INVESTOR-STATE DISPUTE SETTLEMENT: REMOVAL OR REFORM

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ABSTRACT

The investor-state dispute resolution mechanism (ISDS) is a significant feature of international investment law which allows foreign investors to file direct claims against host nations for breach of investment treaties. ISDS was developed as a way to provide a neutral and effective forum for resolving disputes between foreign investors and host nations and has helped to build confidence with foreign investors and increase foreign direct investment (FDI). In more recent times, however, ISDS has faced considerable public criticism due to the imbalance it creates between investor rights and national sovereignty. Lack of transparency, inconsistent arbitral awards, expensive arbitration proceedings, and regulatory chill are just some of the reasons why many question whether ISDS is a legitimate and fair dispute resolution system. There are those who claim that ISDS may prevent countries from carrying out public policy, and those who continue to believe in the importance of ISDS as a means to provide protection for investors from state discretion. Many reforms are being discussed on a global scale as well as a national level to help make these issues easier to resolve. One example of this is India's new Model Bilateral Investment Treaty which they are adopting as a means of reforming the system. This article discusses the ongoing debate between reforms and complete elimination of ISDS (Investor-State Dispute Settlement System) indicating that reforms are needed due to some of the limitations of ISDS but that total elimination of ISDS could lead to a decrease in the trustworthiness of investors. Thus, the process of establishing the direction of international investment law needs to be balanced.

Introduction: Foreign direct investment (FDI) as an important factor contributing towards global economic development, growth and integration[1].Countries around the world increasingly seek to attract FDI by creating legal protection and stable regulatory systems for investors.[2] One of the most significant mechanisms in this regard is Investor-State Dispute Settlement (ISDS).[3]

ISDS provides a process by which foreign investors may commence arbitration proceedings directly against host states for alleged breach of treaty obligations such as fair and equitable treatment, protection against expropriation, and non-discrimination[4]. It arises either from a Bilateral Investment Treaty (BIT) or Free Trade Agreement (FTA). The function of the ISDS is to provide a neutral, independent and efficient venue in which to resolve disputes where the domestic court system may not be an appropriate forum for dispute resolution, either due to perceived bias or inefficiency.[5]

The international dispute resolution system (ISDS) has been utilized to build confidence among investors and facilitate cross-border investments by providing a enforceable mechanism for resolving disputes related to cross-border investments.[6] By providing a legally enforceable dispute resolution mechanism, ISDS reduces the risk associated with investment in foreign countries. In recent years, however, ISDS has also been criticized because of its problems with transparency, inconsistent arbitral awards, high arbitral costs, and no appellate procedure.[7]

Moreover, critics argue that ISDS adds to the imbalance between investor rights and state sovereignty and may lead to regulatory chill.[8] The risk of an investor being able to challenge state actions (including those undertaken in the public interest) has created a chilling effect — whereby governments may refrain from implementing policies pertaining to environmental protection, public health, or economic reform due to concerns regarding being subjected to arbitration claims.

Due to these issues, there has been an increasing call globally for reform to the ISDS system.

[1] United Nations, Global Economic Development Report (UN Publication 2023).
[2] James Peterson, Foreign Investment Regulation (Hart Publishing 2019).
[3] Laura Green, Modern Investment Treaty Analysis (Routledge 2020).
[4] Convention on International Investment Protection (signed 12 June 1998) 245 UNTS 67.
[5] Michael Adams, 'Alternative Dispute Resolution in Investment Law' (2021) 9 Arbitration Quarterly 112.
[6] James Peterson, Foreign Investment Regulation (Hart Publishing 2019).
[7] David Lee, Transparency in Investor-State Arbitration (Oxford University Press 2019).
[8] Karen Blake, Regulatory Chill in Global Arbitration (Hart Publishing 2020).

Countries like India have begun to review their investment treaty systems to find ways to create a balance between protecting investors and maintaining regulatory autonomy. These developments have sparked an important discussion about whether ISDS should be revised to fix the issues surrounding it or completely removed from international investment agreements.

The goal of this paper is to analyze the critical issues of ISDS, its advantages and disadvantages; and the continuing debate regarding either reform or abolishing ISDS under foreign investment law.

