International Investment Arbitration: A Critical Analysis

Sanya Yadav, Assistant Professor, Amity Law School, Amity University Rajasthan

ABSTRACT

Lack of a proper dispute settlement mechanism will have a detrimental effect on the Investment flows. To create a favourable climate for foreign investment and to protect their own citizens, states have entered into large number of bilateral and multilateral treaties. In these efforts to promote and protect investment, the issue of dispute resolution has been of crucial importance and adopted 'Arbitration' as an alternative means of dispute resolution method in Investor-State disputes.

Keywords

Investment, Arbitration, Bilateral Investment Treaties

INTRODUCTION

In this era of globalization Foreign Direct Investment (FDI) is seen as essential for economic growth in developed and developing nations. Foreign Direct Investment involves the transfer of tangible or intangible assets from one country into another for the purpose of their use in that country to generate wealth under the total or partial control of the owner of the assets[1]. Thus FDI is an integral part of world economy. In developing countries, major infrastructure projects like roads and air ports, telecommunication systems and the exploitation of natural resources often require financing by and technical Know-How of private foreign investors. Even in developed countries the share of foreign investment in the GNP is significant[2]. The Volume of capital flow through foreign investment is larger than all forms of public development aid, bilateral and multi lateral[3].

The significant features of these investments are, they are considerably huge which may need years for the investor[4] to recover and they constitutes a significant component of the national economy. These factors make foreign investment particularly vulnerable to possible interference by host state. While clear cut nationalisations or direct expropriations[5] are rare but there are number of other measures of lower threshold which affect foreign investment, such as currency restrictions preventing repatriation of profits, prohibition on price increases, tax increases or new taxes or environmental regulations. These acts of host state leaves investors right untouched but deprives the investor of the possibility to utilize the investment in a meaningful way[6]. This often lead to dispute between 'The Host State' and 'The foreign Investor'. In the absence of other specified arrangements, a dispute between host state and a foreign Investors will normally settled by domestic courts of host state. But from the investor's perspective, this type of dispute settlement carries important disadvantage. Host state courts are not perceived to be sufficiently impartial in this type of situation. In addition domestic courts are formally bound to apply domestic law even if that law should fail to

[1] Definition of Muthukumaraswamy Sornarajah in his Article '*The International Law on Foreign Investment'* By Compareing the definition of foreign investment in the Encyclopaedia of Public International Law (vol.8, p. 246), where foreign investment is defined as 'a transfer of funds or materials from one country (called capital exporting country) to another country (called host country) in return for a direct or indirect participation in the earnings of that enterprise'. The difficulty with this definition is that it is broad enough to include portfolio investment. The IMF, Balance of payments Manual (1980), para. 408, used a narrower definition which excluded portfolio investment. It defined foreign investment as 'investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of an investor, the investor's purpose being to have an effective choice in the management of the enterprise'.

[2] See UNCTAD Book of Statistics. Online version available at <http:/stats.unctad.org/public/eng/TableViewer/Wdsview/dispviewp.asp?ReportID=60>.

[3] See Article By Christoph Schreuer, 'The future of Investment Arbitration'.

[4] Individual who makes an Investment. In a foreign Investment nationality of the investor determines the foreignness of the Investment. Investors can be either natural person or companies. See A Sinclair, *'The Substance of Nationality Requirement in Investment Treaty Arbitration'* (2005) ICSID Review FILJ 357

[5] It is an official act by host state which takes the title of the foreign Investors property without giving adequate compensation to the Investor.

[6] Indirect Expropriation.

protect the investor's right under international law[7]. This amounts to an institutionalised bias towards host state and over against other legal commitments and obligations. In addition, regular court as might be expected, often lack the technical expertise required to resolve complex international investment disputes[8]. On the other hand states are rarely willing to submit the dispute to foreign courts[9]. Moreover such courts lack effective territorial jurisdiction over investment operations taking place in another country. Furthermore, even if diplomatic protection available, it can only be brought to bear after the exhaustion of the possible local remedies, which is precisely where all of the earlier problems encountered[10].

International organisations have been established and have engaged in promoting international or regional treaties and conventions providing a stable frame work for the investment in creating a worldwide standard for the treatment of foreign Investment[11]. Most of the International Conventions provide for arbitration as the preferred method of dispute settlement[12].

