# State-to-State Dispute Settlement Pursuant to Bilateral Investment Treaties: Is There Potential?

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## 1 Introduction

It is well known that one of the most salient innovations brought by the now almost 3,000 Bilateral Investment Treaties (BITs) entered into by States in the last 50 years has been the incorporation of provisions on the settlement of investment disputes granting investors of the home State the right to directly resort to international arbitration against the host State (investor-State arbitration).[1] Thanks to these provisions generally contained in BITs, the last few decades have experienced a "boom" in such treaty-based investor-State cases initiated under different arbitration rules,[2] and the interest for the scope, policy, and the mechanics of

The text of this chapter has been updated as of 15 October 2011.

[1] The first BIT to provide for the contracting States' unconditional offer to resolve disputes with the foreign investor through investor-State arbitration appears to be the Italy-Chad BIT of 1969, http://itra.esteri.it, accessed 15 October 2011. See Newcombe and Paradell 2009, p. 45. Interestingly, the Italy-Chad BIT eliminated the State-to-State adjudication provision and simply provided that disputes between the two State Parties were to be resolved diplomatically (Article 7, final sentence).

[2] The majority of investor-State cases are conducted pursuant to the Rules of the International Centre for Settlement of Investment Disputes (ICSID) and the United Nations Commission on International Trade Law (UNCITRAL), with other venues (such as the Stockholm Chamber of Commerce or the International Chamber of Commerce) being used only marginally. See Latest Developments in Investor-State Dispute Settlement, IIA Monitor No. 1, UNCTAD doc. UNCTAD/WEB/DIAE/PCB/2011/3 (30 June 2011), p. 2 available at www.unctad.org, accessed 15 May 2012.

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N. Boschiero et al. (eds.), *International Courts and the Development of International Law*, DOI: 10.1007/978-90-6704-894-1_55,

investment arbitration has resulted in a now abundant literature on the topic. Investor-State arbitration is, however, not the only type of dispute settlement mechanism contained in BITs. In fact, almost all BITs also provide, in addition to investor-State arbitration, for State-to-State arbitration for the resolution of disputes between the Contracting Parties concerning the "interpretation and application" of the treaty. These clauses are the heritage of the dispute settlement provisions contained in the BITs' predecessors, the Friendship, Commerce and Navigation (FCN) Treaties, and in fact early BITs, such as the very first one entered into by Germany and Pakistan in 1959, included only the State-to-State and not the investor-State dispute settlement mechanism.[3] Despite being incorporated in almost every BIT, State-to-State dispute settlement clauses have attracted very little attention, with rare contributions being devoted to the issue. The scarce interest in inter-State arbitration pursuant to BITs is certainly to be explained by its limited success in practice. Until recently, in fact, arbitral practice had been limited to only one case in which Peru had called for the initiation of State-to-State proceedings pursuant to a BIT in an attempt to block or hinder the ongoing investor-State arbitration where it was a Respondent.[4] As the attempt proved unsuccessful, the State-to-State arbitration was no longer pursued.[5] The *terra incognita* of State-to-State arbitration has however been recently fully explored by Italy, which, acting in diplomatic protection of a group of Italian investors operating in Cuba, brought arbitration proceedings against Cuba invoking the dispute settlement procedure contained in the Italy-Cuba BIT. These proceedings culminated in the issuance of an "Interim Award" of 2005 and of a "Final Award" of 2008 by an *ad hoc* Arbitral Tribunal constituted pursuant to Article 10 of the BIT.[6] The Italy-Cuba arbitration can thus be considered as a milestone in the law of investment claims as it marks the first real attempt to invoke the inter-State dispute settlement mechanism contained in a BIT, in a scenario where investor-State arbitration would have been an alternative option according to the treaty,[7] but where the certainly more unusual avenue of inter-State arbitration was selected. The invocation of this kind of dispute settlement

[3] See, e.g., Article 11 of the Germany-Pakistan BIT of 1959, www.investmentclaims.com, accessed 15 October 2011.

[4] In 2003, Peru initiated State-to-State arbitration against Chile pursuant to the Chile-Peru BIT in response to the investment claim brought against it by the Chilean investor Lucchetti. Peru requested the suspension of the investor-State proceedings as a consequence of the inter-State arbitration. The request was denied by the investor-State Arbitral Tribunal. See ICSID: Empresas Lucchetti SA and Lucchetti Peru SA v. Peru, ARB/03/4, Award on Jurisdiction (7 February 2005), paras 7, 9.

[5] Schreuer 2007, pp. 350–351.

[6] See Arbitral Tribunal: Italy v. Cuba, Interim Award ("*Sentence Preliminaire*") (15 March 2005), and Final Award ("*Sentence Finale*") (15 January 2008), with Dissenting Opinion, http://italaw.com, accessed 15 October 2011. The Arbitral Tribunal was composed of Yves Derains (President), Attila Tanzi and Olga Miranda Bravo (later replaced by Narciso A. Cobo Roura). For a comment on the case, see Tonini 2008.

