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Research Report

Settlement of investor-state disputes: Can states avoid arbitration?

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Settlement of investor-state disputes: can states avoid arbitration?

by

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Investor-state dispute settlement (ISDS) is widely used to resolve disputes between foreign investors and host states. Most disputes over alleged breaches of international investment agreements (IIAs) are decided by arbitral tribunals, through often lengthy and costly proceedings. States and investors are therefore [increasingly](#) looking for more flexible alternative ways of settling such disputes amicably.

Two recent *Perspectives* discuss how host states can implement effective reforms to this end. For instance, host states should consider [increasing recourse to meaningful mediation and conciliation](#) procedures by introducing [specific clauses](#) in their IIAs.¹ Moreover, host states can improve their internal dispute-management processes, including by [designating lead agencies](#) competent and “technically” capable to handle investors’ claims and liaise with the relevant state organs.²

Where successful, mediation and conciliation procedures normally lead to the conclusion of some form of settlement agreement between investors and host states. Although in principle nothing prevents states from settling investor-state disputes, many governments struggle to do so. An informal survey conducted by the authors among state officials shows that a principal reason for this difficulty is the inability or unwillingness of concerned government officials to take responsibility for settlements. Indeed, very few domestic legal frameworks address the “nuts and bolts” of settlement agreements in this field. Moreover, public officials fear that settlements may [expose them to corruption allegations or civil/administrative liability](#) for any losses the state may suffer. And since settlements could also negatively affect public opinion, governments may prefer to adopt a “wait-and-see” approach.

Host states can address these obstacles by implementing “settlement-specific” measures as part of structural ISDS reforms.

Enabling investor-state dispute settlement. As a first step, states should contemplate binding settlement as one means to resolve investment disputes. Domestic law should define the scope and content of settlement agreements, while leaving competent organs to evaluate settlements on a case-by-case basis. Second, states should set out in their domestic legislation the requirements for approving—and later enforcing—settlement agreements. Depending on the state’s system of government and on the nature of each settlement, settlements may require parliamentary approval or only an executive order, but hybrid solutions are possible. Third, states should provisionally allocate part of the national, ministerial or agency budget for potential monetary settlements of ongoing or foreseeable investor-state disputes (e.g., through the annual budget or special resolutions). Lastly, settlement agreements may require approval or review by supra-national authorities—for instance, EU member states may be required to cooperate with the EU Commission to ensure that settlements are compatible with state-aid rules.³ Applicable domestic legal frameworks, as well as dispute resolution clauses in IIAs, should regulate these steps and allow time for their completion.

Creating a “settlement-favorable” environment. Host states should also facilitate settlements by reducing state officials’ exposure to criminal, civil or administrative liability for negotiating and concluding settlements.

One solution is to shield officials from liability, save for extreme cases (e.g., fraudulent behavior, abuse of power). States with lead agencies should also make sure that, within the agency, the government-appointed members (i.e., its “political” component) decide whether to attempt a settlement and set the conditions for a potential agreement. Only then will state officials, duly empowered by the government, seek to negotiate the best possible terms within their mandate. In addition, host states may require that the lead agency obtain independent third-party assessments on the merits and suitability of a proposed settlement (e.g., from external counsel). States may also, or alternatively, subject the approval of settlement agreements to internal review by independent officials (e.g., courts of auditors). Similar mechanisms are already in use in several countries to evaluate *ex ante* financially burdensome or politically sensitive decisions.

Mitigating political risk. Although legal and procedural solutions may not eliminate the political risks intrinsic in settlement decisions, sometimes settling may be preferable to engaging in lengthy and burdensome arbitration proceedings. While the way settlement decisions are best conveyed to the public depends on country-specific and timing-related factors, communicating the reasons behind settlements may reduce political backlash where it helps states to pursue widely supported [social or economic policies](#) (see, e.g., Germany’s recent multi-billion settlement in the [Vattenfall case](#) and its stance [against the use of nuclear power](#)). Settlements may also be more easily presented as beneficial where disputes are likely to produce hefty financial consequences (e.g., India’s settlement of [retrospective tax claims](#)) or help states preserve business relationships with strategic investors (e.g., [Croatia’s](#) non-monetary settlements with several European banks).

The settlement of investment disputes is no panacea, and its usefulness and appropriateness wholly depend on the circumstances at hand. In the right circumstances, however, governments should be equipped to engage efficiently and effectively with settlement opportunities.

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¹ These clauses may include references to mediation-related rules and treaties (e.g., [ICSID Mediation Rules](#), [Singapore Convention](#)).

² See the World Bank's "Systemic Investor Response Mechanism" ([SIRM](#)) on dispute-prevention, and the dispute management mechanisms of countries like [Peru](#), [Chile](#) and [Mongolia](#).

³ E.g., Art. 13 of [Regulation \(EU\) No 1219/2012](#) and Chapter IV of [EU Regulation 912/2014](#), requiring that EU member states cooperate with the EU Commission in respect of investment dispute-related decisions.

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