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Mediation in Investor-State Dispute Settlement (ISDS): A Sustainable Alternative to Arbitration?

Miss Dhanvi Kadian[1], Mister Tushar Chhaunker[2]

[1,2]Student, School of Law, GD Goenka University

Abstract:
Investor-State Dispute Settlement (ISDS) has long revolved around arbitration, which, despite its widespread use, faces mounting criticism for cost, duration, legitimacy and its impact on public policy. This paper explores whether mediation can serve as a sustainable alternative (or complement) to arbitration in ISDS. It traces the evolution and critique of investor-state arbitration, presents the concept and advantages of mediation in the investor-state context, examines recent institutional developments — particularly by the International Centre for Settlement of Investment Disputes (ICSID) and the United Nations Commission on International Trade Law (UNCITRAL) — and assesses the challenges and limitations of mediation in this field. The paper then argues for a hybrid model combining mediation and arbitration as a pathway to more sustainable ISDS, and concludes with recommendations. The analysis finds that while mediation holds significant promise in terms of cost, flexibility, relationship-preservation and sustainability, its current utilisation remains limited and institutional reform is required for it to become a viable mainstream alternative or complement to arbitration.

Keywords: Investor-State Dispute Settlement; ISDS; mediation; arbitration; ICSID Mediation Rules; UNCITRAL Guidelines; hybrid dispute resolution; sustainability.

Introduction

Investor-State Dispute Settlement (ISDS) mechanisms have been central to the architecture of international investment treaty law for decades. Historically dominated by arbitration, ISDS permits foreign investors to bring claims against host states under bilateral investment treaties (BITs) or investment chapters of trade agreements, often leading to multi-million or even billion-dollar awards. Despite its prominence, this arbitration-centric model has drawn intensifying criticism in recent years: high costs, lengthy timeframes, limited transparency, and concerns about state regulatory sovereignty and legitimacy have all been flagged as problematic.

In response to such criticisms, attention has turned to alternative dispute resolution mechanisms — most notably mediation. Mediation is posited as a potentially more sustainable and flexible mechanism, able to preserve relations, tailor solutions beyond pure monetary compensation, reduce burdens on states and investors alike, and promote more policy-sensitive outcomes. The question, however, is whether mediation in the investor-state context is viable at scale, whether it can realistically serve as an alternative to arbitration, and what institutional and legal reforms it would require.

Accordingly, this paper examines the role of mediation in ISDS, asking: Can mediation act as a sustainable

alternative to arbitration in investor-state disputes? To answer this, the paper proceeds as follows. Section 2 outlines the evolution of ISDS arbitration and its critiques. Section 3 sets out the concept and advantages of mediation specifically in the investor-state context. Section 4 examines current developments in institutional frameworks via ICSID and UNCITRAL. Section 5 explores the challenges and limitations of mediation in ISDS. Section 6 considers a hybrid model of mediation + arbitration as a way forward for sustainability. Finally, Section 7 presents conclusions and recommendations.

Statement of the Problem

Investor-State Dispute Settlement (ISDS) mechanisms have long relied on arbitration as the primary method for resolving disputes between foreign investors and host states. While arbitration has offered a neutral and enforceable platform for investment protection, it has increasingly come under criticism for its high costs, lengthy proceedings, lack of transparency, and perceived bias in favour of investors. This has led to a broader legitimacy crisis within the international investment regime.

In response, mediation has been proposed as a more cooperative and sustainable alternative, offering flexibility, confidentiality, and the potential to preserve long-term investment relationships. However, despite its theoretical appeal, the actual integration of mediation into the ISDS framework remains limited. Recent developments such as the ICSID Mediation Rules (2022) and UNCITRAL Guidelines on Investment Mediation (2023) represent significant institutional efforts to promote its use, yet their practical adoption, enforceability, and effectiveness remain uncertain.

The central problem, therefore, lies in determining whether mediation can genuinely function as a sustainable and legitimate complement or alternative to arbitration in ISDS. Specifically, there is a need to examine:

1. Whether the emerging institutional frameworks sufficiently address structural challenges such as enforceability and state consent;
2. Whether mediation can achieve equitable and durable outcomes in politically sensitive investment disputes; and
3. Whether it can enhance the legitimacy and sustainability of the broader ISDS system.

