as ICSID or UNCITRAL) which permit an aggrieved investor to proceed to arbitration in a particular case without depending on the co-operation of the host state. Arbitration may generally proceed without first exhausting legal remedies available in the local courts.

Most arbitral systems contain procedural safeguards that prevent or minimise the possibilities for the host state to delay the arbitral process by refusing to cooperate at any point in the arbitral process. Such systems usually specify that the arbitral awards are to be final and binding on the parties and that the host states must enforce the award in local courts.

4. The topics for discussion are: state-to-state dispute settlement (including conciliation), investor-state dispute settlement and other issues relevant to both state-to-state and to investor-state procedures.

1. State-to-State Dispute Settlement

a) Consultation

5. State-to-state dispute settlement is a common feature of virtually all intergovernmental investment protection agreements. In state-to-state dispute settlement, the first step is to engage in “consultations” with the other state with a view to arriving at a settlement of the matter under dispute. Such consultation provisions appear in virtually all BIT’s. The dispute settlement provisions of multilateral treaties such as the GATS, the NAFTA and the ECT also contain consultation provisions. A consultation article also appears in the investor-state dispute settlement provisions of most BIT’s and has been carried over to investor-state dispute settlement in the NAFTA and the ECT.

b) Conciliation

6. “Conciliation” of investment disputes, as opposed to formal dispute settlement procedures, can provide timely and cost-effective resolution of disputes in some instances. Dispute settlement procedures under the OECD Codes and related instruments have been primarily based on the concept of consultation and conciliation. Peer pressure from other OECD members provides an effective technique to persuade Member countries to withdraw or modify measures that contravene OECD Code obligations.

7. A new mechanism exists in the 1994 OECD “Agreement Respecting Normal Competitive Conditions in the Commercial Shipbuilding and Repair Industry “ (which is not yet in force). Under that Agreement, a “Parties Group” open to all signatories, has been created. It acts as an information-gathering and review mechanism and provides “Opinions” on disputed measures or practices. Such opinions are of a binding nature unless the requesting party or the party in respect of whose practices the request for an opinion has been made, objects. In this latter case, the opinion is of an advisory nature only. After a proceeding is commenced to obtain an opinion, a party may subsequently terminate the proceeding immediately if it decides that it wishes to submit the matter to a panel under the Agreement.

8. A Parties Group procedure as described above, could be made an optional part of the state-to-state dispute settlement procedures of the MAI. There would be a number of advantages to such a procedure. Among other things, it would introduce multilateral elements into the resolution of disputes and permit the introduction of broader policy considerations into the deliberations. Such a Parties Group procedure should be without any prejudice to the right of a Party to an investment dispute to proceed, at any stage, to more formal dispute settlement procedures.

c) Applicable Arbitral Regime

9. Only after consultation procedures or diplomatic efforts in respect of investment disputes have failed, are disputes submitted to arbitration. However, the rules governing arbitration vary widely. In European BIT’s, arbitral panels set their own rules. Under the U.S. BIT’s, and the ECT, UNCITRAL rules will apply unless the Parties otherwise agree. The NAFTA utilises a Cabinet-level Commission to attempt to resolve the dispute, failing which an arbitral panel is drawn up from a pre-agreed roster. The NAFTA specifies that “Model Rules of Procedure” will apply unless the disputing Parties otherwise specify.

d) Remedies and Enforcement of Arbitral Awards

10. Adequate and enforceable remedies are essential to the dispute settlement process. In state-to-state dispute settlement, a primary objective of a complaining state will be to secure the amendment or abrogation of a measure which a tribunal has determined is in breach of an investment obligation. In some cases, a decision by an arbitral tribunal directing a host state to modify a non-conforming measure, reverse an administrative action or pay damages, may be all that is necessary to provide an effective remedy for a complaint. However, where an offending state is unwilling or unable to comply with the decision, other measures may be considered. Ultimately the only recourse may be the suspension by the aggrieved state of substantially equivalent investment benefits under the MAI.

11. BIT's and the ECT provide no specific procedure for the enforcement of arbitral awards in the area of investment. Under the NAFTA, panel decisions take the form of "recommendations" submitted to a cabinet-level "Free Trade Commission". Whenever possible, the solution to the dispute is to be non-implementation or removal of the non-conforming measure, failing which compensation is to be provided. Ultimately, suspension of "benefits of equivalent effect" by the injured party is permitted until a satisfactory resolution of the dispute is achieved. These same remedies are envisaged under the GATS dispute settlement provisions once a panel report has been adopted by the Dispute Settlement Body.

