



State–State Dispute Settlement in Investment Treaties

Best Practices Series - October 2014



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The author would like to thank Yalan Fu for their research and Diana Rosert, Martin Dietrich Brauch and Damon Vis Dunbar for their comments and suggestions.



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1.0 Introduction

Investor–state arbitration has boomed over the past decade: the number of recorded cases rose from 51 in 2000 (UNCTAD, 2014b) to 568 by the end of 2013 (UNCTAD, 2014a, p. 3). Alongside the increase in arbitrated disputes has been growing concern by some states about the nature of arbitration claims by foreign investors against host states, which have included challenges to legitimate environmental and other public welfare and financial policy measures. The high costs of arbitration and the perceived lack of openness, independence and predictability have also led several countries to rethink the scope of their investment treaty obligations as well as the arbitration mechanisms incorporated in their investment treaties.

State–state dispute settlement predates investor–state arbitration, and was the norm in the early friendship, commerce and navigation (FCN) treaties and some early investment treaties.¹ It was not until 1969, with the Chad–Italy bilateral investment treaty (BIT), that the first investor–state dispute settlement clause was included in an investment treaty, and not until 1990 that a tribunal asserted its jurisdiction under such a clause.² Today, most investment treaties include both state–state and investor–state dispute settlement mechanisms.

As the number of investor–state arbitration cases has grown exponentially, state–state arbitration has taken a backstage role—to our knowledge only four such cases have occurred under investment treaties. One case was a diplomatic protection claim initiated by Italy against Cuba on behalf of Italian investors. Another claim was brought by Mexico against the United States, and related to alleged treaty violations by the respondent state. This claim was not brought on behalf of any specific investors, and therefore had a declaratory character. In the two remaining cases, host states filed claims in response to investor–state disputes that they were facing at the time, seeking an interpretation of treaty provisions by the tribunal (*Peru v. Chile* and *Ecuador v. United States*).

Despite their rarity, state–state dispute settlement options are gaining renewed attention from both states and academics as an alternative, given the numerous concerns associated with investor–state arbitration.³ State–state mechanisms are also becoming more relevant due to the trend towards full-fledged investment chapters in free trade agreements (FTAs) and comprehensive economic partnership agreements (EPAs). These agreements typically include elaborate state–state dispute settlement provisions to resolve a wide range of disputes. While some countries continue to sign treaties with investor–state dispute settlement, others have decided not to include it, opting instead for state–state dispute settlement only.⁴

The use of state–state dispute settlement in treaty-based investment disputes is contentious. While some experts consider that the state–state mechanism offers possibilities for states to “re-engage with the investment treaty system” (Roberts, 2014, p. 2), others caution that interstate arbitration may “re-politicize” investment disputes (Roberts, 2014, p. 4).⁵ The latter view appears to contradict the view that state–state adjudication at the International Court of Justice (ICJ), under the framework of the World Trade Organization (WTO) or in other fora has helped keep disputes outside of the political realm.⁶ Accordingly, depoliticization may not be a distinct feature of investor–state arbitration, but rather of international adjudication more generally. Nevertheless, all disputes may become politicized to some extent, including investor–state arbitration. For instance, some home states have put pressure on host state governments behind the scenes before or during ongoing investor–state disputes. Some home states have also intervened at the enforcement stage. For example,

¹ See, for instance, Yackee, J. W. (2008). See also Roberts (2014, p. 3).

² *Asian Agricultural Products Limited v. Democratic Socialist Republic of Sri Lanka* (ICSID Case No. ARB/87/3), Award, June 27, 1990.

³ E.g., Potestà (2013). Roberts (2014); Orecki (2013); Seifi (2004); Trevino (2013, Dec. 12).

⁴ Some of the recent investment chapters in comprehensive trade and investment treaties do not contain investor–state arbitration provisions, while providing for state–state dispute settlement clauses, e.g., the Australia–Malaysia Free Trade Agreement (FTA) (2012), the Japan–Philippines Economic Partnership Agreement (EPA) (2006), and the Australia–United States FTA (2004).

⁵ See *Republic of Ecuador v. United States of America* (PCA Case No. 2012-5), Expert Opinion of Prof. W. Michael Reisman, April 24, 2012, paras. 24–25, 36–37.

⁶ On international adjudication more generally, see Bilder (2007). On the ICJ, see Daly (1987). On the WTO, see Evans & Shaffer (2010).



two disputes between U.S. investors and Argentina led the United States to cut trade preferences for Argentina to compel the payment of damages awarded by investment tribunals (Palmer, 2012). In sum, rather than being an issue of investor–state versus state–state dispute settlement, a fundamental difference seems to exist between legal settlement of disputes on the one hand and dispute “resolution” by means of political, economic or military power on the other.

The key questions today are the following: as investor–state arbitration is increasingly put into question, should investment dispute settlement be conducted solely on a state–state basis? Or, if both state–state and investor–state arbitration are included in the treaty, what areas should be subject to either mechanism exclusively, and what areas to both? Finally, if both are included, how should the two mechanisms interrelate?

This paper looks at state–state dispute settlement provisions in investment treaties and investment chapters of wider economic agreements. It examines the different mechanisms used to settle investment disputes, including judicial, quasi-judicial, and—the most frequent—arbitration procedures. It then looks at the different types of claims that can be brought under the typical state–state clause, which include diplomatic protection claims, interpretive claims and declaratory relief requests.

The paper also analyzes how investment treaties and the few arbitral cases available deal with the interaction of state–state and investor–state dispute settlement where the treaty provides for both types of dispute settlement. The presence of two different dispute settlement processes in one treaty raises a host of questions, especially given the overlapping subject matter. Finally, the paper concludes with recommendations on how state–state dispute settlement could be used as an alternative to investor–state arbitration, or, if both mechanisms are included, on how to define the relationship between the two and to strengthen the state parties’ control over the interpretation of their treaty.



2.0 Forms of Treaty-Based Dispute Settlement Between States Relating to Investment

2.1 OVERVIEW

State–state dispute settlement clauses in investment-related treaties typically cover “disputes as to the interpretation or application” of the treaty. The clauses exist either alone, which is common in the FCN treaties and early BITs, or in parallel with investor–state clauses, as is the case in the vast majority of post-1969 BITs and some FTAs.⁷ The bulk of these treaties utilize state–state arbitration to resolve disputes, but a few refer disputes to the ICJ, and use mixed forms of dispute settlement (i.e., quasi-judicial mechanisms), such as the five-member arbitral panel procedure used for state–state investment disputes under the NAFTA.

2.2 STATE–STATE ARBITRATION

2.2.1 “Traditional” Commercial Arbitration Model

Many pre-1969 BITs provide for state–state arbitration exclusively. For example, the Germany–Liberia BIT (1961) sets out the interstate arbitration mechanism as follows:

Article 11

- (1) Disputes concerning the interpretation or application of the present Treaty should, if possible, be settled by the Governments of the two contracting parties.
- (2) If a dispute cannot thus be settled, it shall upon the request of either contracting party be submitted to an arbitral tribunal.
- (3) Such arbitral tribunal shall, in each individual case, be constituted as follows: Each contracting party shall appoint one member, and these two members, so appointed, shall agree upon a national of a third State as their chairman to be appointed by the Governments of the two contracting parties [...].

More recently, state–state arbitration clauses have been included separately or alongside investor–state clauses.

In general, the state–state investment arbitration procedure differs little from the investor–state procedure. Both procedures follow similarly structured rules, often modeled on the United Nations Commission on International Trade Law (UNCITRAL) arbitration rules, and their tribunals consist of arbitrators largely from the same circle.⁸ Typically, treaties contain detailed rules on how to constitute a tribunal in the event of submitting disputes to arbitration. A state–state tribunal is usually composed of three arbitrators. Each state appoints one, and the third arbitrator, i.e., the chairperson or presiding arbitrator, is jointly selected by the party-appointed arbitrators and then appointed by the disputing state parties or appointed upon their

⁷ E.g., Section B in Chapter 11 (Investment) and Section B in Chapter 20 (Institutional Arrangements and Dispute Settlement Procedures) in the NAFTA; Article 48 in Chapter IV (Investment) and Chapter IX (Dispute Settlement) in the EFTA–Singapore FTA (2002); Article 13 (Dispute Between Parties) and Article 14 (Investment Disputes between a Party and an Investor) in the Investment Agreement of the ASEAN–China FTA (2009).

