

Between Aspirations and Reality:
The European Union and International
Investment Law Reform

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Declaration

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Ivana Damjanovic

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Abstract

International investment law, as a subsystem of international law for the protection of foreign investors, is at a crossroads. Public and political controversies prompted a number of reform processes, most significantly the multilateral reform of Investor–State Dispute Settlement (ISDS) in the framework of the UN Commission on International Trade Law. The EU, as an emerging actor in the field, has proposed the establishment of a new Multilateral Investment Court as part of the ISDS reform in the EU and international law.

This research evaluates the contribution of the EU to the development of international law in the field of investment, and in particular it assesses whether the ISDS reforms of the EU address the international investment law problems and contribute to the achievement of the rule of law and legitimacy as the reform’s normative goals. In order to answer this question, this dissertation provides a substantial analysis of EU investment law and policy in the broader context of international investment law and its reform. The investment reform of the EU is the expression of the constitutional aspiration of the EU to promote multilateral solutions to common ISDS problems. In reality, the EU faces a number of challenges, stemming from the external complexities of international investment law and multilateral governance; as well as the internal limitations of the EU’s own constitutional and legal framework.

The approach of the EU to the legal regulation of investment is a pragmatic but ambitious long-term strategy for achieving the EU’s internal integrationist and external trade objectives. Its vision of international investment law is a trade-off between aspirational EU values and its commercial objectives, with a fragmentary contribution to the international rule of law and the legitimacy of international investment law. The ongoing multilateral reform process remains a test for the EU to establish a new international court at times when both international law and multilateralism face significant challenges.

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"Tant de têtes, tant d'avis". Allegory on the Difficulty of Governing

Pieter van der Borch
 Antwerp, circa 1578, Print Room, S.I 1673¹

¹ Picture taken by the author at the exhibition 'Prints in the Age of Bruegel', BOZAR, Brussels, February 2019

Not every solution is an answer to a problem.

David Helbich, Belgian Solutions, Volume 1, 2016

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List of Abbreviations

AG	Advocate General
AIIB	Asian Infrastructure and Investment Bank
APEC	Asia–Pacific Economic Cooperation
BIT(s)	bilateral investment treaties
BRI	Belt and Road Initiative
BRIC(S)	Brazil, Russia, India, China (and South Africa)
CAJAC	China–Africa Joint Arbitration Centre
CARIFORUM	Caribbean Forum
CCSI	Columbia Center on Sustainable Development
CEE	Central and Eastern Europe
CEO	Chief Executive Officer
CETA	Comprehensive Economic and Trade Agreement (EU–Canada)
CFR	EU Charter of Fundamental Rights
CFSP	Common Foreign and Security Policy
CIETAC	China International Economic Trade Arbitration Commission
CIL	customary international law
CCIAG	Corporate Counsel International Arbitration Group
CCP	Common Commercial Policy
CIDS	Center for International Dispute Settlement
CJEU	Court of Justice of the European Union
CPTPP	Comprehensive and Progressive Agreement for Trans-Pacific Partnership
CUP	Cambridge University Press
EAC	East African Community
EC	European Commission
ECR	European Court Reports
ECHR	European Convention on Human Rights
ECtHR	European Court of Human Rights
ECT	Energy Charter Treaty
EEA	European Economic Area
EEC	European Economic Community
EFTA	European Free Trade Association
EP	European Parliament
EPA	Economic Partnership Agreement
ESA	Eastern and Southern Africa
EU	European Union
(EU) IIP	international investment policy of the European Union
EUSFTA	EU–Singapore Free Trade Agreement
EUSIPA	EU–Singapore Investment Protection Agreement
EUVIPA	EU–Vietnam Investment Protection Agreement
FCN(s)	Treaties of Friendship, Commerce and Navigation
FDI	foreign direct investment

FET	fair and equitable treatment
FMV	free market value
FTA(s)	Free Trade Agreement(s)
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GFC	Global Financial Crisis
HKIAC	Hong Kong International Arbitration Centre
IBA	International Bar Association
ICC	International Chamber of Commerce
ICJ	International Court of Justice
ICS	Investment Court System
ICSID	International Centre for the Settlement of Investment Disputes
IIA(s)	international investment agreements
IIL	international investment law
IIR	international investment regulation
IIED	International Institute for Environment and Development
IISD	International Institute for Sustainable Development
ILC	International Law Commission
ILO	International Labour Organization
IMF	International Monetary Fund
INTA	The Committee on International Trade of the European Parliament
IPA	Investment Protection Agreement
IRP	intellectual property rights
ISDS	investor–State dispute settlement
ITA	investment treaty arbitration
MAI	Multilateral Agreement on Investment
MIA	Multilateral Investment Agreement
MIC	Multilateral Investment Court
MIRA	Multilateral Investment Reform Agreement
MFN	most favoured nation clause
MLI	Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Sharing
MNE(s)	multinational eEnterprise(s)
MST	minimum standard of treatment
NAFTA	North America Free Trade Agreement
NGO(s)	non-governmental organizations
NIEO	New International Economic Order
NT	national treatment
OBOR	One Belt One Road
OECD	Organization for Economic Cooperation and Development
OJ	Official Journal
OUP	Oxford University Press
PCA	Permanent Court of Arbitration
PCIJ	Permanent Court of International Justice (replaced by ICJ)

PNG	Papua New Guinea
QMV	qualified majority voting
SAA	Stabilisation and Association Agreements
SADC	Southern African Development Community
SCC	Stockholm Chamber of Commerce
SMEs	small and medium size enterprise(s)
SRF	Silk Road Fund
TEU	Treaty on European Union
TFEU	Treaty on the Functioning of the European Union
TPP	Trans-Pacific Partnership
TRIPS	Agreement on Trade-Related Aspects of IPR
TSD	trade and sustainable development
TTIP	Transatlantic Trade and Investment Partnership (EU-US)
UNCITRAL	United Nations Commission on International Trade Law
UNCLOS	United Nations Convention on the Law of the Sea
UNCTAD	United Nations Conference on Trade and Development
UNGA	United Nations General Assembly
UNTS	United Nations Treaty Series
UK	United Kingdom
US	United States
USMCA	United States–Mexico–Canada Agreement
VCLT	Vienna Convention on the Law of Treaties
WG	Working Group
WTO	World Trade Organization
WWII	World War II

INTRODUCTION

International investment law (IIL) has reached crossroads. Public and political controversies over the Investor-State Dispute Settlement (ISDS) have prompted a number of reform processes in the international regulation of investment. As an emerging actor in this field, the European Union (EU) has been particularly active in the reform debate, proposing a new institutional structure to address identified ISDS concerns. This research aims to make a substantial contribution to this debate by examining the extent to which the ISDS reforms of the EU could address its own and the global ISDS problems. The analysis of EU law and policy solutions in the regulation of investment in this research is undertaken in light of the ISDS controversies, the EU constitutional and legal framework, and the rule of law and legitimacy as the reform's normative goals. In doing so, this dissertation evaluates the contribution of the EU to the development of international law in the field of investment.

This introductory chapter will explain the framework and goals of the research. First, the rationale and the main objectives of the research will be presented through an overview of the fundamental issues in the ISDS reform contexts in the EU and multilaterally. How this dissertation seeks to address those questions will be explained in the methodology section. The final part of this chapter outlines the structure of the dissertation.

(i) Fundamental issues and the objectives of the research

The aspiration(s): the EU and multilateralism

The aspirations of the EU as a normative power are defined in its founding treaties. The Lisbon Treaty of 2009 confirmed the EU's commitment to multilateralism, development of international law and good global governance when developing and implementing foreign policies.¹ These principles equally apply to the Common Commercial Policy (CCP) within which the EU maintains trade relations with the wider world. Accordingly, they have been incorporated in the 'deep' trade agenda of the new post-Lisbon generation of EU bilateral trade agreements that, following the failure of the WTO Doha round, replaced the earlier multilateral strategy of the EU.

¹ Arts 3(5) and 21(1)(h) Treaty on the European Union (consolidated) [2010] OJ C83/13 (TEU).

The Lisbon Treaty has also extended the scope of the CCP to foreign direct investment (FDI).² This change introduced the EU to the field of investment, traditionally occupied by the Member States, and opened a new chapter of international investment policy in Europe. The Lisbon Treaty changes have thus set the platform for the EU to become an international player in the field of foreign investment, as part of the EU broader external trade agenda.

At the time when these changes take place, IIL had already been facing an extensive global public controversy. Protests against the ISDS system, as the most notorious aspect of IIL, took place in the broader context of globalisation fatigue in the aftermath of the Global Financial Crisis (GFC). Mega trade agreements, such as the Trans-Pacific Partnership (TPP) for Pacific nations (excluding China)³ and the Transatlantic Trade and Investment Partnership (TTIP) for Atlantic nations (US and the EU), were strongly opposed on the basis that they included ISDS and promoted capital interests. On the other hand, in the aftermath of the GFC, global capital was seen by States as a condition of economic recovery, and ISDS as an important tool for attracting foreign capital.

In developing its international investment policy (IIP), and in line with its constitutional framework, the EU must comply with international law, while being an active player in promoting an international system based on multilateralism and good global governance. Moreover, the EU is called upon to 'promote multilateral solutions to common problems, in particular in the framework of the United Nations'.⁴ The approach of the EU to the reform of IIL is the expression of the EU aspiration to promote multilateral solutions to the global ISDS problems in the framework of the UN Commission on International Trade Law (UNCITRAL). The new EU investment policy should strive not only to resolve the ISDS crisis in the EU but also globally.

Could the EU, as an emerging actor in the field, become a global actor that transposes its regional ISDS solutions to the multilateral level, and in doing so achieves not only its own external trade objectives but also safeguards the international rules-based order? In addressing this issue, this research explores how are the EU aspirations challenged by the realities of IIL externally, the EU's limited investment sovereignty internally, and the complexities of the investment reform that is taking place in the broader international relations context.

² Art 207 Treaty on the Functioning of the European Union (consolidated) [2010] OJ C83/47 (TFEU).

³ In its original form, the parties to this agreement were Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, Peru, New Zealand, Singapore, the United States and Vietnam. In the meantime, in 2018 the agreement was signed as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) without the participation of the USA.

⁴ Art 21(1) TEU, second sentence.

The problem: international investment law between law and politics

IIIL sets standards by which States must treat foreign investors. These standards include substantive rights, such as protections against expropriation and discrimination, fair and equitable treatment, and free transfer of capital. Procedural rights in the form of ISDS, which give foreign investors as private individuals the option to sue their host State before a tribunal that is independent from the host State, is the most significant and the most notorious aspect of IIIL.

IIIL lacks a multilateral legal basis and a central authority. Over 2500 different international investment agreements (IIAs) that are in force are interpreted by hundreds of *ad hoc* tribunals, with no appellate mechanism to check for the correctness and consistency of investment awards. Due to the factual and legal specifics of investment claims and IIAs under which these claims are submitted, the jurisprudence stemming from investment awards is diverse and often inconsistent in displaying the required standards of protection.

At the same time, regardless of the fragmentation, the field functions according to strikingly similar rules and encompasses a narrow legal specialisation. The legal practitioners in the field come mostly from private law backgrounds and bring a different perspective and methods of interpretation to a system that is supposed to reflect public law. Not all legal cultures have been sufficiently represented in this system that has created its own distinct and uniform culture.

The principled idea behind this system was to create a new set of rights and procedures and thus establish a parallel legal system in international law, which would be unilaterally open only to foreign investors. The system was created on a rather simple assumption that it would protect 'good' (Western) investors that were powerless in the hands of 'bad' (decolonised) States, revengeful for the colonial past. It was meant to set the record straight by providing a neutral forum, which could detach the present from the past, and law from politics. In fact, however, it largely institutionalised the application of foreign (Western) law in the new sovereign States.

The colonial origins and its transnational private justice nature did not pose a problem until the system turned against its original creators – the Western States. Globalisation ended the bipolar world of State-controlled and market economies. In the new narrative, capital has become the 'good', and regulatory activity of any State, which can negatively affect interests of the capital, the 'bad'. High profile cases, such as *Loewen*

v USA,⁵ *Vattenfall v Germany I*⁶ and *II*⁷ and *Philip Morris v Australia*,⁸ opened the debate: do we need this legal system alongside the functioning domestic legal systems? On the other hand, what kind of legal and political problems could the abolition of the ISDS system pose for investors in the countries with 'bad' legal systems?

The fundamental question of IIL – what the required standard of protection for foreign investors should be – has not changed over the years. For the developing States, foreigners should not have better protections than the nationals. These thoughts are essentially shared by the developed States, but with the recognition that their legal standards are higher. The challenge of IIL is to provide sufficient protections for foreign investors but not more, beyond the protection guaranteed under the developed legal systems. However, what is a developed legal system is ultimately a value judgement. How are we to reform the system without returning it to its binary colonial origins while sufficiently protecting the globalised capital?

The complexity of this essentially legal reform is further compounded by the new constellation of international relations in the post-Cold War world. Instead of reaching the 'end of history' as predicted by Francis Fukuyama in 1989,⁹ a brave new multipolar world has been created,¹⁰ resulting in a 'new great game' between the US, the EU, China and 'the others'.¹¹ Globalisation has led to the economic decline of the West and the rise of China. The return of the government through State-owned enterprises has increased political concerns. The issues of economic security and foreign investment have become issues of national security. The problems of globalisation have further led to domestic populism in the West, influencing foreign trade and investment policies. Contemporary IIL is accordingly shaped around the divergent interests of States, their domestic constituencies and transnational elites.

International economic law, including IIL, has failed to keep pace with these rapid global changes. In the new COVID-19 reality, legal uncertainties in international trade and investment have only been further increased due to economically invasive State measures and emerging political divisions. The global economy has moved away from a largely

⁵ *Loewen Group, Inc. and Raymond L. Loewen v United States of America*, ICSID Case No. ARB(AF)/98/3.

⁶ *Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG v Federal Republic of Germany (I)*, ICSID Case No. ARB/09/6.

⁷ *Vattenfall AB and others v Federal Republic of Germany (II)*, ICSID Case No. ARB/12/12.

⁸ *Philip Morris Asia Limited v The Commonwealth of Australia*, UNCITRAL, PCA Case No. 2012-12.

⁹ Francis Fukuyama, 'The End of History?' (1989) 16 *The National Interest* 3.

¹⁰ See Lester C Thurow, *The Future of Capitalism: How the Today's Economic Forces Will Shape Tomorrow's World* (William Morrow and Company 1996).

¹¹ Depending on the context, the constellation of the big players can change, often involving also Russia. However, instead of through IIL Russia has found other ways to retain its influence in the countries of the former Soviet Union.

collaborative game into a multiplayer 'zero-sum' game, in which multilateral solutions are difficult, if not impossible.

Although an instrument of public international law, the mixed legal nature of ISDS and its political and economic context compound the complexity of IIL and its reform. This complexity on the one hand explains the fragmentation of the system and the limitations of its multilateral reform. On the other hand, it stimulates us to question the feasibility of a workable reform which could effectively address the array of tensions in this field. The aim of this research is to portray these various existing tensions as challenges for the multilateral ISDS reform. The EU solutions for IIL reform are considered against this broader background and in light of the rule of law and legitimacy as the ISDS reform's normative goals, both in the EU context and globally.

The normative conceptions: ISDS controversy between perceptions and law

Although introduced in the 1960s, the ISDS acronym has become notorious only in the new Millennium. It is now known as a symbol for the citizens' struggle against corporate interests, a synonym for 'a privatised justice system for global corporations',¹² a 'toxic mechanism',¹³ a 'Trojan Horse',¹⁴ and a Pandora's box of all corporate evils against democracy and public good that undermines the sustainable development agenda of national public policies. In addition, the ISDS critics emphasise the arbitration industry, 'the elite club of lawyers behind the scenes',¹⁵ that promotes ISDS for its own interests.

In recent years, ISDS has been subject to much criticism, due to several factors: the rise in the number of ISDS cases, the controversial cases challenging State regulation made in the public interest, and the GFC which has exposed the shortcomings of unregulated markets in more general terms. The perceived shortcomings of the system are both substantive (relating to standards of protection) and procedural (relating to ISDS), and often intertwined.

While the critics would like to see the system abolished, the majority of States have accepted that public controversy and criticism should be addressed through a legal

¹² Thomas Mc Donagh, 'Unfair, Unsustainable, and Under the Radar: How Corporations Use Global Investment Rules to Undermine a Sustainable Future' (*The Democracy Center*, 2013) 8

<<https://www.democracyctr.org/unfair-unstable-and-under-the-radar>> accessed 30 June 2020.

¹³ George Monbiot, 'The lies behind this transatlantic trade deal', *The Guardian* (3 December 2013)

<<http://www.theguardian.com/commentisfree/2013/dec/02/transatlantic-free-trade-deal-regulation-by-lawyers-eu-us>> accessed 30 June 2020.

¹⁴ Matthew Rimmer, 'Trojan Horse Clauses: Investor-State Dispute Settlement', Trade and Foreign Investment (Protecting the Public Interest) Bill 2014, Submission 104 – Supplementary Submission to the Australian Parliament.

¹⁵ Mc Donagh (n 12) 8.

reform, which will improve international investment governance. These reform goals have their normative dimension in the rule of law, as primarily a legal concept, and in legitimacy, as primarily a political concept.

However, the reform debate has been caught between ‘perceptions’ as a subjective concept and ‘law’ as an objective concept. On one side of the spectrum are legal practitioners in the field of arbitration, who insist that the majority of issues are only a matter of perception. They disregard the argument of legitimacy since it is related to politics. At the same time, they approach IIL purely from the perspective of technical legal rules, which are always objective. On the other side are the representatives of civil society who perceive the whole system as unfair, for both political and legal reasons. In their view, any reform is unlikely to fix the systemic problems of IIL. The broader political reality in their scenario does not matter. Most States that participate in the reform are somewhere between these two extreme positions.

This research aims to provide a different perspective on the reform by examining how the issues of the rule of law and legitimacy in IIL intersect. In analysing these concepts as the reform’s normative goals, the focus is placed both on their formal and substantive issues. Rather than excluding legitimacy as political, the aim is to determine the normative dimension of legitimacy and aspects in which legitimacy overlaps with the rule of law. At the same time, the aim is to elucidate the aspects of IIL’s legitimacy that are difficult to resolve through international law. On the other hand, the rule of law is examined not only as an instrument of formal and procedural equality but also a concept with its important substantive dimension, which questions the assumed neutrality of IIL and the perceived bias of arbitration as its dispute settlement mechanism.

