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COURSE ON DISPUTE SETTLEMENT

INTERNATIONAL CENTRE FOR
SETTLEMENT OF INVESTMENT DISPUTES

2.1 OVERVIEW



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NOTE

The Course on Dispute Settlement in International Trade, Investment and Intellectual Property consists of forty modules.

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OVERVIEW

This Module gives a general introduction to the series of Modules dealing with the settlement of international investment disputes at ICSID. It explains the close link between economic development and foreign direct investment. Foreign direct investment depends in large measure on the economic, political and legal conditions prevailing in the host State. Access to an impartial and effective method of dispute settlement is an important element of the legal conditions.

This Module then gives an outline of the various traditional methods for the settlement of disputes between host States and foreign investors and explains the shortcomings of these traditional methods. The idea underlying the ICSID Convention is to close the gaps caused by these shortcomings.

This Module explains the origins and history of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the ICSID Convention). It also explains why the mechanism created by the ICSID Convention works to the advantage of the investor as well as of the host State.

It also gives a broad description of the leading principles underlying dispute settlement under the ICSID Convention. These include the choice of methods between conciliation and arbitration, the specialization on investment disputes, the substantive law applicable to investment disputes, the mixed nature of proceedings between a State and a foreign investor, the requirement of consent to ICSID's jurisdiction, the institutional support given by the International Centre for Settlement of Investment Disputes (the Centre), the self-contained and automatic nature of proceedings and the overall effectiveness of the system.

At the same time this Module summarizes the most important points that are explained in more detail in the subsequent Modules 2.2 to 2.9. The idea is to offer the reader a broad and general picture before (s)he turns to the specific issues covered in these Modules. Where appropriate, this Module offers references to the Modules which explain these points in more detail.

OBJECTIVES

Upon completion of this Module the reader should be able to:

- Describe the significance of foreign investment for development.
- Appreciate the influence of dispute settlement on a country's investment climate.
- Compare dispute settlement under the ICSID Convention with other methods of dispute settlement.
- Recount the history of the ICSID Convention.
- Identify the institutional framework of ICSID.
- Analyse the object and purpose of the ICSID Convention.
- Define the respective interests of host States and investors in dispute settlement under the ICSID Convention.
- Describe the most important characteristics of dispute settlement under the ICSID Convention.

INTRODUCTION

Investment and development

Foreign direct investment (FDI) plays a pivotal role in economic development. It provides access to a number of economic factors which are indispensable in this context. These include capital, technology and know-how. The volume of capital transfers through FDI is considerably larger than all forms of development aid, bilateral and multilateral. During the 1990s and the first years of the twenty first century, the amount of FDI has grown dramatically.

In addition, FDI facilitates access to world markets, to worldwide distribution channels and other networks. Not infrequently, FDI contributes to the improvement of infrastructures in developing countries like tele-communication systems, roads and airports, to the training of the local workforce and to the development of indigenous industries.

This is not to say that all phenomena associated with FDI and with globalization in general have been welcomed in all quarters. But there is broad consensus, that private investment constitutes the most important factor in economic development. This has led many developing countries to revise their previously reserved attitudes towards FDI and to adopt an open and welcoming attitude towards foreign investors.

Investment climate

The recognition that FDI is an important element in development has led many if not most developing countries to strive to create conditions that are attractive to foreign investors. In fact, nowadays developing countries often compete for FDI.

Economic and political factors

Much of the investment climate in a country will consist of economic and political factors such as market access, the availability and cost of production factors, taxation, the existence of infrastructures, the existence of a functioning public administration, the level of corruption and political stability.

Legal factors

In addition to economic and political factors, the legal framework for FDI is also important in determining its investment climate. This legal environment is, in turn, determined by a number of factors. These include the stability of the legal conditions under which an investor can operate, the quality of the local public administration in applying relevant regulations, the transparency of the system of local regulations and an effective system of dispute settlement.

Investment codes

Many developing countries have attempted to improve their domestic legal framework by passing specialized legislation, often referred to as investment codes. These investment codes are designed to combine clarity with favourable conditions for foreign investments.

BITs

In addition to guarantees contained in domestic law, potential host States to investment also give international legal guarantees to investors. First and foremost among these are bilateral investment treaties (BITs). These contain

substantive as well as procedural guarantees to investors of the respective countries. It is estimated that over 2000 such BITs have been concluded worldwide.

Regional treaties

In a similar vein, regional treaties offer guarantees to investors. These include the North American Free Trade Agreement (NAFTA) and the Energy Charter Treaty.

Dispute settlement

A particularly important aspect of the legal protection of foreign investments is the settlement of disputes between host States and foreign investors. Impartial and effective dispute settlement is an essential element in investor protection. This element had serious shortcomings until the creation of the ICSID system.

