

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

**BEST PRACTICES IN
INVESTMENT FOR
DEVELOPMENT**

CASE STUDIES IN FDI

**How to Prevent and Manage Investor-
State Disputes**

Lessons from Peru

Advanced unedited un-cleared draft



UNITED NATIONS

New York and Geneva, 2011

NOTE

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PREFACE

The Investment Advisory Series provides practical advice and case studies of best policy practice for attracting and benefiting from foreign direct investment (FDI), in line with national development strategies. The series draws on the experiences gained in, and lessons learned through, UNCTAD's capacity-building and institution-building work in developing countries and countries with economies in transition.

Series A deals with issues related to investment promotion and facilitation and to the work of investment promotion agencies (IPAs) and other institutions that promote FDI and provide information and services to investors. The publications are intended to be pragmatic, with a how-to focus, and they include toolkits and handbooks. The prime target audience for series A is practitioners in the field of investment promotion and facilitation, mainly in IPAs.

Series B focuses on case studies of best practices in policy and strategic matters related to FDI and development arising from existing and emerging challenges. The primary target audience for series B is policymakers in the field of investment. Other target audiences include civil society, the private sector and international organizations. Series B was launched in response to a call at the 2007 Heiligendamm G-8 Summit for UNCTAD and other international organizations to undertake case studies in making FDI work for development. It analyses practices adopted in selected countries in which investment has contributed to development, with the aim of disseminating best practice experiences to developing countries and countries with economies in transition. The analysis forms the basis of a new technical assistance work programme aimed at helping countries to adopt and adapt best practices in the area of investment policies.

For Series B, UNCTAD's approach is to undertake case studies of a pair of developed and developing or transitional economies that exhibit elements of best practices in a selected issue. Country selection follows a standard methodology, based primarily on the significant presence of FDI and resulting positive outcomes.

The Investment Advisory Series is prepared by a team of UNCTAD staff and consultants in the Investment Policies Branch, under the guidance of James Zhan. This study of the Series B was prepared and finalized by Silvia Constain. Contributions and comments were received from Richard Bolwijn, Roberto Echandi, Anna Joubin-Bret, Jan Knoerich, Elisabeth Tuerk, Cam Vidler and Joerg Weber. The report has also benefited from interviews with current and former government officials, the domestic and foreign private sector, and local stakeholders. Financial support was received from the Government of Germany.

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ABBREVIATIONS

ADR	alternative dispute resolution
BIT	bilateral investment treaty
CICP	central investment contact point
DMP	dispute prevention mechanism
DPP	dispute prevention policies
DTT	double taxation treaty
FDI	foreign direct investment
FTA	free trade agreement
ICC	International Chamber of Commerce
ICSID	International Centre for the Settlement of Investment Disputes
IIA	international investment agreement
ISDS	investor–state dispute settlement
MEF	Ministry of Economy and Finance (Peru specific)
MOFA	Ministry of Foreign Affairs
PPA	public private associations (Peru specific)
SC	Special Commission (Peru specific)
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development

Peru



KEY FACTS TABLE

Peru			
	1981-1990	1991-2000	2001-2010
Population (million)*	21.76	25.66	29.54
Annual GDP growth (%)*	-.09	4.45	8.9
GDP per capita (\$)*	1354	2078	9.200
GDP by sector (%)			
Services	61.9	61.6	55
Industry	60.4	29.9	35
Agriculture	19.4	15.8	10
FDI inflows (annual average) (\$ million)	29	3106	5491
FDI outflows (annual average) (\$ million)	11	12	280.4
FDI inflows (% of GDP)	19.3	20.16	29.1
FDI inflows (% gross fixed capital formation)	0.7	7.5	22.3
Exports of goods and services (% GDP)	15.76	16.00	28.05
Imports of goods and services (% GDP)	13.83	18.16	20.00

Source: UNCTAD, FDI/TNC database and GlobStat database.

Note: Simple annual average.0*

Data are for 1990, 2000 and 2010 only

I. INTRODUCTION

The last decade has seen a considerable increase in the flows of foreign direct investment (FDI), generally recognized to have significant potential to contribute to economic growth and development. As part of efforts to enhance investor protection and attract more investment countries have concluded an ever-growing number of international investment agreements (IIAs) which provide for international arbitration in cases of disputes between investors and host States. Additionally, many countries include clauses for international arbitration in contracts they sign directly with individual foreign investors for specific projects. This has been the background behind a sharp rise in the number of cases of investor-State arbitration in the last decade.

The increase in international investment arbitration has generated concerns including with regard to the ability of governments to regulate economic activities within their borders, the high costs of arbitration and of awards rendered, State capacity to appropriately manage international investment arbitration, the prevention of frivolous claims and others. In response, some countries have introduced or strengthened policies to prevent investor-State disputes from emerging and escalating, and to manage investor-State dispute settlement (ISDS) proceedings more effectively.

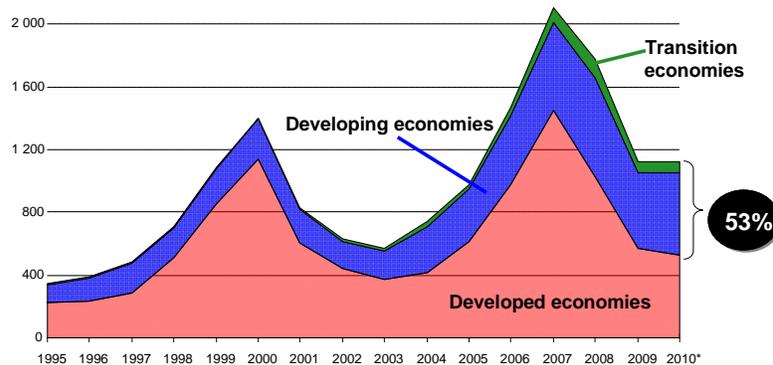
This study examines the case of Peru which designed a dispute prevention policy (DPP) and implemented a dispute prevention mechanism (DPM), which foresees the promotion of alternative dispute resolution (ADR) mechanisms and the implementation of prevention policies. This is an example of a case of good practice in the prevention and management of investor-State disputes.

First, the study presents facts on the IIA landscape and investor-State disputes, as well as general issues for host countries to consider when designing policies to prevent and manage these disputes. Second, it looks specifically at the framework implemented by Peru to prevent and manage investor-State disputes more effectively, as well as the impact it has had so far. Finally, the study draws conclusions and lessons from Peru's experience that may help other countries as they design and implement policies, systems and measures to prevent and manage investor-State disputes.

A. International investment and the IIA system

Investment is an important contributor to development, and foreign investment to domestic economies in particular plays an important role in growth, including through its contributions the integration of local markets in global production chains, transfer of technology and access to new forms of finance. Despite the fact that global FDI flows are still some 25% below the pre-crisis level, foreign direct investment surpassed \$1.1 billion in 2010 (figure 1), and for the first time, developing countries and economies in transition accounted for over half of total FDI.

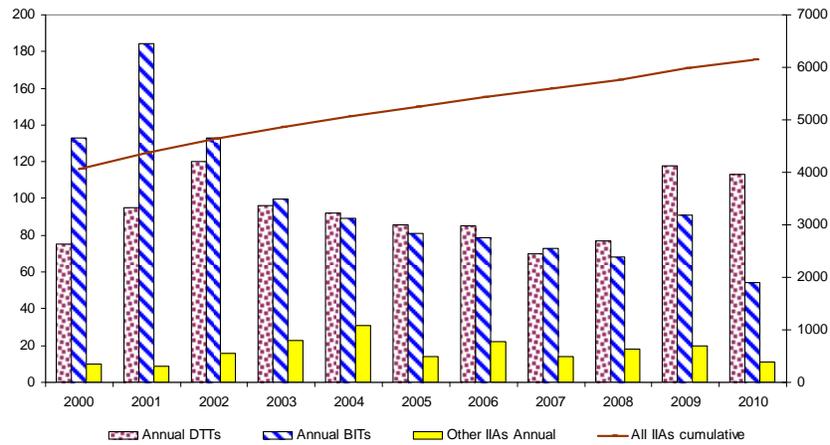
Figure 1
Value of global FDI inflows by economy grouping, 1995 - 2010
\$ billions



Source: UNCTAD

At the same time, by the end of 2010 there were over 6,000 international investment agreements (IIAs), including bilateral or regional investment treaties (BITs), double taxation treaties (DTTs) and free trade agreements (FTAs) with investment chapters (figure 2). These agreements are signed between States to provide a set the conditions facing their respective investors when investing in each other's economies. In addition to IIAs, which are agreements between States, many countries include similar arbitration clauses in specific contracts with foreign investors or include umbrella clauses in IIAs that automatically cover specific contracts.

