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## Introduction

The overall concept of investors and investments <sup>3</sup> are the key elements responsible for determining the scope of applications of various rights and obligations. Delving into the details of it, it can be said that <sup>5</sup> *International Investment Law* (IIL) <sup>5</sup> is known to be an instrument of *Public International Law* (PIL), that is eligible to govern foreign direct investments. It basically helps in providing the resolution of disputes between sovereign states and foreign investors. Based on the fact that international investment has become one of the most crucial forms of international economic transactions, the effectiveness of IIL has become the most powerful vector of integration among the different economies.

Some of the significant legitimacy challenges can be noticed in the recent *Investor-State Dispute Settlement (ISDS)* <sup>4</sup> systems, where it can be seen that <sup>4</sup> critics have raised concerns about the pro-investor interpretations. Unpredictability and a lack of transparency in arbitral proceedings can be experienced which can create issues. In regard to this, This essay is going to critically examine the most crucial legitimacy challenges that persist in the current ISDS system. In addition to this, the focus is also going to be given to identifying the possible reforms that are currently being considered to deal with the issues.

## Discussion

### *Investigation of the current ISDS system*

ISDS is considered to be a system, with the help of which countries can be sued by foreign investors for specific state actions that can affect foreign direct investment (FDI). This system is seen to take the form of international arbitration that happens between the nation which is receiving the FDI and the foreign investors. Data reveals that ISDS is known to be a unique instrument of PIL that is responsible to grant private parties the significant right to prosecute a sovereign nation in a specific forum apart from the domestic courts of the nations. It should be also mentioned in this regard that, in order to bring an ISDS claim in front of an arbitral tribunal, it is important for an investor in a country to have an investment in another country. Additionally, both of these countries need to have agreed to the ISDS system along with the fact that the foreign investor should have a specific claim that the state has violated rights that have been granted to the investors under some specific treaty. Although, this particular system has been criticised as well for having investors biases, high damage awards, inconsistent rulings and higher costs in many cases.

Discussing it broadly, it can be added that this mechanism is seen to be found in more than 3000 international investment treaties. However, it has been criticised increasingly in recent years for many significant challenges. This mechanism has actually been created in order to protect the investors from different arbitrary expropriation and at the same time ensure non-discriminatory treatment, in the countries where it is considered to be risky. The countries where the judiciary is not fully independent and separate from the government, arbitration has been considered a neutral framework in the process of ensuring the enforcement of the obligations of the host states towards their investors. Providing a significant example in this regard, *the agreement done by EU Member States on 5th May 2020* can be taken. This has been done for terminating the intra-EU BITs, in the process of implementing the ruling in the *Achmea* Case, where it has been found that, the Investor-State arbitration clauses in Intra-EU BITs are considered to be incompatible with the law of the EU.

One of the main features of the recent ISDS regime gives light to its legal basis, which is beneficial to determining the rights of the investors. It consists of different clauses that provide consent for arbitration, for the disputes between the investors and the host states. This regime is also seen to be quite effective in providing protection standards to investors. This deals with the protection against discrimination, under national Treatment (NT) as well as under the most Favoured Nation's Treatment (MFN). Based on this, a host government should give proper importance to foreign investors as equally to national investors. The benefits of this mechanism can also be observed in the process of protecting the investors from expropriations. In many cases, it can be noticed that expropriations can be regarded as either lawful or unlawful. Different professions are there that are helpful to provide protection to the investors against the undirect expropriation that is interpreted as governmental actions of the host country.

Fair and equitable treatment is also considered to be an important element that can help investors in an effective way. Although, the specific principal lacks a clear definition and in most cases seen to be frequently invoked by investors. It basically deals with the process of protecting investors from the abusive actions of the host state along with applying the regulatory fairness and transparency that acts as a safeguard to the investors. The protection can also be provided with the help of the ISDS system from capital transfers. This can be done by banning the activity of the host government in the process of restricting flows of capital within a country. Another significant example can be provided in this regard, such as *Ncell Private Limited and Axiata Investments (UK) v. the Federal Democratic Republic of Nepal*. The summary of this dispute highlights the claim which has been arising out of the imposition

of the government of a capital giant tax on Axiata's acquisition of Reynolds Holding Ltd in the year 2016.

