



## Investor-State Dispute Prevention: A Critical Reflection

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### Introduction

With the rise of treaty-based investor-state dispute settlement (“ISDS”) which has taken place over the last two decades,<sup>1</sup> a number of governments have adopted varying approaches to avoid those arbitration cases. Countries including Bosnia and Herzegovina, Colombia, Mexico, Mongolia, and Peru have pursued such initiatives, often with the support of intergovernmental organizations such as the United Nations Convention on Trade and Development (“UNCTAD”) and the World Bank.

In the context of discussions on ISDS reform taking place at the United Nations Commission on International Trade Law (“UNCITRAL”), some states have identified development and implementation of such ISDS-avoidance strategies and tools as initiatives they would like to pursue. There remains, however, relatively little dialogue and research exploring the comparative institutional design, functional workings, and costs and benefits of different approaches, and identifying, articulating, and disseminating lessons learned from experiences to date.

This article draws from a broader research project exploring the effectiveness of dispute prevention approaches (and perceptions thereof) at resolving underlying conflicts between investors and states, and at their implications for other stakeholders.<sup>2</sup> Understanding how dispute prevention approaches

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<sup>1</sup>UNCTAD, *Investor-state dispute settlement cases pass the 1,000 mark: cases and outcomes in 2019*, IIA Issues Note (July 2020).

<sup>2</sup>Many of the approximately 1,000 publicly-known treaty-based ISDS cases have related to sectors or projects where the interests of communities, consumers, or other local stake-

can and do operate and whether and how they can provide meaningful and lasting solutions to the broader conflicts underlying investor-state disputes can critically inform the assessment of existing approaches and the design of new ones.<sup>3</sup>

## I. Dispute Prevention: Two Basic Approaches and Variations Within Them

The rapid and consistent rise of ISDS claims against governments has accelerated and shaped national and international discussions around strategies for preventing such arbitration claims. Governments are increasingly deeming the expense of arbitration, the reputational cost of an ISDS claim or liability, and the potential for a high damages award (both in the specific case and in ISDS cases more generally), to be unacceptably high.<sup>4</sup> There-

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holders are directly affected by the underlying dispute, including, for instance, related to extractive industry or other land-based investments, or to the delivery, quality and cost of water, electricity, and other services.

<sup>3</sup>This article focuses on dispute prevention mechanisms (“DPMs”) designed to avoid ISDS-disputes; however other potential, sometimes overlapping, objectives motivate the objectives and design of DPMs, including: attracting or retaining investment or attracting reinvestment (see Maria Borga et al., *Drivers of divestment decisions of multinational enterprises—A cross-country firm-level perspective*, OECD Working Papers on Int’l Investment, No. 2019/03 (2020)); avoiding disgruntled investors; promoting beneficial and mutually-accepted outcomes from investment; fostering reform of domestic policies and institutions; and capacity-building. Some countries, such as Brazil, adopt DPMs while rejecting ISDS. See Richard C. Chen, *Bilateral Investment Treaties and Cosmetic Institutional Reform*, 55 Colum. J. Transnat’l L. 547 (2017). The objectives of DPMs are critical to their design and assessment, as is explained later in this article.

<sup>4</sup>See, e.g., United Nations Commission on International Trade Law, *Possible Reform of Investor-State Dispute Settlement: Dispute prevention and mitigation—means of alternative dispute resolution*, Note by the Secretariat, A/CN.9/WG.III/WP.190, 3-6 (Jan. 15, 2020). For more on the costs of ISDS, see, e.g., Lise Johnson et al., *Costs and Benefits of Investment Treaties: Practical considerations for states*, Columbia Center on Sustainable Investment (Mar. 2018), <http://ccsi.columbia.edu/2018/04/20/costs-benefits-iiis/>; Joachim Pohl, *Societal Benefits and Costs of International Investment Agreements: A critical review of aspects and available empirical evidence*, OECD (Jan. 2018), [https://www.oecd-ilibrary.org/finance-and-investment/societal-benefits-and-costs-of-international-investment-agreements\\_e5f85c3d-en](https://www.oecd-ilibrary.org/finance-and-investment/societal-benefits-and-costs-of-international-investment-agreements_e5f85c3d-en). On the use of DPMs as tools to avoid the costs of ISDS, see, e.g., World Bank Group, *Retention and Expansion of Foreign Direct Investment: Political Risk and Policy Responses*, 36 (2019); United Nations Commission on International Trade Law, *Possible Reform of Investor-State Dispute Settlement: Dispute prevention and mitigation—means of alternative dispute resolution*, Note by the Secretariat, A/CN.9/WG.III/WP.190, 3-6 (Jan. 15, 2020).

<b>ISDS-Elevating Approaches:</b> The role of investment treaty obligations and threat of ISDS is emphasized within domestic law and institutions. May include:	<b>ISDS-Minimizing Approaches:</b> The threat of ISDS is minimized, often through treaty approaches (though obligations of IIAs may still be emphasized). May include:
use of high-level committees to seek and secure resolution of potential ISDS claims	use of state-to-state filters or state-to-state dispute resolution to limit or control investor access to ISDS
training to help ensure domestic actors are mindful of and avoid triggering ISDS claims	requirements for investors to exhaust domestic remedies so as to encourage and enable resolution of disputes in domestic courts rather than through ISDS (may enable direct claims for treaty breach in domestic courts)

Table 1: ISDS Prevention: Two Main Types of Approaches

fore, their objective is to avoid, to the greatest extent possible, all such claims.

