nccr trade regulation
swiss national centre of competence in research

Working Paper No 2011/46| August 2011

Towards a New Approach to Address Investor-State Conflict: Developing a Conceptual Framework for Dispute Prevention

Roberto Echandi*

The significant escalation in the use of investor-State arbitration over the last decade has revealed a series of shortcomings of the existing investor-State dispute settlement system that risk to corrode the legitimacy of the international investment regime as a whole. Investor-State arbitration has turned out to be a costly, rights-based process that can leave both investors and host States dissatisfied with both the process and outcome. Further, increased litigation undermines the development of long-term harmonious relationships between foreign investors and host States. Such outcome in fact would be contrary to one of the key objectives that IIAs are supposed to promote, i.e. the creation a political and economic environment in host States conducive towards increasing investment inflows. Within this context, this paper argues that the international investment regime should complement the existing *dispute resolution* procedures with effective investor-State *conflict management* mechanisms that can enable host States and investors to effectively prevent their conflicts from escalating into full-blown investor-State disputes. After analyzing the experience in the use of non-litigious means for investor-State disputes, this paper unveils the critical variables that would need to shape the design of protocols for investor-State dispute avoidance. On that basis, this paper develops the embryonic concept of investor-State dispute prevention and proposes a conceptual framework comprising a typology of both dispute prevention policies (DPPs) and mechanisms (DPMs). Further, this paper proposes a preliminary sketch of the essential elements that a standard protocol or the development and implementation of DPMs should contain.

Key words: International investment, investor-State dispute settlement, investor-State conflict management system, dispute system design, dispute prevention.

* Director, Program on International Investment, World Trade Institute, University of Bern.
Email:roberto.echandi@wti.org

NCCR TRADE Working Papers are preliminary documents posted on the NCCR Trade Regulation website (<www.nccr-trade.org>) and widely circulated to stimulate discussion and critical comment. These papers have not been formally edited. Citations should refer to a "NCCR Trade Working Paper", with appropriate reference made to the author(s).

FNSNF
Fonds national suisse
Schweizerischer Nationalfonds
Fondo nazionale svizzero
Swiss National Science Foundation

Die Nationalen Forschungsschwerpunkte (NFS) sind ein Förderinstrument des Schweizerischen Nationalfonds.
Les Pôles de recherche nationaux (PRN) sont un instrument d'encouragement du Fonds national suisse.
The National Centres of Competence in Research (NCCR) are a research instrument of the Swiss National Science Fondation.

TABLE OF CONTENTS

I. Introduction 3

II. Context and Background: The Search for Alternatives to Investor-State Arbitration 5
A. Background 5
B. The shortcomings of investor-State arbitration: a summary 7

III. The search for interest-based alternatives to investor-State arbitration 8
A. Interest-based dispute resolution and its advantages 9
B. Interest-based dispute resolution in the current international investment regime 13
1. Barriers related to the novelty of interest-based conflict resolution in the investor-State context 15
2. Barriers related to the private/public nature of treaty-based investor-State disputes 16
3. Barriers related to the lack of clarity and evolving nature of international investment law 18

IV. Developing the concept of investor-State dispute prevention 20
A. The distinction between “conflict” and “dispute” and its application to the investment context 20
1. The investor-State conflict continuum 22
2. Conflict management vs. dispute resolution: practical implication of the distinction 24
B. The two fundamental dimensions of dispute prevention 26

V. Creating the infrastructure for investor-State conflict management: DPPs and DPMs 27
A. Dispute Prevention Policies (DPPs) 27
1. Domestic DPPs 27
2. State-to-State Cooperation for DPPs 28
B. Dispute Prevention Mechanisms (DPMs) 29
1. Contractual DPMs 30
2. Institutional DPMs 30

VI. Conclusions 34

VII. References 37

Towards a new approach to address Investor-State Conflicts: Development of a conceptual framework for Investor-State Dispute Prevention

I. Introduction

Over the last two decades, investment has become one of the most prolific areas of international economic law. This development stems in part from the negotiation of a patchy but extensive framework of International Investment Agreements (IIAs) worldwide, and more recently, also from the escalation in the use of adjudication mechanisms of IIAs to address conflicts surging between foreign investors and host States.

IIAs have included provisions for investor-State dispute settlement (ISDS) since the 1960s. Nevertheless, for more than three decades, investors rarely made use of these dispute resolution rights. The situation started to change from the mid of 1990s, and since then the number of treaty-based investor-State disputes has grown enormously. The increase in ISDS has had a deep political impact, leading sectors of civil society in many countries to challenge investor-State arbitration on various grounds, such as insufficient transparency, incoherent jurisprudence, lack of a balanced protection of the interests of all investment stakeholders,[1] and even lack of legitimacy to be an adequate vehicle for international investment adjudication. (Van Harten, 2005, Franck, 2005).

Furthermore, the increase in investor-State litigious activity has added another dimension to the discussion on ISDS. Two decades of practice has revealed the limitations of existing investor-State arbitration procedures to fully satisfy the interests of both foreign investors and host States alike when it comes to ensure the effective implementation of IIAs, and the optimal functioning of the international investment regime.[2] Both investors and States alike have considered existing ISDS processes too costly, too slow and too indeterminate (Coe, 2005). Further, some stakeholders have also cautioned that increased litigation curtails the possibility to develop long-term harmonious relationships between foreign investors and host States (UNCTAD, 2010). Such outcome is contrary to one of the key objectives that IIAs are supposed to promote, i.e. the creation of a political and economic environment in host States conducive to foster increasing investment inflows.

On this background, and considering the success that Alternative Dispute Resolution (ADR) mechanisms have had in other contexts, different investment stakeholders have started to

[1] In this paper, the term "investment stakeholders" makes reference to all those sectors with an interest in international investment relations. The category comprises international investors, host States and domestic and international groups of civil society –including academia.

[2] For purposes of this paper, the "international investment regime" is understood to be the network of international agreements of various kinds comprising rules and disciplines on investment, mainly but not exclusively, Bilateral Investment Treaties (BITs) and investment chapters in Preferential Trade Agreements, (PTAs).

advocate for the consideration of non-litigious means of resolution for investment-related disputes arising between investors and host States. (Coe, 2005, Legum 2006) Interestingly, in addition to investor-State arbitration, most IIAs include provisions calling both investors and host States to settle their disputes amicably. Further, the international investment regime provides for different institutions –such as ICSID-- and rules –such as UNCITRAL—that provide investors and host States with the opportunity to use ADR mechanisms different from arbitration to solve their differences, such as fact-finding, mediation and conciliation. Yet, in practice, such ADR mechanisms have been rarely used in the context of treaty based investor-State disputes[3]. (UNCTAD, 2010)

This paper analyzes the variables that can explain the limited use of ADR as a means to solve treaty-based investor-State disputes, and argues that a critical factor explaining such trend is that ADR techniques have so far been conceived exclusively as alternative *dispute resolution* processes. ADR techniques such as mediation or conciliation have been visualized as alternative procedures to attempt to solve a conflict that has already escalated into a full-blown dispute under an applicable IIA. This paper argues that the hybrid private/public nature of treaty-based investor-State disputes has many implications that do not arise in the purely private and commercial context. In addition to other critical political effects, those implications make it extremely difficult for ADR to replace investor-State arbitration as a dominant means of dispute settlement. Thus, this paper proposes a new conceptual approach to deal with investor-State conflict, by developing a dispute prevention framework enabling investors and governments to manage their treaty-based conflicts before they escalate and become disputes under IIAs.

After almost two decades of experience with investor-State arbitration, this paper argues that the international investment regime can no longer afford to leave all problems arising between investors and host States to be exclusively addressed through *dispute resolution procedures*. It is necessary to complement the latter with the development of an effective investor-State *conflict management* mechanisms enabling host States and investors to effectively prevent their problems from escalating into full-blown investor-State disputes –thus the reference to Investor-State dispute prevention.[4] The problem is that currently, the institutional infrastructure required to enable such investor-State conflict management mechanisms to develop is practically non-existent. The main focus of this paper is then, to provide an initial contribution to fill this gap.

After analyzing the experience in the use of non-litigious means for investor-State disputes, this paper unveils the critical variables that would need to shape the design of protocols for investor-State dispute avoidance. On that basis, this paper develops the embryonic concept of investor-State dispute prevention and proposes a conceptual framework comprising a typology of both Dispute Prevention Policies (DPPs) and Dispute Prevention Mechanisms (DPMs). Further, this paper proposes a preliminary sketch of the essential elements that a standard protocol or the development and implementation of DPMs should contain, and that could also be used to guide further research on this subject.

[3] In 45 year history, ICSID only reports 6 cases where conciliation procedures have been initiated. See: http://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDDocRH&actionVal=CaseLoadStatistics
[4] This article uses the terms investor-State dispute prevention and investor-State conflict management as synonymous.

In addition to this introduction, this paper has five additional sections. Section II provides an introductory background for the discussion and presents an overview of the literature explaining the shortcomings of exiting ISDS procedures that have lead the different stakeholders to explore the use of ADR in the investor-State context. Section III explains the different approaches for dispute resolution identified by conflict theory, placing particular emphasis on interest-base processes and the advantages that their use can provide for the parties involved. Further, Section III also presents an overview of the use of amicable means for dispute resolution in the international investment regime, and explains the main factors identified by the literature that attempt to explain their limited utilization in the context of treaty-based disputes between foreign investors and host States.

Section IV focuses on the elaboration of the incipient concept of dispute prevention in the context of investor-State relations. In particular, on the basis of conflict theory and the theoretical background used by Dispute Systems Design (DSD), section IV will explain the distinction between the concepts of "*conflict*" on the one hand and "*dispute*" on the other, and will address the practical implications of such distinction for purposes of developing protocols of investor-State dispute avoidance. Section V will elaborate on the practical implementation of the dispute prevention concept, and explain how the notion of investor-State dispute prevention can be materialized into policies (DPPs) and specific mechanisms (DPMs) for dispute avoidance. Section IV also proposes preliminary sketch of the essential elements that a standard protocol or the development and implementation of DPMs should contain, and that could also be used to guide further research Last but not least, section VI deals with the conclusions of the paper, placing the technical discussion in the broader context of the evolution of international investment law.

II. Context and Background: The Search for Alternatives to Investor-State Arbitration

A. Background

Although the genealogy of the current network of IIAs can be traced back to the XVIII century, and the first BIT was negotiated during the late 1950s, it was not until the 1990s, where there was an explosion in the negotiation of IIAs. Before 1990, the number of IIAs negotiated amounted approximately to 265 (Newcombe and Paradell, 2009:46) and one decade later the number had increased to more than 2000 (UNCTAD, 2001) Most of these agreements, in particular those negotiated after the 1960s, contain specific provisions granting foreign investors and their investments a series of treatment and protection rights, including the possibility for covered investors to enforce those rights through Investor-State dispute settlement (ISDS) procedures. In this regard, IIAs deviated from the until then prevailing paradigm of diplomatic protection as the exclusive means through which international investors could seek redress in situations where the host State breached an international obligation related to their investments. It was also until the 1990s, where investors started to regularly invoke IIAs to institute investor-State arbitral proceedings. Since 1987 – when the first investor-State dispute based on bilateral investment treaties (BITs) was recorded under the arbitral proceedings of the International Centre for Settlement of Investment Disputes (ICSID) – until April 1998, only 14 treaty-based cases had been brought before ICSID, and only two awards and two settlements had been issued (UNCTAD, 1998).

However, since the late 1990s, the increase in litigious activity has skyrocketed. The total cumulative number of known treaty-based cases submitted to investor-State arbitration reached 390 by the end of 2010. (UNCTAD, 2011a). Among these claims, 245 were brought before ICSID, 109 under UNCITRAL rules, 19 submitted to the arbitration Centre of the Stockholm Chamber of Commerce (SCC), 19 under the International Chamber of Commerce (ICC), and the remaining 10 submitted to other arbitration venues. (UNCTAD, 2011a) The number of States which have had to confront international arbitration claims has also tended to increase over the period, reaching by the end of 2010 the figure of 83 governments, the overwhelming majority being from developing countries. (UNCTAD, 2011a)

The increase in the number of ISDS claims over the last two decades can be attributed to several factors. A first factor is clearly related to the development of the extensive network of IIAs, which extensively developed in the 1990s. Second, one could easily argue that increases in international investment flows lead to more occasions for disputes, and more occasions for disputes combined with more IIAs are likely to lead to more cases. Third, another factor that has been acknowledged by the literature is associated with the vague language used in some provisions of IIAs –for instance, the definition of the term "investment", and the breadth and content of certain standards such as national treatment, MFN, fair and equitable treatment and expropriation, just to name a few. The unpredictability in the interpretation of certain key provisions of IIAs has been exacerbated as the growing investment jurisprudence has not always been consistent – an outcome that should not cause surprise considering the des-centralized nature of the adjudication procedures under IIAs and the multiple variations on the same topic existing among the myriad of very similar --but yet different-- treaties subject to interpretation. Fourth, given the significantly broad scope of application of the obligations included in IIAs, some countries have experienced difficulties in securing their proper implementation among the different layers of their intra-governmental structure. (UNCTAD, 2005) Indeed, recent empirical data reveals that an important part –more than half-- of the cases submitted to investor-State arbitration under IIAs relate not to measures taken by central governments –which are the ones who negotiated those agreements— but rather, to measures taken by municipal or provincial governments or by State agencies in charge of specific sectors of the economy (Franck 2008).