[7] See Article 9 of the Italy-Cuba BIT, providing for investor-State arbitration.

mechanism raises, as the Italian-Cuban dispute displays, a number of issues of great relevance for the architecture of the investment dispute settlement system, such as the scope of inter-State dispute resolution provisions, the possible role to be played by the exhaustion of local remedies rule, and the potential interplay between inter-State and investor-State dispute settlement.[8]

## 2 The Scope of State-to-State Dispute Settlement Clauses in BITs

A BIT State-to-State dispute settlement clause may read as follows: "any dispute between the Parties concerning the interpretation or application of this Treaty, that is not resolved through consultations or other diplomatic channels, shall be submitted on the request of either Party to arbitration for a binding decision or award by a tribunal in accordance with applicable rules of international law".[9] Similar formulations, with variations and different levels of detail as to the negotiation/consultation period, the method for appointing the arbitrators, and the applicable law, are to be found in virtually every existing BIT.[10] In examining the potential use which may be made of such clauses, the point of departure must be the understanding of the scope of such a dispute settlement clause. What kinds of controversies are likely to be considered as "disputes concerning the interpretation and application" of the BIT? Two conceptually different situations may be envisaged which may trigger the use of inter-State dispute settlement.

In the first type of scenario, arbitration proceedings may be launched by one of the Contracting Parties to the BIT against the other Contracting Party with a view to resolving questions of "abstract interpretation" of the treaty. One may for example imagine the situation where a legislative measure is enacted by the host State in violation of the relevant standards contained in the BIT (e.g., because it is discriminatory towards foreigners, or because it prohibits the transfer of capital) and where the other Contracting Party to the BIT seeks from the arbitral tribunal an interpretation of the relevant provisions of the treaty, without any national of the claimant State having (yet) been affected.[11] One difficulty in this kind of

[8] Beyond the issues which are discussed in the present paper, the Arbitral Tribunal's Interim Award and Final Award in the Italy-Cuba dispute raise several further issues which would warrant separate examination, such as the definition of "investment" pursuant to the BIT, questions of corporate nationality for the purpose of diplomatic protection in relation to the BIT's definition of "investor", and issues of attribution of State responsibility. On the latter two issues see in particular the Dissenting Opinion of Arbitrator Tanzi, appended to the Final Award.

[9] Article 37.1 of the 2004 U.S. Model BIT, www.ustr.gov/assets/Trade_Sectors/Investment/Model_BIT/asset_upload_file847_6897.pdf, accessed 15 October 2011.

[10] For an analysis of State-to-State dispute settlement clauses contained in BITs, see Sacerdoti 1997, pp. 428–436; Peters 1991, pp. 102–117.

[11] Paparinskis 2008, pp. 314–315.

scenario would be to demonstrate the existence of a 'legal dispute', a precondition to the exercise of jurisdiction by any dispute settlement body, in terms of a disagreement between the parties beyond mere hypothetical grievances.[12]

In the second type of scenario, the investor's home State could resort to the State-to-State dispute settlement procedure with the purpose of espousing its national's claim and of exercising diplomatic protection. The language of the dispute settlement clauses (extending also to the "application" of the treaty, and not simply to its "interpretation") would seem to clearly comprise issues relating to the host State's compliance with its substantive treaty obligations in a situation of concrete implementation involving foreign investors.[13] Moreover, often identically phrased dispute resolution clauses were contained in the FCN treaties and there is little doubt that disputes relating to an alleged injury to a national were subject to the dispute resolution clauses of those treaties.[14]

## 3 The Exhaustion of Local Remedies Rule

The distinction between a dispute on abstract interpretation (where the alleged violation of the treaty is said to arise directly in the relationship between the two States *inter se*) and a diplomatic protection claim (where the home State is espousing a claim of its national) is significant in view of the applicability of the rule of exhaustion of local remedies. The rule requires that local remedies be exhausted before international proceedings may be instituted and it ensures that "the State where the violation occurred should have an opportunity to redress it by its own means, within the framework of its own domestic legal system".[15]

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[12] See Schreuer 2008, pp. 970–972.

[13] One could also think of a third situation: a State may bring State-to-State proceedings if the host State which has been a respondent in a previous investor-State claim fails to abide by or to comply with the arbitral award (a scenario which is expressly addressed by Article 27 of the ICSID Convention and by many BITs, on which see *infra*). While a dispute of this kind would involve the interpretation of the obligation to comply with the award arising out of the BIT, it may not be entirely assimilated to a question of "abstract interpretation" in the first sense seen above, because it would involve and presuppose an injury (already ascertained by an investor-State arbitral tribunal) to the home State's national, on whose behalf the home State is acting. At the same time, it is different from the "classic" diplomatic protection scenario described above, because it would not involve a full litigation on the facts and substantive breaches of the BIT (on which a different tribunal has already ruled), but would merely aim at obliging the host State to comply with the arbitral award.

