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ТЕЗИСЫ | NOTES

Spirit of the Investor-State Dispute Settlement (ISDS) reform: insights and forecasts

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Дух реформы системы урегулирования споров между инвесторами и государствами: наблюдения и прогнозы

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For several decades international investment arbitration has been a unique mechanism for resolving disputes between foreign investors and host states. But the unique nature of investment arbitration does not mean that it is free from shortcomings. Today, critical views about the fairness and effectiveness of the investment arbitration system are common not only at the Global South, but also in the Western countries, which at the times, when investment arbitration appeared, actively promoted its maximum expansion, but are now forced to “try on” the status of respondents.[1]

A mechanism that was originally set up to provide legal protection for the US and Canadian, Western European and Japanese investments in states with fragile legal and judicial systems, is now also used against the First World countries.[2] It prompted the European public to question the international treaties, originally intended to secure Western investment in other states, but which has become now “a truly anti-democratic tool in the hands of private arbitrators (representing a mysterious parallel justice system)”; in addition, “the threat of substantial financial sanctions has also become a concern, forcing states to change their policies, including on the protection of rights to a healthy environment” (Galperin, 2020, p. 53).[3]

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1 See, e.g., *Vattenfall AB and others v. Federal Republic of Germany*, ICSID Case No. ARB/12/12; *Loewen Group, Inc. and Raymond L. Loewen v. United States of America*, ICSID Case No. ARB(AF)/98/3; *Philip Morris Asia Limited v. The Commonwealth of Australia*, UNCITRAL, PCA Case No. 2012-12; *Ashok Sancheti v. United Kingdom*, UNCITRAL.

2 According to A.S. Ispolinov, global changes to the investment arbitration system appeared in the international agenda by developed countries when arbitration tribunals began to accept disputes against them. This move totally changed the paradigm in which investment arbitration was created. It was previously based on the progressive idea of excluding investment disputes from the scope of national courts in host states. The latter was understood at the time to include only developing countries. However, when developed countries emerged as defendants and began to challenge state measures of a general nature, including laws passed by parliaments, it was nothing short of an intrusion into the competence of courts with a long history, experience and authority. See: https://zakon.ru/blog/2018/05/10/reshenie_cuda_es_po_delu_achmea_krestovyj_pohod_protiv_investicionnogo_arbitrazha.

3 See also: Hourticq, B. (7 September 2020). How the little-known Energy Charter Treaty is holding environmental policy hostage. *Equal Times*. URL: https://www.equaltimes.org/how-the-little-known-energy?lang=en#.X2NoGOtuzb1.

Another reason for the distrust of the investment arbitration system has been the dramatic increase in the number of claims brought by European investors against other EU member states on the basis of the Energy Charter Treaty as well as the so-called intra-EU bilateral investment treaties (hereinafter — BITs). The EU governing bodies first expressed their dissatisfaction with this practice in 2007–2008. The main reason for this dissatisfaction is that in the opinion of the EU, arbitral tribunals dealing with such investment disputes must necessarily interpret EU law. However, such a power should be within the exclusive competence of an EU court. Thus, the very possibility of adjudicating investment disputes under the present system is incompatible with the principles and functioning of EU law (Alvarez & Obolenetsev, 2021, p. 351–352).

It is therefore not entirely unexpected that the Working Group III of the United Nations Commission on International Trade Law (UNCITRAL) (hereinafter — Working Group) obtained the mandate to initiate in 2017[4] the discussion on the potential reform of international investment arbitration, and the EU member states, the EU itself and Canada have taken the initiative to replace the investment arbitration system with something else.

In the first phase, it was recorded by the Working Group that dissatisfaction of states with the existing investment dispute settlement regime is most often related to: 1) inconsistency of law application in arbitral awards; 2) lack of mechanisms to ensure that awards are correct; 3) lack of predictability of awards; 4) doubts about the impartiality and independence of arbitrators; 5) lack of transparency in the proceedings; 6) increasing length and cost of proceedings.[5] In general, critical feedback has fallen into two categories: criticism of the arbitration process and its outcomes; and criticism of arbitrators/individuals involved in the decision-making in arbitration proceedings (Galperin, 2024, p. 513).

During last few years, the Working Group has discussed and proposed some initiatives to address the concerns of states, such as advancing the advisory centre for the respondent states, establishing the standing dispute resolution mechanism instead of the numerous *ad hoc* tribunals, permitting states to file counter-claims against the investors and dramatically reducing the grounds for the investor's initial claims, and made several proposals, which to some extent could be qualified as a "radical departure from the current status quo" and even "abandoning international arbitration altogether" (Fyock, 2025, p. 1). Some commentators point out that "when we read the academic literature, we see a lot

[4] The mandate was given to the Working Group of the UN General Assembly at its 50th session in 2017. See Official Report of the UN General Assembly, 72nd Session, Supplement No. 17 (A/72/17), paras. 263–264. URL: https://undocs.org/ru/A/72/17.

[5] Preliminary note to the Working Group: https://undocs.org/ru/A/CN.9/WG.III/WP.142, para. 5.

of criticism of the UNCITRAL Working Group for being too small and too incremental. When we read practitioner literature, we hear the opposite: the process is too big and too radical".[6] The truth is that only states (and their affiliates) are represented in the Working Group officially, but not the other party of the process – investors from the commercial sector, so the last are forced to camouflage themselves at the Working Group meetings as the observers, researchers or non-governmental institutions.