In considering the substantive issues of legitimacy and the rule of law, the rather technical legal aspects of IIL are placed in the broader perspective of general international law. In this respect, we consider how the developments in IIL relate to the transition of international law to fragmented positivism, in which technical rules and narrow expertise dominate different fields of international law to the exclusion of others.¹⁶ While the EU reform aims to return IIL to the States, how will it affect the issues of power and fragmentation in IIL and international law more broadly?

¹⁶ Martti Koskenniemi, *The Politics of International Law* (Hart 2011).

The solution: the court

Political scientists have recognised that the Court of Justice of the European Union (CJEU) has played an important role in the process of European integration. For EU lawyers, the CJEU has provided a positive contribution to the development of EU law, which is the core basis of the European integration.¹⁷ Accordingly, it should not surprise us that in the EU vision of IIL reform, the enhancement of the rule of law in IIL would be ensured through the establishment of a new international court. The improved rule of law, in particular with respect to the independence of adjudicators, should then also increase the legitimacy of the new system.¹⁸

While the choice to establish a judicial body as part of the IIL reform process was political, this research aims to understand the rationale behind the institution of the court as the EU solution for the multilateral IIL reform, beyond independence as the core EU criterion of legitimacy. In doing so, this dissertation draws legal parallels and differences between IIL and EU law and the ways in which their adjudicative bodies (investment tribunals and the CJEU respectively) have been shaping each system through their case-law. This analysis assists in understanding why one legal order and its court have been normatively more widely accepted than the other, and how this could have affected the creation of a court as a new normative solution.

The EU reform of ISDS in an intra-EU dimension emphasises the role of the independent national and EU judge, while in the extra-EU dimension guarantees the independence of the Multilateral Investment Court (MIC) judges. The new MIC with independent judges would serve to conduct the judicial review of State acts under IIL (externally), while the CJEU reviews the legality of acts of EU institutions and Member States under EU law (internally). Ultimately and in the long run, the coherence between the internal and external dimension is to be achieved in procedural terms through the institution of the court, subject to the same EU requirements of independence and access to justice (constitutionalism). While such coherence is possible in theory, how achievable is it in reality? This research considers the limitations of this approach in the specific legal and political context of IIL.

¹⁷ For both perspectives, see Anne-Marie Burley and Walter Mattli, 'Europe before the Court: A Political Theory of Legal Integration' in Mette Eilstrup-Sangiovanni, *Debates on European Integration: A Reader* (Palgrave 2006).

¹⁸ See European Commission, 'Multilateral reform of investment dispute resolution, Impact Assessment' SWD (2017) 302 final.

(ii) The scope and methodology of the research

In light of the complexity of the research question and its related fundamental issues, the following methodological choices were made in undertaking this research.

The scope of investment

In this research, the consideration is given to the broad scope of investment. From a legal perspective, investment encompasses a variety of economic operations. It thus overlaps with broad areas of private and public law (property law, contract law, tort law, administrative law, and subcategories of these legal fields such as tax law, finance law etc.). Investment further overlaps with other concepts which can have legal as well as political meaning, such as public health, the environment, human rights, or sustainable development. In economic and legal terms, a distinction can be made between different forms of investment (FDI, portfolio, capital, establishment). Our analysis will illustrate a variety of investment issues, taking into account its interdisciplinary character.

Investment is regulated both in international and in domestic law. In international law, investment is closely related to trade. It is often regulated as one of the ‘deep trade’ issues in the modern day comprehensive free trade agreements (FTAs), or through separate IIAs. The primary focus of this research is international context; however, where relevant, we also consider the effects of investment regulation within the domestic context.

Systemic comparative analysis

The emphasis of this research is on the analysis of IIL and EU law as two separate legal orders with their own rules and logic, which overlap in the field of investment. Since they have different objectives, they are only partially comparable. However, comparative systemic analysis serves to explain why and how they produce different legal effects on private and public rights in international and domestic legal spheres.

Most studies focus on some aspects of the interaction between IIL and EU law through the lenses of one or the other system. However, this dissertation attempts to explain this interaction in light of the distinct systemic features and legal postulates according to which each system operates. This approach should provide a more global understanding of investment regulation in each legal system and across them, and present the system-specific insights which can better explain their normative

relationships. This should enhance the understanding of the relevant features of EU law among international investment lawyers, and *vice versa*, in dealing with legal issues involving both legal systems.

The first part of the dissertation examines IIL. Focus is placed on the macro legal questions in order to determine the international investment mechanisms in which IIL functions as a legal system, despite its fragmented nature. In the second part of the dissertation, the emphasis is placed on the main features of the EU legal order. Against that background, we explain internal and external dimensions of the EU regulation of investment. While examining the core substantive and procedural rules relating to investment in each legal system, the analysis is largely comparative. On one hand, it aims to explain systemic conflicts between IIL and EU law in the relations between the Member States. On the other hand, when considering EU and Member States' relations with third States comparative analysis is utilised to determine the extent of cross-fertilisation between international investment and EU rules. In this regard, the analysis serves to examine how the two legal orders interact when developing new rules in IIL.

Law in context

This research takes into account the political economy and international relations contexts of IIL since these contexts inevitably shape international investment governance. On one hand, the aim is to explore the rationale of the EU investment agenda and enquire how this agenda relates to the broader EU objectives, both internally (EU integration) and externally (multilateralism, free and fair trade). In this context, the research examines whether law serves as an instrument of politics. On the other hand, the aim is to place the EU investment agenda in the broader context of international investment governance to illustrate the external challenges for the EU reform, in UNCITRAL and beyond.

The law in context issues in IIL, including the early developments of the new EU international investment policy (IIP), have in the literature been explored in a rather one-dimensional way (within the IIL context or within the EU context). Through the examination of international and EU legal rules, this dissertation aims to provide a comprehensive global understanding of the implementation of EU investment policy internally (in relations between the Member States) and externally, in bilateral relations between the EU/Member States and third States, and multilaterally (in UNCITRAL). These different dimensions have their distinct law and policy perspectives, where law serves both to facilitate and to complicate the political process.

This dissertation aims to interrelate different dimensions and perspectives (internal, external, bilateral, multilateral, legal, political) and correlate them to the broader framework of EU integration and the international relations context.

From positive law to legal scholarship and policy considerations

In light of its legal nature, this research is based on legal rules found in the primary legal sources, which are critically considered through a variety of theoretical approaches and secondary sources.

The core substantive and procedural rules of IIL are explained through the analysis of international treaties and other instruments, and their interpretation and practical application through investment awards. In light of the fragmented nature of the field, in the selection of the treaties importance been placed on those of the Western States that have had a defining role in the development of the rules (the US, European States in the pre-Lisbon era), while also providing the main perspectives of the emerging actors (China), the strong players of the Global South (India, Brazil) and the developing nations. In the selection of investment awards importance was placed on those awards that have set important principles for the subsequent awards, dealt with important broader public policy issues or have provided relevant opinions supporting the development of legal scholarship.

When examining the legal nature and methods of interpretation and application of international investment rules, parallels have been drawn with domestic legal systems, other international rules (general international law, trade law, EU law) and legal families (common law, civil law). In this sense, the analysis should be of interest to a broader legal audience.

Given the historical and contemporary political context of IIL, the analysis of legal rules is inspired by realism and critical legal studies, questioning the politics behind IIL. Focus is placed on the main components of the system and their controversial aspects in the legal literature, while ensuring a balanced approach when presenting different theoretical perspectives. The instrumentalist perspective on IIL (law as a tool of Western States/capital) is confronted with the formalist perspective of the investment legal profession (neutrality of IIL). Investment relations (between States *inter se*, between international institutions) are analysed through a realist perspective (investment as a 'zero-sum' game; struggle for institutional hegemony) and confronted with the idealism of legal and economic values (rule of law, sustainable development). When examining

investment arbitration as a professional legal field, reference is made to seminal socio-legal studies and available empirical data.

IIL as a system and its rules are further evaluated normatively against their legitimacy and the rule of law. In assessing legitimacy, the approach adopted combines theoretical concepts of political science with legal scholarship on the legitimacy of international courts. In assessing the rule of law, relevance is given to legal scholarship, soft law sources and case law (the CJEU and the European Court of Human Rights), acknowledging different understandings of the rule of law in a variety of contexts (domestic, international, European).

When examining EU law, importance has been placed on CJEU judgments that are landmarks in definition of the EU legal order, and its normative relationships with domestic (Member States' legal orders) and international law. When examining the role of law and the CJEU in defining and shaping EU investment regulation, the analysis unfolds around three core CJEU decisions in the field of investment: Opinion 2/15¹⁹ (defining the EU's investment sovereignty), the *Achmea* judgment²⁰ (defining internal EU aspects of investment regulation) and Opinion 1/17²¹ (defining external EU aspects of investment regulation, both bilaterally and multilaterally).

Policy implications of these legal decisions are explained in order to relate the CJEU's legal reasoning to the broader policy context (law as a limitation of policy and law as an instrument of policy). They serve to support the integrationist judicial approach in the intra-EU dimension and a more politically pragmatic approach to EU international relations. The examination of EU rules is inspired by legal scholarship on the international rule of law in the EU context and constitutionalism.

Since this research examines two international legal systems in their political contexts, it has also been inspired by general international legal theory on politics and fragmentation in international law. Given the diverse threads of its theoretical approach, which combines law with politics, this dissertation challenges legalistic approaches to IIL and its reform, and confronts its many problems with the realities of international law and international relations. As such, it should be of interest not only to lawyers but also to political scientists in the field of international law as well as policy practitioners working on IIL reform.

¹⁹ Opinion 2/15 ECLI:EU:C:2017:376. See chapter 6.

²⁰ Case C-284/16 *Achmea* ECLI:EU:C:2018:158. See chapter 7.

²¹ Opinion 1/17 ECLI:EU:C:2019:341. See chapters 8 and 9.

Boundaries of this research

This dissertation does not attempt to offer a comprehensive analysis of all issues related to IIL, nor is it intended to compile a digest of those IIL issues with which it deals. In legal analysis, the dissertation is not intended to provide a complete review of IIAs and arbitral decisions dealing with substantive and procedural provisions of IIL. In the same manner, the purpose of the dissertation is not to cover comprehensively all intricacies of EU law, in particular in those parts that deal with substantive EU law.

Rather, with respect to IIL, the dissertation strives to provide a critical overview of different complexities involved in the reform of ISDS by examining a sufficiently representative selection of issues and jurisprudence. In the part dealing with EU law, the dissertation focuses on the institutional and constitutional frameworks of the EU legal order and its methods (for example, its approach to public interest assessment) and procedures (for example, the relationship with domestic courts), even when it deals with substantive law issues. In this way, in comparing and contrasting the two legal orders, the emphasis is on structural issues of both legal orders and their different legal and policy impacts, in bilateral and multilateral contexts. Although a bird's-eye perspective has been adopted in this research, the analysis of selected issues provides sufficient detail through extensive reference to case-law and thus will also be of interest to legal practitioners in both fields.

While great effort has been put into presenting different perspectives, some generalisations could not be avoided in view of the aim of this research to provide a general understanding of investment issues across the board. The aim of the dissertation has, however, always remained the same: to provide an objective analysis in a highly polarised legal field.

Ultimately, this research is a story about a clash between private and public justice paradigms, a clash which continues without discussion of the concept of justice appropriate to the issues in dispute, inviting the reader to reach his or her own conclusions about what justice in IIL should be.

(iii) The structure of the dissertation

This dissertation is divided into ten chapters, which are organised into three distinctive parts. In Part I we explore the global problem that the EU aims to resolve. In Part II we consider the ways in which the EU has developed solutions to address the ISDS crisis in its internal relations between the Member States, and the external bilateral relations with third States. Finally, in Part III we examine the EU attempt to transpose its regional solutions to a global level through the multilateral reform underway in UNCITRAL. A general conclusion, by drawing upon this research as a whole, outlines its essential messages.

The three parts differ in their length, with the longest, Part II, reflecting the aim to provide a thorough analysis of the EU approach to the reform of IIL. First, the EU investment policy is assessed in the broader policy context of the EU external trade agenda (Chapter 4) and also with respect to the EU legal order as its defining framework (Chapter 5). This approach is justified for explaining the EU constitutional arrangements in which law functions as a limitation for a more efficient external investment policy (Chapter 6). At the same time, in the internal dimension of EU regulation, law works as a facilitator of internal market integration that eliminates the need for ISDS, albeit not without difficulties (Chapter 7). Finally, Chapters 8 and 9 comprehensively explain the substantive and procedural aspects of the EU external regulation, with respect to EU IIAs and Member States' extra-EU BITs, in light of the long-term perspective to achieve full realisation of the EU IIP.

Part II sits between Part I, which presents extensively the complexities of IIL that the EU aims to reform, and Part III, which explains the EU proposal for a MIC in the context of the UNCITRAL's multilateral process. The final *de lege ferenda* part of this dissertation reflects on the reform process and potential future directions. Given that the ongoing reform processes and confrontation of competing perspectives are discussed in Part I, and with an aim to avoid speculation, the single substantive chapter in Part III is relatively short. However, its division into a separate part is justified as marking a transition between the EU's bilateral and multilateral approaches. Its brevity is also an indication of a process that will likely result in many more PhDs to come.

PART I

INTERNATIONAL INVESTMENT REGULATION

International law is at its strongest when developed in politically and intellectually interesting, but financially mostly irrelevant, directions. When international law meets the cruel external world of private financial interests, it is on much more precarious ground.¹

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¹ Matthew Parish, *Mirages of International Justice* (Edward Elgar 2011) 153.

International investment law (IIL) and its dispute settlement mechanism is a rare model in international law that allows foreign investors to bring claims for monetary awards directly against States in an international forum, on the basis of international law.² Traditionally, individuals have not been subjects of public international law, while State sovereignty has been the main tenet of public international law. How then could individuals, let alone foreign private entities, compel States to engage in dispute resolution with far-reaching consequences? Born out of necessity to protect cross-border investment flows, this area of international law has developed into an extensive and yet fragmented system of instruments for protection of foreign investments and liberalisation of international markets. The development of IIL in a relatively short period of time has been stimulated by an increase in the number of international investment agreements (IIAs) and driven by the rise of investment treaty arbitration (ITA) and jurisprudence. Consequently, the institutional design for investment disputes has become the focus of intense criticism. Debate has evolved around questions of the legitimacy of the international investment regime and its compliance with the rule of law.

In order to contextualise the current ISDS reform trends,³ Part I of this study provides an overview of international investment regulation (IIR), focusing on its legal, political and economic characteristics. Chapter 1 explains the emergence of IIR by focusing on political and historical circumstances that influenced and shaped its institutional design. Chapter 2 discusses the complexities of IIR through legal analysis of select substantive and procedural issues. Finally, Chapter 3 identifies different tensions within the field as challenges of ISDS reform, linking them to the conceptual framework of the legitimacy and the rule of law. Part I thus sets the stage for the analysis of investment regulation issues in the EU context in Part II, and the consideration of the proposed Multilateral Investment Court (MIC) as a response to ISDS challenges in Part III.

² There are many dispute resolution mechanisms in public international law. Similar to ISDS, some of these mechanisms allow private individuals to sue States, such as the European Court of Human Rights (ECtHR) created by the European Convention on Human Rights (ECHR). However, there are significant differences in the access to the system, remedies, legal costs and general procedural differences stemming from differences between an arbitration system and adjudication by courts, which significantly distinguish ISDS from other international dispute resolution mechanisms. See David Gaukrodger and Kathryn Gordon, 'Investor-State Dispute Settlement: A Scoping Paper for the Investment Policy Community' (OECD Publishing 2012) 68-77.

³ The term is used interchangeably for the system of investor-State dispute settlement more broadly (e.g. in the context of its reform or debate) and investment treaty arbitration more narrowly. While ISDS as a system can include methods of dispute resolution between investors and States other than just arbitration based on an IIA (mediation, conciliation, commercial disputes under national law or a contract), ISDS is mostly used as a synonym for investor treaty arbitration. The use of the ISDS acronym in this thesis (broadly or narrowly) depends on the specific context.

International investment regulation in historical perspective

- 1.1. Early developments of international investment law**
 - 1.2. Post-colonial developments in international investment law**
 - 1.3. International investment law in the post–Cold War period: towards international investment regulation**
 - 1.4. (Re)politicisation of investor–State dispute settlement?**
 - 1.5. Conclusion**
-

The legal foundation of international investment regulation (IIR) is vast, complex and varied, across numerous substantive and procedural rules.¹ These rules are laid down in close to 3000 different international law instruments. As of 30 June 2020, there are 2339 bilateral investment treaties (BITs) in force (2896 in existence),² and 319 other treaties with investment provisions (390 in existence).³ Under one umbrella, they are referred to as international investment agreements (IIAs). This network of investment treaties is complemented by two key arbitration treaties: the 1958 New York Convention for the enforcement of arbitral awards⁴, and the 1965 ICSID Convention,⁵ which provides a

¹ Detailed overview of IIAs and investment dispute settlement is available at UNCTAD, 'International Investment Agreements Navigator' (*Investment Policy Hub*)

<<https://investmentpolicy.unctad.org/international-investment-agreements>> accessed 30 June 2020.

² BITs are always concluded with a specific intention to cover a wide range of reciprocal investment arrangements between two nations. They usually cover: scope and definition of investment, admission and establishment, national treatment, most favoured nation treatment (MFN), fair and equitable treatment (FET), compensation in the event of expropriation or damage to the investment, guarantees of free transfers of funds, and dispute-settlement mechanisms (both State to State, and investor to State): see Simon Lester, Bryan Mercurio and Arwel Davies, *World Trade Law* (2nd edn, Hart 2012) 680.

³ According to the UNCTAD classification, treaties with investment protections include a range of different treaties, such as free trade agreements, regional trade and investment agreements, economic partnership agreements, cooperation agreements, association agreements, economic complementation agreements, closer economic partnership arrangements, agreements establishing free trade areas, and trade and investment framework agreements. They are aimed at more comprehensive economic liberalisation of trade and investment. See UNCTAD, 'World Investment Report 2016 - Investor Nationality: Policy Challenges' (22 June 2016) UNCTAD/WIR/2016. In many instances, treaties with investment provisions will have an investment chapter that includes investment protection standards similar to BITs. In other cases, they can have more limited investment-related provisions (e.g. only related to establishment of investment) or only clauses which provide a framework for negotiations on investment issues in the future.