There are several approaches governments have taken to avoid ISDS disputes. We group these approaches into two broad, non-exclusive categories: those that seek to limit the availability of ISDS (relative to domestic, state-to-state, or other dispute resolution methods) as a means of reducing such cases, and others that seek to avoid ISDS disputes by amplifying and elevating the voice of investors and their powers to bring ISDS claims (Table 1).<sup>5</sup>

### A. ISDS-Minimizing Approaches

ISDS-minimizing approaches reduce the availability of, exposure to, and risk of ISDS.<sup>6</sup> This could be by reducing access to ISDS, narrowing the scope of permissible claims, or increasing the procedural requirements prior to

<sup>5</sup>For further discussion on investor protections under IIAs, see Columbia Center on Sustainable Investment, *Primer: International Investment Treaties and Investor-State Dispute Settlement* (2019).

<sup>6</sup>For instance, in the United Nations Commission on International Trade Law (“UNCITRAL”), which is working on ISDS reform, some of these approaches, including state-to-state dispute settlement and exhaustion of local remedies, are being examined as part of reforms designed to prevent or mitigate ISDS claims. See, e.g., United Nations Commission on International Trade Law, *Working Group III: ISDS Reform, Strengthening of Dispute Prevention Mechanisms other Than Mediation (Ombudsman, Mediation)*, <https://uncitral.un.org/en/strengtheningmechanisms> (last visited Mar. 17, 2021) (listing exhaustion of local remedies as a potential relevant reform, and containing a working paper referring to state-to-state filters, ombuds mechanisms, and other similar approaches).

accessing ISDS. Reducing access to ISDS could be achieved through more limited eligibility for claimants, greater exceptions or carve-outs, or through filter mechanisms that give state actors greater control to determine whether an ISDS claim can proceed. For instance, treaties can require that an ISDS claim can only proceed if the states party to the treaty agree that the claim(s) can go ahead, or fail to agree that the claim cannot; in many such cases, treaty parties designate domestic officials or institutions with resolving the disputes on a technical level, with arbitration only allowed if officials cannot agree or miss the deadline to do so. This approach, found in a number of treaties, is most commonly used when the ISDS claim relates to a sensitive or technical issue, such as financial services regulation or taxation.<sup>7</sup> Some treaties allow for diplomatic resolution prior to a dispute going to arbitration, or include state-to-state dispute settlement in lieu of ISDS altogether.<sup>8</sup>

States can also narrow the scope of permissible claims by reducing substantive protections enforceable through ISDS. Under this approach, while the treaty may contain various substantive protections for investors, investors are only entitled to invoke a subset before arbitral tribunals, such as claims for direct expropriation, discrimination, and denials of justice.

A state could also permit ISDS, but require that investors exhaust domestic remedies prior to bringing their ISDS claims. Exhaustion can poten-

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<sup>7</sup>Lise Johnson et al., *International Investment Agreements, 2014: A Review of Trends and New Approaches*, in *Yearbook on International Investment Law & Policy 2014-2015*, 44-47 (Andrea K. Bjorklund ed., 2016); Catherine Titi, *Non-adjudicatory State-State Mechanisms in Investment Dispute Prevention and Dispute Settlement: Joint Interpretations, Filters, and Focal Points*, 14:2 *Revista de Direito Internacional* 37 (2017).

<sup>8</sup>See, e.g., references to these approaches in United Nations Commission on International Trade Law, *Possible Reform of Investor-State Dispute Settlement: Dispute prevention and mitigation—means of alternative dispute resolution*, Note by the Secretariat, A/CN.9/WG.III/WP.190, 12 (Jan. 15, 2020). Brazilian CFIA's do not provide for investor-state arbitration at all. Focal Points from each member-state coordinate between investors and government authorities in addressing investor complaints; implementation of CFIA's dispute settlement mechanism through consultations and mediation. Fabio Morosini & Michelle Ratton Sanchez Badin, *The Brazilian Agreement on Cooperation and Facilitation of Investments (ACFI): A New Formula for International Investment Agreements?* *Investment Treaty News* (Aug. 2015); Catherine Titi, *Non-adjudicatory State-State Mechanisms in Investment Dispute Prevention and Dispute Settlement: Joint Interpretations, Filters, and Focal Points*, *Revista de Direito Internacional* (2017).

tially filter out some ISDS cases by providing a resolution at the domestic level; and it can also enable other actors in the government to identify when a domestic dispute might evolve into an ISDS dispute meriting attention from other types of dispute prevention approaches discussed further below.

These are all approaches that seek to minimize the role of ISDS in the broader investment policy landscape, placing greater emphasis on other tools and fora such as domestic legal systems and institutions or inter-state diplomacy and dispute resolution to resolve investors' complaints about their host states' conduct.<sup>9</sup>

## B. ISDS-Elevating Approaches

In contrast, a different category of approaches, and one on which this article focuses, elevates the role and impact of ISDS in the broader domestic investment policy landscape (even while seeking to avoid the use of ISDS). Some of these approaches may create new institutional structures such as inter-ministerial committees that will be apprised of, and have powers and responsibilities to resolve, ISDS claims or threats thereof.<sup>10</sup> While these approaches may take a variety of forms, and vary in terms of their degree

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<sup>9</sup>For example, many of these approaches can be found in the recently renegotiated North American Free Trade Agreement between the U.S., Canada, and Mexico. ISDS is excluded between the U.S. and Canada, and limited between the U.S. and Mexico through narrowing actionable claims, requiring exhaustion, integrating state-to-state filters, and other tools.

