portion of the nation's commercial activity, mediation (or any form of settlement) may face bureaucratic or other institutional obstacles, such as the fear that settlement may signal a manager's incompetence or even corruption. This is unfortunate, because it is often those countries where more efficient forms of dispute resolution are most needed.

Not that this ever really happens

The second time the in-house counsel among the authors offered mediation to a counterparty was in a developing country, and although it was also a failure (in terms of getting a mediation started), at least the rejection was polite. The general manager of a government-owned entity said that he appreciated the explanation of what mediation might accomplish in helping the parties avoid the arbitration that was getting underway, but he did not want the suspicion of corruption that a settlement might create. So it was better for him not to settle and let the arbitration continue. This was also in 1999, and at the time of this writing the arbitration is still pending.

IV. INTERNATIONAL MEDIATION AND ARBITRATION AS RISK MITIGATORS

I-029 The value of international mediation and arbitration as tools for doing business is thus that parties can enter into contracts globally having reduced their concerns about dispute resolution. In the best of cases, they will settle any disputes before embarking on any formal proceedings. And, when disputes are not settled at the outset, international arbitration should avoid the necessity of knowing and understanding the idiosyncrasies of local dispute resolution. But it will provide this benefit only if a party takes positive steps to preserve the international character of dispute resolution and resist the forces tugging it towards domestic procedures.

Chapter One

The Elements of an International Dispute Resolution Agreement

Parties to cross-border contracts can agree to submit disputes to a particular form of dispute resolution both before and after those disputes arise. This dispute resolution agreement in most instances is a clause that the parties insert into a broader contact between them (usually described as the main contract). Occasionally, they may decide after a dispute arises that they prefer arbitration over the available courts and enter into a 'submission agreement', by which they agree to submit their existing dispute to arbitration even though their contract makes no provision for it. In contrast, mediation was traditionally proposed only after a dispute arose, but the cost of arbitration and litigation is increasingly leading parties to agree in advance to attempt settlement through mediation before they can proceed to arbitration or the courts. This is often through a mediation requirement in the dispute resolution clause. **1-001**

Parties and commentators often refer to the 'drafting' of dispute clauses, a term that does not nearly capture the degree of negotiation and compromise that may take place before a final text is agreed. While we discuss the negotiation of dispute clauses in Chapter 2, in this chapter we look at the elements that a dispute clause may or should contain. We consider the broad range of available options that, if clearly expressed, will ensure that disputes will be resolved as the parties expected, as well as the practical implications of a failure to develop and express an effective dispute resolution agreement. **1-002**

The danger of an incomplete or unclear dispute clause. If the contract fails to set out the most basic elements of dispute resolution, or is not clear in stating what those elements are, a variety of difficult subsidiary disputes may arise, which may **1-003**

weaken a party's settlement leverage and prevent the merits being decided effectively. This can happen (1) even before a settlement negotiation is initiated, for example when the lack of an effective dispute option reduces the potential claimant's negotiation leverage and expectations; (2) at the inception of legal proceedings when one party refers a dispute to a court or arbitration, while the other objects that the forum was not the one chosen by the parties; (3) during the arbitration, as for example when one party contests the tribunal's jurisdiction to decide certain of the claims before it; or (4) after the arbitration, when the losing party applies to have the award set aside, or resists enforcement, on grounds such as that the parties did not agree to submit the decided issues to arbitration. This chapter explores methods for negotiating the text of an arbitration clause in order to avoid these sorts of problems.

Not that this ever really happens: the financial impact of a defective dispute clause *before* legal action is initiated

Party A's representatives had scheduled a meeting at the offices of Party B in Madrid in an effort to settle Party B's refusal to pay the EUR 1.5 million that remained due to Party A under the contract. A minor technical issue was being raised to justify non-payment, but the real reason was not a secret. Party B had found itself in financial difficulties and was selectively resisting or delaying payments to as many of its suppliers as it could. In preparing for the meeting, Party A discovered that the dispute resolution clause in its contract provided for 'any disagreements under the contract to be settled by arbitration under the Spanish Institute of Arbitration, with any dispute to be submitted for binding resolution under the rules of the International Chamber of Commerce (ICC) in Paris. Acceptance of arbitration, however, shall not deprive the Court of Madrid to hear any actual disputes that may exist between the parties'. Realising that the initiation of legal proceedings would first require years of litigating the question of whether the dispute should be heard in the court or one of the mentioned arbitration institutions (one of which did not appear to exist), Party A lowered its expectations and settled for a payment of EUR 400,000. The 'cost' of a defective dispute clause, in this case, was over EUR 1 million even before litigation or arbitration was started.

I. DIFFERENT SORTS OF INTERNATIONAL DISPUTE RESOLUTION CLAUSES

1-004 There are several different sorts of agreement that parties may use to provide for the resolution of an international commercial dispute. The principal ones among them are introduced in paragraphs 1-005 to 1-009 below.

1-005 *Agreements to submit disputes to court.* Where the parties to a contract have agreed to refer their disputes to court, they will typically set out that agreement in a clause in their main contract, often referred to as a forum selection clause. That clause will usually designate one or more courts to which a party may or must refer any dispute that arises out of the contract, and will often specify whether or not the jurisdiction of the designated courts is exclusive or not. If the jurisdiction of a court is stated to be exclusive, the intention is that a party cannot sue the other in another court. If it is non-exclusive, the intention is that a party cannot object to the jurisdiction of that court, but can sue in another court if it wishes. If there is no forum selection clause and no arbitration agreement, a party can start legal action against its counterparty in any court that will accept jurisdiction over the dispute.

1-006 *Agreements to arbitrate.* Arbitration is a creature of contract. An arbitration agreement, or agreement to arbitrate, is itself the contract in which parties agree to refer disputes between them to arbitration. It most often takes the form of an arbitration clause inserted in the parties' main contract, but it can also be an independent agreement entered into before, at the same time as, or after the main contract. If the arbitration agreement is concluded after the dispute arises, it is known as a submission agreement (paragraph 1-009 below). Although arbitration agreements may be part of the parties' main contract, they survive the termination or breach of the main contract except in the rare cases where the parties agree otherwise. In other words, even though the contractual relations between the parties may have ended, their agreement to submit disputes to arbitration will continue. Where a party has entered into a valid arbitration agreement, it must submit disputes covered by that agreement to arbitration, and courts will enforce the arbitration agreement by declining to hear disputes covered by it and referring the parties instead to arbitration.

