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## Role of Actors and Factors for the Emergence of Contemporary Regime of Investor-State Dispute Settlement

Vol. V, No. IV (Fall 2020)

Pages: 40 – 47

p- ISSN: 2708-2474

e-ISSN: 2708-2482

L-ISSN: 2708-2474

### Abstract

*Dispute resolution mechanism happened to be the fundamental aspect of the protectionist discourse of foreign investment. The consistent efforts were rolled out on behalf of international economic organizations such as UNO, OECD and IBRD of World Bank Group for the establishment of an impartial forum for the settlement of investment disputes. The opposite approaches of capital-exporting developed economies and less developed recipients of foreign capital lead certain attempts to failure to build consensus for dispute resolution mechanism relating to foreign investments. The World Bank started its effort for a specialized forum for investor-state dispute settlements in 1961. This effort remained successful in building consensus for exclusive jurisdiction for investment disputes. The members of the World Bank Group adopted the international convention on the settlement of investment disputes between states and nationals of other states, 1965, i.e. ICSID Convention. The paper has concluded that the efforts of international organizations and the large-scale recognition of the ICSID mechanism have ensured the legitimacy of the system.*

**Key Words:** Actors, Factors, Investment, Dispute, Settlement

### Introduction

The international economic organizations played a pivotal role in the establishment of institutions for the protection of foreign assets and to achieve global economic stability goals. These organizations put their persistent efforts into the encouragement and protection of foreign investment across borders. Consequently, the protectionist approach of international economic organizations has been linked with the growth of foreign investment flow across borders. International economic organizations have shown their inclination to the supranational adjudicatory forum of investor-state dispute settlement in the post-World War II era. The paper has highlighted the efforts which undertook by the international organizations for the establishment of an exclusive regime of investor-state dispute settlements.

In post-WWII economic developments, the institutional dispute resolution mechanisms were introduced through WTO, ICJ, ICC, SCC and LCIA. The dispute settlement understanding (DSU) procedure of WTO is only available at the request of the states. The jurisdiction of the international court of justice (ICJ) has been available to states only to the extent of interpretation of laws that were consented to by the contesting states. A foreign investor can invoke this forum for the resolution of their investment disputes. The jurisdictions of these adjudicatory institutions have been appeared to be limited to deal with the legal disputes of foreign investors. In the context of a long-standing demand for a specialized jurisdiction of investment disputes, some international economic organizations, generally and International Bank for Reconstruction and Development (IBRD, i.e. World Bank), specifically undertook a successful effort in 1965. The member of the World Bank Group adopted the ICSID Convention to establish a specialized forum to deal with the legal dispute relating to foreign investment disputes.

Apart from the role of international organizations, the paper has highlighted politico-economic derives proved to be the impetus for the creation of the specialized mechanism for the settlement of investment disputes.

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## **Role of Actors for the Development of Investment Arbitrations**

The institutional organizations played a pivotal role in the economic stability of the world. Some international economic organizations rolled out their efforts for the establishment of an impartial and independent forum for the resolution of investment disputes. The efforts of UNO, OECD and IBRD lead to evolving a specialized mechanism for the settlement of investment disputes finally.

Organization of Economic Changes and Developments (OECD) has been involved in building consensus to draft convention to protect the assets of foreign investor since the 1950s. In 1962, OECD ministers endorsed Abs-Shawcross Draft Convention. The convention introduced provisions to regulate expropriations and dispute settlement of investment disputes. The attempt failed due to the emergence of unresolved differences between capital-exporting states and less developed countries (LDCs) (Subedi, 2020). This model of the instrument contained exemptions to address special situations or concerns of contracting states. In 1976, OECD endorsed a Declaration on International Investment, including guidelines for Multilateral Enterprises (Houde, 2004).

OECD supported a progressive liberalization approach for stakeholders of the foreign investment regime. The efforts have emphasized suppressing discriminatory treatment of foreign investors and encouraging transparencies of foreign investments (Houde, France & Yannaca-Small, 2004). The code and declarations promulgated by OECD, i.e. Code of Liberalization of Capital Movements and Declaration on International Investment, contain legal obligations to refer to the transnational forum for their settlement according to the consent of the parties. At the same time, OECD Guidelines for Multinational Enterprises have recommended guidelines of responsible business in the different parts of the world (Houde, France & Yannaca-Small, 2004). These guidelines are not providing rights to the signatory states but constitute normative standards for the international investment agreements (Schill, 2018). OECD guidelines have been recognized in the decisions of the tribunals in investor-state dispute settlements and international investment agreements.