Figure 2. Trends of BITs, DTTs and other IIAs



Source: UNCTAD (www.unctad.org/iaa)

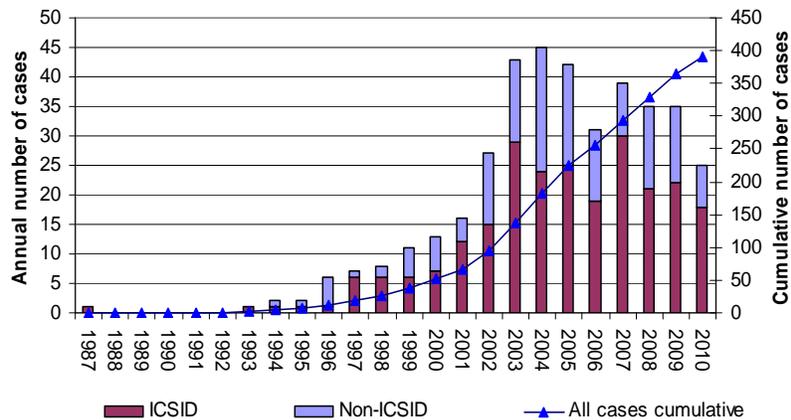
One of the elements of investor protection provided by these agreements is the prior consent given by a host country to allow investment disputes to be submitted to international arbitration. In other words, the State agrees that the investor may take an investment dispute that alleges a breach of the treaty or contract provision to international investor-State arbitration.

As the number of treaties and the cross-border flow of investments have increased, so have the number of cases of investor-State dispute settlement (ISDS) under IIAs.

B. Investor-State international arbitration

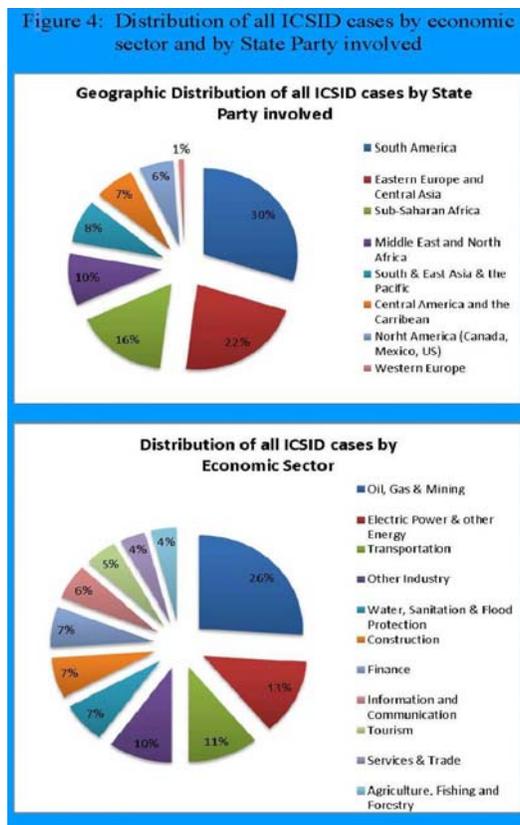
The proliferation of IIAs and other legal instruments allowing for investor-State arbitration has been accompanied by an exponential increase in the number of ISDS arbitration cases (figure 3). In fact, 90% of the known ISDS cases have taken place since 2000. It is difficult to know the exact number of ISDS cases because the International Centre for Settlement of Investment Disputes (ICSID) is the only arbitration institution that keeps track of and publishes the number of cases involving States in which it is involved. Therefore, although UNCTAD has identified 390 ISDS cases (UNCTAD, 2011), the total number is likely to be higher.

Figure 3. Known investment treaty arbitration



Source: UNCTAD (www.unctad.org/iia)

At the close of 2010, at least 83 countries had faced ISDS, and most of the countries facing ISDS have been either developing countries (51) or economies in transition (15) (UNCTAD, 2011). A revision of the ICSID caseload shows that ISDS involved all regions and a wide range of economic sectors (figure 4).



Source: ICSID: The ICSID Caseload – Statistics, (Issue 2010-2). Reproduced with permission of ICSID, original found at <http://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDDocRH&actionVal=CaseLoadStatistics>

The rise in ISDS cases has generated concern among many governments not just because of the implications on a country's right to regulate and follow what are perceived to be legitimate public policy objectives, but also because of the large sums claimed by investors, the sums that have been awarded to investors and the high cost of the arbitration process itself. Developing countries in particular find themselves vulnerable due to limited technical capacity to appropriately prevent and manage disputes, and the potentially detrimental financial impact of the costs of the procedures and of the awards on a country's budget. Some of these causes of concern are detailed below.

- **Sums awarded to investors**

Arbitration awards against a host State can amount to hundreds of millions of dollars. To expedite payment of the awards, funds may be diverted from important development objectives, such as investment in infrastructure, education, health or other public goods. For example, in 2004 a Czech commercial bank brought a dispute against the Slovak Republic before ICSID. The tribunal awarded approximately \$877 million in favor of the Czech bank.¹ In Argentina, awards rendered by ICSID in 2007 alone would require the payment of over \$600 million to investors, while the claims for those cases alone surpassed one billion.

These high sums can be a considerable budgetary burden for the responding country involved in the dispute, and the quality of the defense during the arbitral procedures can have a direct effect on the outcome of the arbitration and decisions rendered.

- **Costs of treaty arbitration**

Arbitrators have broad discretion to allocate arbitration costs and legal fees. Additionally, there is no clear pattern on allocation of expenses and fees.² Therefore, it is difficult for countries to budget costs of proceedings or determine final costs, including in cases where they are confident they can win on the merits. Even if the award is

favorable to the host country, legal costs of the proceedings can reach very high sums, especially for developing countries that generally require outside legal expertise.

Examples include:

- In *Plama Consortium Limited v. Republic of Bulgaria* (ICSID Case No. ARB/03/24), Bulgaria reported legal costs of \$13.2 million and the claimant reported \$4.7 million. The claimant was ordered to bear all fees and expenses of the tribunal and reimburse respondent \$460,000 of the advance in costs and \$7 million in legal fees and costs, leaving the net cost to Bulgaria at approximately \$6 million.
- In *ADC Affiliate Limited and ADC & ADMC Management Limited v. Republic of Hungary* (ICSID Case No. ARB/03/16), Hungary reported costs of \$4.4 million and the claimant \$7.6 million. Hungary was ordered to pay the claimant's legal expenses (\$7.6 million), and cover its own costs and expenses.
- In *Československá Obchodní Banka A.S. v. Slovak Republic* (ICSID Case No. ARB/97/4), the Slovak republic reported costs of \$14.3 million and the claimant of \$16.3 million. Arbitrators ordered the Slovak Republic to pay \$10 million of the claimant's reported costs and expenses, and its own costs and expenses.
- In *PSEG Global Inc. v. Republic of Turkey* (ICSID Case No. ARB/02/05), the total costs of the arbitration, including legal costs and fees, was recognized at \$20,851,636.62, of which Turkey was ordered to pay 65 percent and the claimant 35 percent.

Additionally, given the increasing complexity of the issues, international investor-State arbitration is becoming increasingly difficult to manage, especially for developing countries. While some countries may have some local expertise in arbitration, the specificity of investor-State arbitration generally requires outside expertise which may be quite expensive.

- **Length of ISDS arbitration**

An additional element of concern to investors and governments is the length of ISDS arbitration, which has increased in part because cases are becoming more complex and the number of annulment proceedings has increased. While each case is different and unique, examples of long processes include ICSID's longest running case, Víctor Pey Casado and President Allende Foundation v. Republic of Chile (ICSID Case No. ARB/98/2) that on December 31st, 2010 reached its 4,638 day, and Duke Energy International Peru Investments No. 1 Ltd. v. Republic of Peru (ICSID Case No. ARB/03/28) which lasted a total of 2,685 days from start to finish.

While some consider that parties may be interested in prolonging the length of arbitration to defer payment of an award, uncertainty with regard to the duration of a process or its outcome seems problematic and costly for all parties involved. This is especially relevant for international investment arbitration given that one of the perceived advantages is the expected shorter time periods when compared to domestic legal systems.

- **Other concerns**

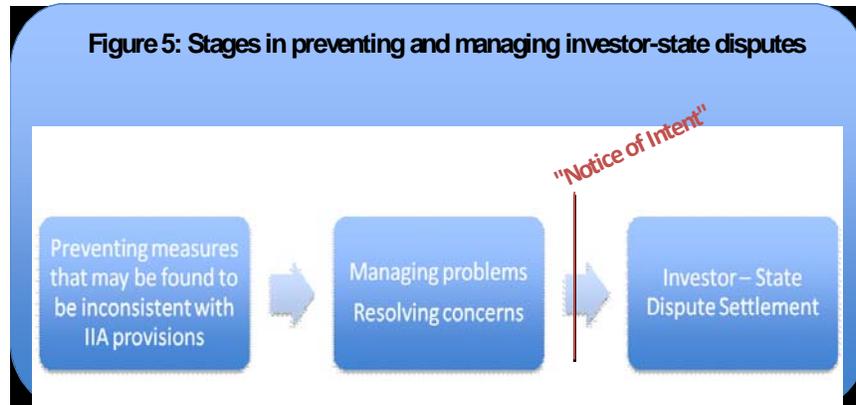
Other criticism include the possibility of frivolous claims, difficulties in managing disputes due to the complex network of IIAs with great divergence in drafting of core elements and commitments, and the severance of what often was originally conceived as a long-term relationship.

These concerns affect not only the host State, but also investors and civil society (which is increasingly aware and monitoring these proceedings). Given these and other shortcomings of international investment arbitration, many countries have set up policies or programmes to manage and prevent disputes that may lead to treaty-based dispute settlement, even before they reach the phase of disputes.

