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Privately financed infrastructure projects: draft chapters of a legislative guide on privately financed infrastructure projects

Report of the Secretary-General

Addendum

VI. Settlement of disputes

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Notes on the legislative recommendations

A. General remarks

1. An important factor for the implementation of privately financed infrastructure projects is the legal framework in the host country for the settlement of disputes. Investors, contractors and lenders will be encouraged to participate in projects in countries where they have the confidence that any disputes arising out of contracts forming part of the project will be resolved fairly and efficiently. By the same token, efficient procedures for avoiding disputes or settling them expeditiously will facilitate the exercise of the contracting authority's monitoring functions and reduce the contracting authority's overall administrative cost. In order to create a more hospitable climate for investors, the legal framework of the host country should give effect to certain basic principles, such as the following: foreign firms should be guaranteed access to the courts under substantially the same conditions as domestic ones; parties to private contracts should have the right to choose foreign law as the law applicable to their contracts; foreign judgments should be enforceable; and there should be neither unnecessary restrictions to access to non-judicial dispute settlement mechanisms nor legal impediments for the creation of facilities for settling disputes amicably outside the judicial system.

2. Privately financed infrastructure projects typically require the establishment of a network of interrelated contracts and other legal relationships involving various parties. Legislative

provisions dealing with the settlement of disputes arising in the context of these projects must take account of the diversity of relations, which may call for different dispute settlement methods depending on the type of dispute and the parties involved. The main disputes may be divided into three broad categories:

(a) *Disputes arising under agreements between the concessionaire and the contracting authority and other governmental agencies*. In most civil law countries, the project agreement is governed by administrative law (see chap. VII, "Other relevant areas of law", paras. 24-27), while in other countries the agreement is in principle governed by contract law as supplemented by special provisions developed for government contracts for the provision of public services. This regime may have implications for the dispute settlement mechanism that the parties to the project agreement may be able to agree upon. Similar considerations may also apply to certain contracts entered into between the concessionaire and governmental agencies or government-owned companies supplying goods or services to the project or purchasing goods or services generated by the infrastructure facility;

(b) *Disputes arising under contracts and agreements entered into by the project promoters or the concessionaire with related parties for the implementation of the project*. These contracts usually include at least the following: (i) contracts between parties holding equity in the project company (e.g. shareholders' agreements, agreements regarding the provision of additional financing or arrangements regarding voting rights); (ii) financing and related agreements, which involve, apart from the project company, parties such as commercial banks, governmental lending institutions, international lending institutions and export credit insurers; (iii) contracts between the project company and contractors, which themselves may be consortia of contractors, equipment suppliers and providers of services; (iv) contracts between the project company and the parties who operate and maintain the project facility; and (v) contracts between the concessionaire and private companies for the supply of goods and services needed for the operation and maintenance of the facility;

(c) *Disputes between the concessionaire and other parties*. These other parties include the users or customers of the facility. These users may be, for example, a government-owned utility company that purchases electricity or water from the project company so as to resell it to the ultimate users; commercial companies, such as airlines or shipping lines contracting for the use of the airport or port; or individual persons paying for the use of a toll road. The parties to these disputes may not necessarily be bound by any prior legal relationship of a contractual or similar nature.

B. Disputes between the contracting authority and the concessionaire

3. Disputes that arise under the project agreement frequently involve problems that do not often arise in connection with other types of contracts. This is due to the complexity of infrastructure projects and the fact that they are to be performed over a long period of time, with a number of enterprises participating in the construction and in the operational phases. In addition, disputes under project agreements may concern highly technical matters connected with the construction processes, the technology incorporated in the works and the conditions for operating the facility. Furthermore, these projects usually involve governmental agencies and a high level of public interest. These circumstances place emphasis on the need to have mechanisms in place that avoid as much as possible the escalation of disagreements between the parties and preserve their business relationship; that prevent the disruption of the

construction works or the provision of the services; and that are tailored to the particular characteristics of the disputes that may arise.

4. Some of the main considerations particular to the various phases of implementation of privately financed infrastructure projects are discussed in this section. The settlement of the concessionaire's grievances in connection with decisions by regulatory agencies has been considered in the context of the authority to regulate infrastructure services (see chap. I, "General legislative and institutional framework", paras. 51-53). The settlement of disputes arising during the process of selecting a concessionaire (that is, pre-contractual disputes) has also been dealt with earlier in the Guide (see chap. III, "Selection of the concessionaire", paras. 118-122).