The 'Guidelines' has the potential to harden the obligations that were integrated as part of international investment agreements. At the same time, these guidelines have influenced the considerations of the tribunals in case of investment disputes. Thus, the guidelines of the Responsible Business Conduct (RBC) have been part of 90% of the existing framework of international investment agreements (IIAs) (Schill, 2018). The amicus curia in the case of 'Pac Rim vs El Salvador' has referred to OECD guidelines to support the argument of the respondent state. At the same time, the respondent's host states have invoked the guidelines of OECD to support their arguments in ICSID litigations (Pac Rim v El Salvador, 2009).

In post-WWII developments, UNO initiated its demand for the protection of foreign investment assets among the members' states with the object to avoid any future conflict. The UN Economic and Employee Commission had conducted a study for the "investment code" in 1947 (Parra, 2017). After the UN initiatives were taken for the promotion and protection of foreign investment, some other world economic organizations started their efforts for providing an acceptable solution for ISDS. The international court of justice was established under UNO for the resolution of disputes among nations post-WWII era. There is a number of instances where ICJ has resolved investment-related disputes between the states ICJ by treating such as a dispute between states. There is a number of international treaties which have referred ICJ for the dispute resolution forum in case of investment disputes. Friendship, Navigation and Commerce (FCN) treaties of the trading states can be cited as an example.

The transnational tribunals such as ICC, SCC, and LCIA have provided an impartial forum for the settlement of the commercial disputes of foreign investors. The ad hoc arbitration procedures of ICC, SCC, LCIA and other regional arbitration institutions can be invoked at the request of the private parties for their commercial disputes. The deficiencies of these forums to address the legal issues of investment disputes against state actions and diplomatic privileges of states raised its dire demand for a specialized forum for the settlement of investment disputes. Thus, the efforts of the World Bank remained successful in introducing a specialized forum for the settlement of foreign investment dispute. The paradigm shifted when the 'foreign investors' were allowed to approach the international tribunals for the redress of their grievances directly without the intervention of the home states.

In the early 1960s, the president of the International Bank for Reconstruction and Development (World Bank) took the initiative to establish a specialized international adjudicatory body for the settlement of foreign investment disputes (Parra, 2017). The secretary-general of the World Bank put up their notes for the establishment of a multilateral approach to settle investment disputes. The executive director gave their affirmation for the proposal to establish an international multilateral forum for the settlement of investment disputes in its meeting in March 1962 (History of ICSID Convention).

A special committee was constituted for the preparation of a working paper for the multilateral agreement to establish a body of international arbitration for the investment disputes (History of ICSID Convention). The preliminary draft was considered by Regional Expert Committees in their Consultative Meetings at the UN regional headquarters from December 1963 to May 1964. *The first draft* of the convention was prepared in the light of discussions of regional consultative committees, their reports, and discussions of executive directors of the preliminary draft. The jurisdiction clause of the icsid tribunal was heavily discussed during this whole process of consultations and formation of the convention. The proposed draft suggested flexible jurisdiction of the tribunals by excluding diplomatic involvement of the host state (Parra, 2017). The private foreign investor party can directly approach the forum without seeking help or intervention from the home state.

The political subdivisions are suggested to consent for the jurisdiction of the centre. But the suggestion for the subrogation of the home state and the nationals of both the contracting states was dropped on the objections of some states in the First Draft stage. The writing consent of the contracting states is required to be proved by the claimant. The consent might be witnessed by investment contract or legislation, or any other legal instrument. The consent, once given, suggested to be irrevocable for the existing transactions, which barred diplomatic protection under international law (Parra, 2017).

At a legal expert stage, the issues relating to the nature of jurisdiction remained irritant due to the difference of politico-economic approaches of developed and LDCs. The legal committee held 22 meetings on the issues of dispute settlement mechanism in the Washington DC session from November 23 to December 11, 1964. The changes for the revised draft of the convention were summarized by the Chairman of the Legal Committee in the report to the executive directors of the World Bank. The executive director, in their meeting between February 16 and March 4, 1965, adopted certain changes and gave final approval of the text of the convention along with their report on March 18, 1965 (Parra, 2017).