<sup>10</sup>For example, South Korea has set up the Office of the Foreign Investment Ombudsman ("OIO"). The Investment Aftercare Team works directly with companies to offer advice and information, and also coordinates with public officials to work to improve the investment environment based on investor feedback. All agencies within the government are required to cooperate with the OIO. The Regulatory Reform Committee and Foreign Investment Committee lead on regulatory reform and investment policymaking, respectively, informed largely by feedback collected by the OIO. UNCTAD, *Investor-State Disputes: Prevention and Alternatives to Arbitration*, UNCTAD Series on International Investment Policies for Development, United Nations, New York and Geneva, UNCTAD/DIAE/IA/2009/11 (2010). Bosnia & Herzegovina established a Negotiating Body charged with handling investor complaints, consisting of permanent representatives from (1) Office of the State Attorney, (2) Ministry of Finance and Treasury, (3) Ministry of Foreign Trade and Economic Relations, and (4) Ministry of Justice. When taking up a specific investor complaint, this Body is joined by (1) one legal entity charged by the investor with causing the dispute, (2) the competent authority within the state responsible for the area in which investment is located, and (3) competent state attorneys. Decision on the establishing the Negotiating Body of Bosnia and Herzegovina for the Peaceful Settlement of International Investment Disputes (2017) Official Gazette of Bosnia and Herzegovina, No. 17/18.

of institutionalization, centralization, and powers, in this article, we refer to these ISDS-elevating approaches generally as ISDS “dispute prevention mechanisms” or DPMs.

Some DPMs may be tasked with confidentially settling all suits. They might be able to employ such high-powered tactics as effectively overriding the decisions of other ministries or branches of governments, or subnational jurisdictions. If, for example, a mining company’s notice of an ISDS claim were triggered by the environmental agency’s denial of a required environmental permit, this DPM could have broad power to (confidentially)<sup>11</sup> settle the case by offering compensation or awarding the permit on terms sufficient to cause the investor to drop its suit.

Other models might similarly prioritize the resolution of ISDS claims, but do not confer such great powers on the relevant DPM. These models might, for instance, require that other government actors give a high-level national DPM notice of any potential ISDS dispute their actions triggered,<sup>12</sup> but not empower that DPM to override those other government actors responsible for the challenged conduct. Rather, the DPM’s powers to resolve complaints regarding other national or federal-level actors might include conducting negotiations, recommending certain courses of action, or placing political or “peer pressure” on other government agencies.<sup>13</sup> The DPMs might not be able to conclude agreements that are legally binding on other

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<sup>11</sup>Settlements of ISDS cases are commonly confidential. In conversations with officials engaged in efforts to resolve or settle ISDS claims or threats thereof, confidentiality was often cited by officials as being useful for securing agreements with investors. But there are public costs associated with private settlements. For a discussion of the issue and prevalence of confidential settlements in ISDS, and arguments in favor and against confidentiality in that context, see, e.g., Emilie M. Hafner-Burton et al., *Against Secrecy: The Social Cost of International Dispute Settlement*, 42 Yale J. Int’l L. 279 (2017).

<sup>12</sup>For example, through Peru’s State Coordination and Response System for International Investment Disputes, domestic agencies inform the central government about issues with investors and seek a resolution through the involvement of the central authorities. An early alert function allows the Commission to engage and act early on to prevent disputes. UNCTAD, *Investor-State Disputes: Prevention and Alternatives to Arbitration*, UNCTAD Series on International Investment Policies for Development, UNCTAD/DIAE/IA/2009/11 (2010); Ricardo Ampuero Llerena, *Peru’s State Coordination and Response System for International Investment Disputes*, Investment Treaty News (Jan. 2013).

<sup>13</sup>World Bank Group, *Retention and Expansion of Foreign Direct Investment: Political Risk and Policy Responses* 43 (2019).

government actors or entities,<sup>14</sup> but they may be able to elevate the disputes to higher political levels capable of concluding or causing the conclusion of such agreements.

Reflecting this type of approach, the World Bank, which has been involved in establishing DPMs in a number of countries, states that the lead agency of such a mechanism may lack the expertise and legal authority to override a regulator's decision, especially in technical and highly regulated areas; nevertheless, it counsels, the DPM, which the World Bank titles a "Systemic Investor Response Mechanism" or SIRM, could use political and other means to convince the relevant agency to help the investor achieve its desired outcome and avoid a legal dispute. That pressure, the World Bank explains, can include highlighting to the public the potential loss of jobs, loss of investment, and ISDS liability associated with the challenged conduct.<sup>15</sup>

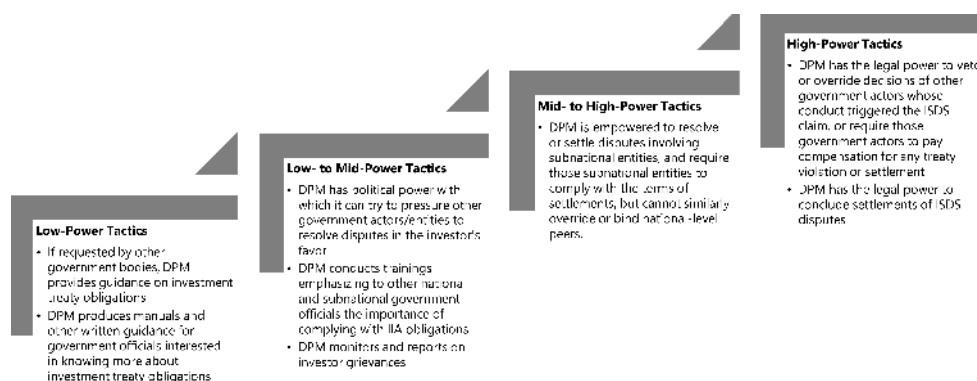
Another variation involves DPMs that are not able to override decisions of other national or federal level actors, but are empowered to settle claims involving alleged wrongdoing by *subnational* governments, even if that means effectively vetoing decisions of those subnational entities or requiring the subnational entities to pay compensation agreed by the DPM.