First part of the Research paper will be dealing with the Evolution of Investor-State Arbitration, Second part deals with the concept of Investment Arbitration and, The third and the fourth part deals with backlashes against Investment Arbitration and Alternative dispute mechanisms available.

THE EVOLUTION OF INVESTMENT ARBITRATION

Since at least 1794, arbitration has been used as a mechanism for fostering foreign investment and providing a neutral forum to resolve international disputes[13]. Although there have been bumps and bruises as international arbitration has evolved[14] into an independent discipline with impartial and expert decision makers, arbitration is now the preeminent method for resolving complex international disputes[15]. But there was no trace of arbitration of investment dispute as because individual investors had no standing and no direct cause of action against a Sovereign for a violation of international law that adversely affected their investment[16].

In 1924 , in the first judgement on the *Mavrommatis concessions case*, The permanent court of International Justice deemed the right of a state to protect its subjects injured by the acts of another state to be an elementary principle of international Law[17]. In the light of this case law the state can give diplomatic protection to its injured national. But it has a pre requisite that in order to give diplomatic protection the complaining party has tried and failed to obtain relief through ordinary channels. According to the International court of Justice (ICJ) 'the rule that local remedies must be exhausted before international proceeding may be instituted is a well

[7] See UNCTAD, Overview – Course on Dispute Settlement, ICSID, UNCTAD/EDM/Misc.232, p 7.
[8] See Ibid
[9] See walde, "*Investment Arbitration Under Energy Charter Treaty – From Dispute to Implementation*", 12 Arb Int 429 (1996) 431 et seq; Lorcher, *Neue Verfahren der Internationalen Streiterledigung in Wirtschaftssachen*, 156; Turner, *"Investment Protection through Arbitration: The dispute Resolution Provisions of the Energy Charter Treaty",* 1 *Int ALR* 166 (1998) 167.
[10] See Won-Mog Choi, "*The Investor State Dispute Settlement Paradigm"*
[11] See Comparitive International Commercial Arbitration By Julian D M Lew QC, Chapter 28, Arbitration of Investment disputes p 762
[12] In general International Conventions provide for ad hoc arbitration under the UNCITRAL Rules of an acceptable arbitration institution, e.g. ICC, SCC and in particular ICSID. In addition some treaties such as NAFTA, also devise their own arbitration system take account of particular circumstances.
[13] Guillermo A. Alvarez & William W. Park, *The New Face of Investment Arbitration: NAFTA Chapter 11*, 28 Yale J. Int'l L. 365, 366 (2003).
[14] *See* Kenneth S. Carlston, The Process of International Arbitration 259-64 (1946).
[15] *See generally* Joanne K. Lelewer, *International Commercial Arbitration As a Model for Resolving Treaty Disputes*, 21 N.Y.U. J. Int'l L. & Pol. 379 (1989). *See also* Susan D. Franck, *The Liability of International Arbitrators: A Comparative Analysis and Proposal for Qualified Immunity*, 20 N.Y.L. Sch. J. Int'l & Comp. L. 1, 1-2 (2000) (explaining that arbitration is the preferred dispute resolution mechanism for international disagreements). Arbitration was historically perceived as promoting respect for the rule of law. This respect is necessary for investment stability, and is particularly relevant when investors are concerned about facing investment dispute resolution conducted by a foreign sovereign. This concern is exacerbated when the defendant is the Sovereign. Delocalized arbitration, by contrast, offers a neutral forum where impartial tribunals with specialist expertise could make determinations pertaining to investments in a way that would bolster investor confidence and foster greater certainty.
[16] Statute of International Court of Justice, Article 34(4) noting that "[o]nly state[s] may be parties in cases before the [International] Court [of Justice]"
[17] See Supra Note 10

established rule of customary international law[18]. Once the party has exhausted the local remedies the state advances the claim and state at this juncture asserting its own right on behalf of its national, respect for the rules of international law. It is generally accepted that the institution of diplomatic protection has brought a remarkable stability to International relations[19]. In spite of the stability brought by the diplomatic protection it also has some serious flaws particularly the nationality rule leaves millions of stateless person without any protection. The notion of the state as a claimant against another state has had important consequences, it tends to politicize disputes, increasing international friction[20]. It also leads to political controversy if it is viewed as the institution of unfriendly action[21]. It can seriously disrupt the international relations leading to protracted disputes. Diplomatic protection in investment disputes by capital-exporting countries against developing countries has been a frequent source of irritation for latter[22]. These shortcomings of the traditional paradigm have led several prominent international scholars to argue for a reform that would allow individuals to access in their own right to adjudication by International tribunals[23].