Tunisia was the first country to sign the convention. There were thirty countries that signed the convention till December 1965. The nine industrial capital-exporting states, seventeen African LDCs and only three Asian countries, including Pakistan, were the pioneer signatory members of the convention. There were no Latin American and countries from the communist and socialist block, which signed till the end of the year 1965. Nigeria was the first countries which submitted its ratification with the World Bank on 23<sup>rd</sup> August 1965. The USA ratified the convention on 10<sup>th</sup> June 1966. The first 20 countries which ratified include 14 countries from African and the Netherland was the 20<sup>th</sup> country that ratified the convention to qualify on October 14, 1966. Therefore, The ICSID Convention 1965 was entered into force on October 14, 1966, with the ratifications of 20 founding members of the convention. ICSID forum has been provided consent base facilities for investor-state dispute settlement (ISDS) (Parra, 2017).

### Factors Contributed to the Establishment of Icsid

There are factors political and economic factors which have contributed to the establishment of exclusive transnational jurisdiction for investment disputes.

The emergence of ICSID jurisdiction, in consequence of a weak governance system, deprived the position of investors of their and international sentiment for economic liberalization. Strong demand for independent, impartial and skilled forum advocated in response to the large scale nationalization of multinationals with the alleged bias and deficient legal structure of the host states. The deprived position of foreign investors motivated the sentiment for an impartial and skilled system of ISDS. The democratic norms demand liberal policies to provide an opportunity for commercial activities, including trade and investments. The adoption of liberal economic policies provides space to attract foreign investment by adopting international contractual obligation for the states to boost their economic conditions.

The events and determinants that contributed to the establishment of a transnational system of ISDS include incentivized liberal economic policies to redress the apprehension of foreign investors and the weak legal governance system of host states. The major factors which contributed to the establishment of a new mechanism for ISDS are:

Firstly, the vulnerability and deprived position of foreign investors under the customary international law is one the major factor for redefining the discourse of settlement of investment disputes. The urge to protect investments by foreign investors has been the predominant factor for elevating demands for an independent system of ISDS. Multinationals have experienced large scale nationalization or expropriation in the twentieth century (Harten, 2010). The loss of foreign investments raised concerns for the protection of their investments in the host states. The diplomatic protection for foreign investors can be declined by the host state. At the same time, the home state has the option to settle, waive and modify the settlement of a claim for political

considerations. These political settlements may not satisfy the claims of foreign investors. In customary international law, the right to receive compensation not vested with the foreign investors but the home states which pursue the claim ([Brower & Schill, 2008](#)). Under the customary international law, foreign investors have no right to initiate their claims before the international tribunals, but the home state can do. The exhaustion of local remedy rule in customary international law hardly provides an efficient dispute settlement option for the satisfaction of foreign investors ([Brower & Schill, 2008](#)). Thus, the non-availability of enforceable rights of foreign investors against host states derived capital-exporting nations to build consensus for recognition of rights of aggrieved foreign investors. The foreign investors have no enforceable rights to compel the home state for the prompt and adequate satisfaction of their claims in case of expropriation.

Secondly, weak governance of the rule of law has been explained as the justification for the dramatic rise in private enforcement of international obligations and for bypassing the domestic judicial mechanisms ([Garcia, 2004](#)). The perceived partiality of the host state judicial system is another factor for a shift of paradigm for transnational adjudications for ISDS. The reluctance rather handicaps of domestic courts to scrutinize the affairs of the sovereign state actions fully due to constitutional or legal hurdles. Thus, the domestic courts are considered to be biased to protect the alien's property and politically motivated because of their restricted approach to deal with questions of international law. The incapability of domestic court is obvious because they have expertise in dealing with the issues of international obligations, which are the prerequisite of the ISDS mechanism. These act of the state in its sovereign capacity got its justification to redress the issue through international forums by independent adjudicators under the customary international law ([Brower & Schill, 2008](#)).

Thirdly, the economic liberalization efforts of the capital-exporting nations have been part of controversies by opposite economic ideologies during the cold war era. The capital-exporting nations and international economic organizations lobbied for the comprehensive mechanism for the protection of their assets abroad. The efforts started in the context of taking over foreign investments owned by capital importing countries or their multinational corporations by the abusive interference with the alien properties ([Garcia, 2004](#)). The USA and other capital-exporting nations started their efforts for the liberalization of restriction on investment in the post-WWII era ([Brower & Lee, 2001](#)). The two opposing political and economic ideologies of the bipolar world were at the helm of affairs. The opposite economic regimes activated their efforts to block each other politico-economic strategies. The major economic liberalization efforts were implemented through the incentivized contributions of Breton Wood Organizations after WWII. The international economic institutions like IBRD and IMF extended their major role to capital importing nations through structural reform policies to attract foreign capital ([Head, 2007](#)). The protection of foreign investments and its dispute resolution mechanism has been the major strategies to implement a free market economic system.