Finally, some DPMs mostly play roles as informational conduits. They might have early warning and notice systems through which governments and/or investors are to flag potential ISDS disputes to the DPMs. Once notified, the DPM might then seek to facilitate a resolution between the investor and government and support its implementation. The DPM might also provide training to government officials that deal with or are likely to deal with foreign investors regarding how to ensure their conduct does not violate their IIA obligations. The aim of such trainings is to mainstream concerns about investor protection and ISDS risks into government decision-making at national and, at times, sub-national levels.

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<sup>14</sup>It is important to note though that even if an agreement concluded by a DPM is not legally binding or valid under domestic law, a tribunal may deem it valid and binding under the protections offered by investment treaties.

<sup>15</sup>World Bank Group, *Retention and Expansion of Foreign Direct Investment: Political Risk and Policy Responses*, 45 (2019).



**Figure 1.** ISDS-Elevating Approaches: A Possible Range of Powers

Each of these approaches elevates the power of ISDS and ISDS claims, either by advising government officials to avoid taking any measures that might elicit an ISDS claim or by rapidly responding to threatened or actual claims in ways that may be contrary to otherwise applicable domestic policy or procedure.

Figure 1 illustrates possible powers and approaches of these ISDS-elevating DPMs. Those authorized to employ high-power tactics may also utilize any of the lower-powered tactics.

## II. Evaluating the Costs and Benefits of ISDS-Avoidance Strategies

These two models—ISDS-minimizing and ISDS-elevating—differ among and between themselves in their ability to achieve the overarching objective of avoiding or resolving ISDS claims. And, crucially, they differ in terms of their other costs and benefits. Broadly, ISDS-minimizing approaches seek to minimize the risk and impact of ISDS claims by reducing the scope for such claims, favoring domestic and other technical or diplomatic means of resolving disputes. By contrast, with ISDS-elevating approaches, the threat of ISDS is used to give heightened legal and political powers and/or duties to certain actors within government (e.g., central level executive officials) to address investor concerns. This, in turn, may increase both the power of ISDS for claimants and the power of investors due to their increased ISDS-



related voice and leverage. This section focuses on some of the potential benefits and costs of each of these types of DPMs. While not exhaustive, the illustrative costs and benefits highlight the potential range of impacts and especially the challenges in assessing those costs and benefits.

### **A. Potential benefits and measurement issues**

Recall the hypothetical example of a mining company's threatening or filing an ISDS claim because the environmental agency denied a required environmental permit. With ISDS-minimizing approaches, the threat or risk of such a claim may be reduced, for instance by circumscribing the scope of investor protections to avoid suggesting investors have a 'right' to environmental permits, filtering the assessment of the environmental agency's decision through technical experts or officials as designated by the treaty parties, or requiring that the mining company exhaust all domestic judicial and administrative remedies. The benefits of these approaches are the reduced exposure to ISDS claims and liability, and the increased ability of domestic institutions (including administrative agencies and judicial mechanisms) to consider such issues that arise in the course of investments, to resolve them in line with domestic and international law and policy, and to engage domestic stakeholders and institutions in understanding whether and what adjustments need to be made to the way investment is governed in law and in practice. This approach also maintains the integrity of environmental review processes and the legitimacy of the permitting process for other applicants, including domestic actors who would not have recourse to ISDS.

With an ISDS-elevating mechanism in this hypothetical example, a DPM may be able to override the environmental agency's denial of the permit, or place adequate pressure on the agency to do so. If the DPM were able to cause the issuance of that permit on the terms demanded by the investor, then the DPM could report that it both prevented the ISDS claim (and avoided major financial losses had the ISDS case been successful) and retained the investment, including the corresponding jobs, fiscal revenues, and so on.

Accurately measuring the benefits of either type of approach is challenging. It is difficult to quantify or even to qualitatively ascribe value to the integrity, legitimacy, and capacity of domestic institutions to resolve disputes. Domestic ‘rule of law’ is a generally accepted value for domestic institutions and judicial systems; but disaggregating its components and valuing its individual elements is exceedingly difficult, if not impossible. Accordingly, the benefits of approaches that seek to rely upon, and holistically strengthen, domestic institutions may be underestimated. While data is lacking, and while outcomes would likely depend on the specific strategies adopted by the relevant state or states, we hypothesize that ISDS-minimizing approaches, which place greater emphasis on the interest and ability of domestic institutions to self-correct, would generally produce greater benefits for the functioning of domestic institutions than ISDS-elevating approaches, which may seek to achieve investors’ preferred outcomes by displacing or distorting the standard functioning of domestic systems.<sup>16</sup>

Estimating the value of either an averted ISDS claim or a retained investment is also exceedingly challenging. An investor seeking a favorable government response, for instance, might overstate the investment it seeks to make, the length of time it expects to stay in the country, and the number and quality of jobs it expected to create or keep in the future. (It may also downplay the potential negative impacts the investment may have, such as those on the environment, local communities, or local competitors). Similarly, an investor might give inflated estimates of the profits it expects to generate and taxes it can bring in when seeking DPM assistance, or when threatening an ISDS claim. It can be difficult for a government to check the accuracy of such projections; and the investor would presumably not be bound by its representations regarding future operations.