The world trade Organization (WTO)/(GATT 1947) dispute settlement system remained with the form of the state-to-state dispute resolution based on the diplomatic protection. However it opted for one significant procedural reform, removal of the crucial requirement of exhaustion of local remedy. According to Article XXIII of GATT 'If any benefit accruing directly or indirectly under this Agreement is being nullified or impaired... as a result of the application by another contracting party of any measure.', the contracting party may bring a WTO complaint if another WTO member violates this provision. By virtue of this provision home state may bring a WTO complaint on behalf of a national whose benefits have been impaired, regardless of whether he or she has exhausted local remedies[24]. WTO's intervention in eliminating the time consuming constraint of exhaustion of local remedies really benefit the trading system. Other than this procedural facilitation, however all other draw backs under the traditional state to state dispute settlement mechanism still persist.

A remarkable change in the dispute settlement of investment disputes was bought by the introduction of Bi-lateral and Multilateral treaties which was originally governed by traditional diplomatic protection. It was during 1970s when direct investment claims were introduced in a series of bilateral investment treaties (BITs) initiated by United States[25]. These BITs differed from earlier commercial treaties, including the FCCRs[26] and FCNs[27]. The first BIT which US signed in 1982 provided for International Centre for Settlement of Investment Disputes (ICSID) Arbitration. The most interesting feature of BITs is that it offered foreign investors the benefit of avoiding domestic courts in less developed countries and also foreign investors preferred the use of a comparatively depoliticized process in which they could press their own claims without the need for intermediation of their home states[28]. On the other hand developing and less developed countries treat BITs as a mechanism to improve their investment climate.

Another shift occurred to International Investment dispute in 1990 were there were subsequent efforts to reach a multilateral agreement on Investment (MAI) and many Free Trade Agreements (FTAs). MAI negotiations were focused on established international organizations. MAI negotiations in the OECD would have allowed direct claims by the Investors but they ended without any result[29]. The choice of OECD (composed mainly of developed states as the negotiating forum for MAI was specifically driven by a desire to exclude developing countries from the negotiations due to the concerns that the developing countries demands would dilute MAI commitments[30]. The failure of MAI paved the way to FTAs. Therefore, the 1990s were characterized by a strong

[18] ICJ, *Interhandel Case (Switzerland V United States)* 1959 I.C.J 5, 27
[19] See Supra Note 10
[20] See Hersch Lauterpacht, '*The subject of law of Nations'* 63 Quarterly Review 1947, 438
[21] See Ibid
[22] See Rudolf Dolzer and Christoph Schreuer, The principles of International Investment law, Chapter X, Settling Investment Disputes.
[23] Supra note 20.
[24] Supra note 22.
[25] Rudolf Dolzer and Margrete Stevens, Bilateral Investment Treaities.
[26] Friendship, commerce and consular related treaties which USA negotiated with other developed countries for the protection of foreign investors
[27] Friendship, Commerce and navigation Treaties.
[28] See William S Dodge, *'Investor State Dispute Settlement Between Developed Countries'*. Reflections on Australia –US Free Trade Agreement, Vanderbilt Journal Of Transnational Law, 39 1 (January 2006).
[29] See Supra Note 10
[30] See Jurgen Kurtz, *'A general Investment Agreement in the WTO? Lessons from the Chapter 11 of NAFTA and OECD Multi lateral Agreement on Investment*, University of Pennsylvania Journel of International economic Law.

push to conclude regional rules to liberalize investment flows[31]. These various regional initiatives include investor-state dispute settlement including direct claims by individuals. And in investment disputes this has become a common feature. In addition there are also many other international agreements which enable private person to make direct claims to international dispute settlement bodies[32].

WHAT IS AN INVESTMENT ARBITRATION?

