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5.10 Disputes: Anticipating and Managing Them

The likelihood of a dispute emerging at some point in the life of a long-term EI project is high, and can even occur prior to any production of the deposit. With respect to oil and gas, a dispute may arise between the host government and/or its state resources company and the investor; or among the parties to a joint venture; or between the host state and a neighbouring state over a range of issues such as ownership of land or sea-bed or the use of infrastructure such as pipelines. In the mining sector, it will typically arise between the state and the title holder or applicant; between competing miners; or between a title holder or applicant and non-competing parties. The range of issues may include revocation or suspension of a licence, perhaps due to alleged lack of compliance with performance obligations, a dispute over environmental or social obligations during the development phase or interpretation of issues relating to mine closure. For a foreign investor, a key question will be whether such disputes are to be referred to the country’s relevant courts and tribunals or to a separate non-domestic agency such as an international tribunal.

Anticipation of this possibility is essential. The appropriate time to prepare for it is during initial contract negotiations: prior to the commencement of EI operations. Every investor will be aware of this need for preparation, partly because disputes can arise not only with the host state but also among the investors themselves, such as between parties to joint venture contracts as much as between the parties to an HGA (and so need to be prepared for). It is important that the host state should understand this risk too and identify the responses it would be most comfortable with, not least because of the high public profile likely to attend on any such dispute with investors.

Prevention is the best cure. The downsides of a formal dispute (in terms of costs, time, reputation and potential damage to the project) are usually greater than any benefits to the parties. Management of differences is therefore a highly desirable goal and procedures should be put in place to try to resolve it at an early stage. Although precise evidence is lacking, due to confidentiality, it appears that many disagreements in oil, gas and mining are settled prior to the triggering of formal legal processes, or if that occurs, they may be settled before they reach the stage of an arbitral award. This reflects the importance of both commercial realities and the need to preserve the long-term relationships between investors and host states.
There are commonly used ways for parties to settle their differences amicably and speedily (such as mediation, conciliation, or cooling-off periods). They can also include the use of stepped or multi-tiered approaches in the contract itself. In this way, parties are required to submit disputes to an increasingly rigorous and formal series of dispute resolution methods.

This allows the parties to encourage and allow opportunities for an agreed settlement, either through mediation or (in the AIPN models) negotiation by senior executives on each side. It means that the parties retain control over their own destinies in the initial stages, but also ensures that if these relatively informal efforts at a settlement fail, the next step will be one that allows a third party to render a binding decision. If a stepped approach is adopted, it is important that the transition from one step to another is made clear (to avoid challenges by one of the parties).

The increasingly wide adoption of multi-tiered dispute resolution procedures makes them part of good practice in contract design.¹

Failing these dispute prevention methods, or a reluctance by either party to include them, one or both parties may choose to pursue formal and binding legal proceedings. This may require the dispute to be heard by the local courts, but often in the EI sector the parties will have agreed that in the event of a dispute they will submit their disputes to international arbitration: a form of private justice.² Many governments would prefer to see their domestic courts used to settle disputes but international arbitration will be keenly sought by most foreign investors to limit actual or perceived risk from local court processes: it is a concession which many states have been prepared to make. The possibility of lengthy delays, open-ended proceedings, corruption or lack of due process in local courts comprises some of the perceived risks by investors. Arbitration is unlikely to be quick but once a decision is made, it provides finality about the dispute. Appeal is only possible in very limited circumstances and not on errors of law or fact.

Apart from international arbitration, there is another dispute settlement route for issues that have a technical, scientific, or accounting character. It is called expert determination. The central idea is that a third party expert should be appointed to evaluate the dispute. For example, a dispute concerning the specifications of a

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¹ Their main aims are: to minimize or contain the escalation of disputes that arise between the parties; to preserve the parties’ long-term relationship; to maximize cost efficiency; to ensure that the parties can agree on mechanisms for maintaining the performance of ongoing obligations under the contract, pending resolution of their dispute, and to ensure that there is a notification procedure in place, which allows the parties to be fully aware of the timing of each stage in the dispute process, and the transition, or escalation of the dispute, from one stage to the next. Without such notification procedure, this approach would fail to achieve its essential function of streamlining and setting the pace to the parties’ dispute.

² This subject is examined in detail in a number of texts. For example, see Cameron, P. (2010). International Energy Investment Law: The Pursuit of Stability. Oxford: OUP; Duval, supra n. 14, Ch. 19.
particular product used during operations could be resolved by an expert determination without having to proceed with legal proceedings.