C. Preventing and managing investor-State disputes

The concerns referred to above have generated increased awareness among countries regarding their exposure to investment treaty arbitration and the possible lack of preparedness to face such cases. Additionally, countries have identified the lack of institutional frameworks capable of detecting and solving disagreements with investors at early stages. As a consequence, countries are proactively implementing policies aimed at preventing international investor-State arbitration, where possible.

Investor-State disputes normally begin as problems, which later evolve into disputes and ultimately arbitration (figure 5). A system to prevent investor-State disputes should target all stages leading up to arbitration. In general, the process of preventing and managing investor-State disputes can be divided into three different stages:



One of the challenges of an investor-State dispute prevention and management system is the fact that IIA provisions and commitments apply to all levels of government. Despite this, it is the central government that is ultimately responsible for representing and defending the State and for payment of final arbitral award adjudications. Therefore, it is important that all levels of government and agencies that interact with foreign investors understand the scope and consequence of the commitments under IIAs and the practical implications for their day-to-day activities

While the central government is ultimately responsible for the commitments undertaken under IIAs, several domestic government agencies usually interact with foreign investors and investments. Sub-national entities and agencies involved with foreign investors may implement measures that can be challenged as inconsistent with treaty provisions. Thus, their participation in any phase of dispute prevention and management is critical.

Arbitration procedures are not the first choice of either the investor or the host State. ISDS comes at a high cost in time and resources for both parties, and more predictable, timely and cost-effective alternatives would be worth exploring. Disputes that reach the stage of arbitration can originate with measures taken by agencies or entities that at times do not have full understanding or knowledge of the commitments undertaken by central governments in IIAs. Additionally, by the time a dispute is submitted to arbitration, relationships between the parties are often strained and confidence levels are at their lowest. Therefore, it is useful to identify and resolve problems at the earliest stage possible.

D. The case of Peru

The case of Peru combines many of the elements driving efforts in this area:

- (1) A large number of IIAs with other countries (33 FTAs and BITs) as well as investment contracts (53) and legal stability agreements (769) with individual investors.
- (2) High levels of foreign investment (FDI stock reached 20.8 billion in 2010) in different sectors of the economy from diverse home countries.
- (3) An increasing number of international ISDS proceedings (nine in ICSID alone, four between 2010 and 2011). ISDS has come with high costs in terms of cost of the process, and in amounts awarded to investors.

Peru's assessment, design and implementation of a system to efficiently prevent and deal with ISDS presents lessons that could be useful to other countries as they design their own dispute prevention and management policies and practices. This paper will look at the specific measures that Peru has put into place as an example of good practices in this area and identify lessons that may be useful to others.

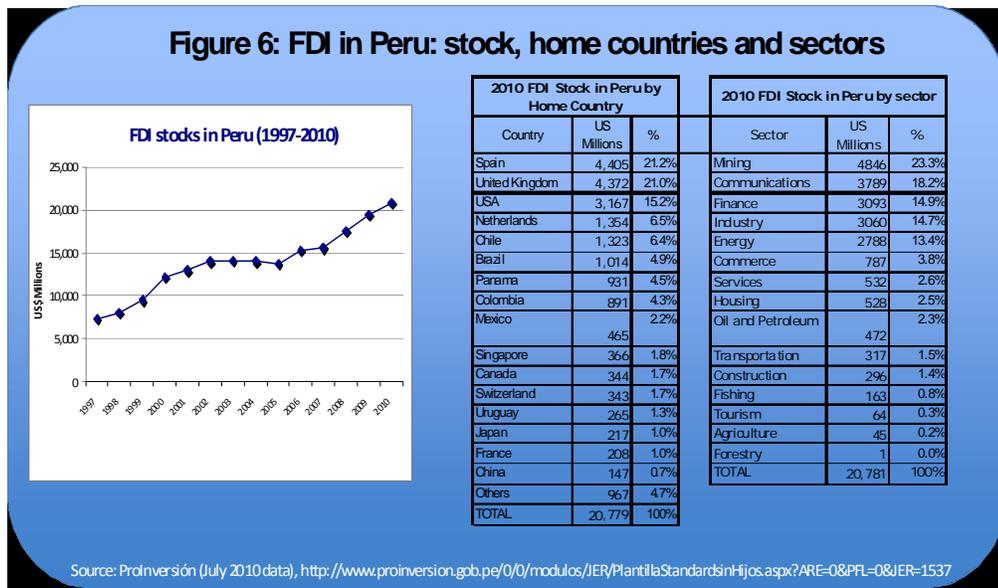
Notes

¹ Československa obchodní banka, a.s. v. Slovak, ICSID Case No. ARB/97/4

² ICSID Review – Foreign Investment Law Journal, The Allocation of Costs and Attorney's Fees in Investor-State Arbitration, Noah D. Rubins

II. FOREIGN DIRECT INVESTMENT AND IIAs IN PERU

Peru has pursued an active foreign investment promotion policy that has rendered fruits. FDI stocks reached \$20.8 billion¹ in 2010 and has gone to different sectors and come from a wide array of home countries (figure 6).



Consistent with its investment promotion policies, Peru signed the ICSID Convention in September of 1991.² Additionally, Peru is an active negotiator of BITs and broader economic agreements such as free trade agreements with investment chapters.³ Peru also has domestic mechanisms that provide investors with guarantees, including access to international arbitration. These include legal stability agreements and investment contracts, including concessions.

According to ProInversión, since 1993 Peru has signed 33 IIAs including bilateral investment treaties, and free trade agreements with Canada, Chile, China, the United States and Singapore (Annex 1), 769 Legal Stability Agreements,⁴ and 53 investment contracts since 1998.⁵

Peru has investment protection agreements (BITs or FTAs) with most of the home countries of its biggest investors including Spain, the United States, Chile, Switzerland, the United Kingdom, Canada, Italy, Japan, Norway, France and China. These agreements have served to improve the climate for foreign investment in Peru, but have also been the basis for international investment arbitration.

Peru's first case before ICSID was in 1998, which saw the parties settling the dispute. It was not until 2003 that Peru confronted its first full ISDS procedure before ICSID. In all, Peru has been a respondent in 9 cases in diverse sectors under ICSID (table 1):

Table I.1. Peru's ISDS cases	
1.	1998: ARB/98/6: gold mining project (Settlement agreed by the parties) Compagnie Minière Internationale Or S.A. v. Republic of Peru.
2.	2003: ARB/03/4: Pasta factory (concluded - awarded in favor of the State). Industria Nacional de Alimentos, S.A. and Indalsa Perú, S.A. (formerly Empresas Lucchetti, S.A. and Lucchetti Perú, S.A.) v. Republic of Peru.
3.	2003: ARB/03/28: Power generation (concluded) Duke Energy International Peru Investments No. 1 Ltd. v. Republic of Peru
4.	2006: ARB/06/13: Electricity generation and transmission (concluded) Aguaytia Energy, LLC v. Republic of Peru (concluded – awarded in favor of the State).
5.	2007: ARB/07/6: Fish flower production (concluded) Tza Yap Shum v. Republic of Peru.
6.	2010: ARB/10/2: Highway construction (pending) Convial Callao S.A. and CCI - Compañía de Concesiones de Infraestructura S.A. v. Republic of Peru.
7.	2010: ARB/10/17: Banking (pending) Renée Rose Levy de Levi v. Republic of Peru.
8.	2010: UNCITRAL, Metallurgical sector (pending) Renco Group, Inc. v. Republic of Peru.
9.	2011: ARB/11/9: Electricity transmission agreements (pending) Caravelí Cotaruse Transmisora de Energía S.A.C. v. Republic of Peru.
10.	2011: ARB/11/17: Property development project (pending) Renée Rose Levy and Grencitel S.A. v. Republic of Peru.
11.	ARB/11/21: DP World Callao S.R.L., P&O Dover (Holding) Limited, and The Peninsular and Oriental Steam Navigation Company v. Republic of Peru (pending).

The increase in investment arbitration involving Peru led the country to design and implement a system to appropriately prevent and deal with investor-State disputes.

Notes

¹<http://www.proinversion.gob.pe/0/0/modulos/JER/PlantillaStandardsinHijos.aspx?ARE=0&PFL=0&JER=1537>

² ICSID entered into force for Peru in September of 1993.

³ When Peru signed the FTA with the United States in April of 2006 it adopted a new model with pre-establishment provisions, and broader commitments than those in the post-establishment model it had used until then.

⁴ <http://www.proinversion.gob.pe/webdoc/convenios/convenios.aspx>

⁵<http://www.proinversion.gob.pe/0/0/modulos/JER/PlantillaStandardsinHijos.aspx?ARE=0&PFL=0&JER=5021>

III. POLICIES ON DISPUTE PREVENTION IN PERU

The long history of negotiations and the diverse characteristics of the different legal instruments – BITs, FTAs, legal stability agreements, investment contracts – have resulted in Peru having a broad and complex set of obligations in the field of foreign investment. Additionally, Peru's six international investment arbitration cases since 2000 revealed weak areas which required improvements in order to ensure the best possible defense of the State.