Questions:

- *Should there be a consultation or "amicable settlement" provision in the state-to-state (and in the investor-state?) dispute settlement provisions of the MAI?*
- *Are there elements in existing OECD Code procedures or in the OECD Shipbuilding Agreement that might be used in developing a conciliation procedure in the MAI involving a "Parties Group" that would operate, as part of the state-to-state dispute settlement procedure, as an alternative or prelude to more formal arbitral proceedings?*
- *Should the MAI specify an arbitral forum in the form of an ad hoc tribunal for state-to-state disputes in line with the practice of most BIT's and the ECT? Should existing arbitral rules (e.g. UNCITRAL) apply, should the MAI provide its own rules or should the choice of rules be left to the parties to the arbitration as is the case in most BIT's?*
- *Should the MAI specify the sorts of remedies that an arbitral tribunal might decide? If so, in addition to the usual determinations of the tribunal on the legality of the measure in question, should the tribunal provide its recommendations as to the sorts of measures to be implemented to resolve the dispute? Or should the MAI remain silent on this issue and leave the issue to the tribunal itself?*
- *If a defending state is unwilling or unable to modify or remove the offending measure, what measures if any, could be envisaged to enforce the arbitral ruling? Would a system of compensation or regulated retaliation, through the suspension of equivalent benefits in the area of investment, be appropriate?*

2. Investor-State Dispute Settlement

12. An investor-state dispute settlement mechanism, separate from the state-to-state mechanism, provides specific treaty-based rights to foreign investors to take the initiative to obtain redress for damages arising out of breaches, by host governments, of investment-related obligations. Such investor-state dispute settlement provisions have been a common feature of BIT's and exist in the multilateral context, in both the NAFTA and the ECT. Investor-state dispute settlement mechanisms normally contain a prior consent on the part of the host state to arbitration of disputes.

a) Scope of Application

13. A basic question concerns the scope of application of such a mechanism. A number of BIT's create a right of action on the part of foreign investors in relation to any disputes regarding investment-related matters. Other BIT's restrict the scope of possible rights of action to specified matters such as investment authorisation and concessions. The ECT requires host states to observe obligations entered into with an investor or an investment of another Party to the ECT. (Four countries, including three major energy exporters, have lodged specific reservations regarding this requirement.) The NAFTA provides a right of action only in respect of breaches of specified obligations of NAFTA itself.

b) Applicable Arbitral Regime

14. There is also the question of the applicable arbitral framework to govern investor-state arbitration. Possible variants include, inter alia, the applicable rules under ICSID, UNCITRAL, the ICC and the Stockholm Arbitration Institute. European BIT's tend to specify ICSID procedures for arbitration whereas the U.S. and Canada provide a choice as between ICSID and UNCITRAL rules. The NAFTA provides a choice between ICSID or UNCITRAL rules and the ECT provides a choice between ICSID, UNCITRAL or the Arbitration Institute of the Stockholm Chamber of Commerce. Where a choice of forums is provided, it is the investor making the claim who makes the choice as to the applicable regime.

c) Preconditions to Commencement of an Action

15. Generally BIT's provide for the host state's prior unconditional consent to arbitration. NAFTA's investor-state provisions also provide a prior unconditional consent by the Parties to arbitration, with certain specified exceptions. The ECT provides for prior unconditional consent to arbitration in investor-state disputes unless an ECT signatory specifically indicates in an Annex to the Treaty that it does not consent to such arbitration for specified categories of disputes.

16. Some BIT's provide an obligation in the case of disputes, for the investor and the host state to attempt to settle the matter amicably. A number of BIT's as well as the NAFTA and the ECT provide a "cooling-off" period before which an investment dispute cannot be taken to investor-state arbitration.

d) Conciliation

17. The possibility of providing conciliation in the investor-state context exists under a number of arbitral regimes as a less complicated and less expensive alternative to arbitral proceedings. For example, ICSID provides for conciliation proceedings but only with the consent of both parties to the dispute and only with respect to matters within ICSID jurisdiction. The Conciliation Commission appointed to deal with the dispute is responsible for clarifying the issues in dispute and endeavouring to bring about agreement between the disputants on mutually acceptable terms. It is for consideration whether the MAI requires such a conciliation procedure, together with a prior consent provision, or whether existing mechanisms such as ICSID already provide the necessary facilities for conciliation to take place.