Further, and from an historical perspective, a major impetus for the increase in investment-related judicial activism came in the mid 1990s, from the conclusion and implementation of the Investment Chapter of the North American Free Trade Agreement (NAFTA) negotiated among Canada, Mexico, and the United States. Arbitrations under the ISDS procedures of NAFTA's Chapter 11 resulted in a growing number of cases that not only raised a series of issues regarding the practical impact of the wording used to draft IIAs, but also acted as an "eye opener" to the international investor community regarding the practical use of ISDS procedures. After the initial NAFTA experience, and the series of investment disputes triggered by the crisis in Argentina the late 1990s, the number of treaty-based investment disputes tended to reflect an increasing trend until recently, when the growing curve has started to stabilize. (UNCTAD 2011a, ICISID 2011). Thus, it seems clear that ISDS is here to stay and its use by foreign investors continues to be a prevalent trend in the international investment field.

Although the figures describing the increase in ISDS are impressive, they should be placed in perspective. Some well-known experts have drawn attention to the fact that considering that the

significant level of international economic integration and huge amount of investments flowing everyday in the current world economy, the actual figure of disputes submitted to ISDS is much lower than what it could actually be.

> "The gross amount of foreign direct investment is very large, indeed greater than the volume of world trade. There are approximately 80.000 multinational enterprises, which are by definition foreign investors. These entities have some 100.000 affiliates. If these 180.000 potential claimants are factored by the number of BITS, bearing in mind that many of these entities are multiple foreign direct investors and that not every foreign direct investor is a multi-national enterprise, then the number of actual disputes going to arbitration seems to be a miniscule fraction of the universe of foreign direct investment." (Reisman, 2011 p.22-23)

On the basis of the points mentioned above, clearly the number of claims submitted to investor-State arbitration could in fact be significantly greater. However, it is also true that the increase in ISDS has revealed a series of shortcomings of the existing investor-State arbitration procedures. If not properly addressed, such weaknesses not only can represent a lost opportunity to consider alternative ways to better address investor-State conflict, but can also undermine the legitimacy of ISDS and the international investment regime as a whole.

B. The shortcomings of investor-State arbitration: a summary

The increase in the use of ISDS has exposed various shortcomings of the existing adjudication mechanisms, generating concern not only among various sectors of civil society –including the academia—but also governments and even international investors. Some of those concerns can be briefly summarized as follows.

First, one shortcoming of current ISDS relates to time. Investment disputes are fact intensive and may take years to resolve. For both investors and States, such a lengthy process entails not only a high economic and political cost but also the possibility of irreparable damage to the parties' long-term working relationship.

Second, another critical issue is the high cost of arbitration, which represents an important financial burden governments have to face when defending a case. Governments are confronted with the possibility of having to pay—using taxpayer money— not only the damages if the dispute is lost, but also attorney's legal feels and arbitral fees, which tend to represent several million US dollars. These are not insignificant sums and can create political challenges for States. Furthermore, the high cost of arbitration leads to a sense that neither the investors nor the States are the "real winners" of the existing ISDS system.

Third, the high cost of arbitration has other implications, including challenges to the political legitimacy of the ISDS system. For small and medium enterprises (SMEs), the investments of which may represent only several million US dollars but ISDS may be *de facto* unavailable if the costs of bringing a proceeding exceed the value of the investment. This feeds into concerns that the current system primarily offers legal protection to multinational entities and dis-empowers SMEs. (Echandi, 2011)

Fourth, the practice in the use of investor-State arbitration has also evidenced certain procedural shortcomings. For instance, a number of claims submitted by investors have not had any merit, and yet have not prevented host States to avoid the costs associated to arbitration procedures. Further, the current system allows the possibility to have two different arbitration proceedings addressing the same measure and yet lead to contradictory results.

Fifth, some civil society groups have expressed concerns related to the inherent features of investor-State arbitration, in the sense that they are mainly geared at providing monetary compensation and address sensitive public policy issues. The critique to ISDS is grounded on alleged insufficient transparency, incoherent jurisprudence and even lack of legitimacy to foster an appropriate international adjudication.(Franck, 2005) With host States tending to regulate a wide variety of fields --such as health and the environment-- and investors increasingly participating in concession-based activities regulated by States, arbitral tribunals have begun to address matters going beyond pure commercial acts and to consider matters of public concern. Despite useful increases in ISDS transparency, certain groups have questioned whether the problem is more structural and suggested revising the totality of the investment protection system. (Van Harten, 2005)

Clearly, not all investment stakeholders share the same diagnosis of ISDS. However, for purposes of this paper, it is interesting to note that all of them would probably agree on one specific point: the experience with investor-State arbitration over the last two decades has shown that such procedures have turned out to be too costly –both in economic and political terms-, too slow and too indeterminate. (Coe, 2005). Moreover, most stakeholders would also tend to recognize the fact that ISDS entails the use of an *"adversarial model of zero-sum adjudication of rights"* (Hernandez-Crespo, 2011 p.75) in which the decision of the arbitration tribunal determines a winner and a looser over an argument attempting to make a particular legal interpretation prevail over another. As litigation is by definition an adversarial rather than a collaborative exercise, it tends to lead to confrontation between the parties in the dispute. Often such confrontation can be counterproductive to one of the fundamental objectives that the international investment regime should promote: that is, the consolidation of long-term harmonious relationships based on trust between foreign investors and host States.

Within this context, several experts have started to advocate the consideration of other non-litigious means of dispute resolution as alternatives to ISDS, in particular mediation and conciliation. At the core of this exercise lies the recognition that, in practice, the existing international investment regime has tended to exclusively rely on third-party adjudication, and that perhaps the time has come to explore other means of dispute resolution that focus on reconciling interests of the parties.

III. The search for interest-based alternatives to investor-State arbitration

The context outlined in section II above explains the crescent interest in the literature in exploring the feasibility of using non-litigious dispute resolution means to solve investor-State disputes. A growing body of scholarship has started to explore the application of alternative dispute resolution (ADR) techniques such as conciliation and mediation to the investor-State

context. (Coe,2005,2007,2010;Onwuamaegbu,2005;Legum,2006; Rubins, 2006; Salacuse, 2007, Clodfelter, 2011) Further, recent academic writings have also suggested a more systematic and holistic approach by applying Dispute System Design to investor-State arbitration.[5] (Franck, 2007) These proposals are based on the common idea that adjudication should not be visualized as the exclusive means to settle disputes between international investors and host States. Further, such literature recognizes the significant potential benefits of applying interest-based dispute resolution methods to investor-State disputes. Given its important implications, the concept of interest-based resolution and its relation with other approaches of dispute settlement is discussed below.

A. Interest-based dispute resolution and its advantages

According to the approach used by the parties in attempting to resolve their disputes, dispute resolution theory classifies the universe of dispute resolution process into three broad categories. First, the parties involved in a quarrel may attempt to solve their disagreements by determining who is more powerful –*"power-based resolution"*--; second, by determining who is right –*"rights-based resolution"*— or third, by reconciling their interests—what is also called "*interest-based resolution*". (Ury, Brett and Goldberg, 1993; Smith and Martinez, 2009).

From a historical perspective, probably the oldest approach to solve conflicts and disputes at all levels of human interaction has been through recourse to power. The exercise of power entails the capacity of one party to the dispute to compel another party to behave in a manner that otherwise the latter would not willingly do.(Ury, Brett and Goldberg 1993). Such power can be of different nature, physical, social, economic or political. As the relative power of each of the parties involved in a dispute may not be always clear to the other, power-based resolution often entails power contests. Such power contests may range from totally peaceful means --as taking a vote to measure political power, or to organize a strike to demonstrate economic power—to the threat or actual use of force.

A second approach to resolve disputes is to rely on some independent standard with perceived legitimacy or fairness to determine who is right. This is what the doctrine denominates "*rights-based*" resolution.(Ury, Brett and Goldberg, 1993) Although some rights can derive from other socially accepted patterns of behavior, rights typically derive from the applicable legal system. The development of laws or contracts, either at national or international level, is the main source for rights, which act as the legitimate standard according to which the disputes are resolved. The problem is that frequently, in every legal system, to determine the scope and content of a particular right is not easy. Rights are seldom crystal clear and a particular right cannot be assessed in isolation, but in function of other existing rights which may apply to the same situation, and which may even conflict with each other. Thus, rights-based dispute resolution very often entails the need for an impartial and independent third party to examine the applicable rights to a given situation and determine the outcome of the dispute. Thus, the *"... prototypical rights-based procedure is adjudication, in which disputants present evidence and arguments to a*

[5] Dispute System Design is not a dispute resolution itself. *"Rather, it is the intentional and systematic creation of an effective, efficient and fair dispute resolution process based upon the unique needs of a particular system… [by] analyzing existing patterns of disputing, creating new processes, and implementing and evaluating the new system to improve its efficacy."* (Franck, 2007, p.178.)

neutral third party who has the power to hand down a binding decision." (Ury, Brett and Goldberg, 1993: 7).

A third approach to solve disputes is to rely on the reconciliation of the different interests of the respective parties involved in a conflict, and thus its denomination as "*interest-based"* dispute resolution. Interests are defined as the *"needs, fears, concerns and desires people want or cares"* (Ury, Brett and Golberg, 1993:6). Reconciling interests is not an easy task. "*It entails identifying and revealing deep-rooted concerns, devising creative solutions and making trade-offs and concessions where interests are opposed"* (Ury, Brett and Golberg, 1993:6). Interest-based dispute resolution processes have to promote constant and interactive communication among the parties in order to let them reach an agreement. Such processes could entail direct negotiations among the parties in the dispute. Further, interest-based processes often entail the intervention of a third party, which intervenes as a facilitator, either through conciliation, mediation, or other techniques.

In practice, interest-based processes such as negotiations, conciliations or mediations, rarely exclusively focus on the interests of the parties involved. Negotiation seldom takes place in a vacuum. In practice, negotiation often takes place in the shadow of the law or in the shadow of power. Thus, some negotiations focus on determining who is right, such as when the negotiating parties compete to prove whose position has greater merit. Other negotiations take place in the shadow of determining who is more powerful, such as when nations exchange threats and counter-threats. Other negotiations involve a mix of all these variables (Ury, Brett and Golberg, 1993). Thus, in the process of resolving a dispute, it is not infrequent that the attention of the parties involved may shift from interests to rights to power and back again to interests. As will be further explained in section "B" below, this is particularly relevant in the context of investor-State disputes.

Illustrating the relationship between power, rights and interests, and its application to the reality of investor-State relations, might be better explained by an example. Let's take the case of Company "X" who decided to invest in a small country "A" to build a manufacturing plant of high-tech medical components. The government of country "A" was very pleased when the investment was made not only because the important amount of highly-paid jobs generated by Company "X," but also for the potential benefits for the country in terms of transfer of technology, exports and signaling effect to other potential investors. Company "X" was also very pleased with the investment, until there was a change in government in country "A."

The new authorities were interested in getting more fiscal resources to undertake a series of social programs. Instead of asking Company "X" about its interest in participating in programs of corporate social responsibility—which the investor was more than willing to undertake—, once the new government learned about Company "X"'s high profits, it opted to unilaterally raise by 0.5 percent the rate of income tax applicable to exporters of medical components.

Considering that Company "X" was the only exporter of medical components in the country, the legal advisors of Company "X" complained to the new government authorities, arguing that the unilateral raise in taxes was discriminatory and inconsistent with the obligations of the country under an applicable IIA. The government officials dismissed Company "X" claims. Although the legal advisors of the government recognized that Company "X"'s legal argument could be

correct, they were confident that the investment of Company "X" was already made, the tax increase was not too high, and that despite complaining, there was little Company "X" could do, as the costs to relocate the manufacturing plant in another country, or submitting a case to investor-State arbitration, would likely be higher than paying the additional amount of taxes.