An investor might also overstate the relevance of the government’s decision for its investment or divestment decisions. The investor may threaten

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<sup>16</sup> See, e.g., Mavluda Sattarova, *The Impact of Investment Treaty Law on Host States: Enabling Good Governance* (2018); Lise Johnson et al., *Aligning International Investment Agreements with the Sustainable Development Goals*, 58 Colum. J. Transnat’l L. 58 (2019); Lise Johnson et al., *Alternatives to Investor-State Dispute Settlement*, Columbia Center on Sustainable Investment (2019).

to exit the country in response to a government's decision, but the threat to leave and to pursue the ISDS case may be more of a bargaining tool rather than a serious plan.<sup>17</sup> Similarly, the investor may already be contemplating divestment for challenging or underperforming projects, but use the threat of ISDS so as to extract value from the otherwise disappointing investment.<sup>18</sup> As the OECD notes, divestment is not uncommon.<sup>19</sup> And while the number of investors that elect to divest very likely dwarfs and will continue to dwarf the number of investors that choose to bring ISDS disputes, it is plausible that investors considering divestment decisions use ISDS or the threat thereof to put what may have been poorly planned or executed projects in a better position than market and policy conditions would have otherwise allowed.<sup>20</sup> The rise of ISDS-elevating DPMs may increase the frequency with which ISDS is invoked and threatened in relation to potentially inevitable divestment decisions, and cause special treatment to be unduly afforded to doomed projects.<sup>21</sup> Moreover, just as an investor

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<sup>17</sup>One of the authors has documented the use of such divestment threats in the context of proposed or actual fiscal reforms, finding that despite their threats of divestment in the face of fiscal reforms, investors do not in fact leave if projects remain profitable. See Lisa E. Sachs, et al., *Impacts of fiscal reforms on country attractiveness: Learning from the facts*, in *Yearbook on International Investment Law & Policy 2011-2012*, 345-86 (2013).

<sup>18</sup>Examples of projects in which the investor decided to sue for early phase investments, which very likely would not have proceeded to the next phase of exploitation or construction for reasons outside of the state's control, include *Glamis Gold v. U.S.*; *Bear Creek v. Peru*, and *TCC v. Pakistan*. Versant Partners, *Valuation of Early State Investments: Recent Trends and Perspectives* (2019). In the case of *TCC v. Pakistan*, for example, the tribunal awarded billions of dollars in damages through the estimation of "future lost profits[.]" despite the fact that the investor had never secured the approvals necessary to begin intended mining construction, nor secured the contractual terms on which compensation for future lost profits was based. Caroline Simson, *Scrutiny Creeps in On Damages in Investment Arbitration*, Law360 (Oct. 2019); *Tethyan Copper v. Pakistan* Award, ICSID Case No. ARB/12/1 (2012). Similarly, in *Bear Creek v. Peru*, the investor had not obtained the approvals required by Peru to obtain an exploitation license for the project. Nonetheless, it was awarded a total of \$30.4 million. *Bear Creek v. Peru* Award, ICSID Case No. ARB/14/21 (2015).

<sup>19</sup>Maria Borga et al., *Drivers of divestment decisions of multinational enterprises—A cross-country firm-level perspective*, OECD Working Papers on Intl Investment, No. 2019/03 (2020).

<sup>20</sup>World Bank Group, *Retention and Expansion of Foreign Direct Investment: Political Risk and Policy Responses* 33 (2019).

<sup>21</sup>Project failure is not uncommon; failures may be due to various factors, including flawed project conception, management, or operation. One study of the Commonwealth

may seek regulatory and other incentives for investments it would make even without those benefits, an investor may ultimately divest irrespective of what regulatory or other concessions the host state offers.<sup>22</sup>

Benefits of both types of ISDS-avoidance approaches are therefore difficult to measure. Certain measurement issues (value of the project, value of a potential ISDS claim, risk of divestment of a project) are common to both ISDS-minimizing and ISDS-elevating strategies. On balance, however, the benefits of ISDS-minimizing approaches are prone to under-assessment (due, e.g., to the challenges of valuing elements of and effects on domestic rule of law), while the benefits of ISDS-elevating approaches are likely prone to over-statement, due to reliance on investors' statements and assertions, and incentives investors may have to inflate the value of ISDS claims.<sup>23</sup>

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Development Corporation's investments in 179 projects in 32 countries throughout Sub-Saharan Africa and Southeast Asia and the Pacific between 1948 and 2000 found that 49 percent of the projects were financial failures, and concluded that the major cause of 60 percent of those failures was that the project concept was "fatally flawed, for example wrong location, wrong crop, or overoptimistic planning assumptions." Geoff Tyler & Grahame Dixie, *Investing in Agribusiness: A Retrospective View of a Development Bank's Investments in Agribusiness in Africa and Southeast Asia and the Pacific*, Agriculture and Environmental Services Discussion Paper No. 1, 3 (The World Bank 2013), <https://documents.worldbank.org/en/publication/documents-reports/documentdetail/384141468008773142/investing-in-agribusiness-a-retrospective-view-of-a-development-banks-investments-in-agribusiness-in-africa-and-southeast-asia-and-the-pacific>). In comparison, about 10 percent of failures were linked to government policies, and 13 percent to "bad luck." *Id.* With ISDS, a risk is that otherwise valueless projects due to poor planning or poor execution can nevertheless seek to manufacture value by shifting narratives about project failure and creating (saleable) legal claims for hundreds of millions if not billions of dollars. ISDS-elevating DPMs may magnify that risk.

