

Investor-State Dispute Settlement (ISDS) Mechanism: A Multifaceted Examination of their Jurisprudential Underpinnings

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Abstract

Investor-State Dispute Settlement (ISDS) mechanisms and arbitration play a pivotal role in modern international investment law. This abstract provides an overview of ISDS mechanisms and arbitration, highlighting their significance, evolution, and the ongoing debates surrounding their use. ISDS mechanisms offer a platform for resolving disputes that may arise between foreign investors and host states. These disputes often pertain to alleged breaches of investment protection agreements, including bilateral investment treaties (BITs) and international investment agreements (IIAs). The primary aim of ISDS is to protect foreign investments by providing a neutral and efficient means of dispute resolution. Over the years, ISDS mechanisms have evolved significantly. Early ISDS provisions were one-sided, heavily favouring investor interests. However, the legal landscape has evolved, leading to increased emphasis on balancing investor protection with host state sovereignty. This balance is reflected in newer agreements, which include more stringent requirements and procedural safeguards. Notably, many countries have moved towards promoting transparency in the arbitration process and ensuring arbitrators are independent and impartial. ISDS arbitration typically involves a panel of arbitrators who decide on disputes between investors and states. The choice of arbitrators, often from diverse backgrounds, ensures neutrality and impartiality in the decision-making process. However, concerns have been raised about the lack of consistency and predictability in arbitral decisions, leading to questions about the system's legitimacy and transparency. The ongoing debate around ISDS mechanisms and arbitration revolves around several key issues. First, there is the question of whether ISDS is necessary in the first place. Critics argue that it grants investors significant rights and disproportionately impacts state sovereignty. They advocate for alternative dispute resolution mechanisms, while proponents highlight the

importance of providing a stable and secure environment for foreign investors. Another contentious issue is the lack of transparency in ISDS proceedings. Critics argue that the confidentiality of arbitration can hinder public interest, leading to potentially inconsistent decisions. Efforts have been made to address this concern by encouraging transparency through mechanisms like the United Nations Commission on International Trade Law (UNCITRAL) Transparency Rules. Furthermore, there is a need to address the issue of third-party funding, where external entities finance investor-state disputes. While it can provide access to justice for investors, it has raised concerns about potential conflicts of interest and its impact on arbitral decisions. The future of ISDS mechanisms and arbitration remains uncertain. Some countries have chosen to reform their existing agreements, while others have sought to terminate or renegotiate them. The future of ISDS mechanisms and arbitration will depend on striking a delicate balance between safeguarding investments and respecting the sovereignty of host states.

Introduction

The intricate arena of Investor-State Dispute Settlement (ISDS) mechanisms has, over time, emerged as a focal point of scholarly scrutiny and political discourse within the expansive curtains of international law and policy. These mechanisms, invariably enshrined within the ambit of Bilateral Investment Treaties (BITs), Free Trade Agreements (FTAs), and assorted international pacts, delineate a legal framework tasked with the adjudication of disputes arising between foreign investors and the sovereign entities in whose territory they invest. The underlying rationale of ISDS manifests in the provision of safeguarding the rights and interests of foreign investors, inculcating within them a shield against arbitrary and capricious treatment at the hands of host governments. However, the evolving narrative surrounding ISDS mechanisms is rife with contentions pertaining to their propensity to impinge upon the regulatory sovereignty of host states and to obfuscate proceedings within a veil of opacity. This treatise undertakes the formidable task of a comprehensive inquiry into the concept of ISDS, tracing its historical trajectory, delineating its inherent intricacies, unpacking the critiques that have assailed it, and proffering potential avenues of reform in the spirit of academic rigor.

Origin

The origins of ISDS can be traced back to the denouement of the 19th century when the international community embarked on a journey of forging treaties geared toward promoting and safeguarding foreign investments. A watershed moment in this trajectory was the signing of the first modern BIT, consummated between the Federal Republic of Germany and Pakistan in 1959. This historic juncture presaged an unprecedented proliferation of bilateral investment treaties and paved the way for ISDS mechanisms to assume a meritorious role in the international legal landscape. The fundamental premise of ISDS provisions lies in their conferral of a substantive right upon foreign investors, entitling them to instigate arbitration proceedings against a host state in the event of a perceived violation of their treaty-based entitlements. Arbitral tribunals, panels composed of legal luminaries well-versed in the intricacies of international law, are convened to preside over these disputes, with outcomes often culminating in pecuniary restitution or the invocation of alternative remedial measures.