Investor–State disputes arising under BITs and International Investment Agreements (IIA) are not ordinary international legal disputes. Rather, they exhibit specific characteristics that distinguish them from other types of disputes. This special nature of investor–State disputes is likely to affect the way the parties to a dispute handle their conflict. It will also be important in the choice of techniques used for dispute resolution[33]. An investor–State dispute will involve a *sovereign as the defendant*, either the central government itself or subnational entities of the State[34]. The dispute can arise from measures or acts taken at lower levels of government, or State agencies that are not signatories to the IIAs but have to abide by its provisions. The foreign investor will challenge acts and measures (or the lack of appropriate action) taken by the sovereign State or a sub-entity thereof in its sovereign capacity. The nature of the applicable law is also specific, as the dispute is governed by international law and based on the violation of an international instrument, moreover one of the sources of international law, i.e. an investment treaty[35].

Another peculiarity of investor–State disputes refers to the fact that the nature of the relationship between the disputants involves a long-term engagement, sometimes requiring a complex interconnection between the two parties resulting from a situation of mutual dependence[36]. The amounts of money at stake in investor–State disputes are often very high, on average many times those of commercial arbitration cases. Hence, the high awards rendered in investor–State disputes are often a major burden on the governments involved[37].

As I mentioned earlier Investment Arbitration has become a prominent factor in BITs. Investment Arbitration is a unique dispute resolution mechanism that investors can invoke to seek redress for treaty violations. Without exhausting local remedies[38]and other cumbersome ICJ process Investor can proceed directly[39] to Arbitration. Investors typically bring their arbitral claim after non-legal routes such as commercial discussions have been unsuccessful[40].

Investment treaties generally offer investors a choice of where they can bring their disputes, often including the Sovereign's own national courts or arbitration. Some treaties give investors a very narrow set of choices[41], but

[31] See Ibid

[32] International labour Organization, Multilateral Investment Guarantee Agency, 1982 Law of Sea Convention, WTO Agreements like Agreement on Pre shipment inspection and Agreement on Government Procurement.

[33] Salacuse JW (2007). *"Is there a better way? Alternative Methods of Treaty-Based, Investor-State Dispute Resolution"*. Fordham International Law Journal. Vol. 31, No. 1: 138–185

[34] Sornarajah M (2004). *The International Law on Foreign Investment.* Cambridge: Cambridge University Press.

[35] The dispute can also arise from the violation of contract terms by the State and will follow the provisions of the contract as far as applicable law and dispute settlement are concerned and in the absence of an "umbrella clause"

[36] See Supra Note 33

[37] Ibid

[38] Resolve Disputes through Sovereign's Court.

[39] There are, however, often "cooling" periods which are applicable. For example, many investment treaties require investors to wait three to six months after the investor notifies a Sovereign of a dispute before an arbitrator can submit the request for arbitration. See German Model BIT, art. 11(2), (providing for a six month waiting period); Great Britain Model BIT, art. 8(2),(noting the three month waiting period found in the British Model BIT); see also Swiss Model BIT, art. 9(2),(noting the BIT requires twelve months to pass from the time notice of the dispute is given to the Sovereign before recourse may be sought in arbitration);

[40] Investors do not directly sue governments as they are aware that Sovereigns will staunchly defend their corner; and, as a result, when initiating arbitration, investors undertake a major financial risk with the possibility of minimal recovery. *Ian A. Laird, NAFTA Chapter 11 Meets Chicken Little, 2 Chi. J. Int'l L. 223, 228-29 (2001).*Juliet Blanch, the Global Head of Norton Rose's International Arbitration Group, explains that in her experience, investors are initially reluctant to initiate arbitration against a Sovereign. Rather, investors try to resolve disputes by negotiations and only if that route completely fails will they commence arbitration.

[41] P.R.C.-Ghana, art. 10 (providing the following: the quantum phase of certain investment disputes is subject to ad hoc arbitration; the SCC is the default appointing authority; and, although no specific procedural rules are

the trend is to provide investors with a range of options (such as tribunals organized under ICSID, the International Chamber of Commerce ("ICC"), the Stockholm Chamber of Commerce ("SCC") and/or the United Nations Commission on International Trade Law ("UNCITRAL") Rules).