The specific stages of the ISDS procedure involve sending a notice of arbitration to the host state by an investor, then the focus is given on and proceeding to the selection of arbitrators. In the proceeding, both parties are seen to be represented by teams of lawyers which can last several years. The awards in this case determine the amount of compensation in the process of allocating the legal cost. In the process of dealing with the applicable rules, it can be seen that arbitration tribunals operate most often under the specific rules which are established by the International Centre for Settlement of investment disputes by the World Bank. This can be done by resolving the disputes between nationals and states and their additional facilities. According to the *Arbitrational Rule of 1979* of the United Nations Commissions which was revised in the year 2010 on International trade law that is considered to be the second most used system.

The ISDS system was actually introduced to protect the former coloniser's property specification from the newly independent States. A huge number of organisations have argued because of the fact that the rule of the law was actually lacking the territories which are overseas and are in many cases usually known to be former colonies. Presently, it has been observed that the investors and some of the states have claimed that domestic justice systems lack overall independence. On the contrary, it can be added that ISDS is actually a powerful legal tool for organisations that can help to achieve policy objectives which are suitable for their interest around the world. Information also highlights the fact that ISDS is considered to be quite problematic in the process of implementation. It basically creates a parallel business-friendly judicial system which is exclusively vital for transnational corporations. In addition to this, the power is seen to rest upon for-profit arbitrators which are coming from the corporate sector along with facing different and verifiable conflicts of interest. Besides, they do not have any sovereign legitimacy and can not be considered accountable to the public. Apart from that the decisions that they make are in many cases inconsistent and cannot be appealed perfectly.

Providing proper justification for the statement and example can be given by introducing the *Ethyl( US) vs Canada* case, Which is dealing with environmental and health issues. It has been observed in the case that Ethyl which is a US chemical company launched an ISDS dispute over Canadian for banning MMT in the year 1997. This has been done because of using toxic gasoline additives and Canadian legislation is seen to be banned from MMT all over the world because of public health and environmental concerns. This particular case was seen to be settled

in June 1998 by paying US \$13 million to Ethyl and required Canada to lift the ban in the process of doing proper advertising which says that MMT was actually safe.

***Identification of the significant legitimacy challenges of the current ISDS system***

Legitimacy is basically considered to be the basic condition of governing and without it becomes quite difficult for a government to govern the entire process. This can make the government suffer from legislative deadlocks that lead to collapse. It has been seen that the ISDS system is currently facing a legitimacy crisis which has threatened the basic foundation of the entire system. These crises can be divided into two categories: one is dealing with a procedural crisis that can be addressed by inventing reforms. Another one is the substantive crisis that has the ability to threaten the existence of the overall regime. Going into the details of this point it can be said that the EU has failed to reach an agreement with the United States about Transatlantic trade along with the investment partnership. It is seen to be quite clear that the legitimacy issue is presently creating a significant threat, which has introduced significant challenges that are creating a huge impact. The first crisis, in this case, of procedural legitimacy, is considered to be strictly internal to the system and it basically stems from issues which are connected to the process in which ISDS is dispensed. The second crisis is the legitimacy crisis which is exogenous to the working of the system. This particular crisis is rooted in the very logic of specific investment Treaty law and is responsible for bringing a negative threat to the implementation of the ISDS.

It has been understood that the ISDS system is basically plunged into a profound legitimacy crisis and a need for reform has been felt by the UN. The three identified proposals such as the potential introduction of a standalone review, the creation of a multilateral investment court along with a fairer selection and appointment of the adjudicators and arbitrators, has been able to identify the legitimacy crisis in a significant way. Delving into the details of it it can be stated that a narrow focus on procedural issues is considered to be the biggest challenge. This carries a significant reason for ignoring the substantive challenges of this particular system. Additionally, it has also been observed that UNCITRAL also refused to address the substantive challenges of the mentioned system. Information is able to highlight that protecting the interest of the foreign investor is considered to be quite diplomatic in its approach. The basic reason for its being diplomatic is the political and discretionary process, which is ultimately considered to be quite ineffective. Besides this, it is also unable to ensure the fact that foreign investors are getting benefited from an international minimum standard.