There are important differences between determination by an expert and arbitration: there are usually no statutory provisions governing the former in contrast to the latter; the legal requirements of an arbitration may be absent with the parties not necessarily being required to present their case or to submit evidence. Whereas the courts may be used to assist in an arbitral process, by appointing arbitrators if necessary, by granting interim injunctions and above all by enforcing awards (that is, like a court judgment) of the tribunal, there is no comparable role for the courts in the process of expert determination. Enforcement of the expert’s determination is a matter left to the contract itself, if it is enforceable at all. On the international level, this is even more problematic; since it is not an arbitral award, it cannot be enforced under the New York Convention. Challenges to an expert’s role may be made on limited grounds such as fraud or collusion, or that the expert had departed from the instructions given to a material extent.

Whatever method is used, the dispute settlement mechanisms will be set out in the contract and will constitute a very important assurance to the investor that the bargain struck in the contract will be secure over time. A well-drafted dispute resolution clause will, in the event of breach, provide a means for seeking compensation through an arbitral award enforceable against the state hosting the investment. Under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention), an arbitral award is enforceable through the local courts of 156 states. ³

Investment Treaties  In making such preparations it is crucial to note that investors may bring a legal claim for damages against a state based on a legal instrument existing outside of the contract: a Bilateral Investment Treaty (BIT) or a Multilateral Investment Agreement (MIT), of which there are now more than 3,000 in existence. These treaties are concluded between states for the reciprocal protection and promotion of investment by investors from either state in the territory of the other state; they are part of international law. Among the rights they confer is the right to initiate arbitration if the host state or its agencies have taken measures alleged to be inconsistent with the treaty obligations. The treaties generally cover access to arbitration, the rules applicable to the arbitration and the enforcement of arbitral awards.

BITs and more recently Free Trade Agreements (FTA) have become very popular as a means of promoting and protecting foreign direct investment in the globalised economy. The typical content comprises substantive provisions (see the list in **Box 5.12**) and mechanisms for dispute settlement. All of these treaties will contain a provision which protects foreign investors from expropriations without compensation.

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**Box 4.12: Claims under BITs**

The substantive rights protected under a BIT usually include the following:

- Fair and equitable treatment.
- National treatment
- Most favoured nation treatment
- Full protection and security
- Protection from expropriation
- Umbrella clauses.

Many claims have included a reference to the **fair and equitable** treatment standard. Some of these concern the review of administrative decisions, and the weight given to legitimate expectations and due process. In *Occidental v Ecuador* (2004) the tribunal held that the stability of the legal and business framework is an essential element of fair and equitable treatment; this view was also supported in the *CME v Argentina* case (2005). Other cases support the view that in certain circumstances the standard has limited application only. There are other cases concerning the application of this standard that involve the treatment of investors by the courts of the host state (denial of justice, for example).

The requirement of **national treatment** is a different substantive right and aims to provide a level playing field for foreign investors at least after the investment has been made.

Another requirement commonly found in BITs is that investments of nationals of either contracting party shall enjoy **full protection and security** in the territory of the other contracting party. This is typically concerned with failures of the state to protect the investor’s property from actual damage caused by state officials or by the actions of others, where the state has failed to carry out due diligence.

On the matter of **umbrella clauses** these are clauses in BITs whereby States promise to observe obligations entered into in respect of investments.

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To date, tribunals have held, for example, that a government expropriated an investor’s property when it revoked its licence to operate, and that it violated the ‘full protection and security’ obligation because it failed to protect the investment from losses and disruptions caused by local citizens. Clearly, such treaties limit sovereignty; a question commonly raised is whether the system of justice they based on these treaties and resulting awards is as fair to sovereign states as it appears to be to investors\(^5\).

The Role of MITs The most relevant of these multi-party treaties to the Source Book are the North American Free Trade Agreement (NAFTA); the Energy Charter Treaty (ECT) and the ASEAN Investment Agreement. In each case, investment disputes have arisen under their provisions. The NAFTA Agreement is concerned with trade generally, and the ASEAN Agreement is concerned with any legal disputes that may arise directly out of an investment. By contrast, the ECT is concerned with energy only. It was opened for signature in December 1994 and was ratified in 1998. The aim of the ECT is to establish “a legal framework in order to promote long-term co-operation in the energy field” (Art 2). The definition of investment is comprehensive, and lists specific asset types.

The ECT has been widely used for disputes involving Russia, Kazakhstan and other states on petroleum, mining and renewable energy subjects. It contains provisions on the settlement of any investment disputes that may arise. They provide for the use of compulsory arbitration against governments at the option of foreign investors for alleged breaches of the investment agreements, without the need to first exhaust local remedies. Moreover, binding state-to-state arbitration is provided for in Article 27. This involves the use of an ad hoc tribunal for disputes between states concerning the application or interpretation of the Treaty. It is not restricted to the resolution of disputes arising from investment issues. The dispute settlement procedures may in fact be diverse, including international arbitration, and provide for final and binding solutions to many disputes. The rules and procedures governing transit disputes in particular have been enhanced since ratification to minimize disruption when a dispute is taking place. A key provision lies in Article 26 which provides various options to investors to take host governments to international arbitration in the event of an alleged breach of the Treaty’s investment provisions\(^6\).