e) Relationship between Investor-State and State-to-State Dispute Settlement

18. It will be necessary to define to some extent the interface between the investor-state and state-to-state dispute settlement processes. Depending on the ultimate shape of the text, dispute settlement under both procedures could cover many, if not all of the same questions. It is for consideration whether an investor should be required to use one alternative to the exclusion of another or whether they should be able to use both procedures concurrently or sequentially. Some arbitral agreements, such as the ICSID Convention, require an investor to desist from pursuing his state-to-state remedies if ICSID procedures are invoked.

f) Remedies and Enforcement of Arbitral Awards

19. Investor-state arbitration provides a means for investors themselves to obtain redress for damage to their economic interests stemming from breaches of obligations by host governments. The scope and nature of remedies under investor-state procedures as well as their enforcement has varied widely. Some BIT's provide for a limited range of remedies, in the form of monetary damages or restitution of property. Other agreements incorporating ICSID rules do not prescribe the available remedies, but provide for remedies in accordance with the rules of law agreed by the parties to the dispute. The NAFTA limits the redress in the investor-state context to monetary damages and accrued interest or restitution of property.

20. Normally investor-state arbitral awards are enforceable in local courts under implementing legislation passed pursuant to international arbitration conventions. The ECT provides that arbitral awards are "final and binding" and shall be carried out without delay. Ultimately, as under the NAFTA, failure to carry out an arbitral award by a host government, may result in a state-to-state dispute settlement action under the Treaty.

Questions:

- *Should the scope of application of the investor-state dispute settlement provisions be limited to MAI obligations or should they provide a right of action arising out of obligations existing in other agreements, including private contracts? If a broad range of disputes were eligible for dispute settlement under the MAI, should they be raised under investor-state procedures or could they also be raised in state-to-state dispute settlement?*

- *Could delegations provide their views on which procedural rules, if any, ought to apply in the context of an investor-state dispute. Could existing regimes such as ICSID and UNCITRAL be used? Should Model Rules of Procedure be developed for the MAI? Or should the rules be left to the disputants to decide?*
- *Should the MAI provide for a specific conciliation procedure, together with a prior consent provision, in the investor-state dispute settlement procedures?*
- *Should there be a mandatory period for efforts by the disputants to reach an amicable settlement or alternatively a “cooling-off” period before a foreign investor takes a dispute to arbitration under the investor-state dispute settlement provisions of the agreement?*
- *Should investors have access to investor-state dispute settlement without the necessity of prior consent of the host government?*
- *Should the MAI explicitly provide that local remedies need not be exhausted before an investment dispute is taken to arbitration?*
- *Should arbitral tribunals under the MAI be empowered only to award monetary damages plus interest or to order restitution of property in specific cases? Or should the investor-state provisions simply direct the party to agree as between themselves what the applicable law is for the dispute and leave the available remedies to be determined under that system of law?*
- *A related question is whether investor-state and state-to-state dispute settlement procedures should be mutually exclusive. If the intention is to provide a broad range of remedies for investors, are concurrent local, arbitral or diplomatic remedies necessarily harmful? Are there sufficiently strong reasons for denying such remedies to investors?*
- *Are specific provisions required regarding the enforcement of arbitral awards?*

3. Issues Common to Both State-to-State and Investor-State Arbitration

21. Certain issues common to both modes of dispute settlement will have to be considered in the context of the dispute settlement discussions. Other issues will be taken up at a later time - e.g. the coverage of subnational governments, regional economic integration organisations and taxation issues.

a) Application of Dispute Settlement Provisions to Pre- and Post-Establishment Issues

22. An important question concerns the application of the investor-state and state-to-state dispute settlement provisions to pre-establishment questions. Most BIT's, apart from those of the U.S., do not address pre-establishment questions. In the NAFTA, dispute settlement applies in principle to all of the substantive obligations regarding investment, including national treatment pre- and post-establishment, MFN, standstill and rollback commitments in the area of liberalisation as well as disputes in relation to certain obligations related to monopolies and state enterprises. However, both Canada and Mexico have lodged reservations in respect of the application of the dispute settlement provisions of the NAFTA to

decisions of their respective national investment screening bodies on whether or not to permit an acquisition. The ECT leaves the issue of binding obligations in relation to pre-establishment questions for the conclusion of a supplementary treaty now under negotiation.