A. Shortcomings and limitations identified by Peru

Despite having acquired considerable experience in negotiation of international investment agreements, Peru did not have a structured system to prevent or respond to international investment arbitration cases when these first came up. Nevertheless, during the first two cases, the Ministry of Foreign Affairs (MOFA), with support from hired outside legal counsel, oversaw general coordination of the defense of the State and represented Peru in ISDS proceedings with positive results. Subsequently *Ad hoc* committees were created for cases 3 and 4 (see table 1) to improve coordination in the defense of the State during the ISDS process. The *ad hoc* Committees were chaired by the Ministry of Economy and Finance (MEF), while the Ministry of Foreign Affairs (MOFA) continued to represent Peru and was in charge of hiring outside legal counsel.

Although this new institutional arrangement of *Ad hoc* committees led to a more organized participation of the sectors involved in the controversies with the investors and a more efficient defense of the State, Peru realized that the institutional framework required to optimally defend the State in ISDS cases was not in place. Some of the difficulties identified by Peru were:¹

- A rising number of agreements with international dispute settlement provisions were being signed.
- Lack of domestic understanding of the implications of international dispute settlement clauses that were being included in contracts with investors.
- The State could not centralize actions when disputes came up at different levels of government, or coordinate actions with the involved agency (agency that adopted the measure triggering the dispute).
- Lack of an adequate, timely and coordinated management of disputes by the State.
- Lack of responsibility of involved agencies due to absence of a mechanism to make them accountable for the consequences of the actions or measures they took.
- Difficulty by the State to directly and promptly hire defense attorneys, and pay arbitrators and arbitration expenses, which jeopardized an optimal defense of the State.
- High risk of disputes due to poor coordination and at times discretionary actions taken by national, regional or local government agencies.

In order to correct these shortcomings, in 2006 Peru adopted Law 28933 and several subsequent regulatory decrees in 2008 and 2009 that created the International Investment Disputes State Coordination and Response System (the Response System). The following section describes the main elements and characteristics of this system.

B. International investment disputes State coordination and response system

In 2006 Peru created the State Coordination and Response System for International Investment Disputes (Response System). The legal framework is comprised of:²

- Law N° 28933 (December, 2006): established the International Investment Disputes State Coordination and Response System.
- Supreme Decree 125-2008-EF (October, 2008): set out regulations for Law No. 28933, such as transparency and mandatory guidelines with regard to international dispute settlement clauses.
- Supreme Decree 002-2009-EF (January 2009): set out specific procedures for hiring legal counsel and law firms and other advisors to support ISDS cases.

Given the broad and encompassing scope and coverage of the policy, the Response System required the support and commitment of the legislative branch that approved the Law and of the highest level of government that issued and adopted the Supreme Decrees. Peru's Response System not only creates and provides certainty with regard to the institutional structure that defends the State in ISDS proceedings, but also provides guidelines for future investment agreements' arbitration provisions, and consolidates all existing commitments for consultation of relevant agencies. The System expressly requires all government agencies involved in an investment dispute to cooperate and provide all relevant information, thereby creating accountability at all levels of government for IIA inconsistent measures or policies.

Peru redesigned its investor-State dispute prevention and management institutional framework in a very inclusive manner, bringing in the different State agencies and actors that create the international investment legal framework and commitments (IIAs, investment contracts and stability agreements) and those with specific knowledge or experience that may contribute to the best representation in an ISDS context:

- The Ministry of Economy and Finance, agency responsible for international investment policies in Peru, was named coordinator and chair of the Special Commission (SC).
- The Ministry of Foreign Affairs was the agency that had up to that point represented Peru in all investor-State dispute settlement cases, and brought the experience and history of managing investment disputes as well as that of international negotiations of BITs.
- ProInversión is a key member of the Bilateral Investment Treaty negotiating team and the agency in charge of the negotiation and adoption of legal stability agreements.
- The Ministry of Justice brings its expertise in the areas of litigation and legal interpretation and application of laws and regulations.
- The Ministry of Trade and Tourism provides the Free Trade Agreements' negotiating history and experience.

Additionally Peru's Response System requires continuous training for all relevant agency officials at all levels of government on IIA commitments and on the benefits, characteristics and obligation of the Response System.

The Law and Supreme Decrees specifically set out the Response System's scope, definition of actors and objectives. They also include provisions on direct negotiation, conciliation and mediation, budgeting and funding dispute settlement, confidentiality of information, and standardization of investor-State disputes settlement clauses. These elements are described below.

1. Scope

The law sets out definitions that clearly outline the scope of its application.

1. The Response System applies to any investment dispute between the State of Peru and an investor (domestic or foreign) subject to international ISDS arbitration.
2. The Response System covers any public entity, which includes any agency at a national, regional or municipal level, decentralized public entities and enterprises, and companies where the government has control via voting rights, autonomous entities, regulatory authorities, supervisory and collecting authorities, special fund, and "any other entity with similar nature not explicitly mentioned".

2. Definition of actors

In order to have a coordinated and effective response team, Peru identified the different actors and defined specific mandates, thereby seeking to eliminate conflicts or contradictions.

In general, the Response System (figure 7) is made up by the Coordinator, the SC and all the agencies at all levels of government that negotiate agreements or enter into contracts that provide for investor-State international arbitration in the case of investment disputes.

Figure 7: Peru's International Investment Disputes State Coordination and Response System

Coordinator: Ministry of Economy and Finance

Special Commission:

Permanent members:

- The Ministry of Economy and Finance (Chair)
- The Ministry of Foreign Relations
- The Ministry of Justice
- The Private Investment Promotion Agency – PROINVERSION

Case Specific:

- Involved Agency / agencies
- Ministry of Foreign Trade and Tourism (in case of FTA)

All the agencies at all levels of government that negotiate agreements or enter into contracts that provide for investor-state international arbitration in the case of investment disputes.

The SC is in charge of representing the State in any investment disagreement, conflict or dispute, and incorporates the agencies that negotiate the international investment legal framework for Peru as well as those with knowledge or experience in areas relevant to ISDS. The SC has four permanent members – Ministry of Economy and Finance (MEF), Ministry of Foreign Relations, Ministry of Justice and

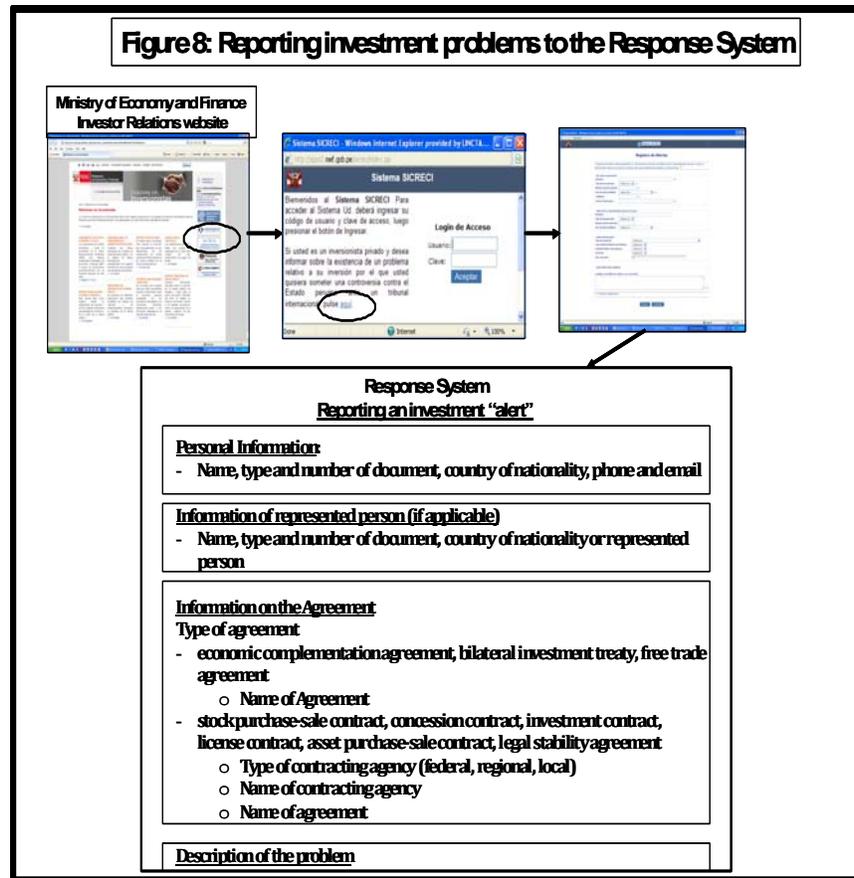
ProInversion, and may be joined by the Ministry of Trade for FTA and BIT based disputes and the relevant involved agency or agencies for each specific case. The SC integrates a team with all the expertise, knowledge and experience from all the State agencies that play a part in international investment and the defense of the State.

Coordinator

The MEF is the Coordinator of the system. As such, it is in charge of (1) centralizing all the information and coordinating the system (2) acknowledging any investment dispute and informing the Chairman of the SC, (3) receiving notifications of any investment dispute, and reporting the dispute to the Chairman of the SC and relevant parties, (4) registering and keeping track of all agreements and treaties with international ISDS provisions, and making them publicly available.

Additionally, the Coordinator of the System is in charge of making sure that the involved agency is informed of all the decisions taken by the permanent members of the SC.

