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SETTLEMENT OF INTERNATIONAL INVESTMENT DISPUTES AND ITS MECHANISMS

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Abstract:

Investment disputes usually arise between foreign investors and host countries when investment agreements or international law are violated. There are several reasons for international investment disputes, and these reasons are analyzed in the article. It is analyzed to what extent the occurrence of investment disputes affects the internal economy of the states, investors, global economy, and diplomatic relations. The factors of settlement of investment disputes are analyzed. Also, investment dispute resolution mechanisms and their pros and cons are explored. Concepts such as ISDS, FDI, BIT, TTIP, ICSID and LCIA will be covered during analysis and study. In addition, the Ukraine-Lithuania BIT, the case between Tokyo Tokelés and Lithuania will be considered. After conducting research in this field and analyzing it, proposals are made for the development of the field and elimination of the shortcomings that have arisen in the research.

Keywords: Investment disputes, FDI (foreign direct investment), Ukraine-Lithuania BIT, case of Tokyo Tokelés and Lithuania, negotiation, meditation, arbitration, bilateral investment treaties (BIT), Investor–state dispute settlement (ISDS), ICSID (the International Centre for Settlement of Investment Disputes of the World Bank), conflict, Shareholder Disputes, TTIP (Transatlantic Trade and Investment Partnership).

In today's interconnected global economy, international investment plays an important role in stimulating economic growth, technological innovation and creating new jobs. However, with the expansion of cross-border investment, disputes between investors and host countries inevitably increase. These disputes, often stemming from conflicting interpretations of investment agreements or changes in the regulatory environment, pose significant challenges for both parties. Understanding the dynamics of international investment disputes and their resolution mechanisms is important in maintaining investor confidence and ensuring fair treatment for all stakeholders.

What is investment disputes and what is the concept? Investment disputes typically arise between foreign investors and host states when there's a perceived breach of investment agreements or international law. These disputes often involve issues such as expropriation without adequate compensation, breach of contract, discrimination, or regulatory changes impacting investment. Resolution mechanisms can include negotiation, mediation, arbitration, or resort to international courts or tribunals. Investment dispute resolution frameworks, such as those provided by bilateral investment treaties (BITs) or multilateral agreements, aim to provide protections and mechanisms for resolving disputes to encourage foreign investment and ensure fair treatment of investors.

Importance of resolving investment disputes? Resolving investment disputes is of paramount importance for several reasons: Firtsly, Maintaining Investor Confidence. When investors perceive that their investments are protected and disputes will be resolved fairly, they are more likely to invest. This confidence is essential for attracting both domestic and foreign investment, which in turn stimulates economic growth and development. Secondly, Promoting Economic Stability. Investment disputes, if left unresolved, can lead to uncertainties that undermine economic stability. A clear and effective dispute resolution mechanism helps mitigate risks associated with investment, reducing uncertainty and fostering a stable economic environment. In addition, Protecting Investor Rights. Resolving disputes ensures that investors' rights are upheld according to international law and agreements. This protection is crucial for safeguarding investments against arbitrary actions by host states, such as expropriation without adequate compensation or discriminatory treatment. Fourthly Encouraging Foreign Direct Investment (FDI).[1] Countries with robust dispute resolution mechanisms are more attractive destinations for foreign direct investment. Investors are more likely to commit capital to jurisdictions where they have confidence in the legal framework and mechanisms for resolving potential disputes. Also, Enhancing Rule of Law. Effective resolution of

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investment disputes reinforces the rule of law both domestically and internationally. It demonstrates a commitment to upholding legal agreements and respecting the rights of investors, which is fundamental for a well-functioning global economy. Besides, Preventing Escalation and Diplomatic Tensions. Unresolved investment disputes can escalate into diplomatic tensions between states. Timely resolution through diplomatic channels or international arbitration can prevent such escalations and maintain positive relations between countries. Finally, Promoting Innovation and Entrepreneurship [2]. When investors feel confident that their investments are protected, they are more likely to engage in innovative and entrepreneurial activities. This can lead to increased productivity, job creation, and technological advancements, contributing to overall economic prosperity. Summary, resolving investment disputes is essential for fostering a conducive environment for investment, protecting investor rights, promoting economic stability, and upholding the rule of law. It plays a vital role in facilitating global commerce and ensuring mutually beneficial relationships between investors and host states.

Background on Investment Disputes

An investment dispute typically involves a conflict or disagreement between a foreign investor and a host state regarding the treatment or protection of an investment. Some key elements that constitute an investment dispute include:

- Breach of Contract.