Question:

-- *Should the dispute settlement provisions of the MAI cover both pre-establishment and post-establishment issues without exceptions?*

-- *For pre-establishment, should both the investor-to-state and state-to-state mechanisms be available?*

b) *Choice between Local Legal Remedies and Arbitration: The “Fork in the Road”*

23. An important issue concerns the “fork in the road” - that is, whether investors ought to be required at some point in the dispute settlement process to elect between pursuing local legal remedies through the courts or other tribunals, or pursuing their remedies in international arbitration. In some BIT's, a foreign investor must choose from the outset whether or not to pursue domestic legal remedies or international arbitration. The NAFTA requires an investor to waive his rights to initiate or continue local remedies once arbitral procedures under the agreement have been initiated. The ECT affords two options - Contracting Parties may indicate in an Annex to the Treaty that they do not consent to international arbitration if an investor has initiated local legal remedies or any applicable previously agreed dispute settlement procedure¹, or they may agree to permit aggrieved investors to seek arbitration after three months even if proceedings have previously been commenced in local courts.

24. A related issue is that of the rule of international law in the area of state-to-state dispute settlement that requires a claimant to exhaust local legal remedies before being permitted to proceed to international arbitration. Many BIT's and the ECT deal with this issue by specifically providing that there is no requirement to exhaust local legal remedies before invoking the dispute settlement provisions of the agreement. This appears to be the general practice of OECD countries. However it should be noted that ICSID specifically provides that an ICSID signatory may require that local legal remedies be exhausted as a pre-condition to its consent to arbitration under ICSID. Further, some agreements, such as the U.S. model BIT and the NAFTA, provide that an investor must make an election between pursuing local legal remedies and pursuing arbitral remedies.

Questions:

-- *Could negotiators specify whether, and at what point, there should be a “fork in the road” i.e. a point at which an investor is required to make an election between pursuing his remedies locally or under international arbitration?*

-- *Should there be a specific provision dealing with the issue of exhaustion of local legal remedies?*

¹ At present, twelve OECD Member countries are listed in the relevant Annex (Annex 1 D).

c) *Interim or Injunctive Relief*

25. Certain BIT's provide for explicit rights for an investor to initiate applications to local courts for interim or injunctive relief pending the final outcome of an arbitral or other proceeding. Such applications are purely interim in nature and are employed to protect or maintain property pending the resolution of an outstanding dispute. Where there is a clear "fork in the road" requiring an investor to make a choice between pursuing local legal remedies or seeking arbitration, and the investor has elected arbitration, such rights would be precluded unless the MAI contained a specific clause preserving rights to interim or injunctive relief. An ICSID tribunal has the power to make recommendations on provisional measures that should be taken to preserve property pending the completion of the arbitral procedures.

Question:

-- *Should there be a specific clause allowing the arbitral tribunal to deal with the issue of preserving rights to interim or injunctive relief in the MAI?*

d) *Consolidation of Claims*

26. In the case of broad-ranging measures of expropriation or nationalisation or other acts breaching obligations toward foreign investors, there may be numerous foreign investors with claims arising out of a single measure. In the case of certain multilateral agreements affecting investment such as the NAFTA, measures have been provided in investor-state and state-to-state procedures allowing for the consolidation of claims of multiple claimants arising out of a single measure of a host state.

Question:

-- *Would it be desirable to have a "consolidation of claims" procedure to allow the consolidation of multiple claims in both investor-state and state-to-state proceedings in respect of a single measure taken by a host state?*

e) *Subrogation*

27. Many governments today provide their investors with the possibility of obtaining insurance against non-commercial risks such as expropriation or the introduction of exchange controls. Under the subrogation clauses of such insurance agreements, where the insuring entity has compensated an investor for a loss covered by the policy, such entity succeeds (i.e. is "subrogated") to the rights or claims of the investor against the host state that occasioned the loss. Many BIT's explicitly grant recognition to such subrogated rights and provide that the insuring entity, whether it is the state itself or an agency thereof, preserves all rights previously vested in the insured party to make a claim against the other state. The Drafting Group on Investment Protection is considering the inclusion of a provision dealing with subrogation. This issue becomes relevant to dispute settlement because certain states in the past have sought to use payment of losses under a policy as a basis for denying further liability to an investor. Thus for example, certain BIT's provide that a defending Contracting Party may not assert as a defence or counterclaim, that indemnification or compensation has been received by the investor and that hence no further claim exists.

Question:

- *Is a specific provision on allowable defences in relation to subrogated rights desirable in the dispute settlement chapter?*

National Security

28. The issue of the possible use of dispute settlement mechanisms, including conciliation, to review measures by Contracting Parties involving national security considerations is addressed in a separate Secretariat Note on this issue.