1. General considerations on methods for prevention and settlement of disputes

5. The issues that most frequently give rise to disputes during the life of the project agreement are those related to possible breaches of the agreement during the construction phase, the operation of the infrastructure facility or in connection with the expiry or termination of the project agreement. These disputes may be very complex and they often involve highly technical matters that need to be resolved speedily in order not to disrupt the construction or the operation of the infrastructure facility. For these reasons it is advisable for the parties to devise mechanisms that allow for the choice of competent experts to assist in the settlement of disputes. Furthermore, the long duration of privately financed infrastructure projects makes it important to devise mechanisms to prevent, as much as possible, disputes from arising so as to preserve the business relationship between the parties.

6. With a view to achieving the objectives mentioned above, project agreements often provide for composite dispute-settlement clauses designed to prevent, to the extent possible, disputes from arising, to foster reaching agreed solutions and to put in place efficient dispute settlement methods when disputes nevertheless arise. Such clauses typically provide for a sequential series of steps starting with an early warning of issues that may develop into a dispute unless the parties take action to prevent them. When a dispute does occur it is provided that the parties should exchange information and discuss the dispute with a view to identifying a solution. If the parties are unable to resolve the dispute themselves, then either party may require participation of an independent and impartial third party to assist them to find an acceptable solution. In most cases, adversarial dispute settlement mechanisms are only used when the disputes cannot be settled through the use of such conciliatory methods.

7. However, there may be limits to the parties' freedom to agree to certain dispute prevention or dispute settlement methods: one such limit may arise from the subject matter of the dispute; another limit may in some legal systems arise from the governmental character of the contracting authority. In some legal systems, the traditional position has been that the Government and its agencies may not agree on certain dispute settlement methods, in particular, arbitration. This position has often been restricted to mean that it does not apply to public enterprises of industrial or commercial character, which, in their relations with third parties, act pursuant to private law or commercial law.

8. Limitations to the freedom to agree on dispute settlement methods, including arbitration, may also relate to the legal nature of the project agreement. Under some civil law systems, project agreements may be regarded as administrative contracts, with the consequence that disputes arising thereunder need to be settled through the judiciary or through administrative courts of the host country. Under other legal systems, similar prohibitions may be expressly

included in legislation or judicial precedents directly applicable to project agreements, or may be the result of established contract practices, usually based on legislative rules or regulations.

9. For countries that wish to allow the use of non-judicial methods, including arbitration, for the settlement of disputes arising in connection with privately financed infrastructure projects, it is important to remove possible legal obstacles and to provide a clear authorization for domestic contracting authorities to agree on dispute settlement methods. The absence of such legislative authority may give rise to questions as to the validity of the dispute-settlement clause and cause delay in the settlement of disputes. If, for example, an arbitral tribunal finds that the arbitration agreement has been validly concluded despite any subsequent defence that the contracting authority had no authorization to conclude it, the question may reappear at the recognition and enforcement stage before a court in the host country or before a court of a third country where the award is to be recognized or enforced.

2. Commonly used methods for preventing and settling disputes

10. The following paragraphs set out the essential features of methods used for preventing and settling disputes and consider their suitability for the various phases of large infrastructure projects, namely, the construction phase, the operational phase and the post-termination phase. Although the project agreement usually provides for composite dispute prevention and dispute settlement mechanisms, care should be taken to avoid excessively complex procedures or to impose too many layers of different procedures. The brief presentation of selected methods for dispute prevention and dispute settlement methods contained in the following paragraphs is intended to inform legislators about the particular features and usefulness of these various methods. It should not be understood as a recommendation for the use of any particular combination of methods.

(a) Early warning

11. Early warning provisions may be an important tool to avoid disputes. Under these provisions, if one of the parties to a contract feels that events that have occurred, or claims that the party intends to make, have the potential to cause disputes, these events or claims should be brought to the attention of the other party as soon as possible. Delays in making these claims are not only a source of conflict, because they are likely to surprise the other party and therefore create resentment and hostility, but they also render the claims more difficult to prove. For that reason, early warning provisions typically require the claiming party to submit a quantified claim, along with the necessary proof, within an established time period. To make the provision effective, a sanction is frequently included for non-compliance with the provision, such as the loss of the right to pursue the claim or an increased burden of proof. In infrastructure projects, early warning frequently refers to events that might adversely affect the quality of the works or the public services, increase their cost, cause delays or endanger the continuity of the service. Early warning provisions are therefore useful throughout the duration of an infrastructure project.