Each State that is party to the ECT is obliged to provide for effective enforcement of arbitral awards in its country. There are three ways of bringing an action under the ECT, giving a party several options:

\(^5\) South Africa became embroiled in an investor-state dispute and as a result it carried out a review to assess the value of BITs for investment in the country. A review of this process can be found in ‘Lessons from South Africa’s BITs Review by Xavier Carim: http://ccsi.columbia.edu/files/2013/10/No_109_--Carim_--FINAL.pdf

\(^6\) Rules Concerning the Adoption of Transit Disputes (‘Rules’), adopted Dec 1998.
• ICSID;
• Sole arbitrator or an ad hoc tribunal established under the UN Commission on International Trade Law; or
• An application to the Arbitration Institute of the Stockholm Chamber of Commerce.

**Arbitration**

Arbitral proceedings are often complex and have become an increasingly common forum for resolving disputes in the petroleum and mining industries throughout the world. Since arbitration is a private mode of dispute settlement in international commerce in which the rules are agreed by the parties themselves, it is often assumed that it exists independently of the national courts. In fact, there is a ‘global adjudication system’ in which international investment and other commercial disputes are “resolved by binding and final arbitration, as regulated, however, by national legislation and judiciaries”. It is crucial at all stages (design, proceedings and settlement) to be aware of this fact of *enforcement*, and the role played by the New York Convention in making awards enforceable through the local courts. The amounts awarded by tribunals can be very large, amounting in some cases to billions of dollars. An investor can try to enforce a ruling in the national courts of a third state where the host state has assets and have them seized or have bank accounts frozen.

If arbitral proceedings become a reality for a government, it is essential to review the law governing the dispute and the method of arbitration chosen in the contract.

**The Arbitration Agreement**

The defining feature of arbitration is that it is a form of justice based on the parties’ agreement. So the fundamental document for the jurisdiction of the tribunal is the arbitration agreement, usually the arbitration or dispute settlement clause in the hydrocarbons or mining licence or contract. This will set out a description of the disputes that will be subject to arbitration, the scope of the tribunal’s authority, applicable law, language and location of the arbitration, whether it will be administered by an institution such as ICSID or the ICC, and may include rules and procedures to be followed.

The *lex arbitri* or law of the place where the arbitration is held (sometimes called the seat) will govern the procedures of the arbitration. This includes the admissibility of evidence, security for costs, judgment and confidentiality orders, appeal ability, and

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the enforceability of an award against assets in New York Convention countries. From a practical point of view, it is best to choose the governing law of a country in which there is a probability that the legal profession/judges have some knowledge of the law relating to oil, gas and mining.

**Institutional or ad hoc arbitration?** The parties may choose to have the arbitration conducted through an international arbitral institution or on an ad hoc basis. This is sometimes called administered and non-administered arbitration. An institutional form of arbitration lays down timetables and procedures to be followed when establishing the arbitral tribunal for the conduct of the arbitration. An ad hoc one is conducted under rules agreed by the parties or set by the arbitration tribunal. There are a growing number of options in institutional arbitration. The most popular forums for arbitral disputes in oil, gas and mining are institutions such as: the International Centre for the Settlement of Investment Disputes (ICSID), the International Chamber of Commerce (ICC) and the London Court of International Arbitration. There are also a number of regional arbitration centres that are available to assist in resolving disputes, such as the Singapore International Arbitration Centre and the Arbitration Centre of the Stockholm Chamber of Commerce.

The **advantages** of an institutional approach are usually thought to include the following: it provides a wealth of arbitral experience, including that of the arbitrators themselves; it ensures that the arbitral tribunal is appointed and deals with any challenges to arbitrators; it has rules that are a known quantity; it sometimes has sufficient prestige to persuade a reluctant part to arbitrate and comply with the award, and it can be particularly useful when parties have different levels of sophistication or different languages and cultures. In an ad hoc arbitration, parties may designate the rules in their contract or they may adopt a pre-existing set of rules such as the UNCITRAL rules⁸. They are designed to provide a comprehensive set of procedural rules on which the parties may agree for the conduct of arbitrations arising out of their commercial relationships. This freedom of the parties to customize the arbitration is thought to be the main advantage of the ad hoc approach, inviting comparisons between a tailor-made suit and one bought ‘off the peg’.

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