Amicable Settlement of Investor-State Disputes

Investment arbitration is usually considered an effective and major way of resolving investor-state disputes. At the same time, despite its many benefits as any adversarial process it entails certain disadvantages for both investors and States. In light of this, in recent years the tendency to promote amicable settlement in ISDS by means of ADR tools has loomed large.

In this regard, over the past 3 years, the Government of Ukraine has showed its readiness to reach pre-arbitration settlements in disputes with investors. That said, this article sheds some light on the benefits of using negotiation and mediation in ISDS with the purpose of achieving a win-win outcome for both parties.

**SHORT INTRODUCTION TO ISDS**

Foreign investors, in case a host state violates their rights or interests, have an additional tool in their box compared to domestic businesses — Investor State Dispute Settlement (or ISDS).

ISDS means a process of resolving disputes between a foreign investor and a host state, where respective investments are located, generally based on multilateral or bilateral international investment agreements concluded by a host state and the investor’s home state (“IA”). States conclude those IAs, *inter alia*, to ensure a certain level of legal protection to their investors abroad, but, at the same time, grant the same level of protection to foreign investments on their own territories. Ukraine is a party to around 70 IAs in force.

IAs generally protect investors from unlawful expropriation of their assets, guarantee fair and equitable treatment and full protection and security with regard to their investments. In case a state violates an investor’s rights under the IA, the investor is entitled to request compensation for this in international investment arbitration.

**INVESTMENT ARBITRATION HAS ITS OWN DEFICIENCIES**

At first glance, an opportunity to refer an investment dispute to arbitration looks very attractive for an investor, *inter alia*, enabling a dispute to be shifted from the domestic legal system to the international plain through resolution by highly-reputable arbitrators.

However, both investors and States should be mindful that, in unison with its benefits, investment arbitration carries a list of disadvantages pertaining to the adversarial process. We name some of them below:

1. It takes long time to resolve a dispute — an average of 3 years to only get the final arbitral award. As such, there are prospects that justice delayed may end up being justice denied;
2. Heavy arbitration costs including fees of arbitrators, expenses on high-caliber counsels and experts. As such, investment arbitration is an expensive luxury, which might not be available and a reasonable decision for relatively small investments.
3. Unpredictability — IAs contain provisions that are usually susceptible to different interpretations, and arbitrators have different opinions on various ISDS issues.
4. Compulsory enforcement against States may be problematic, since their property used for public purposes is protected by sovereign immunity. A striking example in this regard is the Yukos case initiated in 2005, where a $50 billion UNCITRAL arbitral award has not been enforced against Russia.

A former CEO of an American landfill management company Metalclad — Grant Kesler — while describing his company’s win in the precedential investment arbitration case against Mexico (*Metalclad v. Mexico*), put it as a “hollow victory” when considering the amount of resources the company put into this dispute. With hindsight, he would prefer amicable resolution of the dispute.

That is understandable, since amicable settlement of investor-state disputes may, in certain cases, help parties to avoid or at least minimize the above-mentioned disadvantages of arbitration. Below we will explain how.

**BENEFITS THAT NEGOTIATION AND MEDIATION CAN BRING TO THE ISDS TABLE**

Negotiations and, in recent years, mediation are becoming more and more popular in the ISDS context. The approximate number of settled ICSID cases is 30-40%, which proves that interest-based dispute resolution methods are viable in this sphere.

The main advantages of mediation and negotiation are, *inter alia*:

— Time — it would only depend on the parties and how quickly they can reach a settlement, escaping long-lasting arbitral proceedings.
— Costs — mediation and negotiation are much cheaper procedures. Also, it is sometimes possible to settle some investment claims which, due to their relatively low value, would not end up in arbitration.
— Control over results — the absence of control over results in investment arbitration can be especially frustrating due to its unpredictable nature, when different tribunals may render different decisions in relatively similar circumstances. At the same time, negotiation and mediation give parties control over the outcome and an opportunity to find win-win-way-outs from a dispute. However, for government officials it may sometimes be easier to blame “bad arbitrators and counsels” for the negative outcome than for concessions to be made from the side of the state during negotiations. Although it is not always the case, investors and their counsels should be mindful of that.
— Fostering relationships and creating value — robust arbitration battles, as any other adversarial processes, may substantially hinder relationships between the parties and at best lead to win-lose or at worst to lose-lose results. Negotiation and, moreover, mediation allow parties to think “out of the box”, identifying creative solutions acceptable for all stakeholders.

The above benefits are relevant to both mediation and negotiations. However, a mediator can, as a third-party neutral, help the parties to overcome deadlocks in negotiations by, inter alia:
— Designing and moderating the process of reaching settlement, and calibrating it to the specific dispute at hand;
— Using and suggesting mediation techniques to foster negotiations, like caucusing, brainstorming of options appropriate for both parties, etc.

**Compliance with settlement agreements**

In the vast majority of cases the parties voluntarily comply with the settlement agreements, to which they freely agreed in the first place. Also, when a state signs a binding settlement agreement with an investor it might be prejudicial for it to backpedal on its promise, and the investor may potentially initiate a dispute on compliance with such agreement.

Sometimes, most often when arbitration is pending, in order to ensure enforceability of their settlements the parties request the arbitral tribunal to issue an award on agreed terms fixing the parties’ agreement. Such award can be later enforced as any other arbitral award based on international treaties, including the New York Convention. However, this scenario requires pending arbitration, and, as a result, substantial costs and time.