(b) Partnering

12. Another tool that is used as a means of dispute avoidance is partnering. The object of partnering is to create, through mutually developed formal strategies and from the outset of a project, an environment of trust, teamwork and cooperation among all key parties involved in the project. Partnering has been found to be useful to avoid disputes and to commit the parties to work efficiently to achieve the goals of the project. The partnering relationships are defined in workshops attended by the key parties to the project, and usually organized by the

contracting authority. At the initial workshop, a mutual understanding of the concept of partnering is established, goals for the project for all the parties are defined and a procedure to resolve critical issues quickly is developed. At the conclusion of this workshop, a "partnering charter" is drafted and signed by the participants, signifying their commitment to work jointly towards the success of the project. The charter usually includes an issue resolution procedure designed to determine claims and resolve other problems, beginning at the lowest possible level of management and at the earliest possible opportunity. If a solution is not reached within a given time- frame, the issue is raised to the next level of management. Outsiders to the project are only called in if no agreement by the people responsible for the project is achieved.

(c) Facilitated negotiation

13. The purpose of this procedure is to aid the parties in the negotiation process. The parties appoint a facilitator at the commencement of the project. His function is to assist the parties in resolving any disputes, without providing subjective opinions on the issues, but rather coaxing them into analysing thoroughly the merits of their cases. This procedure is specially useful when there are numerous parties involved who would find it difficult to negotiate and coordinate all the differing opinions without such facilitation.

(d) Mediation and conciliation

14. The term "conciliation" is used in the Guide as a broad notion referring to proceedings in which a person or a panel assists the parties in an independent and impartial manner in their attempt to reach an amicable settlement of their dispute. Conciliation differs from negotiations between the parties in dispute (in which the parties would typically engage after the dispute has arisen) in that conciliation involves independent and impartial assistance to settle the dispute, whereas in settlement negotiations between the parties no third-person assistance is involved. The difference between conciliation and arbitration is that conciliation ends either in the settlement of the dispute agreed by the parties or it ends unsuccessfully; in arbitration, however, the arbitral tribunal imposes a binding decision on the parties, unless they have settled the dispute before the award is made. In practice, such conciliation proceedings are referred to by various expressions, including "mediation". Nevertheless, in the legal tradition of some countries, a distinction is drawn between conciliation and mediation to emphasize the fact that, in conciliation, a third party is trying to bring together the disputing parties to help them reconcile their differences, while mediation goes further by allowing the mediator to suggest terms for the resolution of the dispute. However, the terms "conciliation" and "mediation" are used as synonyms more frequently than not.

15. Conciliation is increasingly being increasingly practised in various parts of the world, including in regions where it was not commonly used in the past. This trend is reflected, inter alia, in the establishment of a number of private and public bodies offering conciliation services to interested parties. The conciliation procedure is usually private, confidential, informal and easily pursued. It may also be quick and inexpensive. The conciliator may assume multiple roles and is in general more active than a facilitator. He or she may frequently challenge the parties' position to stress weaknesses that usually facilitate agreement and, if authorized, may suggest possible settlement scenarios. The procedure is generally non-binding and the conciliator's responsibility is to facilitate settlement by directing the parties' attention to the issues and possible solutions, rather than passing judgement. This procedure is particularly useful when there are many parties involved and it would therefore be difficult to achieve an agreement by direct negotiations.

16. If the parties provide for conciliation in the project agreement, they will have to settle a number of procedural questions in order to increase the chance of a settlement. Settling such procedural questions is greatly facilitated by the incorporation into the contract, by reference, of a set of conciliation rules such as the UNCITRAL Conciliation Rules.[1] Other sets of conciliation rules have been prepared by various international and national organizations.

(e) Non-binding expert appraisal

17. This is a procedure where a neutral third party is charged with providing an appraisal on the merits of the dispute and suggested outcome. It serves as a "reality check" showing the contesting parties what the possible outcome of the more expensive and usually slower binding procedures such as arbitration or court proceedings would be. This procedure is useful where the parties have difficulty in communicating because their positions have become entrenched or where they do not see clearly the weaknesses of their positions or the strengths of the other party's positions. A non-binding expert appraisal is usually followed by negotiations, either direct or facilitated.

(f) Mini-trial

18. This procedure assumes the form of a mock trial in which site-level personnel of each party make submissions to a "tribunal" composed of a senior executive of each party and a third neutral person. After the submissions, which are typically to be made within predetermined time periods, the executives enter into a facilitated negotiation procedure with the assistance of a neutral person, to try to reach an agreement taking advantage of the issues that have been elucidated during the "trial". Counsel for the parties are frequently present and are useful in identifying the relevant issues. The purpose of the mini-trial is to inform senior executives of the issues involved in the dispute and to serve as a reality check of what the outcome of a real trial might be.