1-007 *Agreements to mediate: in the shadow of agreements to litigate or arbitrate.* Agreements to mediate obey many of the same principles as agreements to arbitrate and will also survive the termination or breach of the main contract. Importantly, an agreement to mediate will only complement an arbitration clause; it will not replace the need for binding dispute resolution. In fact, the presence of a credible threat of effective, binding dispute resolution will encourage parties to engage constructively in negotiation or mediation. Particular attention should therefore be paid to what is needed to construct an arbitration clause with teeth and how to include a mediation provision that may avert the need for that arbitration to take place. In many jurisdictions a mediation agreement will require the parties to attempt mediation but, unlike with arbitration, does not compel them to continue with the process if it is not to their liking.

1-008 *Agreements to arbitrate in investment treaties.* A relatively new and unusual form of agreement to arbitrate is that found in investment treaty arbitration, where a state party to the investment treaty makes a general offer of arbitration in the treaty to a category of investors from the other state party, and one or more members of that

investor group perfects the arbitration agreement by accepting the offer of arbitration when a dispute arises.[1]

1-009 *Submission agreements*. Parties enter into a submission agreement when they are already in dispute and agree to submit that dispute to arbitration, despite the absence of an existing arbitration agreement. Although submission agreements obey the same principles as other arbitration agreements, they are less common because parties with a pending dispute seldom agree on the forum for resolving it. While there is no formal practice of 'submission agreements' with respect to mediation, mediators commonly require parties to enter into a 'mediation agreement' irrespective of whether there is a requirement to mediate in the contract.[2]

II. THE BASIC COMPONENTS OF AN INTERNATIONAL DISPUTE RESOLUTION AGREEMENT

1-010 Dispute resolution clauses that contemplate arbitration consist of at least four sorts of components: first, the submission or reference of disputes to the chosen form of dispute resolution, which is the essence of the agreement; second, a number of important variables, such as the place, language, and rules of arbitration; third, optional 'bells and whistles'– features that are not strictly needed to ensure an effective dispute resolution agreement, but which the parties may choose to include to enhance the agreement in view of their own circumstances; and fourth, any requirement to attempt mediation before arbitration or court action may be initiated. The first three components are presented in turn below, followed by special attention to the provision for mediation.

1-011 *The benefits of simplicity and recommended institutional clauses*. Before getting to the specifics, we give a general word of advice to anyone involved in the negotiation or drafting of a dispute resolution clause: it is important to keep dispute resolution agreements as simple as possible. The more complex they are, the more scope there is for internal inconsistencies and other difficulties of interpretation, which a defending party can exploit before, during or after any proceeding (e.g., by raising objections to the jurisdiction of an arbitral tribunal, or seeking to set aside or resist enforcement of an arbitral award). The leading arbitral institutions all publish model or standard arbitration clauses that are clear, simple, and effective. They contain the submission of disputes to arbitration and explain what the variables are (the parties then have to agree on those variables). They contain few or none of the optional 'bells and whistles' that can often be redundant or counterproductive. Parties are often wise to prefer these sorts of simple, effective arbitration agreements over the long and intricate offerings often put forward by lawyers in large

1. The same sort of arbitration agreement is formed where a state makes, in an investment law, an offer of arbitration to investors, which an investor with a claim against the state later accepts. Chapter 7, *ICSID and Investment Treaty Arbitration*.
2. Chapter 4, *International Settlement Negotiation and Mediation*.

transactions. Even in complex transactions, simple institutional model clauses are good starting points and can easily be adapted to reflect the agreement of the parties.

1-012 *The probability of negotiation and the limitations of boilerplate*. While the clauses recommended by arbitration institutions are simple, good, and in many instances will suffice even in a complex agreement, that does not mean that parties to complex and highly negotiated contracts should slavishly cut and paste arbitration agreements from institutions' websites, or from previous contracts for that matter, without giving consideration to any special needs that may arise in the course of the contract's performance. And even when a party wishes to cut and paste a boilerplate clause, this may not be possible. An arbitration clause has significant value independent of the other clauses of the contract and each party will want to enhance the protection of its own interests and to mitigate its own perceptions of risk. Thus, while it is fine to speak of how to 'draft' an international dispute resolution clause, it is better to be prepared to *negotiate* one, with consideration for the types of disputes that might arise.

Not that this ever really happens

The seller, a US company, appeared at the contract negotiations prepared to discuss price and delivery terms and assuming that the buyer would accept the seller's international terms and conditions of sale, which provided for ICC arbitration in New York, under New York law. The buyer, an Egyptian company, was prepared to discuss and be flexible on price and delivery but insisted on dispute resolution in Cairo. While both parties were happy with their negotiated price and delivery terms, they were unable to reach agreement on the form of dispute resolution to be adopted, and negotiations over what each side viewed as a profitable contract were delayed for six months while each waited for the other to move from their position on dispute resolution.

A. The Core of the Arbitration Agreement: Submission of Disputes to Arbitration

1-013 The operative sentence of an arbitration agreement identifies a group of disputes that may arise in the future (or an existing dispute, in the rare case of a submission agreement) and stipulates that the disputes thus identified will or may be resolved by arbitration.

1-014 *Identification of disputes*. Looking first at the identification of the disputes to be referred to arbitration, the usual practice is to identify as broad a group as could possibly be connected with the contract. Typical wording is 'all disputes arising out

of or in connection with this contract'. Assuming the parties do want to refer all disputes arising out of their contract to arbitration, they should look no further than this simple, catch-all language. It will cover claims based on contract as well as those sounding in tort or other extra-contractual theories. It will also cover claims or defences that the contract never came into existence, as well as disputes regarding the termination of the contract. Trying to be more specific in one's identification of disputes can be hazardous: one example is where parties agree to refer 'all disputes concerning the interpretation or performance of this contract' to arbitration, intending this to cover all disputes arising out of the contract. It is arguable that such a clause would not cover claims or defences concerning the termination of the contract, or concerning the existence of the contract in the first place. If contracting parties feel the urge to be more specific in their definition of disputes to be referred to arbitration, they can begin with the catch-all language and then add the more specifically described disputes as a subset of the broader group of disputes. Appropriate language in such a case would be 'all disputes arising out of or in connection with this contract including, without limitation, disputes concerning the interpretation or performance of this contract'.

