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SYMPOSIUM ON INSTITUTIONALIZING INVESTMENT DISPUTE PREVENTION

DISPUTE PREVENTION MECHANISMS AS LEGAL ENCLAVES

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Introduction

This contribution examines the role of dispute prevention mechanisms (DPMs) in domesticating and broadening foreign investor privileges. Although conceived as a means of responding to the backlash against investor-state dispute settlement (ISDS), dispute prevention mechanisms are likely to produce legal enclaves whereby a privileged group of actors are afforded special treatment, and their interests are elevated into policy priorities. As currently conceived, DPMs are expected to operate as a regime embedded in domestic law, but replicating and amplifying investment law's emphasis on the exclusivity of foreign investor rights. Thus, the effect of DPMs is to anchor and extend foreign investor rights to a pre-dispute stage. By analyzing the premises and core features of the emerging DPMs, this contribution argues that, rather than addressing the systemic issues underpinning international investment law, the dispute prevention agenda will further expand and entrench foreign investor privileges.

In the history of international law, enclaves were both vehicles and products of imperial expansion. The emergence and enlargement of empires were synonymous with the creation of corridors of control, the establishment of missions and outposts, carving out areas of partial or shared sovereignty, and designating spheres of influence.[1] Law traveled to those spaces with agents of empire to form new political communities, export imperial designs, and create variations of familiar legal practices.[2] In the colonial histories of international investment law, enclaves are understood as regimes "conferring specialized privileges on the foreigner that exempt him from local conditions that may substantially diminish his privileges."[3]

The core pillars of contemporary international law reinforce its functions as an enclave, as foreign investors are afforded a bespoke set of protections. Foreign investors can escape the jurisdiction of national courts and the application of national laws. They can claim monetary remedies for a breach of rights that often have no domestic equivalent, even in advanced legal systems.[4] Foreign investors can challenge a wide variety of national and subnational actions. Investment arbitration, the principal mechanism for dispute settlement under investment treaties, is not subject to democratic control or other accountability mechanisms.[5] By inscribing these investor rights and

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[1] Lauren Benton, A Search for Sovereignty: Law and Geography in European Empires, 1400–1900 2 (2014).

[2] *Id.* at 3.

[3] David Schneiderman, Investment Law's Alibis: Colonialism, Imperialism, Debt and Development 32 (2022).

[4] Santiago Montt, State Liability in Investment Treaty Arbitration: Global Constitutional and Administrative Law in the BIT Generation (2012).

[5] Gus Van Harten, Investment Treaty Arbitration and Public Law (2008).

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remedies into international law, international investment law enables foreign investors to enjoy an exclusive legal framework operating in parallel to, and frequently superseding, national law. The enclave-like features of international investment law have met with extensive criticism, catalyzing the contemporary reform agenda that seeks to address and mitigate some of these concerns. As I show, while sometimes viewed as part of that reform agenda, in practice DPMs replicate and expand the legal enclave of investment law from the international to the domestic.

DPMs and Their Evolving Objectives

Although DPMs have become particularly prominent in the context of the recent ISDS reform efforts, the notion of investment dispute prevention is not new. Strategies of prevention have been proposed before, paradoxically in the context of justifying, rather than curbing, the expansion of international mechanisms for the settlement of investor-state disputes. As the first wave of ISDS awards led to efforts to better articulate the justifications behind the fast-growing and potent regime, new narratives proliferated claiming that international investment law benefits not only investors but also host states. Damages awards rendered by ISDS tribunals would arguably "exert considerable pressure on states to bring their domestic legal orders into conformity with their investment treaty obligations,"[6] spawning broader improvements in domestic governance and thus reducing the number of investment disputes. It was in response to these arguments that a number of studies emerged to test the underlying assumptions with the aid of empirical data.[7] These studies unveiled evidence pointing to the emergence of a dispute prevention agenda in developing states. Empirical data also found that dispute prevention mechanisms may lead to overprotection of foreign investors and the creation of legal enclaves.[8]

In contrast, the more recent emphasis on dispute prevention as part of recent reform initiatives envisions DPMs as a genuine response to the concerns posed by critics of international investment law. At the United Nations Commission on International Trade Law's (UNCITRAL) Working Group III (WGIII), several states emphasized the mounting dissatisfaction with investment arbitration and in particular its costs and impact on the host states. Reform efforts, they argued, should focus on identifying the means by which the number and incidence of investment disputes could be reduced.[9] Concentrating on the "prevention" of disputes was presented by some states and international organizations as a cost-effective approach to the reform of ISDS.[10] Elsewhere, as discussed by Priyanka Kher in her contribution to this symposium,[11] the World Bank has long been involved in the reform efforts, providing technical assistance and advice on DPMs, including through its Systemic Investment Response Mechanism project.[12]

[6] Roberto Echandi, *What Do Developing Countries Expect from the International Investment Regime?*, *in* The Evolving International Investment Regime: Expectations, Realities, Options 13 (José E. Alvarez & Karl P. Sauvant eds., 2011).