(g) Senior executive appraisal

19. This procedure is similar to the mini-trial but it is less adversarial and uses a more consensus-oriented approach. The procedure begins with the presentation of short position papers by each party, followed by short responses. At an "appraisal conference" headed by a facilitator, a senior executive from each of the parties makes brief oral presentations elucidating the issues submitted in the position papers or other points raised by the parties or the facilitator. This conference is followed by a negotiation meeting, chaired by the facilitator, with a view to reaching an agreement. Both the mini-trial and the senior executive appraisal tend to be less of a strong reality check than the non-binding expert appraisal and therefore less likely to motivate difficult decisions in the absence of commercial pressure to do so.

(h) Review of technical disputes by independent experts

20. During the construction phase, the parties may wish to consider providing for certain types of disputes to be referred to an independent expert appointed by both parties. This method may be of particular use in connection with disagreements relating to technical aspects of the construction of the infrastructure facility (for example, whether the works comply with contractual specifications or technical standards).

21. The parties may, for instance, appoint a design inspector or a supervisor engineer, respectively, to review disagreements relating to the inspection and approval of the design, and the progress of construction works (see chap. IV, "Construction and operation of

infrastructure", paras. 69-79). The independent experts should have expertise in the designing and construction of similar projects. The powers of the independent expert (such as whether the independent expert makes recommendations or issues binding decisions), as well as the circumstances under which the independent expert's advice or decision may be sought by the parties, should be set forth in the project agreement. In some large infrastructure projects, for instance, the advice of the independent expert may be sought by the concessionaire whenever there is a disagreement between the concessionaire and the contracting authority as to whether certain aspects of the design or construction works conform with the applicable specifications or contractual obligations. Referral of a matter to a design inspector or to a supervising engineer, as appropriate, may be particularly relevant in connection with provisions in the project agreement that require prior consent of the contracting authority for certain actions by the concessionaire, such as final authorization for operation of the infrastructure facility (see chap. IV, "Construction and operation of infrastructure", para. 78).

22. Independent experts have been often used for the settlement of technical disputes under construction contracts, and the various mechanisms and procedures developed in the practice of the construction industry may be used, mutatis mutandis, in connection with privately financed infrastructure projects. However, it should be noted that the scope of disputes between the contracting authority and the concessionaire is not necessarily the same as would be the case for disputes that typically arise under a construction contract. This is so because the respective positions of the contracting authority and the concessionaire under the project agreement are not fully comparable with those of the owner and the performer of works under a construction contract. For instance, disputes concerning the amount of payment due to the contractor for the quantities of works actually performed, which are frequent in construction contracts, are not typical for the relations between contracting authority and concessionaire, since the latter does not usually receive payments from the contracting authority for the construction works performed.

(i) Dispute review boards

23. Project agreements for large infrastructure projects often establish permanent boards composed of experts appointed by both parties, possibly with the assistance of an appointing authority, for the purpose of assisting in the settlement of disputes that may arise during the construction and the operational phases (referred to in the *Guide* as "dispute review boards"). Proceedings before a dispute review board can be informal and expeditious, and tailored to suit the characteristics of the dispute that it is called upon to settle. The appointment of a dispute review board may prevent misunderstandings or differences between the parties from developing into formal disputes that would require settlement in arbitral or judicial proceedings. In fact, its effectiveness as a tool for avoiding disputes is one of the special strengths of this procedure, but a dispute review board may also serve as a mechanism to resolve disputes, in particular when the board is given the power to render binding decisions.

24. Under the dispute review board procedure, the parties typically select, at the outset of the project, three experts renowned for their knowledge in the field of the project to constitute the board. These experts may be replaced if the project comprises different stages that may require different expertise (that is, different expertise will be required during the construction of the facility from during the later administration of the public service), and in some large infrastructure projects more than one board has been established. For example, one dispute review board may deal exclusively with disputes regarding matters of a technical nature (e.g. engineering design, fitness of certain technology, compliance with environmental standards) whereas another board may deal with disputes of a contractual or financial nature (regarding,

for instance, the amount of compensation due for delay in issuing licences or disagreements on the application of price adjustment formulas). Each board member should be experienced in the particular type of project, including experience in the interpretation and administration of project agreements, and should undertake to remain impartial and independent of the parties. These persons may be furnished with periodic reports on the progress of construction or on the operation of the infrastructure facility, as appropriate, and may be informed immediately of differences arising between the parties. They may meet with the parties, either at regular intervals or when the need arises, to consider differences that have arisen and to suggest possible ways of resolving those differences.