Disputes may arise when one party fails to fulfill the terms outlined in an investment contract. For instance, if an investor fails to receive the promised returns or if the terms of the agreement are not honored by the other party, it can lead to a dispute.

- Misrepresentation or Fraud.

If an investment opportunity is misrepresented or if there are fraudulent activities involved, investors may take legal action to recover their losses. This can include cases where the performance of an investment was falsely inflated or the risks were downplayed.

- Violation of Securities Laws.

Investments are often subject to regulatory compliance. Disputes can arise if there are violations of securities laws, such as insider trading, market manipulation, or failure to disclose relevant information to investors.

- Disputes over Investment Performance.

Investors may dispute the performance of their investments if they believe that the returns were lower than expected or if there are discrepancies in how the investment was managed or reported.

- Shareholder Disputes.

Shareholders in a company may have disagreements with management or other shareholders regarding corporate governance, dividend policies, executive compensation, or strategic decisions, leading to disputes that may require legal resolution.

- Partnership Disputes.

In investments involving partnerships or joint ventures, disputes can arise over management decisions, profit sharing, distributions, or breaches of the partnership agreement.

- Real Estate Investment Disputes.

Real estate investments can lead to disputes over property ownership, lease agreements, development plans, zoning issues, or breaches of contract between buyers, sellers, landlords, and tenants.

- International Investment Disputes.

Disputes between foreign investors and host governments or between international business partners may arise due to breaches of investment treaties, expropriation of assets, unfair treatment, or regulatory changes impacting investments.

EXAMPLES OF COMMON INVESTMENT DISPUTES

Investment disputes can arise from various situations in the realm of finance and investment. Although not binding as a precedent, arbitral awards under investment agreements have a significant influence on subsequent arbitral awards. I will briefly summarize the principal issues which have been debated in the leading investment treaty arbitration cases. In general, claims over jurisdiction are raised quite often before arbitral tribunals. Where it is determined that the arbitral tribunal has jurisdiction, a decision on the merits of the case is made thereafter. The decisions on jurisdiction and the substance of the case are given either separately or together as one decision. Regarding decisions on the merits of the case, decisions on breach of obligation and on compensation are given either separately or together. As shown by the fact that many cases reach an amiable settlement after the jurisdiction of the arbitral tribunal is held in the affirmative, the determination of jurisdiction has a great influence on the negotiation between investor and state.

It is known that "Investor" can include enterprises established in the home country and owned or controlled by nationals of the host country. Tokios Tokelés, a business enterprise established under the laws of Lithuania, owned a publishing company in Ukraine. Tokios Tokelés filed for arbitration, contending that because the Ukrainian publishing company in which Tokios Tokelés had invested published a book that favorably portrayed a politician in the opposition party,

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Tokios Tokelés became subject to tax investigations by Ukrainian authorities that hindered its business activities, and that, for that reason, Ukraine breached the Ukraine-Lithuania BIT. The Ukrainian government claimed that because Tokios Tokelés was 99% owned and controlled by Ukrainians, it did not fall under the definition of an "investor" who was protected under such BIT. The arbitral tribunal held that the nationality of a company is determined not based on the provisions of Article 25(2)(b) of the ICSID Convention but by the respective BIT. Consequently, it rendered a decision that Tokios Tokelés would be deemed to be a Lithuanian investor, as the BIT only defines an investor to be "any entity established in conformity with the laws and regulations in the Republic of Lithuania. [3]

IMPACT OF INVESTMENT DISPUTES ON INVESTORS, STATES, AND THE GLOBAL ECONOMY

The impact of investment disputes can be significant and wide-ranging: Investment disputes can result in financial losses, eroding investor confidence, and trust in the financial system. Investors may become hesitant to engage in future investments, leading to decreased capital flows and stifled economic growth. Disputes can also tarnish the reputation of individual investors or investment firms, impacting their ability to attract future investments. In other hand, Investment disputes can strain diplomatic relations and create legal liabilities for states. If states are found liable for breaches of investment agreements or international treaties, they may face hefty compensation claims, leading to budgetary constraints or potential credit rating downgrades. Moreover, disputes can deter foreign direct investment (FDI) inflows, hindering economic development and job creation. [4]

Investment disputes impact also Global Economy [5]. Investment disputes can disrupt global trade and investment flows, contributing to economic uncertainty and volatility. Prolonged disputes may lead to market instability, affecting asset prices, exchange rates, and investor sentiment worldwide. Additionally, disputes involving multinational corporations and sovereign states can have broader geopolitical implications, influencing international relations and geopolitical dynamics. Overall, investment disputes pose risks to global economic stability and hinder efforts to promote sustainable development and prosperity.