⁴ Convention on the Recognition and Enforcement of Foreign Arbitral Awards (adopted 10 June 1958, entered into force 7 June 1959) 330 UNTS 3 (New York Convention).

⁵ Convention on the Settlement of International Investment Disputes between States and Nationals of Other States (adopted 18 March 1965, entered into force 14 October 1966) 575 UNTS 159 (ICSID Convention).

forum and procedural rules for investment treaty arbitration (ITA). This complex landscape thus legitimately begs the question: how have we come to this complicated network of legal instruments?

1.1. Early developments of international investment law

International investment law (IIL) is a rather new subfield of international law; however, the need for investment protection is not a modern phenomenon.⁶ Before the Second World War (WWII), investment was an ancillary of various commerce agreements and a feature of customary international law (CIL), while the enforcement of property protections for foreign subjects was left to gunboat diplomacy. The main characteristic of this – in literature called the colonial period⁷ – is globalisation through colonisation and the political and economic prevalence of Western (European and American) powers.

Western commercial interests in colonised territories were protected under imperial laws and enforced through political and military control in the colonies. Outside of colonised territories, mostly in Asia and the Far East, foreign commercial interests were guaranteed through extraterritorial application of European or American laws, ensured through treaties.⁸ Among the Western powers, the predecessors of today's investment agreements were bilateral 'treaties of friendship, commerce and navigation' (FCNs), which governed commerce relations between the United States and its trading partners.⁹ The focus of FCNs, however, were trading rights and protection of property, rather than investment protections as such.¹⁰ The principal mechanisms for protection of foreign commercial interests in this era were non-legal. Protection was granted through foreigners' home State diplomatic protection, supported if necessary by military means, which were at the time recognised as legitimate in cases of breaches of international law.¹¹ According to the then-dominant theory, under customary international law (CIL),

⁶ Importantly, investment issues are interlinked with trade and commerce more generally. International commercial arbitration as a dispute settlement mechanism can be traced back to merchant tribunals of medieval Europe and it is far from a 20th century occurrence, as often described in the literature on IIL: see Amr A Shalakany, 'Arbitration and the Third World: A Plea for Reassessing Bias under the Specter of Neoliberalism' (2000) 41 *Harvard International Law Review* 419, 430-433.

⁷ Kenneth J Vandeveld, 'A Brief History of International Investment Agreements' (2005) 12 *UC Davis Journal of International Law and Policy* 157, 158-161. This period started in the late 18th century.

⁸ Hendrik Hugn Angus Van Harten, 'The Emerging System of International Investment Arbitration' (DPhil thesis, London School of Economics 2005), 31-32. Often these treaties were capitulation treaties. Extraterritorial jurisdiction existed, for example in China, the Ottoman Empire, Egypt and Persia, aimed at opening the economies of these States to foreign commerce and industry.

⁹ The first such treaty was the Treaty of Amity and Commerce in 1782, negotiated between the United States and France in 1778. See Vandeveld (n 7) 158.

¹⁰ *ibid* 159.

¹¹ The first judicial recognition of diplomatic protection was the case *The Mavrommatis Palestine Concessions* (Greece v UK) [1924] PCIJ Rep Series B No. 3, where the Permanent Court of International Justice (predecessor of the International Court of Justice) laid down a principle that a State is entitled to protect its

the property of foreign subjects was entitled to a minimum standard of treatment (MST), but the content of this standard was vague and unclear.¹²

The main opponent of the Western interpretations of CIL and the MST principles were Latin American States, which adhered to national treatment according to the Calvo doctrine.¹³ The compromise between the two opposing theories was found in the mechanism of espousal, whereby the home State would assume the investor's claim, but only after all local remedies of the host country had been exhausted.¹⁴ The disagreement between the US and Latin American countries over the MST received an additional dimension in the view of the Hull Rule. This disputed rule demanded 'adequate, effective and prompt' compensation for expropriation of property as an international law standard, and emerged as a response to Mexican expropriations of American oil interests in 1938.¹⁵

Much of the early history of IIL was built around the economic relationship between the US and Latin America, and investors' reliance on diplomatic protection, where investment protection depended on the good will and political calculations of investors' home States.¹⁶ While IIL hardly had any relevance for the investors in the colonial period, the contours of the divide between capital-importing and capital-exporting States started to appear. The Soviet nationalisation of private property in Russia in 1917 introduced ideological divisions that would dominate the post-colonial period.

subjects when these subjects are injured by acts contrary to international law by another State, by resorting to diplomatic action or international judicial proceedings on behalf of its subjects. See Vandevelde (n 7) 160-161.

¹² Andrew Newcombe and Lluís Paradell, 'Law and Practice of Investment Treaties: Standards of Treatment' (Kluwer 2009) 11-12.

¹³ The Calvo doctrine, named after the Argentinian lawyer Carlos Calvo, argued that a foreign investor was entitled only to the same level of protection that the host State afforded to its national investors under the national laws. Under international law, the obligation in regard to foreign investment was thus limited to non-discrimination. According to this doctrine, a dispute between the host State and the foreign investor should be settled in domestic courts. See Mathucumaraswamy Sornarajah, 'The Past, Present and Future of the International Law on Foreign Investment' in Wenhua Shan (ed), *China and International Investment Law: Twenty Years of ICSID Membership* (Brill 2014) 24-26.

¹⁴ Vandevelde (n 7) 160. Basically, that meant that diplomatic protection could be afforded only in cases of denial of justice by the domestic courts: Sornarajah (n 13) 26.

¹⁵ Newcombe and Paradell (n 12) 18. The rule was named after the US Secretary of State Cordell Hull who formulated this rule in his correspondence to the Mexican Minister for Foreign Affairs.

¹⁶ For a critique of diplomatic protection for investors, see Charles N Brower and Stephan W Schill, 'Is Arbitration a Threat or a Boon to the Legitimacy of International Investment Law' (2009) 9 *Chicago Journal of International Law* 471, 480-481.

1.2. Post-colonial developments in international investment law

In the post-WWII period, the development of IIL was shaped by decolonisation and the establishment of a multilateral economic framework. This period – in the literature called post-colonial – lasted until the end of the Cold War in 1989.¹⁷

Decolonisation of Africa and Asia reformulated the balance of power in international relations. Former colonies, now newly independent States, believed that economic independence was an integral part of their political self-determination and were determined to gain greater control of their resources.¹⁸ Many embraced a socialist economic agenda, which allowed them to nationalise key sectors of their economy, expropriating existing foreign investment.¹⁹ Foreign capital and its ownership and control over the means of production was seen as a new form of colonisation, which could lead to foreign interference in domestic affairs.²⁰

Developing States held the balance of power in the UN General Assembly, supported by the Eastern Bloc, which equally embraced the policy of nationalisation. Together they pressed for the recognition of the right to expropriation without payment of fair market value. The Declaration on the New International Economic Order (NIEO) in 1974²¹ proclaimed the entitlement of each State to exercise effective control over their natural resources and all economic activities, ‘including the right to nationalisation or transfer of ownership to its nationals’, without specifying any obligation to pay compensation.²² Although by nature political, these UN instruments denounced the Hull Rule as a rule of CIL, leaving the status of foreign investment in the former colonies uncertain.

While developing States embraced a State-controlled economy with the premise of nationalism, the West was heading towards economic liberalisation. International consensus on trade liberalisation was reached in the General Agreement on Tariffs and Trade (GATT).²³ However, investment liberalisation posed more difficulties. The failed Havana Charter,²⁴ which attempted to provide a legal framework for both trade and investment, indicated that IIL would be developed separately from trade. Other non-governmental initiatives that emerged at the time were equally unable to mount a

¹⁷ Vandevelde (n 7) 161.

¹⁸ See Sornarajah (n 13) 27.

¹⁹ Newcombe and Paradell (n 12) 19.

²⁰ Vandevelde (n 7) 166.

²¹ UNGA Res 3201 (S-VI) (1 May 1974) UN Doc A/RES/320 (S-VI).

²² *ibid* 4(e).

²³ General Agreement on Tariffs and Trade (adopted 30 October 1947, entered into force 1 January 1948) 55 UNTS 194 (GATT 1947).

²⁴ Havana Charter for an International Trade Organisation (1948) UN Doc E/CONF.2/78 (Havana Charter).

consensus on a multilateral legal framework for investment.²⁵ In the absence of a multilateral investment agreement and with uncertain CIL on investment, a new bilateral mechanism was introduced to allow protection of foreign investment under international law in the volatile political and economic environments of newly formed States.

The first BIT was signed between West Germany and Pakistan in 1959.²⁶ Germany had a particular interest in reaching an international agreement on investment as it lost the majority of its investments following WWII.²⁷ Failing to induce a multilateral agreement, Germany introduced its own BIT program, with other European countries soon to follow this practice.²⁸ The BIT with Pakistan, outlining in its Preamble an intention to create favourable investment conditions for promotion of investment and encouragement of private industrial and financial prosperity, set out a series of rights for investors.²⁹ The underlying consideration was nevertheless political. Pakistan's internal instability prompted Germany to gain reassurance from Pakistan that Germany's economic interests in Pakistan would be protected, while Pakistan differentiated itself from its rival India.³⁰ The conclusion of such an agreement was also a German domestic law requirement, which allowed the government of the day to provide guarantees and insurance for its investors abroad with an aim to foster Germany's development through outward private investment.³¹ The US kept FCNs with improved investment focus³² until it established its own BIT program in 1977.³³

In this initial period, BITs were signed exclusively between developed and developing countries.³⁴ In theory, they had reciprocal obligations and could be considered symmetrical in their legal effects. In practice, they were asymmetrical in their political and economic effects with a one-sided flow of foreign capital from developed to

²⁵ See Newcombe and Paradell (n 12) 20-22. See Part III, chapter 10, section 10.1.

²⁶ Germany and Pakistan Treaty for the Promotion and Protection of Investments (with Protocol and exchange of notes) (signed 25 November 1959, entered into force 28 November 1962) 457 UNTS 24 (Germany-Pakistan BIT).

²⁷ Chester Brown, 'The Development by States of Model Bilateral Investment Treaties', in Wenhua Shan (ed), *China and International Investment Law: Twenty Years of ICSID Membership* (Brill 2014) 132.

²⁸ *ibid* 137.

²⁹ These rights include non-discriminatory treatment (Art 2), protection and security (Art 3(1)), protection from expropriation (Art 3(2)), most favoured nation treatment in compensation for losses suffered in armed conflict (Art 3(3)), free transfer of funds (Art 4), and an umbrella clause (Art 7).

³⁰ Matthew Parish, *Mirages of International Justice* (Edward Edgar 2011) 128.

³¹ Directorate-General for External Policies of the European Parliament, 'Investor-State Dispute Settlement provisions in the EU's international investment agreements: Volume 2-Studies' (September 2014) EXPO/B/INTA/2014/08-09-10, 9-10. The German Budget Act 1959 in section 18 allowed the use of the government's guarantee and insurance scheme for German foreign investments if an investment agreement with a host country had been concluded, or if the legal system of the host country provided sufficient protections for the investment.

³² For analysis of FNCs' investment provisions, see Brown (n 27) 129-131.

³³ Andrew T Guzman, 'Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties' (1998) 38 *Virginia Journal of International Law* 639, 654.

³⁴ *ibid* 680.

developing countries. This led to *de facto* asymmetrical legal effects with obligations borne by the developing countries.³⁵ BITs formalised the Hull Rule, undermining the economic independence that developing countries so fiercely promoted as a collective. However, developing countries were willing to enter into BITs individually to better compete for Western foreign investment with other developing countries.³⁶ At the same time, they were unwilling to enter into a multilateral investment treaty, which would undermine their comparative advantage to attract foreign investment obtained by signing a BIT.³⁷

The first BITs did not provide for ISDS.³⁸ A conditional ISDS provision was introduced in the Netherlands–Indonesia BIT in 1968.³⁹ A year later, the Italy–Chad BIT incorporated the first unconditional ISDS clause.⁴⁰ ISDS provisions started to be included in BITs following the establishment of the International Centre for Settlement of Investment Disputes (ICSID) in 1965–1968.⁴¹ Under the auspices of the World Bank, ICSID was created with a view to providing a neutral forum for the settlement of disputes between investors and States, outside the ambit of influence of national laws.⁴² It was seen as an important step in placing investment protection ‘in the realm of law rather than politics’.⁴³ However, ICSID was primarily envisaged as a forum for disputes arising from large contracts between States and foreign investors. Its focus shifted from arbitration under State contracts to treaty-based arbitration only because State contracts did not generate a sufficient number of disputes – until 1990 ICSID had only 26 registered cases.⁴⁴

³⁵ Sornarajah (n 13) 29.

³⁶ Guzman (n 33) 666.

³⁷ *ibid* 679.

³⁸ The German BIT with Pakistan only provided for a State-to-State dispute settlement: Art 11.

³⁹ ISDS was conditional upon the host State giving consent to arbitration to ICSID: see Art 11, Netherlands and Indonesia Agreement on economic cooperation (with protocol and exchanges of letters dates on 17 June 1968) (signed 7 July 1968, entered into force 17 July 1971)

⁴⁰ Brown (n 27) 124

⁴¹ The ICSID Convention was adopted on 18 March 1965, and it entered into force on 14 October 1966. Following its entry into force, the ICSID Centre was created, and its Rules and Regulations entered into force on 1 January 1968. For a history of ICSID, see Crina Baltag, ‘The ICSID Convention: A Successful Story – The Origins and History of the ICSID’ in Crina Baltag (ed), *ICSID Convention after 50 Years: Unsettled Issues* (Kluwer 2017) 1-24.

⁴² Newcombe and Paradell (n 12) 27-28.

⁴³ Vandevelde (n 7) 175.

⁴⁴ Veijo Heiskanen, ‘Forbidding depechage: law governing investment treaty arbitration’ (2009) 32 *Suffolk Transnational Law Review* 367. Almost all of these cases were arbitrations under State contracts. See available statistics in ICSID, ‘Background Information on International Centre for Settlement of Investment Disputes (ICSID)’ (*ICSID*, 2020)

<<https://icsid.worldbank.org/en/Documents/ICSID%20Fact%20Sheet%20-%20ENGLISH.pdf>> accessed 30 June 2020, and ICSID, ‘Spotlight on Contract-based Disputes at ICSID’ (*ICSID*, 2020)

<<https://icsid.worldbank.org/en/Pages/resources/Spotlight-on-Contract-based-Disputes-at-ICSID.aspx>> accessed 30 June 2020.

BITs provided a credible commitment to consent to private arbitration and were an important development in IIL. However, in this early period BITs were still weak instruments with imperfect dispute settlement provisions.⁴⁵ Their number remained modest with less than 400 agreements concluded between 1959 and 1989.⁴⁶ It is only the next period in the history of IIL that brought a proliferation of different instruments.

1.3. International investment law in the post-Cold War period: towards international investment regulation

The end of the Cold War opened a new chapter in the development of IIL. With the dissolution of the Soviet Bloc, the new global political and economic order was to be based on democracy and market capitalism, as neoliberalism became the dominant creed. IIL was to be developed on the same ideological foundation.⁴⁷

In the new order, the old differences – capital-exporting vs capital-importing and free market vs State-controlled economies – would diminish. The triumph of the Western political and economic idea suggested that we might have reached ‘the end of history’ – with liberal democracy and free market capitalism as the final form of human government.⁴⁸ The role of the State was to fundamentally change, from ownership of business enterprises to regulator with little involvement in the market. There was a dramatic rise in the number of BITs concluded because they signalled a country’s openness to foreign investment.⁴⁹ The World Bank promoted this practice, as the access to development funds was made conditional upon signing BITs.⁵⁰

In parallel, a new generation of comprehensive bilateral and regional trade agreements started to emerge, encompassing trade and investment provisions to better reflect new economic realities, shaped by the economic activity of multinational and transnational companies (MNEs). These global enterprises rose in numbers and size, but also in power, with the ability to influence the flows of trade by controlling FDI flows. Their economic activity had significant impact on production, sales, services and employment in many different locations.⁵¹ Their impact, however, transcends a purely

⁴⁵ Jason Webb Yackee, in his study of BITs, analysed differences between BITs in regard to States’ consent to arbitration, finding that a vast number of pre-1990 BITs contain partial and promissory pre-consent to ISDS. See Jason W Yackee, ‘Conceptual Differences in the Empirical Study of Bilateral Investment Treaties’ (2008) 33 *Brooklyn Journal of International Law* 405.

⁴⁶ Vandevelde (n 7) 172.

⁴⁷ Sornarajah (n 13) 30-31.

⁴⁸ Francis Fukuyama, ‘The End of History?’ (1989) 16 *The National Interest* 3.

⁴⁹ Parish (n 30) 131.

⁵⁰ Sornarajah (n 13) 33.

⁵¹ John M Kline and Rodney D Ludema, ‘Building a multilateral framework for investment: comparing the development of trade and investment accords’ (1997) 6 *Transnational Corporations* 1, 20-21.

economic sphere. The concept of globalisation advances the idea of a global system in which transnational corporations are dominant forces.⁵² Ultimately, they necessitate legal instruments to facilitate their cross-border operations.

New global economic governance meant closer economic integration between countries of different economic development. In North America, this integration was to happen through NAFTA, a new regional trade agreement between Canada, the US and Mexico, while in Europe through the enlargement of the EU. In this global era of IIL, the distinctions of the previous era seemed to disappear, with investment agreements being concluded at all levels (bilateral, regional, multilateral) and between any States, regardless of their economic development or geographic position.⁵³ States were willing to enter into these agreements in the expectation of increased levels of investment capital inflows.⁵⁴ This era marked a shift from nation State-centred IIL towards the implementation of treaties through specialised bodies and their international investment regulation.⁵⁵

However, while seen as instruments for attracting foreign capital, States were not fully aware of the policy implications of IIAs.⁵⁶ Arbitral proceedings under BITs were rare and there was no jurisprudence to indicate their practical effects. The first claim brought under a BIT was in the case *AAPL v Sri Lanka*⁵⁷ under the UK–Sri Lanka BIT, for which the

⁵² Leslie Sklair, 'Discourses of Globalisation: A Transnational Capitalist Class Analysis' in Revathi Krishnaswamy and John C Hawley (eds), *The Postcolonial and the Global* (University of Minnesota Press 2008).