25. In their capacity as agents to avert disputes, the members of the board may make periodic visits to the project site, meet with the parties and keep informed of the progress of the work. These meetings help identify any potential conflicts early, before they start festering and turn into full-fledged disputes. When potential conflicts are detected, the board proposes solutions, which, given the expertise and prestige of its members, are likely to be accepted by the parties. Referral of a dispute triggers an evaluation by the board, which is done in an informal manner, typically by discussion with the parties during a regular site visit. The board controls the discussion, but each party is given a full opportunity to state its views, and the dispute review board is free to ask questions and to request documents and other evidence. The advantages of conducting hearings at the job site, soon after the events have occurred and before adversarial positions have hardened, are obvious. The board then meets privately and seeks to formulate a recommendation or a decision. If the parties do not accept these proposals and disputes do arise, the board, if authorized to do so by the parties, is in a unique position to solve them expeditiously because of its familiarity with the problems and contractual documents.

26. Given their usually long duration, many circumstances relevant to the execution of privately financed infrastructure projects may change before the end of the concession term. While the impact of some changes may be automatically covered in the project agreement (see chap. IV, "Construction and operation of infrastructure", paras. 126-130) there are changes that might not lend themselves easily to inclusion in an automatic adjustment mechanism or that the parties may prefer to exclude from such a mechanism. It is therefore important for the parties to establish mechanisms for dealing with disputes that may arise in connection with changing circumstances. This is of particular significance for the operational phase of the project. Where the parties have agreed on rules that allow a revision of the terms of the project agreement following certain circumstances, the question may arise as to whether those circumstances have occurred and, if so, how the contractual terms should be changed or supplemented. With a view to facilitating a resolution of possible disputes and avoiding a stalemate in case the parties are unable to agree on a contract revision, it is advisable for the parties to clarify whether and to what extent certain contractual terms may be changed or supplemented by the dispute review board. It may be noted, in this context, that the parties might not always be able to rely on an arbitral tribunal or a domestic court for that purpose. Indeed, under some legal systems, courts and arbitrators are not competent to change or supplement contractual terms. Under other legal systems, courts and arbitrators may do so only if they are expressly so authorized by the parties. Under yet other legal systems, arbitrators may do so but courts may not.

27. The law governing arbitral or judicial proceedings may determine the extent to which the parties may authorize arbitrators or a court to review a decision of the dispute review board. Excluding such review has the advantage that the decision of the dispute review board would be immediately final and binding. However, permitting such a review gives the parties greater assurance that the decision will be correct. Early clauses on dispute review boards did not

provide that their recommendations would become binding if not challenged in arbitral or judicial proceedings. In practice, however, the combination of the persuasive force of unanimous recommendations by independent experts agreed by the parties has led both contracting authorities and project companies to accept the recommendations voluntarily rather than litigate. Recent contract provisions on dispute review boards usually provide that a decision of the board, while not immediately binding on the parties, becomes binding unless one or both parties refer the dispute to arbitration or initiate judicial proceedings within a specified period of time. Apart from avoiding potentially protracted litigation, the parties often take into account the potential difficulty of overcoming what might be regarded by the court or arbitral tribunal as a powerful recommendation, inasmuch as it had been made by independent experts familiar with the project from the outset and was based on contemporaneous observation of the project prior to, and at the time of, the dispute having first arisen.

28. Although this occurs very rarely, the parties may agree to make the board's decision final and binding. It should be noted, however, that despite the parties' agreement to be bound by the board's decision, under many legal systems, the decision by the dispute review board, while binding as a contract, may not be enforceable in a summary proceeding, such as a proceeding for the enforcement of an arbitral award, since it does not have the status of an arbitral award. If the parties contemplate providing for proceedings before a dispute review board, it will be necessary for them to settle various aspects of those proceedings in the project agreement. It would be desirable for the project agreement to delimit as precisely as possible the authority conferred upon the dispute review board. With regard to the nature of their functions, the project agreement might authorize the dispute review board to make findings of fact and to order interim measures. It may specify the functions to be performed by the dispute review board and the type of issues with which they may deal. If the parties are permitted to initiate arbitral or judicial proceedings within a specified period of time after the decision is rendered, the parties might specify that findings of fact made by a dispute review board are to be regarded as conclusive in arbitral or judicial proceedings. The project agreement might also obligate the parties to implement a decision by the dispute review board concerning interim measures or a decision on the substance of specified issues; if the parties fail to do so, they will be considered as having failed to perform a contractual obligation. Regarding the duration of the board's functions, the project agreement may provide that the board will continue to function for a certain period beyond the expiry or termination of the project agreement, in order to deal with disputes that may arise at that stage (for example, disputes as to the condition of and compensation due for assets handed over to the contracting authority).