[14] Rubins and Kinsella 2005, p. 420. One such example is the *ELSI* case, where there was no doubt that the claim brought by the US on behalf of two American companies was subject to the State-to-State dispute settlement clause contained in the FCN Treaty between Italy and the US, which provided that "any dispute (…) as to the interpretation and the application of this Treaty" be submitted to the ICJ. See ICJ: Elettronica Sicula S.p.A. (ELSI) (United States v. Italy), Judgment (20 July 1989), paras 48–49.

[15] ICJ: Interhandel (Switzerland v. United States), Judgment (21 March 1959), p. 25.

The International Court of Justice (ICJ) referred to the rule as a "well-established rule of customary international law".[16] The question arises as to what extent the exhaustion rule should apply within the framework of inter-State arbitration proceedings in BITs.[17] BITs are silent in this regard.[18] In public international law dispute settlement generally, the rule is understood to be applicable only in cases of international claims arising from injury to natural or juridical persons, whereas it is irrelevant in claims arising from direct injury to States in their relations *inter se*.[19] As the International Law Commission (ILC) Special Rapporteur on Diplomatic Protection John Dugard explained in his Second Report of 2001, "the rule applies only to cases in which the claimant State has been injured 'indirectly', that is, through its national. It does not apply where the claimant State is directly injured by the wrongful act of another State, as here the State has a distinct reason of its own for bringing an international claim".[20] Transferring the distinction to the field of inter-State disputes pursuant to a BIT, *prima facie* the rule would thus seem to be inapplicable in the first type of scenario (dispute on abstract interpretation), and only applicable in the second one (proper diplomatic protection claims). The solution is not, however, as clear-cut as it would appear at first sight. As evidenced by the extensive discussions in Dugard's reports (as well as in the ILC's final commentary to the 2006 Draft Articles on Diplomatic Protection), the distinction between direct and indirect injuries is commonly accepted in principle, but is difficult to maintain in practice.[21] This is so because most of the time the claim is of a "mixed" nature, that is, it contains elements of both injury to the State and injury to its nationals. In this regard, the ILC in its 2006 Draft Articles

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[16] Ibidem. See also ELSI, supra n. 14, para 50, where the rule is referred to as "an important principle of customary international law".

[17] The question also arose in the negotiation of the so-called Multilateral Agreement on Investment (MAI) within the OECD framework. See The Multilateral Agreement on Investment. Commentary to the Consolidated Text, OECD Doc. DAFFE/MAI(98)8/REV1 (22 April 1998), hereinafter MAI Commentary, p. 36 for a commentary on Article C.1.*a* (dealing with State-to-State proceedings). Documents related to the MAI are available at www1.oecd.org/daf/mai/index.htm, accessed 15 October 2011.

[18] It may occur—although this is rather infrequent—that BITs expressly address the applicability or inapplicability of the exhaustion of local remedies rule within the framework of clauses on investor-State arbitration. In this regard, see also Article 26 of the ICSID Convention, providing for a waiver of the exhaustion rule with regard to investor-State arbitration. See also Schreuer et al. 2009, pp. 402–413, esp. 405–407.

[19] See Amerasinghe 2004, pp. 146–168; International Law Commission, Draft Articles on Diplomatic Protection with Commentaries, UN Doc. A/61/10 (2006), hereinafter Draft Articles on Diplomatic Protection, pp. 70–76. For a case applying this distinction, see Arbitral Tribunal: Air Service Agreement of 27 March 1946 between the United States of America and France (United States/France), Decision (9 December 1978), paras 19–32.

[20] ILC, Second Report on Diplomatic Protection by Mr. John Dugard, Special Rapporteur, UN Doc. A/CN.4/514 (28 February 2001), hereinafter Dugard Second Report 2001, para 18 (footnotes omitted).

[21] See ibidem, paras 18–31; Draft Articles on Diplomatic Protection, supra n. 19, pp. 74–76. See also Amerasinghe 2004, pp. 146–168; Meron 1959, pp. 84–86.

resorted to the "preponderance test" in order to decide between the two categories of injuries[22] (although it must be noted that doctrine and case law have also advanced other criteria to establish whether the claim is direct or indirect).[23]