The MEF, as coordinator, has given the Response System important prominence on its website, and provides a direct link for investors to register concerns or investment problems (figure 8).



Special Commission

The SC is assigned to the MEF and represents Peru in any ISDS or ADR procedure, including arbitration, mediation, conciliation and direct negotiations with the investor. The SC is also in charge of analyzing the dispute, assessing the possibility of an amicable settlement, adopting a strategy, obtaining any technical information from the involved agency or agencies, selecting outside legal counsel or other advisory services (subsequently contracted by the MEF), designating arbitrators, supporting outside legal counsel and approving funds necessary for the phases of direct negotiation, conciliation or arbitral proceedings. Additionally, the SC determines the liability of the involved agency, especially as regards the costs incurred by the State in resolving or managing the dispute and payment of an award.

Besides the four permanent members, the SC has non-permanent members that are case-specific, and include the Ministry of Foreign Trade and Tourism when the dispute is based on an FTA, and the agency responsible for taking the measure that triggered a dispute (involved agency). Non-permanent members of the SC must be named within two days after the Chairman convenes the SC for a specific dispute. The Chairman of the SC is the final decision-maker in case of a deadlock or ties.

The law and regulations specifically require the involved agency and any public entity to provide any information required by the SC within set time frames and make the head of the agency responsible for making sure this is done promptly. The involved agency must cooperate with the SC and ensure that its officials can participate in the process, if the SC so requires. Additionally, public employees who are aware of or have participated in actions relevant to the dispute are obliged to cooperate with the SC, even if the dispute is initiated after they have left public office.

Finally, the SC can call the involved agency to lead the negotiations in the case of disputes derived from agreements or contracts with ISDS provisions signed directly with investors (i.e. privatization contracts, concessions, legal stability agreements, etc.). The MEF serves as the technical secretariat for the SC, and prepares and presents the initial review of the dispute to SC members, prepares strategy papers and the minutes of the meetings.

Besides the responsibilities with regard to specific disputes outlined above, the SC should also present proposals for legislative or regulatory changes that improve the capacity of the SC to adequately represent the interests of the country in an international ISDS process.

3. Objectives

Law 28933 and its regulatory decrees specifically set out the following objectives:

- Provide a framework for optimal responses to investment problems and disputes susceptible to international arbitration.
- Collect and consolidate information on investment commitments and ISDS provisions.
- Provide an early alert system for investment controversies and disputes.
- Provide optimal State coordination.
- Generate accountability and responsibility with regard to investment commitments.
- Require uniformity of dispute settlement clauses.

Optimal response

The new system is created to ensure an optimal response of the State to problems with investors, even before they escalate into disputes, as well as an appropriate institutional organization for the handling of arbitration of international investment disputes themselves. This includes creating the SC to deal with investment disputes. The SC is brought in at an early stage of a problem, thus ensuring timely and appropriate attention. The SC is empowered to negotiate with investors, and to seek and propose amicable settlements and recourse to alternative dispute resolution.

Information on International ISDS commitments

Peru has a diverse set of legal instruments with investment commitments that can trigger international arbitration.³ The Response System requires any agency that enters into an agreement that provides for international ISDS to report the agreement to the Response System Coordinator, and promptly send a copy of the agreement to be included in the database.

The MEF sets up an electronic reporting system where agencies report any agreement covered by the Response System within 30 days after the agreement enters into force or is signed. A sixty-day period for reporting was provided for the contracts or agreements already in force when the system was put into place.

This system not only consolidates all investment and ISDS commitments in a central database, but also allows relevant agencies and entities to consult all ISDS commitments from a single source. The MEF reports that the system is up and running, and training and publicity on its use with relevant agencies will begin in the near future.

Early alert

The law created an early alert mechanism. Every agency at all levels of government has the obligation to promptly report to the Response System Coordinator any investment disagreement or dispute that may become subject to international investor-State arbitration. The MEF has set up an electronic reporting system where agencies report disputes within five days after the agency has been notified *or has learned* of the intention of the investor to initiate international investor-State arbitration.

The Response System provides the investor with a direct gateway (figure 8 above) to the SC and thus gives the State timely information on investment problems, either from the investor directly or from the involved agency. This provides an opportunity to be more responsive to investment disagreements, and therefore allows more time to resolve a problem, prepare a case, coordinate the relevant actors, and to ensure that all the necessary information is available. This may facilitate an amicable settlement, or at least will provide the State with more time to prepare a strong and complete case for arbitration.

Coordination

The law sets out specific procedures for optimal coordination of an ISDS process within government agencies, and assigns the SC with a central role. It includes provisions that require involved agencies and public servants to provide all relevant information to the case and specifically empowers the SC to lead the process. The Response System applies to all levels of government and any IIA or contract that provides for international ISDS.

Accountability

The Response System empowers the SC to require the agency that has triggered the dispute (involved agency) to bear the costs of the process and of any award against the State. This provision makes government agencies and bodies accountable for decisions taken that may be contrary to investment commitments in IIAs.

Uniformity of dispute settlement clauses

One of the difficulties with ISDS in Peru and in other countries who have actively negotiated IIAs is the existence of different clauses in diverse agreements. Peru includes international ISDS clauses not only in State-State agreements such as BITs or FTAs with investment chapters, but also in agreements and contracts with individual investors.

The new system sets out guidelines for ISDS clauses included in agreements or contracts (Supreme Decree N° 125-2008-EF). The objective is to achieve, as far as possible, a single standard clause or consistent content in ISDS provisions.

The guidelines require negotiators to include the following elements in all international dispute settlement provisions:

1. Mandatory minimum six-month period of direct negotiations before triggering international arbitration.
2. Use of neutral dispute settlement systems.
3. Shared costs in arbitration or conciliation procedures.
4. Mandatory reporting of the dispute by the investor to the Response System Coordinator. The reporting triggers the six-month direct negotiation phase described in 1, and is without prejudice to a possible required notification to the involved agency.

Article 22 of the Guidelines adopted by Supreme Decree N° 125-2008-EF defines a neutral dispute settlement system as one where the applicable law for objection, recognition and or execution of its decisions is not that of any State, but that established by the mechanism itself. The decree presents a non-comprehensive list of alternatives, including ICSID, the Hague Permanent Court of Arbitration, Australian Centre for International Commercial Arbitration (Melbourne), the Australian Commercial Disputes Centre (Sydney), Singapore International Arbitration Centre, Commercial Arbitration Center (Bahrain), the German Institution of Arbitration, the American Arbitration Association and the International Chamber of Commerce in Paris.

4. Direct negotiation, conciliation and mediation

The SC is empowered to negotiate directly with the investor in order to find a mutually agreeable solution to investment problem or dispute through channels other than arbitration. The SC also represents the State in mediation or other alternative processes to arbitration.

Any settlement must be reported to the Council of Ministers and approved through a Supreme Resolution with the support of the ministers that are members of the SC, and if appropriate, with that of the minister of the sector in charge of implementing the agreement, conciliation or amicable settlement.

5. Budgeting and funding dispute settlement

In the Response System, the funds for international ISDS are included in the MEF's budget, which is then spent in accordance with the decisions made by the SC. Subsequently the SC determines the financial responsibility of the involved agency, which can be made liable for the costs derived from the ISDS process and settlement or

award. The involved agency itself is ultimately responsible for the payment of any settlement, mediation, conciliation or award.

6. Confidentiality of information

Every public entity is required to provide the SC with information requested in the framework of the defense of the State in an international ISDS procedure. The information obtained and prepared by the legal advisors is protected by the lawyer's confidentiality obligation vis-à-vis their clients; the information generated in the legal representation of the government of Peru, as well as advice, recommendations and opinions, are considered confidential by Peruvian Law.⁴

The SC is exclusively empowered to manage and access the information received during an international ISDS process, as well as the information and documentation generated in it. Information can only be made public with prior approval from the SC and in consultation with legal counsel.

Notes

¹ ProInversión presentation at the APEC Workshop on Dispute Prevention and Preparedness, Washington, DC, July 26-30, 2010

²http://www.mef.gob.pe/index.php?option=com_content&view=article&id=378&Itemid=101182&lang=es

³ BITs, FTAs, investment contracts, legal stability agreements, etc

⁴ Supreme Decree 125-2008-EF, article 17

IV. IMPACT OF THE RESPONSE SYSTEM

The creation of the Response System modified the institutional structure that responds to international investor-State arbitration in Peru. The new system provides certainty for investors in creating a single contact in the government for investment disputes, and simultaneously endows the SC with the required tools and power to coordinate and organize the State's resources, negotiating strategy and defense.

Peru's system specifically provides for several elements that facilitate appropriate representation in ISDS cases, and foresees several additional steps that the Government of Peru is currently planning or implementing, and that will complete the full system once concluded.

A. Elements already in place

Peru created the post of "Technical Secretary" to the SC. The recently created "Technical Secretary" team has the responsibility of providing the SC with ISDS technical support, undertaking initial assessment of the cases and supporting procedural requirements in disputes. Besides these tasks related with defense of the State in investment disputes, the "Technical Secretary" team also oversees and coordinates the functioning of the system as such, and design and implement a strategy to make sure the relevant parties are aware of the benefits, characteristics and obligations of the system.