(j) Non-binding arbitration

29. This procedure is sometimes used when less adversarial methods such as facilitated negotiation, conciliation or dispute review board procedures have been unsuccessful. Non-binding arbitration is conducted in the same manner as binding arbitration, and the same rules may be used except that the procedure ends with a recommendation. The procedure contemplates that the parties will proceed directly to litigation if the dispute is still unresolved under non-binding arbitration. Those who choose this procedure do so (a) if they have reservations about the binding nature of arbitration; or (b) as an incentive to avoid both arbitration and litigation, arbitration because it would seem redundant to go through the same procedure twice and litigation because of its length and cost.

(k) Arbitration

30. In recent years, arbitration has been used increasingly for settling disputes arising under privately financed infrastructure projects. Arbitration is typically used both for the settlement of disputes that arise during the construction or operation of the infrastructure facility and for the settlement of disputes related to the expiry or termination of the project agreement. Arbitration is preferred by private investors and lenders, in particular foreign ones, since arbitral proceedings may be structured by the parties so as to be less formal than judicial proceedings and better suited to the needs of the parties and to the specific features of the disputes likely to arise under the project agreement. The parties can choose as arbitrators persons who have expert knowledge of the particular type of project. They may choose the place where the arbitral proceedings are to be conducted. They can also choose the language or languages to be used in the arbitral proceedings. Arbitral proceedings may be less disruptive of business relations between the parties than judicial proceedings. The proceedings and arbitral awards can be kept confidential, while judicial proceedings and decisions usually cannot. Furthermore, the enforcement of arbitral awards in countries other than the country in which the award was rendered is facilitated by the wide acceptance of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958.[2]

31. With regard, in particular, to infrastructure projects involving foreign investors, it may be noted that a framework for the settlement of disputes between the contracting authority and foreign companies participating in a project consortium may be provided through adherence to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States.[3] The Convention, which has thus far been adhered to by 131 States, established the International Centre for the Settlement of Investment Disputes (ICSID). ICSID is an autonomous international organization with close links to the World Bank. ICSID provides facilities for the conciliation and arbitration of disputes between member countries and investors who qualify as nationals of other member countries. Recourse to ICSID conciliation and arbitration is voluntary. However, once the parties to a contract or dispute have consented to arbitration under the ICSID Convention, neither can withdraw its consent unilaterally. All ICSID members, whether or not parties to the dispute, are required by the Convention to recognize and enforce ICSID arbitral awards. The consent of the parties to ICSID arbitration may be given with regard to an existing dispute or with respect to a defined class of future disputes. The consent of the parties need not, however, be expressed in relation to a specific project; a host country might in its legislation on the promotion of investment offer to submit disputes arising out of certain classes of investment to the jurisdiction of ICSID and the investor might give its consent by accepting the offer in writing.

32. Bilateral investment agreements may also provide a framework for the settlement of disputes between the contracting authority and foreign companies. In these treaties, the host State typically extends to investors that qualify as nationals of the other signatory State a number of assurances and guarantees (see chap. VII, “Other relevant areas of law”, paras. 4-6) and expresses its consent to arbitration, for instance, by referral to ICSID or to an arbitral tribunal applying the UNCITRAL Arbitration Rules.

(i) Sovereign immunity

33. When arbitration is allowed and agreed upon between the parties to the project agreement, the implementation of an agreement to arbitrate may be frustrated or hindered if the contracting authority is able to plead sovereign immunity, either as a bar to the commencement of arbitral proceedings or as a defence against recognition and enforcement of the award. Sometimes the law on this matter is not clear, which may raise concerns with the interested parties (for instance, the concessionaire, project promoters and lenders) that an agreement to

arbitrate might not be effective. In order to address such possible concerns, it is advisable to review the law on this topic and to indicate the extent to which the contracting authority may raise a plea of sovereign immunity.

34. In addition, a contracting authority against which an award has been issued may raise a plea of immunity from execution against public property. There is a diversity of approaches to the question of sovereign immunity from execution. For example, under some national laws immunity does not cover governmental entities when engaged in commercial activities. In other national laws a link is required between the property to be attached and the claim in that, for example, immunity cannot be pleaded in respect of funds allocated for economic or commercial activity governed by private law upon which the claim is based or that immunity cannot be pleaded with respect to assets set aside by the State to pursue its commercial activities. In some countries, it is considered that it is for the Government to prove that the assets to be attached are in non-commercial use.