MECHANISMS FOR RESOLVING INVESTMENT DISPUTES

Overview of existing mechanisms (e.g., arbitration, negotiation, mediation)

Negotiation. Negotiation involves direct discussions between the parties to reach a mutually acceptable resolution without involving third parties. It can be informal or facilitated by legal representatives. Negotiation allows for flexibility and confidentiality, and it can preserve relationships between parties. [6] The negotiation mechanism for resolving investment disputes offers parties flexibility, confidentiality, and control over the outcome, allowing them to work collaboratively towards a resolution that meets their interests and objectives. However, negotiation may not always be successful if parties are unable to find common ground or if there are significant power imbalances or disagreements that cannot be resolved through dialogue. In such cases, parties may choose to pursue other dispute resolution mechanisms such as mediation, arbitration, or litigation.

Arbitration. Arbitration is a commonly used mechanism for resolving investment disputes, especially in cases involving international investments or investor-state disputes. Arbitration can be used as a method to resolve disputes only if both parties have expressed their consent to do so. Their consent also includes the choice of the procedural rules. These rules govern the arbitration proceedings and cover issues such as the constitution of the tribunal, the potential participation of third parties, the rendering and possible publication of decisions, and the determination of costs. The disputing parties submit their dispute to an arbitral tribunal (usually composed of either one or three arbitrators) of their choice. The decision of the arbitral tribunal (also known as an 'award') binds the parties and is enforceable in domestic courts. That means that if a losing party refuses to abide by a decision, a winning party can ask a domestic court to compel the other party to comply. [7]

Overall, arbitration provides a flexible, neutral, and enforceable mechanism for resolving investment disputes, particularly those involving complex legal and technical issues or cross-border investments. However, it is important for parties to carefully consider the arbitration agreement and procedural rules governing the arbitration process to ensure a fair and effective resolution of their dispute.

Meditiation. Mediation is another mechanism for resolving investment disputes, offering parties a facilitated negotiation process with the assistance of a neutral third-party mediator.

Mediation serves to preserve the relationships of parties. The majority of investment disputes arise out of matters involving information, communication, and supply of energy resources,[8] and such activities are of utmost importance to both parties, namely the foreign investor

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and the state. Mediation, being a process leading to a mutually acceptable solution, helps parties to preserve their ongoing relationships which accordingly carries economic benefits for both.[9] Mediation decreases the risk of unpredictable outcomes. Investor-state arbitration tribunals are bedeviled for rendering unpredictable awards.[10] It might be said that some degree of inconsistency in the outcome of investment disputes is inevitable since the system of international investment law has evolved on the basis of more than 2000 BITs [11] or other treaties with investment provisions, each containing differing definitions of substantive standards. Arbitral tribunals are bound to make their decisions based on these respective treaties. However, parties to an investment dispute – both the investor and the state alike – might prefer to avoid any kind of risk, especially when there is a question of damages worth billions of dollars involved. Mediation, being a voluntary endeavor of both parties, might be a lot less risky than arbitration in the sense that it offers a self-tailored outcome based on the structured negotiation of the parties. In mediation, parties may craft an outcome to the dispute that may very well depart from the disputed law and facts by considering non-legal issues, shared interests, and acceptable accommodations.[12] This helps parties not only to mitigate the financial risk of an unpredictable award but also enlarges the value of the outcome to each. Mediation is quicker and cheaper than arbitration On average, ICSID cases take approximately 3.6 years.[13] As regards costs, the average amount spent is approximately USD 5.6 million for claimants and USD 4.9 million for respondents. [14] These factors often represent a big burden for investors and states alike. Despite the advantages of mediation, there some obstacles of meditiation: Lack of domestic legal frameworks on mediation, Willingness to avoid accountability for settlement, Fear of public criticism for accepting fault.

Investor-State Dispute Settlement (ISDS) mechanisms

Investor–state dispute settlement (ISDS), or an investment court system (ICS), is a set of rules through which countries can be sued by foreign investors for certain state actions affecting the investments (FDI) of that investor by that state. This most often takes the form of international arbitration between the foreign investor and nation.[15] For the rules to be effective, they must have been agreed upon between the states concerned. ISDS most often is an instrument of public international law, granting private parties (the foreign investors) the right to sue a sovereign nation in a forum other than that nation's domestic courts.[15] Investors are granted this right through international investment agreements between the investor's home nation and the host nation. Such agreements can be found in bilateral investment treaties (BITs), international trade treaties such as the United States–Mexico–Canada Agreement and the proposed Transatlantic Trade and Investment Partnership (TTIP), or other treaties like the Energy Charter Treaty. Settlement of a dispute by arbitration also can be agreed upon only by the parties concerned. To be allowed to bring an investor-state dispute before an arbitral tribunal, both the home country of the investor and the country of investment must have agreed to ISDS, the investor from one country must have an investment in a foreign country and the foreign investor must put forward that the state has violated one or more of the rights granted to the investor under a certain treaty or agreement.