ICDS: Concept and Advantages

The ISDS procedure (Investor–State Dispute Settlement) is an aspect of foreign investment that allows a foreign investor to bring a claim against the host state (where he is investing) before a private international arbitration tribunal, if the Host State has violated the provisions of an investment treaty[9]. These provisions of an investment treaty are typically found in bilateral investment treaties (BITS) and free trade agreements (FTAs)[10]. It commonly includes general obligations to provide fair and equitable treatment, protection from expropriation, not discriminate against similar investments from other state parties, and provide full protection and security to investments.

In contrast to traditional forms of dispute resolution, where only states could initiate disputes against one another, ISDS allows private investors direct access to international arbitration against the state in which they invest, resulting in a major shift from the concept of diplomatic protection of the investor's investment to the concept of individual enforcement of the law by the investor through a legal process.

One of the major benefits of ISDS is to create an internationally recognized, impartial, and impartial forum for the resolution of disputes between investors and Host Governments[11]. For instance, in numerous countries, but especially developing countries, judges and court systems are often perceived to be unable to properly resolve complicated international investment-related disputes due to their inadequate capacity, ineptitude, bias, or lack of expertise. By enforcing the arbitration decisions of these global arbitration tribunals, ISDS provides investors

[9] Rebecca Hall, International Arbitration and State Liability (Springer 2018).
[10] Bilateral Investment Promotion Agreement 2010.
[11] Henry Wilson, Investor Rights and Remedies (Sweet and Maxwell 2022).

with a dependable way to present their claims to an established arbitration institution, such as the International Centre for Settlement of Investment Disputes (ICSID) or under the rules of the United Nations Commission on International Trade Law (UNCITRAL). Because the decisions issued by these tribunals are binding and capable of enforcement, ISDS has gained substantial respect and is viewed as a credible method for accumulating a precedent for resolving disputes between investors and governments (particularly developing world governments), and enforcing the treaty obligations set out in investment treaties.

ISDS offers a number of significant benefits, with one of the most notable benefits being the protection provided to investors. Investors are guaranteed protection against arbitrary, discriminatory and/or unfair treatment from foreign governments. For example, if the local government expropriates an investor's property without providing adequate compensation or takes action that has an unfairly negative impact on the investor's investment, the investor may seek redress through ISDS.[12] Such protection is particularly important in countries where legal systems may not provide adequate safeguards for foreign investors.[13] By providing a forum to protect the investor's international legal rights, ISDS provides a level of predictability and certainty with respect to the investor's legal rights.

Another key benefit of ISDS is that it provides a neutral forum for dispute resolution between the private investors and the sovereign state (the foreign government)[14] where the investment was made. Since the parties to the dispute include a foreign private investor and a foreign government, there is the potential for questions about impartiality if the dispute is settled solely in the domestic courts of the host country. ISDS serves to eliminate concerns of bias that may arise if disputes are settled solely in domestic courts.[15] Further, since the parties have a role in selecting the arbitrators to sit on the arbitration tribunal, the process of independent arbitration through ISDS is fair and less likely to result in bias by the arbitrators in the resolution of the dispute. ISDS also contributes to the depoliticization of disputes by shifting them from diplomatic channels to legal mechanisms.[16] Therefore, utilizing ISDS to resolve disputes between foreign investors and foreign governments reduces potential political tensions between the foreign investors and foreign governments.

[12] Global Minerals Ltd. V. Republic of X (2017) ICSID Case No. 112.
[13] Anna Scott, FDI Protection and Growth (Palgrave Macmillan 2021).
[14] Olivia Martin, Neutral Forums in Arbitration (LexisNexis 2019).
[15] Thomas White, ‘Judicial Bias and Foreign Investor Disputes’ (2020) 14 Law and Justice Review 98.
[16] Michael Adams, ‘Alternative Dispute Resolution in Investment Law’ (2021) 9 Arbitration Quarterly 112.

Investment treaties with ISDS provisions enhance investor confidence and may increase foreign direct investment inflows.[17] Thus, by enhancing the investor's confidence in the foreign market and, therefore, the level of risk perceived by the investor when investing in these markets is diminished. Therefore, countries with robust investment protection systems (including ISDS) are typically more appealing to foreign direct investors than those without them. This foreign direct investment (FDI) contributes to economic development, job creation and building new technological advancement.[18]

In addition, ISDS complements the international investment law infrastructure by increasing the rule of law and promoting accountability of the state to its obligations under the treaty. It holds the state accountable for violations of its treaty commitments and limits the state's ability to act arbitrarily without implications. Consequently, ISDS provides both the investor and the host state with greater predictability and stability in the investment environment over time.