When there is an investment dispute, investors evaluate the dispute resolution provision of a relevant treaty and determine if they have standing to initiate the treaty's dispute resolution mechanism. While the scope and content of these provisions differ, the provisions in the investment treaty are generally understood to constitute a unilateral offer by the Sovereign to settle disputes by arbitration, which the investor accepts by initiating arbitration under the treaty[42]. The dispute process generally follows a relatively standard set of procedures, including: (1) submitting a notice of dispute to the Sovereign, (2) complying with the applicable waiting period, (3) electing where to resolve the dispute, and (4) taking the chosen procedure forward in accordance with the chosen mechanisms articulated in the investment treaty[43].

The next step in the process is appointment of the arbitral tribunal, which typically permits each party to appoint one arbitrator and requires the chair to be selected jointly by the two party-appointees, often with the help of an institution[44]. It is standard for both party appointed arbitrators and chairs to be well-known and respected figures in the areas of international public, economic, and investment law[45]. The remainder of the procedure (including the process of procedural meetings, memorials and replies, interim relief, evidence gathering, hearings, awards, and annulment or set aside[46]) depends upon the rules of arbitration selected by the Investor and arguments of the parties. Typically, parties exchange memorials setting out their case, evidence is exchanged, the parties make further submissions, both the evidence and law is debated during an oral hearing, and, thereafter, the tribunal issues an award.

As investment arbitration is based upon a model of commercial arbitration where there are strong presumptions of confidentiality, even though a Sovereign is involved, the dispute resolution process is not transparent[47]. This means, unless one is a party (an investor or a Sovereign), there is minimal access to the pleadings and evidence, there is little opportunity for amicus curiae participation, and often the decisions themselves are confidential and not made available to the public[48].

BACKLASHES

Despite of numerous advantages of Arbitration the recent multiplication of investor–State disputes, the unpredictability of interpretations of key treaty provisions, the increase in financial amounts involved, the challenges to public policy acts and some shortcomings of international arbitration itself have raised concerns on the part of States, whether developed or developing, and of academia and civil society. Voices of dissatisfaction can also be heard among practitioners, both those representing investors and defending sovereign States in these cases. Attempts at amending some of the shortcomings have already found their way into the revision of the ICSID rules in 2006[49] and are currently being discussed for UNCITRAL rules. However, despite these changes, these sceptical voices and critical views of current investment arbitration are still increasingly heard, and in some cases such views have already influenced some relevant policy steps[50]. Some Important disadvantages of International

established, the tribunal can use either the SCC or ICSID rules "as guidance"), at *http://www.unctad.org/sections/dite/iia/docs/bits/china_ghana.pdf;*

[42] See Jan Paulsson, *Arbitration Without Privity*, 10 ICSID Rev.-Foreign Investment L.J. 232 (1995);

[43] NAFTA: The NAFTA Investor-State Process, at *http://www.appletonlaw.com/3dProcess.htm*

[44] ICSID, Additional Facility Arbitration Rules arts. 6, 9

[45] Jan Paulsson, *Ethics, Elitism, Eligibility*, J. Int'l Arb., Dec. 1997

[46] Supra Note 39, Rules of Procedure for the Institution of Conciliation and Arbitration Proceedings, at http://www.worldbank.org/icsid/basicdoc/partD.htm; art. 16; UNCITRAL Rules.

[47] Howard Mann & Konrad von Moltke, NAFTA's Chapter 11 and the Environment: Addressing the Impacts of the Investor-State Process on the Environment 3 (1999)(expressing concern about the lack of transparency and inability to appeal decisions), at http://www.iisd.org/publications/publication.asp?pno=408

[48] Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, Mar. 18, 1965, art. 48(5)

[49] International Centre for Settlement of Investment Disputes (ICSID) (2006). *ICSID Convention, Regulations and Rules.* Washington, D.C.

[50] This is evidenced by the novel positions taken by the Plurinational State of Bolivia, the Bolivarian Republic of Venezuela and Ecuador, which began to limit the access to international arbitration in sensitive sectors of the economy. The Plurinational State of Bolivia and Ecuador even denounced the ICSID Convention under article 71.

Investment Arbitration developed over the time mentioned below.

The first and most apparent of the disadvantage is that the *costs involved in investor–State arbitration have increased tremendously* in recent years. This refers not only to the damages States must pay to foreign investors in the case of a violation of a treaty provision, but the costs for conducting arbitration procedures are extremely high, with legal fees amounting to an average of 60 per cent of the total costs of the case[51]. In addition to legal fees, there are arbitrator's fees, administration fees of arbitration centres and additional costs for the involvement of experts and witnesses[52].