⁸ In *Ecuador v. United States*, all three arbitrators—Prof. Luiz Olavo Baptista (Presiding Arbitrator), Prof. Donald McRae and Prof. Raúl Emilio Vinuesa—have also arbitrated other treaty-based investor-state cases. Among the three arbitrators in *Italy v. Cuba*, it appears that only Yves Derains has acted as arbitrator in investment treaty disputes before, while this seems not to be the case for Prof. Attila Tanzi and Dr. Narciso Cobo-Roura. In *Mexico v. United States*, J. Martin Hunter (Presiding Arbitrator) and David A. Gantz have acted as arbitrators in treaty-based investor–state cases. The other three arbitrators, Luis Miguel Diaz, C. Michael Hathaway and Alejandro Ogarrio appear not to have been active in this area. It is not known whether and which arbitrators were appointed in *Peru v. Chile*. Information is based on www.italaw.com (as of May 22, 2014).



approval; this arbitrator must be a national of a third country.⁹ Where the appointment fails, treaties normally designate an appointing authority, e.g., the President of the ICJ or Secretary-General of the Permanent Court of Arbitration (PCA).

Given the similarities, many of the issues raised in the context of investor–state arbitration are also relevant for state–state arbitration. These include issues arising from party-appointment of arbitrators, the desirability of having for-profit arbitrators deciding disputes involving states and the public interest, the “multiple hats” problem (i.e., that arbitrators often act as counsel in other investment treaty disputes), the issue of legal correctness of decisions and the overall predictability of the system due to the absence of an appeals process.

In addition to the issues noted above, a major critique of investor–state arbitration relates to the lack of transparency. Investor-state disputes are often conducted in secret, sometimes with the public not even knowing about their existence. Given the important public policy issues involved in many cases and the high claims and arbitration costs, this has led to widespread critique. Some states have now introduced more transparent arbitration rules in their treaties. UNCITRAL has recently adopted the UNCITRAL Transparency Rules on Treaty-Based Investor-State Arbitration, contributing to a more transparent approach for investor–state dispute settlement in the future. Whether this development will spill over into state–state arbitration is unclear, but several states have already extended transparency into state–state arbitration. For example, the 2012 U.S. Model BIT provides that the transparency rules in investor–state arbitration apply *mutatis mutandis* to the interstate arbitration provisions (Article 37(4)). The Investment Agreement for the Common Investment Area of the Common Market for Eastern and Southern Africa (COMESA) also sets out transparency of arbitral proceedings in interstate arbitrations (Article 27(3)–(4); Annex A, Article 9).

2.2.2 “Modified” Arbitration Model

Furthermore, there are instances where states have adopted a more elaborate approach to state–state arbitration, not simply applying UNCITRAL or similar rules. In the context of investment chapters, examples of more structured types of arbitration exist that resemble a quasi-judicial mechanism. For example, the state–state mechanism in NAFTA Chapter 20 stipulates that a party could request a meeting of the NAFTA Free Trade Commission to resolve the dispute after the consultation fails, and if the Commission fails to resolve the dispute, a party may call for the establishment of an arbitral panel consisting of five panelists chosen from a roster. Explicit qualification requirements for roster members are also set out in NAFTA Chapter 20, e.g., compliance with the code of conduct established by the Free Trade Commission (Article 2009(2) and Article 2010).

NAFTA is a special case in that arbitral panels consist of five members. In addition, the panel selection process is somewhat different from others: the five-member panel is established by using a reverse selection process in which each party selects two panelists who are citizens of the other disputing party. The chair of the panel is selected by the disputing parties and may be a citizen of a NAFTA party or any other country (Article 2011). By contrast, the Investment Agreement for the COMESA Common Investment Area moves away from party-appointed panelists or arbitrators, stipulating that all the three members of an arbitral panel shall be appointed by the COMESA Secretary-General (Annex A, Article 6). Moreover, both NAFTA and the COMESA agreement require arbitrators to be selected from rosters.¹⁰

⁹ Article 37 (State-State Dispute Settlement) of the 2012 U.S. Model BIT slightly differs from this model, e.g., the third arbitrator is appointed by the agreement of the Parties.

¹⁰ NAFTA Article 2011(3); Investment Agreement for the COMESA Common Investment Area, Annex A, Article 6.



2.3 JUDICIAL MECHANISMS TO RESOLVE STATE–STATE DISPUTES

2.3.1 International Court of Justice

In post-1945 FCN treaties and early BITs, investment disputes are uniformly referred to a judicial institution, more precisely, the ICJ. Such a referral forms a *compromis* conferring jurisdiction on the ICJ over the investment claim. For instance, the dispute settlement clause in the 1948 Italy–United States FCN treaty, which is also the jurisdictional basis of the ICJ in the *Elettronica Sicula S.p.A. (ELSI)* case,¹¹ provides:

ARTICLE XXVI

Any dispute between the High Contracting Parties as to the interpretation or the application of this Treaty, which the High Contracting Parties shall not satisfactorily adjust by diplomacy, shall be submitted to the International Court of Justice, unless the High Contracting Parties shall agree to settlement by some other pacific means.

Likewise, Article XIV of the 1966 Treaty of the Amity and Economic Relations between the United States and the Togolese Republic provides:

2. Any dispute between the Parties as to the interpretation or application of the present Treaty, not satisfactorily adjusted by diplomacy shall be submitted to the International Court of Justice, unless the Parties agree to settlement by some other pacific means.

Instead of solely referring to the ICJ, some investment treaties include state–state dispute settlement clauses combining both judicial settlement and international arbitration, subject to the choice of states. An example is the 1959 Germany–Pakistan BIT,¹² a treaty often described as the first BIT to be concluded but which did not, however, incorporate an investor–state arbitration clause. It provided:

Article 11

- (1) In the event of disputes as to the interpretation or application of the present Treaty, the Parties shall enter into consultation for the purpose of finding a solution in a spirit of friendship.
- (2) If no such solution is forthcoming, the dispute shall be submitted
 - (a) to the International Court of Justice if both Parties so agree or
 - (b) if they do not so agree to an arbitration tribunal upon the request of either Party [...].

In contrast to the earlier example above, in which the parties to the treaty agreed in advance to submit disputes to the ICJ, the 1959 Germany–Pakistan BIT required specific agreement by the parties to submit the dispute to the ICJ. At the same time, the BIT did allow for arbitration upon request of either party.

2.3.2 Regional Courts

Some investment treaties submit the disputes to regional courts. For example, the Investment Agreement for the COMESA Common Investment Area (2007) allows states to choose between an arbitral tribunal and the COMESA Court of Justice by providing:

¹¹ *Elettronica Sicula S.p.A. (ELSI)* (United States of America v. Italy), ICJ, Judgment of 20 July 1989.

¹² A new BIT between Germany and Pakistan was signed in 2009, replacing the old BIT signed in 1959 upon entry into force. A significant difference in the 2009 Germany–Pakistan BIT is that it incorporates an investor–state arbitration clause.



ARTICLE 27 Settlement of Disputes between Member States

1. Any dispute between Member States as to the interpretation or application of this Agreement not satisfactorily settled through negotiation within 6 months, may be referred for decision to either:
 - (i) an arbitral tribunal constituted under the COMESA Court of Justice in accordance with Article 28(b) of the COMESA Treaty; or
 - (ii) an independent arbitral tribunal; or
 - (iii) the COMESA Court of Justice sitting as a court [...].

2.4 QUASI-JUDICIAL MECHANISMS TO RESOLVE STATE–STATE DISPUTES

Some investment treaties establish a quasi-judicial state–state dispute settlement system, inspired by the WTO’s Dispute Settlement Panel and Appellate Body system. One example is the Comprehensive Investment Agreement (ACIA) of the Association of Southeast Asian Nations (ASEAN), signed in 2009. The ACIA refers to the state–state disputes “concerning the interpretation or application” to the 2004 ASEAN Protocol on Enhanced Dispute Settlement Mechanism.

This Protocol establishes an administrative body, the Senior Economic Officials Meeting (SEOM), that has the authority to establish panels, adopt panel and Appellate Body reports, maintain surveillance of implementation of the adopted reports, and authorize suspension of concessions and other obligations under the ACIA. Upon the request for a panel raised by the complaining party after the consultation fails, the SEOM is to establish a panel unless it decides by consensus not to establish a panel (Article 5). The panel is to make an objective assessment of the dispute on both factual and legal issues, and submit its findings and recommendations in the form of a written report to the SEOM (Articles 7 and 8). The SEOM will adopt the panel report except for the initiation of appeal and a reversed consensus of not adopting the report. In the event of an appeal, the ASEAN Economic Ministers (AEM) establishes an Appellate Body composed of three persons from a seven-person pool appointed by the AEM on a four-year term. The standard of review of the Appellate Body is limited to the issues of law. The report made by the Appellate Body shall be adopted by the SEOM unless rejected by a reversed consensus and unconditionally accepted by the parties (Article 12).