Fourthly, the economic assistances of Breton Wood economic organizations are the major motivations for capital importing countries for the adoption of liberal economic policies and to attract foreign capital for their social and economic uplift. The international financial institution World Bank carry its one of the objective is to promote and encourage foreign investment by the private investors by extending grantees of participation loan of the Bank ([Head, 2007](#)). The World Bank has created its organ, i.e. ICSID, as part of the World Bank group for investor-state disputes settlement. The conditionality of privatization and the free-market economy for providing loan facilities are used as policy tools to keep the peace and equilibrium in international economic balance ([Kaushal, 2009](#)).

IMF is the sister financial institution of the World Bank under the Bretton Woods Agreement, whose main function is to protect the national economies from the international fluctuation of exchange rates. This economic organization has emerged as the world's largest lending institution over the period of time. The organization requires structural adjustment programs (SAPs) for repairing the national economies. The majority of national economies have been the partners of IMF and World Bank for their SAPs or Structural Adjustment Loan (SALs). At the same time, the World Bank requires the approval of its Structural Adjustment Loan (SALs) from the IMF. The creditworthiness of national economies has been linked with the level of openness for the protection of foreign investment. These financial institutions induce conditionality of reform in borrowing countries to provide protection of foreign investment and its disputes resolution mechanism ([Kaushal, 2009](#)). The World Bank is providing ICSID facilities for the resolution of investment disputes. The majority of national economies have been the participant of these programs of IMF and World Bank with a lack of alternatives in bargaining except to accept the conditionality for receiving IMF and World Bank programs ([Kaushal, 2009](#)). The lack of alternatives for capital and credible commitments through BITs has been necessary alternatives for the capital importing nations to keep pace with their economic goals.

Fifthly, the shift of paradigm with the end of the cold war in the last decade of the twentieth century, after the fall of the Soviet Union, has been emerged as a decisive factor to establish a new political and economic dominance of the unipolar world. The political and economic interests of the United States and its allies made the interest of the third world developing options less significant ([Sornarajah, 1997](#)). The United States and its European allies promoted their political and economic interdependent interests by supporting to establish democracies. They encouraged global free-market economies in the world, which ensure the liberalized flow of trade and investment. The USA prioritized democracy and market capitalism as its ideological preferences in the post-cold war era. The instruments of international law have used to promote both the preference of the USA lead unipolar world ([Sornarajah, 1997](#)).

In 1980s and 1990s, the majority of developing nations of Asia and Latin America significantly switched their economic strategy toward free-market economies to attract foreign capital for economic growth. These nations changed their economic strategies by their reduced regulatory, governmental role for industrialization. The majority of nations joined WTO, ICSID, MIGA, FTAs, BITs and promulgated liberalized laws for FDIs to enhance their export base economies ([Garcia, 2004](#)). In the Latin American region, US-Argentina BIT in 1991 was the first treaty signed by any Latin American state to accept the ICSID jurisdiction for investment disputes. This has been the symbolic importance for the abolition of Calvo Doctrine ISDS purpose ([Garcia, 2004](#)).

Sixthly, the treaty shopping facilities to choose ICSID forum for ISDS has made it attractive for the foreign investors to invoke its jurisdiction. Gus Van Harten has analyzed that the freedom of foreign investors to bring their claim relating to all the aspects of the treaty without exhausting any local remedy has been the major attraction in the current ISDS regime. The foreign investor can shop forum of their choice without any interference from the home states. These forum regulated by the capital-exporting nations, where the majority of arbitrators belong to these economically dominating nations, are attractive deal for the foreign investor to demand such elite ISDS mechanism.

In the last decade of the 20<sup>th</sup> century, investment treaties, BITs, MITs and FTAs have become the main instruments for the protection of foreign investment. The alleged claim that the signing of BIT attracted foreign investments has been the motivation of proliferation in the BITs since the last decade of the twentieth century. These incentives of signing BIT are operative in the background of investments by the private investors for the participation in the privatizations programs in the capital importing countries ([Kaushal, 2009](#)). The majority of these BITs have referred to ICSID jurisdiction for the settlement of investment disputes as an assurance for the protection of foreign investment interests in the host states.

### **Appraisal of Accumulative Effects of Isds**

The demand for an exclusive adjudicatory forum to protect the assets of foreign investors was reasserted in a number of negotiations. The incorporation of the icsid convention engendered the specialized forum for the settlement of investment disputes where arise between a foreign investor and host state. However, the realization of capital importing economies of providing exclusive protection to investment dispute resolution affected to establish politico-economic stability generally and special benefits for the recipients of foreign investment.