The difficulty in distinguishing the two types of situations, for the purpose of the applicability of the exhaustion rule, also arose in the Italy-Cuba arbitration. Italy maintained that, in pursuing its claim, it was invoking a "double standing" ("*double légitimation*"), i.e., that first it was protecting its own rights; and secondly, it was protecting the rights of its nationals on whose behalf it was acting.[24] According to Italy, this "double standing" was rooted in the very institution of diplomatic protection, which implies that the rights of the State which acts in diplomatic protection are indissolubly linked to the interests of the physical or juridical persons in whose favor it is acting.[25] Coherently with this purportedly double facet of its claim, Italy was seeking from the Tribunal both compensation (calculated in relation to each of the injuries allegedly suffered by the investors) and satisfaction. In relation to the latter, Italy requested the Tribunal to award "the symbolic amount of 1 euro for the continued and reiterated violation of the terms, the spirit and the purposes of the BIT, and for the refusal, the indifference and the silence by the Cuban authorities vis-à-vis the several diplomatic initiatives directed at the amicable settlement of the disputes concerning the Italian investors".[26] In the preliminary phase of the arbitration, Cuba raised the objection that local remedies had not been exhausted by the Italian investors, and thus Italy was barred from resorting to diplomatic protection.[27] For its part, Italy's line of defence was not very dissimilar to the one advanced by the United States in *ELSI*. In that case, the United States, in an attempt to bypass the exhaustion rule, sought to present its diplomatic protection claim clothed as a request for a declaratory judgment, directed at finding that the United States' own rights under the FCN Treaty had been infringed.[28] The Chamber of the ICJ did not accept this line of reasoning. It held that it was unable "to find a dispute over alleged violation of the

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[22] Article 14(3) of the ILC Draft Articles provides: "Local remedies shall be exhausted where an international claim, or request for a declaratory judgment related to the claim, is brought preponderantly on the basis of an injury to a national or other person referred to in draft article 8".

[23] See in particular the discussion in Dugard Second Report 2001, supra n. 20, paras 18–31.

[24] Italy v. Cuba Interim Award, supra n. 6, paras 24–25.

[25] Ibidem, para 25. It could be said that Italy's position was coherent with the more traditional (but highly debated) view on the legal nature of diplomatic protection as reflected in the "Mavrommatis paradigm" (whereby "[b]y 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"). The discussion of this topic (on which see ILC, Preliminary Report on Diplomatic Protection by Mr. Mohamed Bennouna, Special Rapporteur, UN Doc. A/CN.4/484 (4 February 1998); ILC, First Report on Diplomatic Protection by Mr. John Dugard, Special Rapporteur, UN Doc. A/CN.4/506 (7 March 2000), paras 10–40; Pellet 2008) is beyond the scope of this paper.

[26] Italy v. Cuba Final Award, supra n. 6, para 96.

[27] Italy v. Cuba Interim Award, supra n. 6, para 57.

[28] ELSI, supra n. 14, paras 50–52.

FCN Treaty resulting in direct injury to the United States that is both distinct from, and independent of, the dispute over the alleged violation in respect of [the US companies]".[29] It went on to say that it had no doubt "that the matter which colors and pervades the United States claim as a whole, is the alleged damage to [the US companies]".[30] In the Italy-Cuba dispute the Tribunal did not question the conceptual "double standing" scheme advanced by Italy. However—at least for the purposes of the applicability of the exhaustion rule—a clearer inquiry by the Tribunal as to the preponderance of either the direct or the indirect damage to the State in the dispute at issue would have perhaps been desirable. In retaining the distinction suggested by Italy, the Tribunal concluded that the exhaustion rule applied only in relation to those claims where the State was acting in diplomatic protection, but not in relation to that part of the claim where the claimant State was pursuing its own rights.[31] Alternatively, the Tribunal could have found, in line with the ICJ precedents (*Interhandel* and *ELSI*), that the two claims could not be severed and that the international claim should be treated as a unity, with the consequence that being the *indirect* damage of the State the one "preponderant" the exhaustion rule had to be applied. The fact that Italy was not simply asking for compensation but also for declaratory relief is not decisive in this regard. As explained by Dugard in his second report, as per *Interhandel* and *ELSI* "[w]here the request for a declaratory judgment is incidental to or related to a claim involving injury to a national—*whether linked to a claim for compensation or restitution on behalf of the injured national or not*—it is still possible for a tribunal to hold that in all the circumstances of the case the request for a declaratory judgment is preponderantly brought on the basis of an injury to the national."[32]

A second issue raised in the Italy-Cuba dispute with regard to the exhaustion rule is worthy of consideration. Italy submitted that, even if the exhaustion rule was deemed to be applicable in principle, it had been in effect waived by the Contracting Parties to the BIT. A waiver of the exhaustion rule is indeed generally possible and resorted to in practice.[33] It may be either express or implied.[34] In the dispute between Italy and Cuba, Italy's argument with regard to the waiver was twofold. First, the Contracting Parties' intention to waive the exhaustion rule would allegedly result from the fact that they conditioned the submission of

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[29] Ibidem, para 51.

[30] Ibidem, para 52. But see ICJ: Avena and Other Mexican Nationals (Mexico v. United States), Judgment (31 March 2004), para 40.

[31] Italy v. Cuba Interim Award, supra n. 6, paras 86–91.

[32] Dugard Second Report 2001, supra n. 20, para 30 (emphasis in the original); Draft Articles on Diplomatic Protection, supra n. 19, p. 76.

[33] See ILC, Third Report on Diplomatic Protection by Mr. John Dugard, Special Rapporteur, UN Doc. A/CN.4/523 (7 March 2002), paras 46–64; Draft Articles on Diplomatic Protection, supra n. 19, Article 15.*e* and relating commentary (pp. 83–86); Amerasinghe 2004, pp. 247–279, with further references.