ISDS mechanisms, which have historically operated discreetly, have recently come under increased scrutiny due to a few prominent legal cases and the reluctance of certain European stakeholders to include ISDS provisions in agreements like the Comprehensive Economic and Trade Agreement (CETA) between Canada and the European Union (EU)ⁱ, as well as in potential future agreements such as the Transatlantic Trade and Investment Partnership between the United States and the EU. The level of criticism directed at the ISDS system has grown significantly, prompting the United Nations Conference on Trade and Development (UNCTAD) to propose reforms in its 2015 World Investment Report. UNCTAD emphasized that maintaining the current state of affairs is no longer a feasible option. Beyond the enhancement of international legal frameworks, proponents of Investor-State Dispute Settlement (ISDS) assert that this mechanism has additionally engendered a depoliticization of investment disputes, thereby significantly mitigating the potential for these conflicts to escalate into intergovernmental confrontations. ISDS is also gaining traction amid the heightened deliberations surrounding the ambitious Chinese One Belt One Road Initiative (OBOR), with an envisioned elevation in investment protection standards and expanded ISDS accessibility across the expansive regions of Asia and Europe.ⁱⁱ

Principles

Within the intricate architecture of ISDS, several cardinal principles form the bedrock upon which its edifice is meticulously constructed:

- a. **Fair and Equitable Treatment (FET):** Predominant among these is the sacrosanct principle of ensuring fair and equitable treatment to foreign investors. It mandates that host states adhere to the twin canons of non-discrimination and the prohibition of capricious and arbitrary conduct in their dealings with foreign investors.
- b. **Expropriation:** Integral to ISDS provisions is the proscription of expropriation, whether direct or indirect, of foreign investments without just and adequate compensation. The principle serves to insulate foreign investors from unwarranted confiscatory actions.
- c. **National Treatment and Most-Favoured-Nation (MFN) Treatment:** The tenets of national treatment and MFN treatment mandate that foreign investors be accorded treatment on par with domestic investors, thus obviating any form of discriminatory bias that might impinge upon the sanctity of their investments.

Fundamental aspects of ISDS

ISDS is a legal framework found in many international investment agreements and treaties, which allows foreign investors to bring claims against host states for alleged violations of treaty rights. Here's a comprehensive explanation of the key elements and processes involved in ISDS:

- **Consent to Arbitration:** ISDS requires the consent of both the host state and the foreign investor to initiate arbitration. This consent is typically granted through the inclusion of ISDS provisions in bilateral investment treaties (BITs), multilateral agreements, or investment chapters of trade agreements.
- **Protected Investors and Investments:** ISDS is designed to protect the rights of foreign investors and their investments in host states. Investors can be individuals, corporations, or other entities from one country investing in another.

- **Treaty Violations:** Claims under ISDS usually revolve around alleged treaty violations. Common violations include expropriation without compensation, fair and equitable treatment, protection against discrimination, and violations of national treatment (treating foreign investors on par with domestic ones).
- **Arbitration Proceedings:** Arbitration is the primary method for resolving ISDS disputes. It offers several advantages, including neutrality, flexibility, and a choice of arbitrators. The arbitration process typically involves the following stages:
 - **Notice of Intent:** The investor initiates the process by sending a notice of intent to the host state, outlining the alleged treaty violations.
 - **Consultations and Negotiations:** The parties often engage in consultations and negotiations to resolve the dispute amicably before proceeding to formal arbitration.
 - **Arbitral Tribunal Establishment:** If negotiations fail, the investor can submit a request for arbitration. An arbitral tribunal is established, typically composed of three arbitrators: one chosen by the investor, one chosen by the host state, and a presiding arbitrator agreed upon by both parties.
 - **Proceedings and Evidence:** The arbitration tribunal conducts proceedings where both parties present evidence and arguments. These proceedings are typically confidential.
 - **Arbitral Award:** The tribunal issues an arbitral award, which can include findings on liability, damages, and legal costs. The award is binding on both parties.
 - **Enforcement:** The winning party can seek enforcement of the arbitral award in domestic courts. Many countries enforce these awards under international treaties, such as the New York Convention.
- **Transparency:** In response to concerns about a lack of transparency, some efforts have been made to make ISDS more open to the public. The United Nations Convention on Transparency in Treaty-based Investor-State Arbitration (Mauritius Convention) is one such initiative.