Summary:

- **Foreign direct investment is widely regarded as the most important factor in economic development.**
- **The investment climate of a country is determined by economic, political and legal factors.**
- **Among the legal factors, an impartial and effective system of dispute settlement is essential.**

1. SETTLEMENT OF INVESTMENT DISPUTES

Domestic courts of host State

In the absence of other arrangements, a dispute between a host State and a foreign investor will normally be settled by the domestic courts of the host State. From the investor's perspective, this type of dispute settlement carries important disadvantages. Rightly or wrongly, the courts of the host State are often not seen as sufficiently impartial in this type of situation. In addition, domestic courts are bound to apply domestic law even if that law should fail to protect the investor's rights under international law. In addition, the regular courts will often lack the technical expertise required to resolve complex international investment disputes (see Module 2.2).

Domestic courts of other States

Domestic courts of other States are usually not a realistic alternative. In most cases, they will lack territorial jurisdiction over investment operations taking place in another country. Even if a host State were to agree to a choice of forum clause pointing to the courts of the investor's home State or of a third State, sovereign immunity or other judicial doctrines will usually make such proceedings impossible (see Module 2.2).

Diplomatic protection

Diplomatic protection is a frequently used method to settle investment disputes. It requires the espousal of the investor's claim by his home State and the pursuit of this claim against the host State. This may be done through negotiations or through litigation between the two States before an international court or arbitral tribunal. But diplomatic protection has several disadvantages. The investor must have exhausted all local remedies in the host country. Moreover, diplomatic protection is discretionary and the investor has no right to it. Also, diplomatic protection is unpopular with States against which it is exercised and may lead to tensions in the relations of the States concerned (see Module 2.2).

Arbitration

Direct arbitration between the host State and the foreign investor is another option for the settlement of investment disputes. International arbitration provides an attractive alternative to the settlement of investment disputes by national courts or through diplomatic protection. Arbitration is usually less costly and more efficient than litigation through regular courts. It offers the parties the opportunity to select arbitrators who enjoy their confidence and who have the necessary expertise in the field. Moreover, the private nature of arbitration, assuring the confidentiality of proceedings, is often valued by parties to major economic development projects.

Ad hoc arbitration

If arbitration is not supported by a particular arbitration institution, it is referred to as *ad hoc* arbitration. *Ad hoc* arbitration requires an arbitration agreement (called a *compromis*) that regulates a number of issues. These include the selection of arbitrators, the applicable law and a large number of procedural questions. A number of institutions, like UNCITRAL, have developed standard rules that may be incorporated into the parties' agreement. *Ad hoc* arbitration is subject to the rules of the arbitration law of the country in which the tribunal

has its seat. The enforcement of awards rendered by such tribunals is subject to the same rules as awards by tribunals dealing with commercial cases (see Module 2.2).

Summary:

- **Domestic courts of the host State are usually not seen as offering sufficient guarantees to foreign investors.**
- **Domestic courts of the investor's home State and of third States are usually not available for the settlement of investment disputes.**
- **Diplomatic protection is a form of dispute settlement that carries uncertainties for the investor and inconvenience for the host State.**
- ***Ad hoc* arbitration between the investor and the host State is a useful option but carries several procedural disadvantages.**

2. THE HISTORY OF THE ICSID CONVENTION

a) Preparation

Origin of the ICSID Convention

The gaps in the existing structures for the settlement of investment disputes led to a new initiative in the 1960s. The plan was to create a mechanism specifically designed for the settlement of disputes between host States and foreign investors. The initiative came from the World Bank, an institution that is concerned with economic development. The driving force behind the Convention's drafting was the World Bank's General Counsel at the time, Aron Broches.

Drafting

The Convention's drafting took place from 1961 to 1965. The main bodies involved were the World Bank's legal department, the World Bank's Executive Directors and a series of regional meetings in which experts from 86 States participated.

Adoption

The text of the Convention together with a short explanatory report was adopted by the Executive Directors of the World Bank on 18 March 1965. Its official designation is Convention on the Settlement of Investment Disputes between States and Nationals of Other States.¹ It created the International Centre for Settlement of Investment Disputes (ICSID).² This is why the Convention is commonly referred to as the ICSID Convention.

b) Entry into Force and Participation

Entry into force

The ICSID Convention entered into force on 14 October 1966 after its ratification by 20 States.³ Of the early participating States most were developing countries notably in Africa.

Participation

Over the years, participation in the Convention has grown steadily. By mid-2002 135 countries were parties to the Convention. Another 17 had signed but not yet ratified the Convention.⁴ All major industrialized countries with the exception of Canada have become parties.⁵ Most African countries are parties. The majority of Arab countries are represented. Most Asian countries, including China, are parties. A number of former Soviet Republics, including the Russian Federation, have signed but not yet ratified the Convention.