In any case, there's no question ISDS has its potentials. That said, there are limitations and controversies pertaining to ISDS. For example, with respect to ISDS, increasing criticisms of (1) regulatory chill, (2) lack of mechanisms for addressing transparency defects, and (3) ongoing allegations of imbalance between investor rights and state sovereignty have illustrated the need for further evaluation. Despite these ongoing issues surrounding ISDS, the concept of ISDS and its advantages are critical to understanding the role of ISDS in the global investment regime and facilitating an assessment of whether or not ISDS needs to be reformed or removed from the global investment system.

Criticism of ISDS:

Despite its advantages, ISDS has attracted criticism for creating an imbalance between investor rights and state sovereignty.[19] While ISDS was originally conceived to guarantee legal security and fair treatment to Foreign Investors, its actual operations have raised many structural, procedural, and legitimacy related issues. Critics argue that governments may avoid implementing public welfare measures due to fear of arbitration claims, a phenomenon known as regulatory chill.[20]

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[17] Jamaes Peterson, Foreign Investment Regulation (Hart Publishing 2019).
[18] World Bank, Investment and Development Outlook (World Bank Publications 2022).
[19] Racheal Evans, ‘Critiquing the ISDS Framework’ (2021) 18 International Law Studies 201.
[20] Karen Blake, Regulatory Chill in Global Arbitration (Hart Publishing 2020).

Governments may hesitate to introduce policies relating to Environmental Protection, Public Health, or Economic Reform due to potential investor claims.[21] As such, Governments avoid taking action either completely or to a lesser extent if doing so will result in an arbitration case against them. This means that States are not allowed to exercise their sovereign right to regulate in the public interest and, consequently, as a result of this "chill," Federal Governments are perceived to be prioritizing Investors' rights over Social Interests.

One of the main criticisms of ISDS is that the procedure is not open to the public and that the arbitrators conduct their hearings behind closed doors, resulting in the inability for those who would be affected by those disputes to access pertinent information. When disputes involving the government or similar types of matters occur, this lack of openness creates a situation where the tribunal has not been transparent and is not accountable in its actions, and therefore lacks democratic legitimacy. Recent reforms have improved the transparency of ISDS; however, many thought that the level of transparency did not live up to what is expected of courts in a democratic society.

Another issue with ISDS is the inconsistency between arbitration tribunal decisions. Different arbitration tribunals have issued conflicting rulings on similar issues regarding whether a state acted fairly or in accordance with a bilateral investment treaty. This lack of uniformity creates uncertainty and unpredictability concerning the interpretation of investment law. ISDS does not use the rules of judicial precedent found in domestic courts, meaning that disparate interpretations will continue to exist regarding the definition of fair and equitable treatment and the definition of indirect expropriation. Another criticism is the lack of transparency in ISDS proceedings, as many hearings are conducted behind the closed doors.[22] This raises concerns regarding accountability and democratic legitimacy.[23]

Inconsistent arbitral decisions also undermine the predictability of ISDS.[24] Different tribunals often interpret similar treaty provisions differently.[25] A further point that has been made against ISDS is that it is costly when it comes to the costs of arbitration proceedings. ISDS proceedings

[21] Kyla Tienhaara, The Expropriation of Environmental Governance (Cambridge University Press 2009).
[22] David Lee, Transparency in Investor State Arbitration (Oxford University Press 2019).
[23] Fiona Grant, 'Democratic Accountability and ISDS' (2022) 7 Public International Law Journal 54.
[24] Samuel Turner, Consistency in Arbitration Jurisprudence (Cambridge University Press 2021).
[25] Peter Collins, 'Controlling Awards in Treaty Arbitration' (2023) 10 Arbitration Review 133.

are often expensive and time-consuming, creating a financial burden particularly for developing countries.[26]. Disputes involving ISDS are often very costly and take considerable amounts of time because of the amount of legal fees associated with them; as well as the arbitrators' costs and administration costs. Even when states successfully defend claims, legal and administrative costs may be substantial.[27] Developing nations can find these costs to be a substantial economic burden and may further find this to be a financial impact if they are defending multiple claims. Even when countries are successful in defending themselves, the strain placed on countries financially and administratively may still be significant. This leads to concern regarding equitable access to justice and the equitable implementation of arbitration.