<sup>22</sup>Maria Borga et al., *Drivers of divestment decisions of multinational enterprises—A cross-country firm-level perspective*, OECD Working Papers on International Investment, No. 2019/03 (2020).

<sup>23</sup>*See, e.g.,* George Kahale III, *Rethinking ISDS*, 44 Brooklyn J. Int'l L 11, 39 (2018) (referring to the reasons for and practice of overstating the value of a compensation claim). Even outside the context of an ISDS claim, an investor would likely have incentives to inflate both the significance of its investment to the host economy, and the significance of the relevant grievance to the investor's future investment decisions, so as to encourage the DPM to address the investor's complaints. On average, damages awarded are 34% of the amount claimed by the investor. Tim Hart & Rebecca Vélez, *Study of Damages in International Center for the Settlement of Investment Dispute Cases*, TDM 3 (2014), [www.transnational-dispute-management.com](http://www.transnational-dispute-management.com).

## B. Potential costs and measurement issues

Alongside the potential benefits of ISDS-avoidance approaches in terms of preventing costly ISDS cases or awards and potentially retaining investments and their benefits, there are also costs to be considered. First and most directly are the actual costs associated with the relevant approach, including its staffing and activities. With ISDS-minimizing approaches, the direct costs might include those associated with any extra work required of domestic officials or institutions to resolve disputes through domestic fora or treaty bodies.

With ISDS-elevating DPMs, the direct costs include not only the staffing and activities of the mechanism itself but also any financial settlement facilitated by the DPM or waiver of taxes levied on the investor. The administrative costs of DPMs are straightforward to measure, while the sums claimed by the investor, and corresponding amounts paid or forgone by the government, are more difficult to predict *ex ante*. While there may also be settlement costs associated with domestic resolution of disputes through ISDS-minimizing approaches, remedies available under domestic law are generally more limited than those awarded by ISDS tribunals.<sup>24</sup> The settlement costs (and benefits in terms of avoided litigation and liability) are likely to be lower with ISDS-minimizing approaches than ISDS-elevating DPMs.

Other costs are more difficult to assess. For ISDS-minimizing approaches, reducing the scope of ISDS may require the renegotiation of bilateral or multilateral investment treaties or investor-state contracts that provide for expansive ISDS. The actual and political costs of such renegotiation will vary tremendously among countries, based on the number of such agreements, their diplomatic relationships, domestic politics, and other factors. States may also consider that reducing ISDS may have an impact on investment flows, although extensive research has failed to show that ISDS has a positive impact on investment flows.<sup>25</sup>

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<sup>24</sup>See, e.g., OECD, *Investor-State Dispute Settlement: Public Consultation Scoping Paper*, 25-26 (2012).

<sup>25</sup>Joachim Pohl, *Societal benefits and costs of International Investment Agreements: A critical review of aspects and available empirical evidence*, OECD Working Papers on International Investment, No. 2018/01 (2018).

Many costs of ISDS-elevating DPMs are also difficult to assess. In the hypothetical example of the dispute over the denied mining permit, for instance, if the DPM were to override or cause a shift in the environmental agency's determination, associated costs could include increased negative environmental externalities generated by the mining permit (which could harm individuals, communities, and other businesses such as agricultural and tourism operations), and loss of positive externalities that might have been generated by more stringent regulatory standards. Indeed, some government measures such as adopting stronger environmental regulations or raising labor wages and standards—measures which are taken on behalf of the public interest—have been found to increase the chance of multinational enterprise (“MNE”) divestment.<sup>26</sup> This further indicates that actions DPMs might take to resolve investor complaints, in some cases overriding or waiving such important public measures, could come at a substantial (if difficult to measure) cost to other stakeholders.

The effect of DPMs on other domestic interests and stakeholders is likely exacerbated by the fact that a significant percentage of ISDS disputes—70% by some estimates—“involve measures adopted by subnational or sector-specific regulatory agencies.”<sup>27</sup> While DPMs have been touted for their very ability to efficiently discipline such subnational or specialized agencies, and to cause the government to speak with one, more investor-responsive, voice,<sup>28</sup> this approach can have negative effects. It may demote local authorities and the local constituencies to which they are accountable, and depress the role of government agencies responsible for advancing other policy priorities such as environmental protection, social equality and security, and sound government budgeting.

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<sup>26</sup>Maria Borga et al., *Drivers of divestment decisions of multinational enterprises—A cross-country firm-level perspective*, OECD Working Papers on Int'l Investment, No. 2019/03 (2020).

<sup>27</sup>World Bank Group, *Retention and Expansion of Foreign Direct Investment: Political Risk and Policy Responses*, 30 (2019) (citing Susan D. Franck, *Development and Outcomes of Investment Treaty Arbitration*, Washington & Lee University School of Law Scholarly Commons (2008) and UNCTAD, *World Investment Report* (2010)).

<sup>28</sup>See, e.g., World Bank Group, *Retention and Expansion of Foreign Direct Investment: Political Risk and Policy Responses* (2019).

Loss of faith among different stakeholder groups regarding the responsiveness and accountability of their governments to different interests is an incalculable cost of ISDS-elevating DPMs. Moreover, the difficulty in measuring these costs makes them prone to under-assessment. Because those bearing the costs (e.g., taxpayers, residents of a community affected by environmental pollution, users of public institutions) are also often relatively diffuse, or, as is often the case with natural resource projects, relatively marginalized, there may be limited capacity among stakeholder groups to independently calculate those costs, or to advocate for the government to ensure full assessment, minimization, and avoidance of those benefits.