The remedial actions and enforcement mechanism associated with an adopted report of either panel or Appellate Body are the same as those available in the WTO. The basic remedy to which a successful party is entitled is an order requiring the respondent state to bring inconsistent measures into conformity with the ACIA (Article 14). The parties are obliged to comply with the findings and recommendations of the reports adopted by the SEOM, which in turn keeps this implementation process under surveillance (Article 15). In the case of a failure to implement the report, compensation and suspension of concessions and other obligations under the ACIA with the authorization from the SEOM could be ordered (Article 16).

The state–state dispute settlement mechanism set out in the ASEAN Protocol on Enhanced Dispute Settlement Mechanism (2004) applies beyond investment to a wide range of treaties signed by the ASEAN Member States, such as those in relation to food security reserve, trade, industrial projects, energy cooperation, and intellectual property cooperation.¹³ To date, it appears that member states have not used the state–state mechanism available under the 2004 Protocol or its predecessor, the Protocol on Dispute Settlement Mechanism of 1996 (Ewing-Chow & Hsien-Li, 2013, p. 18).

¹³ Appendix I (Covered Agreements) of the ASEAN Protocol on Enhanced Dispute Settlement Mechanism (2004).



3.0 State–State Dispute Settlement Clauses: Scope and Definition

3.1 OVERVIEW

Most state–state dispute settlement clauses in investment treaties provide that any dispute between the state parties “concerning the interpretation or application” of the treaty be brought to arbitration. For example, Article 12 of the Cambodia–Netherlands BIT (2003) provides:

1) Any dispute between the Contracting Parties concerning the interpretation or application of the present Agreement, which cannot be settled within a reasonable lapse of time by means of diplomatic negotiations, shall, unless the Parties have otherwise agreed, be submitted, at the request of either Party, to an arbitral tribunal, composed of three members [...].

“Interpretation” is the determination of the meaning of particular provisions of an agreement in concrete or proposed situations. “Application” relates to the extent to which the actions or measures taken or proposed by the contracting parties comply with the terms of an agreement, its object and purpose (UNCTAD, 2003, p. 14). These two interact closely because application inevitably involves interpretation of treaty provisions, and application could in turn feed into interpretation. The scope set by these two phrases is “all-encompassing” (UNCTAD, 2003, p. 14), capable of covering all disputes arising from the treaty at issue, such as disputes regarding the interpretation of a treaty provision in an abstract manner or for a specific case, whether an act amounts to a treaty violation either based on direct claims or indirect, diplomatic protection claims. Some treaties contain carve-outs that limit the broad availability of state–state dispute settlement to disputes relating to particular provisions of the agreement.¹⁴

In contrast to the phrases “interpretation” and “application,” which lead to an all-encompassing result, the reference to “dispute” could impose certain constraints on the overall scope. Pursuant to public international law, “dispute” is defined as “disagreement on a point of law or fact, a conflict of legal views or of interests between two persons.”¹⁵ Furthermore, the ICJ in the South West Africa Advisory Opinion noted that, for a dispute to exist, “it must be shown that the claim of one party is positively opposed by the other.”¹⁶ The requirement of “positive opposition” for a dispute to exist can lead to situations in which the respondent state seeks to “avoid” the dispute by not answering the claimant’s claims. This is what allegedly occurred in the recent case launched by Ecuador, in which the United States, according to Ecuador, chose to be silent in response to Ecuador’s request to clarify the interpretation of a treaty provision in the Ecuador–United States BIT (1993). In that case the majority of the state–state arbitral tribunal found that there was no “dispute,” and by majority dismissed jurisdiction.¹⁷

Drawing on case law, the typical state–state dispute settlement clauses in investment treaties can be grouped to encompass three types of claims: diplomatic protection claims brought by home states seeking redress on

¹⁴ E.g., the 2012 U.S. Model BIT carves out the matters relating to state’s obligations not to weaken its domestic environmental and labour laws to encourage investment (Article 37(5)).

¹⁵ *The Mavrommatis Palestine Concessions*, Judgment of 30 August 1924 (Objection to the Jurisdiction of the Court), PCIJ 1924 (Series A, No. 2), p. 11. See also *Northern Cameroons (Cameroon v. United Kingdom)*, Preliminary Objections, Judgment of 2 December 1963, ICJ Reports 1963, p. 15 (pp. 20, 27); *East Timor (Portugal v. Australia)*, Judgment, ICJ Reports 1995, p. 90 (pp. 99, 100).

¹⁶ *South West Africa (Ethiopia v. South Africa; Liberia v. South Africa)*, Preliminary Objections, Judgment of 21 December 1962, ICJ Reports 1962, p. 319 (p. 328).

¹⁷ *Republic of Ecuador v. United States of America* (PCA Case No. 2012-5). The final award dismissing the jurisdiction is not public. See also U.S. Department of State. United States–Ecuador BIT: Ecuador v. United States. Retrieved from <http://www.state.gov/s/l/c53491.htm>.



behalf its investors, interpretive claims seeking a decision interpreting an investment treaty and requests for declaratory relief seeking a determination that the treaty has been breached by a specific measure (Roberts, 2014, p. 3).

Diplomatic protection claims most closely resemble investor–state dispute settlement claims in terms of their objective, since the home state of the injured person (here the investor) can secure its protection and obtain reparation for an internationally wrongful act.¹⁸ Diplomatic protection claims predate claims brought under investment treaties. Today, we find such claims brought both outside and within the investment treaty context.¹⁹ Interpretive claims and declaratory claims, on the other hand, serve more a complementary role. Their objective is not reparation and damages, but instead determining a treaty breach or clarifying the meaning and scope of treaty obligations. They can provide clarity to investors and host states about their specific rights and obligations under the treaty and can potentially help avoid diplomatic protection disputes or investor–state disputes where these are available.

3.2 DIPLOMATIC PROTECTION CLAIMS

State–state dispute settlement exercised by investors’ home states on behalf of their investors forms part of the diplomatic protection under international law. According to the International Law Commission (ILC) Draft Articles on Diplomatic Protection “diplomatic protection” is the “procedure employed by the state of nationality of the injured persons to secure protection of that person and obtain reparation for the internationally wrongful act inflicted.”²⁰

Diplomatic protection is well established in customary international law; for a state to take action two requirements must be fulfilled, i.e., nationality and exhaustion of local remedies.²¹ States exercise diplomatic protection as their own rights and have discretion to exercise or not.²² While a national has the right to request that its home country exercise diplomatic protection, there is no obligation upon the state under international law to provide such protection.²³ The nationality requirement for diplomatic protection means that, under international law, a state may bring claims only on behalf of its own nationals, but not on behalf of those of other states.²⁴

Both FCN treaties and investment treaties contain state–state dispute settlement clauses covering disputes concerning the interpretation and application of the treaty. Early case law indicates that these state–state dispute settlement clauses also allow for diplomatic protection claims. For instance, in the *ELSI* case, the United States filed a diplomatic protection claim against Italy over the alleged injury caused to its nationals.²⁵

¹⁸ See the 2006 ILC Draft Articles on Diplomatic Protection with commentaries, *Yearbook of the International Law Commission*, 2006, Vol. II, Part Two.

¹⁹ For an early case of diplomatic protection, see *The Mavrommatis Palestine Concessions*, Judgment of 30 August 1924 (Objection to the Jurisdiction of the Court), Permanent Court of International Justice (PCIJ) 1924 (Series A, No. 2), p. 12. For a contemporary claim of this kind, see *Ahmadou Sadio Diallo (Republic of Guinea v. Democratic Republic of the Congo)*, Judgment, ICJ Report (2010).

²⁰ The 2006 ILC Draft Articles on Diplomatic Protection with commentaries, *Yearbook of the International Law Commission*, 2006, Vol. II, Part Two, p. 24.

²¹ ILC Draft Articles on Diplomatic Protection, Articles 3–15.

²² See the judgment of the PCIJ in the *Mavrommatis Palestine Concessions* case: “By taking up the case of one of its subjects and by resorting to diplomatic action or international judicial proceedings on his behalf, a State is in reality asserting its own rights - its right to ensure, in the person of its subjects, respect for the rules of international law. [...] Once a State has taken up a case on behalf of one of its subjects before an international tribunal, in the eyes of the latter the State is sole claimant.” *The Mavrommatis Palestine Concessions*, Judgment of 30 August 1924 (Objection to the Jurisdiction of the Court), PCIJ 1924 (Series A, No. 2), p. 12.

²³ *Ibid.*

²⁴ *Barcelona Traction, Light and Power Company, Limited (Belgium v. Spain)*, Judgment, ICJ Reports (1970).