[34] See Draft Articles on Diplomatic Protection, supra n. 19, Article 15.*e* and relating commentary (pp. 83–86).

disputes *inter se* only to a negotiation period (Article 10 para 1 of the BIT). In Italy's view, the presence of this sole condition would indicate that they intended to clearly exclude the exhaustion rule. The Arbitral Tribunal did not address this particular argument. It would not seem, however, that the presence of such a negotiation period can be taken as amounting to an express waiver, as Amerasinghe has convincingly explained.[35] The second argument advanced by Italy on the alleged waiver of the exhaustion rule is particularly interesting because it goes to the heart of the policy of the rule within the present architecture of the investment dispute settlement system. Italy submitted that there would be no room left for the exhaustion rule (not even in State-to-State proceedings) once the investment treaty grants investors a direct right to resort to arbitration against the host State in alternative to resort to domestic courts. If the rule is dispensed with in connection with investor-State arbitration (Article 9 of the BIT), so it was argued, then "it would be illogical to require Italy to respect such rule when it is invoking Cuba's responsibility pursuant to Article 10 of the BIT [inter-State arbitration] and when it seeks to obtain a favorable result for its investors".[36] The Arbitral Tribunal did not share this view and held that nothing in the Article 9 of the BIT would indicate that the State Parties had waived the exhaustion rule for the purpose of diplomatic protection.[37] The reasoning on this point would perhaps have warranted a more in-depth discussion, although in the end the Tribunal's conclusion has to be shared. In fact, there is ample authority that a waiver of local remedies must not be readily implied,[38] and it would be too far-fetched to conclude that the mere presence of the investor-State arbitration mechanism constitutes an implied waiver of the exhaustion rule within the State-to-State framework. It is however true that, from a broader policy point of view, this solution may seem somewhat paradoxical and perhaps not effectively reflecting the latest developments within investment dispute settlement (where there has been, thanks to the web of thousands of BITs, a generalization of investors' standing to pursue direct arbitration against the host State). There is thus a certain force in the view (put forward by Italy) which considers it "illogical" to hold that, on the one hand, local remedies need not be exhausted when the investor brings a direct claim, while, on the other, the rule strictly applies when the investor invokes the diplomatic espousal from its government pursuant to the same treaty—even when the investor had the option to pursue investment arbitration in the first place. But the functional underpinnings of the exhaustion rule should not be overlooked. If those lie, among others,[39] in considerations aimed at "reduc[ing] the chances of unwelcome interference in the

[35] Amerasinghe 2004, p. 276 (noting that "[t]he reference to negotiation as a pre-condition for arbitration is a reference to what is required of the parties to the BIT. It does not affect what is required of the investor, if a party to the treaty wishes directly to exercise diplomatic protection").

[36] Italy v. Cuba Interim Award, supra n. 6, para 41.

[37] Ibidem, para 90.

[38] Draft Articles on Diplomatic Protection, supra n. 19, p. 85; ELSI, supra n. 14, para 50.

[39] See extensively Amerasinghe 2004, pp. 56–64.

relations between [States] and of the elevation of disputes to an international level",[40] then a differentiation between the applicability of the rule in investor-State and State-to-State proceedings continues to be justified. When the choice is made to elevate the dispute to the higher level of inter-State adjudication, rather than to submit it to the more "depoliticised" mechanism of investor-State arbitration, then there is sufficient reason for keeping the exhaustion rule operative.

## 4 The Interplay Between State-to-State and Investor-State Dispute Settlement Mechanisms

These last considerations of the possible repercussions of the availability of investor-State mechanisms on the applicability of the exhaustion rule in State-to-State proceedings lead us to a further point which merits attention. From a broader perspective, how do the two types of mechanisms interrelate with one another? Given that in most cases BITs offer both possibilities, in which terms (alternative, complementary, additional, etc.) should one dispute settlement mechanism be seen *vis-à-vis* the other? Although investment arbitration and inter-State arbitration proceedings would not *strictly* compete with each other, because they would not involve the exact same parties,[41] the issue that parallel proceedings may lead to conflicting decisions on either the interpretation of the same treaty or the same set of facts should not be underestimated.

In order to address the issue of the interplay between the two types of mechanisms, it is useful to maintain the distinction drawn above between possible State-to-State disputes on abstract interpretation and diplomatic protection claims.

### *4.1 Abstract Interpretation v. Investment Arbitration*

Neither the arbitration rules under which investor-State arbitrations may be conducted nor BITs contain provisions addressing the coordination between State-to-State proceedings and investment arbitration *in general terms*.[42] There are certain rules, as we shall see further, on the relationship between investor-State arbitration and diplomatic protection, with Article 27 of the ICSID Convention being the foremost example. But Article 27 ICSID Convention, as well as those provisions in BITs modeled around it, are not concerned with disputes on abstract

[40] Ibidem, p. 57.