ISDS claims are often brought under the rules of ICSID (the International Centre for Settlement of Investment Disputes of the World Bank), or one of several other international arbitral tribunals governed by different rules or institutions, such as the London Court of International Arbitration (LCIA), the International Chamber of Commerce (ICC), the Hong Kong International Arbitration Centre (HKIAC), or the UNCITRAL Arbitration Rules.Investor-State Dispute Settlement (ISDS) mechanisms are found in more than 3 000 international investment treaties, but have been increasingly criticised in recent years.[16]

International investment agreements, and the ISDS mechanism, were originally created to protect investors from arbitrary expropriation and ensure non-discriminatory treatment for foreign investments, in countries considered risky. In such countries, with the judiciary not fully independent from government, arbitration was considered a more neutral framework to ensure enforcement of the host state's obligations towards investors. The progress made on comprehensive free trade agreements (FTAs) between the EU and Canada and the United States – in both cases including provisions for ISDS – has intensified discussion on the mechanism in the EU.[17] A number of doubts exist with respect to the impartiality of arbitrators, while the relative broad interpretation given to the provision has been considered to have substantially reduced states' freedom to regulate, creating an imbalance between the investor's right to protection and the host state' sovereign right to regulate its market. The EU supports ISDS arbitration in general, while recognising the need for its reform.[18] Indeed a consensus seems to be emerging on systemic problems found in this increasingly used system. That has led the European Commission to propose some innovative

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provisions in the framework of negotiations on EU trade and investment agreements, but without calling into question the ISDS system itself.

According to some scholars,[19] an International Investment Court would be the best option to replace the current ISDS system, judged to lack basic standards of openness and independence, as well as being structurally biased towards companies. An International Investment Court established by a group of states linked by IIAs would have the advantage of replacing private arbitrators, appointed case by case, with judges nominated for set terms, a recognised prerequisite for judicial independence.

A June 2013 UNCTAD note on reform of ISDS recognised that this solution would contribute to resolving some of the current system's major problems. It would ensure legitimacy and transparency of the system; facilitate consistency in judgments and the independence of adjudicators. However some scholars and arbitrators stress that any centralised dispute resolution institution would continue the danger of enlarging its jurisprudential powers, with which states may not agree, thus posing a new problem of legitimacy.[20]

Options for reform

Several major reforms are advocated to improve the existing system. Improving transparency Ensuring public access to proceedings and awards could be achieved in two ways: Investment treaties, like the recent EU-Canada CETA, can include transparency obligations directly in their text. A new treaty could add to existing arbitration rules. The Rules on Transparency, adopted by UNCITRAL in July 2013, and which came into effect on 1 April 2014, are a step in this direction. For the time being, the new rules will only apply to cases using UNCITRAL rules and initiated under investment treaties concluded after 1 April 2014. However UNCITRAL has announced the start of work on a convention to apply the new rules to existing investment treaties too. The CETA draft rules allow for the possible application of both UNCITRAL arbitration rules and the ICSID Convention and Additional Facility rules.

Introducing the possibility of appeal A standing body with competence to receive appeals would provide the possibility to correct erroneous awards and enhance the predictability of the law. Some IIAs contain provisions on the opening of negotiations to create such an appeal mechanism, but none has yet been started.[21] This approach would, however, further increase the length and costs of proceedings. The ISDS procedure as currently proposed would include several stages: first, consultation, second, mediation and, only after that, arbitration. Each of the stages would have a set time limit. The draft provisions include the possibility to ask for revision or annulment of an arbitration award.

As I mentioned above, The ISDS system has been criticized for its perceived failures, including investor bias, inconsistent rulings, inaccurate rulings, high damage awards, and high costs. There is a widespread call that the ISDS system should be reformed. As of May 2022, multiple reform efforts are underway; the EU's European Economic and Social Committee, for instance, backs criticism of ISDS and calls for a more holistic approach.

In conclusion, International investment disputes can arise in several cases as we have listed above, and these disputes also have an impact on countries and diplomatic relations. We can see that there are several mechanisms for the resolution of international investment disputes, which can be chosen according to their type, and each of them has its own advantages and disadvantages. As for the ISDS mechanism, we can see that despite being the most common and popular mechanism, it has received several criticisms. Despite the criticism, the mechanism is being reformed from year to year.

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