35. In some contracts involving entities that might plea sovereign immunity, clauses have been included to the effect that the Government waives its right to plead sovereign immunity. Such a consent or waiver might be contained in the project agreement or an international agreement; it may be limited to recognizing that certain property is used or intended to be used for commercial purposes. Such written clauses may be necessary inasmuch as it is not clear whether the conclusion of an arbitration agreement and participation in arbitral proceedings by the governmental entity constitutes an implied waiver of sovereign immunity from execution.

36. The legislator may wish to review its laws on this matter and, to the extent considered advisable, clarify in which areas contracting authorities may not plead sovereign immunity.

(ii) Effectiveness of the arbitration agreement and enforceability of the award

37. The effectiveness of an agreement to arbitrate depends on the legislative regime where the arbitration takes place. If the legislative regime for arbitration in the host country is seen as unsatisfactory, for instance, because it is found to pose unreasonable restrictions on party autonomy, a party might wish to agree on a place of arbitration outside the host country. It is therefore important for the host country to ensure that the domestic legislative regime for arbitration resolves the principal procedural issues in a manner appropriate for international arbitration cases. Such a regime is contained in the UNCITRAL Model Law on International Commercial Arbitration.[4]

38. If the arbitration takes place outside the host country or if an award rendered in the host country would need to be enforced abroad, the effectiveness of the arbitration agreement would also depend on legislation governing the recognition and enforcement of arbitral awards. The Convention on the Recognition and Enforcement of Foreign Arbitral Awards (see para. 30), inter alia, deals with the recognition of an arbitration agreement and the grounds on which the court may refuse to recognize or enforce an award. The Convention is generally regarded as providing an acceptable and balanced regime for the recognition and enforcement of arbitral awards. The fact that the host country is a party to the Convention is likely to be seen as a crucial element in assessing the legal certainty of binding commitments and of the reliability of arbitration as a method for solving disputes by arbitration with parties from the country. It would also facilitate the enforcement abroad of an arbitral award rendered in the host country.

(l) Judicial proceedings

39. As indicated earlier, in some legal systems, pursuant to mandatory rules of a public law nature, the settlement of disputes arising out of project agreements whereby the concessionaire

is entrusted with the provision of public services is a matter of the exclusive competence of the domestic judiciary or administrative courts. In some countries, governmental agencies lack the power to agree to arbitration, except under specific circumstances (see paras. 7-9), while in other legal systems the parties have the freedom to choose between judicial and arbitral proceedings.

40. Where it is possible for the parties to choose between judicial and arbitral proceedings, the contracting authority may see reasons for leaving any dispute to be resolved by the courts of the host country. Those courts are familiar with the law of the country, which often includes specific legislation directly applicable to the project agreement. Furthermore, the contracting authority and other governmental agencies of the host country that might be involved in the dispute may prefer local courts because of the familiarity with the court procedures and the language of the proceedings. It may also be considered that, to the extent project agreements involve issues of public policy and the protection of public interest, state courts are in a better position to give them proper effect.

41. However, such a view by the contracting authority may not be shared by prospective investors, financiers and other private parties. These parties may consider that arbitration is preferable to judicial proceedings because arbitration, being to a larger degree subject to the agreement of the parties than judicial proceedings, is in a position to resolve a dispute more efficiently. Private investors, in particular foreign ones, may also be reluctant to submit to the jurisdiction of domestic courts functioning under rules unfamiliar to them. In some countries it has been found that allowing the parties to choose the dispute settlement mechanism helped to attract foreign investment for the development of its infrastructure.

42. In considering whether any dispute should be resolved in judicial proceedings or whether an arbitration agreement should be entered into, where such choice is permitted under the applicable law, factors typically taken into account by the parties include, for example, their confidence that the courts competent to decide a dispute will be unbiased and that the dispute will be resolved without inordinate delay. The efficiency of the national judicial system and the availability of forms of judicial relief that are adequate to disputes that might arise under the project agreement are additional factors to be taken into account. Furthermore, in view of the highly technical and complex issues involved in infrastructure projects, the parties will also consider the implications of using arbitrators selected for their particular knowledge and experience as compared to domestic courts which may lack specific knowledge or experience in handling the technical questions in the area where the dispute arose. Another consideration may be the confidentiality of arbitration proceedings, relative informality of arbitral procedures, and the possibly greater flexibility arbitrators may have in awarding appropriate remedies, all of which may be beneficial for preserving and developing the long-term relationship implicit in project agreements.