⁵³ Vandevelde (n 7) 182.

⁵⁴ UNCTAD, 'Trade and Development Report 2014: Global Governance and Policy Space for Development' (2014), UNCTAD/TDR/2014, 141.

⁵⁵ IIL can in this sense be placed within the broader developments in international law after the Cold War, which Martti Koskenniemi calls 'new natural law', with its own specialised experts and 'vocabulary above sovereignty': from institutions to 'regimes'; from rules to 'regulations'; from government to 'governance'; from responsibility to 'compliance'; from law to 'legitimacy'; from lawyers to 'international relations experts': see Martti Koskenniemi, *The Politics of International Law* (Hart 2011) 318-324.

⁵⁶ See Lauge N. Skovgaard Poulsen and Emma Aisbett, 'When the Claim Hits: Bilateral Investment Treaties and Bounded Rational Learning' (2013) 65 *World Politics* 273. The authors conducted a survey interviewing 30 officials (negotiators and stakeholders) from 13 developing countries involved in investment protection policies during the 1990s about their awareness of the scope and implications of BITs. Their study has shown that many officials actually ignored the risks of BITs, seeing them as instruments with no practical implications apart from attracting foreign investment. In another study, Christine Côté investigated the impact of NAFTA on Canadian regulatory processes in the sensitive areas of health, safety and environment. Her study revealed that Canadian regulators are not aware of investment dispute implications when developing regulation. From this, she draws conclusions in regard to likely difficulties when forming an informed consent for stakeholders in developing countries. See Christine Côté, 'Is Chilling Out There? International Investment Agreements and Government Regulatory Autonomy' (2016) 16 *Academy of International Business Insights* 14.

⁵⁷ *Asian Agricultural Products Limited v Democratic Socialist Republic of Sri Lanka*, ICSID Case No. ARB/87/3, Award (27 June 1990).

award was issued in 1990.⁵⁸ Since then, ITA has risen to 1023 known cases as of 31 December 2019.⁵⁹

1.4. (Re)politicisation of investor-State dispute settlement?

The rise of ITA brought to States awareness of possible negative implications of IIAs, not only because of large monetary compensations⁶⁰ but also increased limitations on government regulatory powers, prompting the change in the approach to investment treaties.⁶¹ The change of mood can also be linked to the global financial crisis of 2008. In the age of 'guarded globalisation',⁶² countries have become aware of the risks that come with opening markets to foreign competition, showing signs of reversion towards economic protectionism. The American policy under the Trump administration, discontinued negotiations on TTIP, and new NAFTA (USMCA) are signs of the global investment policy change.⁶³

ITA was promoted as a tool for depoliticisation of disputes involving a foreign investor and a sovereign State.⁶⁴ It built upon instruments of international commercial arbitration, with the same aim of removing business conflicts involving States from Cold-War politics.⁶⁵ However, while the credibility of commercial arbitration remains largely intact, there is a growing distrust in the arbitration system for matters involving public interest. Some studies suggest that commercial diplomacy remains an important aspect of investment dispute settlement and in some cases is even more desirable than law.⁶⁶ On

⁵⁸ The case concerned the military action by the Sri Lankan Government on the investor's fish farm, which destroyed the farm in the attempt to expel the Tamil rebels. The Tribunal upheld the claim and awarded the investor US\$460,000.

⁵⁹ UNCTAD, 'International Investment Dispute Settlement Navigator' (*Investment Policy Hub*) <<http://investmentpolicyhub.unctad.org/ISDS>> accessed 30 June 2020.

⁶⁰ An exemplary cost ramification of the investment treaty arbitration is the award against Ecuador in the case *Occidental Petroleum Corporation and Occidental Exploration and Production Company v The Republic of Ecuador*, ICSID Case No. ARB/06/11, Award (5 October 2012). Ecuador was compelled to pay US\$1.8 billion for terminating the contract with the oil company (US\$2.3 billion with interest).

⁶¹ UNCTAD 2014 (n 54) 141. Other factors are also mixed results from studies on the impact of BITs on investment flows: see chapter 3.

⁶² Ian Bremmer, 'The New Rules of Globalization' (2014) 92 *Harvard Business Review* 103.

⁶³ For example, a number of countries have terminated their investment treaties (or have announced to do so) or have withdrawn from the ICSID Convention. See chapter 3, section 3.1.1. Some new regional trade treaties exclude ISDS altogether; for example, the Regional Comprehensive Economic Partnership (RCEP).

⁶⁴ Catharine Titi, 'Some Reflections on Repolitization of Investment Disputes and (New) Forms of Diplomatic Protection' (2015) 32 *Journal of International Arbitration* 261, 263.

⁶⁵ Yves Dezalay and Bryant G. Garth, *Dealing in Virtue* (University of Chicago Press 1996) 311.

⁶⁶ See, for example, Geoffrey Gertz, 'Commercial Diplomacy and Political Risk' (2017) *Global Economy and Development Working Paper 106, Brookings Institute* <<https://www.brookings.edu/wp-content/uploads/2017/08/gertz-working-paper.pdf>> accessed 30 June 2020. Gertz suggests that American investors resort to ISDS when they lack access to effective diplomacy. See also the historical study of Jason W Yackee, 'Investor-State Dispute Settlement at the Dawn of International Investment Law: France, Mauritania, and the Nationalization of the MIFERMA Iron Ore Operations' (2019) 59 *American Journal of Legal History* 71.

the other hand, legal disputes in investment arbitration are now seen as instruments of politics in the hands of foreign investors and specialised legal experts.

Balancing private and public interests is inherently always political. Why is a government measure, aimed at protecting the local community but frustrating economic interests of a foreign investor, deemed political? On the other hand, why is a decision of a tribunal that sits outside the national court system, which places fairness for foreign investors (at the expense of other stakeholders) and investment promotion (at the expense of other values), deemed neutral? Is it because the decision in the first case is made by an elected government and in the second case by a *prima facie* neutral tribunal, accountable to no-one? And what if the decision in the first case is the decision of a national court, which is then effectively 'overturned' by an international tribunal? Why is a national court assumed to be biased, even in countries that adhere to the rule of law, and an international tribunal assumed to be neutral? Framed in this way, decisions of international investment tribunals indeed have potential to be instruments of politics. In the age of increasing politicisation,⁶⁷ ISDS suffers from the same ills. Heated political debate has prompted States to react, through bilateral and multilateral ISDS reforms.

1.5. Conclusion

Looking at the past, the development of IIR can be described as a one-way street. It was a mechanism developed by the need to protect the interests of the capital-exporting countries in their capital-importing counterparts. In the beginning it was the relationship between colonisers and the either *de iure* or *de facto* colonised, which in the period after decolonisation metamorphosed into the relationship between developed and developing countries. The States, not fully aware of the real economic, political and legal implications, were the main players in the development of instruments of IIL, acting individually rather than collectively.

In the meantime, the one-way street has turned into a road with many directions. In the multipolar economic order, the clear differentiation between capital-exporting and capital-importing States has disappeared. The power has diversified between economically powerful States acting alone and others formed in different regional economic interest blocks or supranational entities. Transnational private capital interests have diversified from the interests of their home States. Regulation of investment,

⁶⁷ For example, Bremmer gives examples of financial services, information technology, telecommunications and food sectors as being politicised in the context of contemporary governments' tendency to define national security more broadly: Bremmer (n 62). See also chapter 4 in Part II.

domestically and internationally, has been shaped by investment claims and jurisprudence emanating from arbitral tribunals. The global economic world order has introduced 'transnational' players into the arena: MNEs, legal practitioners, arbitrators, academics, civil society. All of them, one way or another, participate in defining the – modern, global and 'managerial' – international investment governance.⁶⁸

⁶⁸ See comments on the 'managerial world' of modern international law by Koskenniemi (n 55) 324.

Legal complexity of international investment regulation

2.1. Substantive rules: the scope of investment protection

- 2.1.1. *Protection against expropriation*
- 2.1.2. *Fair and equitable treatment*
- 2.1.3. *Protection against discrimination*
- 2.1.4. *Free transfer of capital*

2.2. Procedural rules: investment treaty arbitration

- 2.2.1. *Access to ISDS: broadening rather than limiting the scope of investment arbitration*
 - 2.2.1.1. Admissibility *ratione materiae*: what is 'investment'?
 - 2.2.1.2. Admissibility *ratione personae*: who is the 'investor'?
 - 2.2.2. *'Shopping' in investment treaty arbitration*
 - 2.2.3. *Tip of the iceberg: arbitration as a dispute resolution method*
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International investment agreements (IIAs) provide a legal framework for foreign investment in the host States by including specific substantive and procedural guarantees for foreign investors. While international investment law (IIL) lacks a multilateral legal basis,¹ substantive protections provided in numerous treaties are considerably similar.² The majority of IIAs provide for international dispute settlement through investment treaty arbitration (ITA), involving diversified procedural rules. The discussion in this chapter explains these substantive and procedural rules in order to provide a legal framework of contemporary international investment regulation (IIR). The discussion is not meant to be exhaustive but rather functional to the examination of relevant legal issues stemming from IIAs' provisions and the practice of international investment tribunals. The focus is placed on the most contentious issues and systemic problems. In

¹ This is often contrasted with international trade law, which is mostly governed by the WTO Agreement and its Annexes, despite a large number of bilateral and regional trade agreements. See Ozge Varis, 'Understanding the Interaction between the WTO Regime and International Investment Regime: Reversing the Approach' in Dario Moura Vicente (ed), *Towards a Universal Justice? Putting International Courts and Jurisdictions into Perspective* (Brill 2016). For contrasts between public international investment law and international uniform law in private international commercial law, see Joshua Karton, 'Lessons from International Uniform Law' in Jean E Kalicki and Anna Joubin-Bret, *Reshaping the Investor-State Dispute Settlement System* (Brill 2015).

² See Marie-France Houde and Katia Yannaca-Small, 'Relationships between International Investment Agreements' (OECD Publishing 2004) Annex III.

doing so, this chapter aims to demonstrate that issues of relevance for IIR are not exclusively matters of politics and public perception but also matters of law.

2.1. Substantive rules: the scope of investment protection

Given the complexity of substantive protections, we limit this discussion to key guarantees provided to foreign investors in IIAs and their interpretation by investment tribunals. Where necessary the analysis is comparative, drawing parallels with domestic or other international regimes dealing with the protection of the same rights. Recent trends of States in improving substantive protection provisions are also noted.

2.1.1. Protection against expropriation

International law duly protects foreign property against expropriation. However, this concept has always been the subject of controversy. In the second half of the 20th century, the debate was centred on divergent views between developed and developing countries regarding the standard of compensation for ‘direct’ expropriation of property that was nationalised.³ With the proliferation of IIAs at the end of 20th century, full compensation for expropriation has become an accepted standard. The debate has since shifted toward the issue of what constitutes expropriation, especially in situations other than the classical category of nationalisation, and the impact of the concept of expropriation on regulatory powers of the State for the protection of health, safety, environment and other legitimate public policy goals.

There are two types of expropriation. ‘Direct’ or *de iure* expropriation involves legislative or administrative acts of the State, which result in the transfer of title to foreign property or its physical possession, with permanent deprivation of property. ‘Indirect’ or *de facto* expropriation refers to government measures without formal transfer of title, which interfere with exercise of property rights, leading to effective loss of control or significant depreciation of property value.⁴ Such measures are also described as measures ‘tantamount’ or ‘equivalent’ to expropriation or nationalisation.⁵ While the first

³ Lee A O’Connor, ‘The International Law of Expropriation of Foreign Owned Property: The Compensation Requirement and the Role of the Taking State’ (1983) 6 *Loyola of Los Angeles International and Comparative Law Review* 355. See also chapter 1 on historical developments.

⁴ UNCTAD, ‘International Investment Agreements: Key Issues’ (2004), UNCTAD/ITE/IIT/2004/10 (Vol. I), 236.

⁵ Other terms used in regard to the concept of indirect expropriation include ‘creeping’, ‘constructive’ and ‘regulatory’ or expropriation. In *Tecmed v Mexico*, the Tribunal explained: ‘Generally, it is understood that the term “... equivalent to expropriation ...” or “tantamount to expropriation” included in the Agreement and in other international treaties related to the protection of foreign investors refers to the so-called “indirect

category, well recognised and prohibited in international law, has become more rare, the significance of the second category has greatly increased through jurisprudence of investment tribunals.⁶ Under international law, all State measures, which directly or indirectly interfere with tangible or intangible property are regarded as expropriation.⁷

Expropriation is a well-known concept in domestic and international law. On the one hand, expropriation of private property is an exercise of State sovereignty. On the other hand, private property is an inalienable right of an individual. Natural law theory in particular emphasised the right to private property, which is, however, not without limitations.⁸ Thus, property is a social category which serves public functions. A State, however, cannot take private property without compensation, as that would deprive an individual of their rights and would abrogate natural law.⁹ Natural law theory has influenced domestic constitutional orders in protection of private property, however not with the same results.

In the European legal tradition, as exemplified by the German Constitution and the jurisprudence of the European Court of Human Rights (ECtHR), the concept of social responsibility implicit in private property is clearly incorporated in constitutional traditions and fundamental rights instruments.¹⁰ Expropriation by way of acquiring private property for a public purpose, which corresponds to the concept of 'direct' expropriation in international law, is permissible only for the common good, pursuant to a law that provides for compensation, which is determined by establishing 'equitable balance' between public and private interests.¹¹ Such equitable balance may lead to

expropriation" or "creeping expropriation", as well as to the above-mentioned de facto expropriation. Although these forms of expropriation do not have a clear or unequivocal definition, it is generally understood that they materialize through actions or conduct, which do not explicitly express the purpose of depriving one of rights or assets, but actually have that effect': *Técnicas Medioambientales Tecmed, S.A. v The United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award (29 May 2003) para 114. Creeping expropriation happens through a series of actions (e.g. excessive or arbitrary taxation, interference with management rights, forced divestment of shares, refused access to labour or materials), which incrementally lead to the diminishment of value of the investment. Regulatory expropriation refers to takings of property within the doctrine of police powers. See *ibid* 238.

⁶ Michael W Reisman and Robert D Sloane, 'Indirect Expropriation and its Valuation in the BIT' (2004) Yale Law School Faculty Scholarship Series, Paper 1002, 118-119.

⁷ In this context, IIAs also provide for a definition of investment, which is usually broad: see section 2.2.1. below.

⁸ For John Locke, the natural commons is the world of unappropriated materials, which are resources of the world in their natural state. From these resources, an individual labours to appropriate a part of the commons and thus gains property rights. However, Locke limits private appropriation in order not to overly deplete the commons, thus recognising the public rights in a natural commons of resources. See Steven J Horowitz, 'Rethinking Lockean Copyright and Fair Use' (2005) 10 Deakin Law Review 209.

⁹ Jon A Stanley, 'Keeping Big Brother Out of Our Backyard: Regulatory Takings as Defined in International Law and Compared to American Fifth Amendment Jurisprudence' (2001) 15 Emory International Law Review 349, 352-353.

¹⁰ For example, the German Constitution expressly states that 'property entails obligations' and 'its use shall serve the common good': Art 14(2), German Basic Law. On property protections under EU law, see Part II, chapter 7, section 7.1.2.

¹¹ *ibid* Art 14(3) (emphasis added).

compensation below market value.¹² Regulatory measures, which could be characterised as ‘indirect’ expropriation in international law, generally do not qualify as expropriation but rather are expressions of the content and limits of the property in question.¹³ Whether such measures require compensation will depend on the proportionality analysis, which in balancing public and private interests takes into consideration reasonableness of the measure (i.e. whether it is in the common interest), protection of legitimate expectations of the affected owner, and whether the affected owner was treated equally in comparison with other owners. If the regulation of the property is disproportional, it must be accompanied by compensation to ensure the constitutionality of the interference, which again can be below market value.¹⁴ Therefore, the concept of property in German law is strongly characterised by social responsibility with respect to the property in which an individual holds a proprietary interest.¹⁵ Common law traditions, while recognising the absolute right to property attributed to the *Magna Carta*, also recognise that parliament has limited power to encroach on private property for public purpose by enacting ‘the law of the land’ but only where reasonable compensation is given.¹⁶

However, the natural law theory found different expression in US law. In US constitutional thought, property is seen as an absolute and indefeasible right, protected by the Fifth Amendment, which prohibits the taking of private property for public use, without just compensation.¹⁷ The clause is an expression of the concept of eminent domain, which entails the State’s inherent power to compulsorily acquire one’s property against compensation. One exception to this takings rule is the power of the State to regulate property under the ‘police powers’ doctrine, which includes the State’s inherent and plenary power to regulate property in the interests of health, safety, or morality, and does not involve payment of compensation for expropriation.¹⁸ However, the invocation of police powers in late 19th century US constitutional thinking required strict scrutiny in order not to be invoked for the promotion of private interests, in particular interests of

¹² Gebhard Bücheler, *Proportionality in Investor–State Arbitration* (OUP 2015) 132.

¹³ Art 14(1) German Basic Law.

¹⁴ Markus Perkams, ‘The Concept of Indirect Expropriation in Comparative Public Law – Searching for Light in the Dark’ in Stephan W Schill (ed), *International Investment Law and Comparative Public Law* (OUP 2010) 135-136.

¹⁵ Murray Raff, *Private Property and Environmental Responsibility: A Comparative Study of German Real Property Law* (Kluwer 2003) 165-166.

¹⁶ William Blackstone, *Commentaries on the Laws of England* (vol I, bk I, first published 1765) 135; Australian Law Reform Commission, *Traditional Rights and Freedoms – Encroachments by Commonwealth Laws* (ALRC Interim Report 127, 2015) para 7.8-7.10.

¹⁷ The Fifth Amendment, in part relevant to protection of property, prescribes: ‘No person shall be ... deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation’. The Fifth Amendment must be read together with the due process clause of the Fourteenth Amendment.