- **Arbitrators:** The arbitrators in ISDS cases are typically legal experts in international law, ensuring a high level of expertise and neutrality. Some investment agreements have established codes of conduct for arbitrators.

The World Arena

In 2014, there were 42 new ISDS cases initiated globally, bringing the total known cases to 608 at that time.ⁱⁱⁱ This number was lower than the record 59 cases filed in 2013 but significantly higher than in the 1990s when annual cases ranged from 0 to 10.^{iv}

The primary reason for this increase seems to be the substantial growth in foreign direct investment (FDI) over the past decades. In 1990, global inward FDI stock was \$2.2 trillion, while it had reached \$26 trillion by 2014. This rise in FDI has a strong correlation with the increase in ISDS cases.^v

In 2014, ISDS arbitration tribunals issued 43 decisions, with 34 of them being made public.^{vi} By the end of 2014, a total of 356 cases had reached completion, with 37% resolved in favor of the state, 25% in favor of the investor, and 28% settled by the parties involved.^{vii}

According to UNCTAD, Canada faced 23 arbitration complaints, ranking fifth after Argentina (56), Venezuela (36), the Czech Republic (29), and Egypt (24).^{viii} Regarding the nationality of claimants, Canadian investors filed 35 complaints, putting Canada in a tie for fifth place with France, following the United States (134), the Netherlands (69), the United Kingdom (49), and Germany (42).^{ix}

Legal Implications of Awards in ISDS:

The legal implications of arbitral awards in Investor-State Dispute Settlement (ISDS) mechanisms are significant. Here are some key implications:

- **Binding and Enforceable:** Arbitral awards issued by ISDS tribunals are generally binding on the parties involved. States and investors are legally obligated to comply with the decision, and they are enforceable in national and international courts.

- **Finality:** ISDS awards are often considered final, with limited avenues for appeal. This finality provides legal certainty and encourages the parties to accept and implement the tribunal's decision.
- **Enforcement of Awards:** Many countries are signatories to international conventions, such as the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, which facilitates the enforcement of ISDS awards in multiple jurisdictions. This means that an award can be enforced in various countries, making it a powerful tool for investors seeking compensation.
- **Role of National Courts:** The enforcement of ISDS awards may require the involvement of national courts. In some cases, a party may resist enforcement, leading to legal proceedings in domestic courts to enforce the award.
- **Potential for Annulment:** While ISDS awards are generally final, in some cases, there may be provisions for annulment or challenges to the award. These provisions typically involve very limited grounds, such as fraud or procedural irregularities.
- **Impact on Bilateral Investment Treaties (BITs):** Successful ISDS claims and awards can impact future negotiations and revisions of bilateral investment treaties (BITs). States may reconsider their treaty commitments in light of adverse awards or public outcry.
- **Political Implications:** ISDS cases and their outcomes can have political implications. They may lead to diplomatic tensions between states and influence public perception of international trade and investment agreements.
- **Precedent:** ISDS awards can establish legal precedent, influencing how future cases are decided. Consistent decisions in favour of investors or states can shape the interpretation and application of international investment law.

Overall, ISDS arbitral awards have a profound legal and practical impact on international investment relations, with significant consequences for the parties involved, national legal systems, and the broader international investment landscape.

Critiques and Controversies

Regulatory Sovereignty at Stake- Foremost among the critiques bedevilling ISDS mechanisms is the inexorable threat they pose to the sacrosanct mantle of regulatory sovereignty vested in host states. Detractors contend that ISDS affords foreign investors an untrammelled avenue for contesting a panoply of governmental policies and regulatory edicts, including those germane to public health, environmental conservation, and labour rights. The subtext of this argument postulates a pernicious "chilling effect," whereby host states, apprehensive of incurring the onus of protracted ISDS litigations, eschew the promulgation of new regulations in the public interest.

The Veil of Opacity: A Cloak of Concern- A cogent concern pertains to the dearth of transparency that pervades ISDS proceedings. These arbitration deliberations, shrouded in confidentiality, transpire beyond the purview of public scrutiny, with the rulings of arbitral tribunals, at times, veiled from the common gaze. Critics posit that this opacity engenders a climate of unpredictability and fosters an incongruity of decisions, thereby eroding the bedrock principle of legal consistency and undermining public faith in the sanctity of the process.