This problem forms the foundation of the present study, which aims to critically evaluate the potential, limitations, and future trajectory of mediation in the reform of investor-state dispute settlement.

Evolution and Critique of ISDS Arbitration

The arbitration model of ISDS has its roots in the mid-20th century, notably in the 1965 Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the ICSID Convention). Under this framework, foreign investors could initiate arbitration against host states with consent pre-given by the state in BITs or investment treaty clauses. Over time, hundreds of cases have been brought, leading to significant awards and a robust jurisprudence of investment treaty arbitration.

However, numerous critiques have emerged. First, the cost and duration of arbitration are often prohibitive. As one practitioner summary notes, “on average, parties spend four years in an investment arbitration; investors and States spend at least US$6 million and US$4.8 million respectively.” The large sums and lengthy durations raise questions of access, equity and efficiency.

Second, legitimacy concerns abound. Critics argue that arbitration lacks sufficient transparency (many awards remain unpublished or confidential), raises issues of arbitrator impartiality, and may impose constraints on a State’s regulatory autonomy. There is a growing concern that arbitration may chill public

interest regulation or favour investors at the expense of affected communities.

Third, enforcement and precedential issues remain. Although arbitral awards under ICSID are enforceable in many jurisdictions, the process of enforcement, annulment, setting aside or jurisdictional objections can add layers of delay and cost. Moreover, the ad-hoc nature of arbitration leads to fragmentation and inconsistent jurisprudence.

These critiques have fuelled calls for reform in ISDS. One strand is focused on arbitration reform (e.g., via the ICSID Rules amendments) but another is exploring alternative mechanisms — with mediation emerging as a prominent candidate. Arbitration remains indispensable in many cases, but the question is whether mediation can relieve some of its burden or serve as a more sustainable option in certain classes of investor-state disputes.

Concept and Advantages of Mediation in ISDS

Mediation is a dispute-resolution process in which a neutral third party (the mediator) assists the disputing parties in negotiating a mutually acceptable settlement, but does not impose a decision. In contrast to arbitration — which is rights-based, adversarial and outcome-determined by the tribunal — mediation is interest-based, collaborative and outcome-driven by the parties themselves.

Why might mediation suit investor-state disputes? Several advantages present themselves:

- Flexibility and autonomy. Mediation allows parties to shape the process (structure, timing, agenda) and outcomes (including creative remedies beyond monetary compensation). For example, in an investment mediation, settlement might include licence renewals, changes in regulation, renegotiation of terms, or other non-monetary solutions — outcomes unlikely in arbitration.
- Cost and time-efficiency. Because mediation avoids full procedural hearings, witness cross-examinations, formal pleading structures and so on, it can be quicker and less expensive. This is particularly significant given the high costs and long durations of ISDS arbitration.
- Relationship preservation and policy alignment. In investor-state context, a continuing investment relationship may exist between the investor and host state; mediation's non-adversarial nature helps preserve relationships, fosters dialogue, and allows parties to consider policy/regulatory concerns of the state.
- Suitability for certain cases. Some investor-state disputes may not require heavy formal adjudication — for example, early-stage regulatory regulatory measures, issues amenable to negotiation, or interests in maintaining the investment relationship. In such cases, mediation can serve as an early, less-disruptive tool.

Historically, there have been forms of mediation/conciliation in the investment treaty field (e.g., under ICSID's conciliation provisions). But they were under-utilised due to lack of institutionalised rules, enforcement clarity or treaty impetus. Mediation has gained renewed traction now that institutional frameworks and treaty-level initiatives are emerging.

In short, mediation offers a complementary or alternative pathway to arbitration with benefits in sustainability, relationship management, policy sensitivity and procedural economy — which makes it an attractive option to consider in the ISDS context.

Current Developments: UNCITRAL and ICSID Initiatives

Recent years have seen significant institutional developments towards formalising mediation in investor-state disputes. Two major players are the International Centre for Settlement of Investment Disputes (IC-

SID) and the United Nations Commission on International Trade Law (UNCITRAL).