Table 2 illustrates some of the potential costs and benefits of a high-powered ISDS-elevating DPM. Low-powered ISDS-elevating DPMs—i.e., whose powers are limited to the powers in the bottom left of Figure 1—will likely have different costs and benefits, as will ISDS-minimizing approaches.

### C. Some insights from practice

At present, it does not appear that the costs and benefits of DPMs are being adequately accounted for in the design and implementation of DPMs. Publicly available data on existing DPMs is limited, but information that does exist indicates there is cause for concern. The “key indicator” for the World Bank’s SIRM is, for instance, “investment retained.” This is defined as “investment at risk when the grievance is registered in the SIRM (ex ante) [minus] investment withdrawn (that is, existing investment withdrawn or expansion plans put on hold or canceled).”<sup>31</sup>

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<sup>31</sup>World Bank Group, *Retention and Expansion of Foreign Direct Investment: Political Risk and Policy Responses*, 56 (2019). World Bank documents describing the SIRM illustrate a narrow approach to cost-benefit analysis. According to the World Bank, a core SIRM task should be to monitor “how much investment is retained and expanded as a result of the resolution” of the investors’ grievances. In some cases, the World Bank notes, the lead SIRM agency “may not have the political authority to discipline another peer agency. In this case, the problem is elevated to higher political levels, such as the ministerial cabinet and in some countries special ministerial councils chaired by the president or prime minister. Once a decision is taken at this higher instance, the lead agency tracks the resolution, positive or negative, and the impact on investments.” *Id.* at 43.

Table 2: Costs and Benefits of High-Powered ISDS-Elevating DPMs

Possible Costs	ISDS-Elevating, High-Powered Tactics	Measurement Considerations	
		Easy to measure	Easy to measure
	Direct costs of staffing and activities		
	Compensation paid to complaining investors		
	Negative externalities caused due to settlements		Difficult to measure; those affected may be many and diffuse
	Loss of trust in government institutions due to concerns about the process or outcomes of resolutions		Difficult to measure; those affected may be many and diffuse
	Can create unequal treatment before the law as not all stakeholders can similarly invoke the ISDS threat and secure the assistance of a high-powered DPM		Difficult to measure; those affected may be many and diffuse
Possible Benefits	Resolution of ISDS suits		Can be easy to measure (e.g., # of complaints settled), though indicators may be prone to overestimation
	Avoidance of reputational harm associated with ISDS suits		It is unclear whether suits cause such harm; if so, it is difficult to measure the extent
	Avoidance of litigation costs		Estimates of average legal and arbitration costs of ISDS claims are available, but can fluctuate widely from case to case, as can the ability of winning party to recover those costs from the losing party <sup>29</sup>
	Avoidance of liability		Investors have incentives to overstate their claimed damages; and predictions regarding the ultimate outcome of an arbitration and damages claims may be highly uncertain <sup>30</sup>
	Investment retained		Investors have incentives to overstate their willingness to leave if the dispute is not resolved in their favor; investors (and DPMs) may have incentives to overstate the amount of investment retained, jobs created/maintained, and other positive spillovers generated. Accurately measuring these benefits is difficult, as is adequately assessing any costs imposed by the retained investment.

<sup>29</sup> A 2017 study concluded that the average costs faced by respondent states to defend ISDS cases is \$5 million (U.S.). (Matthew Hodgson & Alistair Campbell, *Damages and Costs in Investment Treaty Arbitration Revisited*, Allen & Overy (2017)). Some cases cost several times more than the average, amounting to upwards of tens of millions of dollars in legal and other fees and arbitration costs. In *TCC v. Pakistan*, for instance, Pakistan reported spending roughly \$25 million (U.S.) on legal and expert fees and costs. (*TCC v. Pakistan*, ICSID Case No. ARB/12/1, Award, July 12, 2019, 613-14). The significance of these expenses for a given country will vary depending on the size and resources of that country. Lise Johnson & Brooke Güven, *Securing Adequate Legal Defense in Proceedings Under International Investment Agreements: A Scoping Study*, Columbia Center on Sustainable Investment (2019). See also Daniel Behn et al., *Empirical Perspectives on Investment Arbitration: What do we know? Does it matter?*, Academic Forum on ISDS Concept Paper 2020/1 (Jan. 2020).

<sup>30</sup> Tim Hart & Rebecca Vélez, Study of Damages in International Center for the Settlement of Investment Dispute Cases, TDM 3 (2014), [www.transnational-dispute-management.com](http://www.transnational-dispute-management.com).



For the SIRM, there does not appear to be any systemic measurement or evaluation of impacts on other dimensions of law and policy, or on other stakeholders, such as: Was the decision harmful for other private sector competitors? Did it diminish other firms' competitive positions? How did resolution of the dispute affect actors up and down the value chain such as the investors' suppliers and consumers? What are the effects on other stakeholders, such as local residents living near the project? And, as noted above, what are the effects on perceptions of government responsiveness and accountability?