Conflict of Interest Conundrums- The composition of ISDS tribunals finds itself ensnared in the maelstrom of criticism, notably in relation to the potential quagmire of conflicts of interest. It is contended that the limited pool of available arbitrators engenders a situation fraught with potential biases, with arbitrators, driven by financial incentives, possibly predisposed toward investor-friendly rulings. Such perceived conflicts of interest threaten to cast a pall over the impartiality and legitimacy of ISDS arbitral tribunals.

The Ongoing Debate

The debate over ISDS mechanisms persists, with stakeholders on both sides presenting compelling arguments. Proponents argue that ISDS mechanisms are essential for protecting investors, fostering economic growth, and resolving disputes efficiently. They contend that reforms and transparency measures can address many of the criticisms and improve the system's legitimacy. Critics maintain that ISDS undermines state sovereignty and can deter governments from pursuing necessary public policies. They argue for alternatives, such as

domestic courts, mediation, or an international investment court that addresses the perceived shortcomings of ISDS.

1. **Sovereignty vs. Investor Protection:** Proponents and advocates of ISDS argue that it is necessary to protect foreign investors from arbitrary or unfair actions by host states. They contend that ISDS mechanisms are vital for ensuring investor confidence and encouraging foreign direct investment (FDI). By providing a neutral forum for dispute resolution, ISDS contributes to economic growth and development. Critics raise concerns about ISDS mechanisms infringing upon national sovereignty. They argue that these mechanisms can deter governments from implementing legitimate public policies, such as environmental regulations, public health measures, or labor standards, out of fear of facing costly arbitration claims. Some contend that ISDS undermines the democratic decision-making processes of host countries.
2. **Lack of Transparency:** Proponents of ISDS mechanisms acknowledge the transparency issue and argue that it can be addressed through reforms. They believe that increased transparency measures, such as allowing public access to documents and hearings, can enhance the legitimacy and accountability of ISDS. Critics emphasize the persistent lack of transparency in ISDS proceedings. They contend that confidential arbitration can lead to mistrust and speculation about the fairness of arbitral decisions. This lack of transparency can exacerbate the perception that ISDS tribunals operate in a closed, secretive manner, potentially favouring investor interests over the public good. Critics argue that transparency reforms alone may not fully alleviate these concerns. In recent years, the two principal bodies responsible for administering arbitration proceedings, the International Centre for Settlement of Investment Disputes, and the United Nations Commission on International Trade Law, have taken steps to promote greater transparency in the international arbitration of investment disputes.^x
3. **Inconsistent Decisions:** Supporters of ISDS mechanisms acknowledge that inconsistent decisions have been a problem in the past but argue that jurisprudence is evolving, and precedents are being established to provide more clarity and predictability in decision-making. They contend that ISDS can contribute to the development of a coherent body of international investment law over time. Critics point out that despite efforts to improve consistency, ISDS tribunals can still render inconsistent decisions. This lack

of uniformity in interpreting international investment law can create uncertainty for both investors and host states, making it difficult to predict outcomes and understand the scope of investors' rights.

4. **Arbitrator Bias and Conflicts of Interest:** Proponents and advocates of ISDS mechanisms argue that many arbitrators are experienced professionals who adhere to codes of conduct, such as the ICSID Code of Conduct for Adjudicators in Investment Disputes. They believe that arbitrator bias can be mitigated through rigorous selection processes and transparency measures. Critics express concerns about arbitrators having potential conflicts of interest due to their professional affiliations and prior roles as counsel in investment disputes. They argue that the perception of bias can erode confidence in the ISDS system. Efforts to address this issue include proposals for more stringent ethics rules and codes of conduct for arbitrators.
5. **High Costs and Accessibility:** Supporters of ISDS mechanisms acknowledge that the cost of arbitration can be high but argue that it is a necessary trade-off for ensuring access to justice for investors, especially smaller ones. They emphasize that ISDS offers an alternative to potentially biased domestic courts in host countries. Critics raise concerns about the exorbitant costs associated with ISDS proceedings, which can be prohibitively expensive for many countries and investors. They argue that this cost barrier can lead to a perception of an uneven playing field and hinder access to justice for smaller investors or less wealthy states.
6. **Reform Initiatives:** In response to these criticisms, there have been ongoing efforts to reform the ISDS system:
 - **Transcending the Shroud of Opacity:** To address concerns germane to transparency, the clarion call for heightened openness within ISDS proceedings resounds. Proposals encompass the elevation of arbitration hearings to the public domain, the accession of third-party submissions, and the public dissemination of awards and determinations.
 - **Embracing a Code of Conduct:** To circumvent the precipice of conflicts of interest, fervent suggestions advocate the establishment of a stringent code of conduct for arbitrators. This would necessitate arbitrators to divulge any

potential conflicts and to recuse themselves when prudence so dictates, thereby upholding the inviolate doctrine of impartiality.