¹ The text of the Convention is published in 575 United Nations Treaty Series 159; 4 International Legal Materials 524 (1965) and 1 ICSID Reports 3 (1993). An electronic version is available at <http://www.worldbank.org/icsid/basicdoc/9.htm>.

² See Articles 1-24 of the Convention.

³ See Article 68 of the Convention.

⁴ For a current list of participating States see: <http://www.worldbank.org/icsid/constate/c-states-en.htm>.

⁵ Of the 29 Member States of OECD only Canada, Mexico and Poland are not parties to the Convention.

Latin America

During the Convention's drafting, Latin American countries displayed a reserved attitude. Until 1980 Latin American countries uniformly stayed away from the Convention. This position softened in the 1980s. During the 1990s the picture changed completely: most countries in Latin America ratified the Convention. But a few important countries, including Brazil and Mexico, have so far stayed away.

c) Subsequent Developments

Case load

The use of the Convention's mechanisms was scant during its early years. The first case was not decided before 1974.⁶ This situation has since changed profoundly. Especially the 1990s have seen a dramatic increase in the number of registered cases. The current rate of new registered cases is about one per month. By September 2002 there were 66 concluded cases and 39 cases were pending.

Additional Facility

In 1978 the Additional Facility was created (see Module 2.2). It is designed primarily to offer methods for the settlement of investment disputes where only one of the relevant States, either the host State or the State of the investor's nationality, is a party to the Convention. This has turned out to be important in the context of NAFTA and, more recently, of the Energy Charter Treaty. The Additional Facility may also be used for disputes which do not directly arise out of an investment or for fact-finding proceedings.⁷ The Additional Facility is subject to its own rules and regulations. The ICSID Convention does not apply to it.

Summary:

- **The ICSID Convention was conceived and drafted in the framework of the World Bank.**
- **The ICSID Convention is widely ratified by industrialized as well as developing countries.**
- **Use of the arbitration mechanism under the ICSID Convention is widespread and intensive.**
- **The Additional Facility was created in 1978.**

⁶ *Holiday Inns v. Morocco* (Case No. ARB/72/1) Decision on Jurisdiction, 12 May 1974. Unpublished.

⁷ For documentation on the Additional Facility see 1 ICSID Reports 213-280 (1993) and <http://www.worldbank.org/icsid/facility/facility.htm>.

3. THE PURPOSE OF THE ICSID CONVENTION

Economic development

The Convention's primary aim is the promotion of economic development. The Convention is designed to facilitate private international investment through the creation of a favourable investment climate. The Preamble to the Convention expresses this purpose in the following terms:

Considering the need for international cooperation for economic development, and the role of private international investment therein;

Stimulation of investment

The link between an orderly settlement of investment disputes, the stimulation of private international investments and economic development is explained in the Report of the Executive Directors on the Convention in the following terms:

9. In submitting the attached Convention to governments, the Executive Directors are prompted by the desire to strengthen the partnership between countries in the cause of economic development. The creation of an institution designed to facilitate the settlement of disputes between States and foreign investors can be a major step toward promoting an atmosphere of mutual confidence and thus stimulating a larger flow of private international capital into those countries which wish to attract it.

...

12. ... adherence to the Convention by a country would provide additional inducement and stimulate a larger flow of private international investment into its territories, which is the primary purpose of the Convention.⁸

The Tribunal in *Amco v. Indonesia* explained that ICSID arbitration is in the interest not only of investors but also of host States. It concluded:

Thus, the Convention is aimed to protect, to the same extent and with the same vigour the investor and the host State, not forgetting that to protect investments is to protect the general interest of development and of developing countries.⁹

Advantages of ICSID Convention

Compared to *ad hoc* arbitration, the ICSID Convention offers considerable advantages: it offers a system for dispute settlement that contains not only standard clauses and rules of procedure but also institutional support for the conduct of proceedings. It assures the non-frustration of proceedings and provides for an award's recognition and enforcement.

Balance of Interests

ICSID arbitration offers advantages to the investor as well as to the host State. Proceedings may be instituted by either side but in the majority of cases the investor is in the position of claimant. The Report of the Executive Directors

⁸ 1 ICSID Reports 25.

⁹ *Amco v. Indonesia, Decision on Jurisdiction*, 25 September 1983, 1 ICSID Reports 400. See also *Award*, 20 November 1984, 1 ICSID Reports 493.

on the Convention describes this balance of interests in the following terms:

*13. While the broad objective of the Convention is to encourage a larger flow of private international investment, the provisions of the Convention maintain a careful balance between the interests of investors and those of host States. Moreover, the Convention permits the institution of proceedings by host States as well as by investors...*¹⁰

Advantage to investor

The advantage for the investor is obvious: it gains direct access to an effective international forum should a dispute arise. The possibility of going to arbitration is an important element of the legal security required for an investment decision.