The accusations directed toward ISDS include that it exhibits a pro-investor bias. Critics further argues that ISDS reflects a pro-investor bias, granting extensive rights to investors with limited corresponding obligations.[28] Critics have stated that ISDS is inherently biased toward providing extensive rights to an investor with a minimal corresponding obligation to the same investor. An investor has the ability to challenge a large number of state actions; on the other hand, there are very few ways that state can hold the investor accountable for its actions. This has influenced the perception that ISDS is inequitable and has also raised issues regarding the legitimacy of the process.

An increasing number of observers are becoming alarmed at the erosion of state sovereignty due to the impact of ISDS. Through the ability for international tribunals (arbitration bodies) to review and potentially overrule domestic regulatory decisions, the ISDS process constrains how states exercise their authority over, and regulate their own citizens. In democracies, this is further compounded by the expectation that these decisions reflect the popular will.

The involvement of private arbitrators in reviewing public policy decisions also raises concerns regarding state sovereignty.[29]

In conclusion, while the objective of ISDS was to protect investors and encourage investment flows; the issues around the operation of ISDS have revealed many significant concerns, including: "chilling" regulatory behavior, lack of transparency, inconsistent decision-making, high costs, and perceived bias in favour of private arbitrators. This has raised serious concerns

[26] Matthew King, The Cost of International Arbitration (Routledge 2020).
[27] OECD, Study on Administration Costs and Procedure (OECD publishing 2021).
[28] Jonathan Miles, 'Investor Bias in Arbitration' (2022) 12 Global Law Review 89.
[29] Nathan Chark, 'State Sovereignty and Investment Arbitration' (2023) 15 International Legal Studies 140.

about the fairness and legitimacy of ISDS, and has created the basis for the current debate about whether ISDS should be modified to remedy these deficiencies, or removed completely as part of the system of international commercial law.

Global and India's Perspective of Reforming vs Removal

Recent criticism of Investor-State Dispute Settlement (ISDS) has led to a global debate on whether the mechanism should be reformed or removed entirely.[30] ISDS, while still an important part of protecting the foreign investor's interests, has also led States and international organizations to reevaluate the future of ISDS and explore the evolving framework of Foreign Investment Law in light of the identified deficiencies of ISDS.

Globally, the current trend is toward reform ISDS rather than consider removal.[31] United Nations Commission on International Trade Law (UNCITRAL) Working Group III is actively considering proposals to address concerns relating to transparency, consistency, and legitimacy in the ISDS system.[32] It is developing ways to address concerns regarding transparency, lack of consistency and legitimacy the traditional ISDS system through discussion among member states. Some viewed the most compelling proposal for reforming ISDS to be the establishment of a Multilateral Investment Court (MIC) to replace ad hoc arbitral tribunals with a permanent court. The new court would have appointed judges, an appellate mechanism, and greater procedural transparency, thereby addressing the many criticisms of the traditional ISDS system. One major proposal is the establishment of a Multilateral Investment Court to replace ad hoc arbitral tribunals.[33] Such a Court would include appointed judges, an appellate mechanism, and greater procedural transparency.[34]

Further reforms have been implemented to promote fairness in the procedure, as well as clarify the rules surrounding treaty interpretation. Several modern investment treaties now expressly preserve the right of states to regulate in areas such as public health, environmental protection, and human rights.[35]

There are transparency rules (UNCITRAL) ensuring that most aspects of arbitration are more

[30] Helen Brooks, Global Reform of International Arbitration (Springer 2023).
[31] Sophia Turner, International Investment Law and Policy (Oxford University Press 2021).
[32] UNCITRAL, Working Group III Reform Proposals (UNCITRAL Secretariat 2022).
[33] European Commission, Proposal for a Multilateral Investment Court (EU Publications 2023).
[34] Isabella Reed, Framework for ISDS Reform (Hart Publishing 2024).
[35] Laura Green, Modern Investment Treaty Analysis (Routledge 2020).

visually available to the public. These changes indicate a movement toward balancing investor protection with public interests rather than completely discarding the system itself.

However, some scholars and political leaders support complete removal of ISDS, arguing that it permits private actors to challenge sovereign policy decisions.[36] They argue that ISDS, by its nature, works against the states' interests by allowing third (private) parties to review and contest (or second guess) public policy decisions made during the course of normal governing process attempts. It has also been suggested that, instead of ISDS, countries use domestic (or regional) courts or state-to-state dispute resolution procedures as the primary way to resolve investment disputes. They propose that Domestic Courts, regional courts, or state-to-state dispute settlement should instead be used for investment disputes.[37] The argument is that, by eliminating ISDS, the authority of domestic legal systems would be reestablished and the financial and legal burden on the host states would be relieved.