It has been identified that originally the vast majority of the *Bilateral Investment Treaties* (BITs) have been signed only between a country which is developed and exports capital, and a

country which is also developed and imports capital. The adoption of the BITs has actually benefited foreign investors to be encouraged in the process of investing in developing countries. It is considered to be quite important by reassuring the certainty of the fact that their investment is not going to be subjective to the legal institutions of the host countries. Because of this, BITs have been considered a way to head against political risk through significant laws. Discussing it in a greater way it should be mentioned that, legally the treaties are actually considered to be reciprocal, however, the investment flows have never come within the developed countries. This shows that the policies, in developed countries and considered to be very rarely challenged in terms of investment arbitrations. It has become quite evident that foreign investors are able to challenge national policies in democratic states. This also reveals the fact that a foreign investor cannot be subjected to the same regime just like a national investor, whereas the national investor has no preferences and therefore needs to abide by the national regulations correctly. Data from different resources is also able to portray that a foreign investor is able to challenge certain measures depending on the terms of the BIT. These particular issues are considered to be the biggest problem of reverse discrimination, that are creating an impact in developing legitimacy issues in the ISDS mechanism.

A concrete example can be given in the process of providing proper details regarding the legitimacy issues in a better way. In the *Methanex Corporation v United States (2005)*, the focus has been given to identifying whether a sufficient legal relationship existed between Californian measures and Methanex under Art. 1101. It has been identified from the various resources that ISDS is quite effective to grant greater rights to foreign investors in comparison to national investors. This issue actually undermines the state of democratic commitment, in the process of maintaining the equality of rights and also depicts the fact that domestic organisations do not have similar freedom while acting as their domestic counterparts. In addition to this, the rights which are granted to foreign investors manifest themselves in various ways. In most cases, this allows foreign investors to explore a specific avenue so that it becomes easy for them to re-address the fact that a national investor cannot explore. Besides this, this particular mechanism enables foreign investors to claim limitless awards in the process of circumventing each and every limit. Apart from that, It is also quite effective for investors coming from foreign countries to enter into a contract without facing any kind of political risk that a national company can eventually face.

The legitimacy issues are seen to be reflected in developing inequality of rights among the economic activities that are able to significantly distort the market relation taking it in the favour of foreign companies. Additionally, having the ISDS outlet actually means

incorporating a significant amount of risk in the investment decision for domestic organisations in a quite significant way. Some critics have argued that applying the same rules for foreign as well as national investors is actually not desirable based on the fact that they are materially seen to be in different positions to start off with. Depending on this issue a specific regime has been fixed for the foreign investors, which has helped in the process of balancing out the starting positions in a better way. A specific example can be provided in this regard where the initial differences of the due diligence are seen to be imposed on the foreign companies by using the acts like *Enterprise Act* while entering into the UK market. It has been identified that the investment protection system should provide proper focus on eliminating the initial differences while implementing some of the specific standards in the international investment treaties that can act as a medium to provide constitutional guarantees.

Some of the significant issues are also seen to be observed in the process of not subjecting the foreign investors to the national judicial procedures that can create discrimination against them in an unfair way. Besides, the mismatch between the general standard in BITs and the significant balances of the national level is actually able to reveal the practical impossibilities of the ISDS system while highlighting legitimate issues. This has made the entire process quite difficult to satisfy the logic of substitution that can form its guiding principle in an effective way. The impact of Constitutional compromise can also be seen to be quite evident because of the identified legitimate issues while implementing ISDS. Two of the factors are seen to be visible in this regard, one is the political ownership over the common rules along with the freedom and the equality of different actors in the law. Furthermore, the substantive legitimacy crisis of ISDS is responsible to stem from its inherent incompatibility and at the same time the core constitutional values within the host states. Consider being the birth defects in the system which are coming to the surface and are responsible to create the substantive legitimacy crisis. of few of the reasons can be identified where it can be seen that the legal reciprocity of bits is presently accompanied by the reciprocal investment flow that is creating the issues. This is not only evident in the development the developing countries but is seen to be visible between the developing nations themselves. An example can be provided in this regard by taking the case of *Masder V Spain*, where a broad interpretation is seen to be effective in the investment that has been adopted.

Finally, it can be stated that the substantive legitimacy issues in the ISDS system are actually noticed to be caused by the inherent logic of the particular system itself. Due to this reason, it cannot be taken as legitimate but at the same time is considered to be as threatening to undermine the constitutional commitment specifically on the national level. Additionally, it

should be mentioned that it is really important to bring a severe and urgent change in the entire regime so that it can be replaced. Only with the help of this and bringing such drastic measures it can be easy to deal with the substantive challenges posed by the ISDS quite effectively. These challenges are considered to be most important to be dealt with properly while reforming them in a correct way. This can make the ISDS implementation process easy and reduce the severity of the challenges which can ultimately provide benefits to foreign as well as domestic investors.