- **The Quest for an Appellate Mechanism:** In the quest for doctrinal congruence and legal certainty, the proposition of an appellate mechanism emerges as a salient reform. Such a mechanism would proffer an appellate tier for the review of arbitral awards, endowing jurisprudential coherence and harmonization within the ISDS realm.
- **Fortifying Safeguards and Restrictive Drafting:** In a bid to fortify the edifice of regulatory sovereignty, proponents of reform endorse the articulation of ISDS provisions in more circumspect language, explicating the precise ambit of investor claims. Safeguards could be artfully woven into the fabric of ISDS mechanisms, necessitating foreign investors to exhaust domestic remedies before invoking ISDS arbitration.

Conclusion

In conclusion, the Investor-State Dispute Settlement (ISDS) mechanisms represent a double-edged sword in the world of international investment law. On one hand, they provide essential protections for foreign investors, fostering economic growth and encouraging cross-border investments. On the other hand, they raise significant concerns regarding the erosion of state sovereignty, lack of transparency, and the potential chilling effect on public interest regulations. The controversies and criticisms surrounding ISDS mechanisms have not fallen on deaf ears. Recent reform efforts, such as increased transparency initiatives, the proposed Investment Court System (ICS), and the ongoing debate about the balance between investor rights and state sovereignty, demonstrate a commitment to address the flaws in the current system. It is essential to recognize that the role of ISDS mechanisms in the global economy is far from obsolete. In an interconnected world, where capital flows freely across borders, foreign investors require a degree of protection to ensure that their investments are secure and subject to fair treatment. However, this protection must not come at the cost of the public interest and a host state's ability to regulate in areas like health, environment, and labor rights.

As the international community grapples with the complexities of ISDS, it is clear that the path forward lies in finding a delicate equilibrium. Balancing the legitimate rights of investors with the sovereign authority of states is a formidable task, but it is not insurmountable. Through continued dialogue, cooperation, and thoughtful reform, ISDS mechanisms can evolve to become a fair and transparent tool for resolving investment disputes, one that benefits both investors and the broader public.

In this ever-changing landscape of international investment law, stakeholders must remain committed to a vision where ISDS mechanisms promote responsible investment while upholding the principles of democracy, transparency, and the common good. Only through such a harmonious coexistence can ISDS mechanisms truly serve as a catalyst for sustainable economic development, equitable dispute resolution, and the protection of state sovereignty in the 21st century.

Endnotes

ⁱ International Trade Canada, "Canada-European Union Comprehensive Economic and Trade Agreement (CETA)" (last visited 6, October 2023), <https://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/ceta-aecg/index.aspx?lang=eng>

ⁱⁱ Vivienne Bath, 'One Belt, One Road' and Chinese Investment: Legal Dimensions of China's Belt and Road Initiative, Wolters K. HK Ltd., Syd. L. Sch. R. Pap. No. 16/98 (2016)

ⁱⁱⁱ UNCTAD, http://unctad.org/en/PublicationsLibrary/webdiaepcb2015d2_en.pdf, *IIA Issues Note*, No. 2, May 2015.

^{iv} *Ibid.*

^v Scott Miller and Gregory N. Hicks, Centre for Strategic and International Studies, Working Paper, 21 January 2015.

^{vi} *Supra* note 5

^{vii} *Ibid*

^{viii} *Ibid*

^{ix} UNCTAD, Investment Dispute Settlement Navigator, <http://investmentpolicyhub.unctad.org/ISDS>, 31 December 2022.

^x UNCITL, http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/2014Transparency.html, 1 April 2014; and Jason W. Yackee and Jarrod Wong, The 2006 Procedural and Transparency-Related Amendments to the ICSID Arbitration Rules: Model Intentions, Moderate Proposals, and Modest Returns http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1739174, 12 January 2011.