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Investment Protection: The Role of State/Investor Arbitration

Sompong Sucharitkul

Golden Gate University School of Law, ssucharitkul@ggu.edu

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INVESTMENT PROTECTION
THE ROLE OF STATE/INVESTOR ARBITRATION

Honourable Chairperson
Distinguished Partners and Associates of Baker & McKenzie
Ladies and Gentlemen

I. BACKGROUND OF A TWO-WAY STREET PROBLEM RESTATED

First and foremost, I would like to express my grateful thanks to Mr. Tan Chuan Thye, Partner with Baker & McKenzie in Singapore and his colleagues for kindly having me invited to Singapore or Singhaburi, the City of Lions. It is for me a signal honour to have been given an opportunity to address an annual gathering of international legal professionals in an impressive setting at the very hub of an ever-growing and thriving region of South-East Asia. As an ASEAN at heart, I cannot help but crave the indulgence of the international legal experts here present to bear and share with me some of my thoughts and impressions on a matter of mutual interest and concern.

The topic on which I have been chosen to speak may provide little comfort in the face of an ominous challenge from all quarters. A prime object of the current enquiry is to identify the optimal role of State/investor arbitration in the quest for investment protection. To be more precise, a quaere is being raised regarding the extent of positive contribution a body of international legal professionals like ours could be expected to make in the promotion and protection of mutually beneficial foreign direct investment, in the region nearest and dearest to us, in East and South-East Asia, with an eye for more attractive forms and locations of investment such as China and ASEAN Investment Area.

Admittedly, foreign direct investment is inherently welcome anywhere and everywhere, in developing countries as much as in technically advanced economies. We no longer live in a world divided by the haves and the have-nots, or between the rich and the poor. Poverty exists everywhere, even in the richest nation or the most richly endowed nation of the world. Most States, if not every State, are exporting as well as importing capitals. It is only a matter of degree that developed nations tend to export more capital and technical investment than they actually import. In principle, as in practice, investment is a two-way street. The treatment of foreign direct investment should be placed on a more rational basis, without discrimination or arbitrary practices. As a matter of good faith, investment should be welcome and treated with fair and equal protection. Investment should be protected while the rights of the host State and the aspirations of its indigenous population should be respected. International legal professionals have a useful and constructive role to play in implementing the aspirations of all concerned and in alleviating as well as minimizing the likelihood of their differences and the danger of possible tensions between various competing, if not opposing, circles.
Efforts have been made and initiated some score years earlier even in this very city of Singapore, known as the Pearson Commission, to set international standards for the treatment of foreign direct investment. More than a decade ago in 1992, the World Bank Group adopted a Report to the Development Committee, and Guidelines on the Treatment of Foreign Direct Investment.

Parallel to the progressive development of international standards to protect foreign direct investment should be mentioned the report of UNITAR (United Nations Institute for Training and Research) and the Report of the United Nations Secretary General on progressive development of the principles and norms of international law relating to the new international economic order, Agenda Item 116, General Assembly 37th Session (1982). These include the principle of permanent sovereignty over national resources and the principle of the right of every State to benefit from science and technology.

It is essential therefore for international legal professionals to take stock of progressive developments of international norms from two competing though not necessarily opposing perspectives. Indeed, there appears to be no reason to preclude the possibility of their complementarity or mutuality of benefits, and/or reciprocity of reasonable gains and advantages. It is significant that we retain an open mind and maintain a balanced approach to this multi-faceted problem of the right to development as the other side of the same coin as much as the obligation to protect foreign direct investment.

II. AN OBJECTIVE AND POSITIVE ROLE OF THE “INTERNATIONAL LEGAL PROFESSIONAL”

We have reached a point where it should dawn on participants of this gathering of distinguished international legal professionals from every corner of the globe with wide-ranging legal expertise covering a great variety of aspects of the problem of investment promotion and protection, that we must proceed with caution without losing sight of the dire need of host States for economic and social developments in several areas and in innumerable jurisdictions.