One of such "double-hatting" researchers is T. Sikora, who, like the author of this article, participates in the Working Group III as an independent expert, but is actually a counsel for a large multi-national company. In his recent intervention at the Paris Arbitration Week he said that he understands the concern that many states have about the Investor-State Dispute Settlement (hereinafter — ISDS), since they entered the system to attract true foreign investment, not to be sued by their own nationals. However, he noticed that the Working Group is examining some "substantive unnecessary" reforms to the ISDS, which are "debilitating to the entire system".[7] Maybe he is right, but this is not the time for emotions. Rather for a pragmatic approach.

To be honest, in the new reduced form, suggested by the reformers, investment arbitration will not be needed by either states or investors, since it does not match with the economic model, which has remained unchanged for fifty years, while this type of arbitration evolved — investors want their investments to be really protected, and governments want investments to be really attracted. And there are economic discrepancies between them, which need to be effectively resolved to continue business. Investment arbitration was originally constructed for that. Any other legal scheme which does not meet this economic demand, would not fly anyway. Here, economics, not politics or pure law, will go first.

However, we see that the reform is now focused more on legalistic issues: procedural and jurisdictional matters. But the key problem is not in procedures or jurisdiction, or even standards of protection, or procedural independence, but an existential crisis of meanings in the ISDS. If we use a business product approach, which implies focusing on an end-product rather than the process of its producing: What is the end-product of the investment arbitration system? The product approach assumes that a given service solves a specific task.[8] This fact seems obvious, but we know how often a business project starts with an idea like "let's improve such-and-such a process, and then we'll see". Then,

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[6] Roberts, A., & St John, T. (23 November 2023). UNCITRAL and ISDS reform lifelong learning. *EJIL Talk!* URL: https://www.ejiltalk.org/uncitral-and-isds-reform-lifelong-learning/.

[7] Jones, T. (7 April 2025). ISDS proposals under fire at PAW. *Global arbitration review*. URL: https://globalarbitrationreview.com/article/isds-reform-proposals-under-fire-paw.

[8] See: https://sendpulse.com/support/glossary/product-approach.

after months and years, it turns out no one actually needs it. There is a high risk that it could happen with the ISDS reform.

So, what product is really being sold by arbitration lawyers (both in-house and external attorneys), and what governments and corporations are buying from them?

The guess this is no longer justice (because justice is not for sale), and not the legal protection itself, but rather the valuable feeling of the management of the parties (including large corporations and states) that “all is not lost”, even when you have already failed in national instances, and negotiations have reached a dead end.

This hope can be maintained for years by arbitration. Experience shows that actors are willing to pay money just for this feeling, for hope. People make careers on that. This appeared very clearly in the recent sanctions cases, when those who were sanctioned went to international tribunals to challenge the measures with the faintest hopes of success, only with the assurances of lawyers that everything would be fine — just wait and pay. And then, when a client has already invested a lot in the proceedings, it is hard to stop, especially when it's not even money that is at stake, but also the reputation and prestige of a state or company.

Investment arbitration has long been not just about money, since money is not easily recoverable. Can you remember the last known case, when the respondent paid the award in full? It takes millions and years to collect and actually receive money under the awards. It is not about immediate effect now (and there is almost none), and after the reform, which could dramatically change the arbitration, it will be not for hope as well. No hope for real investors. It would be much harder for the lawyer, if the investment got lost, to say to his or her client, as they now do: “Don’t worry, we will win in arbitration one day, it is not the end of the game”.

Back to the beginning, there is still a strong and long-standing economic demand for the confidence that investment arbitration has provided for decades. Confidence for the investors that they may finally win in the tribunal with legal arguments, rather than immediately write off the investment as a financial loss. Confidence for states that they may pay damages only after the years of proceedings, set-asides, enforcements, etc., and more likely finally settle on acceptable terms. However, the reform does not propose anything to ensure this confidence. That is why it will hardly come to success.

Powerful investors will still demand protection for their businesses, and those states that want investments will be forced to provide this protection. If a state really needs investments, it would be forced to provide legal

guarantees on terms no worse than BITs provide now, and may be higher, due to the growing legal and political risks.

If the treaty-based arbitration is not the option, we would see a new rise of direct investment contracts with states, which include bank guarantees, representations, indemnities, and other things well known to contract law. Many investors already have “double protection” — under both an interstate treaty and a direct agreement with the government of the host state at the same time. They mostly don’t care about the ISDS reform, placing hopes on the traditional bargaining power. On top of that, nowadays investors are often more likely to come to an agreement with the host state than the host state and the state of origin with each other.

In conclusion, one may suggest that investment arbitration, and therefore all investment arbitration lawyers, have a future, although it may revert to how things were fifty or seventy years ago in response to the crusading reform against it, becoming more like its parent — good old commercial arbitration. There is nothing wrong with that. What could be wrong both for states and businesses — returning to one and half hundred years back: to diplomatic protection instead of investment arbitration. No one speaks out loud, but investors never wanted to be a bargaining chip in the political relations of governments, especially in these turbulent times. Even when things are bad, they figure it out themselves, including through arbitration.

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