C. Disputes between the concessionaire and its lenders, contractors and suppliers

43. It is generally accepted in domestic laws that parties to commercial transactions, and in particular international commercial transactions, are free to agree on the forum that will decide in a binding decision any dispute that may arise from those transactions. In international transactions, arbitration has become the preferred method, whether or not it is preceded by, or combined with, conciliation. As to contracts between the concessionaire and the lenders, contractors and suppliers, which invariably form part of privately financed infrastructure projects, in many countries the parties are free to subject disputes to arbitration, to select the

place of arbitration and to determine whether or not any arbitration case should be administered by an arbitral institution. These contracts are generally considered commercial agreements to which, as regards dispute settlement clauses, general rules regarding commercial contracts are applicable. Host countries wishing to establish a hospitable legal climate for privately financed infrastructure projects would be well advised to review their laws with respect to these contracts so as to eliminate any uncertainty regarding the freedom of the parties to agree to dispute settlement mechanisms of their choice.

D. Disputes between the concessionaire and its customers

44. Depending on the type of project, the concessionaire's customers may include various persons and entities, such as, for example, a government-owned utility company that purchases electricity or water from the concessionaire so as to resell it to the ultimate users; commercial companies, such as airlines or shipping lines contracting for the use of the airport or port; or individual persons paying for the use of a toll road. The considerations and policies regarding contracts with the end-purchasers of the goods or services supplied by the project company may vary according to who the parties to those contracts are, the conditions under which the services are provided and the applicable regulatory regime.

45. In some countries, public service providers are required by law to establish special simplified and efficient mechanisms for handling claims brought by their customers. Such special regulation is typically limited to certain industrial sectors and applies to purchases of goods or services by customers. Statutory requirements for the establishment of such dispute settlement mechanisms may apply generally to claims brought by any of the concessionaire's customers or may be limited to customers who are individual persons acting in their non-commercial capacity. The concessionaire's obligation may be limited to the establishment of a mechanism for receiving and dealing with complaints by individual consumers. Such mechanisms may include a special facility or department set up within the project company for receiving and handling claims expeditiously, for instance by making available to the customers standard claim forms or toll-free telephone numbers for voicing grievances. If the matter is not satisfactorily resolved, the customer may have the right to file a complaint with a regulatory agency, if any, which in some countries may have the authority to issue a binding decision on the matter. Such mechanisms are often optional for the consumer and typically do not preclude resort by the aggrieved persons to courts.

46. If the customers are utility companies (such as a power distribution company) or commercial enterprises (for instance, a large factory purchasing power directly from an independent producer) who freely choose the services provided by the concessionaire and negotiate the terms of their contracts, the parties would typically settle any disputes by methods usual in trade contracts, including arbitration. Accordingly, there may not be a need for addressing the settlement of these disputes in legislation relating to privately financed infrastructure projects. However, where the concessionaire's customers are government-owned entities, their ability to agree on dispute settlement methods may be limited by rules of administrative law governing the settlement of disputes involving governmental entities. For countries that wish to allow the use of non-judicial methods, including arbitration, for the settlement of disputes between the concessionaire and its government-owned customers, it is important to remove possible legal obstacles and to provide a clear authorization for those entities to agree on dispute settlement methods (see paras. 7-9).

Notes

[1] For the report of the United Nations Commission on International Trade Law on the work of its thirteenth session, see *Official Records of the General Assembly, Thirty-fifth Session, Supplement No. 17* (A/35/17), para. 106 (*Yearbook of the United Nations Commission on International Trade Law*, vol. XI, 1980, part one, chap. II, sect. A (United Nations publication, Sales No. E.81.V.8)). The UNCITRAL Conciliation Rules have also been reproduced in booklet form (United Nations publication, Sales No. E.81.V.6). Accompanying the Rules is a model conciliation clause, which reads:"Where, in the event of a dispute arising out of or relating to this contract, the parties wish to seek an amicable settlement of that dispute by conciliation, the conciliation shall take place in accordance with the UNCITRAL Conciliation Rules as at present in force". The use of the UNCITRAL Conciliation Rules was recommended by the General Assembly in its resolution 35/52 of 4 December 1980.

[2] See United Nations, *Treaty Series*, vol. 330, No. 4739, p. 38, reproduced in the *Register of Conventions and Other Instruments concerning International Trade Law*, vol. II (United Nations publication, Sales No. E.73.V.3).

[3] United Nations *Treaty Series*, vol. ___, No. 8359, p. 160.

[4] For the report of the United Nations Commission on International Trade Law on the work of its eighteenth session. See *Official Records of the General Assembly, Fortieth Session, Supplement No. 17* (A/40/17), para. 332 and annex I. The General Assembly, in its resolution 40/72 of 11 December 1985, recommended that all States give due consideration to the Model Law on International Commercial Arbitration, in view of the desirability of uniformity of the law of arbitral procedures and the specific needs of international commercial arbitration practice.