As legal practitioners, we might ask ourselves what useful positive role we could conceivably play in this international setting. Let us set the stage squarely and try to identify our clients who seek our expert legal advice. Let us see if they consist solely of private investors to the exclusion of any host State or a competent government agency implicated. Amidst the fully evolving competing criteria in the area, many questions remain unanswered, while many answers are still unclear and begging further questions. For instance, it is questionable whether the host State is not authorized by international law to collect Value Added Tax (VAT) on the export of crude oil, and if not, why not, or otherwise, whether the crude oil on sale already had some value added to it after extraction from the ground or ocean floor. Another valid question relates to the power of a State to waive any part of the royalties due by operating companies for the natural gas over which permanent sovereignty is vested in the people and rather than in the State. Absent such power, the question to raise is whether an arbitration award is not the only plausible means to bypass the operation of the mandatory rule which is otherwise automatically applied without exception, taking into account the potential unconstitutionality of legislative or executive intervention. This is further
confounded by the fact that the hands of the territorial judiciary are equally tied. But arbitrators have freer hands and an arbitral award may provide the only way out, an honorable exit from this constitutional labyrinth for the State and the investor alike. (UNOCAL v. Department of Natural Resources of Thailand, 1986.)

Private investors as well as multinational corporations that invest in a foreign country on the one hand, and the host State including its State agencies and government bodies alike are in need of sound legal advice. Even disputes before the WTO which were once closed to non-parties are now open for legal representation by private non-governmental transnational law firms, acting as part of an integral legal team that represents a member or the trading State in a dispute relating to trade which may include aspects of investment dispute.

Many among us have represented national governments in investment disputes, as there are generally two sides to every dispute, the host State on the one hand and the investor on the other. Besides, in any proceeding against a host State, there can be counter-claims and possible set-off. Our prospective clients are not confined to the aggrieved investor but may include also the host State involved which invariably needs sound objective or neutral legal counsel from non-governmental legal professionals.

For this reason, I would urge you to have an open mind, and to be neutral as well as objective in your consultations with clients whether in the private or public sector, whether the client is an individual investor or a government department involved in the dispute or implicated in the proceedings. Fair and equitable treatment is an acquired principle nourished by the principle of good faith all around.

III. POSSIBLE METHODS OF DISPUTE SETTLEMENT AND THE ROLE OF STATE/INVESTOR ARBITRATION

Avowedly, we are concentrating on arbitration as a method of dispute settlement. As a matter of fact, emphasis is placed on one particular type of arbitration, namely, State/investor arbitration of an investment dispute. Yet, we cannot afford to ignore the availability of other methods of dispute settlement, such as negotiation, which can be renewed, recommenced or restarted at any stage of any arbitration proceedings. In addition, other means of dispute settlement are available, such as good offices, enquiries or fact-finding mediation and conciliation without mentioning litigation or adjudication.

An arbitration to resolve an investment dispute between an investor and a State can be founded on any of the variety of instruments, creating different forms or types of arbitration.

1. **An ad hoc Arbitration.** This could be constituted by an agreement between the parties to the dispute, either after the dispute has arisen or before, in anticipation of a possible dispute. The arbitral tribunal thus constituted is the master of its own procedures. Basically, the compromis may specify the model or type of arbitration rules to be adopted, e.g., UNCITRAL, ICC, AAA, ICSID or even the Statute and Rules of the International Court of Justice.

2. **An Institutionalized Arbitration.** Arbitration could be based on a bilateral or a general multilateral treaty, such as a bilateral investment treaty (BIT) or the Washington
Convention on the Settlement of Investment Disputes (ICSID) between States and Nationals of other States, 1965. The multilateral treaties comprise not only the General Multilateral Treaties such as ICSID and MIGA, but also regional instruments such as the 1987 ASEAN Agreement for the Promotion and Protection of Investments (Article X).

IV. DISPUTE PREVENTION AND ASSURING IMPLEMENTATION OF AN OBLIGATION TO ARBITRATE

While the present enquiry does not include a general discussion of the advantages and disadvantages of the various methods and possible mechanisms of dispute settlement, it should be pointed out that in some region of the world such as ASEAN or South-East Asia, it has become a traditional practice within the region to seek to prevent or to preempt any investment dispute from ever arising in the first place. It is only after repeated failures to prevent dispute from ever arising that attention could be devoted more totally to the settlement of an unavoidable dispute, and that every effort should be made to reach a final and mutually satisfactory solution or settlement within the shortest possible time, to save also cost and energy and to renew or begin the process of confidence building.