²⁵ *Eletronica Sicula S.p.A. (ELSI) (United States of America v. Italy)*, ICJ, Judgment of 20 July 1989.



The ICJ upheld its jurisdiction over the U.S. claim based on Article 36(1) of the ICJ Statute²⁶ in conjunction with the state–state dispute settlement clause in the 1948 Italy–U.S. FCN treaty (still in force as of 2013)²⁷ which forms a consent referring the disputes arising under the treaty to the ICJ. In the more recent Italy–Cuba case, discussed below, the ad hoc arbitral tribunal also affirmed that, based on such a state–state dispute settlement clause, the claimant could file a diplomatic protection claim.²⁸

Where an investment treaty provides for a special state–state dispute settlement mechanism that excludes or departs substantially from the general international law rules governing diplomatic protection, the ILC Draft Articles on Diplomatic Protection regard the “treaty provisions for the protection of investment” as *lex specialis* that takes precedence over the draft articles (Article 17). This means that the procedures for exercising diplomatic protection through the state–state dispute settlement clause in investment treaties could be distinct from the procedures set out under customary international law. For example, the state–state clause could provide different requirements on investor nationality or exhaustion of local remedies. However, at least one case indicates clearly that if the state–state clause in the investment treaty is general and does not explicitly deviate from customary international law on diplomatic protection, the customary international law rules must be followed (*Italy v. Cuba*).

3.2.1 Italy v. Cuba (2003)

The ad hoc arbitration initiated in 2003 by Italy against Cuba under Article 10 of the 1993 Cuba–Italy BIT is the first publicly known state–state BIT case where investor–state arbitration would have been an alternative option, under Article 9 of the treaty (Potestà, 2012, pp. 344–345). Italy brought two types of claims: 1) a diplomatic protection claim asserting the investment protection of Italian investors; and 2) a direct claim to defend its own substantive rights.²⁹ On January 1, 2008, the tribunal dismissed all of Italy’s claims on the basis of either jurisdiction or merits.³⁰

Cuba had argued that the existence of investor–state provisions in the treaty barred Italy from bringing a diplomatic protection claim. The tribunal, however, rejected Cuba’s argument by majority. In the absence of any provision dealing with the relationship between investor–state and state–state dispute settlement in the Cuba–Italy BIT, the tribunal decided that the investor’s home country could exercise diplomatic protection as long as the investor had neither consented to arbitrate with the host state nor submitted the dispute to investor–state arbitration (and given consent in that way).³¹ In other words, once the investor accepted the offer of consent to arbitrate or filed investor–state arbitration, the diplomatic protection claim of the home state based on the state–state dispute settlement clause in the treaty would be precluded. In reaching the ruling, the tribunal referred to the view taken by the tribunal in *CMS v. Argentina* holding that diplomatic protection is complementary to investor–state dispute settlement,³² and also drew analogy from Article 27 of the ICSID Convention (to which Cuba is *not* a party).³³ The tribunal found that, given that no investor–state arbitration process had been commenced between any of the investors and Cuba, Italy was entitled to bring diplomatic protection claims.

²⁶ Article 36(1) of the ICJ Statute: “The jurisdiction of the Court comprises all cases which the parties refer to it and all matters specially provided for in the Charter of the United Nations or in treaties and conventions in force.”

²⁷ United States Department of State (n.d.).

²⁸ *Italian Republic v. Republic of Cuba*, Ad hoc state-state arbitration, Final Award (sentence finale), January 15, 2008. Retrieved from <http://www.italaw.com/cases/580>

²⁹ See Roberts (2014, p. 7). See also Babiy, L. (2012).

³⁰ *Italian Republic v. Republic of Cuba*, Ad hoc state-state arbitration, Final Award (sentence finale), January 15, 2008. The tribunal was comprised of Prof. Attila Tanzi (claimant’s nominee), Dr. Nacirso A. Cobo Roura (respondent’s nominee) and Yves Derains (president).

³¹ *Italian Republic v. Republic of Cuba*, Ad hoc state-state arbitration, Interim Award (sentence preliminaire), March 15, 2005, para. 65.

³² See *CMS Gas Transmission Co. v. Argentine Republic*, ICSID No. ARB/01/8, Decision of the Tribunal on Objections to Jurisdiction, para. 45 (July 17, 2003). The tribunal states that “diplomatic protection is intervening as a residual mechanism to be resorted to in the absence of other arrangements recognizing the direct right of action by individuals.”

³³ *Italian Republic v. Republic of Cuba*, Ad hoc state-state arbitration, Interim Award (sentence preliminaire), 15 March 2005, para. 65.



In the diplomatic protection claims (originally on behalf of 16 investors, reduced to six investors at the merits stage),³⁴ the tribunal applied the conditions of diplomatic protection under customary international law, i.e., the nationality and exhaustion of local remedies requirements. In other words, the tribunal found that the state–state dispute settlement clause in the treaty did not vary in terms of the requirements that would apply to a claim for diplomatic protection under customary international law. Accordingly, the tribunal decided to follow the ICJ’s ruling on the nationality requirement in the *Barcelona Traction* case, which only allowed the home state of the corporation to bring diplomatic protection with regard to the injury directed at the corporation.³⁵ For the requirement of exhaustion of local remedies, the tribunal rejected Italy’s argument that the investor–state dispute settlement clause in the BIT constituted a waiver to the exhaustion requirement, noting that nothing in that clause would indicate that the states had waived the exhaustion rule for the purpose of diplomatic protection.³⁶ The tribunal ultimately rendered a merits decision on two of the diplomatic protection claims, ruling that Cuba was not liable for any breach of the BIT.³⁷ In sum, the diplomatic protection claims were all dismissed by the tribunal: four on jurisdictional grounds³⁸ and two on the merits.

3.2.2 Summary of Key Issues

The *Italy v. Cuba* case indicates that where a treaty provides for both state–state and investor–state dispute settlement and the treaty does not clarify the relationship between the two, the existence of an investor–state dispute settlement clause cannot bar the initiation of a diplomatic protection claim under state–state dispute settlement until an investor–state case has been filed.

Italy v. Cuba also suggests that a diplomatic protection claim based on the state–state dispute settlement clause will have to adhere to the same conditions required for the diplomatic protection under customary international law, unless specifically regulated otherwise in the treaty, including the conditions relating to nationality and exhaustion of local remedies. The *Italy v. Cuba* tribunal came to this conclusion even though the same treaty included an investor–state clause, pursuant to which exhaustion would not have been required. The tribunal concluded that this did not constitute a waiver to the requirement to exhaust local remedies for the purpose of the diplomatic protection claim.

3.3 INTERPRETIVE CLAIMS

The broadly defined scope of state–state dispute settlement clauses allows state parties to file claims over the disputes arising from treaty interpretation. The interpretation could serve either a general rule-making purpose or the clarification of a treaty provision that is relevant to a specific dispute. Interpretive rulings could play a potentially important role in the context of investment treaties, where the state parties face great uncertainty in respect of the scope and meaning of their rights and their obligations vis-à-vis each other as well as investors. To date, we know of two cases that have involved interpretive claims under investment treaties (*Peru v. Chile* and *Ecuador v. United States*).

3.3.1 Peru v. Chile (2003)

In *Peru v. Chile* the claimant state aimed at clarifying a provision that was at the heart of an investor–state dispute that a Chilean investor, Lucchetti, had already initiated against Peru. In *Lucchetti v. Peru*, the Chilean investor filed ICSID arbitration against Peru under the Chile–Peru BIT, two years after it entered into force.³⁹

³⁴ At the first stage of the proceeding, Italy brought claims on behalf of 16 investors. Italy pursued six claims (concerning six out of originally 16 investors) at the merits stage. See Interim Award, para. 23; Final Award, para. 55.

³⁵ *Italian Republic v. Republic of Cuba*, Ad hoc state-state arbitration, Interim Award (sentence préliminaire), 15 March 2005, para. 53; *Italian Republic v. Republic of Cuba*, Ad hoc state-state arbitration, Final Award (sentence finale), January 15, 2008, para. 204.

³⁶ *Italian Republic v. Republic of Cuba*, Ad hoc state-state arbitration, Interim Award (sentence préliminaire), 15 March 2005, para. 90.

³⁷ *Italian Republic v. Republic of Cuba*, Ad hoc state-state arbitration, Final Award (sentence finale), January 15, 2008, pp. 103–104.

³⁸ The tribunal found that the four concerned investors could not be regarded as natural or legal persons of Italian nationality, i.e., were not subject to investment protection under the treaty. See Final Award, paras. 195–221.