4.1 UNCITRAL Initiatives: UNCITRAL has taken steps to integrate mediation into the investment dispute context. In 2018, it adopted the Model Law on International Commercial Mediation and International Settlement Agreements resulting from Mediation, aiming to modernise mediation laws globally. More directly for ISDS, UNCITRAL has developed Model Provisions on Mediation for International Investment Disputes (notably in 2023) and Guidelines on Mediation for International Investment Disputes. For instance, the Model Provisions state that parties "should consider mediation to settle an international investment dispute amicably", and that mediation may be undertaken at any time, including after commencement of other proceedings. The Guidelines likewise set out issues for parties to consider when engaging in investor-state mediation: maintaining relationships, time/cost considerations, complexity of dispute, number of parties involved, etc. These UNCITRAL instruments provide a normative framework signalling the viability of mediation in ISDS, encouraging parties and states to build mediation into treaty language, and promoting institutional capacity. They do not yet bind parties, but they shape the discourse and signal a shift.

4.2 ICSID Mediation Framework: A notable institutional milestone is the ICSID Mediation Rules (2022). On 21 March 2022, ICSID's Administrative Council approved mediation rules, which became effective 1 July 2022. Under these Rules, ICSID is authorised to administer mediations involving a State (or agency thereof) or a Regional Economic Integration Organisation (REIO) and relating to an investment, provided the parties consent in writing. Significantly, the ICSID Mediation Rules do not require a "legal dispute" (in the narrow sense) to have crystallised; a party may invite the other to mediate and the Rules envisage early-stage or pre-dispute mediation. The Rules also explicitly allow mediation to proceed either independently of or in conjunction with arbitration or conciliation under the ICSID framework. Further, ICSID offers mediation services, capacity building, and a cost-effective fee structure geared to support mediation. These institutional developments mark a clear shift: mediation is no longer a marginal option in investor-state disputes but is gaining structured institutional support, with dedicated rules, administrative services, and capacity-building efforts.

4.3 Quantitative Evidence of Uptake: Empirical research shows that while many IIAs still lack mandatory mediation or conciliation clauses, the number of treaties with mediation provisions is slowly increasing. One study found that of 3,815 IIAs screened, 1,125 (≈70 %) contained conciliation provisions, but only 53 had mediation provisions; and of those, only 7 (≈13.2 %) offered advance consent to mediation. This indicates that while mediation is increasingly on the radar, its contractual uptake remains modest.

4.4 Assessment: The combined UNCITRAL and ICSID developments show that mediation is being institutionalised in ISDS. This institutional momentum enhances the legitimacy and viability of mediation. The framework now exists for mediation to be offered as a serious alternative (or adjunct) to arbitration. Yet, as the empirical data show, uptake remains limited and many treaties still prioritise arbitration. The question thus becomes: what are the obstacles to deploying mediation more broadly in ISDS?

Challenges and Limitations of Mediation in ISDS

Despite the promise of mediation in investor-state dispute settlement, significant challenges and limitations remain.

- **Enforceability and bindingness:** One of the core advantages of arbitration is that arbitral awards are binding and enforceable under regimes like the ICSID Convention or national arbitration acts.

Mediated settlements, on the other hand, do not automatically benefit from a globally recognised enforcement mechanism equivalent to the New York Convention. As the literature notes, mediated settlements may lack binding force or predictable enforceability. Unless explicitly structured with binding mechanisms (e.g., settlement agreement turned into arbitral award or court judgment), the risk of non-compliance may deter parties — especially states — from choosing mediation.