1-015 It is perhaps possible to further enhance the enforceability of an arbitration clause by expanding the category of matters that are to be referred to arbitration. For example, instead of simply referring to 'disputes', one sometimes sees broader language such as 'all disputes, disagreements, claims, or controversies',[3] which may then be given the defined term 'disputes'. How much difference this sort of wording will make is unclear, but it is unlikely to reduce the effectiveness of the arbitration clause so there is little harm in including it.

1-016 *Carve-outs for certain types of disputes*. If the parties want certain disputes to be referred to arbitration, but not others, they can draft their clause accordingly. A common example is where parties wish to submit technical matters for resolution by experts, with other disputes resolved by arbitrators. These sorts of clauses need to be carefully drafted, to minimise later disagreement over which dispute belongs in which forum. For example, if the dispute is whether equipment should be repaired or replaced during a warranty period, should it be treated as a technical matter (a problem with the equipment) or a legal or commercial matter (the application of the contractual warranty)? The answer may unfortunately be both, giving the claimant the option of choosing which forum to proceed in, and the respondent an opportunity to contest jurisdiction no matter which forum is chosen. Clauses referring disputes to expert resolution are also troublesome because of the uncertain legal status of expert determination: is it arbitration, or is it some other form of dispute resolution? Another difficult issue is the relationship between the expert

3. See the SCC Model Clause: 'Any dispute, controversy or claim arising out of or in connection with this contract, or the breach, termination or invalidity thereof . . . '. See also the UNCITRAL Model Clause proposed by the SIAC: 'Any dispute, controversy or claim arising out of or relating to this contract, or the breach, termination or invalidity thereof . . . .'

determination provision and the arbitration clause: are the arbitrators able to reopen matters determined by an expert and, if so, in which circumstances?

Modern presumption in favour of arbitration and (hopefully) the demise of the 'under' versus 'out of' debate

Parties to international contracts should be aware that the language of their arbitration clause may need to be tested in the courts of more than one country, and they should therefore strive for clarity (and avoid language that may lead to the unfortunate result that their dispute is held to be not covered by the arbitration agreement). Still, they may find comfort in the modern trend in which the courts of most countries will construe language with a presumption in favour of arbitration. For example, in England, the House of Lords (now the Supreme Court) recently refused to draw a distinction between a dispute 'arising under' and a dispute 'arising out of' the contract; both expressions were construed equally broadly. In its own words, the court made a 'fresh start' and departed from earlier case law that had made semantic distinctions between the phrases 'arising under', 'arising out of', 'in relation to', and 'in connection with' the contract.[4]

Jurisdiction even if there is no 'dispute'? There have been cases where parties object to a tribunal's jurisdiction and seek judgment in the courts on the basis that there is no disputed fact or issue – notably that a debt is acknowledged and there is no arguable defence to a claim for its payment – and therefore nothing to refer to arbitration.[5] Although the English courts, in particular, have been tolerant of this sort of argument in the past, most arbitral tribunals and courts are likely to give it short shrift today. If a party considers there to be a dispute and articulates any sort of disagreement between the parties, it should be difficult for the opponent to argue that there is in fact no dispute – at a minimum there is a dispute about whether there is a dispute. Courts will generally find, in the presence of an arbitration agreement, that any disagreement as to whether a dispute exists should be resolved by duly appointed arbitrators. In practical terms, this means that a creditor will generally not have a right to sue immediately in court for payment, and it will need to first go to arbitration. Thus, if a party's only or main concern in drafting a dispute resolution clause is the ability to sue promptly for payment, it should consider whether arbitration is the optimal method of dispute resolution, or whether the courts should be the preferred forum. **1-017**

4. *Premium Nafta Products Limited* (twentieth Defendant) *and others* (Respondents) *v. Fili Shipping Company Limited* (fourteenth Claimant) *and others* (Appellants), 17 Oct. 2007, [2007] UKHL 40.
5. See N. Blackaby & C. Partasides with A. Redfern & M. Hunter, *Redfern & Hunter on International Arbitration*, 5th edn (Oxford: Oxford University Press, 2009), para. 1-059.

Chapter Four

International Settlement Negotiation and Mediation

In the first paragraph of this book, we set out our main theme, which is that international business is about accepting risk, not avoiding it. Throughout, we have discussed how parties to international transactions can accept the risk of disputes and enhance their positions by understanding the legal tools and strategic opportunities available at each stage of the contract negotiation and dispute resolution processes. Mediation is where this rubber hits the road, as both a legal tool and a means of improving outcomes. Although it has yet to develop into a commonly used mechanism for resolving international business disputes, it is undeniable that mediation has this potential and that recourse to it is on the rise. **4-001**

Question: What should we be willing to accept in order to settle this dispute?

Answer: Anything as good as or better than what you can reasonably expect from arbitration or litigation, after considering all of the associated costs and likely impact on the business.

In addition to its usually cited benefits – savings of time, cost, and commercial relationships – mediation provides a common process of dispute resolution that does not require parties to possess any special training, experience, or skills other than their negotiating abilities, and does not advantage parties from one jurisdiction or another. It can be, in other words, a means of simplifying and demystifying the process of international dispute resolution. **4-002**

Against that background, this chapter explores the ways that parties can use mediation to create and exploit leverage in settlement negotiations, preferably before **4-003**

substantial costs of arbitration have been incurred. In doing so, we make the assumption that a party will have estimated the range of probable outcomes of its dispute and the costs that will be incurred if no settlement is reached.[1] From that starting point, we discuss: (1) the risk of sub-optimal settlements of international commercial disputes, and the strategic use of mediation to enhance the range of negotiation opportunities; (2) proposing and organising a mediation of an international commercial dispute; and (3) mediation advocacy and how parties can conduct the process to enhance the outcome.