³⁹ *Empresas Lucchetti, S.A. and Lucchetti Peru, S.A. v. The Republic of Peru*, ICSID Case No. ARB/03/4, Award, February 7, 2005. The Chile–Peru BIT was signed in 2000 and entered into force in 2001.



Peru considered the *Lucchetti v. Peru* case was outside the jurisdiction of the tribunal, arguing that the dispute with Lucchetti existed before the BIT entered into force and that such disputes were explicitly excluded from the treaty scope by its Article 2.⁴⁰ After diplomatic efforts to find a common ground with Chile on this matter failed, Peru lodged state–state arbitration against Chile in 2003,⁴¹ based on the dispute settlement clause in the same BIT.⁴² The stated objective was to obtain an authoritative interpretation of the contested provision.

A few days after the constitution of the tribunal in *Lucchetti v. Peru*, Peru sought a suspension of the ongoing investor–state case, because the “Claimants’ Request for Arbitration was the subject of a concurrent state–state dispute between Peru and Chile.”⁴³ The *Lucchetti* tribunal declined the request for suspension raised by Peru, stating that “the conditions for a suspension of the proceedings were not met.”⁴⁴ While the state–state arbitration seems to have been filed under UNCITRAL arbitration rules (Peterson, 2003), it is not known whether the claim was pursued any further.⁴⁵ Meanwhile, *Lucchetti v. Peru* was decided in favour of Peru: The tribunal declined jurisdiction and the subsequent annulment application by the investor did not succeed.⁴⁶

3.3.2 Ecuador v. United States (2011)

An investor–state tribunal in a dispute brought by Chevron against Ecuador had issued an interpretation of a provision on “effective means,” with which Ecuador did not agree. After Ecuador’s interpretation request to the United States allegedly remained unanswered, Ecuador sought an authoritative interpretation from a state–state tribunal. Reportedly, Ecuador later argued that the purpose of the claim was to clarify the meaning of the provision for future cases rather than to appeal the tribunal’s decision in the *Chevron* case (Peterson, 2012). The state–state tribunal ultimately never rendered an interpretative decision because it declined jurisdiction by majority, determining that there was no “dispute,” an element that was required in the state–state arbitration clause.

Following a decision in favour of the investor rendered in the partial award on the merits in the UNCITRAL case *Chevron v. Ecuador*⁴⁷ based on the Ecuador–United States BIT (1993),⁴⁸ Ecuador initiated state–state arbitration against the United States under the same BIT in 2011.⁴⁹ The state–state case, arbitrated under

⁴⁰ Ibid.

⁴¹ The exact date of the commencement of the state–state procedure is not known. However, several sources state that the registration of the investor–state claim preceded the state–state claim. See Peterson, L. E. (2003).

⁴² Article 9(1) and (2) “Controversias entre las Partes Contratantes” [Disputes between Contracting States] of the Chile–Peru BIT (2000) reads: “1. Las controversias entre las Partes Contratantes relativas a la interpretación o aplicación del Convenio serán resueltas mediante canales diplomáticos. 2. En caso de que ambas Partes Contratantes no pudieren llegar a un acuerdo dentro de seis meses, la controversia será, a petición de cualquiera de las Partes Contratantes, remitida a un tribunal arbitral compuesto por tres miembros. Cada Parte Contratante deberá designar a un árbitro, y esos dos árbitros deberán designar a un Presidente, que deberá ser nacional de un tercer Estado.”

⁴³ *Empresas Lucchetti, S.A. and Lucchetti Peru, S.A. v. The Republic of Peru*, ICSID Case No. ARB/03/4, Award, February 7, 2005, para. 7.

⁴⁴ See *Lucchetti Peru, S.A. v. Peru*, ICSID Case No. ARB/03/4, Award, February 7, 2005, para. 9.

⁴⁵ According to Peterson (2011), it “appears to have been abandoned after arbitrators in the separate *Lucchetti v. Peru* investor–state case declined to suspend their own proceedings.”

⁴⁶ *Empresas Lucchetti, S.A. and Lucchetti Peru, S.A. v. The Republic of Peru*, ICSID Case No. ARB/03/4, Award, February 7, 2005, p. 25; *Industria Nacional de Alimentos, S.A. and Indalsa Perú, S.A.* (previously *Empresas Lucchetti, S.A. and Lucchetti Peru, S.A.*), ICSID Case No. ARB/03/4, Decision on Annulment, September 5, 2007, p. 31.

⁴⁷ *Chevron Corporation and Texaco Petroleum Company v. Republic of Ecuador*, PCA Case No. 34877, UNCITRAL Arbitration Rules, Partial Award on the Merits, March 30, 2010.

⁴⁸ Article VI 3 (a)(iii) of the Ecuador–United States BIT (1993): “Provided that the national or company concerned has not submitted the dispute for resolution under paragraph 2 (a) or (b) and that six months have elapsed from the date on which the dispute arose, the national or company concerned may choose to consent in writing to the submission of the dispute for settlement by binding arbitration: [...] or (iii) in accordance with the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL).”

⁴⁹ Article VII of the Ecuador–United States BIT (1993): “1. Any dispute between the Parties concerning the interpretation or application of the Treaty which is not resolved through consultations or other diplomatic channels, shall be submitted, upon the request of either Party, to an arbitral tribunal for binding decision in accordance with the applicable rules of international law. In the absence of an agreement by the Parties to the contrary, the arbitration rules of the United Nations Commission on International Trade Law (UNCITRAL), except to the extent modified by the Parties or by the arbitrators, shall govern [...]”



the UNCITRAL Rules with the PCA acting as the registry,⁵⁰ concerned the interpretation and application of Article II(7) of the BIT, which stipulates that “[e]ach Party shall provide effective means of asserting claims and enforcing rights with respect to investment, investment agreements, and investment authorizations.” The partial award in *Chevron v. Ecuador* had determined that Ecuador breached Article II(7) by failing to afford Chevron such means in its domestic legal system because of undue delays in rendering judgments related to the *Chevron* case.⁵¹ The tribunal considered that the BIT provision established a *lex specialis* to which “a distinct and potentially less-demanding test” applied than the one required for denial of justice under customary international law.⁵²

Ecuador disagreed with the interpretation of the Chevron tribunal on Article II(7). A few months after the March 2010 decision, it sent a diplomatic note to the United States seeking clarity of the interpretation of this article, arguing that the BIT provision at issue reflected the intention of the parties to incorporate “pre-existing obligations under customary international law relating to the prohibition against denial of justice.”⁵³ According to Ecuador, the United States informally communicated through a Legal Adviser of the U.S. State Department that the Government would not respond on the matter;⁵⁴ the U.S. Government later claimed this allegation to be false.⁵⁵

After the informal communication, Ecuador initiated a state–state arbitration process. It maintained that it had a dispute with the United States regarding the proper interpretation of Article II(7), and sought an authoritative interpretation from the international tribunal.⁵⁶ During the proceeding, Ecuador reportedly stated the purpose of the claim was not to use the state–state arbitration to challenge the 2010 award, as alleged by the United States,⁵⁷ but rather to seek “a forward-looking decision which would help bring clarity to its obligations under the U.S.–Ecuador bilateral investment treaty” (Peterson, 2012).

The dispute engaged several important legal questions, including whether states can use state–state arbitration to impose a definitive interpretation of treaty clauses, and whether such interpretation may, in turn, affect the status or effect of awards already rendered by investor–state tribunals.

The “dispute” requirement

In the final award of the state–state arbitration, the majority of the tribunal dismissed the claim based on jurisdiction, concluding that no “dispute” existed between Ecuador and the United States (Hepburn & Peterson, 2012).⁵⁸ Specifically, the United States contended that, according to Article VII of the BIT (“[a]ny *dispute* between the Parties concerning the interpretation or application of the Treaty”), in order to initiate state–state dispute settlement, a dispute must exist in the first place. However, for the present case, the United States argued that there was no concrete dispute, because non-response did not generate divergent views regarding the interpretation. In its statement of defense, the United States emphasized that “[a]s such,

⁵⁰ *Republic of Ecuador v. United States of America* (PCA Case No. 2012-5). The final award (September 29, 2012) dismissing the jurisdiction is not public.

⁵¹ *Chevron Corporation and Texaco Petroleum Company v. Republic of Ecuador*, PCA Case No. 34877, UNCITRAL Arbitration Rules, Partial Award on the Merits, March 30, 2010, paras. 270 and 275.

⁵² *Ibid.*, para. 244.

⁵³ *Republic of Ecuador v. United States of America* (PCA Case No. 2012-5), Request of the Republic of Ecuador, June 28, 2011, paras. 7 and 8.

⁵⁴ *Ibid.*, para. 13.

⁵⁵ *Republic of Ecuador v. United States of America* (PCA Case No. 2012-5), Statement of Defense of Respondent United States of America, March 29, 2012, p. 7.