The contemporary mechanism of investor-state dispute settlement has ensured the credible commitments for adequate and prompt compensation in case of violation of legal rights of the foreign investors. The contemporary mechanism of ISDS clarifies the unpredictability of disputes resolution in the presence of diplomatic privileges and political relations of states. Contrarily, the exclusive jurisdiction for the protection of foreign investment has incentivized the foreign investors for bringing their assets with confidence in host territories. The establishment of the ISDS mechanism has its relationship with the reduction of expropriation instances. Foreign investors are free to invoke jurisdiction of the ICSID tribunal without the intervention of home states. Foreign investors have been recognized as a subject of international law who can file their complaints against host states. The claim of damages can even be file without the consent of the contracting home and host states. This special privilege has elevated the status of the foreign investor as a legitimate stakeholder of the international economic regime.

The binding effect of the ICSID Convention upon contracting states has improved the political uncertainties' of international politics. The gunboat diplomacy of developed states for the enforcement of economic rights of their citizens has been abandoned after the establishment of the ISDS mechanism for the resolution of investment disputes. The militarily strong states have not undertaken any venture against weak economies of the world. Thus, the contemporary regime of ISDS has contributed to international peace and security.

The non-availability of credible commitments of ISDS adversely affect the competitiveness of the market for the flow of foreign investments to the host states. The increase of inward flow of foreign investment among contracting states has a positive relationship with investment protection by investor-state dispute settlement (Brower & Schill, 2008). The flow of investment capital in the developing economies have brought employment opportunities, technological advancements, specialized skills and revenue collection for the socio-economic uplift of citizens of the host state (Guzman, 1997).

Largescale recognition of the ICSID mechanism has strengthened the legitimacy rhetoric of the contemporary ISDS. States have participated to incorporate ISDS mechanism by international investment agreements. More than 150 states have executed 3284 investment agreements including majority of bilateral investment treaties. (UNCTAD, 2020).

## Conclusions

Protection of foreign investment remained contentious subject in the development of international law. Capital exporting nations initiated efforts to integrate protection measures to save the assets of traders and investors belong to developed nations. The treaties were executed with developing nations to secure smooth conditions for the flow of their assets of their citizens or multinationals.

In post-WWII developments, efforts were initiated to build consensus for the wide acceptance of investment dispute settlement framework by the developing economies of the world. The attempts to consolidate credible commitments were frustrated on the emergence of diametrically opposite stances adjudicatory body for the investment disputes. The deadlock condition to establish the specialized mechanism of investor-state dispute settlement broke due to the initiatives of international organizations.

Globally recognized economic organizations played a decisive contribution to the establishment of a specialized forum for investor-state dispute settlements as a credible assurance to protect the assets of foreign investors. The efforts of the World Bank Group played an influential role to build consensus among capital-exporting developed nations and capital importing nations of the world. The addition of ICSID to be the fifth organ of World Bank Group to adjudicate investor-state disputes. The successful endeavour of the World Bank has been influenced by patent and latent factors.

The patent factors have been the apparent reason to set the stage for consensus building for the commitments of investment protection. The trends of nationalizations and expropriations of assets of foreign investors by newly independent states have the direct reason to initiate a campaign for the transnational adjudicatory forum. The experiences of weak governance and handicap of domestic courts to enforce international obligations against their own sovereign justified the establishment of a special forum to deal in the interest of international peace and security.

In a post-WWII era, the Secular and communist regimes contested to defeat the socio-economic strategies of each other to achieve their hegemonic influence in the bipolar world of the time. The economic liberalization initiatives of stakeholders of the World Bank Group have become attractive on the realization of special benefits relating to the flow of foreign investments. The incentivized approach of the World Bank, affecting the flow of foreign investment, proved to be the major and embedded reason to defeat the anti-liberal economic regime of communist economic strategy. The end of the Cold War has been the major event to shift the paradigm for sweeping recognition of ICSID jurisdiction. The wide adoption of ICSID based investor-state dispute settlement mechanism anchors its legitimacy in international law. Therefore, various factors and actors have effectively contributed to establishing the legitimacy of the special mechanism of investor-state dispute settlement.

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**Abbreviation**

**ICJ**= International court of justice

**ICC**= International Chamber of Commerce

**SCC**= Stockholm Chamber of Commerce

**LCIA**=London Court of International Arbitrations

**WTO**= World Trade Organization