004 *Confusing ADR terminology*. The term 'mediation' is unfortunate in more ways than one. It does not convey much, if any, idea of the objectives of the process or what it consists of. Literal translations into other languages only compound confusion. In Italian, *'mediazione'* is the practice of brokering, and the term *'mediatore'* is more likely to conjure up an image of a stockbroker rather than a legal practitioner. To avoid this ambiguity, the Latinate term 'conciliation' is sometimes used in international practice, even though it is no better at describing the process and may even connote an inappropriate meekness. In many parts of the world, mediation travels under the equally confusing acronym 'ADR', which stands for *alternative* dispute resolution. Moreover, the term ADR, which in the United States can also encompass arbitration, simply begs the question, 'alternative to what'? (The mediation arm of the ICC avoids this question, with its 'ADR Rules' referring to *amicable* dispute resolution.)

005 In this chapter we use the terms 'mediation' and 'ADR' interchangeably. We note that the term 'conciliation' is sometimes used interchangeably with 'mediation', and in other cases is used to denote a particular style or dispute resolution practice that has its roots in the procedural histories of different countries. For example, in Switzerland, the term 'mediation' is used to describe a process in which a neutral third party is expected to be elicitative and non-evaluative, who refrains from making any proposals, and where the outcome should be based on subjective interests, whereas 'conciliation' is used to describe a more directive and evaluative process in which the neutral is expected to express a non-binding opinion based on objective or legal norms and to suggest a zone of possible agreement. Both involve a process in which a neutral assists the parties in reaching a settlement, but the styles and processes can be different experiences for the parties and their lawyers. Such distinctions, to the extent they exist and may be relevant, should not pose a problem if the parties focus on the substantive process and do not become overly preoccupied with the nomenclature.

I-006 *Beyond 'win/win' and expanding pies*. While no doubt some disputes are settled on terms in which cooperation leads to a resolution that is 'win/win' or based on the idea of 'expanding the pie', we believe these cases are the exception rather than the rule. In our experience, the blunt truth about international business disputes is that each side will usually be out to increase its own slice without much regard for how much pie will be left for the other, and that parties to international business transactions generally do not need or want to be coached in identifying which

1. See the discussion on Early Case Assessment (ECA) in Ch. 3, s. III.

opportunities are in their best interest.[2] In this chapter and elsewhere in this book, therefore, we treat mediation simply as a form of negotiation that is sharply focused and usually assisted by a neutral third party.

We assume that in most cases the disputing parties will be engaged in a form of **4-007** 'distributive bargaining' when they attempt to resolve their conflict. This is the most basic form of negotiation in which each dollar paid in settlement will make one side that much richer and the other that much poorer. Thus, our discussion of mediation is straightforward in focusing on its effectiveness in helping parties obtain optimal outcomes for themselves based on the numbers that appear in the dispute.

Type of disputes suitable for mediation. Having attempted to address the issue of **4-008** nomenclature above, we also wish to be clear that nothing about what we are proposing is meant to suggest that parties to a dispute should adopt mediation as an 'alternative' to anything else written in this book.[3] Rather, we discuss mediation as a tool that may be suitable for *any* dispute that a party wishes to attempt to settle, even if our focus is on disputes contemplated in or arising out of international commercial contracts that are likely to have an arbitration clause. A party who excludes mediation from consideration for any type of dispute does so at the risk of missing opportunities and obtaining poorer results than what otherwise might have been available. For example, an argument can be made that claims of fraud are not appropriate for mediation, as they presumably inject principles that a party must defend through binding adjudication. But we have seen cases involving fraud claims settle during or after mediation, with no real added difficulty as compared to disputes with no claim of fraud – and with the same benefits.

2. The expanded pie metaphor is by now so commonplace that we have introduced it without definition here. To avoid any misunderstanding, however, we note that the concept refers to a solution in which the total amount being divided is made greater by identifying common interests or concessions that have a greater value to the receiving party than their cost to the providing party. For example, a seller may offer to settle a dispute of a USD 10 claim by giving the buyer a USD 10 discount on a product that retails for USD 100. If the buyer intends to purchase new products from the seller, it may perceive that it has received full value in settlement. For its part, the seller may both turn a profit on the sale (assuming its profit margin is over 10%) and preserve a customer relationship. In theory, the parties have used their cooperation to construct a settlement in which they are both better off than had they simply divided up the USD 10 claim in a cash settlement (or permitted a judge or arbitrator to make their decision for them with all the associated costs of reaching the decision). As noted, in this section we focus on the existing pie (i.e., finding ways to divide up the USD 10 claim) which, we believe, is in fact the more challenging task in international commercial disputes.
3. The genesis of the 'alternative' moniker (in ADR) was in the United States, where mediation and arbitration were initially proposed to parties as ways of resolving their disputes through a private process rather than the public system of court litigation. In some quarters of the United States today, the term 'ADR' continues to be used in reference to all forms of private dispute resolution (e.g., mediation and arbitration) even if the rest of the world appears to apply the term only to mediation. For international commercial transactions and the disputes that can arise under them, the term 'alternative' has little sense since, in effect, parties may legitimately consider litigation in the courts of a particular country as an 'alternative' to other resolution options, including arbitration and even litigation in the courts of another country.

09 So we make no attempt to define the scope of commercial disputes for which mediation may be suitable, noting only that this scope is certainly broader than that covered by arbitration. For example, whereas most arbitration rules are ill-suited to the resolution of multi-sided disputes involving different contractual relationships (or parties outside of any contractual relationship),[4] mediation faces no such restrictions. All it needs to bring multiple parties together in mediation is their desire to settle.

10 *When mediation is appropriate*. As noted above, mediation is merely a form of negotiation, and each dispute is likely to have different dynamics and times when negotiations are possible or their efficacy can be enhanced. Generally, a good rule of thumb is that settlement negotiations – and mediation with them – should take place at the earliest stage after the dispute arises when both parties are prepared to engage in a meaningful discussion. Depending on the parties and the particular circumstances of the dispute, this can come at any moment up to, during, and even after the arbitration. And more than one suitable moment may present itself in the same dispute. The time to propose mediation also should not depend entirely on whether the other side is inclined to engage in the process; there are moments when just *proposing* mediation may provide strategic advantage to the proposing party even when it is probable the offer to mediate will be rejected. Finally, as discussed below, there may be ways of using mediation strategically to augment the arbitration process, or of planning for mediation to occur in the course of an arbitration, to obtain the best possible outcome for the parties.