[41] Schreuer 2007, p. 349.

[42] Only certain Chinese BITs contain a clause addressing the general relationship between the two dispute settlement mechanisms. See Article 13.12 of the China-New Zealand BIT (1988) and of the China-Singapore BIT (1985), and Article 13.11 of the China-Sri Lanka BIT (1986).

interpretation short of diplomatic protection.[43] Thus, under the present discussion on the ways to coordinate a possible dispute on the inter-State level concerning the abstract interpretation of the BIT and a parallel investor-State arbitration the situation is in principle no different if the ICSID Convention is or is not applicable.

The framework could be delineated in the following terms. Let us first suppose that a State-to-State arbitration is launched on a question of abstract interpretation of the treaty *before* investor-State proceedings are initiated (and that the inter-state tribunal finds that the threshold of a 'legal dispute' between the parties is met). One interesting question that would arise in this regard is whether the interpretation given by the inter-State arbitral tribunal on the compatibility of a legislative measure with the treaty or, even more generally, on the correct interpretation to be accorded to a certain provision (e.g., the meaning of "fair and equitable treatment" or the definition of "investment" under that particular BIT) would have any binding effect on a subsequently constituted investor-State tribunal, which may have to consider the same measure—or the same treaty provision—but from the perspective of an alleged harm to an investor. There are no indications whatsoever in BITs as to how to deal with a situation of this kind. It appears likely that the investor-State tribunal would take the interpretation rendered on the inter-State level into serious consideration. But to imply—absent clear language in the BIT in this regard—that interpretations given by a State-to-State tribunal will enjoy binding authority upon an investor-State tribunal would seem to be an unjustified conclusion.[44] It should be added that when States have intended to bind investor-State tribunals to interpretations given by a different body, they have explicitly done so. Certain investment treaty regimes, in fact, entrust particular non-judicial authorities with the power to issue interpretations of the treaty, which are expressly said to be binding on investor-State arbitration tribunals. The premier example of this is the mechanism established by the North American Free Trade Agreement (NAFTA), which provides that the Free Trade Commission (FTC), comprised of "cabinet level representatives" of the three NAFTA Parties, may issue an interpretation of a provision of the NAFTA, which shall be binding upon a Chapter 11 tribunal.[45] Similar mechanisms are provided in BITs to which the United States or Canada is a party. For example, Article 30(3) of the US Model BIT of 2004, in its provision dedicated to the governing law in investor-State arbitration, provides that "[a] joint decision of the Parties, each acting through its representative designated for purposes of this Article, declaring their interpretation of a provision of this Treaty shall be binding on a tribunal, and any decision or award issued by a tribunal must be consistent with that joint decision". One could perhaps argue *a contrario* that under those treaty regimes the only decision which would be

[43] The wording of Article 27 (quoted *infra* n. 49) is clear on the point at issue. This is also indirectly confirmed by the MAI Commentary, supra n. 17, p. 36, *sub.* Article C 1.*b* of the draft MAI (quoting the view expressed on Article 27 by the ICSID observer).

[44] But see *contra* Broches 1972, p. 377.

[45] See Kaufmann-Kohler 2011.

binding upon an investor-State tribunal is the one stemming from the State Parties themselves (given in the form of either a joint declaration or through an FTC-type body), whereas a decision rendered by an inter-State arbitral tribunal constituted under the same treaty would not be accorded any binding authority.

More problematic would be the situation where a State-to-State tribunal is seized when an investor-State arbitration is already underway. The risk that the investor-State tribunal would perceive any position taken on interpretation issues by the State-to-State tribunal as an interference in its proceedings would arguably be high. It should be noted that certain BITs provide—in addition to the two usual dispute settlement mechanisms—for the possibility to resort to "consultations" between the two Contracting Parties. This is for example envisaged by the BIT between the Netherlands and the Czech Republic.[46] The case of *CME v. Czech Republic* testifies to the use of such a procedure: after the investor-State tribunal had issued a partial award, the Czech Republic requested consultations with the Netherlands, with the purpose of resolving certain issues relating to the interpretation and application of the treaty arising from the tribunal's partial award. This procedure led to certain "Agreed Minutes" containing a "common position" of the parties on the interpretation of the BIT.[47] When the investor-State tribunal rendered its final award, it appeared to take the "Agreed Minutes" into account as supporting its holdings.[48] Once again, however, the interpretation stemmed from the two Contracting Parties to the BIT, and not from a State-to-State arbitral tribunal.

## *4.2 Diplomatic Protection v. Investment Arbitration*

If a State-to-State arbitration is invoked with a view to espousing an investor's claim, a fundamental distinction has to be made between the ICSID framework and non-ICSID arbitrations.

If the ICSID Convention is applicable (because it is in force between the two State Parties and the investor has consented to submit its dispute to ICSID arbitration), the prohibition, contained in Article 27 of the Convention, on the home State to provide diplomatic protection comes into play.[49] A number of BITs

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[46] Netherlands–Czech Republic BIT (1991), Article 9.