The government was correct in assessing that the tax increase was not high enough as to lead Company "X" to submit a request to investor-State arbitration. However, the fact that the measure was discriminatory and targeted Company "X," led the headquarters from then on to distrust the government authorities of country "A." At the end, Company "X" did not close the manufacturing plant in country "A," nor did it submit an investor-State arbitration claim. However, the government of country "A" lost the opportunity to develop programs of corporate social responsibility, which Company "X" was more than willing to undertake. Furthermore, six months later, when considering whether to expand the production line to other medical products—which would have entailed a significant expansion of economic activities in country "A"—, Company "X" opted not to consider country "A" as a potential investment location, and diverted the investment to country "B," a country perceived more committed to comply with its international obligations.

The example above clearly illustrates the interaction between power, rights, and interests. When the government of country "A" opted to unilaterally increase the tax rates and dismissed Company "X"'s legal claims, it was confident and asserting its relative position of power in the relationship. The dispute could have been resolved on the basis of a rights-based process, if Company "X" had opted to enforce its rights under the IIA through investor-State international arbitration. But in this particular case, the costs of submitting the dispute were higher than the short-term consequences of dealing with the measure originating the dispute. However, perhaps the most important point that this example illustrates, is that if in this situation the solution of the dispute would have been interest-based, both parties would have ended in a better position. On the one hand, the government of country "A" could not only have pursued several social programs under a cooperative social responsibility scheme with Company "X," but would have ended up with more fiscal revenues as a result of the expansion of economic activity by the company six months later. On the other hand, Company "X" would have expanded its investment in country "A."

The example above also illustrates that not all disputes end with a resolution. Often a party may simply decide to withdraw from the dispute. According to Ury, Benett and Golberg, the withdrawal can take one of two forms. One party may decide on "*lumping it*"—dropping the claim or giving in to the other's claim because of perceptions that the dispute is not in its interest or that it does not have the power or entitlement to resolve it to its satisfaction (Ury, Benett and Golberg, 1993). In this particular example, the officers of Company "X" dropped their claim to ISDS on the basis of a short-term cost-benefit analysis. The second form of withdrawal of a dispute is avoidance. In this latter situation, one or both parties may decide to withdraw from the relationship, or at least to curtail it significantly (Ury, Benett and Golberg, 1993). In the example above, as a result of the power-based approach used by the government of country "A," when deciding whether or not to expand its investment six months later, Company "X" opted to curtail the investment relationship with country "A."

Our example also illustrates an important trend regarding the interaction between power, rights and interests in dispute resolution. The more effective and accessible rights-based dispute resolution is to the parties to the dispute, the lesser the chance that power will end solving the difference. Moreover, the more predictable the outcome of a rights-based dispute resolution process is, the easier it will be for the parties to ponder the benefits of using interest-based dispute resolution processes. This particular point will be further develop in section .. below. In the example cited above, had ISDS procedures been low-cost, Company “X” would have invoke them, and the government of country “A” could not have relied on its relative position of power to deal with the matter. Further, as the advisors of country “A” knew that Company “X”’s legal claim had merit, their best alternative to the eventuality of losing the case would have been to sit with the investor and try to negotiate a way to foster greater social projects—something that Company “X” would have been willing to do had the government asked it to do so.

The differentiation between power-based, interest-based and rights-based dispute resolution provide a very useful framework to understand various key aspects of the political economy of international investment. First, it enables us to understand the relationship between foreign investors and host States through history, and value the advantages of a rule-oriented investment regime over power-based dispute resolution.

Historically, before foreign investors had the possibility to submit a claim to international arbitration under an IIA, when confronted with a dispute with the host State, investors only had two possibilities. One was to submit a claim to the courts of the host State. As foreign investors often did not trust them, the second possibility was to invoke the diplomatic protection of their own governments. Throughout the XIX and early XX century, diplomatic protection was a common way to deal with investment-related disputes. In many instances, the abuse of diplomatic protection led to “gun-boat” diplomacy and other power-oriented manifestations against developing countries. (Cable, 1981)

As mentioned in the introduction of this paper, even though the development of the web of IIAs over the last two decades has led to many challenges—including the significant economic and political cost for governments and investors as they face rising numbers of investor-State arbitration cases—, it is also true that such trends reflect an evolution towards rights-based dispute resolution. Clearly, with the proliferation of IIAs and the development of an growing body of jurisprudence on international investment law, international investment relations have become increasingly “rule oriented”, moving away from the traditional “power oriented” relationships that historically prevailed in the international investment setting. Investment relations are increasingly being governed by rules and principles included in conventional instruments of international law rather than by political or economic might. (Jackson, 1997, Franck, 2009) Clearly, under most circumstances, rule-oriented adjudication is clearly preferable to power-oriented resolution of investment-related disputes.

A second practical implication of unveiling the distinction between power-oriented, interest-based and rights-based dispute resolution in the context of international investment relations is that such distinction also enables investment stakeholders to clearly see that rights-based international adjudication, such as ISDS, is not the only possible way to solve investor-State disputes. Furthermore, as the high economic and political costs of ISDS have become more evident, the pressure to find alternative means of dispute resolution has increased. Thus, the

distinction between power, rights or interested-based dispute resolution also helps to uncover the enormous potential benefits of the latter to foster more stable and satisfactory investor-State relationships.

Recent literature has recognized many of the potential advantages that fostering interest-based processes could have in the context of investor-State disputes. The very first advantage is that such processes are based on the negotiation of mutually acceptable solutions by the parties themselves. Thus, the parties to the dispute not only can also have much greater control over the problem-solving process, but also, and contrary to a zero-sum adjudication of rights, interest-based ADR, such as direct negotiation, conciliation or mediation, lead to win-win settlements, a situation in which none of parties to the dispute ends being a looser. Thus, reconciling interests tends to generate a higher level of mutual satisfaction with outcomes than solving disputes on the basis of determining rights or power. This fact is particularly important for maintaining productive ongoing relationships in the long term, which are particularly important in the investor-State context.

Further, a more pragmatic and yet critical advantage of interest-based ADR is that clearly pointed out by Michael Reisman: "*Agreements that can be secured by negotiation are unquestionably superior to solutions imposed by third-party decision. Negotiated agreements are, at least in the short term, self-executing and do not require enforcement, which is the most formidable problem in international law.*" (Reisman, 2011, p.25)

Last but not least, one of the most obvious advantages of interest-based or amicable dispute resolution process over investor-State arbitration is that they could save the parties significant time, money and energy spent on disputing. As previously explained, the use of investor-State arbitration entails significant political and economic costs, not only in terms of resources consumed or destroyed, but also in opportunities lost for both investor and host States.[6] Given its multiple advantages, it is worth reviewing how the international investment regime deals with interest-based dispute resolution and what has been the experience in its application.

B. Interest-based dispute resolution in the current international investment regime

There is no data available to appraise the frequency and rate of success or failure of any preliminary amicable consultations that hypothetically could be taking place between investors

[6] Despite their multiple advantages, it should be clarified that interest-based dispute resolution methods may not always be appropriate –or even desirable-- in certain situations. For instance, in cases where there are significant asymmetries of power among the disputing parties, rights-based adjudication—or at least negotiations in the shadow of law—may be more appropriate than purely interest-based negotiation, as the application of the law may have an important effect on leveling the playing field among non-equals. (Constantino and Sickles Merchant, 1996) Moreover, there may be situations where the interests of the parties—or at least one of them—may be better served by achieving complete victory of the dispute—an outcome that could only be reached by rights-based adjudication.(Yu, 2002) An example of such situation would be when one of the parties needs to set a precedent to clarify certain legal issues, or to establish a certain reputation. In the investor-State context, this would be the case of a dispute involving the clarification or assertion of the right of the host State to regulate in favor of key public policy objectives. (UNCTAD, 2010) In such a situation, interest-based dispute resolution may not be the most appropriate alternative because of the need and likely interest of the government to set a clear precedent and signal to its constituents its authority to regulate legitimate public policy objectives.

and host States and that never escalate to the investor-State litigation phase. Some experts have suggested that an important amount of disputes between investors and host States may be currently being channeled through early amicable settlement, as the number of disputes that actually reach the litigation stage through investor-State arbitration are in fact minimal in the light of the huge magnitude and level of integration of current international investment flows. (Reisman, 2011). Such argument is persuasive. However, the lack of reliable empirical data may also hide trends going in the opposite direction. It may also be possible that, given the high costs associated with investor-State arbitration, a significant number of disputes may be simply not finding any legal outlet for resolution under the international investment regime. Further, it may likely that both trends may well be taking place, as they are not incompatible with each other.

However, information that is available suggests a very puzzling trend regarding the use of consensual means of dispute resolution in the context of investor-State investment controversies. Empirical evidence shows that consensual settlement of disputes between investors and governments are taking place not in the context of the application of available interest-based ADR, which have been rarely used, but rather in the context of investor-State arbitration proceedings. For instance, in 2011 ICSID statistics show that 39% of all registered ICSID cases, a majority of which are treaty-based disputes, have been settled or otherwise discontinued by the parties before the arbitration tribunal has rendered a final award (ICSID, 2011). Further, by early 2010, UNCTAD estimated that at least 55 of the 357 then known investor-State arbitration disputes had been settled. (UNCTAD, 2010).[7] This trend raises two questions. First, if in the context of investor-State relations non-litigious means of dispute resolution has so many advantages, how come is that ADR mechanisms are rarely used as alternatives to investor-State arbitration? Second, which variables explain that consensual settlements tend to occur in the context of investor-State arbitrations? Below we address these two questions, starting by the first one.

In general, recourse to means that constitute an alternative to investor-State arbitration is frequently enshrined in IIAs. These treaties often require the parties to a dispute to first seek amicable settlement through negotiations and consultations conducted seriously and in good faith, and only when such negotiations and consultations fail should international arbitration be considered. (UNCTAD 2007) Furthermore, in order to ensure that the parties to the dispute actually make an effort to settle their disputes amicably, most IIAs also provide for "cooling-off" periods –usually oscillating between three and six months from the submission of the notice of intent for arbitration until the arbitration procedure actually starts. (UNCTAD, 2007) Despite these general references, most IIAs do not include provisions specifically referring –and even less mandating-- the use of interest-based ADR procedures as alternatives to investor-State arbitration. On the other hand, being inherently voluntary processes, nothing in IIAs prevent investors and host States engaged in a dispute to opt for interest-based ADR, which in fact are at their disposal thanks to various international instruments and institutions which regulate them in detail. In the patchy legal framework constituting the international investment regime, there are multiple sets of rules that in principle could be referred to or used to conduct ADR in the investor-State context. Probably the most relevant would be the rules set up under the ICSID

[7] Although there is no detailed information yet processed regarding disputes submitted to ad-hoc arbitration under UNCITRAL or other venues such, experts have argued that there is no reason to suppose that the trends regarding settlement of disputes in the context of other arbitration fora would be very different. (Clodfelter, 2011)

Convention and ICSID Additional Facility, the UNCITRAL conciliation rules and the International Chamber of Commerce (ICC) ADR rules. It should be noted, however, that among the latter, only the ICSID rules were specifically designed to apply in the context of investor-State disputes.[8]

In practice, the use of ADR rules referred to above for solving treaty-based investment disputes arising between investors and host States has been extremely limited. For instance, in the case of ICSID, since 1965 --when the ICSID Convention was negotiated-- until 2011, there have been only six cases submitted for conciliation under the ICSID rules. None of them involved a treaty-based investment dispute, and out of the six cases, two were discontinued and four failed to lead a settlement of the dispute.(ICSID, 2011) Further, up to 2011, there has been not a single case submitted under the ICSID Additional Facility fact-finding rules. (ICSID, 2011)

Thus, despite most IIAs containing language encouraging consensual means of dispute resolution and the availability of various procedural venues for ADR, interest-based ADR has not been practically used at all –and consequently neither visualized by investors or host States-- as an effective alternative to treaty-based investor-State arbitration. Considering the widespread encouragement of consensual investor-State dispute settlement in the texts of IIAs, the relative lack of recourse to mediation or conciliation is puzzling. Although still in it embryonic stage, a survey of the literature sheds light on the various factors that can explain the little use of interest-based ADR to attempt to solve treaty-based investor-State disputes.