⁵⁶ *Republic of Ecuador v. United States of America* (PCA Case No. 2012-5), Request of the Republic of Ecuador, June 28, 2011, para. 15.

⁵⁷ *Republic of Ecuador v. United States of America* (PCA Case No. 2012-5), Statement of Defense of Respondent United States of America, March 29, 2012, pp. 1-2.

⁵⁸ *Republic of Ecuador v. United States of America* (PCA Case No. 2012-5). The final award (September 29, 2012) dismissing the jurisdiction is not public.



Ecuador and the United States are not in positive opposition concerning a concrete set of facts affecting the parties' legal rights and obligations, as required by international law."⁵⁹

The majority of the tribunal sided with the United States in this regard, holding that the absence of a U.S. response on the matter did not generate any dispute, but it was reported that the majority also noted that “if the United States had opposed Ecuador’s views on Article II(7) or actively supported the Chevron tribunal’s views, there might have been a dispute eligible for [interstate] arbitration” (Hepburn & Peterson, 2012). As to the majority’s main finding, Ecuador’s nominee, Prof. Raúl Vinuesa, dissented, holding that a dispute existed. He argued that in order to respond to Ecuador’s interpretation request, the United States could either agree or dispute. So the actual silence of the United States should be conceived as giving rise to a dispute (Hepburn & Peterson, 2012).

The relationship between two treaty-based dispute settlement tracks

In terms of the relationship between these two treaty-based dispute settlement tracks, the majority of the tribunal—according to press reports—held that a state–state arbitration case should not impact a parallel investor–state case (Hepburn & Peterson, 2012). The United States had argued it was under no obligation to take a position on the contested BIT provision, particularly as it wished not to interfere with ongoing investor–state proceedings.⁶⁰ Furthermore, the United States asserted that the treaty did not grant the state–state tribunal an “advisory jurisdiction” or establish “an appellate mechanism.”⁶¹ It opposed the use of the state–state mechanism for the purpose of “[c]ompelling States to reach an agreed interpretation in the context of an investor–State dispute whenever demanded by another State.”⁶² The United States argued that an attempt of this kind was contrary to the treaty’s object and purpose, and would lead to “negative and destabilizing consequences.”⁶³ In line with this, an expert opinion stated that Ecuador’s interstate claim, were it accepted, could “do significant injury to the international investment regime.”⁶⁴ The expert argued that the interpretation of substantive rights and guarantees in the BIT was reserved for the investor–state track once that process had been engaged, and thereby the interstate track could not be invoked to amend the interpretation issued by the investor–state tribunal.⁶⁵ This opinion was later criticized in academic journals.⁶⁶

3.3.3 Summary of Key Issues

The recent *Ecuador v. United States* case has made clear that the subject matter of interpretive state–state arbitration must be a “dispute” between the state parties. Silence on the part of one party in response to an interpretation enquiry is insufficient to amount to a dispute. Again, while another state–state tribunal could come to a different conclusion, as indicated in the dissenting opinion in the case, a less stringent approach to the dispute requirement could only be achieved with certainty through different language that avoids the

⁵⁹ *Republic of Ecuador v. United States of America* (PCA Case No. 2012-5), Statement of Defense of Respondent United States of America, March 29, 2012, p. 2.

⁶⁰ *Ibid.* See also *Republic of Ecuador v. United States of America* (PCA Case No. 2012-5), Statement of Defense of Respondent United States of America, March 29, 2012, p. 11. The United States maintained: “Each State Party has the right, but not the obligation, to interpret the Treaty and to comment on the other Party’s interpretation of the Treaty” (p. 3). It also asserted “the basic principle that treaty parties *may*, but are not required to, agree on subsequent interpretation” (p. 11).

⁶¹ *Republic of Ecuador v. United States of America* (PCA Case No. 2012-5), Statement of Defense of Respondent United States of America, March 29, 2012, pp. 11 and 12.

⁶² *Ibid.*, pp. 11-12.

⁶³ *Ibid.*

⁶⁴ *Republic of Ecuador v. United States of America* (PCA Case No. 2012-5), Expert Opinion of Prof. W. Michael Reisman, April 24, 2012, para. 5.

⁶⁵ *Ibid.*, para. 3.

⁶⁶ E.g., Roberts (2014, pp. 4-5, pp. 10-20).



reference to “dispute” or a clarification in the text. An option would be to explicitly clarify that silence of a state with respect to an interpretation by the other state party should be understood as an opposition to that interpretation, leading to the existence of a dispute.

The unresolved issues raised in the *Ecuador v. United States* case in respect of its relationship to the parallel *Chevron v. Ecuador* procedure further indicate that it would be useful for states to clarify in explicit terms the effect that a state–state procedure has on ongoing disputes between the investor and the host state, in case the treaty provides for both state–state and investor–state arbitration.

3.4 CLAIMS FOR DECLARATORY RELIEF

A third category of investment-related state–state disputes are claims for declaratory relief (Roberts, 2014, p. 66-68). A home state could seek a declaration that a host state measure or the abstention from certain actions has breached one or more treaty provisions.

The claim for declaratory relief by a home state, unlike the diplomatic protection claim, would seek declaratory (i.e., non-pecuniary) relief and not focus on whether a particular investor has suffered injury and whether compensation is due. Declaratory decisions may, however, involve that a tribunal makes recommendations—but no orders that are binding—that a host state ceases certain actions or carries out others to achieve compliance with treaty commitments if inconsistency is determined.

From a home state perspective, declaratory claims could give the possibility to bring about clarity about a host state measure; for instance, if the claimant considers it to potentially affect numerous home state investors in the host state. This could lead to subsequent investor–state claims, and the home state might wish to avoid it by seeking a declaratory relief.

Declaratory relief claims could arguably also be pursued by a host state, which could use the state–state mechanism to determine that a measure is consistent with its obligations under a treaty; for example, to avoid future claims of investors or in light of a looming investor–state arbitration: “If the host state is facing many claims, it might wish to have a single award dealing with all of the claims at once to ensure consistency” (Roberts, 2014, p. 68). However, in the absence of case law on this type of claim, it is unclear whether such claims can reasonably be considered to fall within the scope of state–state arbitration provisions commonly found in treaties today. In particular, it might be argued that this type of host state claim is not possible because of the absence of a “dispute” between treaty partners. If states wished to allow for such claims, it would therefore be advisable for them to explicitly express their intent in their treaty and lay out the procedures to follow.

Joint determination procedures

Some treaties set out specific rules for declaratory disputes. For instance, they expressly provide that certain governmental measures, in particular taxation and financial measures, are to be submitted to the state–state dispute settlement mechanism, rather than to the investor–state mechanism, to determine whether treaty violations occurred. The state–state process is typically preceded by a joint determination procedure by the authorities of the state parties. When the joint determination procedure is unable to deliver a determination within a given timeframe, either state could file a claim for declaratory relief before a state–state tribunal. For example, Article 20(2) of the Canada–China foreign investment promotion and protection agreement (FIPA) refers to a state–state arbitral process to determine whether a disputed measure in an investor–state case constitutes a prudential financial measure and thereby qualifies as an exception under the treaty. The



state–state arbitration kicks in if the states fail to reach a joint determination within 60 days. The same article provides that “[t]he decision of the State–State arbitral tribunal shall be transmitted to the investor–State tribunal, and shall be binding on the investor–State tribunal.”

3.4.1 Mexico v. United States (2000)

In the NAFTA case *Mexico v. United States* (in the Matter of Cross-Border Trucking Services), Mexico filed a state–state arbitration claim against the United States based on the dispute settlement clauses in NAFTA Chapter 20, after several attempts to resolve the dispute through consultations between both states and meetings of the NAFTA Free Trade Commission did not succeed.⁶⁷ According to Article 2004, “the dispute settlement provisions of this Chapter shall apply with respect to the avoidance or settlement of all disputes between the Parties regarding the interpretation or application of this Agreement or wherever a Party considers that an actual or proposed measure of another Party is or would be inconsistent with the obligations of this Agreement [...]”

In this case, Mexico alleged that the United States had violated obligations under NAFTA to afford national treatment and most-favoured nation (MFN) treatment for cross-border services with respect to Mexico and potential Mexican investment. According to Mexico, these breaches were due to the failure of the United States to lift a moratorium on processing applications by Mexican-owned trucking firms.⁶⁸ The tribunal upheld jurisdiction and Mexico’s claim on the merits in 2001, finding that the United States had breached the two non-discrimination obligations in NAFTA Chapter 11 on investment and Chapter 12 on cross-border trade in services.⁶⁹ In 2000 when the Panel was constituted, and in 2001 when the final decision was reached, no prior investor–state cases had been initiated against the United States on this issue.