I. OPTIMISING THE SETTLEMENT PROCESS

011 Parties involved in an arbitration may say they do not want to settle (or cannot), but it is rarely the case that a party will wish to pursue the arbitration to conclusion when it can obtain a more favourable resolution by agreement. This is also true of parties that can be described as difficult, or acting in bad faith. Even a scoundrel will take a good deal if he can get it (and he in fact may have provoked or maintained the arbitration in order to obtain one). One frequently mentioned example of party recalcitrance to pursue settlement is when the dispute involves a government or government-owned entity, and its managers are reluctant to accept responsibility for compromising any defences (however tenuous) to a claim for payment. But even in these cases a settlement is usually possible if the other side is willing to accept the position of the government-owned entity or something close to it. This may not be a good settlement from the other side's point of view, but it would be wrong to say that a settlement is not actually possible. Once the possibility of settlement is acknowledged to exist, the question is whether its terms can be improved so that it will be seen as being more advantageous than the alternative of litigating the dispute through to its conclusion.

4. For discussion of the problems of multi-party and multi-sided arbitration, see Ch. 1, *The Elements of an International Dispute Resolution Agreement*, and Ch. 5, *The Conduct of the Arbitration*.

A. Settlement Goals that Leverage the Uncertainties of a Dispute

Again, parties will engage in settlement discussions if they believe they can reach an agreement that is as good as or better than what is available through binding dispute resolution. Rather than pursue a detour on negotiation theory and settlements,[5] perhaps it is easier to think of this in the terms once expressed by a senior manager to one of the authors: 'is the deal we can get today better than the deal we can get through two years of arbitration?' For a party to understand the point at which a settlement becomes attractive, however, requires a degree of predictability of outcome and costs, and a strategy to enhance the opportunities available. **4-012**

Mitigating the uncertainties of international arbitration. The famed flexibility of international arbitration can easily be translated into a sequence of events, each of which can give rise to varying degrees of uncertainty as to the likely outcome and cost of reaching the conclusion of the proceedings. For example, as noted in the following chapter, *The Conduct of the Arbitration*, the appointment of the tribunal is critical to determining how the proceedings will be conducted: will they be in a civil law, common law, or hybrid fashion? Until the tribunal is in place, it may not be reasonably possible to predict the direction the arbitration will take, including the types and range of evidence to be presented, the duration, or the cost of the proceedings. Similarly, once the proceedings have been concluded, as explained in Chapter 6, *After the Arbitration*, there may be opportunities available to the losing party to challenge the award or defeat its enforcement. The point is that many factors may conspire to create an impression of a high degree of unpredictability at the outset of the arbitration. But within the extremes are potential ranges that parties can usefully estimate for purposes of evaluating settlement possibilities[6] and the direction that they want the arbitration to take. **4-013**

Perceptions of litigation cost and risk on settlement positions. We consider elsewhere ways of reasonably estimating potential costs of arbitration and key factors that influence those costs.[7] Party *perceptions* of cost, however, and how these perceptions can influence a willingness or desire to settle, are a somewhat different matter. As much as these perceptions may be grounded in reality, they are also subjective opinions that will be formed on the basis of experiences (of the party or those with whom it consults, including its counsel) in familiar jurisdictions. And while international arbitration is not generally regarded by anyone today as an **4-014**

5. Under the commonly used negotiation lexicon, parties can be said to seek through settlement a better outcome than their 'BATNA', which stands for Best Alternative To Negotiated Agreement, popularised in the well-known book on negotiation, *Getting to Yes*, by Roger Fisher & William Ury.
6. See the discussion of Early Case Assessment (ECA) in Ch. 3, s. III.
7. Chapter 3, *When the Dispute Arises*, and Ch. 5, *The Conduct of the Arbitration*.

inexpensive means of resolving disputes, how a party perceives that cost can have a significant impact on its tolerance for continuing the arbitration.

4-015 It is useful to think of parties as coming from predominantly low-cost and high-cost (or variable-cost) dispute resolution jurisdictions. As parties everywhere tend to view the costs of litigation as being high, we use the terms 'low' and 'high' relative to each other here. For example, for a contract dispute involving a sum of USD 1 million, a party in a low-cost jurisdiction may reasonably predict it will expend USD 20,000 in legal fees, while a party from a high-cost jurisdiction may expect to spend in excess of USD 200,000 to resolve the same dispute.[8] As the cost of litigation in one jurisdiction is clearly much higher than the other in absolute terms, a party from that location may have an appetite for conflict that is considerably lower as a result. But when confronted with an international arbitration, one or both parties may simply not have a frame of reference for estimating costs unless they have had previous, similar experiences.

Not that this ever really happens: impact of cost perceptions on settlement

When the parties reached a roadblock and no further progress towards settlement seemed possible, the mediator asked each side if they had considered the probable costs of resolving their dispute through international arbitration, as contemplated by their contract's dispute resolution clause. He suggested the probable costs could exceed EUR 1 million for each side. Counsel for the claimant, perhaps hoping to impress the respondent with the threat of expensive litigation, added that the total cost to each party might even approach EUR 2 million. The respondent, having had experience with previous international arbitrations, found the estimates to be high but not altogether impossible and did not change its settlement position. The claimant's representative, however, was visibly stunned at his own lawyer's estimate, as he had clearly never considered such costs as being possible in his home (civil law) jurisdiction. Shortly after this exchange, the claimant's representative agreed to substantially lower his last demand, and the parties settled.

4-016 Party perceptions of cost and the various uncertainties of international arbitration can lead them to adopt different, and contrasting, assumptions, each of which can lead them to accept sub-optimal outcomes.[9] On the one hand, uncertainty may

8. Since most costs (fees) are initially borne by parties out of pocket, and a common practice in settlement is for each party to bear its own costs, we make no distinctions in this chapter for jurisdictions where prevailing parties are permitted to recover from the losers all or a portion of what they spent.
9. By 'optimal' we mean the result that would have been attained either through binding resolution, i.e., the arbitration award, or through better negotiation.

drive them to underestimate their risk and likely costs, so that they remain rooted in their positions and overlook reasonable settlement opportunities. On the other hand, uncertainty may cause a risk-averse party to overestimate the risk and cost of arbitration, thus settling for less than what they would have achieved through a final award. In either case, the effect is the same: the party has failed to obtain the optimal outcome.