¹⁸ Perkams (n 14) 122.

well-situated groups at the expense of the larger public interest.¹⁹ In the jurisprudence of the US Supreme Court, a number of criteria have been developed in order to determine whether a government taking has taken place, such as the character of the governmental measure, the extent to which it interfered with investment-backed expectations, and the economic impact of the measure on the owner.²⁰ In the cases where regulation deprives the owner of *any* economic beneficial use, the measure will constitute a taking unless it prohibits a use that was already impermissible under nuisance law.²¹ Thus, while the balancing test in the European legal tradition is used to determine compensation after it has been established that property was expropriated for a legitimate public purpose, the balancing test in the US regulatory takings doctrine is used to determine whether expropriation took place. If answered in the positive, it will attract compensation; if answered in the negative, such expropriation will not lead to compensation. It was this US regulatory takings approach to expropriation that influenced international investment law in the cases of expropriation.²²

In international law, States generally have a right to expropriate, but this right is limited by fulfilment of certain conditions in order for the expropriation to be legal. These conditions include: the public interest purpose of the measure; absence of discrimination; due process of law; and payment of *prompt, adequate and effective* compensation.²³ German BITs refer only to public purpose and compensation requirements but require that the legality of a measure and the amount of compensation be subject to review by due process of law.²⁴ Therefore, even in the cases when expropriation is legal, treaties require the payment of compensation, usually in the amount of 'fair market value'. Only exceptionally can compensation be excluded, and that is in cases which fall within the police powers doctrine.²⁵ In practice, this leads to an unsatisfactory 'all or nothing approach', where the essential question becomes not whether expropriation was lawful

¹⁹ David Schneiderman, 'NAFTA's Takings Rule: American Constitutionalism Comes to Canada' (1996) 46 University of Toronto Law Review 499, 506-509.

²⁰ *Penn Central Transportation Co v New York City* 438 US 104 (1978).

²¹ *Lucas v South Carolina Coastal Council* 505 US 1003 (1992).

²² Mathucumaraswamy Sornarajah, *The International Law on Investment* (3rd edn, CUP 2010) 194.

²³ See, for example, Art 13(1) The Energy Charter Treaty (adopted 17 December 1994, entered into force 16 April 1998) 2080 UNTS 100 (ECT); Art 6 US Model Bilateral Investment Treaty (2012) <<https://ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf>> accessed 30 June 2020 (US Model BIT 2012); Art 1110 North American Free Trade Agreement (adopted 17 September 1992, entered into force 1 January 1994) (NAFTA); Art 8.12 Comprehensive Economic and Trade Agreement between Canada, of the one part, and the European Union and its Member States, of the other part [2014] OJ L11/23 (CETA) (emphasis added).

²⁴ See, for example, Art 4 Federal Republic of Germany and Jordan Treaty concerning the encouragement and reciprocal protection of investments (with protocol and exchange of notes) (signed 15 July 1974, entered into force 10 October 1977); Rudolf Dolzer and Yun-I Kim, 'Germany' in Chester Brown (ed), *Commentaries on Selected Model Investment Treaties* (OUP 2013) 309-310.

²⁵ *Philip Morris Brands Sàrl, Philip Morris Products SA and Abal Hermanos SA Oriental v Republic of Uruguay*, ICSID Case No Arb/10/7, Award (8 July 2016) paras 188, 295.

or unlawful but whether or not it has occurred.²⁶ If expropriation happened, it will trigger the liability of the State to pay full indemnification to the affected investor.²⁷ If the expropriation did not happen, the investor alone will bear the full economic damage to his investment caused by a regulatory measure.

The greatest difficulty in the context of protection against expropriation is, thus, determining the line between a non-compensable regulatory measure and compensable indirect expropriation. While the majority of treaties offer limited guidance in this regard, arbitral tribunals have developed a number of criteria relevant for the determination of expropriation on a case-by-case basis, but offering only limited predictability, as their positions in regard to the relevance of facts in the exercise of tribunals' judgment vary from case to case.²⁸ In general, tribunals have focused on the extent, severity and duration of the impact of a regulatory measure on the investment as decisive elements in determining whether expropriation took place.²⁹

For expropriation to be found, the effect of the measure must result in 'substantial deprivation' of the investor's property interests: to ascertain whether this has occurred the test applied is whether the particular interference with business activities was 'sufficiently restrictive to support the conclusion that the property has been "taken" from the owner';³⁰ that is, 'ousting the investor from full ownership and control of [the] investment'.³¹ Tribunals also examine the effect of the measure on the economic value of investment – for expropriation to be established, the effects of the measure must result in 'depriving the owner in whole or in significant part of the use or reasonably-to-be-

²⁶ Ursula Kriebaum, 'Regulatory Takings: Balancing the Interests of the Investor and the State' (2007) 8 The Journal of World Investment and Trade 717, 719-720.

²⁷ The difference between lawful and unlawful expropriation is in the payment of compensation or damages. Unlawful or illegal expropriation results in *restitutio in integrum*, which includes the payment of damages according to the principle stated in the *Chorzów Factory* case, requiring reparation which must 'as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed': *Case Concerning the Factory at Chorzów (Germany v Poland)*, (Indemnity) [1928] PCIJ Rep Series A No 17; *ADC Affiliate Limited and ADC & ADMC Management Limited v The Republic of Hungary*, ICSID Case No. ARB/03/16, Award (2 October 2006), paras 484-494 and cases cited within. See Kriebaum (n 26) 720.

²⁸ The challenge of predictability was expressed by the Tribunal in *Generation Ukraine, Inc. v Ukraine*, ICSID Case No. ARB/00/9, Award (16 September 2003) in para 20.29: 'Predictability is one of the most important objectives of any legal system. It would be useful if it were absolutely clear in advance whether particular events fall within the definition of an "indirect" expropriation. It would enhance the sentiment of respect for legitimate expectations if it were perfectly obvious why, in the context of a particular decision, an arbitral tribunal found that a governmental action or inaction crossed the line that defines acts amounting to an indirect expropriation. But there is no checklist, no mechanical test to achieve that purpose. The decisive considerations vary from case to case, depending not only on the specific facts of a grievance but also on the way the evidence is presented, and the legal bases pleaded. The outcome is a judgment, i.e. the product of discernment, and not the printout of a computer programme'.

²⁹ Christoph Schreuer, 'The Concept of Expropriation under the ECT and other Investment Protection Treaties' (2005) <https://www.univie.ac.at/intlaw/pdf/csunpublpaper_3.pdf> accessed 30 June 2020

³⁰ *Pope & Talbot Inc. v The Government of Canada*, UNCITRAL, Interim Award (26 June 2000) para 102.

³¹ *ibid* para 100.

expected economic benefit of the property’;³² in other words, depriving the investor in whole or in part of its investment where ‘the loss of value is such that it can be considered equivalent to a deprivation of property’.³³ Depending on the context and circumstances, deprivation can amount to an expropriation even if it was ‘partial and temporary’, but it will usually have to amount to ‘a lasting removal of the ability of an owner to make use of its economic rights’.³⁴ The difficulty lies in determining what constitutes ‘substantial deprivation’, which is a ‘fact-sensitive assessment’ and ‘cannot be conducted on the basis of rigid binary rules’, thus indicating that the assessment is qualitative rather than quantitative.³⁵

While there is no doubt that the gravity of the effects of a government measure on an investment should be a significant factor in determining expropriation, it is more controversial whether it should be the *only* relevant criterion, which is the approach reflecting the ‘sole effect’ doctrine. Such an approach disregards the purpose of the government measure, which can entail an important public interest.³⁶ In some cases where the sole effects doctrine has been applied, tribunals have explicitly stated that motivations behind the State measure play no role in determining expropriation.³⁷ The diametrically opposite approach is the one that applies the ‘police powers’ doctrine: the principle that the State’s reasonable *bona fide* exercise of police powers in matters of

³² *Metalclad Corp v United Mexican States*, ICSID Case No. ARB (AF)/97/1, Award (30 August 2000) para 103. See also *CME Czech Republic B.V. v The Czech Republic*, Final Award (14 March 2003) paras 591, 604-608.

³³ *Charanne B.V. v Spain* SCC Arb. No. 062/2012, Final Award (21 January 2016) para 465.

³⁴ *S. D. Myers, Inc. v Government of Canada*, Partial Award (13 November 2000) para 283. In this case the Tribunal did not find that the Canadian Government measure, which consisted in a temporary closure of the border for a duration of 18 months, amounted to expropriation.

³⁵ *Chemtura Corporation v Government of Canada* (formerly *Crompton Corporation v Government of Canada*), Award (2 August 2010) para 249. The Tribunal in *Sempra Energy International v The Argentine Republic*, ICSID Case No. ARB/02/16, Award (28 September 2007), paraphrasing *Pope & Talbot* (n 30), gave examples of what such qualitative analysis involves: ‘Substantial deprivation results under this list from depriving the investor of control over the investment, managing the day-to-day operations of the company, arresting and detaining company officials or employees, supervising the work of officials, interfering in administration, impeding the distribution of dividends, interfering in the appointment of officials or managers, or depriving the company of its property or control in whole or in part. The list of measures could be expanded significantly in the light of the findings of many other tribunals, but would still have to meet the standard of having as a result a substantial deprivation of rights’: para 284.

³⁶ Rudolf Dolzer, ‘Indirect Expropriations: New Developments?’ (2002) 11 N.Y.U. Environmental Law Journal 64, 79-80.

³⁷ For example, in *Metalclad* (n 32) in para 111 the Tribunal stated that it ‘need not decide or consider the motivation or intent of the adoption of the Ecological Decree. Indeed, a finding of expropriation on the basis of the Ecological Decree is not essential to the Tribunal’s finding of violation of NAFTA Article 1110’, explaining further in para 103 that expropriation can occur ‘even if not necessary to the obvious benefit of the State’. Similarly, in *Tippetts v Iran* (1986) 6 Iran-US CI Trib Rep 219, 225-26, the Tribunal explained: ‘The intent of the government is less important than the effects of the measures on the owner, and the form of the measures of control or interference is less important than the reality of their impact’. In *Compañía del Desarrollo de Santa Elena S.A. v Republic of Costa Rica*, ICSID Case No. ARB/96/1, Award (17 February 2000) para 72, the Tribunal was even more explicit: ‘Expropriatory environmental measures – no matter how laudable and beneficial to society as a whole – are, in this respect, similar to any other expropriatory measures that a State may take in order to implement its policies: where property is expropriated, even for environmental purposes, whether domestic or international, the State’s obligation to pay compensation remains.’ However, it must be noted that this was a case of direct expropriation.

public order, health or morality excludes compensation even when it causes economic damage to an investor, and thus as it is not considered expropriation, does not give rise to *any* compensation.³⁸ The criteria for determining when a government measure will not be considered expropriation include ‘non-discriminatory regulation’, made for a ‘public purpose’, which is ‘enacted with due process’ and does not involve any ‘specific commitments’ that the government would refrain from such regulation given by the government to the putative investor.³⁹ Such regulation must be made in good faith and in the ‘normal exercise’ of the State’s regulatory powers.⁴⁰ However, the mentioned criteria for determining whether an expropriation occurred significantly overlap with the criteria for determining lawful expropriation when expropriation has occurred, and which requires payment of compensation. In addition, it remains unclear what regulations would be permissible as falling within the police powers doctrine, effectively leaving to investment tribunals in each particular case to answer the question ‘*when, how and at what point*’ a valid regulation which does not involve compensation becomes, ‘*in fact and effect*’, an (un)lawful expropriation, which requires the payment of compensation or damages.⁴¹ In some cases, when characterising a measure as within a State’s police power, tribunals have shown a willingness to accept ‘scientific consensus on public health issues’ and a State’s international obligations in regard to a particular measure, while allowing for ‘substantial deference’ to decision-making of specialised national authorities in assessing the necessity of the measure.⁴²

Seeking a middle way between the sole effect and police powers doctrines, tribunals attempted to apply a more balanced approach by taking into consideration the effects of the measure on the investor as well as the purpose of the measure. However, although recognising that it is appropriate for tribunals to examine the ‘purpose and effect of a government measure’, the tribunals effectively still focus on the measure’s effect, and not its purpose.⁴³ In the equation, a relevant factor in determining

³⁸ *Philip Morris* (n 25) paras 188, 295 (emphasis added). However, it is also significant to note that, in coming to this conclusion, the Tribunal first examined the effects of the challenged legislation on the value of investment, establishing that ‘sufficient value’ remained after the measures have been implemented: para 286.

³⁹ *Methanex Corporation v United States of America*, Final Award of the Tribunal on Jurisdiction and Merits (3 August 2005) Part IV, ch D, para 7.

⁴⁰ *Saluka Investments B.V. v The Czech Republic*, Partial Award (17 March 2006) para 255.

⁴¹ This quote is adopted from *Saluka* (ibid) paras 263-264. The original statement of the Tribunal (in para 264) reads: ‘Faced with the question of *when, how and at what point an otherwise valid regulation becomes, in fact and effect, an unlawful expropriation*, international tribunals must consider the circumstances in which the question arises. The context within which an impugned measure is adopted and applied is critical to the determination of its validity.’

⁴² *Philip Morris* (n 25) paras 95, 418-419; *Chemtura* (n 35) paras 134-138. Inter alia, the *Chemtura* Tribunal noted: ‘the rule of a Chapter 11 Tribunal is not to second-guess the correctness of the science-based decision-making of highly specialized national regulatory agencies. We agree with this proposition’: para 134.

⁴³ *S. D. Myers* (n 34) paras 281-282. In the Tribunal’s view ‘[e]xpropriations tend to involve the deprivation of ownership rights; regulations a lesser interference’: para 282. Having established that the measure does not

expropriation is also the investor's reasonable 'investment-backed expectations', involving consideration of the governmental interference 'in light of the investor's chosen business model, the nature of the enterprise, the regulatory regime in place at the time of investment, and associated expectations'.⁴⁴ However, this approach also proceeds from examination, firstly, of the effects of the measure before considering the balancing process. In some cases, tribunals resorted to the proportionality test to establish whether expropriation took place, examining the measure undertaken by government in light of the protected public interest and the legally granted investment protection. However, in this exercise the tribunals also prioritised the significance of a measure's impact on investment as a key element for assessing proportionality.⁴⁵ While the proportionality approach in this context has been inspired by the jurisprudence of the European Court of Human Rights (ECtHR),⁴⁶ it has been applied differently; it is used for determining whether expropriation occurred, and not whether it achieved a fair balance between protection of private and public rights after establishing that lawful expropriation occurred, which can lead to compensation below market value.⁴⁷

Based on the controversies noted in the jurisprudence, more recent IIAs have attempted to strike a balance between compensable and non-compensable regulatory measures by providing a clarification of what constitutes indirect expropriation,⁴⁸ or by providing guidance in regard to criteria which should be used when assessing indirect expropriation.⁴⁹ Arguably, this approach only codifies the middle way already adopted by arbitral tribunals.⁵⁰ While providing more clarity in defining the concept of indirect

have the effect necessary to constitute expropriation, the Tribunal did not go into the examination of the purpose of the measure. See also *Marvin Roy Feldman Karpa v United Mexican States*, ICSID Case No. ARB(AF)/99/1, Award (16 December 2002) paras 110-111.

⁴⁴ *Fireman's Fund Insurance Company v The United Mexican States*, ICSID Case No. ARB(AF)/02/1, Award (17 July 2006) para 176. The Tribunal in this regard provides a comprehensive list of criteria that should be taken into account when assessing whether expropriation occurred. Investment-backed expectations is also a concept taken from the US regulatory takings jurisprudence.

⁴⁵ *Tecmed* (n 5) para 122.

⁴⁶ *ibid* para 122.

⁴⁷ Kriebaum (n 26) 730.

⁴⁸ For example, the US Model BIT 2012 in Annex B, Art 4(b), states: 'Except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriation.'

⁴⁹ For example, the US Model BIT 2012 in Annex B, Art 4(a), requires a case-by-case, fact-based inquiry that considers, among other factors: '(i) the *economic impact* of the government action, although the fact that an action or series of actions by a Party has an adverse effect on the economic value of an investment, *standing alone*, does *not* establish that an indirect expropriation has occurred; (ii) the extent to which the government action interferes with *distinct, reasonable investment-backed expectations*; and (iii) the *character* of the government action' (emphasis added).

⁵⁰ The new US-Mexico-Canada Trade Agreement (signed 30 November 2018, entered into force 1 July 2020) (USMCA) limits the scope of ISDS clauses to direct expropriation only: Art 14.D.3(1), with the exception of covered government contracts in Annex 15-E, whereby ISDS remains available for both direct and indirect expropriation: see Annex 14-E, Arts 2(a)(i) and (b)(i).

expropriation, it does not necessarily provide a more balanced approach to public and private interests in IIL.

2.1.2. Fair and equitable treatment

Another key substantive protection afforded in IIAs is the right to fair and equitable treatment (FET). Due to its divergent formulation and breadth, FET has been widely used by investors as a catch-all provision.⁵¹ Investors have relied upon it in cases when their claims have not been covered by more specific protection clauses.⁵² While difficult to be defined precisely, FET is understood as:

[g]overnment according to the rule of law that establishes basic substantive and procedural rights concerning the stability and predictability of the legal framework; consistency of the host State's decision making; the protection of investor confidence or "legitimate expectations"; procedural due process and the prohibition of denial-of-justice; protection against discrimination and arbitrariness; and the requirement of transparency.⁵³

IIAs refer to these elements differently in their formulation of the FET standard. For example, German BITs include the FET standard as an autonomous obligation, stipulating that investors will be accorded the 'fair and equitable standard and full protection', without specifying the content of the standard, and without reference to international law.⁵⁴ The ECT clarifies that FET treatment in any case shall not be 'less favourable than the treatment required under international law'.⁵⁵ NAFTA and US BITs identify FET

⁵¹ The first tribunal which applied the FET standard was *Emilio Agustín Maffezini v The Kingdom of Spain*, ICSID Case No. ARB/97/7, Award (13 November 2000), establishing breaches of Art 4(1) of the Argentine–Spain BIT with respect to lack of transparency. In 2019, in the decisions rendered on merits holding the State liable, most common were the breaches of the FET standard: UNCTAD, 'World Investment Report 2020: International Production beyond the Pandemic' (16 June 2016) UNCTAD/WIR/2020, 111.