Because Mexico had not brought the case on behalf of specifically named investors, the United States demanded that Mexico name specific Mexican nationals interested in trucking-related investment in the United States and affected by the moratorium.⁷⁰ The United States argued that Mexico would then have to prove that these individuals or enterprises meet the treaty’s definition of investor in NAFTA Chapter 11.⁷¹ Since Mexico did not do so, the United States claimed that Mexico had not met the burden of proof for treaty violations. However, the tribunal determined that the moratorium was inconsistent with NAFTA provisions “even if Mexico cannot identify a particular Mexican national or nationals that have been rejected.”⁷²

Several years later, in 2009, a Mexican association of trucking companies, Cámara Nacional del Autotransporte de Carga (CANACAR), brought an UNCITRAL investor–state arbitration under NAFTA Chapter 11 to seek compensation for violations of national treatment, MFN and minimum standard of treatment related to the same subject matter decided in *Mexico v. United States*. Referring to the tribunal’s findings in the state–state arbitration, CANACAR pointed out that the United States had been held liable for NAFTA violations

⁶⁷ *Mexico v. United States* (in the Matter of Cross-Border Trucking Services), NAFTA Chapter 20 State-to-State arbitration, Final Report of the Panel, February 6, 2001, paras. 15-24.

⁶⁸ *Ibid.* See also Roberts (2014, p. 9).

⁶⁹ *Mexico v. United States* (in the Matter of Cross-Border Trucking Services), NAFTA Chapter 20 State-to-State arbitration, Final Report of the Panel, February 6, 2001, paras. 295 and 297.

⁷⁰ *Mexico v. United States* (in the Matter of Cross-Border Trucking Services), NAFTA Chapter 20 State-to-State arbitration, Final Report of the Panel, February 6, 2001, paras. 147, 182, 283.

⁷¹ *Ibid.*, para. 182. NAFTA Article 1139: Definitions (Chapter 11) determines that “investor of a Party means a Party or state enterprise thereof, or a national or an enterprise of such Party, that seeks to make, is making or has made an investment.”

⁷² *Ibid.*, para. 292. The tribunal further noted: “Where there have been direct violations of NAFTA, as in this case, there is no requirement for the Panel to make a finding that benefits have been nullified or impaired; it is sufficient to find that the U.S. measures are inconsistent with NAFTA.”



by unanimous opinion.⁷³ It appears that this process was discontinued and a tribunal never constituted.⁷⁴ The question therefore remains open whether the investor–state tribunal would have been bound by the determination of the state–state tribunal (Roberts, 2014, p. 9).

3.4.2 Summary of Key Issues

The *Mexico v. United States* arbitration indicates that, under a NAFTA Chapter 20-type clause, a home state can bring a claim for declaratory relief independently of proving that specific investors were affected. Further, since this was not considered a diplomatic protection claim, the fulfillment of nationality and exhaustion of local remedies requirements was not considered a prerequisite.

The NAFTA, like most other similar agreements that include both state–state and investor–state arbitration, does not provide guidance on how a possible later or parallel investor–state case will be affected by the state–state process and outcome. To avoid uncertainty, treaty parties could specifically address this point. An example of such clarification—albeit in a more limited context—is provided in the China–Canada FIPA example above, where the parties provide that the determination of the state–state tribunal with respect to the prudential exception is binding on the investor–state tribunal.

⁷³ *CANACAR (as representative of its constituents) v. the US (NAFTA)*, Notice of Arbitration, April 2, 2008, p. 3.

⁷⁴ *US Department of State, CANACAR v. United States of America*. Retrieved from <http://www.state.gov/s/l/c29831.htm>.



4.0 Provisions Dealing With the Relationship Between State–State and Investor–State Dispute Settlement

The majority of investment treaties provide for not only state–state but also investor–state arbitration. However, only very few agreements explicitly address the relationship between the two mechanisms, leaving it to the arbitral tribunals and panels to decide on the matter. Given that only a very limited number of state–state cases have been filed so far, arbitral tribunals have only touched upon a few issues as to the scope of state–state dispute provision vis-à-vis investor–state arbitration in treaties, leaving the majority of questions unaddressed. Moreover, since there is no binding precedent in arbitration, there is no certainty that future tribunals would adopt the conclusions reached in past cases. Trends cannot be identified with so few cases either. This section presents provisions found in the ICSID Convention and BITs that give additional indications for the interaction between the two mechanisms.

4.1 ARTICLE 27 OF THE ICSID CONVENTION

The International Centre for Settlement of Investment Disputes (ICSID) is an international arbitration institution that facilitates arbitration of legal disputes between investors and host states. It is not an investment treaty and does not set up a permanent body of judges or panel members to decide cases, as known in the context of the ICJ or the WTO Appellate Body. It simply sets out the rules for resolving the disputes, without providing the substantive rights and obligations. The ICSID Convention expressly addresses and clarifies the relationship between investor–state arbitration and the use of diplomatic protection. Article 27(1) stipulates that, when a submission is made to ICSID arbitration, diplomatic protection or an international claim is categorically excluded, except in case of non-compliance with an investor–state arbitral award:

Article 27

(1) No Contracting State shall give diplomatic protection, or bring an international claim, in respect of a dispute which one of its nationals and another Contracting State shall have consented to submit or shall have submitted to arbitration under this Convention, unless such other Contracting State shall have failed to abide by and comply with the award rendered in such dispute.

(2) Diplomatic protection, for the purposes of paragraph (1), shall not include informal diplomatic exchanges for the sole purpose of facilitating a settlement of the dispute.

According to a 2009 Commentary to the ICSID Convention, the inclusion of the phrase “an international claim” as separate from diplomatic protection aims at preventing that two different arbitration procedures arise from the same claim as a result of the existence of state–state arbitration clauses in many BITs: one under ICISD between the investor and the host state, and the other between the two treaty partners also based on the alleged violation of the investment treaty (Schreuer, Malintoppi, Reinisch, & Sinclair, 2009, p. 420). The ICSID Commentary notes that an interstate tribunal may be expected to decline jurisdiction based on the violation of Article 27 of the ICSID Convention if the interstate claim is designed to avoid, obstruct or influence an ICSID arbitration, or to affect the implementation of an ICSID award or to revise its outcome (Schreuer et al., 2009, p. 421).

Despite these clarifications, the ICSID provision leaves many questions unanswered. If a simultaneous diplomatic protection claim is not permitted, what about an interpretive claim? What impact would an interpretation resulting from a state–state procedure have on an investor–state tribunal? What if a diplomatic



protection claim is brought before an investor–state case is launched? Are investors allowed to still bring a claim if they are not satisfied with the outcome of a diplomatic protection claim? The few treaties incorporating provisions on the relationship between investor–state dispute settlement and diplomatic protection claims do little to provide guidance on the questions raised. Typically, they repeat the rule laid out in Article 27 of the ICSID Convention or they do the seemingly opposite, stating that the investor–state process should not prejudice state–state processes.

4.2 PROVISIONS IN INVESTMENT TREATIES DEALING WITH THE RELATIONSHIP BETWEEN STATE–STATE AND INVESTOR–STATE DISPUTE SETTLEMENT

For example, the Turkey–United States BIT (1985) incorporates the following provision, barring the interstate dispute settlement track once an investor–state claim has been filed:⁷⁵

Article VII

(7) This Article [state-state dispute settlement clause, added] shall not be applicable to a dispute which has been submitted to and is still before the Centre pursuant to Article VI [investor–state dispute settlement clause, added].⁷⁶

Another example is the Germany–Poland BIT (1989), which stipulates that, once the investor and the respondent state consent to the ICSID arbitration, the interstate arbitral tribunal may not be resorted to, in accordance with Article 27(1) of the ICSID Convention:

Article 10

(6) If both Contracting Parties are members of the Convention of 18 March 1965 on the settlement of investment disputes between states and nationals of other states the arbitral tribunal provided for above (State-to-State arbitral tribunal, added) may in consideration of the provisions of paragraph 1 of Article 27 of the said Convention not be appealed to in so far as agreement has been reached between the investor of one Contracting Party and the other Contracting Party under Article 25 of the Convention. This shall not affect the possibility of appealing to such arbitral tribunal in the event that a decision of the Arbitral Tribunal established under the said Convention is not complied with (Article 27) [...]. [emphasis added]⁷⁷

Likewise, some treaties import the relationship arrangement provided for in ICSID Convention Article 27(1). For example, Article 14(8) of the Investment Agreement of the ASEAN–China FTA (2009) incorporates a clause identical to the ICSID Convention. The ASEAN Comprehensive Investment Agreement (2009) uses the same wording in Article 34(3).