4-017 A common position is for a party to say that it is willing to be reasonable, but that it cannot settle alone and that the other side needs to be willing to acknowledge the risks that it faces and negotiate on the basis of them. Otherwise, the argument goes, any concessions made in the name of settlement will unilaterally favour the side that is unrealistically optimistic about the dispute. There is some wisdom in this argument in the context of domestic litigation between parties from similar backgrounds and with access to equal information useful for estimating likely outcomes. With the alternative to settlement being an award obtained at the conclusion of an international arbitration, however, the most common default assumption is the uncertainty discussed above. This presents an opportunity for the party that is better informed about the arbitration process to manage the uncertainties in its favour.

4-018 *Use of early case assessments (ECAs) to assess and improve settlement options.* Throughout this section, we have presumed that parties will either have performed an ECA[10] or will at least have a reasonable familiarity with the range of probable outcomes and the costs of arbitration. A party that has performed an ECA will have a net advantage over a party that has not; the ECA not only arms a party with convincing arguments about its strengths and responses to its weaknesses, but may place the party in a position of identifying and seizing settlement opportunities, the value of which the adverse party may not be able to fully appreciate.

Question: Why should I do an ECA sooner in the process, before we have fully developed the case in our pleadings?

Answer: An ECA is not a perfect assessment, but something that can be refined in the course of the arbitration. Conducting one early (as the name implies) is important to maintaining reasonably consistent settlement expectations. Unless a party has performed a reasonably complete ECA, it may hold unrealistically high expectations (and fail to appreciate the costs) until the tribunal is constituted, pleadings submitted, and an evidentiary hearing looms on the horizon. Thus, the party may at the outset fail to recognise reasonable settlement opportunities. Once the proceedings are underway, however, the claimant may substantially lower its expectations as submissions

10. Chapter 3, *When the Dispute Arises*.

and owned by European 'businessmen'. The claimant had in good faith and perhaps naively contracted with the BVI company without obtaining any security for payment or guarantees. When the BVI company failed to make payment, the claimant called in arbitration lawyers and they turned to debt-collection companies to identify and evaluate the adversary's assets. These were discovered to have all been quietly dissipated by the company, although the shareholders continued to own castles in their home countries and drive luxury cars. The lawyers advised that, although the case on the merits was very strong, the chances of collecting on any award were slim. The claimant decided to proceed with the arbitration nonetheless and obtained an order of provisional security for its claim and a subsequent award for all the damages that it sought. However, because the shareholders had looted the company, the claimant has only been able to recover a small amount on the award, and pending proceedings to reach the shareholders (as well as criminal proceedings against them) have yet to yield any fruit.

Chapter Seven

ICSID and Investment Treaty Arbitration

Introduction. Even though international arbitration is often less confidential than parties may suppose,[1] the fact is that little is publicly known about how most international arbitrations are conducted. Investment treaty arbitrations and ICSID arbitrations are exceptions to this rule, and in recent years they have become perhaps the main window through which outsiders can observe the practice of international arbitration. These arbitrations determine claims by private investors against the states hosting their investment. Because they necessarily involve states and therefore the interests of the taxpayer, investment treaty arbitrations (many but not all of which are ICSID arbitrations) are often in the public domain; ICSID arbitrations (most but not all of which are investment treaty arbitrations) are always in the public domain if only because ICSID publishes details of its cases on its website.[2] Many of these disputes also bring up novel legal issues and address questions of public interest beyond the simple impact that a successful claim or defence will have on state coffers. For these reasons too, these cases grab more headlines than 'ordinary' international arbitrations, with parties and lawyers, as well as authors, journalists, and non-governmental organisations (NGOs) keen and able to talk and write profusely about them. So much so that one would be forgiven for concluding, from arbitration publications in particular, that the number of investment treaty arbitrations substantially outweighs the number of ordinary international arbitrations. **7-001**

1. Chapter 2, *Negotiating an International Dispute Resolution Agreement*.
2. See the ICSID website at <http://www.icsid.worldbank.org/ICSID/Index.jsp>. The existence of the arbitration and the procedural details are published on ICSID website, as well as the award if both parties consent. Absent the parties' consent, only excerpts of the legal reasoning contained in the award are published. See ICSID Rule 48.

002 *Investment treaty arbitrations are few in number.* It is easy to overstate the significance of investment treaty arbitration and ICSID arbitration in the broader context of international arbitration. The truth is that investment treaty arbitrations and ICSID arbitrations represent only a small fraction of all international arbitrations. There have only ever been 200 or so ICSID investment treaty arbitrations (including ICSID Additional Facility cases), and maybe 300 or so investment treaty arbitrations in total.[3] These numbers have grown enormously in percentage terms in recent years, but that growth appears to be flattening out.[4] This compares with a total of over 15,000 ICC arbitrations, with a total of 600 or so new cases each year just for this one institution (few or none of the ICC's cases are investment treaty arbitrations).

003 *Relative significance of investment treaty arbitration.* Investment treaty disputes thus occupy a small, specialised place in the arbitration universe, and most users of arbitration and many arbitration lawyers will never encounter them. Ordinary commercial disputes between companies remain the bread and butter of international arbitration.

004 *Differences between investment treaty arbitration and other arbitrations.* Although ICSID and investment treaty arbitrations are relatively rare, we have devoted this separate chapter to them because there are a number of important differences between those forms of arbitration and ordinary international arbitrations. These differences are not so much in the way the proceedings are conducted, but more in the legal regime governing the arbitrations: the conventions, rules, and substantive law applicable in investment treaty and ICSID cases are typically quite different from those found ordinarily in international arbitration.

Question: Does investment treaty arbitration involve only certain types of special investments in a foreign country, such as the exploitation of natural resources?