⁵² For example, the Tribunal in *PSEG Global, Inc., The North American Coal Corporation, and Konya Ingin Elektrik Üretim ve Ticaret Limited Sirketi v Republic of Turkey*, ICSID Case No. ARB/02/5, Award (19 January 2007) para 238, noted: 'The standard of fair and equitable treatment has acquired prominence in investment arbitration as a consequence of the fact that other standards traditionally provided by international law might not in the circumstances of each case be entirely appropriate. This is particularly the case when the facts of the dispute do not clearly support the claim for direct expropriation, but when there are notwithstanding events that need to be assessed under a different standard to provide redress in the event that the rights of the investor have been breached.' Comparison could be made with civil law codes, which include a number of specific clauses, but also a general clause of duty to act in good faith, as a catch-all provision.

⁵³ Charles N. Brower and Stephan W. Schill, 'Is Arbitration a Threat or a Boon to the Legitimacy of International Investment Law' (2009) 9 *Chicago Journal of International Law* 471, 487.

⁵⁴ Dolzer and Yun-I (n 24) 307.

⁵⁵ Moreover, the FET standard of treatment in the ECT is in any case higher than under CIL. Art 10(1) ECT reads: 'Each Contracting Party shall, in accordance with the provisions of this Treaty, *encourage and create stable, equitable, favourable and transparent conditions* for Investors of other Contracting Parties to make Investments in its Area. Such conditions shall include *a commitment to accord at all times* to Investments of Investors of other Contracting Parties *fair and equitable treatment*. Such Investments shall also *enjoy the most constant protection and security* and no Contracting Party shall in any way *impair by unreasonable or discriminatory measures their management, maintenance, use, enjoyment or disposal*' (emphasis added).

standard as a standard of protection in accordance with international law.⁵⁶ These different formulations have thus raised the issue of how the standard is to be measured: as a minimum standard of treatment (MST) of aliens under customary international law (CIL) or as an unqualified concept that is not explicitly linked to international law.⁵⁷ The difference is significant as the former position sets a much higher threshold of liability for States than the latter one, which is thus more favourable to investors.

Depending on the treaty in question, tribunals have approached this issue differently, with many observing that the FET standard is not the same as an MST but it is still a standard which has to be determined by reference to international law, part of which is CIL.⁵⁸ The issue has been most prominent in the context of NAFTA, where the contracting States, being dissatisfied with tribunals' interpretations of the FET standard that goes beyond the MST, issued a binding interpretation of the FET standard.⁵⁹ Despite the initial resistance,⁶⁰ tribunals have generally accepted that the NAFTA FET standard reflects the MST under CIL, which has nevertheless evolved over time,⁶¹ protecting

⁵⁶ Art 1105(1) NAFTA outlines: 'Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.' Art 5 US Model BIT 2012 contains the identical clause, with the only difference referring to covered investments.

⁵⁷ OECD 'Fair and Equitable Treatment Standard in International Investment Law' (2004) OECD Working Papers on International Investment, No. 2004/03, 2.

⁵⁸ *Philip Morris* (n 25) paras 316-317, where the Tribunal also stated that FET cannot be regarded as an 'autonomous' standard but also cannot be read as 'treatment required by the minimum standard of treatment under international law'. See also *Tecmed* (n 5) para 155; *Saluka* (n 40) para 294. In *Sempra* (n 35) para 302, the Tribunal noted that, depending on the circumstances, the FET standard can be equated with the international minimum standard, but it can also be more precise and spelled out in contemporary fashion, which can require a treatment additional to or beyond that of customary law.

⁵⁹ In the joint interpretative statement by NAFTA Contracting parties, it was clarified that Art 1105(1) prescribes the MST of aliens under CIL as the minimum standard of treatment, and that the concepts of 'fair and equitable treatment' and 'full protection and security' do not require treatment in addition to or beyond that which is required by CIL: Provision B, NAFTA Free Trade Commission, 'Notes of Interpretation of Certain Chapter 11 Provisions' (31 July 2001)

<http://www.sice.oas.org/tpd/nafta/Commission/CH11understanding_e.asp> accessed 30 June 2020.

⁶⁰ The Tribunal in *Pope & Talbot* (n 30) whose decision was *inter alia*, a triggering factor for issuing the Notes of Interpretation, questioned whether it was bound by them, claiming they were an amendment to the agreement and not an interpretation: Award in Respect of Damages (31 May 2002) para 47. The Tribunal found that the 'fairness element' in Art 1105 is 'additive' to the requirements of international law, affording investors under NAFTA 'international law, minimum plus the fairness element': Award on the Merits of Phase 2 (10 April 2001) para 110. According to the Tribunal, even if the Notes of Interpretation were applicable to this case, the decision would have been the same: Award in Respect of Damages, paras 52-66.

⁶¹ *Mondev International Ltd. v United States of America*, ICSID Case No. ARB(AF)/99/2, Award (11 October 2002) para 116; *Chemtura* (n 35) paras 121-122. The *Neer* case in 1926 laid down a principle of MST under international law. In this case it was established that for there to be a breach of international law, 'the treatment of an alien ... should amount to an outrage, to bad faith, to wilful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognise its insufficiency': *U.S.A. (L.F. Neer) v United Mexican States*, Decision of the General Claims Commission United States-Mexico (15 October 1926), Opinions of Commissioners, 1927, p. 1, quoted in *Mondev*, para 114 (the case concerned Mexico's responsibility for failure to carry out an effective police investigation of a US citizen, and it was not in regard to foreign investment). In the Tribunals' case-law and doctrine, it is generally considered that MST applies to: the administration of justice in regard to foreign nationals (denial of justice); the treatment of aliens under detention; and full protection and security, referring to duty of to physically protect assets and property from attacks which may be targeted at foreigners: OECD 2004 (n 57) 9. Given the high threshold of liability and the context in which the *Neer* case was made, the vast number of IIAs and arbitration jurisprudence, tribunals have come to the conclusion that

‘against all such acts or behaviour that might infringe a sense of fairness, equity and reasonableness’.⁶² It has been argued that in the NAFTA context tribunals have generally interpreted the FET standard as being comprised of a limited number of defined elements (e.g. denial of justice, failure to protect full protection and security, etc.), which have been interpreted by tribunals in ‘greatly varying ways’ but have not been equated with more abstract notions of justice or the rule of law.⁶³ Importantly, the MST under CIL is a general obligation under international law, which applies to inter-State relations regardless of a treaty. Tribunals’ divergent approaches to the interpretation of MST can lead to fragmentation of international law, and arguably are contrary to *opinio iuris*.⁶⁴

The duty to accord FET treatment expands to the overall treatment of investors by the host State, whereby all kinds of government actions, whether legislative, administrative or judicial, can potentially be in breach of the FET standard.⁶⁵ The FET standard entails an obligation to provide stability and predictability of the legal and business framework in which the investment has been made.⁶⁶ This obligation corresponds to an investor’s legitimate expectations, which is one of the most important concepts of the FET standard. However, legal stability is not absolute and does not exclude the State’s sovereign authority to legislate and to adapt its legal system to changing circumstances.⁶⁷ Such ‘virtual freezing of the legal regulation of economic activities’ would be contrary to ‘the State’s normal regulatory power and the evolutionary character of economic life’ and would not be ‘legitimate nor reasonable’.⁶⁸ Accordingly, some tribunals have claimed that unless the State made *specific* promises or representations to the investor, the investor cannot treat a BIT as an ‘insurance policy against the risk of any changes in the host State’s legal and economic framework’.⁶⁹ However, in the exercise of

the standard of treatment of foreign investment expected under current international law requires more than the standard established by the *Neer* Tribunal in 1926.

⁶² *Merrill and Ring Forestry L.P. v Canada*, ICSID Case No. UNCT/07/1, Award (31 March 2010) para 210.

⁶³ See, for example, remarks by the Tribunal in *Apotex Holdings Inc. and Apotex Inc. v United States of America*, ICSID Case No. ARB(AF)/12/1, Award (25 August 2014) paras 9.41-9.47. Accordingly, the Tribunal concluded that ‘a high threshold of severity and gravity’ is required in order to conclude that the host State has breached any of the elements contained within the FET standard under Art 1105: *ibid*, para 9.47.

⁶⁴ Accordingly, the *Mondev* Tribunal applied the NAFTA Free Trade Commission statement on the basis that the MST incorporates heightened MST, ‘whose content is shaped by the conclusion of more than two thousand bilateral investment treaties and many treaties of friendship and commerce’: *Mondev* (n 61) para 125. Such an approach is basically in contradiction with the NAFTA Free Trade Commission Notes of Interpretation. Other non-NAFTA tribunals have also accepted the proposition that the FET standard, while still far from being settled, is much broader than the *Neer* principle: *Philip* (n 25) para 319.

⁶⁵ UNCTAD, ‘Fair and Equitable Treatment’ (2012) Issues in International Investment Agreements (Second series), UNCTAD/DIAE/IA/2011/5, 12.

⁶⁶ *Occidental Exploration and Production Company v The Republic of Ecuador*, LCIA Case No. UN3467, Final Award (1 July 2004) para 191; *EDF (Services) Limited v Romania*, ICSID Case No. ARB/05/13, Award (8 October 2009) para 217.

⁶⁷ *Philip Morris* (n 25) para 422; *BG Group v Argentina*, UNCITRAL, Final Award (24 December 2007) paras 292-310.

⁶⁸ *EDF* (n 66) para 217.

⁶⁹ *ibid*.

its legislative power, a State cannot act ‘unfairly, unreasonably or inequitably’.⁷⁰ In other words, regulatory change cannot be arbitrary, which includes ‘wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of judicial propriety’ and which is therefore ‘opposed to the rule of law’.⁷¹ A foreign investor whose interests are protected under an investment treaty is entitled to expect that the State will not act in a way that is ‘manifestly inconsistent’ and ‘unreasonable’.⁷² Closely related to the arbitrariness is also the obligation of the host State to act in good faith,⁷³ which includes the duty not to act for ‘purely arbitrary reasons’ related to domestic politics and nationalistic reasons of a discriminatory character.’⁷⁴ Ultimately, the FET standard requires weighing of the investor’s legitimate and reasonable expectations on the one hand and the State’s legitimate regulatory interests on the other.⁷⁵ However, reasonableness rather than proportionality is still the more commonly applied principle in review of government conduct under the FET standard.⁷⁶

The minimalist wording of FET clauses, indeterminacy of the State’s liability threshold, and the lack of clear legal test for the standard, leaves for arbitrators a wide discretion in the interpretation of FET provisions, resulting in inconsistent application and allowing tribunals to review a range of government actions which were previously seen as outside of the scope of international law.⁷⁷ In practice, this has led to the establishment of breaches in very broad categories of State regulatory actions, such as tariff regulations, conduct of negotiations, organisation of tenders, and communication between State and investor.⁷⁸ Therefore, FET raises the same issues of balancing investment protections with the State’s right to regulate in the public interest as indirect expropriation. Additionally, different approaches to the FET standard pose a significant

⁷⁰ *Parkerings-Compagniet AS v Republic of Lithuania*, ICSID Case No. ARB/05/8, Award (11 September 2007) para 332.

⁷¹ *Elettronica Sicula S.p.A. (ELSI)* (United States of America v Italy) (Judgment) [1989] ICJ Rep 15, para 128.

⁷² *Saluka* (n 40) para 309.

⁷³ *Waste Management, Inc. v United Mexican States ("Number 2")*, ICSID Case No. ARB(AF)/00/3, Award (30 April 2004) para 138.

⁷⁴ *Eureko B.V. v Republic of Poland*, Partial Award (19 August 2005) para 233.

⁷⁵ *Saluka* (n 40) para 306.

⁷⁶ Jonathan Bonnitza, *Substantive Protection under Investment Treaties: A Legal and Economic Analysis* (CUP 2014) 224. Recently, to add to rich divergent practice, the Tribunal in *Blusun v Italy* concluded that legality of regulatory changes in the absence of specific representation must be assessed on the basis of proportionality and not ‘unreasonableness’, which can be criticised as ‘an open-ended mandate to second-guess the host State’s policies’. On the contrary, ‘disproportionality carries in-built limitations and is more determinate’: *Blusun S.A., Jean-Pierre Lecorcier and Michael Stein v Italian Republic*, ICSID Case No. ARB/14/3, Final Award (27 December 2017) para 318. Accordingly, the Tribunal found that necessity to modify lawfully granted subsidies ‘should be done in a manner which is not disproportionate to the aim of the legislative amendment, and should have due regard to the reasonable reliance interests of recipients who may have committed substantial resources on the basis of the earlier regime’: *ibid*, para 319(5). The Tribunal rejected all investor claims on merits.

⁷⁷ UNCTAD 2012 (n 65) 11-13, 22.

⁷⁸ Rudolf Dolzer, ‘Fair and Equitable Treatment: Today’s Contours’ (2014) 12 Santa Clara Journal of International Law 7, 32.

challenge for States in the practical implementation of the standard domestically – between different branches and different levels of government – as it becomes difficult to predict what kind of specific conduct could lead to breach of the FET standard.

In order to overcome some of the problems noted to arise from this jurisprudence, the US Model BIT 2012 provides explanations of concepts of FET and ‘full protection and security’,⁷⁹ while also defining CIL.⁸⁰ The new US policy goes even further in the US–Mexico–Canada (USMCA) Trade Agreement.⁸¹ The EU–Canada Comprehensive Economic Trade Agreement (CETA) also provides more detailed FET language.⁸² However, it remains to be seen whether more clarity in the expression of the FET standard also results in more certainty.

2.1.3. Protection against discrimination

Protection against discrimination in IIL is provided through national treatment (NT) and most-favoured-nation treatment (MFN) and it is also included in the concept of FET.⁸³ Unlike FET, which is an absolute standard, NT and MFN are relative standards, whose meaning is defined by reference to the treatment afforded to other investments.⁸⁴ While the principle of NT aims to accord to foreign investors the same treatment as that granted to domestic investors, the MFN standard affords foreign investors the treatment comparable to other foreign investors operating in the host country.

IAs offer different formulations of NT and MFN in one combined⁸⁵ or separate clauses, most commonly requiring treatment ‘no less favourable’ than that accorded to

⁷⁹ Art 5(2) US Model BIT 2012, stating that these standards ‘do not require treatment in addition to or beyond that which is required by that standard, and do not create additional substantive rights’. FET involves a higher threshold of liability as it includes the principles of denial of justice in criminal, civil, or administrative adjudicatory proceedings and due process, while ‘full protection and security’ includes an obligation to provide the level of police protection required under customary international law.

⁸⁰ Annex A US Model BIT 2012. It is clarified that the MST under CIL refers to ‘all CIL principles that protect the economic rights and interests of aliens’.

⁸¹ In Art 14.6 the USMCA prescribes the obligation of treatment in accordance with CIL, including FET (limited to denial of justice in criminal, civil or administrative proceedings and due process) and full protection and security (the level of police protection under CIL). The mere fact that an investor’s expectations have not been met does not constitute the breach, even if there is consequent loss or damage to the covered investment. Breach of FET treatment is excluded from the scope of ISDS clauses in Annex 14-D but not from the ISDS scope of covered government contracts in limited sectors, in accordance with Annex 14-E.

⁸² Art 8.10 Comprehensive Economic and Trade Agreement between Canada, of the one part, and the European Union and its Member States, of the other part [2017] OJ L11/23 (CETA). See chapter 8.

⁸³ *Saluka* (n 40) para 309, where the Tribunal noted that ‘[a] foreign investor whose interests are protected under the Treaty is entitled to expect that the [host State] will not act in a way that is manifestly inconsistent, non-transparent, unreasonable (i.e. unrelated to some rational policy), or *discriminatory* (i.e. based on *unjustifiable distinctions*)’ (emphasis added). See also *Waste Management* (n 73) para 98.

⁸⁴ OECD 2004 (n 57) 2.

⁸⁵ For example, Art 10(7) ECT outlines both standards in the same clause. In CETA both standards are defined under the same section (Section C: non-discriminatory treatment) albeit in two separate provisions.

national⁸⁶ or other foreign investors⁸⁷ respectively, with or without qualification ‘in like circumstances’.⁸⁸ In the European type of BITs, NT and MFN are guaranteed only in the post-establishment stage of investment, while in the US BITs and regional agreements these treatments are also extended to the pre-entry stage.⁸⁹ Additionally, the application of the NT and MFN clauses can be limited by providing a list of categories of investment or activities to which these standards apply (positive list approach) or from the application of which they are excluded (negative list approach).⁹⁰ Further, treaties can offer a number of more general exceptions relating to public health, order and national security, which apply not only to NT and MFN but the whole of the treaty.⁹¹ In the case of a conflict between NT and MFN standards, treaties sometimes prescribe that the standard most favourable to investors applies.⁹²

Another notable issue is the application of NT and MFN standards in regard to subnational authorities which can accord preferential treatment to businesses at local level, and especially when such authorities have a constitutional power to make investment policy, which can grant businesses at local level preferential treatment. In the case of the US, such treatment would not extend to domestic investors outside of a particular local subdivision, thus also preventing foreign investors from invoking it.⁹³ Under CETA, full NT and MFN standards apply to all levels, sub-federal in Canada, and EU Member States and sub-EU Member States levels in the EU.⁹⁴ While the ECT provides for similar broad extension of specific subnational treatment to foreign investors, NAFTA

⁸⁶ Art 3(1) German Model Bilateral Investment Treaty (2008)

<<https://investmentpolicy.unctad.org/international-investment-agreements/treaty-files/2865/download>> accessed 30 June 2020 (German Model BIT 2008); Art 3 US Model BIT 2012; Art 1102 NAFTA; Art 8.6 CETA.

⁸⁷ Art 3(2) German Model BIT 2008; Art 4 US Model BIT 2012; Art 1103 NAFTA; Art 8.7 CETA.

⁸⁸ Although this is found in NAFTA and the US Model BIT 2012, as well as CETA, there is no such formulation in German BITs, which thus arguably offer the widest scope for comparison.

⁸⁹ See chapter 3 for further discussion. CETA is an exception in this regard as it follows the North American model.

⁹⁰ Directorate General for External Policies of the European Parliament, ‘The Investment Chapters of the EU’s International Trade and Investment Agreements in a Comparative Perspective’ (September 2015) EP/EXPO/B/INTA/2015/01, 115.