Advantage to host State

The advantage for the host State is twofold: by offering arbitration it improves its investment climate and is likely to attract more international investments. In addition, by consenting to ICSID arbitration the host State protects itself against other forms of foreign or international litigation.¹¹ Also, the host State effectively shields itself against diplomatic protection by the State of the investor's nationality.¹²

Summary:

- **The purpose of the Convention is the promotion of economic development through the creation of a favourable investment climate.**
- **The creation of an effective system for the settlement of disputes is an important element in the improvement of the investment climate.**
- **The ICSID Convention operates in the interest of investors as well as of host countries.**

¹⁰ 1 ICSID Reports 25.

¹¹ Article 26 of the Convention.

¹² Article 27 of the Convention.

4. CHARACTERISTICS OF THE ICSID CONVENTION

a) Choice of Methods

Conciliation

The ICSID Convention provides for two methods of dispute settlement, conciliation and arbitration. Conciliation is a more flexible and informal method that is designed to assist the parties in reaching an agreed settlement.¹³ Conciliation ends in a report that suggests a solution but is not binding on the parties. Therefore, this method ultimately depends on the continuing willingness of both parties to cooperate (see Module 2.2).

Arbitration

Arbitration is a more formal and adversarial process. Nevertheless, a considerable number of arbitration cases end in an agreed settlement. If no agreed settlement is reached, the outcome is an award that is binding on both parties and may be enforced (see Modules 2.2 and 2.9).

Preference for arbitration

In practice, arbitration is preferred over conciliation. The vast majority of cases brought to ICSID relate to arbitration. In fact, conciliation under the ICSID Convention is very rare.¹⁴ This is due, in part, to the fact that in case of a submission to both methods of settlement, the choice is with the party initiating proceedings. As a rule, it will seem wiser to direct the necessary effort and expense to proceedings that lead to a binding decision.

Summary:

- **The ICSID Convention provides for arbitration and conciliation.**
- **In practice, arbitration is nearly always the preferred method.**

b) Specialization on Investment Disputes

Meaning of «investment»

The ICSID Convention is specialized in the settlement of investment disputes. Therefore, the existence of a legal dispute arising directly out of an investment is a prerequisite for ICSID's jurisdiction.¹⁵ (See Module 2.5). The concept of an investment is not defined in the Convention.

Many BITs and multilateral treaties contain definitions of investment. But these definitions are not necessarily decisive for the meaning of the concept under the ICSID Convention. For instance, whereas some of these treaties extend rights also for the establishment of an investment, the Convention only applies once an investment has actually been made.

Broad concept of «investment»

In actual practice, the concept of “investment” has been given a wide meaning. A variety of activities in a large number of economic fields have been accepted

¹³ See Articles 28-35 of the Convention.

¹⁴ For this reason, this Module concentrates on arbitration and does not deal with conciliation.

¹⁵ Article 25(1) of the Convention.

as investments. In addition to traditional typical investment activities, these include pure financial instruments like the purchase of government bonds and the extension of loans. Decisive criteria are a certain duration of the relevant activities, the regularity of profit and return, the presence of a certain economic risk, a substantial commitment as well as the relevance of the project for the host State's development.

Summary:

- **The procedure under the Convention is available for investment disputes only.**
- **Practice under the Convention has interpreted the concept of investment widely.**

c) Applicable Law

No substantive rules

The ICSID Convention does not contain any substantive rules. It merely offers a procedure for the settlement of investment disputes. Any effort to codify the substantive law of international investment in the framework of the Convention would have led to insurmountable difficulties.

Choice of law

But the ICSID convention does contain a rule on applicable law (see Module 2.6). In other words, it directs tribunals how to find the rules to be applied to particular disputes. Tribunals are to follow any agreed choice of law by the parties. In the absence of an agreed choice of law, the Tribunal is to apply the law of the host State and international law.¹⁶

Importance of proper law

Choice of law issues have played a prominent role in the practice of tribunals. The application of the correct system or systems of law is an essential requirement for a legitimate award. Failure to apply the proper law is regarded as an excess of powers and may lead to an award's annulment (see Modules 2.6 and 2.8).

International law

In applying international law, tribunals have applied treaties, especially BITs, as well as customary international law. General principles of law and judicial practice, especially of previous ICSID tribunals, have also played a prominent role (see Module 2.6).