Answer: No, disputes under investment treaties arise out of virtually any type of business activity that takes place in a host country, and where it is alleged that state involvement (or the failure of the state to act or provide required protections) negatively affects those activities.

005 *Low awareness of investment treaties.* Another reason for giving investment arbitration special attention is that awareness of investment treaties, and of the protections they provide, is still low – despite the publicity given to them in the arbitration

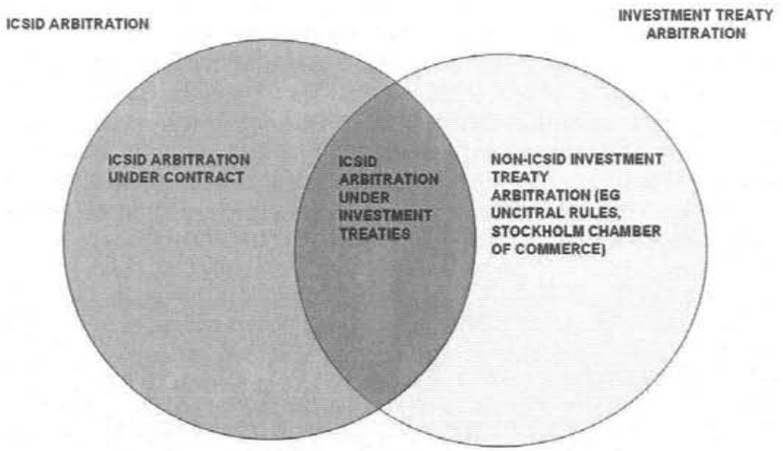
3. See United Conference on Trade and Development, IIA Monitor No. 1 (2009), International Investment Agreements – Latest Developments in Investor-State Dispute Settlement, UNCTAD/WEB/DIAE/IA/2009/6, available at <www.unctad.org/en/docs/webdiaeia20096_en.pdf>.
4. *Ibid.*

press – whether among investors, lawyers, or even some of the states that conclude the treaties. The relatively low level of awareness prevents investors from securing the full benefit of the protections and deprives the states of the additional investment that greater investor awareness would presumably generate.[5] This may be partly due to a misunderstanding that 'investment' treaties and investment treaty arbitration operate only with respect to a narrow range of business activities, when, in fact, they can cover all types of business activities in a foreign country in which state involvement (or lack of it) negatively impacts the financial returns from those activities.

Question: What is the difference between an investment treaty arbitration and ICSID arbitration?

Answer: The phrase 'investment treaty arbitration' is a reference to the nature of the arbitration agreement between the investor and the state. It is based on an offer of arbitration found in an investment treaty between that state and one or more other states. 'ICSID arbitration' refers to the arbitral institution – it is arbitration conducted under the auspices of ICSID, which is the arbitral institution affiliated with the World Bank. Many investment treaty arbitrations (probably the majority) are also ICSID arbitrations, as they are administered by ICSID; some investment treaty arbitrations are not ICSID arbitrations, as they are administered by other institutions or are ad hoc arbitrations (not administered by any institution). The vast majority of ICSID arbitrations are investment treaty arbitrations, but not all: for example, a state and an investor can agree in a contract to ICSID arbitration, even though no investment treaty covers their relationship.[6]

5. States entering into investment treaties usually say, in each treaty's recitals, that the instrument is intended to promote and protect investment by investors of the other state. However, the jury is still out on the extent to which investment treaties actually have any impact on the amount of foreign investment into a given state. See, e.g., J.W. Salacuse & N.P. Sullivan, 'Do BITs Really Work? An Evaluation of BITs and their Grand Bargain', *Harvard International Law Journal* 46, no. 1 (Winter, 2005): 67 et seq; K.P. Sauvant & L.E. Sachs, *The Effect of Treaties on Foreign Direct Investment* (Oxford: Oxford University Press, 2009); and International Institute for Sustainable Development, 'Do Bilateral Investment Treaties Lead to More Foreign Investment?' (30 Apr. 2009), available at <www.investmenttreatynews.org/cms/news/archive/2009/04/30/do-bilateral-investment-treaties-lead-to-more-foreign-investment.aspx>.
6. A small number of ICSID arbitrations are brought under the host state's investment laws. These are very similar to arbitrations under investment treaties and we treat them as identical unless stated otherwise.



006 This chapter continues with a look first at investment treaty arbitration, before considering in more detail some of the specificities of ICSID.

I. INVESTMENT TREATY ARBITRATION

007 *Broad meaning of 'investment'*. As already introduced, a common misunderstanding is that only a vaguely defined class of international commercial transactions fall under the rubric of 'investments' which benefit from treaty protections. In fact, the term 'investment' is misleading, in that there are a large number of international commercial projects and even transactions that could easily fall within the ambit of the protections provided by an investment treaty. Thus, it is important for parties transacting international business to understand the protections that may be available to them, both when negotiating their project or transaction, so that they enhance their ability to benefit from those protections, and in the event that the benefit of their investment is somehow harmed by action or inaction by the host state.

In what ways is investment treaty arbitration different from 'ordinary' international arbitration?

The key difference is that the arbitration agreement in investment treaty arbitration is found in the acceptance by the investor of the state's offer of arbitration in the investment treaty, while the arbitration agreement in other forms of arbitration is found in a more traditional contract. But there are other differences in practice. For example, investment treaty arbitration:

- always involves a state on one side and a private investor on the other;
- usually involves application of international law to procedural and substantive issues;
- raises frequent and complex jurisdiction issues, especially in ICSID cases;
- is staffed by a pool of arbitrators and counsel who are often specialised in these sorts of arbitrations and in international law;
- tends to take more time than other arbitration, mainly because states move slowly and because of the frequent and complex jurisdiction objections that must be decided at the outset of the arbitration; and
- involves greater transparency of proceedings through publicity, NGO interventions as amicus curiae, and so on.

Still, in many ways the arbitral proceedings themselves are quite similar to ordinary international arbitrations. For example, the same (UNCITRAL) or similar (ICSID) arbitration rules are used.