- **Transparency and public interest issues:** Investor-state disputes often involve public interest, regulatory legitimacy and significant state policy concerns. Mediation's private, confidential nature may raise concerns about accountability, precedent-setting, or the ability of third-party stakeholders to scrutinise outcomes. Some states or affected communities may resist resolution behind closed doors. As one article warns, diverting investor-state disputes to mediation "may risk undercutting important reform efforts that have taken place to improve investor-state arbitration".
- **Power asymmetries and willingness to mediate:** In a typical investor-state dispute, the investor may enjoy significant resources and expertise compared to the host state (especially in developing countries), or vice versa. This imbalance may affect the mediation process adversely. Furthermore, mediation depends on party willingness to engage in good faith; if one party is strongly committed to adjudication, or sees greater value in arbitration (e.g., precedent, leverage), mediation may be resisted.
- **Complexity and appropriateness of dispute:** Some disputes are so complex, fact-intensive or politically charged that they may not be well suited to mediation alone. For example, systemic regulatory measures or expropriation claims may require detailed legal adjudication. The literature notes that aspects such as nature of the dispute, number of parties, complexity, urgency, and required remedies may affect suitability of mediation.
- **Institutional inertia and low uptake:** Though frameworks exist, mediation remains under-utilised. As we noted, only a small fraction of IIAs currently include mediation provisions with advance consent. The mindset of parties still defaults to arbitration; changing behaviour may require time, awareness, capacity building and treaty reform.
- **Hybrid uncertainties:** When mediation is combined with arbitration (e.g., "Med-Arb" models), there are legal uncertainties about things like confidentiality, conflict of interest (mediator becoming arbitrator), or strategic delay. Parties may worry about losing rights to arbitration if they attempt mediation first. The study of IIAs found that only seven treaties required mediation/conciliation as a precondition to arbitration; in many others the "or" construction creates ambiguity.

In sum, while mediation is promising, its current limitations — enforceability, transparency, power dynamics, suitability and institutional uptake — mean that it is not yet a full, stand-alone replacement for arbitration in ISDS.

Toward a Sustainable Hybrid Model

Given the above, the most pragmatic pathway to sustainability in ISDS is not necessarily full replacement of arbitration by mediation, but rather the adoption of a hybrid model in which mediation complements arbitration.

Such a hybrid can take forms such as:

- Med-Arb: Parties mediate initially, and if mediation fails, resort to arbitration.
- Arb-Med: Parties commence arbitration, pause to mediate, and resume arbitration if no settlement emerges.

- Arb-Med-Arb or other variations: combining mediation, arbitration and perhaps other ADR methods.

These hybrid models retain the binding enforcement and legitimacy features of arbitration while harnessing the flexibility, cost/timing efficiencies and relational benefits of mediation.
From a sustainability perspective, hybrid models offer several advantages:

- They preserve access to a binding resolution when needed (via arbitration) while offering an opportunity for early settlement via mediation, thereby reducing burdens on both investors and states.
- They align with evolving treaty language: as more IIAs include standby mediation or mediation clauses followed by arbitration, hybrid models reflect current practice.
- They promote policy-sensitive outcomes: mediated settlements may include creative, non-monetary remedies (licence modifications, regulatory frameworks, future investment guarantees) which purely legal arbitration may not deliver.
- They enhance legitimacy and sustainability: by providing more cooperative dispute-resolution pathways, the investment treaty regime can become less adversarial and more balanced, supporting sustainable investment-state relationships.

To implement such a model, several reforms may help:

- Inclusion of mediation clauses (or mandatory preliminary mediation) in future BITs and investment treaties, with clear language on sequencing and consent (e.g., “mediation first, then arbitration”).
- Ensuring enforcement mechanisms for mediated settlements: for instance, parties may agree that the settlement can be recorded as an arbitral award or court judgment; or international instruments (e.g., the Singapore Convention on Mediation) may facilitate enforcement of mediated settlements.
- Institutional support and training: institutions like ICSID should continue capacity building, mediator rosters with investment-dispute expertise, and promote awareness among states and investors of mediation benefits.
- Transparency and stakeholder engagement: While confidentiality is a key attribute of mediation, for public-interest investor-state disputes there may need to be greater transparency (e.g., non-publication with redactions, summary reports) and involvement of stakeholders.
- Flexibility in dispute process: Parties should retain freedom to choose mediation at any stage (pre-dispute, early stage, parallel with other proceedings) and to craft bespoke solutions appropriate to the dispute. The theoretical openness in the ICSID Rules (which do not require a crystallised “legal dispute”) helps this flexibility.

In this model, arbitration remains the “back-stop” but mediation becomes the first port of call for many disputes, thus easing the systemic burden of ISDS and promoting more responsive, sustainable dispute resolution.