International and host State law

The relationship of international law and domestic law has played an important role in ICSID practice. ICSID tribunals have held that where both systems of law are applicable, recourse to the host State's law is indispensable but international law has a supplementary and corrective function (see Module 2.6).

Equity

A tribunal may decide *ex aequo et bono*, that is on the basis of equity rather than law, only if it has been so authorized by the parties.

¹⁶ Article 42 of the Convention.

Summary:

- **The Convention does not contain substantive rules.**
- **The applicable law may be agreed upon by the parties.**
- **In the absence of an agreement, the applicable law is the host State's law and international law.**

d) The Parties to ProceedingsMixed proceedings

Proceedings under the Convention are always mixed. One party (the host State) must be a Contracting State to the Convention. The other party (the investor) must be a national of another Contracting State¹⁷ (see Module 2.4). Either party may initiate the proceedings.

Constituent subdivisions and agencies

States may also authorize constituent subdivisions or agencies to become parties in ICSID proceedings on their behalf.

Natural or legal persons

The investor can be an individual (natural person) or a company or similar entity (juridical person). Both types of persons must meet the nationality requirements under the Convention.

Participation in Convention

Both the host State and the investor's State of nationality must be Contracting Parties, that is, they must have ratified the ICSID Convention. The decisive date for participation in the Convention is the time of the institution of proceedings. If either State is not a party to the Convention, ICSID is not available but it may be possible to proceed under the Additional Facility.

Locally incorporated company

An additional requirement is that the investor must not be a national of the host State. But if a foreign investor operates through a company that is registered in the host State, it is possible for the investor and the host State to agree that the company will be treated as a foreign investor because of foreign control.¹⁸

Summary:

- **Proceedings under the Convention are always mixed.**
- **Proceedings are between a host State that is a party to the Convention and an investor that has the nationality of another State party to the Convention.**
- **Under certain circumstances entities of the host State may become parties to proceedings.**
- **The investor may be a natural person or a juridical person.**
- **Under certain circumstances locally incorporated companies may be recognized as foreign investors for purposes of the Convention.**

¹⁷ Article 25(1) of the Convention.

¹⁸ Article 25(2)(b) of the Convention.

e) Consent to Jurisdiction

Requirement of consent

Participation in the ICSID Convention does not, by itself, constitute a submission to the Centre's jurisdiction. For jurisdiction to exist, the Convention requires separate consent in writing by both parties¹⁹ (see Module 2.3).

Forms of consent

Consent to the Centre's jurisdiction may be given in one of several ways. Consent may be contained in a direct agreement between the investor and the host State such as a concession contract. Alternatively, the basis for consent can be a standing offer by the host State which may be accepted by the investor in appropriate form. Such a standing offer may be contained in the host State's legislation. A standing offer may also be contained in a treaty to which the host State and the investor's State of nationality are parties. Most BITs and some regional treaties dealing with investments contain such offers. The more recent cases that have come before ICSID show a trend from consent through direct agreement between the parties to consent through a general offer by the host State which is later accepted by the investor often simply through instituting proceedings.

Binding nature of consent

Consent by the parties to arbitration under the Convention is binding. Once given by both parties, it may not be withdrawn unilaterally. A party may not determine unilaterally whether it has given its consent to ICSID's jurisdiction: the decision on whether jurisdiction exists is with the tribunal.²⁰

Limitations and conditions on consent

Consent can be given subject to conditions and limitations. For instance, host States may submit to ICSID's jurisdiction only in respect of certain types of disputes such as questions concerning compensation for expropriation. Consent may also be conditioned on certain procedural steps such as a prior attempt to reach a settlement by other means.

Summary:

- **Participation in the Convention does not amount to submission to proceedings under the Convention.**
- **Both parties must have given their written consent to jurisdiction.**
- **Consent may be given in a direct agreement between the parties.**
- **Consent may also be given through a general offer by the host State, contained in its legislation or a treaty, which is accepted by the investor.**

f) Institutional Support

Support by ICSID

Institutional support by the International Centre for Settlement of Investment Disputes (ICSID, the Centre) is one of the main advantages of arbitration

¹⁹ Article 25(1) of the Convention.

²⁰ Article 41 of the Convention.

under the ICSID Convention. The Centre performs a number of supportive functions in relation to arbitration.

Keeping of records

The Secretary-General of ICSID keeps a list of Contracting States that contains all information relevant to their participation in the Convention. In addition, the Secretary-General maintains lists of the Panels of Arbitrators, a register for requests for arbitration containing all significant procedural developments and archives containing the original texts of all instruments and documents in connexion with any proceeding.