⁹¹ See, for example, Art 24 ECT; Art 2102 NAFTA; Art 18(2) US Model BIT 2012; Art 28.3 CETA. In German BITs, such general exception is given in the context of Art 3 which defines NT and MFN standards: ‘Measures that have to be taken for reasons of public security and order shall not be deemed treatment less favourable within the meaning of this Article.’

⁹² Art 10(7) ECT; Art 1104 NAFTA.

⁹³ This is because US BITs contain a clause which stipulates that ‘[w]ith respect to the treatment accorded by a State, Territory or possession of the United States of America, national treatment means treatment *no less favorable than the treatment accorded* thereby, in like situations, *to investments of nationals of the United States of America resident in, and companies legally constituted under the laws and regulations of, other States, Territories or possessions of the United States of America*’ (emphasis added). See, for example, Treaty between the Government of the United States of America and the Government of Croatia Concerning the Encouragement and Reciprocal Protection of Investment (signed 13 July 1996, entered into force 20 June 2001). Arguably, this would mean that comparable treatment for foreign investors would be the best treated out-of-State US investors: see UNCTAD 2004 (n 4) 170.

⁹⁴ Arts 8.6.2 and 8.7.2 CETA contain an identical clause. In practice, this application of NT could lead to a potentially more advantageous treatment of Canadian investors than domestic investors in a particular EU Member State: see chapter 8, section 8.2.1.4.

takes the middle way between the US and the EU approaches, requiring treatment of foreign investors no less favourable than the most favourable treatment accorded to other domestic investors outside the local subdivision.⁹⁵

In the practice of arbitral tribunals regarding NT, the most prominent issue is the scope of comparable activities between national and foreign investors, and, in this regard, the relevance of WTO jurisprudence in the interpretation of BITs.⁹⁶ In some cases, tribunals take into consideration the same economic or business sector,⁹⁷ while in others the examination can be broader, outside the particular sector.⁹⁸ Some tribunals accepted the WTO jurisprudence of 'like products' for interpretation of BITs,⁹⁹ while others explicitly rejected the notion of NT under WTO law, which interprets 'like products' in light of the objective of avoiding the distortion of competition.¹⁰⁰ These tribunals embraced the view that BITs address 'like situations' with a different aim, which is to avoid exporters being placed at a disadvantage in foreign markets.¹⁰¹ Moreover, some tribunals reached a conclusion that NAFTA drafters did not want to incorporate trade law criteria in the NAFTA investment chapter.¹⁰²

In assessing 'like circumstances', tribunals take into account 'circumstances that would justify governmental regulations that treat [domestic and foreign investors] differently in order to protect the public interest'.¹⁰³ Differences in treatment will not violate the NT standard if they have 'a reasonable nexus to rational policies' that do not distinguish between domestic and foreign investors, and do not otherwise unduly undermine 'the investment liberalising objectives of NAFTA', focusing on the regulatory context.¹⁰⁴ In assessing the measure, tribunals examine both *de iure*¹⁰⁵ and *de facto*¹⁰⁶ discrimination, whereby the protectionist intent of the host State is less relevant than the

⁹⁵ Art 23(1) ECT; Art 1102(3) NAFTA.

⁹⁶ Rudolf Dolzer, 'National Treatment: New Developments' (Making the Most of International Investment Agreements: A Common Agenda, OECD Symposium, Paris 2005).

⁹⁷ *Marvin Feldman* (n 43) para 172: 'the Tribunal holds that the companies which are in like circumstances, domestic and foreign, are the trading companies, those in the business of purchasing Mexican cigarettes for export'. Also *S. D. Myers* (n 34) para 248.

⁹⁸ *Occidental* (n 66) para 173: 'In fact, "in like situations" cannot be interpreted in the narrow sense advanced by Ecuador as the purpose of national treatment is to protect investors as compared to local producers, and this cannot be done by addressing exclusively the sector in which that particular activity is undertaken.'

⁹⁹ *S. D. Myers* (n 34) paras 244-247; *Marvin Feldman* (n 43) para 165.

¹⁰⁰ Report of the Appellate Body of 18 January 1999, Korea – Taxes on Alcoholic Beverages, WT/DS75/AB/R, para 118, referenced in *Occidental* (n 66) para 174.

¹⁰¹ *ibid* para 176.

¹⁰² *Methanex* (n 39) paras 30-35.

¹⁰³ *S. D. Myers* (n 34) para 249.

¹⁰⁴ *Pope & Talbot* (n 60) Award on the Merits of Phase 2, para 78.

¹⁰⁵ 'whether the measure, on its face, appears to favour its nationals over non-nationals who are protected by the relevant treaty': *S. D. Myers* (n 34) para 252.

¹⁰⁶ 'whether the practical effect of the measure is to create a disproportionate benefit for nationals over non-nationals': *ibid*; *Marvin Feldman* (n 43) para 173.

practical effect of the measure.¹⁰⁷ The latter line of reasoning corresponds with the WTO approach. However, the ‘rational nexus’ test adopted by investment tribunals differs from the WTO closed list of policy objectives in GATT Article XX, which applies a stricter ‘necessity test’ between the measure and the policy purpose.¹⁰⁸ This dual approach to the same standard in trade and investment law contributes to further fragmentation of international law. Different aims of trade and investment law (trade liberalisation vs investment protection)¹⁰⁹ are moreover less justified in cases of IIAs like NAFTA, which have investment liberalisation at the forefront of their objectives.¹¹⁰

Similarly, MFN clauses also leave wide scope for competing interpretations. Usually, foreign investors use such clauses to import certain standards of protection, whether substantive or procedural, from other IIAs (third party treaties), which are unavailable in the basic treaty directly applicable in their case. The International Law Commission adopted the *ejusdem generis* principle in the application of the MFN clause, which is a rule generally accepted in international practice, whereby MFN from a third party treaty can apply to a basic treaty only in relation to the same subject matter of the same category (*idem genus*).¹¹¹ While this rule seems straightforward, its practical application in tribunals’ jurisprudence has proved to be challenging.¹¹² Some tribunals have resorted to a broader interpretation of the clause, allowing for incorporation of both substantive and procedural protections non-existent in the basic treaty,¹¹³ while others have restricted such incorporation to substantive protections only.¹¹⁴ In order to avoid uncertainties, some more recent IIAs contain MFN clauses which specifically exclude from their application substantive and procedural obligations provided for under other IIAs.¹¹⁵

¹⁰⁷ *S. D. Myers* (n 34) para 254; *Marvin Feldman* (n 43) para 183; *Pope & Talbot* (n 60) Award on the Merits of Phase 2, para 78; *Siemens A.G. v The Argentine Republic*, ICSID Case No. ARB/02/8, Award (17 January 2007) para 320. However, discriminatory intent was required by the *Methanex* (n 39) Tribunal: part IV, ch B, para 12.

¹⁰⁸ Nicholas DiMascio and Joost Pauwelyn, ‘Nondiscrimination in Trade and Investment Treaties: Worlds Apart or Two Sides of the Same Coin?’ (2008) 102 *The American Journal of International Law* 48, 76-77.

¹⁰⁹ *ibid* 88-89.

¹¹⁰ See chapter 3, section 3.1.2.

¹¹¹ ILC Draft Arts 9 and 10 with Commentary, ILC ‘Report of the International Law Commission to the General Assembly on the Work of Its Thirtieth Session’ (1978) UN Doc A/33/10

¹¹² For a more detailed overview of international investment tribunals practice, see Claudia Salomon and Sandra Friedrich, ‘How Most Favoured Nation Clauses in Bilateral Investment Treaties Affect Arbitration’ (2013), Practice note 0-381-7466, <<https://www.lw.com/thoughtLeadership/favoured-nation-clauses-arbitration>> accessed 30 June 2020.

¹¹³ For example, *Siemens* (n 107), Decision on Jurisdiction (3 August 2004) para 103; *Emilio Maffezini* (n 51) Decision of the Tribunal on Objections to Jurisdiction (28 October 1999) para 56. In this decision, in para 63, the Tribunal conditioned the MFN clause application in regard to procedural protections by public policy considerations.

¹¹⁴ *Plama Consortium Limited v Republic of Bulgaria*, ICSID Case No. ARB/03/24, Decision on Jurisdiction (8 February 2005) para 218, where the Tribunal rejected *Maffezini* reasoning, by concluding that an arbitration clause must be ‘clear and unambiguous’ while ‘the reference to an arbitration clause must be such as to make the clause part of the contract (treaty).’

¹¹⁵ For example, Art 8.7.4 CETA; Art 14.D.3(1)(a)(i)(A) fn 22 USMCA.

The standards of NT and MFN together serve to maintain a level playing field between foreign and domestic investors in a host State's investment market. However, special protections that can be given to foreign companies through IIAs, as opposed to domestic companies, can reverse the principle of national treatment by discriminating against domestic companies. Additionally, foreign investors may, depending on the circumstances, resort to a more favourable treatment accorded to other foreign investors, which might be contrary to the original intentions of the host State.¹¹⁶ Ultimately, whether and what kind of a level playing field is achieved in a particular market will depend on the interpretation and application of the relevant NT and MFN provisions in each individual case.

2.1.4. *Free transfer of capital*

IIAs generally provide for free transfer of capital in a separate, usually very specific clause.¹¹⁷ Free transfer provisions usually contain a broad guarantee for free transfer of payments related to an investment, often listing in a non-exhaustive manner types of funds which can be transferred,¹¹⁸ the currency and exchange rate for the transfer,¹¹⁹ and the time period in which free transfer is guaranteed to investors.¹²⁰ Usually, free transfer clauses will be restricted by a number of exceptions, which allow States 'equitable, non-discriminatory, and good faith application of its laws and regulations' generally aimed at prevention of abuses of justice.¹²¹

¹¹⁶ For a view on positive effects of MFN clauses, see Claire Crépet Daigremont, 'Most Favoured Nation Treatment' in Makane Moïse Mbengue and Stefanie Schacherer (eds), *Foreign Investment Under the Comprehensive Economic and Trade Agreement (CETA)* (Springer 2019) 86-89.

¹¹⁷ Art 5 German Model BIT 2008; Art 7 US Model BIT 2012; Art 1109 NAFTA; Art 14 ECT; Art 8.13 CETA.

¹¹⁸ For example, US Model BIT 2012 in Art 7(1) reads: 'Each Party shall permit all transfers relating to a covered investment to be made freely and without delay into and out of its territory. Such transfers include: (a) contributions to capital; (b) profits, dividends, capital gains, and proceeds from the sale of all or any part of the covered investment or from the partial or complete liquidation of the covered investment; (c) interest, royalty payments, management fees, and technical assistance and other fees; (d) payments made under a contract, including a loan agreement; (e) payments made pursuant to Article 5 [Minimum Standard of Treatment](4) and (5) and Article 6 [Expropriation and Compensation]; and (f) payments arising out of a dispute.' Similarly, see Art 14.9(1) USMCA.

¹¹⁹ For example, Art 1109(2) NAFTA stipulates: 'Each Party shall permit transfers to be made in a freely usable currency at the market rate of exchange prevailing on the date of transfer with respect to spot transactions in the currency to be transferred.'

¹²⁰ For example, German Model BIT 2008 in Art 5(2) prescribe: 'Transfers under Article 4(2) or (3), under the present Article or Article 6 [Subrogation], shall be made without delay at the market rate of exchange applicable on the day of the transfer. A transfer shall be deemed to have been made without delay if made within such period as is normally required for the completion of transfer formalities. The period shall commence with the submission of the corresponding application, where such an application is necessary, or the notification of the intended transfer, and must in no circumstances exceed two months.'

¹²¹ For example, the ECT in Art 14(4) specifically refers to laws aimed at protecting the rights of creditors, or ensuring compliance with laws on the issuing, trading and dealing in securities and the satisfaction of judgements in civil, administrative and criminal adjudicatory proceedings. CETA in Art 8.13.4 provides for the most exhaustive list of such restrictions, with a more stringent expression in favour of States applying such laws: 'Nothing in this Article shall be construed to prevent a Party from applying ... its laws', which is

Provisions concerning the free transfer of capital have not yet had great relevance in the practice of investment tribunals.¹²² While it remains to be seen how tribunals will approach the interpretation of free transfer clauses,¹²³ the recent more restrictive trend in drafting these clauses recognises the need of States to adopt extraordinary regimes for extraordinary times, which is certainly a well-learned lesson of the GFC and the Euro crisis.¹²⁴

2.2. Procedural rules: investment treaty arbitration

The approach of States in allowing dispute settlement for investors varies among treaties. Most commonly, modern IIAs offer to investors the choice of ITA.¹²⁵ ISDS provisions that grant specific procedural rights and remedies are the most important component of IIAs.¹²⁶ In most cases, foreign investors have a choice to litigate before domestic courts of the host State or/and pursue arbitration of the dispute, with IIAs determining the coordination between these options.¹²⁷ In some instances, investors in Europe may be able to file a claim under the ECHR or could seek protections available under EU law.¹²⁸ Accordingly, dispute settlement clauses in IIAs raise concerns about forum shopping and

also an expression found in Art 1109(5) NAFTA (cf. ECT and US Model BIT 2012: ‘a Contracting Party may...’). See also Art 14.9(5) USMCA. German BITs are an exception in this regard as they guarantee free transfer without any restrictions: Dolzer and Yun-I (n 24) 312.

¹²² J. Griebel, *Internationales Investitionsrecht* (CH Beck 2008) 92 in European Parliament 2015 (n 90) 145.

¹²³ For current practice, see *Metalpar S.A. and Buen Aire S.A. v The Argentine Republic*, ICSID Case No. ARB/03/5, Award (6 June 2008), which concerns the Argentine financial crisis in the early 2000s. Since the investor was able to transfer funds on the basis of the prior approval of the Central Bank, the Tribunal concluded that restrictions were not absolute. The investor’s claim failed as the investor relied on the faulty private bank’s advice that transfer of funds was not allowed under positive legislation at the time.

¹²⁴ For EU IIA practice in regard to free transfer clauses and their compatibility with EU law, see chapter 8.

¹²⁵ According to UNCTAD, of a total of 2577 mapped IIAs, ISDS clauses were found in 2443 treaties: UNCTAD, ‘Mapping of IIA Project’ (*Investment Policy Hub*)

<<http://investmentpolicyhub.unctad.org/IIA/mappedContent>> accessed 30 June 2020. The other mechanism of dispute resolution in the investment context is State-to-State dispute settlement (SSDS), whereby the investor’s home State may submit a claim against the host State instead of against the investor, thus effectively leaving the investor to rely on diplomatic protection asserted by their home State. This was the dispute settlement mechanism mostly characteristic for older IIAs, which did not have ISDS clauses and which mostly predate the establishment of ICSID. While more rare, State-to-State arbitration in the contemporary context is usually used for disputes about the interpretation or application of IIAs or disputes arising over obligations taken by Contracting States to take or refrain from taking certain measures affecting investments adversely (e.g. measures regarding the establishment of investments (e.g. market access) if such measures do not fall within the scope of ISDS clauses). In some cases, investment treaty arbitration can take place only if satisfactory resolution of the dispute is not reached through inter-State consultations or mediation. See UNCTAD 2004 (n 4) 316-317. More recent IIAs of some developing States prefer SSDS to ISDS; for example, in the case of Brazil: see chapter 3, section 3.1.1. For SSDS clauses see, for example, Art 27 ECT, Art 9 German Model BIT 2008; Art 27 US Model BIT 2012; Section B of ch 20 NAFTA; ch 29 CETA.

¹²⁶ This has been recognised both in scholarly literature as well as in the practice of international tribunals. See, for example, *Emilio Maffezini* (n 113) Decision of the Tribunal on Objections to Jurisdiction, para 55; *Gas Natural SDG S.A. v Argentine Republic* (ICSID Case No. ARB/03/10) Decision of the Tribunal on Preliminary Questions on Jurisdiction (17 June 2005) para 29.

¹²⁷ The right to arbitration is mainly provided in addition to domestic proceedings. See OECD, *Dispute settlement provisions in international investment agreements: A large sample survey* (2012) 9.

¹²⁸ Specific issues in relation to compatibility of IIL and EU law are discussed in Part II.

parallel international and domestic proceedings, which serve as an advantage to foreign investors, otherwise unavailable to domestic investors.

When a dispute between an investor and a host State arises, the IIA between the investor's home State and the host State will specify the conditions for ITA. In international law the participation of sovereign States in dispute resolution generally depends on their consent, which in IIL is given through IIAs.¹²⁹ Investment treaties incorporate in their ISDS clauses an offer to arbitrate, extended by the host State to an undefined number of current and future investors of the other contracting party for all future disputes arising out of investments made in its territory. It is for the eligible investor to accept this standing offer by correctly initiating the proceedings against the host State in accordance with the requirements defined in the treaty's ISDS clause, at which stage the arbitration contract is perfected. Through offer and acceptance both parties express their mutual consent to arbitration,¹³⁰ which is the precondition for jurisdiction of the arbitral tribunal.¹³¹ This unusual arbitration contract in investment disputes, commissioned through an international treaty, gives IIL its public-private nature.

However, ISDS is a rather generic term which encompasses a number of different mechanisms, which in every particular case varies regarding the access to ITA, other dispute settlement procedures and the enforcement of investment awards.¹³² It is exactly with regard to the regulation of the dispute settlement clauses that IIAs differ most. The following sections provide an overview of procedural issues stemming from IIAs and practice.¹³³ The focus is placed on the scope of arbitral tribunals' jurisdiction, the interaction between different IIAs in determining the relevant forum and applicable law, and the arbitration process. The aim is to explain the procedural framework in which ITA takes place and to indicate relevant *systemic* problems, rather than being exhaustive.

¹²⁹ See, for example, Art 26(3)(a) ECT, which refers to this consent as 'unconditional'; Art 10(2) German Model BIT 2008, which defines such consent as 'unreserved' and 'binding'; Art 24 US Model BIT 2012; Art 1122 NAFTA; Art 8.18.1 CETA.

¹³⁰ *El Paso Energy International Company v Argentine Republic*, ICSID Case No. ARB/03/15, Decision on Jurisdiction (27 April 2006) para 25.

¹³¹ The mutual consent takes place only *after* the dispute has arisen. It was said that this 'contract' lacks privity between the host State and an individual foreign investor as the offer to arbitrate in an IIA is extended to all foreign investors: Jan Paulsson, 'Arbitration Without Privity' (1995) 10 ICSID Review – Foreign Investment Law Journal 232.