[47] UNCITRAL: CME Czech Republic B.V. (The Netherlands) v. Czech Republic, Final Award (14 March 2003), paras 87–93, 216–226.

[48] Ibidem, paras 437, 504.

[49] Article 27.1 ICSID Convention reads: "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". During the ICSID Convention's drafting, the question of competing remedies in investor-State and State-to-State proceedings was discussed at some

"replicate" this rule (though sometimes not in identical formulations) within the text of the bilateral treaty itself.[50] The thrust of Article 27 ICSID Convention is that once an investor has consented to submit or has submitted a dispute to ICSID arbitration, the investor's home State is barred from instituting State-to-State proceedings with a view to exercising diplomatic protection (except where the host State fails to abide by the arbitral award). It has been suggested that a State-to-State arbitral tribunal, if seized of such a dispute, would have to decline jurisdiction.[51] This would be the obvious solution if an Article 27-type provision is repeated in the BIT,[52] which would be the legal instrument under which the State-to-State tribunal would derive its authority. But the same could be said to be true even if the BIT lacks a specific 27-type provision: If the ICSID Convention is applicable to the investor-State arbitration, the inter-State BIT tribunal could—even in the absence of a 27-type provision in the BIT—decline jurisdiction,[53] by paying heed and giving effect to a binding obligation of the two Contracting Parties contained in a different legal instrument (the ICSID Convention). The risk that the host State is exposed to litigation at both the inter-State and the individual-State level at the same time would thus be ruled out. The institution by the home State of inter-State proceedings would, on the other hand, constitute a breach of Article 27, but would have no effect on the jurisdiction of the ICSID tribunal, as confirmed by two *obiter dicta* in *Banro v. Congo*[54] and *Aucoven v. Venezuela*.[55] However, the violation of Article 27 may trigger the institution of a second and different type of State-to-State adjudication: the aggrieved State may namely bring a dispute "on the interpretation or application" of the ICSID Convention before the ICJ by resorting to the compromissory clause contained in Article 64 of the Convention.[56]

(Footnote 49 continued)
length. Schreuer notes, with reference to the *travaux* of the Convention, that "[t]he issue remained unregulated but there seemed to be consensus that inter-State arbitration should neither interfere in investor-State cases nor affect the finality of ICSID awards". See Schreuer 2007, p. 349.

[50] See Juratowitch 2008, pp. 16–22; Schreuer et al. 2009, p. 426.

[51] Schreuer 2007, p. 350.

[52] Certain BITs elucidate that the parties are barred from resorting to State-to-State arbitration "in consideration of Article 27", thus clearly instituting a link between this latter provision and the need to avoid concurrent State-to-State proceedings. See Article 10.6 of the Germany-Barbados BIT (1994), of the Germany-Bolivia BIT (1987), of the Germany-Estonia BIT (1992), and of the Germany-Poland BIT (1989).

[53] Schreuer 2007, p. 350.

[54] ICSID: Banro American Resources, Inc. and Société Aurifère du Kivu et du Maniema S.A.R.L. v. Democratic Republic of the Congo, ARB/98/7, Award (1 September 2000), para 18.

[55] ICSID: Autopista Concesionada de Venezuela, C.A. v. Venezuela, ARB/00/5, Decision on Jurisdiction (27 September 2001), para 140.

[56] The compromissory clause in Article 64 has so far never been resorted to.

In contrast, if Article 27 ICSID is *not* applicable (either because the Convention is not in force between one of the two States, or because the investor has consented to submit the dispute to arbitration with the host State according to a different set of rules, e.g., UNCITRAL), the framework for the delineation of the interplay between investor-State and State-to-State proceedings becomes much more uncertain. As already noted, the Contracting Parties to the BIT may have incorporated an Article 27-type provision in the treaty which applies also in situations where *any* type of investor-State arbitration is initiated by the investor. A significant number of the Italian BITs (though not the Italy-Cuba BIT) contain such a clause.[57] In the absence of any such provision, the suggestion that an inter-State tribunal should decline jurisdiction in view of the pending investor-State arbitration cannot be automatically transposed in the non-ICSID context. It has been cogently argued that "there is no practice that would support the existence of customary law analogous to Article 27 and applicable to all investment arbitrations".[58]

The Italy-Cuba arbitration provides once more for an interesting example of how these issues may concretely arise in practice. Faced with Cuba's objection to Italy's lack of standing to act in diplomatic protection of its nationals by way of the inter-State dispute settlement mechanism, the Tribunal considered whether the investor-State provision in the BIT prohibited the home State from exercising diplomatic protection within the framework of State-to-State proceedings. It is worth noting that Cuba is not a Party to ICSID and that the investor-State provision in the BIT provides accordingly for *ad hoc* arbitration. The Arbitral Tribunal found that "as long as the investor has not consented to international arbitration with the host State, its right to diplomatic protection persists".[59] On the contrary, the Tribunal held that if the investor had already seized an investor-State tribunal or provided its advance consent to such a dispute settlement mechanism, then the home State would be barred from espousing its claim. Not going as far as to find that the principle embodied in Article 27 ICSID should be considered as a codification of a customary norm, the Tribunal nonetheless made the statement that it could be applied "by analogy".[60] It is doubtful whether this reflects the *lex lata* or should rather be viewed as a consideration *de lege ferenda* on how to correctly coordinate the two dispute settlement systems.