Support in proceedings

The Secretary-General of ICSID and the staff of the Secretariat provide administrative support in arbitration proceedings. This support includes provision of a place for meetings at the Centre or elsewhere. ICSID also provides other assistance such as translations, interpretations and copying. The Secretary-General appoints an experienced member of the Centre's staff as Secretary for each tribunal. The Secretary of the tribunal makes the necessary arrangements for hearings, keeps minutes of hearings and prepares drafts of procedural orders. The Secretary also serves as the channel of communication between the parties and the arbitrators.

Accounting

The Secretary-General determines the charges payable to the Centre and consults with the tribunal on fees and expenses. He determines the fees of arbitrators. He receives advance payments from the parties and makes the payments necessary for the conduct of proceedings. He determines and receives the fees for lodging requests and the charges for specific services. In a particular proceeding, the Secretary of the tribunal administers this system on behalf of the Secretary-General.

Summary:

- **The Centre gives important institutional support in arbitration proceedings.**

g) Self-Contained and Automatic Nature of Proceedings

Self-contained proceedings

Proceedings under the ICSID Convention are self-contained. This means that they are independent of the intervention of any outside bodies. In particular, domestic courts have no power to stay, to compel or to otherwise influence ICSID proceedings. Domestic courts would have the power to order provisional measures only in the unlikely case that the parties agree thereto.²¹ An ICSID tribunal has to obtain evidence without the legal assistance of domestic courts. An annulment or other form of review of an ICSID award by a domestic court is not permitted.²² It follows that the place of proceedings

²¹ Under Article 47 of the Convention a tribunal has the power to recommend provisional measures.

²² Article 52 of the Convention provides for an autonomous system for the annulment of awards under narrowly defined circumstances.

²³ It is advisable to hold proceedings in a State that is a party to the ICSID Convention since another State would not be bound by the guarantees of independence and non-interference provided by the Convention.

has no practical legal consequences under the ICSID Convention²³ (see Module 2.7).

Non-frustration of proceedings

ICSID proceedings are not threatened by the non-cooperation of a party. The parties have much flexibility in shaping and influencing the proceedings. But if one of them should fail to act, the proceedings will not be stalled. The Convention provides a watertight system against the frustration of proceedings by a recalcitrant party. Arbitrators not appointed by the parties will be appointed by the Centre²⁴. The decision on whether there is jurisdiction in a particular case is with the tribunal.²⁵ Non-submission of memorials or non-appearance at hearings by a party will not stall the proceedings.²⁶ Non-cooperation by a party will not affect the award's binding force and enforceability (see Module 2.7).

Summary:

- **Arbitration proceedings under the Convention are self-contained and independent of outside interference.**
- **Non-cooperation by a party will not frustrate the proceedings.**

h) Effectiveness of the System

Overall effectiveness

The system of arbitration is highly effective. This effectiveness is the result of several factors. Submission to ICSID's jurisdiction is voluntary but once it has been given it may not be withdrawn unilaterally. The principle of non-frustration means that a case will proceed even if one party fails to cooperate. This circumstance alone will be a strong incentive to cooperate.

Binding nature of awards

Awards are binding and final and not subject to review except under the narrow conditions provided by the Convention itself ²⁷ (see Module 2.8). Non-compliance with an award by a State would be a breach of the Convention²⁸ and would lead to a revival of the right to diplomatic protection by the investor's State of nationality.²⁹

Enforcement of awards

The Convention provides an effective system of enforcement. Awards are recognized as final in all States parties to the Convention. The pecuniary obligations arising from awards are to be enforced like final judgements of the local courts in all States parties to the Convention³⁰ (see Module 2.9). Domestic courts have no power to review ICSID awards in the course of their enforcement. However, in the case of an award against a State the normal rules on immunity from execution will apply. In actual practice this will usually

²⁴ Article 38 of the Convention.

²⁵ Article 41 of the Convention.

²⁶ Article 45 of the Convention.

²⁷ Articles 49-52 of the Convention.

²⁸ Article 53 of the Convention.

²⁹ Article 27 of the Convention.

³⁰ Article 54 of the Convention.

³¹ Article 55 of the Convention.

mean that execution is not possible against assets that serve the State's public functions³¹.

Preventive effect

The system of dispute settlement under the ICSID Convention is likely to be effective even without its actual use. The mere availability of an effective remedy tends to affect the behaviour of parties to potential disputes. It is likely to have a restraining influence on investors as well as on host States. Both sides will try to avoid actions that might involve them in arbitration that they are likely to lose. In addition, the prospect of litigation will strengthen the parties' willingness to settle a dispute amicably.

Summary:

- **The system of dispute settlement under the ICSID Convention is highly effective.**
- **It leads to a binding award that may be enforced in all States parties to the Convention.**

TEST MY UNDERSTANDING

After having studied this Module you should be able to answer the following questions. Most answers should go beyond a simple yes/no alternative and would require a brief explanation.