Several variables have been proposed by scholars to explain the relative limited recourse to interest-based ADR. (Coe,2005,2009; Onwuamaegbu,2005; Legum,2006; Rubins, 2006; Salacuse, 2007, Clodfelter, 2011) One way of grouping and assessing these different factors is to distinguish between three broad categories. First, there are those determinants resulting from the relative novelty of the idea of interest-based dispute resolution in the investor-State context. Second, there are those structural factors which are related to the particular nature of treaty based-investor-State disputes. And third, there are the difficulties to use interest-based dispute resolution stemming from the lack of clarity and evolving nature of international investment law. We explain each of these two categories below.

1. Barriers related to the novelty of interest-based conflict resolution in the investor-State context

Regarding the first category, experts have pointed out that from the outset, especially in the western part of the world, the legal culture tends to conceive litigation as the natural way to solve legal disputes, and investor-State is not exception. (Franck, 2007) Thus, to start with, in the context of the evolving international economic law, neither investors nor host States have naturally visualized interest-based ADR as the first option to consider when a dispute arises. The focus of attention has been international adjudication, in particular investor-State arbitration.

[8] In addition to arbitration, the ICSID Convention contains the Rules of Procedure for Conciliation Proceedings that could apply to solve disputes involving ICSID member States themselves and investors from ICSID member States. Further, the Additional Facility of ICSID also envisages conciliation and fact-finding procedures that could apply in situations where either party to the dispute is not a member of ICSID or where the issue at stake is not entirely related to investment. (Onwuamaegbu, 2005).

Consequently, the knowledge, familiarity and predisposition to use of ADR among investment stakeholders –both investors and host governments alike-- is still quite limited.

The lack of practice and the non-binding nature of ADR fuels perceptions that interest-based resolution is ineffective, and at the end may represent a waste of time and resources. Further, other experts have also blamed the limited use of ADR to solve investor-State disputes on the features of some of the ADR rules themselves. It has been pointed out that existing ADR rules need to be adjusted to make them more flexible, informal and easy to administrate. It has been argued that currently, some of them entail processes that are as long, formal, and almost as costly as arbitration and yet, they do not lead to a binding, enforceable award. Last, literature has also recognized that if ADR is to become more common in the investor-State context, it will be necessary to have a readily identifiable pool of experts with both mediation skills and a solid background in international investment law, and such combination is not easy to find.

This current state of affairs generates a vicious cycle. On the one hand, the lack of knowledge, familiarity and confidence of investment stakeholders to consider ADR as an effective option to solve treaty-based investment disputes contributes to prevent the development of the adequate infrastructure –both institutional and in human resources—to efficiently use ADR in the investor-State context.[9] On the other hand, because of the lack of such adequate infrastructure, it is difficult to generate greater familiarity, better perceptions and more confidence on the ability of interest-based processes to efficiently apply to treaty-based disputes arising between international investors and host States.

The incipient nature of interest-based processes in investor-State ADR should also be put into perspective. The use of investor-State arbitration is a relative recent phenomenon. As explained in subsection "II.A" above, it was not until the mid 1990s when the number of ISDS cases started to rise. Thus, the international community is just starting to cope with investor-State arbitration and the multiple challenges arising from such development. Within this context, it should not surprise that the international investment regime has not yet fully developed the infrastructure necessary to enable interest-based processes to become an effective vehicle to address investor-State conflict. It should be noted, however, that the development of such infrastructure requires a full understanding of the nature of the investor-State conflict. In this regard, and as previously stated, the second set of factors explaining the limited recourse to interest-based ADR precisely relate to the peculiar private/public nature of treaty based-investor-State disputes.

2. Barriers related to the private/public nature of treaty-based investor-State disputes

The limited use of interest-based ADR to settle treaty-based investment disputes between foreign investors and host States also stems from variables that go beyond mere issues of infrastructure, and stem from the very structure of these disputes. As Clodfelter clearly points out *"[t]he public nature of the parties and the measures in most investor-State disputes makes them very different from commercial disputes.*" (Clodfelter, 2011,p.40) The circumstance that one of the parties is a

[9] Further, some scholars also point out that such perceptions are fueled by some legal practitioners who do not necessarily have all the incentives to promote the use of ADR. (Walde, 1985)

sovereign State, combined with the fact that claims challenge public measures which often relate to key public policies objectives, generates complex dynamics that disincentive governments from seeking consensual settlement of investor-State disputes. The various explanations offered by the specialized literature could be summarized in three sets of factors which are explained below.

First, governments are quite complex organizations. Authority is allocated among numerous agencies which also operate at different administrative levels. Thus, even assuming that within the administration there is a clear chain of command to deal with investor-State disputes –which often is not the case-- major decision-making tends to be slow and cumbersome. Furthermore, the decision and the terms of settlement of an investment dispute may entail intra-departmental disagreements which may in turn be colored by intra-governmental politics. In those conditions, it is not easy for government officials to undertake the risk and effort of negotiating a settlement which may be later challenged or not respected by another governmental agency. Such a situation does not arise when there is a binding international award settling the dispute.

Second, governments operate within the boundaries of local administrative laws. Thus, participation in ADR entails the existence of an agency with the legal authority to negotiate with investors, represent the host State in those negotiations, reach a settlement of the dispute – including authorization to dispose of taxpayers' money to compensate damages -- and have the means to make the terms of the settlement binding and effective vis-à-vis the other agencies of the administration. Although increased litigation activity has led some States to set up intra-governmental structures to efficiently deal with investor-State arbitration --and such structures could also be instrumental for ADR-- the legal authorization to use public funds to comply with the resolution of an international arbitration tribunal usually does not extend to the use of public funds to reach consensual settlements with foreign investors.

Third, and more important, governments are politically accountable entities. At every level, intra-governmental and external constituencies constantly scrutinize government officials and hold them accountable for their actions. A voluntarily settlement of an investor-State dispute entails the possibility for the government to be held accountable for having conceded –or appeared as conceding-- many serious charges. A settlement may be perceived as a recognition by the government that the State in fact committed a violation of its international legal obligations. Furthermore, a settlement may also be seen as the government conceding responsibility for applying a regulatory measure that many domestic sectors may consider not only appropriate but also fully legitimate under domestic and even international law. As Clodfelter clearly points out: *" …investor-State disputes commonly refer to public values, often involving scrutiny of actions of public authorities in the execution of their public duties or to advance policies stated in the law- Disputes of this nature…implicate deep seated values concerning sovereignty, sovereign reputation and the basic role of the State in managing economic affairs."* (Clodfelter, 2011,p.40)

The extremely sensitive political consequences that a voluntarily settlement of an investor-State dispute may entail are just part of the story. Governments will also have to respond to their constituents for the terms of the settlement reached, and be ready to justify why a particular investor receives a particular treatment relative to other foreign investors or even national constituents.

Further, governments settling investor-State disputes through ADR would also have to justify the use and amount of taxpayers' money to pay the compensation usually claimed by the investor as a result of the damage caused. From a political perspective, using fiscal resources to redress a claim of a foreign TNC –no matter how legitimate the claim might be-- is not an easy sell for any government. Any domestic political actor may argue that instead of making a transfer in favor of a foreign investor, the cash could have been used to finance other public policy priorities such as education, health, among others. Negotiating the payment of damages in the absence of adjudication is also a very sensitive issue because of the risk of allegations of collusive corruption schemes set up between the government and the investors when agreeing the amount of compensation to be paid. Thus, one thing is for a government to use scarce fiscal resources only to the extent necessary to legally comply with an international obligation. In this case, the resulting compensation will be determined not by the government and the affected investor, but rather by an independent international tribunal, who will be the instance bearing the political cost of making such decision. Another thing is for a government to accept a mutually agreed compensation, the amount of which could always be questioned by anyone in the political setting of the host State.

In sum, when attempting to reach mutually agreed solution to an investor-State dispute through ADR, governments are confronted with too many and too sensitive political risks. As these risks may be easily avoided by recurring to adjudication, it only seems natural that the use of ADR to settle investor-State disputes has been so limited.

Within this context, before having to assume the political costs associated with a voluntary settlement of a controversial investor-State dispute, governments often find it more politically convenient to let an international tribunal assume the political cost of making a decision.[10] As the arbitration award is legally binding, it is easy for governments to shield themselves from the controversy generated by the content of the award, an award from which they can disassociate and even criticize, and yet comply with it as a result of the need to respect a decision enacted by a legitimate tribunal under international law.

3. Barriers related to the lack of clarity and evolving nature of international investment law

As explained in subsection "III.A" above, in many contexts, and certainly in the context of international investment relations, any interest-based dispute resolution process is likely to take place in the shadow of the law. Clearly, no party to a dispute will ever agree to voluntarily settle a particular dispute if in the end a negotiated agreement entails higher costs and less favorable conditions than would otherwise be obtained through adjudication. In this regard, the more predictable the likely outcome of a rights-based dispute resolution process becomes, the easier it

[10] As Reisman accurately points out: " *This seems especially to be the situation with respect to governments in international investment law disputes. Indeed, in States in which there are active political oppositions waiting for an opportunity to pounce on the incumbents for having 'betrayed' the national patrimony by settling with an investor, modalities other than transparent third-party decisions can undermine or even bring down governments and destroy personal careers.*" (Reisman, 2011, p.26)

will be for the parties to ponder the benefits of using rule-based negotiation approaches to solve their disputes.

The problem is that, contrary to other international economic law contexts like the WTO where one single dispute settlement system interprets a single set of Agreements, the current international investment regime not only comprises several thousand of similar and yet different IIAs, but also is based on a de-centralized dispute settlement approach. Similar provisions are included in a myriad of agreements, which in turn can be potentially interpreted by a multiplicity of arbitral tribunals. Within this context, it is not surprising that decisions of arbitral tribunals regarding the scope of IIAs and the content and breadth of key of their substantive standards have not been consistent. Inconsistency in international investment arbitration tribunals has not only been widely discussed in the investment literature, but has also been considered by many experts to be one of the fundamental limiting factors to amicable settlement in investor-State cases.

> *"Negotiations need to occur by bargaining in the shadow of the law, which means it is necessary for both parties to properly assess the relative strengths and weaknesses of their own and the opponent's cases (Mnookin and Kornhauser, 1979). But the ability of the parties in many investor-State cases to make such assessments is severely impaired by the fact that, on these key issues, tribunals follow disparate paths to decision and bring about very different outcomes (Gelinas, 2005). On a wide range of [both jurisdiction and substantive protection] issues, there is significant uncertainty about how an arbitral tribunal will rule. Consequently, a party's probabilities of success often cannot be reliably estimated and neither party can get a true picture of what it may be giving up or gaining through a "negotiated" conclusion to the dispute."* (Clodfelter, 2011, p.41)

The analysis of the three sets of variables explained above help us to explain why so far the use of interest-based ADR has been so limited in the context of treaty-based investment disputes. Furthermore, that analysis also sheds light to better understand why, in practice, consensual settlements have tended to be limited to the contentious context of investor-State arbitration.

To be able to settle, governments need to be in a position to clearly and objectively demonstrate to their political constituencies that settling the dispute is in fact a better alternative for the host State than waiting for the arbitral tribunal to render a final award. Such outcome would be achieved by demonstrating at least two key points: first, that unless there was a settlement, the arbitral tribunal would likely hold the State liable for a breach of an international legal obligation, and/or second, that the terms and effects of a negotiated settlement would lead to a more convenient outcome for the State than the terms derived from an adverse award rendered by the tribunal.

Here we have presented an overview of the unique and fundamental obstacles to interest-based dispute resolution in the context of investor-State disputes. At this point, the question that arises is how such barriers can be overcome, and provide investment stakeholders with an alternative approach to deal with their grievances derived from the application of IIAs. This paper argues that a solution to this conundrum can be found by addressing the investor-State conflict at an earlier stage, before the investor-State conflict degenerates into a full-blown dispute under an

IIA. In this sense, this paper argues that it is necessary to complement *dispute resolution procedures* with dispute prevention policies and mechanisms that enable host States and investors to *manage* their conflicts before they escalate into investment disputes under an IIA.

IV. Developing the concept of investor-State dispute prevention

In the literature and practice of international investment law and policy, dispute prevention is still a relatively new and unexplored idea. It has been conceptualized as the action of *"minimizing potential areas of dispute through extensive planning in order to reduce the number of conflicts that escalate or crystallize into formal disputes."* (UNCTAD, 2010:xiv) This paper purports to develop this embryonic definition and take it one step further by distilling its two essential elements.