[7] Mavluda Sattorova, The Impact of Investment Treaty Law on Host States: Enabling Good Governance? (2018); Investment Treaties and the Rule of Law Promise: An Examination of the Internalisation of International Commitments in Asia (N. Jansen Calamita & Ayelet Berman eds., 2022); Josef Ostřanský & Facundo Pérez Aznar, National Governance and Investment Treaties: Between Constraint and Empowerment (2023).

[8] Sattorova, *supra* note 7, at 85–87.

[9] UNCITRAL, Possible Reform of ISDS: Dispute Prevention and Mitigation – Means of ADR, para. 3, UN Doc. A/CN.9/WG.III/WP.190 (Jan. 15, 2020).

[10] *Id.*, para. 5, *citing* UNCITRAL, Possible Reform of ISDS: Submission from the Republic of Korea, UN Doc. A/CN.9/WG.III/WP.179 (July 31, 2019).

[11] Priyanka Kher, *Investment Retention Mechanisms: Rationale and Implementation Experience*, 118 AJIL Unbound 242 (2024).

[12] Roberto Echandi et al., *Retention and Expansion of Foreign Direct Investment: Political Risk and Policy Responses*, World Bank Group, at 5 (2019).

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The shared emphasis of these proposals is on the benefits of avoiding the negative consequences of investment arbitration, including through closer coordination and the empowering of domestic agencies with a dispute resolution function.[13] This can be seen in the examples of existing DPMs discussed in this symposium, including that of China,[14] Peru,[15] and the United States.[16] Yet, although premised on the desire to shield host states from exposure to expensive ISDS disputes, the functions of DPMs are likely to empower investors as a special class of actor. As will be shown below, dispute prevention might in practice serve to strengthen, deepen, and expand legal frameworks foreign investors can use to their own advantage vis-à-vis host states.

DPMs as a Means of Elevating and Prioritizing Investor Rights

A closer look at the concrete features of the recent proposals reveals that DPMs are likely to propagate legal enclaves by elevating investment protection as a policy priority. Consider, for instance, the *Legislative Guide* presented to the UNCITRAL WGIII, as well as its predecessor and an apparent source of inspiration for its drafters, the World Bank's model. Both models are centered on the premise that, to prevent investment disputes, investor grievances might need to be "brought to the attention of a higher political authority (for example, an inter-ministerial committee or the office of the Prime Minister or the President)."[17] To this end, a key feature of both models is the creation and empowerment of a dedicated government agency, whose principal aim is to identify, track, and manage investor grievances as early as possible.[18] The World Bank's proposed problem-solving techniques include mechanisms of peer pressure and, when a solution "cannot be reached at a technical level, a mechanism to elevate the issues to higher political levels."[19]

What criteria are these authorities—and the lead agency coordinating the decision-making processes behind the scenes—expected to be guided by in identifying the appropriate solution to a grievance at hand? For the *Legislative Guide*, it appears that reaching a desired outcome for the investor is an end in itself. For the authors of the World Bank's model, the intended outcome is "inducing the desired behavior among domestic regulatory agencies" and "properly implementing [international investment agreements] . . . in a way that is more in tune with their original intent."[20] The ultimate aim is to satisfy the investor and to address "negative government actions" that might hinder the retention and expansion of foreign direct investment.[21]

Since the apparent goal of dispute prevention is to avoid costly arbitration cases, the proposed de-escalation and problem-solving techniques are based on the same ideals that underpin the work of investment tribunals: shielding investors from the negative effects of governmental actions that are not in tune with the letter and spirit of investment treaties. While the aim of dispute prevention is ostensibly to protect the states from the adverse effect of investment arbitration awards, in practice the looming threat of investor claims is likely to gear the decision making by DPMs toward an outcome favored by a foreign investor. The goal of the proposed dispute prevention

[13] *Id.*

[14] Zhenyu Xiao, *Institutionalizing Investor-State Dispute Prevention in China*, 118 AJIL UNBOUND 253 (2024).