In any event, where both disputing states are ICSID Contracting States, ICSID Convention Article 27 will apply irrespective of whether the investment treaties of these states have clauses dealing with the relationship of interstate and investor–state dispute settlement (Schreuer et al., 2009, p. 421).

In contrast, other treaties stipulate that investor–state arbitration is without prejudice to state–state dispute settlement, seemingly allowing for parallel proceedings, but leaving open the legal effects of each of the outcomes on the other proceeding. One example is Article 13(12) of the China–Singapore BIT (1985):

⁷⁵ Notably, this approach has been abandoned by the United States, and the 2012 U.S. Model BIT does not contain such a clause.

⁷⁶ See also Cameroon–United States BIT (1986), Article VIII (9): “This Article shall not be applicable to a dispute submitted to ICSID pursuant to Article VII(3). Recourse to the procedures set forth in this Article is not precluded, however, in the event an award rendered in such dispute is not honored by a Party, or an issue exists related to a dispute submitted to the Center but not argued or decided.” A similar clause is contained in Article VIII (7) of the Senegal–United States BIT (1983).

⁷⁷ Similar provisions exist in other German BITs, see for instance Article 10(6) in Germany’s BITs with the Barbados (1994), Bolivia (1987) and Estonia (1992).



The provisions of this Article [investor–state disputes, added] shall not prejudice the Contracting Parties from using the procedures specified in Article 14 [disputes between the contracting parties, added] where a dispute concerns the interpretation or application of this Agreement.⁷⁸

This approach is also seen in different wording in other agreements, e.g., Article XII(11) of the Canada–Venezuela BIT (1982), which provides:

Nothing in this Article [investor–state dispute settlement, added] shall deprive a Contracting Party of its right to seek compliance by the other Contracting Party with its obligations under this Agreement, including through use of the procedures set forth in Articles XIII [consultations, added] and XIV [state–state dispute settlement, added].

⁷⁸ Other examples are Article 13.11 of the China–Sri Lanka BIT (1986), Article 20 of the Canada Model FIPA (2004), Article 19 of the Canada–China BIT (2012), and Article XIII (11) of the Canada–Romania BIT (2009).



5.0 State–State Investment Disputes: Issues to consider

Evaluating the pros and cons of including both investor-state and state–state dispute settlement or including state–state dispute settlement as the sole mechanism

The vast majority of investment treaties provide for both state–state and investor–state dispute settlement, allowing investors to challenge host state laws and other executive, judicial or legislative measures pursuant to an open offer to arbitrate. Despite this prevalent approach, states should carefully consider all options, and evaluate the risks and benefits of including investor–state dispute settlement clauses in addition to state–state dispute settlement. Investor–state jurisprudence has demonstrated that investors will cross boundaries to sue for compensation that, arguably, home states would not cross, especially with respect to challenging legitimate public policy measures. Accordingly, the issue of whether or not to include investor–state in addition to state–state dispute settlement remains one of the most controversial aspects of negotiations on investment, as is currently evidenced in the EU context, where certain EU member states are voicing their concern about including investor–state dispute settlement in the trade pacts negotiated by the European Commission. Beside the option of not including any provisions on investor–state dispute settlement altogether, another approach is for treaty parties to include a “placeholder” and postpone negotiations or consultations relating to investor–state arbitration to a later stage—after treaty adoption.⁷⁹ This allows parties to wait until reforms have been put into place before submitting to investor–state dispute settlement. In a multiparty context, where some countries wish to include investor–state dispute settlement, and others do not, a further option is to include a provision allowing states to opt out of investor–state dispute settlement.⁸⁰

Whatever the approach taken with respect to investor–state dispute settlement, getting the state–state process right should not be neglected. The few state–state cases known to date together with some lessons learned in the context of investor–state arbitration give us some indication what to pay attention to.

Requiring exhaustion of local remedies before initiating state–state litigation and other customary international law requirements

Regardless whether states decide to include state–state dispute settlement alone or alongside investor–state dispute settlement, it is recommended that they clarify whether they wish to follow customary international law and require the exhaustion of local remedies before a state–state diplomatic protection claim can be initiated. For example, the SADC Model unequivocally provide that states could file diplomatic protection claims on behalf of investors on the condition of exhaustion of local remedies prior to international arbitration, unless no reasonably available domestic remedies are in place. States could also clarify if they wish to apply the customary international law rule regarding the investor’s nationality.

⁷⁹ Article 107 (Further Negotiation) of the Japan–Philippines EPA reads: “1. The Parties shall enter into negotiations after the date of entry into force of this Agreement to establish a mechanism for the settlement of an investment dispute between a Party and an investor of the other Party [...]”; Article 11.16 (Consultations on Investor–State Dispute Settlement) of the Australia–United States FTA reads: “1. If a Party considers that there has been a change in circumstances affecting the settlement of disputes on matters within the scope of this Chapter and that, in light of such change, the Parties should consider allowing an investor of a Party to submit to arbitration with the other Party a claim regarding a matter within the scope of this Chapter, the Party may request consultations with the other Party on the subject, including the development of procedures that may be appropriate [...]”

⁸⁰ A footnote in the draft TPP investment chapter (leaked in June 2012) stated: “Section B [Investor–State Dispute Settlement, added] does not apply to Australia or an investor of Australia. Notwithstanding any provision of this Agreement, Australia does not consent to the submission of a claim under this Section.” See Draft TPP Investment Chapter, retrieved from <http://www.citizenstrade.org/ctc/wp-content/uploads/2012/06/tppinvestment.pdf>. It needs to be noted here that the Australian government has changed its position in the meantime.



Thoughtfully designing the state–state dispute settlement mechanism

Also regardless whether or not investor–state arbitration is included alongside state–state dispute settlement, it is worthwhile for states to consider the various forms of state–state dispute settlement possible. While some older treaties provide for the judicial settlement of state–state disputes at the ICJ, most treaties today involve ad hoc arbitration. This should not mean, however, that the ICJ option should be a *priori* ruled out. Rather, it is worth for states to assess the benefits of this option, considering its judicial and international nature. Also, although ad hoc arbitration is the prevalent form used in investment treaties today, it is not necessarily the most appropriate for resolving treaty-based investment disputes between state parties. In particular, we have seen in the context of investor–state arbitration that treaty-based investment arbitration based on a commercial ad hoc arbitration model can be problematic, raising issues relating to arbitrator impartiality and independence, secrecy of proceedings, lack of predictability and consistency, etc. These issues could arise in a similar fashion in the state–state context, because the pool of arbitrators and the applicable arbitration rules are largely the same as in the investor–state context. The general expectation is that the dynamics in a purely interstate dispute will be significantly different from the outset, because states are presumably less likely to challenge certain types of regulatory measures, or make certain types of legal arguments that could be brought against them in the future. Even so, it would be useful to consider and weigh the pros and cons of ad hoc third-party adjudication versus a more permanent, judicial or quasi-judicial mechanism.

Clarifying the meaning of “dispute concerning the interpretation or application of the treaty” or allowing for (advisory) opinions

Most treaties provide for state–state dispute settlement about the interpretation or application of the treaty. Jurisprudence shows that this might be interpreted narrowly, especially with respect to the requirement that there be a “dispute” about the interpretation or application. In *Ecuador v. United States*, the tribunal found the United States’ silence about the interpretation of a treaty provision could not be understood as an opposition, and that therefore there was no dispute, so that it did not have jurisdiction. In order to make the use of the state–state process more predictable and avoid such a situation, states could make clear that they understand the definition of “dispute” broadly to include instances where one state refuses to take position on a matter of interpretation raised by another state party. Another option would be to avoid the term “dispute” altogether and allow for advisory opinions by third parties.

Clarifying the interrelationship between state–state and investor–state dispute settlement, and their respective roles

If states choose to provide for both state–state and investor–state dispute settlement in their treaties, they should consider clarifying the role of state–state dispute settlement and, possibly, providing for a clearer and more relevant role. Currently, treaties are generally silent as to the relationship, leaving it to tribunals to decide how the two processes interrelate, and whether and how one tribunal might be bound by another. Some treaties have made clarifications with respect to certain types of issues, like in the recent Canada–China agreement with respect to prudential measures, where the two procedures are integrated entirely.

If a state wanted to strengthen and clarify the state–state process, several steps could be taken in the text of new agreements, or through the amendment or interpretation of existing agreements. In particular, states could clarify whether and in which situations the state–state decision should be binding for subsequent state–state or investor–state tribunals. States could also clarify how parallel state–state and investor–state cases might be coordinated, for example, if one had to be suspended in certain circumstances.



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