First, dispute prevention is conceptualized as the act of reducing the number of conflicts that escalate into formal disputes. This idea stems from a crucial conceptual distinction widely acknowledged by conflict theorists and Dispute System Design (DSD) practitioners, i.e. the differentiation between the notion of *"conflict"* in the one hand, and "*dispute"* in the other. In this section, we will explain the differences between these two concepts, the practical implications of such distinction and why it may be critical to develop protocols of dispute avoidance in the investor-State context.

The second essential element of the dispute prevention definition referred to above is the notion that reduction in conflict escalation may be achieved through "*extensive planning*". In the context of the relations between foreign investors and host States, there is practically no literature providing guidance as to the criteria to be used to decide what should be the focus of such "*planning*", and even less a systematic approach as to how such planning should be organized and implemented. The following subsections below address each of these two essential elements of the dispute prevention concept.

A. The distinction between "conflict" and "dispute" and its application to the investment context

Most of the time, in all contexts – and the field of international investment law and policy is not an exception-- there has been a trend to use the terms *"conflict"* and "*dispute*" interchangeably. Both terms are indistinctively used to refer to a difference or a problem between the parties in a relationship. However, Conflict Theory and DSD literature make a clear conceptual distinction between these two terms, and such differentiation turns out to be critical for creating protocols of investor-State dispute avoidance.

For DSD practitioners the terms "*conflict"* and "*dispute*" are not synonymous. While conflict is a process, a dispute is rather just one of typical by-products of conflict. *"Conflict is the process of expressing dissatisfaction, disagreement, or unmet expectations with any organizational interchange; a dispute is one of the products of conflict…[w]hereas conflict is often ongoing,*

amorphous, and intangible, a dispute is tangible and concrete–it has issues, positions, and expectations for relief." (Constantino and Sickles Merchant, 1996: 5)

This approach visualizes a dispute as the result of a "*continuum*". A dispute stems from a process of degradation, whereby a state of agreement among the parties to a relationship devolves into the identification of a problem; then to a conflict arising from that problem, and then to a dispute arising from that conflict. (Philipps, 2009) Thus, a conflict is a problem unattended, and a dispute is an unattended conflict which has evolved into a *"defined, focused disagreement, often framed in legal terms"*. (Smith and Martinez, 2009:123). This sequential distinction has two important corollaries. The first is that problems and conflicts are inherent to all levels of human interaction, thus, conflict is unavoidable. Instead, disputes can be prevented if conflict is successfully managed and dealt with before it escalates into a focused disagreement expressed in legal terms and entailing expectations of relief. Second, relationships are dynamic rather than static and they evolve over time and according to the circumstances. As conflicts are an inherent part of relationships, they are also dynamic, and evolve with time. Once an attended conflict has degenerated into a dispute, the approaches necessary to solve the difference also vary. Thus, DSD literature also makes the distinction between the concepts of "*conflict management*", and "*dispute resolution*". Conflicts are managed. Disputes are resolved. Let us develop this point further.

At the initial moments of the conflict management stage, dissatisfaction or disagreement is somewhat shapeless, and thus, there is a wide fan of options for the parties to deal with the situation. Conflict management processes attempt to address the interests of the parties involved in the conflict and this way, attempt to eliminate or substantially reduce the source of dissatisfaction or disagreement. As will be further explained below, the fact that a dispute does not yet exist, promotes an environment which is more conducive to the success of interest-based processes. Once a conflict has devolved into a dispute, the situation is quite different. There is a defined and focused disagreement. When the dispute is framed in legal terms – as in the context of treaty-based investment disputes-- the conflict has evolved to the point where one party has formulated a claim that an action of another is not only illegal, but that has also inflicted damage, entitling the affected party to seek a concrete expectation of relief –often expressed in terms of compensation.

In the end, both conflict management and dispute resolution are then different approaches to deal with the different levels of maturity of a conflict. Disputes could be prevented through an appropriate management of conflicts. Thus, an appropriate management of conflict would lead to dispute prevention. As stated before, in all levels of human interaction, conflict is unavoidable. Disagreements among human beings, organizations and States happen all the time. Further, conflicts are not only a natural manifestation of human interaction, in addition, as it has been rightly pointed by Franck, *"…managed conflict creates opportunities for commercial, social, and political innovation… in the investment context conflict may also provide opportunities for more meaningful problem-solving techniques between investors, authorities of host States and civil society, development of stronger relationships and greater levels of investment."* (Franck 2007: 46-48). Within this context, the search of an appropriate management of investor-State conflict creates the opportunity to innovate, and to develop investor-State dispute prevention policies and mechanisms which can contribute to decrease the number of claims submitted to

investor-State arbitration and also represent more efficient means to strengthen the relationships between investment stakeholders.

1. The investor-State conflict continuum

In the context of the relationship between a foreign investor and the host State, conflicts appear when the parties express dissatisfaction, disagreement or unmet expectations in their relationship. In world where in most countries economic activity tends to be highly regulated, and thus leading to a high level of interaction between foreign investors and the authorities of host States, the possibilities for conflict are present every day.

To perform almost any economic activity, foreign investors require permits, licenses or authorizations from public authorities of the host State. Administering concessions for public services, granting all sorts of permits, applying tax, health or any other type of regulations, are just some examples of tasks performed by public agencies that regularly deal with foreign investors on a daily basis. The risk for treaty-based investment disputes between foreign investors and host States is considerably higher than in other contexts because of two important reasons. First, norms and disciplines included in IIAs have a quite broad scope of application, and tend to apply to all measures that a State might take and affect an investment owned or controlled by a covered investor under the agreement. Second, States are a conformed by a conglomerate of governmental agencies. These agencies—which can be part of the national, regional of sub-regional administration—may be bureaucratic, have different policy priorities, and even different attitudes with respect to foreign investment, yet all of them are equally bound by the norms and disciplines of IIAs. Thus, the possibility for a conflict arising between a foreign investor and the host State is considerably high, as different agencies can undertake different measures –even contradictory ones—with respect to a given foreign investment. In numerous countries, red tape and contradictory requirements to get authorizations or licenses are a common source of irritation –and thus, conflict-- to any person interacting with the public administration.

Furthermore, the possibility of conflict in the context of investor-State relations is often exacerbated as a significant number of the agencies that enact measures affecting the economic activity of foreign investors are not familiar with the obligations included in IIAs. Given the wide scope of application of IIAs, and the fact that foreign investment can take place in almost any sector of economic activity, the agencies involved in the negotiation of IIAs tend not coincide with the wide number of agencies which can enact measures affecting the effective implementation of those agreements. These variables help to explain why limited information, communication and coordination —and perhaps even open disagreements—between public agencies are often at the root of numerous conflicts between foreign investors and host States. Moreover, these same variables also explain why in the context of investor-State relationships, a significant number of conflicts are often not effectively managed and degrade into full-blown investment disputes, as in many countries, the very first time that the authorities competent to deal with investor-State disputes hear about a treaty-based investment conflict is when they receive from the investor a formal notice of intent to submit a claim to arbitration.

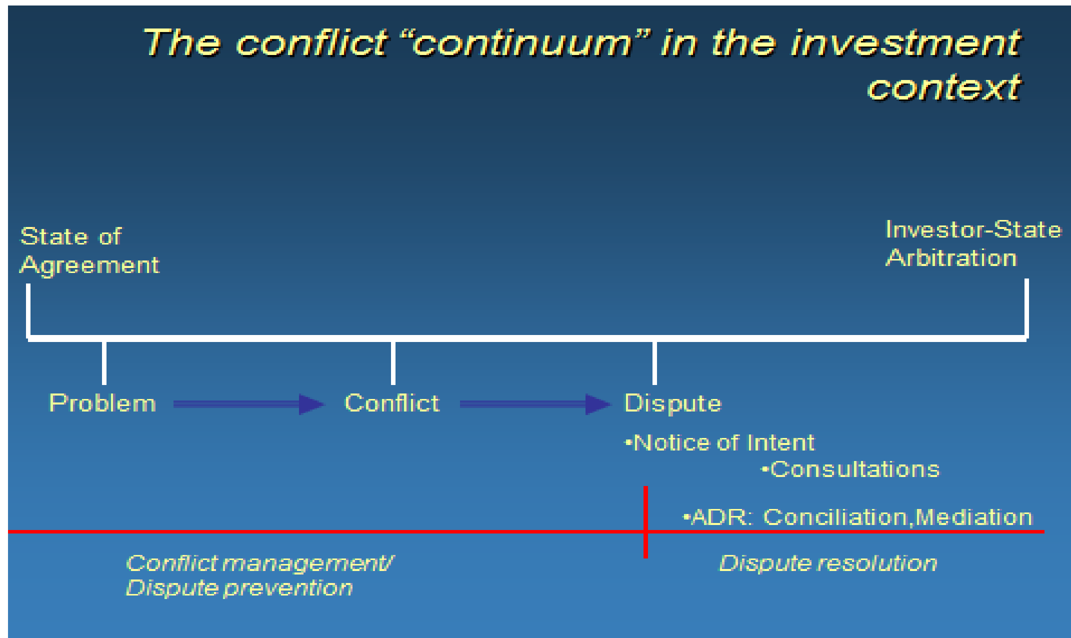
In practice, the existence of a conflict manifests itself when an investor expresses dissatisfaction or concern to an authority of the host State as a consequence of the adoption or rejection to adopt a particular measure. In many countries, the agency adopting the measure may not be familiar

with the rules and disciplines of IIAs, or may even ignore the existence of these agreements. Once the investor raises the problem –usually with the agency which adopted the challenged measure—the problem may or not be solved. In the latter situation, the lack of resolution may stem from various possible factors, ranging from simply bureaucratic inertia or red tape, to the existence of a disagreement between the agency and the investor regarding the problem. Such disagreement may be related to the legality or convenience of the measure or regarding the impact that the contested measure may or not have over the investor.

When confronted with a problem raised by an investor –either domestic or foreign—the public character of the agency concerned entails that its actions have to be framed within the framework of the applicable body of administrative law. The degree of flexibility provided to the agency by the domestic administrative laws to use interest-based processes may vary from country to country. However, regardless of the degree of flexibility that may be available, because of the public nature of the measures at issue and the agency involved, any negotiation will certainly occur in the shadow of the law. In this regard, it is very likely that the agency concerned may assess the problem raised by the investor exclusively in terms of its field of competence and policy priorities, rather than in terms of the potential liability derived from an IIA. Further, even if the norms and obligations of the IIA were taken into consideration at this stage, as previously explained in section "III.B.3" the general and vague language used in most agreements raise complex interpretation issues which may be quite difficult for any public agency to deal with without specialized legal advice.

If the problem remains unresolved, time will pass, and the disagreement and the investor's inconformity will continue. Further, as a consequence of the application or the contested measure, damages may be inflicted over the investor. The conflict will continue to ferment until the investor, motivated by the economic cost generated by the unmanaged conflict, will seek legal assistance and explore the different alternatives to obtain redress. If at this stage the attempts to solve the conflict amicably have not rendered any particular positive result, it is likely that the lawyer assisting the investor will then advice the affected investor to consider resort to investor-State arbitration under the IIA, and then formally present the competent authorities of the host State with a notice of intent to submit a claim to arbitration. Figure 1 illustrates the continuum in the evolution of an investor-State dispute.

Figure 1



As Figure above 1 illustrates, by the time the investor submits a notice of intent to arbitration, the conflict would have crystallized into a dispute. This would be the case as the unattended conflict would had evolved into a defined, focused disagreement, framed in clear legal terms and requiring a particular form of relief, i.e. a request for compensation for the damages generated by the actions of the government. This determination regarding the moment when the conflict devolves into a dispute is particularly relevant, as in the investor-State context, the political economy of conflict management would likely be quite different from the political economy of dispute resolution. This point is further developed in subsection "2" below.

2. Conflict management vs. dispute resolution: practical implication of the distinction

This paper argues that in the context of the investor-State relations, one the most important practical implications of making the distinction between conflict management and dispute resolution is that such differentiation enables us to understand the scenario where interest-based problem-solving techniques different form adjudication may be more likely to be politically feasible. As explained in subsection "III.B.2" above, by time the conflict has crystallized into a dispute, the dynamics of the unresolved conflict between the investor and the host State will likely generate a situation in which various structural factors –in particular those related to the hybrid private/public nature of the dispute-- play against enabling the parties to find a negotiated settlement. However, here we argue that most of these critical barriers apply only once an investor-State dispute has come into existence, and thus, they do not hold in situations when the conflicts have not yet crystallized into disputes under the applicable IIA. Let us develop this assertion further.