Dispute prevention is as important as leaving no stone unturned in the preparation of a draft contract or agreement, particularly the dispute settlement clause or the provisions containing the compromis or an agreement to arbitrate in the event of a dispute. There should be no loophole in the time-frame set up or agreed upon in advance. In any event, the mechanism of arbitration must be set in motion, without one party having the option to neutralize or freeze or suspend the process indefinitely. This could be achieved, for instance in the event the other party fails to appoint the second arbitrator within a time-limit, say 30 days, by letting the first appointed arbitrator serve as the sole arbitrator as in CAFTA or ASEAN-China Free Trade Area Framework Agreement, 2000. Alternatively, an appointing authority could be designated in advance to prevent such failure or inaction on the part of the party unwilling to settle the dispute. The appointing authority could be the President of the International Court of Justice, as in the 1987 ASEAN Agreement, The Secretary-General of the United Nations, the Director-General of the WTO or the Secretary-General of ICSID or the Kuala Lumpur Regional Centre of International Arbitration of the Asian African Legal Consultative Committee.

Once it is clear that the parties have failed to reach an agreement or to prevent the occurrence of an investment dispute, and by the same abundant caution, once the parties to the dispute have been denied any escape route to circumvent the process of arbitration, counsels should proceed with the establishment of an arbitral tribunal in accordance with the consent of the parties, as expressed in a written agreement.

The object of the exercise is to bring the disputing parties back on track for the settlement of their dispute in a mutually satisfactory and timely manner. Counsels’ role is to cooperate with the parties, to collaborate with all sides, and to obtain the most fair and equitable results for their clients without imposing undue hardship on the opposing side. It is Counsels’ role clearly to facilitate the settlement of impending dispute and not to prolong the outcome or the agony, nor to complicate the issue under consideration. Their service to the
client is that of a facilitator, conflict resolver, settler of differences and remover of hindrances to future or exiting partnership based on amicable mutual understanding and reciprocal recognition of respective rights and corresponding duties.

V. COMPOSITION OF AN ARBITRAL TRIBUNAL AND PRELIMINARY PROCEDURAL CONSULTATIONS

In most model clauses as well as in general practice, an arbitral tribunal is generally composed of a panel of three arbitrators, one appointed by each of the parties, and the third by the two appointed co-arbitrators, to serve as the presiding arbitrator. In the interest of speed and under time constraint, party-appointed arbitrators are carefully selected by the parties and with the consent and willingness of the appointees to serve as co-arbitrators. It is not always without a difficulty for the two appointed arbitrators to agree on the selection of a third arbitrator. Failure to reach an agreement may result in the necessity to invoke the discretion of the Appointing Authority to appoint the presiding arbitrator or referee to chair the arbitration commission or preside over the Arbitral Tribunal. Otherwise, a sole arbitrator or a panel of five arbitrators are not unknown.

The process of screening or selecting a nominee to serve as an arbitrator may involve a number of complex considerations, such as the qualifications of the candidate, the past connection and conduct, and the need to make a declaration of impartiality and disclosures to the satisfaction of the Parties to the dispute. This may entail the possibility of recusal and replacement or challenge and new nominations until the process is exhausted and a tribunal is finally set up with its duly appointed members, ready and willing to undertake the process of arbitration. This includes scheduling the submission of written statements of claim and of defense, of reply and rejoinder, as well as the oral proceedings with hearings on all the issues, beginning with jurisdictional issues, exchange of lists of document and lists of witnesses and a number of written and oral pleadings before deliberation and conclusion of all pleadings, the closing of the proceedings and deliberation prior to the adoption of an Award.

It is an established practice that the substantive hearing and exchanges of written pleadings is preceded by a meeting for preliminary procedural consultations between the Tribunal and the Parties to reach consensus on some of the administrative and procedural matters, such as the language of the pleadings, the site or venue of the arbitration and the time and place of the hearings. Other administrative and financial issues are also to be worked out, such as advance contribution and dues to be paid for the administration of the Tribunal and for the cost and fees of the arbitrators and other expenses. A tentative time-frame is normally envisaged in a procedural order issued by the Tribunal after its first conference for preliminary procedural consultations to ascertain the approximate duration of the proceedings before final closing order with or without an Award.