***Analysis of the possible reform that is presently considered***

Some of the significant reforms seen to be considered presently in the process of dealing with the legitimacy issues of the ISDS system in different countries. In Australia, the reform has been brought best on the relevance of perception in regard to the lack of sufficient guarantees of independence. In addition to this, importance has also been given to maintaining the impartiality of the individual arbitrators, Considering both, the perceived as well as the real issues that are associated with the independence of the arbitrators. Along with that neutrality and accountability should be considered and can be accountable to the public in a perfect way. Besides this, the arbitrators are seen to be partially motivated by a desire to be appointed or in many re-appointed by the host states or by the investors. In the case of Canada, it can be seen that the reforms have been implemented on the basis of the perception of bias along with the problems of incorporating balance for permanent tribunals. Differences can be brought up in the process of expressing an interest in reappointing and at the same time providing remunerations to influence the judges.

Going into the details of it, it can be mentioned that, The investment protection system is seen to seek for eliminating the initial differences in the process of implementing different standards specifically in international Investments. The major emphasis, in this case, has been given to the international investment treaties that are able to compare functionally to provide constitutional guarantees along with the administrative law principles specifically at the domestic level. In addition to this, national procedures are seen to be substituted by an international procedure that can be able to emulate the significant ways in which the national procedures work within different domestic organisations. Apparently, this particular artificial mechanism can intend to cut all the discrimination between national investors and foreign investors in a perfect way. A significant change can be seen in the process of selecting adjudicators and the lack of diversity in the United Kingdom. The emphasis, in this case, has seen to be given to identifying the need to clarify the exact role of the arbitrators who are appointed by the party. A lack of proper guidance can be experienced by the arbitrators that are



creating an impact on the process of implementing the system. Therefore bringing perfect clarity in the overall process and at the same time maintaining transparency among the investors is helping the country to deal with the issue in an effective way.