From the perspective of the host State, when a foreign investor submits a legal claim to investor-State arbitration, that very action entails at least four very sensitive political implications. First, there is an open challenge against a measure which may be pursuing legitimate public policy objectives. This may lead to the outcry of several sectors that not only may want to defend the measure, but also may oppose in the first place having any foreign investor second guessing domestic legislation in foreign tribunals. If the investor-State conflict was properly managed at an early stage, interest-based processes could create value for both parties, and focus the discussion on *how the application* of the measure could still pursue its public policy objectives and yet simultaneously prevent the inconveniences originating the conflict with the investor. Thus, the challenge to the public measure, and the political cost associated with such challenge, could be prevented.

Second, an investor-State claim also entails the openly public allegation by the investor that the host State is violating its international obligations. To some degree, such allegation entails a "harassment" effect over the accused sovereign state, leading to defensive attitudes of government officials who find it difficult to recognize any such breach –even assuming that the violation was actually happening and they privately knew it. Again, if an interest-based solution to the problem was found –even if it was the result of negotiations on the shadow of the law-- the investor would never submit a claim to arbitration, and thus, a public allegation of a breach to any international obligation will never arise in the first place.

Third, an investor-State claim also entails the request of the investor for compensation of usually significant amounts of money. In addition to compensation, any payment entails an additional political cost for the host State associated for having to pay a foreign investor --often a transnational corporation- large sums of fiscal resources that could have been spent in other public projects critical for the development of the country. Avoiding the economic and political costs entailed by arbitration is one of the most evident and politically attractive potential advantages of an appropriate management of the investor-State conflict. An early management of the conflict could easily prevent inflicting any significant damage to any of the parties involved in the conflict. Further, the conflict could be resolved through solutions that may not entail the use of public fiscal resources at all.

Fourth, the submission of a treaty-based claim to investor-State arbitration also entails the submission of a dispute to a foreign tribunal who will enact a binding decision on the parties. Having an arbitration tribunal resolving the dispute often leads to claims of violations of sovereignty and lack of legitimacy of the adjudication process. If properly managed, the investor-State conflict would never reach the dispute resolution stage, and thus, there would never be an arbitration tribunal adjudicating. Further, one of the key features of interest-based procedures is to allow the parties themselves to keep control of the management process of their conflict. Even if the parties requested the assistance of a third party to reach an agreement –for instance through the use of preventive ADR techniques—the inherently voluntary nature of these processes ensure the total control of the parties.

In sum, the practical implication of making the distinction between investor-State dispute resolution and investor-State conflict management is that such differentiation enables to overcome some of the structural barriers associated to the private/public nature of investment

disputes that make it very difficult for investors and host States to use non-litigious approaches to address their grievances. That is why experts have rightly recognized that "*the best chance to resolve a dispute between a foreign investor and a government agency is likely before the investment dispute becomes a dispute under an investment treaty.*" (Legum, 2006:3)

B. The two fundamental dimensions of dispute prevention

When addressing the structural difficulties acting as des-incentives for amicable resolution of investor-State disputes, we made reference to three broad categories of barriers. First, those related to the insufficient necessary infrastructure to enable interest-based conflict resolution in the investor-State context. Second, barriers related to the private/public nature of investor-State disputes, and third, barriers related to the lack of clarity and evolving nature of international investment law. In the last section, we explained how the barriers related to the private/public nature of investor-State disputes can be overcome by managing the conflict before it escalates into a dispute under the applicable IIA. The remaining two categories of barriers to interest-based processes shed light regarding the two fronts that require attention to foster effective prevention of treaty-based investor-State disputes.

In this regard, it is worth noting that the prevention of investor-State disputes could be visualized as comprising two broad dimensions: a "substantive" and "procedural" one. From a substantive point of view, prevention of investor-State disputes has a lot to do with the level of clarity and precision of provisions in IIAs. Simply stated, the more clear and precise the obligations of IIAs are, the less need for the parties applying the agreement to elucidate their application in specific practical situations. The problem is that in the context of IIAs, and in particular in the case of Bilateral Investment Treaties (BITs) negotiated before the first investor-State disputes had arisen, several rights and obligations are drafted in terms that are too general and vague.

Evidence shows that over the last decade, a significant number of investor-State disputes have arisen as a result of the lack of clarity of certain key substantive provisions of IIAs. (UNCTAD, 2007)[11] The number of issues that have been submitted for clarification to international arbitration tribunals is significant. With more than 390 treaty-based cases brought to investor-State arbitration by the end of 2010 (UNCTAD, 2011), international arbitration tribunals have dealt with numerous issues that range from the clarification of what constitutes a covered investment for purposes of the application of an IIAs, to clarifying the content of various standards of protection and treatment included in those agreements, such as, *inter alia*, fair and equitable treatment, national treatment and MFN treatment, and the protection against unlawful expropriation. (UNCTAD, 2007) Further, and as explained in section "III.B.3" above, the lack of clarity regarding the breath and content of rights and obligations in IIAs has also been exacerbated by the incoherent jurisprudence resulting from the increase in litigation activity.

[11] The fact that a significant number of IIAs contain substantive provisions that have required clarification is evidenced not only by increased ISDS activity, but also by the impact that litigation has had over investment rule-making. Recent studies (UNCTAD 2007) have documented how over the last decade escalation in ISDS has led various States to redraft their IIAs to clarify several provisions and address some of the shortcomings unveiled during the first years of investor-State litigation.

Within this context, the question relevant for purposes of developing of protocols of investor-State dispute avoidance is what could be done to foster greater clarity in the negotiation and interpretation of rules and obligations of IIAs. A complete answer to this question would clearly go beyond the scope of this paper, as it entails to address a myriad of critical challenges affecting the patchy and extensive framework of IIAs which constitute the basis of contemporary international investment law. Further, solutions for better negotiation and greater coherence in the interpretation of IIAs have already been explored by the literature. Thus, besides just flagging to the reader this dimension of the notion of dispute prevention, this article focuses instead on the other critical dimension of the concept.

In addition to the substantive considerations referred to above, the concept of dispute prevention has also a "procedural" dimension. From this vantage point, dispute prevention entails a more concrete and tangible outcome, that is, the development of the necessary infrastructure to provide the opportunity to investors and host governments to manage their conflicts well before they escalate into full-blown disputes under the IIAs. Such infrastructure may clearly entail specialized human resources and capacity building. However, when referring to infrastructure, here we mostly refer to the basic, underlying legal and institutional framework required to develop an investor-State conflict management system. In this regard, we propose here that such infrastructure may be developed through a series of policies and mechanisms, which in this context we denominate investor-State dispute prevention policies (DPPs) and mechanisms (DPMs).

V. Creating the infrastructure for investor-State conflict management: DPPs and DPMs

A. Dispute Prevention Policies (DPPs)

Dispute prevention policies (DPPs) can be defined as any course of action adopted and pursued by one or more governments specifically aimed at preventing investor-State conflicts arising under IIAs from escalating into full-blown disputes under those agreements. Like any other area of public policy, DPPs can take a wide variety of forms and approaches. DPPs can be implemented at two different levels. On the one hand, governments may unilaterally design and implement DPPs at a domestic level, and on the other, governments may seek an international concerted approach to design and implement DPPs.

1. Domestic DPPs

Domestic DPPs may entail the application of programs of best administrative practices, such as for instance, capacity building to government agencies on the content and potential impact of IIAs and better communication and coordination protocols among the different state agencies dealing with foreign investors, developing protocols. DPPs may also go one step further, and pursue a more ambitious and yet concrete objective. In this sense, domestic DPPs may promote the use of legal means, such as the negotiation of investor-State contracts or the use of domestic administrative laws to provide for the legal infrastructure required to implement the early

management of investor-State conflicts. Here we denominate the development of these legally based investor-State conflict management procedures as Dispute Prevention Mechanisms (DPMs), a concept which is further developed in subsection “B” below.

2. State-to-State Cooperation for DPPs

Besides the domestic front, DPPs can also be formulated and implemented through a concerted approach between governments. State-to-State cooperation in formulating and implementing DPPs can take numerous forms and approaches, and some of them can lead to the negotiation of specific clauses in IIAs. On the basis of the concrete means through which investor-State disputes could be prevented, here we propose a typology comprising four possible categories of DPPs.

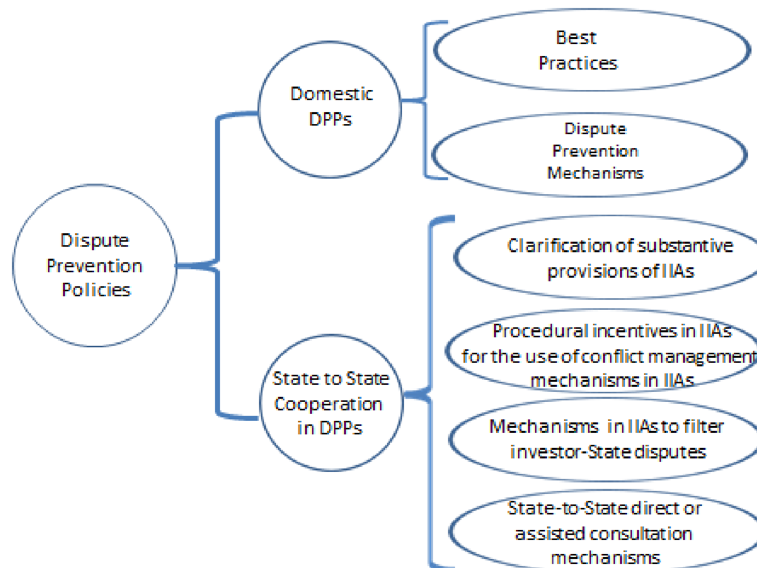
One first category of State-to-State DPPs would be those the focus of which would be on fostering to the greatest extent possible, clarification of the scope and content of substantive provisions of IIAs. Thus, for instance, certain IIAs, such as the investment Chapters of NAFTA, DR-CAFTA and most investment chapters included in FTAs negotiated by the United States, establish joint administrative commissions comprising government authorities of the Contracting Parties with the capacity to enact jointly agreed interpretative notes clarifying particular provisions of the IIAs. NAFTA’s experience with the interpretative note enacted by its Administrative Commission with respect to various provisions of Chapter 11 illustrates this approach. Further, States could also agree on other initiatives geared at promoting, to the extent possible, greater coherence in the interpretation of IIAs. The literature has started to propose several alternatives in this regard.

A second category of State-to-State DPPs would be those promoting the inclusion in the texts of IIAs of more effective incentives inducing both investors and governments to undertake real, serious and good faith attempts to effectively explore interest-based conflict management processes before any notice of intent for arbitration can be submitted by the foreign investor. As explained in section … above, most of IIAs encourage the parties to seek amicable resolution of the dispute before submitting a claim to investor-State arbitration. However, the problem with this conceptual approach is that current dispute settlement provisions in IIAs tend to exclusively focus on dispute resolution rather than on conflict management. The determination of whether, to what extent and how could IIAs foster investor-State conflict management and not only dispute resolution is an interesting area of research that needs yet to be further developed.

A third category of State-to-State DPPs would entail the inclusion in the applicable IIA of joint State-to-State consultation mechanisms to “filter” certain types of conflicts and disputes from being submitted to investor-State arbitration. For instance, an increasing number of IIAs provide in their dispute settlement provisions special procedures that enable the competent authorities of the governments of the Contracting Parties to determine by common agreement, even if a dispute has already been submitted to investor-State arbitration, whether a particular claim by an investor in fact constitutes or not a breach of the IIA. Rather than conflict management provisions, these kind of clauses prevent the dispute from being submitted to investor-State arbitration by converting the claim in an issue to be addressed at a State-to-State level. Thus it could be argued that the DPP character of this kind of measures is rather limited.

Last but not least, a fourth category of State-to-State DPPs would be those promoting the establishment of communication and consultation protocols among governments in order to explore the possibility to manage investment-related conflicts before they escalate into disputes. This alternative would have to be handled with care, as it could lead to the perception of constituting an informal way to promote diplomatic protection in disguise. On the other hand, State-to-state consultations to address problems that affect non-state actors are already a widely diffused practice in the implementation of most international trade and investment agreements. Thus, convening on specific protocols to undertake these consultations on a regular basis could be an option to explore. The creation of State-to-State administrative commissions or the establishment of joint mixed committees with the participation of governments and non-governmental actor are just two concrete potential alternatives that illustrate this approach towards DPP State-to-State cooperation. Figure 2 below illustrates the typology for DPPs we just proposed.