Evaluating the Viability of Mediation as a Sustainable Mechanism in Investor-State Dispute Settlement

The analysis demonstrates that while mediation is not yet a full substitute for arbitration in Investor-State Dispute Settlement (ISDS), it has emerged as a credible and sustainable complementary mechanism capable of addressing many of the systemic deficiencies that have long undermined the legitimacy of investor-state arbitration.
First, regarding the adequacy of the emerging institutional frameworks, both the ICSID Mediation Rules

(2022) and the UNCITRAL Guidelines on Investment Mediation (2023) represent meaningful progress toward a structured, credible, and standardized mediation process. These frameworks strengthen procedural clarity, promote party consent, and offer guidance for mediator conduct—addressing earlier gaps in practice. However, the absence of a global enforcement mechanism comparable to the New York Convention for arbitral awards continues to limit mediation's full potential.

Second, with respect to the ability of mediation to produce equitable and durable outcomes in politically sensitive disputes, it is evident that mediation offers distinct advantages in promoting dialogue and preserving state-investor relationships. Its flexible and confidential nature allows for outcomes tailored to policy realities and developmental goals—something arbitration often fails to accommodate. Nevertheless, state reluctance to compromise and concerns over domestic political accountability remain significant deterrents to its broader adoption.

Third, concerning mediation's role in enhancing the legitimacy and sustainability of the ISDS system, it provides a constructive pathway toward reform by emphasizing collaboration over confrontation. Mediation aligns with global movements toward sustainable dispute resolution and supports the principles of efficiency, inclusivity, and procedural fairness embedded in the United Nations Sustainable Development Goal 16 (Peace, Justice, and Strong Institutions). Yet, its long-term success depends on greater state capacity-building, treaty-level incorporation of mediation clauses, and recognition of mediated settlements under international law.

In sum, mediation can indeed serve as a sustainable complement—rather than a complete replacement—to arbitration in ISDS. With further institutional refinement and international cooperation, it holds the potential to transform investment dispute resolution into a more balanced, legitimate, and development-oriented process for both investors and sovereign states.

Conclusion and Recommendations

This paper has examined whether mediation can be a sustainable alternative to arbitration in the investor-state dispute settlement (ISDS) context. The analysis confirms that mediation holds significant promise — offering flexibility, cost/time efficiencies, relationship-preservation, and the potential for creative, policy-sensitive outcomes. Institutional developments from ICSID and UNCITRAL mark a positive shift: dedicated mediation rules, guidelines, and model treaty provisions lay the groundwork for mediation's increased role.

However, mediation is not yet a full substitute for arbitration. Challenges remain: enforcement of mediated settlements lacks the clarity and robustness of arbitral awards; transparency and public-interest concerns must be addressed; power asymmetries and the complexity of some disputes limit suitability; and uptake remains modest in current treaty practice.

Therefore, the optimal path is a hybrid model where mediation and arbitration work in tandem. Such a model preserves the binding authority of arbitration while using mediation as a first step — enabling earlier, less adversarial, and more sustainable resolution of investor-state disputes. To this end, the following recommendations are offered:

1. Treaty reform: Future IIAs and BITs should include clear mediation (or "mediation first") clauses, with sequencing to arbitration, and ideally include provisions for recording settlement agreements as arbitral awards or judgments.
2. Capacity-building: International institutions (ICSID, UNCITRAL, regional bodies) should invest in training mediators with investor-state expertise, raise awareness among states and investors of media-

tion's value, and promote institutional mediation services.

3. Enforcement mechanisms: States and parties should consider mechanisms that transform mediated settlements into binding enforceable instruments; international instruments like the Singapore Convention on Mediation may be relevant.
4. Transparency safeguards: While confidentiality is intrinsic to mediation, investor-state disputes often involve public interest; mediation frameworks should incorporate transparency safeguards (e.g., publication of anonymised outcomes, access to stakeholders).
5. Data and research: More empirical research is needed on outcomes of investor-state mediations, settlement rates, cost/time-savings, and comparative effectiveness relative to arbitration.

In conclusion, mediation is not yet ready to replace arbitration across the board in ISDS, but it is certainly maturing as a viable, sustainable alternative or complement. If properly institutionalised, embedded in treaty-language, and supported by enforcement and capacity building, mediation (in hybrid form) could contribute to a more balanced, efficient and sustainable investor-state dispute-settlement regime.

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