The "Technical Secretary" reviews the data available on cases reported in the early alert system, and those that ultimately are resolved or go to arbitration, and assesses how the system is functioning.

The creation of a single core team to handle disputes allows government officials to gain expertise in the area of international ISDS, thereby creating in-house capabilities that can improve the negotiating and strategic positions of the country in future dispute settlement procedures and dispute prevention.

Peru's Response System includes a set of guidelines that provide guidance for government officials in the negotiation of IIAs including with regard to the dispute settlement provisions, and details operational procedures for the system. Providing specific elements for investment disputes clauses in law enhances transparency for IIA and contract negotiations, and ensures a minimum standardization of the provisions in international dispute settlement clauses in all agreements covered by the system. While these provisions do not affect the agreements already in place (which create a wide array of commitments, on which current dispute settlement cases are based), they do generate consistency in future IIA obligations undertaken by Peru.

As was mentioned before, Peru signs investment contracts such as concessions with individual investors. This is done in accordance with the Public Private Associations (PPA) law, which requires the MEF to issue a prior opinion on any such contract. Since the MEF became Response System Coordinator, it reviews these contracts from the point of view of IIA consistency as well. Although this is not specifically in the Response System system, this review is likely to contribute to preventing IIA inconsistent or vulnerable provisions in future investment agreements in Peru.

B. Areas in planning or implementation

There are issues that are being reviewed as the system is implemented. One such issue came up with the conclusion of the ICSID case ARB/06/13 where Peru won the case, but arbitrators determined that each party should bear its own costs in the arbitration. Generally, the SC determines the relevant agency's liability in a case, and in general requires it to pay the costs of the proceedings and of the award. Nonetheless, the SC is reviewing if the relevant agency should be made liable in a case where the measures taken were not found to be inconsistent with Peru's international investment commitments.

The SC has worked on the central database containing all IIAs mandated in the Law. The MEF reports that the database is fully completed, and the next step is to make its availability known to all the relevant actors, and to train them on how it is used. This new tool will allow all national, regional and local level officials to consult the different investment related commitments Peru has as they develop policies, regulations and enters into obligations with investors.

Peru's negotiation of investment agreements and contracts over the last decade created a complex and broad set of commitments that apply to all levels of government: national, regional and local (or municipal). Therefore, one of the biggest challenges faced by Peru in implementing the Response System is precisely making its advantages and characteristics widely known. Making the system and tools known to investors, the legal community and all relevant government officials at all levels will require considerable resources, effort and time.

During the first years of the system, training has centered on the members of the SC and their teams, especially through participation in seminars and training sessions organized by international organizations such as UNCTAD. Domestic training and making the system known to all relevant actors at all levels of government will

require a massive capacity-building effort, as well as a communication strategy toward investors. MEF reports that this will include all the agencies at a national, regional and local level endowed with the legal capacity to conclude investment agreements that bind the State.

The full implementation of the system will take time, and both investors and government officials at all levels will require training and practice before it is widely known and used. A reflection of this is that the MEF reports that the two cases filed before ICSID in 2010 did not go through the SC, but were registered with ICSID by the investor directly. Therefore, the SC only entered into these processes after international arbitration had been triggered. Peru foresees that future ISDS provisions will require investors to go before the SC before triggering international arbitration, although several of the existing IIAs do not require this step.

C. Cases of success

Since its creation, the SC has prevented investment disputes from reaching the stage of arbitration. The SC spearheaded negotiations in a case in the energy sector where the Ministry of Energy and Mines, as competent sector agency, formed part of the SC and was actively involved in the settlement of the dispute. The outcome did not include any compensation or payment, but a review of the regulations and interpretations. The MEF highlighted the positive outcome, which not only avoided international arbitration, but also allowed the relationship between the State and the investor to continue.

Another case where the SC was successful in avoiding international arbitration was in the transportation sector, where a Spanish investor and a municipality had a disagreement on the interpretation and implementation of a contract. Company representatives and counsel highlighted the importance of the SC in

bringing in and engaging the different relevant actors, including the municipality. The SC for this case also included the Ministry of Transportation, as competent sector agency. Representatives of the company involved recognized the importance of having the Ministry of Economy, Ministry of Foreign Affairs and ProInversión in the Commission, as well as the Ministry of Transportation who was especially relevant in the technical discussions. The decision-making power of the SC was clear in this process, and highlighted as an important element by investor representatives. There was recognition of the role of the SC in providing municipality representatives with the context and specificity of the commitments contained in the Peru-Spain BIT, and how they applied to the case at hand. Investor representatives appreciated the certainty with regard to the investment dispute institutional framework in Peru that the Response System provides, especially in setting up a single and clear window within the Peruvian authorities for investment disputes. They also highlighted the objective and fact-based fashion in which the SC undertakes its work eliminating political considerations, as well as the high technical and professional caliber of the officials that form part of the SC. The role of the SC allowed the contract implementation to continue, and re-established the relationship in the long-term.

Representatives from the legal community highlighted the importance of consolidating all IIA commitments at all levels of government in a single database. They additionally draw attention to the importance of having a central authority to provide agencies and government officials at all levels with guidance regarding international investment commitments entered into by Peru. While these positive elements are clear, some are of the opinion that there is space for improvement with regard to transparency and public access to information on the work undertaken by the SC. Others would welcome more outreach to the investment community on the characteristics and benefits of the Response System.

The public information component of the Response System website could contribute to this endeavor. Other countries such as Republic of Korea publish information about the cases resolved such as grievance summary and action taken,¹ while protecting confidential information.

The SC has been successful in detecting investment controversies and managing them before they reach international arbitration, thereby saving time and resources for the State and the investor, and contributing to a better and more predictable investment climate. Nevertheless, challenges remain, including with regard to making the system widely known and information on the Response System extensively and easily accessible.

Note

¹ <http://www.investkorea.org/InvestKoreaWar/work/ombman/eng/au/index.jsp?num=3>

V. GOOD PRACTICES LESSONS

Several countries have implemented or are planning investment prevention and management policies to guarantee understanding of IIA commitments, early detection of investment disputes, mechanisms for early management and proper coordination and representation of host governments in case of international arbitration.

Peru implemented an ambitious system to provide the government with the tools to prevent investment disputes, manage disagreements and, if need be, deal with investor-State international arbitration. Other countries have implemented different approaches, which are also successful.

As the Peru case shows, the full implementation of all aspects of a system can be a challenge. To date, Peru has successfully managed problems to avoid international arbitration and has consolidated the institutional framework for a well functioning defense of the State. Nevertheless, the purely preventive aspect will take longer to implement.

The following sections identify policy measures and instruments that Peru and other countries have implemented at various stages:

- Before a problem arises.
- After a problem has come up.
- Once arbitration has been initiated.

As Peru's example shows, these options can be adopted individually or several in tandem, depending on each country's specific institutional framework, level of development, experience in ISDS, etc. and some of the options can be used in any of the stages listed above.

A. How to prevent problems

While countries like Peru have followed investment promotion strategies, including the conclusion of IIAs, there has not always been appropriate information sharing among relevant domestic actors of the scope and broad application of these commitments to ensure proper implementation and compliance.

Preventing problems or conflicts with foreign investors is the best way of preventing treaty-based arbitration. In other words, it is better to anticipate sources of problems and take preventive action, rather than acting only after an incident arises and damage has been caused.

The following is a list of some of the policies taken by countries and that may be useful when designing and structuring a mechanism and system to prevent and deal with investment disputes.

1. Map and update agreements with ISDS provisions

Although the central government is generally in charge of negotiating BITs, FTAs, investment provisions and double taxation treaties, their commitments and discipline are applicable at all levels of Government. Like Peru, several countries also sign investment specific contracts such as legal stability contracts, privatization contracts, concessions, agreements for the exploration and exploitation of natural resources and all other agreements that provide for international arbitration in the case of a dispute.

For governments to adequately measure exposure and identify sectors and areas where liabilities may arise, these should also be centralized in a single focal-point. Peru created a centralized database for all these instruments and is a basis not only for identifying commitments but also for targeting relevant agencies.

2. Identify and monitor sensitive sectors

More than half of ICSID cases involve oil, gas and mining (26%), electric power and energy (13%), transportation (11%) and water, construction (7%) and water, sanitation and flood protection (7%).¹ Although each country is different, some sectors may be more susceptible to problems given the complexity of the schemes used such as privatization contracts, build-operate-transfer (BOT), public utilities or concessions. As was seen above, FDI in Peru has gone to some of these sectors, including mining and energy, and three of the nine ICSID cases where Peru is or has been a respondent are in the energy sector.

While the structure of incoming foreign investment is different for each country, and the mechanisms used to promote private investment differ, countries may benefit from providing special attention to operations in certain targeted sectors and specific training on IIA disciplines to agencies and officials actively involved in those relevant to each specific economy.

Monitoring these sectors and contracts allows countries to target agencies that work with foreign investors or issue regulations or decisions that affect them, and to make sure that they are aware of the obligations in IIAs in their day-to-day decision making. While this is not specifically an element of Peru's Response System, ProInversión maintains constant contact with current and potential investors, and maps sectors and country of origin of investors.

The Response System's SC in Peru identifies investment contacts within certain relevant agencies and sectors to facilitate information exchange, update training and promote early detection of any investment dispute. This practice enhances communication channels between the different officials involved with foreign investors, and may be a practice that other countries could find useful.