Another problem is the significant increase in the average time frame for claims to be settled by a final award and executed subsequently. Parties sometimes make use of every procedural possibility to avoid enforcement of awards taken against them, thereby further extending this time frame. In recent years, the average duration of cases has increased significantly, with parties resorting to annulment and other set aside procedures, and an almost systematic recourse to bifurcation (separating jurisdiction from the merits) on the part of States and recourse to provisional measures. The average for a case to be heard and finally settled varies from three to four years. A different finding suggests that it takes 392 days on average between the hearing of the merits and the issuance of the final award, with a range from as little as 92 days to 941 days[53]. This will bring Investment arbitration to a similar footing as that of litigation in national or domestic court because amount of time required is not different.

Investor–State cases have become increasingly *difficult to manage* for the parties and are resulting in a substantial loss of control over the procedure by the State parties to the underlying IIA and particularly by the defendant State. Beyond the decision to agree on the submission to arbitration and appoint arbitrators, parties have little influence over the arbitration procedure itself[54].

Another problem is International arbitration of a dispute between an investor and a State will, in almost all cases, result in a *severance of the links between the two parties*. This is of course exactly the opposite of what States are seeking when embarking on active investment promotion strategies to establish long-term relationships with investors and foster meaningful contributions of investments to the host State's economic development. An investor–State dispute inevitably severs this relationship and creates bad precedent for both the State and investor.

Also the increase in North American Free Trade Agreement (NAFTA) cases against the United States, Mexico and Canada have also triggered *fears about frivolous and vexatious claims* that could inhibit legitimate regulatory action by governments.

Another problem concerns about the legitimacy of the ISDS system have recently emerged and have given rise to discussions in various forums. The triggers for these concerns come from a perception of inconsistency among arbitral awards in the interpretation of core elements of protection, but also from the mere fact that an arbitral tribunal composed of only three individuals, however highly competent and respected, is looking into a national law or measure and interpreting it, as a last resort[55]. There is also a continuing debate over whether it is appropriate to use arbitral tribunals to rule on public policy issues without having the same levels of safeguards for accountability and transparency as are typically required from the domestic judiciary[56]. Another drawback is the settlement of a dispute through *arbitration is focused entirely on the payment of compensation* for damages arising from the violation of a treaty provision. It does therefore not provide room for the investor and the State to strike other "deals" between themselves, e.g. ones that

Its denunciation occurred on 2 May 2007 and Ecuador's on 6 July 2009, respectively.

[51] In Plama Consortium v. Bulgaria (ICSID Case No. ARB/03/24), the legal costs to the claimant (related to both the jurisdiction and merits phases of the arbitration), amounted to $4.6 million, while the respondent's legal costs (for both phases) were $13.2 million. The claimant was required to pay all arbitration costs and half of the respondent's legal costs. In *Pey Casado v. Chile* (ICSID Case No. ARB/98/2), the claimant's legal costs (relating to the jurisdiction and merits phases) totaled approximately $11 million, while the respondent's legal costs for both phases amounted to $4.3 million. The respondent was ordered to pay 75 per cent of the arbitration costs and $2 million in claimant's fees.

[52] "Latest developments in investor–State dispute settlement", *IIA Monitor No. 1*. UNCTAD 2008, "Latest developments in investor–State dispute settlement". *IIA Monitor No. 4*. UNCTAD 2006

[53] Investor–State Disputes: Prevention and Alternatives to Arbitration UNCTAD Series on International Investment Policies for Development

[54] See Supra Note 33

[55] Supra Note 53

[56] Ibid

refer to possible changes to the measure itself or offer other forms of compensation[57].

These are the main problems which investment arbitration regime faces. This could be addressed to some extend through developing alternative steps, taking preventive measures, avoid disputes from arising, and then from escalating, putting in place internal mediation or settlement facilities, or proposing recourse to ADR within the existing international framework for investment established by multilateral and Bilateral instruments and IIAs.