[15] Ricardo Ampuero Llerena, *Investor-State Dispute Prevention Institutions in Latin America – The Case of Peru*, 118 AJIL UNBOUND 248 (2024).

[16] Jeremy K. Sharpe, *Institutionalizing Investment Dispute Prevention: The U.S. Experience*, 118 AJIL UNBOUND 259 (2024).

[17] *Id.* at 43; UNCITRAL, Possible Reform of ISDS: Draft Legislative Guide on Investment Dispute Prevention and Mitigation, para. 20, UN Doc. A/CN.9/WG.III/WP.228 (Jan. 19, 2023).

[18] *Id.*, para. 21.

[19] Echandi et al., *supra* note 12, at 43.

[20] *Id.* at 16.

[21] *Id.* at 5

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models—ensuring compliance with, and enforcement of, investment treaties—is likely to equip investors with another tool to elevate their dispute to a domain where it is to be resolved in line with investment treaty precepts.[22]

Expanding the Reach of Investment Protections to a Pre-dispute Stage

There is an inherent tension in the aims and objectives of dispute prevention and its place in the broader package of recent reforms of ISDS. On the one hand, the professed goal of the DPM agenda as articulated in the proposals by the UNCITRAL and the World Bank, is to address the broader concerns over the negative impact of ISDS on host states and redress the imbalance stemming from the breadth of rights it affords to investors vis-à-vis host states. Yet, on the other hand, to tackle these structural issues of international investment law, the proposed DPM models effectively grant investors further privileges, this time embedded in domestic laws. Emerging empirical data from developing states reveals that DPM agencies operate as a form of institutional bypass enabling investors to side-step the problems that affect the national judicial and administrative system, which others cannot avoid.[23] This opens DPMs to charges of operationalizing "justice bubbles for the privileged"[24] and entrenching "special rights for special people."[25] Although the *Draft Legislative Guide* envisages a model that treats domestic and foreign investors equally, there are reasons to be wary that such mechanisms will favor the interests of investors over those of others. Domestic investors cannot use the threat of ISDS to resolve a grievance in the same way foreign investors can.

Another crucial feature of DPMs is the fact that they empower investors from an earlier stage of conflict, before it transforms into a fully blown ISDS dispute. The effect is to broaden the "focal points" effect of investment treaties: even if investment treaties are not expected to be used directly in the domestic dispute prevention process, they can help indirectly by shaping the contours of default solutions.[26] Investment treaties historically sought to internationalize property right protections provided in Western legal systems and thus facilitate "the crystallization of principles of international law, with respect to the treatment of companies."[27] DPMs seek to square the circle by domesticating these privileges in national legal and constitutional settings of host states across the globe, and thus extending such privileges to a pre-ISDS stage of investor-state relations. Although dispute prevention, portrayed as a national solution to ISDS problems, is located primarily outside investment treaty law, it hinges on investment treaties as a focal point; as long as ISDS provides investors with an avenue for obtaining *ex post* compensation, DPMs effectively institutionalize and embed *ex ante* investor rights to "pressure, cajole and threaten States from taking measures adverse to their interests."[28]

As noted above, international investment law has already been extensively critiqued for operating as a form of legal enclave by creating and preserving legal entitlements for privileged classes of foreigners. DPMs should be understood as a related, but different sort of enclave: they do not always supersede domestic law but are enabled by it. While international investment law works by both "decentring national states yet relying upon state legal forms in order to maintain the high priority accorded to the rights of global capital,"[29] DPMs are the product of

[22] Jonathan Bonnitcha & Zoe Phillips Williams, *The Impact of Investment Treaties on Domestic Governance in Developing Counties*, 2 Law & Pol'y 140, 159 (2024).

[23] *Id.* at 157.

[24] Anil Yilmaz-Vastardis, *Justice Bubbles for the Privileged: A Critique of the Investor-State Dispute Settlement Proposals for the EU's Investment Agreements*, 6 London Rev. Int'l L. 279 (2018).

[25] J. Benton Heath, *The Anti-reformist Stance in Investment Law*, 24 J. World Invs. & Trade, 564, 571 (2023).

[26] Lauge N. Skovgaard Poulsen, *Beyond Credible Commitments: (Investment) Treaties as Focal Points*, 64 Int'l Stud. Q. 26, 29 (2020).

[27] *Id.*

[28] Heath, *supra* note 25.

[29] David Schneiderman, Resisting Economic Globalization: Critical Theory and International Investment Law 49 (2013).