1. How do you evaluate the importance of private investment for economic development?
2. What factors influence a country's investment climate?
3. What are the most important legal aspects of the conditions for investment in a country?
4. What is the most important type of treaty in contemporary investment law?
5. What are the traditional methods of settlement for investment disputes between States and foreign investors? What are their advantages and disadvantages?
6. In what institutional framework was the ICSID Convention created?
7. What is the full official name of the ICSID Convention?
8. What does the acronym ICSID stand for?
9. What is the Additional Facility?
10. What is the purpose of the ICSID Convention?
11. Is the ICSID Convention in the mutual interest of the host State and the investor? If so, why?
12. What are the methods for the settlement of disputes under the ICSID Convention? Which is used more often in actual practice?
13. Does the Convention contain substantive rules of investment law?
14. What is the applicable law on the merits in ICSID proceedings?
15. ICSID proceedings are always mixed. What does that mean?
16. Does participation of a State in the Convention entail consent to jurisdiction in ICSID proceedings?
17. In what way may the parties give consent to jurisdiction?
18. What type of institutional support does ICSID offer?
19. In what way are ICSID proceedings self-contained?
20. Can a party frustrate ICSID proceedings through non-cooperation?
21. What makes ICSID proceedings effective?

HYPOTHETICAL CASE

This is a hypothetical case. But it contains elements that have arisen in real cases or may well arise in future cases.

The purpose of this hypothetical case is twofold:

1. After you have studied this Module, you should look at this case as an illustration of the various legal questions that can arise in proceedings under the ICSID Convention. These legal questions are discussed in more detail in Modules 2.2 to 2.9.
2. After you have studied all Modules on the Settlement of International Investment Disputes and ICSID (Modules 2.1 to 2.9) you should be able to discuss the questions arising in this case in detail and you should be able to offer answers to all of them.

Veggies UnLtd v. Felafistan

Veggies UnLtd is a corporation registered under the law of Lechuga. The majority of its shares are in the hands of citizens of Pommonia. It is specialized in large scale agricultural projects. In 2003 Veggies UnLtd successfully competes for a contract to develop the agriculture of Felafistan, a small developing country. On 3 March 2003 Felafistan and Veggies UnLtd sign a Protocol of Understanding which outlines the basic features of a contract. Veggies UnLtd is to register a local company in Felafistan for the purpose of carrying out the project. This company, Veggies UnLtd(FE) is to provide the capital and know-how and is to establish twelve large farms called “industrial crop concerns” within three years from the date of signature of the Protocol of Understanding. After that, it is to operate the farms for a period of 25 years in order to recoup its expenses and to make a profit. After that period it is to hand over the facilities to the Government of Felafistan. The contract contains an Article 7 according to which “The investor shall have full access to the courts of Felafistan in case any disputes under the present Protocol of Understanding should arise.” Further details are to be worked out in subsequent contracts. The project is valued at •120 million.

After a change of government in Felafistan in August 2003, the new administration needs time to study the project. Veggies UnLtd, aware of the limited period it has for the establishment of the industrial farms, incorporates a wholly owned subsidiary Veggies UnLtd(FE) and starts work in May 2004. It continues to do so until September 2004. In the meantime, enthusiasm for the project fades in public opinion and in government circles in Felafistan. In particular, there is widespread criticism that the control over a major part of agricultural production and over natural resources connected with it should be in foreign hands for a quarter of a century. On 7 September 2004, the Parliament of Felafistan passes a resolution calling upon the government to

cancel the project. The government simply informs Veggies UnLtd(FE) of that decision without any further comment. By that time none of the more detailed contracts subsequent to the Protocol of Understanding have been signed. Veggies UnLtd, which claims to have invested over •80 million discontinues work immediately after it hears of the decision to cancel the project.

After some unproductive attempts to reach an agreed settlement, the government of Lechuga starts exercising diplomatic protection on behalf of Veggies UnLtd against Felafistan. After about a year of fruitless negotiations, Veggies UnLtd decides to institute arbitration against Felafistan. The Bilateral Investment Treaty between Lechuga and Felafistan of December 2003 (the BIT) contains the following provision on the settlement of disputes between host States and foreign investors in its Article 11:

- (2) *If such disputes cannot be settled according to the provisions of paragraph (1) of this article within a period of six months from the date either party to the dispute requested amicable settlement, the dispute shall be submitted to international arbitration or conciliation.*
- (3) *Where the dispute is referred to international arbitration or conciliation, the aggrieved party may refer the dispute either to:*
 - (a) *the International Centre for the Settlement of Investment Disputes ...; or*
 - (b) *an international arbitrator or an ad hoc arbitration tribunal to be appointed by a special agreement or established under the arbitration rules of the United Nations Commission on International Trade Law.*
- (4) *Each Contracting Party hereby consents to the submission of an investment dispute to international arbitration or conciliation.*