Figure 2.
Investor-State Dipute Prevention Policies (DPPs):
Implementation Levels and Approaches



B. Dispute Prevention Mechanisms (DPMs)

We have defined DPMs as concrete procedural mechanisms, established either by law or contract, to enable investors and host States to early manage investment-related conflicts and prevent dispute escalation. Here we propose a typology distinguishing between two main categories of DPMs. One first category would comprise *ad-hoc* DPMs resulting from the direct negotiation by the parties involved in given relationship, and thus our denomination as *contractual* DPMs. In addition to *contractual* DPMs, a second category of DPMs would comprise those investor-State conflict management mechanisms embedded within the

institutional structure of the host State. Here we propose their denomination as *institutional* DPMs

1. Contractual DPMs

This kind of *contractual* DPMs would have to be negotiated by the investor and the host State well before any conflict arose, most probably in the context of the negotiation of an investment contract. In this scenario, the idea would be that, in addition to the substantive rights and obligations governing the investment relationship, the contract could include specific provisions prescribing procedures for managing any future eventual conflicts with the explicit purpose of avoiding any escalation to litigation. The use of contractual DPMs is a widely diffused practice in private contracts, thus, the notion is not really new. Rather, the novelty would be to envisage such practices in the investor-State context as part of the infrastructure required to establish an investor-State conflict management system.

In the investor-State context, contractual DPMs could either consist in mechanisms enabling the parties to directly consult among themselves to manage any conflict which may arise during the implementation of the contract, or entail a particular problem-solving technique to allow a third party to assist the parties in managing the conflict. The latter situation would entail the use of *preventive* ADR. Although originally envisaged to apply in situations where a dispute has already crystallized, literature has recognized the application of ADR problem-solving techniques as methods to assist the management of conflicts.(Constantino and Sickles Merchant, 1996) Dispute resolution boards, mediation, fact-finding or early neutral evaluation are just some of these preventive ADR techniques to which the parties could agree on a contract, well before any particular conflict arose.

At least in theory, contractual DPMs have the advantage of enabling the parties involved in the potential conflict to tailor-made the mechanisms to the particular needs of their specific relationship. However, the main limitation of this kind of DPMs is that, as said before, they would likely apply exclusively in situations where the relationship between the investor and the host State was regulated by a contract.

2. Institutional DPMs

Institutional DPMs can be defined as investor-State conflict management mechanisms institutionalized within the structure of the public administration of the host government. Contrary to contractual DPMs, institutional DPMs would in principle apply horizontally to all investments, regardless of whether or not they are governed by an investment contract.

From the outset, it is important to clarify that institutional DPMs do not --nor should-- guarantee that all investment-related conflicts will be prevented from escalating into investor-State disputes. As explained in section “III.A” above, interest-based processes are not adequate to deal with certain kinds of conflicts, for instance, those arising from the application of a key public policy measure, or in situations where the investor is submitting a frivolous claim, or when the host State may be more interested in setting a precedent for the future. For these kinds of situations, adjudication may in the end turn out to be a more appropriate alternative.

Empirical data reveals that around half of the cases submitted to investor-State arbitration under IIAs do not arise from measures adopted at central or national levels of government –which is the level at which IIAs are negotiated. Rather, evidence shows that a significant number of investor-State disputes tend to arise with respect to measures adopted by municipal or provincial governments or by State agencies in charge of specific sectors of the economy. (Franck, 2008) Thus, although not exclusively, institutional DPMs may be particularly useful to deal with investment-related conflicts stemming from the application of inconsistent policies and measures by different instances of a given government -- in particular, inconsistencies which could entail the liability of the host State under an IIA.

As a result of the increase in the use of investor-State arbitration and costs associated therein, over the last decade an increasing number of governments have started to explore different ways to be better prepared to handle those disputes. Literature documenting these incipient administrative practices is scant. (UNCTAD 2010,2011, Pawlack and Rivas 2008) However, such writings clearly evidence a critical fact: that governments are not autistic to the increase in investor-State litigation activity, and that such trend is indeed having an impact on host States' administrative practices. Further, the incipient experiences on investor-State dispute preparedness also shed light regarding some of the key elements that standard protocols for institutional DPMs should include. Procedures for intra-governmental information, coordination and decision-making with respect to grievances raised by investors are some of the issues that various governments –especially those with experience as defendants in investor-State arbitration—have addressed and developed best practices which can inform the development of institutional DPMs. (UNCTAD 2010, 2011, Pawlack and Rivas 2008)

In addition to policies on dispute preparedness, some countries have also started to focus specifically on the exploration of mechanisms to prevent investor-State disputes. Given the novelty of the topic, and the inexistence of standard protocols to design and implement institutional DMPs, it is not surprising that so far the experience has been limited to very few countries. In those cases, the dispute prevention initiatives have tended to be framed within the context of aftercare services provided by investment promotion agencies. The most well known experience in this regard is the case of the Office of the Foreign Investment Ombudsman in the Republic of Korea. (UNCTAD, 2011) In 2010 Russia also announced the creation of an Investment Ombudsman Office.[12] The embryonic experience of most governments regarding institutional DPMs certainly deserves further research. The scant literature has tended to provide only a preliminary and casuistic description of the few best practices so far developed by a limited number of countries.(UNCTAD 2010, 2011) The conceptual framework developed in this paper purports to be a preliminary contribution in the direction to organize such research.

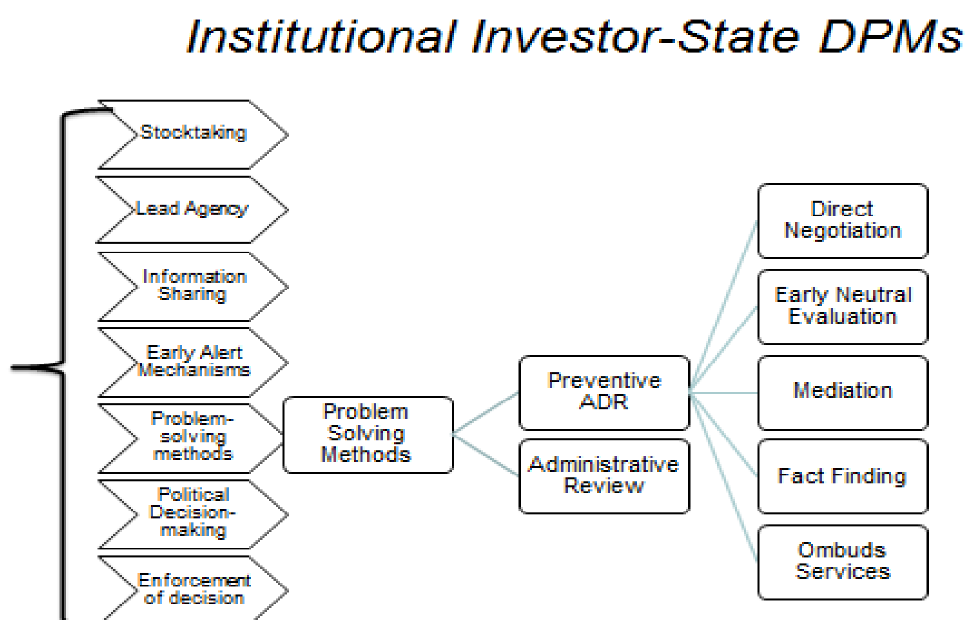
On the basis of the analysis presented, here we propose a preliminary sketch of the essential elements that a standard protocol for the development and implementation of institutional DPMs

[12] *In 2010 the President decided to establish the office of investment ombudsman to investigate complaints submitted by foreign investors. Per the President's directive, the Russian Government adopted a decision in August last year that an investment policy department will be set up at the Economic Development Ministry, and such a department was established."* Commentary by First Deputy Prime Minister Igor Shuvalov following the meeting with investment ombudsmen in federal districts, August 2, 2011. Official Site of the President of Russia: http://eng.news.kremlin.ru/ref_notes/62/print

should contain. It should be stressed that this sketch does not purport to represent a design of a particular form of institutional DPM. The design of a specific conflict management system is an exercise that has to be undertaken, on a case by case basis, by the relevant investment stakeholders in a particular country. Thus, to propose a "one size fits all" institutional DPM would be clearly inappropriate. Rather, the identification of the essential structural elements of institutional DPMs purports to provide a framework that will permit stakeholders to create their own adaptive conflict management solutions, and apply these principles and approaches to their own specific political, legal economic contexts.

Clearly, in most countries, the proper development of institutional DPMs would likely entail the implementation of a comprehensive program. Such program would have to be geared towards djusting and modernizing parts of the host State's public administration infrastructure in order to enable investment stakeholders to early manage investor-State conflicts. As illustrated by Figure 3 below, here we propose that a protocol for further research and implementation of institutional DPMs should at least comprise seven fundamental elements.

FIGURE No.3



First, the preparation of a comprehensive investment stocktaking process represents the point of departure of any well-conceived national strategy for institutional DPMs. The purpose of an investment stocktaking process is to allow government authorities to have a clear diagnosis on three fundamental aspects. First, there should be clear identification of the concrete international legal obligations undertaken by the country through the different IIAs. Many countries have many IIAs in force, each one with similar but not exactly the same rules and disciplines. Through invocation of MFN, some investors may attempt to assimilate the guarantees provided by these different agreements. Second, the stocktaking process should also lead to a clear profile of the main features of the foreign investment existing in the host country. Third, the stocktaking analysis should also assess the different kinds of problems, conflicts and disputes known to have

arisen between foreign investors and governmental authorities. Thus, a complete investment stocktaking process should comprise at least three key components: a regulatory audit, an empirical analysis of investment stock and flows into the country, and third, a record of the investor-State conflict history of the country. (Pawlack and Rivas, 2008)

Second, there should be institutional structure clearly identifying the competent government instance in charge of implementing the DPMs. There is a clear consensus in the literature on the importance of having a Lead Agency within the government with the competence of coordinating the management of investor-State conflicts and disputes. (Legum 2006, Pawlack and Rivas 2008, UNCTAD 2011). Further, experts coincide that is critical that such Lead Agency be provided with the necessary resources and political and legal authority to fully engage with the affected investor in conflict management processes.

Third, protocols for the development of institutional DPMs should also include efficient intra-governmental information sharing techniques. Information sharing should enable the Lead Agency to coordinate the diffusion of relevant information to those agencies more likely to generate or become involved in investment-related conflict. Information sharing may involve substantive information on the contents and breadth of the obligations included in the different IIAs. Further, it should also entail informing the highest possible number of governmental departments about the existence and purpose of the institutional DPMs existing in the host State, so the latter know who to call in case they have a doubt regarding the consistency of their measures with IIAs or if a conflict with a foreign investor arises. In this regard, the role of the Lead Agency becomes critical, as it would act as the focal governmental contact point for the other agencies for all matters related to the application and implementation of IIAs.

Fourth, protocols for the development of institutional DPMs should also include early alert mechanisms. The purpose of these mechanisms is to enable the Lead Agency to learn about the existence of an investment-related conflict as early as possible. As previously explained, timing is a key variable to enable the prevention of a conflict from crystallizing into a dispute under an IIA. Indeed, only by detecting the conflict early enough, institutional DPMs will have a chance to operate.

Fifth, institutional DPMs must also envisage different problem-solving methods for the parties to seek an interest-based solution to the conflict. Although the difference may be quickly solved through the administrative review by the host State of the measure generating the conflict, protocols on institutional DPMs should also provide the possibility of the affected investor and the host State to use preventive ADR techniques to manage their conflict. Mediation, Fact-finding, Early Neutral Evaluation or Ombuds services are just some of the possible preventive ADR techniques that could be useful to consider (UNCTAD, 2011). Even in the conflict management phase, government officials may still require the "political cover" that only the participation of an independent expert third party may provide. We should recall that, to be able to find any amicable solution to a conflict, governments may always be asked to clearly and objectively demonstrate to their political constituencies that solving the conflict is in fact a better alternative for the host State than proceeding to litigation. The opinion of an independent expert may be critical to achieve this result.

Sixth, once the problem-solving process has enabled the parties to find a solution to the conflict, it is paramount that such solution receives the approval of the adequate political instance of host State and the investor. Such high-level political endorsement would guarantee that the measure providing a solution to the problem would be effectively implemented. If such mechanisms are not clearly included in the protocols for institutional DPMs, there is the risk that the consensual solution to the conflict agreed by representatives of governments and investors may subsequently be ignored or disrespected by one of the many other agencies of the government or even by higher hierarchical levels of the enterprise involved in the conflict.

Last but not least, and closely related to the aspect referred to above, the seventh essential element that a standard protocol for the development of institutional DPMs should include would be effective enforcement mechanisms to enable the decision solving the conflict to actually stick, and be effectively implemented. Such mechanisms would prevent a conflict that in principle was solved, to later escalate into a full-blown dispute as a result of the lack of compliance with the terms of the solution agreed by any of the parties.