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international investment legality grafted onto and operationalized in national law. Moreover, the domestication of privileges and safeguards for foreign investors through national laws acts to shield the enclave of investment law: since the benefits that DPMs confer on foreign investors are enshrined in domestic laws rather than investment treaties, they may remain effectively obscured, hidden from the gaze of those involved in the contestation and reform of the international investment regime.

Empowering Foreign Investors and Exacerbating Governance Distortions

The DPM agenda is an example of transnational legal process in action, whereby transnational actors create "legal rules and models that reconfigure the respective roles of the state, the market and other forms of social ordering"[30] and thereby "promote new architectures of the state."[31] By treating investment protection as a policy objective that deserves high priority—in particular where an investor grievance is caused by the clash between commercial interests and public policy measures—DPMs often go further in protecting investor interests than international investment law or even the domestic constitutional regimes of Western states.

For example, neither the UNCITRAL's *Draft Legislative Guide* nor the World Bank's model adequately consider the role of other non-investor stakeholders, or how their interests in relation to investment disputes should be represented.[32] While both models acknowledge that some investor grievances may arise due to a clash between the interests of investors and public policy objectives, there is no indication as to how these competing objectives are to be reconciled in the work of DPMs. This creates the risk of undermining democratic processes and altering the ways in which governments balance investors' interests against those of the broader public.[33] The concentration of decision-making prerogatives within a dispute prevention agency creates the risk that issues of significant economic magnitude and public policy importance will be addressed through non-transparent processes.[34]

In the end, dispute prevention mechanisms, as currently conceived, may exacerbate governance distortions. ISDS has been extensively criticized for the lack of transparency, accountability, and predictability of its outcomes;[35] DPMs closely mirror the way international investment law empowers investors by enabling the latter to resolve disputes outside existing adjudicatory processes. By placing the emphasis on political solutions, to be found outside the formal legal frameworks, DPMs effectively enable not just ordinary bargaining, but "bargaining in the shadow of the law"[36]—enabled by the institutional mandate of a DPM, but beyond the reach of transparency and accountability safeguards. For instance, empirical evidence from the earlier studies of national DPMs reveal that to resolve investor grievances, competent authorities are expected to deploy ad hoc, informal solutions—as one interviewee put it, solutions that "may have no basis in law."[37] Concerns have been raised that pre-dispute settlements fall outside the traditional mechanisms of bureaucratic accountability.[38] Rather than

[30] Gregory Shaffer, *Transnational Legal Process and State Change*, 37 L. & Soc. Inquiry 229, 243–44 (2012).

[31] *Id.* at 245

[32] *See* Lise Johnson, Lisa Sachs & Ella Merrill, *Investor-State Dispute Prevention: A Critical Reflection*, 75 Disp. Resol. J. 107 (2021).

[33] *Id.*

[34] *Id.*

[35] Thomas Schultz & Cédric Dupont, *Investment Arbitration: Promoting the Rule of Law or Over-empowering Investors? A Quantitative Empirical Study*, 25 Eur. J. Int'l L. 1147 (2014).

[36] Srividya Jandhyala, *The Politics of Investor-State Dispute Settlement: How Strategic Firms Evaluate Investment Arbitration*, *in* Handbook of International Investment Law and Policy 1 (Julien Chaisse, Leïla Choukroune & Sufian Jusoh eds., 2020).

[37] Sattorova, *supra* note 7, at 78.

[38] Jonathan Bonnitcha & Zoe Philips Williams, *Investment Dispute Prevention and Management Agencies: Toward a More Informed Policy Discussion*, IISD, at 10 (2022).

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addressing the systemic governance issues at the heart of ISDS, the dispute prevention agenda may propagate them on the domestic plane.

Conclusion

At a time when ISDS continues to attract significant criticism, questions arise whether expanding investor privileges to a pre-dispute stage would reduce host state exposure to investor claims. As the resurgence of the DPM agenda coincided with the recent wave of reform efforts, it is important to scrutinize which proposals are likely to solve the problems of the investment treaty regime and which will service to entrench them. Although UNCITRAL's *Draft Legislative Guide* ultimately faced opposition at the WGIII session in March 2023,[39] dispute prevention is likely to remain a significant piece of the broader investment governance reform agenda. While the notion of dispute prevention continues to exert its pull, in practice the proposed models reinforce and extend special enclaves for foreign investors without addressing the foundational concerns over the impact of ISDS on the scope of the state's authority over its internal affairs.

[39] UNCITRAL, Report of Working Group III (ISDS Reform) on the Work of Its Forty-Fifth Session, paras. 48–51, UN Doc. A/CN.9/1131 (Apr. 14, 2023).

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