3. Identify obstacles to investment

ProInversión in Peru is the agency at the forefront of day-to-day contact with investors, and as a permanent member of the SC, provides relevant information on problems faced by investors that the SC can then refer to in its role of proposing changes or improvements to laws or regulations.

Permanent channels of communication with foreign investors are useful, be it through surveys, meetings or other means of interaction that allows governments to identify investment obstacles and possible problems. The identification of investment obstacles and permanent contact with foreign investors can provide countries with useful information to detect potential investment disputes early on, and take corrective measures before a problem becomes a dispute. As is the case in Peru, a country's investment promotion agency often maintains the closest and most fluid communication with foreign investors, and it may therefore play an important role in detecting, preventing and managing disputes.

4. Establish a central investment contact point

Peru created a SC as central investment contact point (CICP) in charge of centralizing and disseminating information on IIA provisions, providing guidance for implementation and compliance of IIA provisions, and managing the information on ISDS commitments, among others.

5. Build capacity and awareness of IIA provisions and commitments

IAs are normally negotiated by central governments. Because IIA provisions are generally applicable at all levels of government, it is important that officials at a national, regional and municipal level, and those that deal with foreign investors on a day-to-day basis understand

the scope and content of these commitments. A review by UNCTAD showed that almost half of recent cases relate to decisions taken by municipal or provincial governments or by State agencies in charge of specific sectors (UNCTAD, 2010, p. 66), who are not involved in IIA negotiations.

Peru is currently in the process of designing a communications strategy to make sure that relevant officials at all levels of government and investors are aware of the characteristics and advantages of the Response System and how to access its information and contact points. Countries frequently organize information sessions about agreements such as FTAs and economic partnership agreements for private sector and government officials. More recently, as ISDS proliferates, several countries have undertaken ambitious training programmes and workshops with relevant officials at different levels of government and investors to promote awareness of IIA and ISDS provisions and commitments specifically.

Efforts such as those described above (mapping sectors and obstacles) can help a government better target training by identifying agencies at a national and sub-national level, and entities involved in sectors with foreign investment that may enact measures that could be non-compliant with IIA commitments. It is important to ensure the continuity and regularity and updating of training, especially in ministries, sub-national entities and agencies where officials change frequently and information flow may be interrupted.

In tandem, it may be useful to identify investment contact points in agencies and sub-national entities and other targeted institutions and maintain follow-up activities with them. This can generate a network of officials with knowledge on IIA and ISDS issues, and promote appropriate information flow and dissemination of ISDS issues.

Constantly updating investment contact point information at all levels is useful to ensure, and to promote confidence building between different agencies and levels of government and the CICP, or the SC in the case of Peru. These contact points may consult with the CICP on the compatibility of measures that may be under consideration with IIA provisions. Additionally, if a dispute does arise, these contact points can be very useful in obtaining necessary information for defending the State.

Peru's Response System foresees capacity building to all Response System agencies. Since the creation of the system, much of the effort has been concentrated on consolidating all the relevant information, designing and implementing necessary software, and managing new and existing disputes. Besides awareness within government, it is also important to make investors and the legal community aware of the system and its characteristics and advantages. As relayed above, the SC expects to design a communications strategy to generate public awareness of the characteristics of IIA commitments and the benefits of the Peru's Response System in the near future.

6. Make agencies liable for enacting measures contrary to IIA provisions

Despite the fact that central governments are responsible vis-à-vis the investor for non-compliance of treaty provisions, Peru's legislation allows the SC to make the involved agency ultimately liable for the cost of the arbitration and/or the award.

Coupled with broad information sharing and training on IIA provisions, this policy may serve as a deterrent of measures not compatible with IIAs, and encourage agencies to reach out to the central investment contact point to consult on measures before they are taken or when problems do arise, thereby promoting early detection.

The SC is reviewing the application of this provision in the specific case where measures taken by involved agencies were found to be consistent with IIA provisions. Despite the fact that Peru won ICSID case ARB/06/13, arbitrators determined that each party should bear its own costs in the arbitration. The SC is examining if the relevant agency should be made liable for arbitration costs in this case where the measures taken were not found to be inconsistent with Peru's international investment commitments.

B. How to avoid the escalation of problems into disputes

Despite the best of efforts on the side of governments to avoid problems, difficulties with foreign investors may arise. In these cases, it is important for governments to put procedures into place that can determine the viability of an amicable solution of a disagreement with an investor and help facilitate it.

Peru's Response System empowers the SC to negotiate with the disgruntled investor and relevant agencies, and propose amicable solutions. The SC has succeeded avoiding problems from escalating into international arbitration. Parties involved have highlighted that the legal empowerment given to the SC to engage government agencies at all levels and to negotiate are very important elements that have contributed to the success of the SC.

The SC serves as a single gateway of entry for foreign investors with concerns or complaints. Even when foreign investors go to the agency responsible for taking the measure that triggered a dispute - the involved agency - the SC can serve as a neutral third party and facilitate resolution of concerns before they become disputes.

1. Detect problems early on

The longer a problem remains, the more serious it tends to become. Therefore, an early detection system can help governments identify possible disputes and facilitate problem-solving with the investor before getting to the stage of arbitration.

Peru created a requirement for agencies at all levels of government and State enterprises to report problems with foreign investors within a set period of time after they come up. This allows the SC to come into the process at an early stage, and try to find solutions to investment controversies and to work with relevant agencies in problem-solving.

2. Encourage administrative review of investor problems

Before going to international dispute settlement, investors may be encouraged to initiate domestic administrative review of their problem. An administrative review of a measure by a higher level or body in many instances can modify measures that are contrary to commitments in IIAs, or provide for parallel measures to reduce adverse impact on the investment.

While not a part of the Response System itself, some of Peru's investment agreements and instruments require recourse and exhaustion of domestic administrative review procedures before submission of a dispute to arbitration and in some cases limit the length of time of this review. Requiring investors to exhaust this stage before entering any international dispute settlement procedure can save time and resources for the investor and for the government, and provide speedy administrative resolution to problems, thus avoiding lengthy and costly arbitration.

3. Designate a lead agency while seeking the cooperation of other agencies

Peru created a predictable and stable institutional set-up for investment disagreements that can trigger international arbitration. Practitioners expressed the usefulness of a specific contact point – the SC – for these disputes.

The SC provides the investor with a single central alternative counterpart that is empowered to promote early detection and amicable resolution on disagreements with investors. Given its early involvement and knowledge of the dispute, it is also in a better position to coordinate the defense of the State if the issue does go to international arbitration. The multi-agency nature of Peru's SC with a clear decision-making process was identified as a strong point in Peru's model.

While the multi-agency commission approach is very useful in achieving a comprehensive view of a dispute, consensus building may however not be conducive to the coherent and structured building of a case. Therefore, if the multi-agency approach is taken, it is important to have clear guidelines with regard to decision-making, and to designate a specific lead agency in charge of overall coordination and follow-up, with a clear authority structure within the government agencies involved.

A single government authority and concentrating all ISDS cases in it creates a knowledge pool in government that will enable informed and competent management of ISDS cases. Government officers will accumulate experience and expertise in dealing with investors and ISDS cases, which will lead to more effective management of cases and better outcomes for the State.

4. Share case-specific information while ensuring confidentiality

In seeking amicable resolution or in defending the State, it is important to have full cooperation of the involved agency and of all other government agencies that may be relevant to the dispute. Complete, timely and accurate information derived from all relevant sources is necessary for the commission or lead agency and legal counsel to fully understand the dispute and to structure alternative settlements and packages for any stage of the dispute, including amicable settlement negotiations, conciliation or other alternative forms of dispute settlement.

Arguably, information is even more important in the arbitration itself, and the commission and legal counsel can only build a strong case based on the information made available to them by the involved agency and any other relevant sector authority.

Peru's Response System requires all pertinent cooperation with the SC from all government agencies involved in an investment dispute, including access to all information required to defend the State in an investment dispute. An example of this is Special Decree N° 170-2007-EF, which authorizes Peru's tax authority – SUNAT – to provide the SC with information relevant to case ARB/07/6, Tza Yap Shum v. Republic of Peru.

Additionally, given the sensitive nature of the information managed during ISDS cases (including cost structure, supply chain, etc.), Peru specifically defined in Supreme Decree 125-2008-EF that the information managed in ISDS cases is confidential, and allows publication only if the commission, prior consultation of legal counsel, lifts its confidentiality.

While agencies may want to cooperate voluntarily, given the time constraints and complexity of some of the cases as well as that of building a case, these types of provision in law provide the SC with the

legal power to require information from all relevant sources within strict time limits.

5. Develop, propose and use alternative dispute resolution mechanisms

Alternative dispute resolution (ADR) refers to methods other than arbitration for settling a dispute. Peru's system specifically refers to the SC's capacity to recommend formulas for "transaction, conciliation and/or amicable settlements in a given controversy".² These alternatives often involve a neutral third-party to assist in the negotiation of a settlement that is mutually agreeable.