ALTERNATIVE MEATHODS OF DISPUTE RESOLUTION

A study conducted by UNCTAD mainly identifies two approaches as alternatives to investment treaty arbitration. The first is the application of Alternate Dispute resolution Mechanism (ADR) to the context of investment disputes. And the second approach is the application of Dispute Prevention Policies (DPP) that aim at reducing occurrence of Investor state dispute. ADRs usually involves the intervention of a third party to assist the disputants in negotiating a settlement of an existing conflict and DPPs usually constitute the establishment of institutional mechanisms within the government of the host State that are conducive to preventing the emergence and escalation of conflicts between the State and investors. The key to both types of alternative approaches lies in *the consent and cooperation required from both parties* to which is essentially a voluntary process.

Regarding ADRs, it is possible to differentiate between several types and subcategories of ADR, depending on the purpose and the timing of the intervention in a dispute. ADR usually involves either conciliation or mediation, but it may also concentrate on a fact-finding exercise that makes it possible to narrow down the actual extent of the dispute. It may also be of an advisory nature, or involve a combination of all the above elements[58]. Mediation involves a third-party neutral (the mediator) who will intervene in the dispute and, at the request of the two parties, help them work out a solution. The mediator's role can vary from helping the parties establish a dialogue to effectively proposing and arranging a workable settlement to the dispute. In international conciliation, the parties will give the conciliator (or the panel of conciliators) even greater control over the dispute and process. This is because the conciliator is usually entrusted with finding and proposing the actual solution that the parties will then follow. Conciliation, which has its historical roots in public international law, tends to provide for a relatively structured process that is replete with formal rules related to jurisdictional objections, potential pleadings, the gathering of evidence, and issuing written recommendations for settlement[59]. Conciliation has been described by some as a kind of non-binding arbitration[60]. Mediation is a rather informal process, in which mediators tend to focus on identifying interests, reframing representations and canvassing a range of possible solutions to move the parties towards an agreement[61]. Mediation is hence classified as assisted negotiation[62].

The basic objective of the mediator or conciliator who intervenes in the dispute is to help the parties overcome the barriers to agreement. Such barriers can have many sources, including the way in which parties communicate with each other, the tactics employed in dealing with the respective other party, and a general inability or unwillingness to consider new solutions to their problem.

Dispute prevention policies (DPP) are instituted prior to the existence of an investor–State dispute or even a conflict, but in anticipation of the possibility that disagreements between the State and investors may emerge. The concept of DPPs is relatively new and unexplored, and hence, contrary to ADR. DPPs can take a variety of forms. In most cases, DPPs aspire to establish effective early alert mechanisms that improve, at an early stage, the awareness among government authorities of a possibly emerging conflict with an investor. Such early alert mechanisms may be established by improving inter institutional linkages, information sharing and channels of communication among government authorities. Links between local governments that deal with investors and the central government that concludes the IIAs could be enhanced in this way. Early alert mechanisms may also involve the establishment of an institution as a one-stop-

[57] Ibid

[58] Franck S (2008b). "Challenges facing investment disputes: reconsidering dispute resolution in international investment agreements"; in Sauvant K with Chiswick-Patterson M (eds.). *Appeals Mechanism in International Investment Disputes.* Oxford University Press: 143–192.

[59] Reif LC (1991). "Conciliation as a Mechanism for the Resolution of International Economic and Business Disputes". *Fordham International Law Journal,* Vol. 14: 578–638.

[60] Onwuamaegbu U (2005). "The role of ADR in investor–State dispute settlement: The ICSID experience". *News from ICSID*, Vol. 22 (Winter), No. 2: 12–15

[61] Supra Note 58

[62] Supra Note 60

shop to which investors can turn in case of dissatisfaction with a policy or measure enacted by the host State. A similar approach would be to offer the foreign investor a right to ask for an administrative review of a policy or measure by which it is thought to have been harmed.

In sum, DPPs are meant to give the government advance notice of a problem and enough time and flexibility to address investor concerns, either unilaterally or in coordination with the investor. DPPs ought to be considered as a very promising approach to addressing the problem of increasing ICSDS cases. While ADR processes, like arbitration, still have to deal with an existing dispute that needs to be settled, the prospect of not having a dispute at all must be the preferable option in the view of governments[63].

This alternatives are having many advantages as compared to Investment arbitration and at the same time use of such methods also came up with many inherent disadvantages and challenges too.