VI. JURISDICTIONAL ISSUES FACING THE ARBITRAL TRIBUNAL AND THE PARTIES TO THE DISPUTE

Several series of questions and issues before an arbitral tribunal are inevitable, innumerable and multifarious. For current purposes, it would seem highly useful to identify
some of the few preliminary questions that need to be addressed following the formation of the Tribunal.

(1) **The existence of an investment dispute**

First and foremost is the need to identify the dispute before the Tribunal, whether or not there is a dispute, that involves the determination of a legal as well as some factual questions. Purely factual disputes could be decided by a fact-finding mission or verification team without invoking any arbitral proceedings. Political disputes are not always justiciable. A conflict could be brought before the arbitral tribunal prematurely, that is to say without any dispute as to a question of law or legal rights and/or obligations of the parties. In the absence of a ‘dispute’, there will be no reason to try to resolve or settle what is not or never disputed by the Parties. The matter remains unripe for submission to the Tribunal for settlement.

Even granted that there is clearly a dispute between the parties, the next question to be examined is whether the dispute is one of investment dispute and not other types of legal dispute, such as a breach of contract or a breach of promise or frustration of contract, which would lie outside the purview of investment dispute to require settlement. The Tribunal is obliged in such a case to declare itself to be without competence to determine disputes other than investment disputes.

Furthermore, even when there have been expenses incurred by the prospective investor such as in the preparation of an international bidding to be offered. These expenses are purely preliminary spendings, not yet forming integral part of the actual investment, although it could be included in the accounting once the bidder has become successful and the contract (engineering or construction or concession) was finally awarded. Failure to receive the award of a contract is not an expropriation and expenses incurred prior to the actual investment could be pre-investment expenses, not recoverable, in the event of unsuccessful bidding pre-investment disappointments are not regarded as investment disputes, although pre-investment expenses may be included in the actual investment cost once an investment contract or agreement was definitely awarded or concluded. It could amount to a breach of pre-contractual understanding. (Mihaly International Corporation v. Democratic Socialist Republic of Sri Lanka, ICSID Case No. ARB 100/02, 41 ILM 867, 2002.)

(2) **Jurisdiction or competence of the arbitral tribunal or commission**

Once it is determined that there is a dispute and that it is an investment dispute or dispute relating to or arising out of actual investment and not from pre-investment incidental expenses, it is not unusual for the Tribunal or Commission, as well as legal representative on both sides, the State as well as the investor, to verify whether the investment dispute in question is within the jurisdiction of the Tribunal seized of the matter. In other words, it is necessary to ascertain the existence of the competence of the deciding body. The dispute could lie outside or beyond the scope of the jurisdiction as intended and agreed upon by the Parties. Jurisdiction is traceable back to the mutual consent of the Parties to the dispute as well as the States Parties to the relevant bilateral investment treaty or multilateral convention invoked. No jurisdiction or competence can exist in vacuum, nor can it float in the air without the winged support of the consent of the Parties concerned, Parties to the Treaty as well as Parties to the investment contract.
The jurisdictional issues could be intricately mixed with the merits of the case that decision on the jurisdiction has to be joined with consideration of the merit.

(3) **Lack of standing or *jus standi* of one of the Parties**

The third question relating to preliminary issues is that of standing or *jus standi* of the Parties, especially the claimant, and also the Respondent. Without a *locus standi* or a place to stand, a party can neither initiate an arbitration proceeding, nor be a proper respondent before the Tribunal. A defect in the standing could deprive the Tribunal of its ability or capacity to proceed, for it is without competence or jurisdiction.

VII. **DIFFERENT STAGES OF THE MERITS OF EACH PENDING CASE**

After all jurisdictional issues are cleared, an arbitral process may involve a number of intricate substantive questions. It would save time and energy to bifurcate or divide up the examination of the merits into two or more stages of the proceedings, especially when the dispute includes claims as well as counter-claims.

(1) **The Liability Phase**

The first substantive question to be determined is one of liability. If liability is established either for the claim or for the counter-claim or both, then the proceeding could continue on to be next phase or stage. If the Tribunal found that there was no liability, that would be the end and final conclusion of the Award on the merits. On the other hand, the Tribunal might also find as it considers the merits together with the jurisdictional question and reach the conclusion that it is without competence or jurisdiction to proceed further with the merits of the case, for instance, on the ground that there was in reality no investment dispute.