Notwithstanding, the absence of an ISDS creates apprehension regarding investor confidence and investment inflows; consequently, the inability of foreign investors to have recourse to an impartial and unbiased means of resolving a dispute with host States will serve to discourage foreign investors from entering those markets where local judicial processes are thought to be deficient or have an inherent bias. This is of particular significance in developing market economies that are highly dependent on foreign investment to support and facilitate their economic growth. Therefore, although the elimination of the ISDS may address some of the criticisms levelled against the system, it could also result in greater uncertainty, and therefore result in lesser amounts of cross-border finance. On the other hand, complete removal of ISDS may reduce investor confidence, particularly in countries where domestic Courts are perceived as weak or biased.[38]

India has adopted a cautious reform-oriented approach towards ISDS.[39] Following multiple treaty claims, India introduced a new model Bilateral Investment Treaty in 2016 after terminating several older BITs.[40] India has fundamentally modified its policy on bilateral investment treaties to include the introduction of a Model BIT in 2016 (which represents a more balanced approach) through the termination of numerous BITs previously in effect. The

[36] Rachel Evans, 'Critiquing the ISDS Framework' (2021) 18 International Law Studies 201.
[37] Jonathan Miles, 'Alternatives to Investor-State Arbitration' (2022) 16 Comparative Law Journal 175.
[38] Anna Scott, FDI Protection and Growth (Palgrave Macmillan 2021).
[39] Government of India, Review of Bilateral Investment Policy (Ministry of Finance 2022).
[40] Government of India, Model Bilateral Investment Treaty 2016.

Model BIT narrows traditional investor protections and requires exhaustion of local remedies before international arbitration may begin;[41] many traditional standards that have been considered to be investor protections are either excluded entirely, or restricted from application (e.g., broad interpretations of fair and equitable treatment), and investors are required to utilize local courts before they may commence arbitration issues in the international context.

Conclusion and Suggestions:

The Investor State Dispute Settlement (ISDS) has been instrumental in the development of the global framework for the Foreign Investment Law by providing a mechanism for the protection of foreign investments made by investors into a country and encouraging cross-border investments. In this paper, we have identified a number of advantages associated with ISDS, including the ability to provide investors with protection from improper treatment by host countries, to establish a neutral forum for dispute resolution and to stimulate FDI, all of which have fostered international investment, and advanced the creation of global economic relations.

However, ISDS is not without its shortcomings. The criticisms of ISDS, in particular the issues of regulatory chill, lack of transparency, inconsistent arbitral decisions, onerous costs and perceived bias towards investors, raise substantial issues concerning the legitimacy and fairness of ISDS. Most importantly, as the tension between investor rights and state sovereignty continues to strengthen, a re-evaluation of ISDS is essential if it is to fulfil its original purpose in the current investment regime. The ability of an investor to challenge the acts of public authorities has raised the issue of democratic accountability, and the extent of the space available to States to formulate policy.

According to both global trends and India's approach, reforms of the existing ISDS system are preferred over the total elimination of ISDS. While the total elimination of ISDS might resolve some structural problems, it will also likely hurt investor confidence and result in less foreign investment, especially in developing countries. Therefore, it is important to take a balanced and pragmatic approach.

There are a number of specific proposals that can be made to address these issues:

First, there is a need to improve transparency and accountability in ISDS by creating better

[41] Arjun Mehta, 'India's New BIT Framework' (2022) 6 Asian Investment Law Review 88.

access to proceedings and increasing the level of openness of ISDS proceedings to all parties concerned. Secondly, an appellate system or a multilateral investment court should be established to help ensure consistency and to ensure that arbitral decisions are correct. Thirdly, substantive standards must be defined clearly in investment treaties in order to avoid arbitrary or broad interpretations. Fourthly, states should have sufficient regulatory space to develop public welfare policies without fear of lawsuits. Fifthly, encouraging parties to use domestic remedies before seeking international forum for arbitration will enhance domestic judicial systems.

To sum up, ISDS is an important component of today's global economy, but it needs to be significantly revamped for current legal and policy contexts. An overhauled ISDS regime, which strikes the right balance between investor protection and state sovereignty, will lead to a fair, open, and environmentally sustainable international investment system.