There is a recent development in the sphere of mediation, namely signing of the Singapore Convention by forty-six States, including Ukraine, on 7 August 2019. The Convention is aimed at ensuring enforcement of mediated settlement agreements around the globe being the prototype of the New York Convention but for mediation. It is still to be seen whether the Singapore Convention will apply in the investor-State context. However, the ICSID takes the position that it will, albeit, without no reasoning on this matter. If that happens, it will likely increase the attractiveness of mediation for not only investors, but also States, which can also potentially have some monetary claims against investors under settlement agreements.

**Negotiation and mediation — a panacea for all woes**

Although reaching amicable settlement of investment disputes should be tried whenever possible, to be realistic, often situations arise when the parties would not be able to escape arbitration or even should rather use it. It could be due to different factors, including highly-antagonistic relations between the parties, an insuperable deadlock in negotiations, a State’s need to establish a public policy precedent, for which adjudication is vital, etc.

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**Settlement of investments disputes in Ukraine**

An investment dispute usually starts when an investor sends a notice of dispute to a State describing the relevant factual background of the dispute and alleged breaches of the applicable IA. In Ukraine, such notice shall be sent to the Ministry of Justice of Ukraine, which is responsible for representing Ukraine in investment disputes.3

A notice of dispute generally triggers a so-called cooling off period in the applicable IA (usually 3-6 months), after the expiry of which an investor can refer the dispute to arbitration.4 The cooling off period is designed specifically for the negotiation purposes and allows States to rectify their wrongdoing before arbitration is stated. This is usually the best timeframe for reaching a settlement.

Within 5 days of receiving information on an investment dispute, the Ministry of Justice of Ukraine creates an Inter-Agency Working Group ("IAWG") to ensure coordination between interested state bodies in the protection of Ukrainian interests. The framework of the IAWG allows investors to conduct negotiations on the matter with the participation of all stakeholders from the State side.

Following negotiations with the investor, the IAWG may issue a recommendation for a relevant state body to terminate the violation of the investor’s rights under the IA or to wipe out its consequences. If the dispute is not resolved in such way, the Ukrainian Government and the investor may conclude a binding settlement agreement.

If the dispute is not settled in advance of arbitration, there are still chances to settle it during arbitral proceedings. This is one of the great sides of mediation and negotiation that the parties can have recourse to during the entire lifespan of a dispute. Even when an investor has a final award against
a State, which is not willing to comply with it, the parties may settle on the voluntarily enforcement under certain terms.

**Recent Successful Ukrainian Practice**

Ukraine has on many occasions settled in ISDS. In the majority of cases settlement was reached when the arbitration was already under way (for example, Western NIS v. Ukraine). There are also at least two recent investment disputes when the pre-arbitration settlement was achieved (Gilead Sciences Inc. (USA) v. Ukraine and Philip Morris v. Ukraine). Those settlements took place in the last 3 years, showing that the Ukrainian Government is prone to amicable settlement of ISDS disputes. Below we briefly describe the last Ukrainian settlement in the dispute with Philip Morris.

In the Phillip Morris case, Phillip Morris was excused from import duties and taxes on materials used in processing cigarettes in Ukraine for re-export. Later, the tax authorities, as a result of a tax inspection, obliged Philip Morris to pay the very taxes from which the company was earlier exempted. On top of that, the tax service fined the investor for non-payment. The authorities reportedly demand around USD 22 million in taxes and penalties. Philip Morris challenged the demand made by tax authorities, *inter alia*, in Ukrainian courts. In parallel, at the beginning of 2018, the investor commenced the ISDS process, notifying Ukraine about alleged violations of the USA-Ukraine and Switzerland-Ukraine BITs.

Following negotiations between Ukraine and Phillip Morris, the Ukrainian Government approved a draft settlement agreement with Philip Morris companies on 5 December 2018, which was subsequently signed on 31 January 2019. The Government explained this move by its desire to show to foreign partners and investors that Ukraine complies with its obligations under international treaties.

On 22 March 2019, the State Fiscal Service of Ukraine withdrew its tax demands against Philip Morris pursuant to the settlement agreement, and the Second Administrative Court of Appeal closed the proceedings on the matter accordingly. This case clearly shows how effective and beneficial amicable settlement in ISDS can be.

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**Conclusive Remarks**

Although arbitration is a great method of resolving investor-state disputes, it is advisable for both investors and States to try amicable settlement whenever possible before commencing arbitration. Even during arbitration, the parties should keep in mind that the settlement may still be possible. That would help the parties to avoid getting into “Russian roulette” pertinent to adversarial procedures like arbitration.

Arbitration practitioners should consider suggesting their clients a strategy for an amicable settlement of investor-state disputes, whenever reasonable and appropriate. In fact, such expertise in the lawyers’ tool box can help them to successfully manage client expectations and promote a unique value proposition to their clients.

On a final note, these words said by Abraham Lincoln when he was a practicing attorney succinctly convey this article’s main message: “Discourage litigation. Persuade your neighbors to compromise whenever you can. Point to them how the nominal winner is always a loser in fees, expenses, and waste of time. As a peace maker, a lawyer has a superior opportunity of being a good man. There is still be business enough”.

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