(2) **The Quantification of Compensation Phase**

The holding that there is liability should lead to the next phase to assess the nature and extent of compensation or the redress sought, which could be *restitutio in integrum*, or in the event of impossibility of performance or restitution there would be occasion to assess the quantum of compensation or reparation in the Award.

VIII. **FINALITY AND INTEGRITY OF AN ARBITRAL AWARD : INTERPRETATION, REVISION AND ANNULMENT**

An arbitral award such as that of ICSID is deemed to be final and without appeal. It is possible however that under ICSID Regulations especially Rule 50: The Application, there may be room for an application for interpretation, revision or annulment of the Award rendered. ICSID is an autonomous régime of arbitration which admits of no external appeal nor independent judicial review. It is nonetheless open to interpretation, revision or even an annulment proceeding, if an application can be based on one of the permissible grounds for annulment, available within the ICSID system.
Article 52 of the Washington Convention 1965 provides that either party may request annulment of the Award on one or more of the following grounds:

(b) that the Tribunal was not properly constituted;
(c) that the Tribunal has manifestly exceeded its powers;
(d) that there was corruption on the part of a member of the Tribunal;
(e) that there has been a serious departure from a fundamental rule of procedure;

or

(f) that the Award has failed to state the reasons on which it is based.

If the Award is annulled by the ad hoc Committee, the dispute shall, at the request of either party, be submitted to a new Tribunal constituted under the Convention. It is also possible to annul the Award in whole or only in part, such as confirming the liability issue but annulling the quantum of damages or compensation to be reconsidered by a new Tribunal.

In practice, ICSID has witnessed a number of instances of application for interpretation, revision and annulment. Interpretation is possible if any dispute should arise between the parties as to the meaning or scope of an Award (Article 50 (1)). Either party may request revision of the Award on the ground of discovery of some fact of such a nature as decisively to affect the Award, provided that when the Award was rendered that fact was unknown to the Tribunal and that the applicant's ignorance of the fact was not due to negligence. (Article 50 (1)). Subject to a specified time limit, a party may apply in writing addressed to the Secretary-General of ICSID requesting interpretation and/or revision. In either or both events, the Tribunal that rendered the Award may be reconvened or reconstituted, or if not possible, a new Tribunal may be established.

In the application for annulment, however, an ad hoc Committee will be constituted to consider a timely request for annulment. Neither the Tribunal in cases of interpretation and revision, nor the ad hoc Committee in case of annulment is precluded from finding that the application, in any given case, is not receivable, if it has been filed after the expiration of the absolute or the variable time limit established by the Convention. (Three years for the absolute time limit, and for the variable time limits 90 days for discovery of an unknown fact (Article 51 (2)) for revision, or 120 days for discovery of corruption (Article 52 (2)) for annulment.)

Pending decision on an application for interpretation, revision or annulment, an ICSID Award may be subject to an order by the competent Tribunal or ad hoc Committee to stay execution.

IX. EXECUTION OF AN ICSID AWARD

In the absence of an application for interpretation, or revision or annulment followed by an order for a stay of execution, an ICSID Award entitles its beneficiary to proceed to have it enforced by an exequatur or leave to levy execution by a court of law with jurisdiction over some assets of the party, against which the Award was rendered. Indeed, an ad hoc Committee may order a provisional stay of execution or enforcement of the Award in question, while also imposing an obligation for the party seeking annulment to provide a satisfactory guarantee or bank guarantee for eventual implementation of the Award pending annulment proceedings (Amco v. Indonesia, Annulment Proceedings of the Award of the
Second Tribunal, ICSID Case ARB/81/1, 3 December 1992, Interim Order No. I, 2 March 1991.)

It should be remembered that an ICSID Award against a foreign sovereign State has received previous consent of that State as party to the ICSID Convention, so that no immunity is invoked on behalf of the State from the jurisdiction of the ICSID Tribunal. Nevertheless, consent to an ICSID Arbitration is no consent for other types of arbitration such as AAA or UNCITRAL (Mine v. Republic of Guinea, ICSID Case ARB/84/4, partial annulment decision, 22 December 1989.)

Consent to arbitration is no consent to execution. For measures of constraint against properties of a foreign State, consult Article 19 of the 2004 United Nations Convention on Jurisdictional Immunities of States and Their Property, UNGA Res. 59/38 (A/59/508).