ADR is available to the parties in a dispute even after ISDS procedures have been initiated, although the earlier ADR begins, the less the parties will spend on preparing their cases for costly arbitration. Additionally, direct negotiations and ADR methods provide the parties with larger flexibility in terms of the process itself, and with a broader range of options that go beyond the interpretation of a legal framework and identification of violation or damage that arbitration is limited to. In direct negotiation and ADR methods, the parties can be more inclined toward a problem-solving mode that can actually promote long-term engagement and relationship building with the investor, and that the violation-damage-compensation scheme of arbitration cannot provide.

Unlike ISDS where the government has given its prior consent in an agreement or contract, ADR requires both parties to be involved throughout the process of negotiation, and in the process of implementation and payment of a settlement.

For ADR to work in an investor-State context, the lead agency or commission needs to be adequately empowered to negotiate with the investor, propose alternatives, and commit to settlements, such as the SC is empowered in Peru's Response System.

Some countries have limitations on the capacity of public officials to negotiate or ambiguous provisions that expose public officials to personal liability in cases they settle. Therefore, for early settlements or ADR to work, governments must have clear negotiating mandates for the commission or lead agency, with unambiguous guidelines and rules for settlement. In Peru's case, any settlement must be reported to the Council of Ministers and authorized through a Supreme Resolution by the ministers of the sectors that form part of the SC, and by the minister of the sector that would implement the agreement.

Unlike arbitration, where a panel rules a binding decision and where the role of government representatives is limited to making the case for the State but the award is crafted by the arbitrators, direct negotiations and ADR require personal involvement in the settlement, and constructive, creative and some times assertive thinking on the part of government representatives. Since they are dealing with official funds, it is important that the government representatives be adequately empowered and that guidelines for this type of negotiation be clear.

ISDS arbitration has advantages that direct negotiation and ADR do not have. The most important is that unlike arbitration, the settlements in direct negotiations and ADR are not binding to the parties and may be difficult to enforce. Additionally, not all measures taken by a government are subject to negotiation, especially those of general application such as taxes or environmental standards.

International arbitration where a private party challenges a sovereign State is an exception to international law principles and poses distinctive challenges. A negotiated solution may be politically costly

for a government, and there will always be critics who will say that the outcome of arbitration would have been more beneficial for the State coffers than the settlement reached with the investor, and subsequent allegations of corruption may arise. Governments are aware that it is difficult to remove political realities from investment disputes, and may therefore be more inclined toward arbitration. Nevertheless, the cost of arbitration and large sums adjudicated in some ISDS arbitration cases have generated interest among governments to explore alternative methods to arbitration.

C. How to effectively and efficiently manage ISDS arbitration

Despite the best efforts on the part of the parties, at times dispute settlement procedures are initiated and it is important that countries have the appropriate resources, institutional framework and operational conditions to adequately manage the process and defend the country's interests. Peru's system provides all these elements, and creates an in-house expertise that will allow better defense of State interests if arbitration is triggered.

1. Define and empower lead agency or commission

As in the case of Peru's SC, given the broad nature of foreign investment issues, often several agencies as well as the involved agency that took the measure that triggered the dispute participate in an ISDS case. Peru's approach of having permanent members and ad-hoc members depending on the dispute provides flexibility and sector-specific participation.

The designation of the SC as the one and only representative of the State in international investment arbitration provides certainty to all involved, and generates in-house ISDS expertise within government. Additionally, Peruvian law endows the SC with broad powers vis-à-vis all government agencies in all investor-State conflict management issues.

Representatives of investors that have dealt with the Commission praise its multi-agency composition, clear decision-making capacity, and power to engage other agencies at all levels of government. While the SC is only a couple of years old, the clear mandate and empowerment of the SC under the Response System is a positive characteristic that facilitates dispute management and settlement.

2. Ensure funds for defense and specialized advisors and legal costs

Investor-State dispute settlement requires parties to cover not only the costs of the arbitration itself, but awards against a government can imply considerable expense for the treasury. ISDS processes can be lengthy and costly. Peru's budgetary and institutional arrangements ensure the needed resources for the dispute settlement process as such, including costs related to the arbitrators, administrative costs, and possibly outside counsel, as well as eventually for the payment of an award.

With the Response System, Peru solved the problem faced by many countries that face difficulty budgeting for a case or cases that have not materialized. Many countries have rigid budgeting processes and cycles that create difficulties when disputes arise that have not been considered from the beginning of the fiscal year. Some systems penalize unused funds at the end of the fiscal year, which deter agencies from budgeting funds for disputes that may never happen.

Unfortunately, these situations create difficulties for countries to secure funds for the ISDS process if it does arise.

Given the uniqueness of each country's budgetary cycle, system, rules, etc., each country has to find its own approach to confront the limitations its system may pose, in order to ensure the prompt and necessary funds if an ISDS process does come up.

Notes

1 ICSID Caseload – Statistics, Issue 2010-2

2 Supreme Decree 125-2008-EF, Article 13

VI. CONCLUSIONS

There are currently over 3,000 bilateral investment treaties and FTAs with investment chapters in force, and FDI continues to be a dynamic force in the international economy. While in general the interaction between foreign investors and host countries is harmonious, problems will arise and governments, especially in the developing world, are strengthening their institutional capacity to prevent and manage international investor-State dispute settlement proceedings.

This paper looks at several tools that Peru has implemented to prevent international ISDS, and to be better prepared to manage ISDS cases when they do arise. Peru's response system constitutes a good example of how a country can begin to prevent problems even before they arise and deal with them if they do. Although prevention policies are recent and evolving, several lessons can be learned from reviewing the options that have been identified so far.

Given the broad scope of IIA commitments, a well-functioning ISDS prevention and management system will likely require high-level government commitment to promote appropriate legislation and to implement the system. In some countries, useful elements of an ISDS system may only be possible through law. Examples of elements adopted by Peru include mandatory and timely information sharing by the involved agency and relevant sector ministries, empowerment of the lead agency or commission to negotiate with investors and lead State defense and necessary budgetary arrangements to guarantee the required funds for the arbitral proceedings and payment of awards.

The teams that negotiate IIA commitments are generally not the same as those who deal with investors on a daily basis, or those who defend investors in ISDS cases. Agencies or sectors may adopt measures that are inconsistent with IIA provisions. Therefore, a broad

and continued information sharing and workshop programme to promote IIA awareness in government officials is a strong ISDS prevention tool. Accurate mapping of sectors with high levels of investment and of investment obstacles can facilitate strategic targeting of sectors and agencies. As can be seen in the case of Peru, complete implementation of a system can take several years, especially as regards consolidation of all information, and generating awareness of the characteristics, advantages and obligations a the system.

While early detection is a useful tool to prevent arbitration, governments must set up the system to secure it, and inform all actors in the system of their responsibilities in terms of information sharing with the lead investment agency, mandatory assignment of investment contact points and prompt reporting if investment disputes or disagreements arise.

The creation by Peru of a single government body to manage disputes generates expertise within government, and provides investors and relevant agencies with predictability and certainty regarding the investment institutional framework for preventing and dealing with investment disputes.

Each country is different and can choose the policy instruments that best fit its needs. In general investors are rent-seekers and not litigators, and therefore share the interest of the government of arriving at a speedy and mutually beneficial settlement of a dispute, when possible. Therefore, a transparent, well-defined and well-structured ISDS prevention system can positively contribute to an improved investment climate.

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ANNEX 1

BILATERAL INVESTMENT TREATIES AND FREE TRADE AGREEMENTS SIGNED BY PERU SINCE 1993

<u>Country</u>	<u>Entry into Force</u>
Argentina	24-Oct-1996
Australia	2-Feb-1997
Belgium–Luxembourg Economic Union	11-Sep-2008
Bolivia	19-Mar-1995
Canada ¹	1-Aug-2009
Chile ²	1-Mar-2009
China ³	1-Mar-2010
Colombia ⁴	21-Mar-2004
Cuba	25-Nov-2001
Czech Republic	6-Mar-1995
Denmark	17-Feb-1995
Ecuador	9-Dec-1999
El Salvador	15-Dec-1996
Finland	14-Jun-1996
France	30-May-1996

Germany	1-May-1997
Italy	18-Oct-1995
Japan	10-Dec-2009
Malaysia	25-Dec-1995
Netherlands	1-Feb-1996
Norway	5-May-1995
Paraguay	18-Dec-1994
Portugal	18-Oct-1995
Republic of Korea	20-Apr-1994
Rumania	1-Jan-1995
Singapore ⁵	1-Aug-2009
Spain	17-Feb-1996
Sweden	1-Aug-1994
Switzerland	23-Nov-1993
Thailand	15-Nov-1993
United Kingdom	21-Apr-1994
United States ⁶	1-Feb-2009
Venezuela	18-Sep-1997

Source:

<http://www.proinversion.gob.pe/0/0/modulos/JER/PlantillaSectorHijo.aspx?ARE=0&PFL=0&JER=3860>

Notes

¹ Investment Chapter is part of FTA. A BIT had been signed in 2006.

² Investment Chapter is part of FTA. A BIT had been signed in 2000.

³ Investment Chapter is part of FTA. A BIT had been signed in 1994.

⁴ Peru and Colombia signed a BIT that enhances the commitments on investment already in place.

⁵ Investment Chapter is part of FTA. A BIT had been signed in 2003.

⁶ Investment Chapter is part of FTA.

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