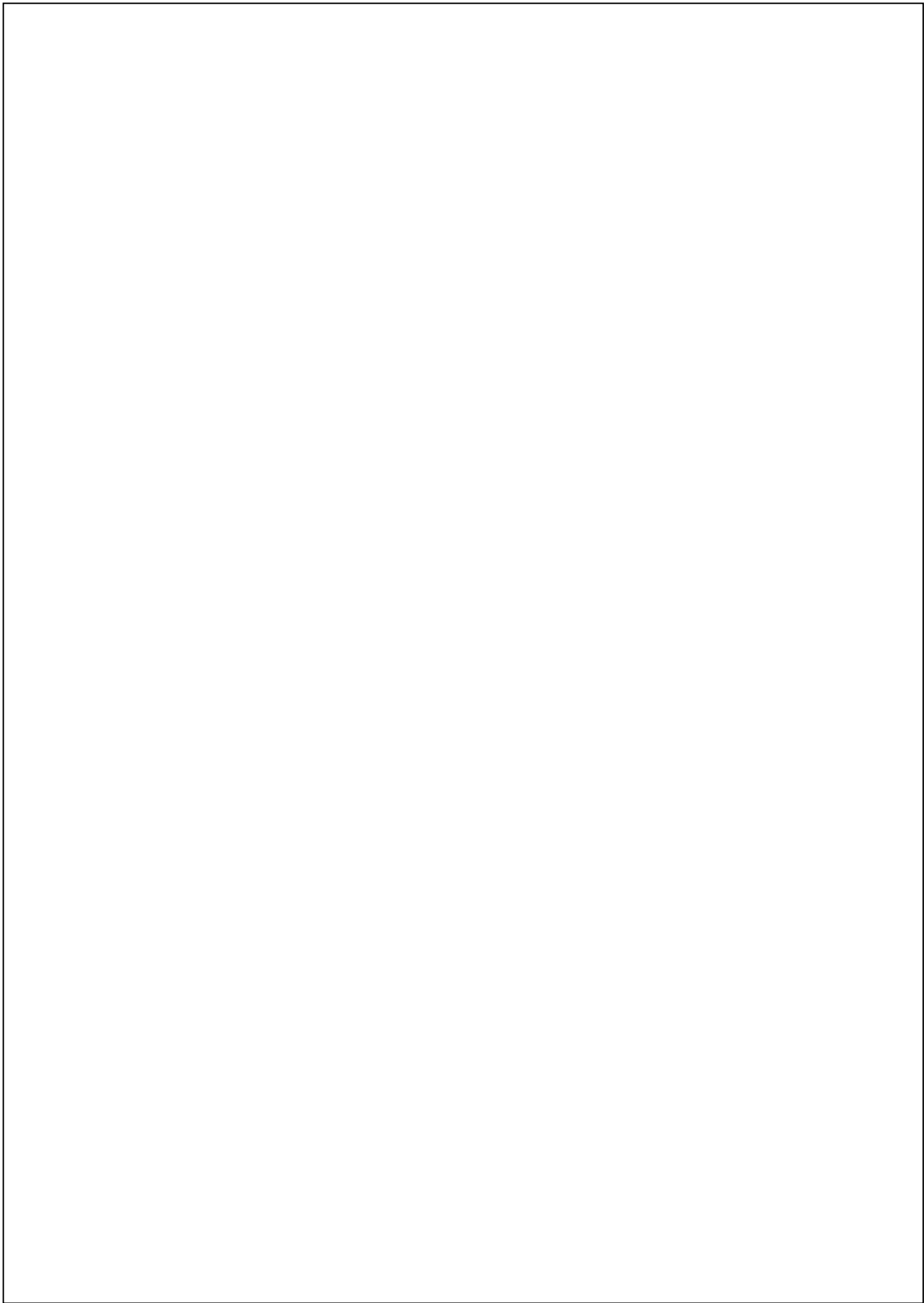
The EU has been able to realise the actual significance of the problem which is posed by reverse discrimination, and they are continuously working for addressing the substantive challenges which are contained in the ISDS regime perfectly. The reforms are also same to be brought in the compensation of arbitrators in the process of maintaining ethical rules along with the code of conduct. In regard to this UK, delegations are seen to consider ensuring clarity along with maintaining ethical standards among the arbitrators. In addition to this, it can be seen that the arbitrators are often guided by the ethical rules which are provided in the domestic legislation. The country is seen to give proper focus on not setting any standard ethical rules for the arbitrators which can help them to deal with the issue why effectively. Renunciation of the existing IIAs is also considered to be an important reform that is helping to deal with the challenges. Data from significant resources highlights that the 2010 appeal from a lot of academics in terms of renegotiating the IIAs with a specific few for replacing ISDS is seen to be considered as hampering the ability of the government to work for their citizens in response to the concerns. It has also been seen that international organisations have been asked to stop promoting the current system and at the same time look for specific alternatives. These alternatives are giving light to private risk insurance along with the contract-based arbitration that has created a significant impact.

According to some scholars, it has been identified that an international investment Court is considered to be one of the best options to replace the current ists system which is lacking the basic standards of Independence and openness. UNCTAD note on the Reform of ists in June 2013, has been able to recognise that these particular solution is going to contribute to the process of resolving some of the major problems that are associated with the current system. Along with that, it has been able to ensure transparency as well as the legitimacy of the mentioned system while facilitating the consistency of judgement and at the same time maintaining the independence of the adjudicators. Furthermore, it should be added at last that bringing transparency is considered to be one of the greatest options to have the proper benefits of the reforms in many different cases. Additionally, a new treaty can also be added with the Attribution rules which are already existing in the countries in order to bring a positive impact.

## Conclusion

Based on the overall discussion, it has been easy to provide proper information regarding the various aspects of the ISDS system and its impact on international investment treaties. Has been identified that ISDS is known to be a legal mechanism that has been able to allow an investor from One of the contracting states in which the investment has been made. Basically, ISDS has been created to reduce the political risks which are associated with foreign investment and gradually increase day by day. In many cases, this particular mechanism is also known to be a *toxic mechanism* or *trozen horse* that can enable a foreign company to challenge environmental and social protection laws along with public health and at the same time harm the overall profits.

In regard to this, the particular essay is giving light on identifying significant and crucial legitimacy issues that are impacting the ISDS system, along with highlighting the possible reforms which are being considered presently. In order to do this an introduction has been given that is dealing with the overall concept of the topic along with the aim and objectives of the essay to provide a complete background to the readers. Additionally, the discussion section is dealing with <sup>3</sup> the basic features of the current ISDS system with the help of the literature and case laws. Proper identification of the legitimate issues has been done and analysed in a perfect way that has helped to know about the issues. Lastly, the most possible reforms have been discussed to complete the essay in a perfect way.



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