It has been noted that an ICSID Award attracts its own sanctions. Within the World Bank Group, non-compliance or failure to implement or fulfill an Award rendered by an ICSID Tribunal will not be viewed in a favorable light by various institutional components of the group.

For purposes of the United Nations Convention on Recognition and Enforcement of Foreign Arbitral Awards (New York Convention 1958), an ICSID Award is generally regarded as ‘foreign’ as opposed to ‘domestic’ arbitral Award and will be honoured and given effect to by the Court of all the States Parties to the Convention. This ranks as a highly successful safety net. Most ASEAN nations, including Thailand, are Parties to the New York Convention. Unless complete implementation violates any of the mandatory rules of the Forum, effect will be given to an ICSID Award in full.

An ICSID Award is, as a general rule, designed to wipe out the consequences of a wrongful act giving rise to an investment dispute, the settlement of which under international law can only be compensatory and not exemplary or punitive.

Judging from its continuing existence, ICSID appears to have weathered a great many storms in its early formative years which might have been viewed as filled with trials and tribulations. It has become seasoned by the passage of time and the lessons learned through experience and the practice of the Centre and its Member States. It has grown in membership and popularity. The success stories and achievements could be measured by the rising cost of ICSID arbitration, paralleled only by an ever-increasing docket.

X. CLOSING OBSERVATIONS

The object of my address today has been stated at the outset, namely, to encourage the promotion and protection of foreign direct investment in Asia, with particular emphasis on China and ASEAN Investment Area.

It has been noted that foreign investments will automatically speak for themselves whether or not they are being accorded a fair and equitable treatment, together with the most-favored-nation and national treatment standards.

The fact that China has achieved a phenomenal growth in the recent past and that the year 2004 China’s surplus account in foreign currencies soared over the 800 billion dollars mark. This total included more than 200 billion dollars in direct foreign investments, thus, *res ipsa loquitur* may tell an incomplete tale. This could not have been achieved without
China’s relentless efforts. China has literally left no stone unturned in the field of incentives and advantages offered to foreign investors. But no praise can be more eloquent than the truth that China has become a party to every conceivable multilateral convention that provides comforting assurances for international investors in all sectors of economic development, infrastructure, finance, communication, insurance, telecommunication, and e-commerce, etc. Between 1982 and 1991, during a short span of less than ten years, China concluded 28 Bilateral Investment Treaties with its Partners in Asia and Europe, and not without great sacrifices subsequently gained admission or accession to the World Trade Organization, a giant step to booster the land as a welcome investment area, suffering from no deficiencies nor discrimination in the treatment of goods and exports from China.

ASEAN Investment Area has also attained a growth rate beyond expectation, not only because ASEAN nations have firmly believed in free movement of goods and fair and equitable treatment of foreign investment, but also as statistics readily show, ASEAN nations have managed to preempt or prevent investment disputes from arising, hence the scarcity of disputes not preempted or remaining unsettled.

Both China and ASEAN practice what they preach, namely, willingness and preparedness to face the prospect of an investment dispute and to prevent its occurrence or growth or rise to a dangerous point. The paucity of actual investment disputes within the ASEAN Investment Area testifies to the success of ASEAN Program to ‘nip in the bud’ any potential or prospective dispute or difference. Likewise, China’s readiness and willingness to cooperate and to negotiate in good faith to reach a settlement even before the outbreak of a dispute also account for the marked increase in intra China investment from ASEAN, notably from Singapore, thanks to the bilateral treaty arrangement as early as 1985, and the basic mutual understanding of reciprocal interests and advantages in the promotion and protection of investment between Singapore and China.

It is with this profound appreciation of the mutual need to expand and sustain the continuing advance thus far achieved that international legal professionals can be expected to help contribute to further the promotion and protection of foreign direct investment, with the assurance that whatever difficult problems that may stand in their path to success could be removed through skilled and patient negotiations and with the realization that whatever dispute that may arise will ultimately be resolved through peaceful and amicable means at the option and disposal of the investors, notably ICSID mechanisms including ICSID Additional Facility for the settlement of investment dispute which are accessible to all investors in China and ASEAN Investment Area. The benefits of New York Convention for ICSID Awards are shared by all who elect to invest in the above selected countries.

Sompong SUCHARITKUL