The World Bank's Independent Evaluation Group has highlighted related concerns about the World Bank's investment climate work more generally:

[T]he social value of regulatory reforms—that is, their implications for inclusion and shared prosperity as reflected in effects on a range of stakeholders—has not been properly included in the design of reforms and assessment of their impact. While regulatory reforms need to be designed and implemented with both economic and social costs and benefits in mind, in practice, World Bank Group support focuses predominantly on reducing costs to businesses.<sup>32</sup>

There is a risk that DPMs—especially strong, ISDS-elevating DPMs that prioritize resolution of investor complaints and avoidance of ISDS claims—intensify policymakers' focus on addressing the concerns of, and measuring benefits to, foreign investors to the exclusion of other stakeholders and considerations.<sup>33</sup>

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<sup>32</sup>Independent Evaluation Group, *Investment Climate Reforms*, xi (2015).

<sup>33</sup>This approach could be contrasted to the World Bank's Multilateral Guarantee Agency and other multilateral or bilateral public investment guarantee agencies or risk insurance programs that are not only explicit on the importance of social and environmental risk assessments, but also include requirements regarding project proponents' consultations with impacted communities. These requirements of risk insurers or guarantee can help prevent investor-state disputes for which the insurer/guarantor may face liability. See, e.g., Multilateral Investment Guarantee Agency (MIGA), *MIGABrief: Supporting Mining Investments*, MIGA, World Bank Group, 3 (2013) ("Well-designed environmental and social programs can

### III. RETHINKING DISPUTE-AVOIDANCE STRATEGIES

DPMs, in principle, can be valuable mechanisms to bring a range of concerns and interests related to complex projects to a common table, and to find means of reducing overall harms (including those faced by investors) and maximizing overall benefits. But defining their objectives, and doing so in a way that directly informs their design, is critical to their success. A careful consideration of a country's overall objectives not only with respect to a particular project but with respect to the balance of various public policy considerations can help to avoid unintended costs and consequences, or the inequitable distribution of those costs over time and across different stakeholder groups.

DPMs that are designed for the purpose of avoiding ISDS merit further scrutiny. Those studying business strategy have recognized that litigation—or the threat of litigation—is a tool that, like lobbying, corporations use as part of their non-market strategies in order to maximize their profitability.<sup>34</sup> They may use litigation to “seek improved terms from federal, state and municipal governments, to facilitate or to obstruct market entry, to ease or to tighten market access conditions, to lighten or to waive taxes. Actions can be brought in the courts to enforce, to review or to annul governmental decisions to promote corporate goals or to thwart those of others.”<sup>35</sup> Societies widely recognize that companies should not have unfettered powers to lobby lawmakers; and they recognize that good governance does not mean lawmakers should accede to all demands for which corporations lobby—quite the opposite. But there seems to be less awareness around the use of litigation (or threats thereof) as a tool used by corporations to exer-

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help manage reputational risks for project sponsors, reduce social conflicts within communities, protect the environment, and reduce political risks”); MIGA, *Policy on Environmental and Social Sustainability*, MIGA, World Bank Group (2013) (discussing requirements for project proponents to consult with affected communities and, where relevant, secure Free Prior and Informed Consent of Indigenous Peoples to projects).

<sup>34</sup>Melissa Mialon, Boyd Swinburn & Gary Sacks, *A Proposed Approach to Systematically Identify and Monitor the Corporate Political Activity of the Food Industry with Respect to Public Health Using Publicly Available Information*, 16 *Obesity Reviews* 519 (2015).

<sup>35</sup>Ewan Sutherland, *Lobbying and Litigation in Telecommunications Markets: Reapplying Porter's Five Forces*, 16 *Info: The Journal of Policy, Regulation and Strategy for Telecommunications, Information and Media* 1, 2 (2014).

cise influence over the law. The threat or existence of an ISDS claim may be too often seen as a signal that the government is doing something wrong, as opposed to an example of potentially inappropriate corporate political activity.

ISDS is costly for governments. The costs of litigation are high, and claims for damages often reach into the hundreds of millions if not billions of dollars. There are generally no requirements for claimants to have first pursued local remedies, no system to sanction claimants for making frivolous arguments and demands, and no dependable mechanism for filtering and securing early dismissal of meritless suits. Thus, even when a government is skeptical of the legal soundness of the claim, it may want to find ways to resolve rather than contest it.

As reflected by the SIRM mechanism, DPMs may seek to exploit that uncertainty, and the high costs of ISDS, as a way to pressure “offending” agencies to resolve investor concerns. It is therefore decisively important whether DPMs that seek to avoid ISDS disputes, by design, minimize or reduce this threat and power, or amplify it by creating additional structures that add to the pressure already exerted on relevant government entities.

Designing DPMs with the purpose of avoiding ISDS disputes may already be unduly narrow relative to the objectives of dispute-avoiding governments. A broader framing for the avoidance or resolution of investment-related disputes, including approaches to avoid and mitigate stakeholder tensions before they escalate into legal conflicts, would allow countries to consider approaches that allow for broad participation and the consideration of a range of stakeholders’ interests and policy considerations on equal footing. For instance, a dispute avoidance approach could be one that focuses on mitigating social and environmental impacts through mandatory due diligence and consultation processes, reducing the source of tensions before disputes arise.

Such an approach—one that is designed to be more inclusive in terms of the stakeholders able to raise concerns, issues addressed, and policy considerations evaluated—could be especially valuable in the sectors in which ISDS disputes are most common, such as utilities, water and sanitation, transportation, extractive activities, and agriculture, in which important consid-

erations of public policy, societal rights and well-being, and environmental issues are at stake.<sup>36</sup> Earlier and more robust mechanisms to address and resolve the types of impacts and tensions prevalent in such projects could yield far greater societal benefits with more limited costs.

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<sup>36</sup>World Bank Group, *Retention and Expansion of Foreign Direct Investment: Political Risk and Policy Responses*, 31 (2019).