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[57] See Article 10.5 of the Model Agreement involving the Government of the Italian Republic on the Promotion and Protection of Investments. In: UNCTAD (2003) International Investment Instruments: A Compendium 12: 295–303, www.unctad.org/en/docs/dite4volxii_en.pdf, accessed 15 October 2011. A similar provision had been incorporated in the draft MAI. See Article C.1.*b* of the MAI Draft Consolidated Text, OECD Doc. DAFFE/MAI(98)7/REV1 (22 April 1998).

[58] Paparinskis 2008, p. 285.

[59] Italy v. Cuba Interim Award, supra n. 6, para 65.

[60] Ibidem.

## 5 Concluding Remarks

This contribution has attempted to draw a preliminary overview on State-to-State dispute settlement clauses contained in BITs and has pointed out some of the intricacies which may arise when investor-State and State-to-State mechanisms are combined or otherwise interrelate. This complex field would certainly deserve to be further explored. No doubt the illustration of the interrelationship between investment arbitration proceedings and diplomatic protection State-to-State claims (probably the most thorny question in this area) is likely to be significantly affected by the different conceptions one takes on both diplomatic protection and the nature of the substantive BIT rights at issue. Different solutions may in fact be advanced depending on the answers one will give to questions such as whose rights the State is protecting through diplomatic protection as well as to whom the substantive rights contained in BITs are in reality owed.

A few final observations should be made on the role which inter-State arbitration will play within the present and future architecture of investment law dispute settlement. Is the Italy-Cuba dispute bound to remain an exceptional occurrence reinforcing the general rule (i.e., that direct investor-State arbitration will almost always be the preferred mechanism), or does it have the potential of awakening the attention of States (and their nationals) towards a tool which has so far been largely neglected? It is difficult to provide a clear-cut answer to this question, though it would appear that the success of investor-State arbitration in BITs is unlikely to be eroded by the availability of inter-State dispute settlement mechanisms in the same treaty. When the investor has a choice between a direct remedy (which "allows the true complainant to face the true defendant"[61]) and a request for espousal by its home Government, it will more likely resort to the first option, because it will retain more control over the proceedings, it will not normally have to observe the local remedies rule, it will recover—in the case of a favorable decision—direct compensation, and will in general avoid, or at least reduce, the risk of the politicized atmosphere characterizing diplomatic protection.

Does this mean that the thrust of inter-State dispute settlement is bound to remain limited? For certain authors the inter-State arbitration option should be characterized as a guarantee "of last resort" for the protection of foreign investors should they encounter difficulties in investor-State proceedings.[62] In a similar vein, State-to-State dispute settlement could be viewed as an "additional tool" in case investor-State arbitration fails, for example due to a lack of co-operation by the host State.[63] This seems to be certainly correct in a scenario where the losing host State in an investor-State arbitration fails to comply with the award, and thus the award creditor turns to its home State for support.[64] In contrast, ordinary

[61] Paulsson 1995, p. 256.

[62] Sacerdoti 1997, p. 436.

[63] See Kokott 2002, pp. 24–25; Juratowitch 2008, p. 33.

[64] Article 27 ICSID Convention envisages precisely this possibility. See supra n. 49.

difficulties encountered in the course of investment proceedings (deriving, for example, from the refusal by the host State to take part in the arbitration or to appoint their party-appointed arbitrators, or from other dilatory tactics, etc.) should not be viewed as a sufficient reason for discontinuing (or failing to initiate) investor-State proceedings and for "elevating" the dispute to an inter-State level. That is so because investor-State provisions in BITs are normally drafted so as to avoid such scenarios, either by referring to arbitration administered by an institution (*in primis*, ICSID) which will therefore ensure that the arbitration is not derailed, or by providing for procedural safeguards in case of *ad hoc* arbitration. The room for resorting to inter-State arbitration would thus not seem to be too wide in practice. Things, however, may change in the future if the backlash, perceived in certain quarters, against investor-State arbitration should succeed in convincing States to discard this mechanism in their future treaties. It is still early to attempt to identify trends in this area. But it appears significant that certain countries, such as Australia, have recently expressed the firm resolution to avoid investor-State dispute settlement mechanisms in their future investment treaties (or in the investment chapter of their free trade agreements).[65] If this choice is effectively pursued in future treaty negotiations, the so far dormant inter-State dispute settlement mechanisms are likely to experience renewed interest.

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