First and most important of the advantage is the flexibility of this alternative approaches. There is flexibility with the legal commitments at hand and the specific facts of the dispute, where a solution is not necessarily based on the interpretation of treaty provisions, identifying the existence of a violation or damage, but focuses on finding an acceptable and workable solution even if it requires departing from the legal framework surrounding the facts of the case. Another advantage is that ADR comes with the possibility to strike "deals" between the investor and the State. Much more than arbitration, ADR can include issues in the bargain that go beyond the mere payment of compensation. It can impact more on the measure itself compared to arbitration, and can hence lead to a solution that solves the entire problem and not only leads to the payment of compensation without any change in the problem at hand. Another possible advantage of alternative approaches is to provide for a faster and less costly settlement, the more so when the problem is tackled at an early stage and with the specific goal of avoiding escalation. By virtue of ADRs foreign investors and host countries avoid the risk of an arbitral award that might set an unsatisfactory precedent for the future and might encourage other foreign investors to challenge the same type of governmental measure or regulation[64].

On the other hand these ADRs also have some inherent disadvantages and challenges. Most importantly, the result of a negotiation, mediation or conciliation is not binding on the parties and is not necessarily enforceable through any binding international rule. Since it is a new approach both investors and States lack familiarity and experience with the techniques involved in alternative methods.

At present, it is also a challenge to find the right neutrals with parallel expertise in both alternative methods as well as in the area of investment law and investor–State disputes. Alternative approaches can result in a waste of time and funds. Alternative approaches are not suitable for all types of investment disputes. Alternative methods may simply not be possible or be subjected to too many obstacles when a sovereign State is involved. The confidential nature of many ADR procedures may be criticized, as it results in a lack of transparency regarding the way disputes involving a State party are resolved. DPPs can also generate inter-institutional conflicts involving overlapping priorities within the State. For example, disagreements may emerge whether the protection of foreign investors or the protection of the environment are to take precedence. Such examples can apply to many areas of a State's regulatory powers[65].

Hence it can be concluded that ADRs and DPPs are not 'Magical Formula' to resolve investment disputes but It can be nicely blended with Arbitration or add as a lubricant in Investment arbitration and there by smooth settlement of disputes.

CONCLUSION

No system of dispute resolution is perfect. There are inevitably challenging transitions which require a re-examination of the bedrock principles upon which the system was founded. Investment arbitration is now at this critical juncture. Part of the difficulty caused by above disadvantage in investment arbitration is that it is experiencing "growing pains." This evolution is inevitable and was even anticipated[66]. This urge bring forth the ADRs to investment arbitration that can be used to resolve already existing disputes (ADR techniques such as mediation and conciliation) and innovative approaches to prevent disputes from arising in the first place (DPP). All actors in the area of international investment should be

[63] Investor–State Disputes: Prevention and Alternatives to Arbitration UNCTAD Series on International Investment Policies for Development
[64] Supra Note 60.
[65] Ibid
[66] Ray C. Jones, *NAFTA Chapter 11 Investor-to-State Dispute Resolution: A Shield to Be Embraced or a Sword to Be Feared?*, 2002 BYU L. Rev. 527, 529-31

encouraged to give these alternative approaches more intensive consideration in the future.

States could pay more attention to ADR techniques as alternatives to conventional investment treaty arbitration by making them available and building the necessary capacity and authority within the government to enable the appropriate application of such techniques. Investors involved in an investment dispute or those having complaints about government policy could give more consideration to alternative means. Legal practitioners in the field of international investment law, i.e. those advising investors or undertaking the defence of the State, as well as arbitrators, can also play an important role in exploring the use of alternative approaches. Arbitration institutions1 will also have a role to play in making the resort to alternative means more commonplace within the international investment law community. Finally, international organizations could play an important role in building awareness within the international law community and especially among States of the possible advantages that alternative approaches to investment treaty arbitration could bring.

In order to have a favourable investment climate it is very essential that there should be good dispute resolution mechanism which should give investors security for their investments. On the other hand it is equally important that the interests of the state of the host state should be protected against abuse of Investment treaties by the investors. To strike a balance between the needs of the investor and host state in a climate of mutual understanding and cooperation is the obligation of a Dispute settlement mechanism, and the present Investment Arbitration should be finely tuned to achieve this goal.