VI. Conclusions

The significant escalation in the use of investor-State arbitration over the last decade has revealed a series of shortcomings of the existing investor-State dispute settlement system that risk to corrode the legitimacy of the whole international investment regime. Although not all investment stakeholders share the same diagnosis, there is a point on which most of them agree: existing dispute settlement procedures have turned out to be too expensive –both in economic and political terms- too slow and too indeterminate. Thus, literature has started to explore the use of other non-litigious means of resolution for treaty-based disputes arising between investors and host States.

This paper has explained how empirical evidence shows that consensual settlement of disputes between investors and host States are taking place not in the context of the application of existing ADR rules but rather, almost exclusively within the context of investor-State arbitration proceedings. We have also unveiled the factors that explain such trend. After analyzing the political and legal barriers that in practice have prevented the use of interest-based approaches in the context of investor-State disputes, we have found that most of those obstacles do not apply in situations when the conflict has not yet crystallized as a dispute under an applicable IIA. Within this context, we have proposed a conceptual framework for investor-State dispute prevention based on the critical distinction between the notions of *dispute resolution* on the one hand and *conflict management* on the other.

Further, the dispute prevention framework develops the concepts of dispute prevention policies (DPPs) and mechanisms (DMPs). Such policies and mechanisms would represent the fundamental infrastructure to enable investment stakeholders to design, in a given context, a conflict management system. The rationale of such system would be to enable host States and investors to effectively manage and solve their conflicts before they escalate into full-blown investor-State arbitration disputes. Clearly, the conceptual framework developed in this paper is just an initial step in the field of investor-State dispute prevention. Research and policy in this

new area of international investment law is just beginning, and thus the potential usefulness of the conceptual framework to assist in organizing those endeavors.

In the current inter-dependent world, the search for alternatives to investor-State dispute resolution entails much more than a procedural discussion. In fact it raises a profound philosophical question: which should be the parameters of governance orienting the evolution of the international investment regime?

The differentiation between power-based, rights-based and interest-based dispute resolution used in the context of conflict theory results quite useful when translated to the context of the historical evolution of international investment relations and international investment law in particular. From a trend where investor-State investment disputes used to be predominantly resolved through diplomatic protection –an approach that in practice led to power-based dispute resolution— with the proliferation of IIAs and the increase in investor-State arbitration the trend has shifted towards rights-based dispute resolution.

Thus, international investment relations have become increasingly *"rule-oriented"* rather than being *"power oriented"*, in the sense that they have become increasingly governed by rules and principles included in conventional instruments of international law rather than by political and economic might (Jackson, 1997, Franck, 2009). In general, that should be considered a very positive development for both international and domestic investment governance.[13] However, the legalization of international investment relations is also exerting strong pressures over host countries' administrations, leading various political actors to resist to those pressures, and to challenge the legitimacy of the current international investment regime. Within this context, it is not surprising that a significant share of the literature on international investment law has recently focused on how such regime -- and investor-State dispute settlement procedures in particular-- should be revisited and adjusted to properly respond to the realities of the XXI century.[14]

No one could argue that the current international investor-State arbitration mechanisms in IIAs do not need to be improved ---there may be, however, significant disagreements as to what kind of improvements to make and how they should be implemented. However, regardless of this discussion, this paper has demonstrated that any serious attempt to modernize the international investment regime should bear in mind that, to properly perform its function, the regime can no longer afford to leave all problems arising between investors and host States to be exclusively addressed through adjudication.

After almost two decades of experience with investor-State arbitration, the time has come for the international investment regime to complement *dispute resolutio*n procedures with *conflict management* mechanisms. Several reasons justify this assertion. First, in this paper we have

[13] Today no one could seriously argue that power-based dispute resolution should predominate in current international economic relations.

[14] Some governments have even taken a more radical reactive approach as a response to the increase in investor-State litigation. While some have started to refrain from continuing negotiating investor-State dispute settlement provisions in IIAs –like the government of Australia—others have even taken steps to withdraw from international conventions regulating those procedures – as some South American countries. It may be early to tell whether those decisions will represent a trend or rather isolated decisions, but what seems clear is that such policies go in the direction of returning to an era where investor-State conflict was resolved through diplomatic protection.

explained how, in principle and from many vantage points, consensual solutions to investor-State conflict would be much more efficient than adjudication. We have made reference to the convergent views among investment stakeholders that such procedures have turned out to be too costly –both in economic and political terms-, too slow and too indeterminate. Second, the exclusive reliance on adjudication as a means to manage investor-State conflict is generating such high economic and political costs, that the legitimacy of the international investment regime is being corroded. This is a serious problem if we take into account how central the relations between investors and host States have become within current international economic dynamics. As Reisman clearly points out:

> *"The popular demand to increase national wealth and, through some form of distribution, to expand economic and other life opportunities for all citizens, is a universal feature of modern political life.* ***That this demand can be met solely by autochthonous national development is no longer seriously argued.*** *Responsible officials at the national level, knowing that positive development now requires a constant flow of incoming and outgoing investment,* ***have little choice but to participate in the making and applying of international investment law****."* (Reisman, 2011 p. 25) (emphasis added)

It is time to conceive the application of international investment law as going beyond litigation. After evolving from power-based to rule-based dispute settlement, it is time for the international investment regime to evolve, and also incorporate within its structure interest-based conflict management mechanisms. The conceptual framework developed in this paper attempts to represent an initial contribution to guide further research and policy in this new potential dimension of international investment law.

VII. References

Cable, J.(1981), *Gunboat Diplomacy 1919-1979: Political Applications of Limited Naval Force* (London: Macmillan)

Coe JJ.Jr (2005) "Toward a complementary use of conciliation in investor-State disputes: A preliminary sketch", *Journal of International Law and Policy*, University of California, Davis, Vol, 12: 7-46.

_______ (2009) "Settlement of Investor-State Disputes through Mediation: Preliminary Remarks on Processes, Problems and Prospects", in Doak Bishop (Ed), *Enforcement of Arbitral Awards Against Sovereigns* (Huntington, New York: JurisNet LL.C). p.52

Clodfelter, M. (2011) "Why Aren't More Investor-State Treaty Disputes Settled Amicably?" in UNCTAD (2011), *Investor-State Disputes: Prevention and Alternatives to Arbitration II, Proceedings of the Washington and Lee University and UNCTAD Joint Symposium on International Investment and Alternative Dispute Resolution, held on 29 March 2010 in Lexington, Virginia, USA* (New York and Geneva: United Nations), United Nations, UNCTAD/WEB/DIAE/IA/2010/8. p.38

Costantino, C. and Sickles- Merchant, C (1996) Designing Conflict Management Systems, (San Francisco: Jossey-Bass)

Echandi, R. (2011), "What do Developing Countries Expect from the International Investment Regime?" in J. Alvarez & K. Sauvant et. Al (Eds) *The Evolving International Investment Regime: Expectations, Realities, Options,* (Oxford, New York: Oxford University Press, 2011)

Franck, S. (2009) "Development and Outcomes of Investment Treaty Arbitration", *Harvard International Law Journal*, Vol.50, No.2: 435-489

________ (2008) "Empirically evaluating claims about investment treaty arbitration", North Carolina Law Review, Vol.92:161.

________ (2007) 'Integrating investment treaty conflict and dispute settlement design,' *Minnesota Law Review*, Vol.92 (2007), 161-230.

_________ (2005) " The legitimacy crisis in investment treaty arbitration: privatizing public international law through inconsistent decisions", Fordham Law Review, Vol.73:1521.

Hernandez Crespo, M. (2011) "From Paper to People: Building Conflict Resolution Capacity and Frameworks for Sustainable Implementation of IIAs to Increase Investor-State Satisfaction", in UNCTAD (2011), *Investor-State Disputes: Prevention and Alternatives to Arbitration II, Proceedings of the Washington and Lee University and UNCTAD Joint Symposium on International Investment and Alternative Dispute Resolution, held on 29 March 2010 in Lexington, Virginia, USA* (New York and Geneva: United Nations), United Nations, UNCTAD/WEB/DIAE/IA/2010/8. p.55

International Centre for the Settlement of Investment Disputes (ICSID), (2011) The ICSID Caseload Statistics, 2010, available at: http://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDDocRH&actionVal=CaseLoadStatistics

Jackson, J. (1997), *The World Trading System: Law and Policy of International Economic Relations* (Cambridge, MA:MIT Press)

Legum, B. (2006) " The difficulties of conciliation in investment treaty cases: A comment on Professor Jack, C.Coe's 'Towards a complementary use of conciliation in investor-State disputes: A preliminary sketch"' 21:4 *Mealey's Arbitration Rep.* 72, reprinted in 2:2 *Mediation Committee Newsletter* 27 (International Bar Association 2006).

Newcombe A. and Paradell L.(2009) Law and Practice of Investment Treaties (The Netherlands: Wolters Kluwer)

Onwuamaegbu,U.(2005) "The Role of ADR in Investor-State Dispute Settlement: The ICISD Experience", *News from ICSID*, Vol.22, No.2:12.

Reisman, M. (2011) "International Investment Arbitration and ADR: Married but Best Living Apart" in UNCTAD (2011), *Investor-State Disputes: Prevention and Alternatives to Arbitration II, Proceedings of the Washington and Lee University and UNCTAD Joint Symposium on International Investment and Alternative Dispute Resolution, held on 29 March 2010 in Lexington, Virginia, USA* (New York and Geneva: United Nations), United Nations, UNCTAD/WEB/DIAE/IA/2010/8. p.22

Rubins, N. (2006) "Comments To Jack C. Coe Jr's Article on Conciliation" *Mealey's International Arbitration Report*, Vol.21, No.4.

Salacuse, J. (2007), "Is there a Better Way? Alternative Methods of Treaty-Based, Investor-State Dispute Resolution", *Fordham International Law Journal*, Vol.31:138.

Smith, S. & Martinez, J. (2009) 'An Analytic Framework for Dispute Systems Design,' *Harvard Negotiation Law Review*, Vol. 14 , 123-169.

United Nations Conference on Trade and Development (UNCTAD) (2011) *Investor-State Disputes: Prevention and Alternatives to Arbitration II, Proceedings of the Washington and Lee University and UNCTAD Joint Symposium on International Investment and Alternative Dispute Resolution, held on 29 March 2010 in Lexington, Virginia, USA* (New York and Geneva: United Nations), United Nations, UNCTAD/WEB/DIAE/IA/2010/8.

_________(UNCTAD) (2011) *Latest Developments in Investor-State Dispute Settlement*, IIA Issues Note, No.1, March 2011

________ (UNCTAD, 2010) Investor-State Disputes: Prevention and Alternatives to Arbitration UNCTAD Series on International Investment Policies for Development. New York and Geneva. United Nations. United Nations Publication, Sales No.E.10.II.D.11.

_________ (UNCTAD, 2010a). World Investment Report 2010: Investing in a Low-Carbon Economy. New York and Geneva. United Nations. United Nations Publication, Sales No.E.10.II.D.2.

_______ (UNCTAD, 2007) Bilateral Investment Treaties 1995-2006: Trends in Investment Rulemaking, New York and Geneva. United Nation, United Nations Publication, Sales No.E.06.II.D.16

_________ (UNCTAD, 2005). Investor-State Disputes Arising From Investment Treaties: A Review. UNCTAD Series on International Investment Policies for Development. New York and Geneva. United Nations. United Nations Publication, Sales No.E.06.II.D.1.

_________ (UNCTAD, 2001). World Investment Report 2001: Promoting Linkages. New York and Geneva. United Nations. United Nations Publication, Sales No.E.10.II.D

_________(UNCTAD) (1998). Bilateral Investment Treaties in the Mid-1990s. New York and Geneva. United Nations. United Nations Publication, Sales No.E.98.II.D.8.

Ury, W, Brett, J.and Goldberg S. (1993) Getting Disputes Resolved: Designing Systems to Cut the Costs of Conflict, The Program on Negotiation at Harvard Law School, Cambridge, Massachusetts,

Van Harten G.(2005) "Private authority and transnational governance: The contours of the international system of investor state protection". *Review of International Political Economy*, Vol.12, No.4: 600-623.

Wälde, T. (1985) "Mediation/Alternative Dispute Resolution in Oil, Gas and Energy Transactions: Superior to Arbitration/Litigation from a Commercial and Management Perspective." *Transnational Dispute Managemen*t, Vol.1:2.

.