What is an investment treaty? Investment treaties are agreements between two or more states in which each state party undertakes to protect 'investments' in its territory made by investors (who we refer to for convenience as 'qualifying investors') of other states that are party to the treaty. As part of the protections offered in most investment treaties, each state agrees that qualifying investors may sue it in neutral offshore arbitration, without the need for a pre-existing arbitration agreement with the particular investor. **7-008**

Types of investment treaties. There are two types of investment treaties: bilateral investment treaties (BITs), entered into by two states, and multilateral investment treaties, entered into by three or more states. There are over 2,500 BITs worldwide, most of which are concluded by at least one developing country.[7] Certain free trade agreements (FTAs) contain chapters protecting investments, and for present purposes these can be assimilated with investment treaties. **7-009**

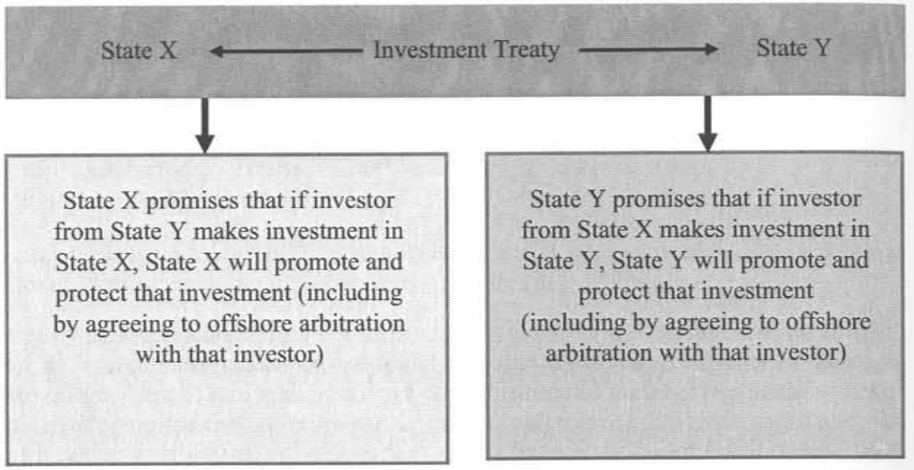
Multilateral investment treaties. There are a handful of multilateral investment treaties that cover certain regions or industry sectors. The best known multilateral investment treaties are: **7-010**

– the North American Free Trade Agreement (NAFTA), to which Canada, Mexico, and the United States are party, or more precisely, Chapter 11 of NAFTA, which is the treaty's investment chapter;[8]

7. The text of many investment treaties is available on the website of the United Nations Conference on Trade and Development (UNCTAD) at <www.unctadxi.org/templates/DocSearch____779.aspx>.
8. Available at <www.naftaclaims.com>.

- the Agreement among ASEAN Governments for the Promotion and Protection of Investments, to which the ten ASEAN countries are party;[9]
- the United Agreement for the Investment of Arab Capital in Arab States, to which around twenty Arab states are party;[10] and
- the Energy Charter Treaty, which covers the energy sector, and to which over forty-five countries worldwide are party.[11]

011 *A BIT in diagram form.* A bilateral investment treaty (one between only two states) is represented diagrammatically as follows:



012 *International treaty network of investment protection.* It is important to understand that the worldwide investment treaty network is extensive but far from comprehensive. Some countries have concluded relatively few investment treaties. Japan, for example, had concluded at the time of writing fewer than twenty investment treaties, but has been increasingly entering into FTAs with investment chapters. Other countries have entered into a large number of treaties, but the protection provided by those treaties may be less effective than the norm. For example, China has more than 100 treaties, but many of these provide for only limited access to neutral offshore arbitration. Because the investment treaty network is not comprehensive and does not provide a universal standard of protection, it would be a mistake to assume that *every* foreign investment is covered by an effective

9. ASEAN is the Association of Southeast Asian Nations. The 1987 ASEAN investment agreement is due to be replaced before the end of 2009 by the ASEAN Comprehensive Investment Agreement, which was signed by ASEAN Member States in February 2009. ASEAN investment agreements are available at <www.aseansec.org/6462.htm>.
10. Available at <www.unctad.org/Templates/webflyer.asp?docid=1592&intItemID=2323&lang=1&mode=toc>.
11. Available at <www.encharter.org>.

investment treaty. This is why investors – especially those who intend to do business in developing countries – should exercise particular care if they want to secure investment treaty protection (this is discussed further below).

Model investment treaties. The following sections introduce some of the important provisions common to most investment treaties. Two model treaties are attached in Appendices 15 and 16, one of which (the Dutch Model) is a traditional, older treaty, and the second of which (the US Model) is a more contemporary instrument. Many bilateral and multilateral investment treaties adopt a similar structure and contain broadly similar provisions. However, investment treaties are almost never identical. There are often apparently minor differences between corresponding provisions in treaties that can result in significant disparity in the level of protection provided. **7-013**

A. Which Investors and Investments are Protected by Investment Treaties?

Investors and investments. States agree in investment treaties to protect only certain 'qualifying' investors who make certain 'qualifying' investments. This will mean, among other things, that only these investors are entitled to bring disputes to arbitration against a state under the treaty. The definitions of investor and investment are usually found in the initial provisions of the investment treaty. **7-014**

1. Investors

Protected investors. Investment treaties protect a limited group of investors, usually nationals or companies of each state party to the treaty. Companies are usually considered to be 'of' a state if they are incorporated there or organised under its laws.[12] Some treaties may limit the group of qualifying investors further, by adding conditions: for example, the treaty may require that a company, in order to fall within the definition of investor and qualify for coverage by the treaty, be owned by nationals of the state in which it is incorporated, or conduct business in the state in which it is incorporated, or both.[13] **7-015**

12. See, e.g., Art. 1(b)(ii) of the Dutch Model BIT, at Appendix 15 and Art. 1 of the US Model BIT, at Appendix 16.
13. See, e.g., Art. 1 of the US Model BIT, at Appedix 16. See also Art. 72 of the Agreement between Japan and the Republic of Singapore for a New-Age Economic Partnership Agreement: '(e) the term "investor of the other Party" means any natural person of the other Party or any enterprise of the other Party; . . . (h) the term "enterprise of the other Party" means any enterprise duly constituted or otherwise organised under applicable law of the other Party, except an enterprise owned or controlled by persons of non-Parties and not engaging in substantive business operations in the territory of the other Party'.