Lechuga is a party to the ICSID Convention since 1975. Felafistan ratified the Convention in November 2003. Veggies UnLtd as well as Veggies UnLtd(FE) institute proceedings with ICSID. The request is registered in February 2006. Veggies UnLtd relies on Article 11 as well as on Article 1 of the BIT which says:

For the purposes of this Agreement:

- (a) *“investment” means every kind of asset and in particular, though not exclusively, includes:*
 - (i) *movable and immovable property and any other property rights such as mortgages, liens or pledges;*
 - (ii) *shares in and stock and debentures of a company and any other form of participation in a company;*
 - (iii) *claims to money or to any performance under contract having a financial value;*
 - (iv) *intellectual property rights, goodwill, technical processes and know-how;*



- (v) *business concessions conferred by law or under contract, including concessions to search for, cultivate, extract or exploit natural resources...*

Felafistan does not, at first, respond to the communications from ICSID. The Tribunal is composed in accordance with Article 38 of the ICSID Convention. After its constitution, the Tribunal holds its first session at which Felafistan is not represented. The Tribunal sets time limits for the submission of memorials. Felafistan misses the first deadline, whereupon Veggies UnLtd requests the Tribunal to render an award in its favour on the basis of its submissions. The Tribunal instead gives Felafistan an extension of the deadline. Felafistan submits a memorial within the extended deadline signed by the law firm Avocado, Legume & Krautkopf. The memorial contains detailed arguments on jurisdiction and on the merits.

On jurisdiction, Felafistan argues that there was no legitimate investment since the parties never signed the detailed contracts envisaged in the Protocol of Understanding. Felafistan also argues that both Veggies UnLtd and Veggies UnLtd(FE) do not fulfil the nationality requirements under the ICSID Convention. Veggies UnLtd is controlled by shareholders of Pommonian nationality and is hence a Pommonian national. But Pommonia is neither a party to the ICSID Convention nor has it entered into a BIT with Felafistan. Veggies UnLtd(FE) is registered in Felafistan and hence not a national of another Contracting State. In addition, Felafistan argues that the Protocol of Understanding contained a choice of forum in favour of the local courts thereby ousting ICSID's jurisdiction. Finally, Felafistan argues that Article 11 of the BIT requires an agreement of the parties to choose between arbitration and conciliation as well as between ICSID and UNCITRAL.

On the merits, Felafistan argues that it has violated neither the standards of fair and equitable treatment nor of most favoured nation treatment guaranteed in the BIT. Moreover, the investment (if it was indeed an investment) was contrary to the law of Felafistan since Veggies UnLtd never obtained the necessary licences that were to be issued on the basis of the detailed contracts.

Veggies UnLtd contests all the arguments put forward by Felafistan. It insists that it made an investment on the basis of a binding contract. It also insists that it has the nationality of Lechuga. It also argues that the reference in the Protocol of Understanding to the courts of Felafistan did not deprive it of its right under the BIT to resort to ICSID arbitration. It also argues that it can exercise the choice of settlement procedures provided in Article 11 of the BIT unilaterally.

Veggies UnLtd relies on the protection offered by the BIT and on the international law doctrines of acquired rights and good faith. It refers to Article 12 of the BIT which provides:

The arbitration Tribunal established in accordance with Article 11 shall decide on the basis of the law of the Contracting Party which is a party to the dispute (including its rules on the conflict of law), the provisions of the present Agreement, special Agreements concluded in relation to the investment concerned as well as such rules of international law as may be applicable

In a second memorial, Felafistan reiterates its arguments on jurisdiction as well as on the merits and indicates that it shall seek the annulment of the award should the Tribunal find against it. It also adopts a defiant attitude towards compliance with an adverse award.

You are a member of the arbitral tribunal. The tribunal will discuss all the issues raised by the parties and reach a conclusion on them. These conclusions should be reflected in the award which must comply with all the requirements under the ICSID Convention.

FURTHER READING

Books

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Articles

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- **Szasz, P. C.**, A Practical Guide to the Convention on Settlement of Investment Disputes, 1 Cornell International Law Journal 1 (1968).

Documents

- Convention on the Settlement of Investment Disputes between States and Nationals of Other States:
<http://www.worldbank.org/icsid/basicdoc/9.htm>
- List of Contracting States and other Signatories of the Convention:
<http://www.worldbank.org/icsid/constate/c-states-en.htm>
- ICSID Cases:
<http://www.worldbank.org/icsid/cases/cases.htm>