¹³² Joachim Pohl, Kekeletso Mashigo and Alexis Nohen, 'Dispute Settlement Provisions in International Investment Agreements: A Large Sample Survey' (OECD Publishing 2012).

¹³³ This includes cases of contract-based relationships between the foreign investor and State, which have come under the protection of an IIA (due, for example, to the umbrella clause). For umbrella clauses, see section 2.2.2 below.

2.2.1. Access to ISDS: broadening rather than limiting the scope of investment arbitration

When determining its jurisdiction for a particular investment dispute, a tribunal must primarily consider: (i) the notion of investment (admissibility *ratione materiae*) and (ii) the determination of the claimant's status as an 'investor' affiliated with the home State (admissibility *ratione personae*). Additionally, ISDS clauses in IIAs contain different *preconditions* which serve to limit the access of investors to international arbitration: the limitations of the time period in which claims may be brought (admissibility *ratione temporis*);¹³⁴ and the formalities that must be observed before launching the claim,¹³⁵ including preliminary procedures, other amicable methods of dispute resolution¹³⁶ or local remedies. These preconditions are important as correct compliance with them perfects the consent to arbitration.¹³⁷

ISDS clauses also specify the *arbitration rules and the forum* available for the settlement of investment disputes arising under the specific IIA. ITA is usually divided into two types: an *ad hoc* arbitration, with the application of the UNCITRAL rules;¹³⁸ and

¹³⁴ These provisions may limit access to ISDS by introducing a waiting period in which amicable dispute resolution must be attempted: see, for example, Art 26(2) ECT; Art 1120 NAFTA; Art 24(3) US Model BIT 2012; Art 10(2) German Model BIT 2008; Arts 3.5.1 and 3.6.1 Investment Protection Agreement between the European Union and its Member States, of the one part, and the Republic of Singapore, of the other part (signed 15 October 2018) (EUSIPA); Art 8.22.1(b) CETA. IIAs can also completely preclude access to arbitration after a specified period of time by introducing statutes of limitation: see, for example, Art 1116(2) NAFTA; Art 26(1) US Model BIT 2012; Art 3.3.4 EUSIPA; Art 8.19.8 CETA. ECT does not have a provision on statutes of limitation. Equally, ICSID Convention and UNCITRAL rules also do not refer to statutes of limitation. The new USMCA limits the applicability of arbitration in accordance with NAFTA ch 11 to legacy investments – those established under NAFTA and in existence when the USMCA comes into force – so long as the investor submits the claim within three years of termination of NAFTA: see Annex 14-C.

¹³⁵ Such formalities include, for example, submission of a notice of intent to arbitrate (see Art 24(2) US Model BIT 2012; Art 1119 NAFTA; Art 3.5 EUSIPA), requirements regarding written consent (see Arts 26(3), (4) and (5) ECT; Art 8.25 CETA), or other procedural requirements for the submission of a claim to the tribunal (see Art 8.22 CETA). See also new USMCA in Art 14.D.5 (Conditions and Limitations on Consent).

¹³⁶ These methods usually involve consultations and negotiations during the waiting period, and mediation as an alternative dispute resolution method in the case of EUSIPA (Art 3.4) and CETA (Art 8.20). Only EUSIPA (Art 3.3) and CETA (Art 8.19) offer a more structured consultation process, by defining more accurately time periods of the consultation process and by specifying information which must be included in the request for consultation.

¹³⁷ Whether or not the consent has been given, its scope and validity are among the most complex issues in investment arbitration. Beside in IIAs, offers of consent by host States can be given in contracts between States (contract-based arbitration) and investors and host State legislation. Procedural requirements may impose waiting periods for amicable settlement or the requirement to exhaust local remedies, and the consent may also be affected by the fork-in-the-road clauses: see section 2.2.2 below. The issues involved in the scope of consent are compounded by MFN and umbrella clauses: see respectively sections 2.1.3 above and 2.2.2 below. In light of numerous treaties and insufficiently defined rules, the issue of consent has been the subject of divergent practice and interpretations. Tribunals have both extensively and restrictively approached the interpretation of the consent agreement. For an overview of these issues in tribunals' practice, see Christopher Schreuer, 'Consent to Arbitration' in Peter Muchlinski, Federico Ortino and Christopher Schreuer (eds), *The Oxford Handbook of International Investment Law* (OUP 2008). For critical issues in the tribunals' practice, see Guiguo Wang, 'Consent in Investor-State Arbitration: A Critical Analysis' (2014) 13 Chinese Journal of International Law 335.

¹³⁸ UNCITRAL Arbitration Rules (as revised in 2010)

<<http://www.uncitral.org/pdf/english/texts/arbitration/arb-rules-revised/arb-rules-revised-2010-e.pdf>> accessed 30 June 2020. According to Art 1(2), these Rules apply to an arbitration agreement concluded after

an institutionalised arbitration under the auspices of a professional arbitration institution, such as the International Centre for Settlement of Investment Disputes (ICSID), the International Chamber of Commerce (ICC), the London Court of International Arbitration (LCIA), the Institute of Arbitration of the Stockholm Chamber of Commerce (SCC), and the Permanent Court of Arbitration (PCA). These institutions may apply UNCITRAL rules if so determined by the treaty, or their own set of rules if designated by the parties or if the treaty in question does not specify procedural rules.¹³⁹ Most commonly investment arbitrations are carried out as ICSID arbitrations pursuant to the ICSID Convention¹⁴⁰ (and alternatively under ICSID Additional Facility Rules¹⁴¹ if one of the parties is not a party to the ICSID Convention) or *ad hoc* arbitrations under UNCITRAL rules. In addition to ISDS clauses in IIAs, specific procedural rules determining the jurisdiction of the particular arbitration forum may also govern the admissibility of claims, thus limiting the access of investors to ISDS. For ICSID arbitration, beside the requirements under the specific IIA, the requirements of admissibility under the ICSID Convention must also be met.

2.2.1.1. Admissibility *ratione materiae*: what is ‘investment’?

IIAs allow for a broad scope of claims that can be subject to investment arbitration,¹⁴² sometimes expressly limiting the scope of disputes to breaches of substantive protections under the treaty,¹⁴³ and linking the claim to the loss or damage caused to the investor by

15 August 2010 (the date when the Rules became effective), unless the parties have agreed to apply a different version of the Rules.

¹³⁹ European Parliamentary Research Service, ‘From Arbitration to Investment Court System (ICS): The Evolution of CETA Rules’ (2017), 8-9. For comparison of different arbitration rules see the Annex of this publication.

¹⁴⁰ Convention on the Settlement of International Investment Disputes between States and Nationals of Other States (adopted 18 March 1965, entered into force 14 October 1966) 575 UNTS 159 (ICSID Convention). The ICSID Centre only has jurisdiction between Contracting States to the ICSID Convention: Art 25 ICSID Convention. As of September 2017, there are 153 Contracting States. Arbitrations established under the ICSID Convention are conducted in accordance with ICSID Arbitration Rules, unless otherwise agreed by the parties: Art 44 ICSID Convention. The Arbitration Rules (The Rules of Procedure for Arbitration Proceedings) of ICSID are adopted by the Administrative Council of the ICSID Centre in accordance with Art 6(1)(c) of the ICSID Convention. The current Rules came into effect on 10 April 2006.

¹⁴¹ Rules Governing the Additional Facility for the Administration of Proceedings by the Secretariat of the International Centre for Settlement of Investment Disputes (Additional Facility Rules), as amended effective 10 April 2006.

¹⁴² Such are usually described as ‘disputes *concerning* investments between a Contracting State and an investor of other Contracting State’: Art 10(1) German Model BIT 2008; ‘Disputes between a Contracting Party and an Investor of another Contracting Party *relating to* an Investment of the latter in the Area of the former’: Art 26(1) ECT; ‘an investment dispute’: Art 24(1) US Model BIT 2012 (emphasis added).

¹⁴³ For example, Art 26(1) ECT, Arts 24(1)(a)(i)(A) and 24(1)(b)(i)(A) US Model BIT 2012; Art 1116(1)(a) NAFTA; Art 3.1.1 EUSIPA. The US BITs also include investment authorisation to the investor to make an investment and investment contracts between the investor and the State within the scope of ISDS clauses, which allows wider jurisdiction of the arbitral tribunals beyond the alleged breaches of substantive protections in the BIT: US Model BIT 2012 Arts 24(1)(a)(i)(B), 24(1)(b)(i)(B), 24(1)(a)(i)(C) and 24(1)(b)(i)(C) respectively.

the breach.¹⁴⁴ The disputed investment must be within the definition of ‘investment’ provided in the IIA, which is usually set out in broad terms,¹⁴⁵ and sufficiently broad to include both direct and non-direct types of foreign investment (portfolio investment).¹⁴⁶ In some cases, the scope of investment disputes can be limited by the scope of the treaty in question,¹⁴⁷ or IIAs can expressly limit the scope of ISDS clauses in regard to the subject-matter of claims.¹⁴⁸ The German Model BIT and EU investment agreements, unlike the US Model BIT, limit the jurisdiction of arbitral tribunals to breaches of substantive protections in regard to *established* investments, thus excluding the pre-establishment phase of investment from the scope of ISDS clauses.¹⁴⁹ The USMCA is an

¹⁴⁴ For example, Arts 24(1)(a)(ii) and 24(1)(b)(ii) US Model BIT 2012; Art 1116(1) NAFTA; Art 3.1.1 EUSIPA; Art 8.18.1 CETA.

¹⁴⁵ Usually IIAs will have an open-ended definition of investment, referring to ‘every kind of asset which is directly or indirectly invested’ (Art 1(1) German Model BIT 2008); ‘every kind of asset, owned or controlled directly or indirectly by an Investor’ (Art 1(6) ECT), ‘every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk’ (Art 1 US Model BIT 2012); ‘every kind of asset which has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, the assumption of risk or a certain duration’ (Art 1.2 EUSIPA). In addition, the general definition will also include a list of illustrative but non-exclusive categories of investments that are covered by the IIA.

¹⁴⁶ Portfolio investment is an investment of a purely financial character (a range of securities, such as equity and debt securities), made primarily to maximise the value and return on the invested capital, regardless of the control of the management of the investment and its longevity. Usually it is defined as a less than 10% share in ownership of the investment or an investment which does not give the investor the possibility to exercise management or influence the management of the investment. In more general terms, IIAs in their definitions of investments rarely define minimum size, value or percentage of the share interest, which leads to a conclusion that portfolio investments are also considered investments: David Gaukrodger, ‘Investment Treaties and Shareholder Claims: Analysis of Treaty Practice’ (OECD Publishing 2014) 12-13. Whether portfolio investment is covered as investment in the specific IIA will ultimately depend on the wording of the definition. For example, in some IIAs the definition of investment is expressly limited to direct investment, some IIAs expressly exclude portfolio investment from the definition of investment, and some distinguish between long-term and short-term debt securities to exclude the latter: see UNCTAD, ‘Scope and Definition (A sequel) – UNCTAD Series on Issues in International Investment Agreements II’, (2011), UNCTAD/DIAE/IA/2010/2, 29-31. The NAFTA definition of investment in Art 1139 contains an exhaustive list of investment, which also includes portfolio investments (equity and debt security of an enterprise, with certain qualifications).

¹⁴⁷ This is in cases of IIAs that deal with investment in specific areas. For example, the ECT is limited to energy sector related disputes: Arts 1(6) and 2 ECT.

¹⁴⁸ The new USMCA significantly limits the availability of ISDS clauses. ISDS applies only in relations between the US and Mexico, and it is limited to discrimination (breaches of NT and MFN) in the post-establishment phase and direct expropriation: Art 14.D.3(1). These limitations do not apply to government contracts in the ‘covered sectors’: oil and natural gas, supply of power generation, telecommunications, transport services to the public, and infrastructure (ownership and management of railroads, railways, bridges or canals, that are not for the exclusive or predominant use and benefit of the government). In these sectors ISDS can be used for any breaches of USMCA: see Annex 14-E.

¹⁴⁹ The German Model BIT 2008 does not have reference to pre-establishment activities, while practice in regard to EU agreements varies. For example, EUSIPA in Art 2.1 limits the scope of the Investment chapter to ‘covered investors and covered investments *made* in accordance with the applicable law’ (emphasis added) with NT limited to the post-establishment phase (Art 2.3) and excluded altogether from certain measures (subsidies and grants) or activities and sectors (related to government public functions): see Arts 2.1.2 and 2.1.3 EUSIPA. CETA includes the obligation of non-discriminatory treatment for the establishment of the investment (Arts 8.6 and 8.7), but these clauses are excluded from the scope of investment dispute settlement clauses (Arts 8.2.4 and 8.18).

exception from the previous US practice, which now provides for limited ISDS in the post-establishment phase.¹⁵⁰

Under the ICSID Convention, for a dispute to fall within the ICSID jurisdiction, the dispute must be 'legal' and 'arising directly out of an investment', which is decided on the facts of each particular case.¹⁵¹ The definition of 'investment' in the particular IIA and the views of the parties on the subject-matter of the dispute are not binding or decisive.¹⁵² The ICSID jurisdiction, although widely interpreted, is not available for any kind of activity that parties might regard as an investment if such activity does not fall within the ICSID set of criteria for investment,¹⁵³ and even if the activity in question is defined as investment under the particular IIA.¹⁵⁴ Latter situations include purely commercial transactions arising out of contracts for international sale of goods,¹⁵⁵ which could alternatively be submitted to an *ad hoc* UNCITRAL arbitration if the specific IIA's

¹⁵⁰ See USMCA, Art 14.D.3(1).

¹⁵¹ Art 25(1) ICSID Convention. Therefore, the dispute must relate to a controversy in regard to legal rights as opposed to merely conflict of interest, and must have a real connection to the investment, as opposed to being a remote ancillary transaction, which is a distinction difficult to establish in many cases: UNCTAD 2004 (n 4) 363.

¹⁵² *ibid.* See also *Aguas del Tunari, S.A. v Republic of Bolivia*, ICSID Case No. ARB/02/3, Decision on Respondent's Objections to Jurisdiction (21 October 2005) para 278. This effectively means 'supremacy' of the ICSID Convention over an agreement between the parties and an IIA: *Patrick Mitchell v Democratic Republic of Congo*, ICSID Case No. ARB/99/7, Decision on Annulment (1 November 2006) para 31.

¹⁵³ Although the ICSID Convention does not define 'investment', ICSID arbitral tribunals have developed an objective definition of investment in their practice, based on a set of criteria, which include: (i) a substantial contribution of money and resources, (ii) a certain duration; (iii) risk, and (iv) the contribution to the economic development of the host State: *Salini Costruttori S.p.A. and Italstrade S.p.A. v Kingdom of Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction (31 July 2001) para 52 (so-called 'Salini test'). The 'Salini test' is often cited as an authority for determining investment under ICSID Convention: see, for example, *Joy Mining Machinery Limited v Arab Republic of Egypt*, ICSID Case No. ARB/03/11, Award on Jurisdiction (6 August 2004) para 53, which refers to both ICSID decisions and commentators (citing Christoph H Schreuer) to support its conclusion on 'Salini test' elements as determinative for an activity to qualify as an investment.

¹⁵⁴ In this respect the Tribunal in *Joy Mining* noted: 'The parties to a dispute cannot by contract or treaty define as investment, for the purpose of ICSID jurisdiction, something which does not satisfy the objective requirements of Article 25 of the Convention. Otherwise Article 25 and its reliance on the concept of investment, even if not specifically defined, would be turned into a meaningless provision': *ibid* para 50. However, investment under the ICSID Convention includes portfolio investment if portfolio investment is covered by the definition of investment in the specific IIA: UNCTAD 2004 (n 4) 363. In the context of the 'Salini test', it could be then arguable whether portfolio investments in fact contribute to the economic development of the host State. However, the ICSID *ad hoc* Committee, in its Decision on Annulment in the case of *Mitchell v Congo*, clarified that such contribution must not 'always be sizeable and successful', where 'it suffices for the operation to contribute in one way or another to the economic development of the host State', with the consequence that this concept is 'extremely broad but also variable depending on the case': *Patrick Mitchell* (n 152) para 33 (the investor's claim in this case was rejected by the Annulment Committee, which found that the original ICSID Tribunal manifestly exceeded its powers and failed to state reasons for finding that the legal practice constituted an investment under Art 25(1) ICSID). Notably, however, some more recent ICSID decisions question the contribution to the development of the host State as the requirement for investment in the context of ICSID jurisdiction, rejecting it as an element of the objective definition of investment: see *Quiborax S.A., Non Metallic Minerals S.A. and Allan Fosk Kaplún v Plurinational State of Bolivia*, ICSID Case No. ARB/06/2, Decision on Jurisdiction (27 September 2012) paras 219-225.

¹⁵⁵ *Joy Mining* (n 153) para 52, referring to a 1999 case of the ICSID Secretary-General refusal of registration of a request for arbitration of a dispute arising out of a supply contract for the sale of goods. Similarly, *Global Trading Resource Corp. and Globex International, Inc. v Ukraine*, ICSID Case No. ARB/09/11, Award (1 December 2010) paras 56-57.

definition of investment covers these commercial transactions and offers the option of an *ad hoc* arbitration.¹⁵⁶

In essence, the particular set of criteria developed by ICSID tribunals to determine ‘investment’ set the objective ‘outer limits’ of investment beyond which parties’ consent is ineffective.¹⁵⁷ They indicate ICSID’s public law character, reflected in the ICSID Convention Preamble, which balances ‘the need for international cooperation for economic development’ and the role that private investment has for that development.¹⁵⁸ However, in light of tribunals’ inconsistent jurisprudence, such conclusions cannot be certain.¹⁵⁹ On the other hand, the UNCITRAL Rules, originally intended and commonly involved in international commercial arbitration, reflect the principle of freedom of contract of private parties, whereby any kind of asset, even a “pure” one-off sales contract’ may constitute an investment if such was the intention of the Parties.¹⁶⁰ Additionally, UNCITRAL tribunals in their approach to investment also reflect the commercial character of investment, which does not necessarily involve any element of contribution to the economic development of the host State.¹⁶¹

¹⁵⁶ With this in mind, the definition of investment in some IIAs expressly excludes claims to money solely from commercial contracts for the sale of goods and services and domestic financing of such contracts: see, for example, Arts 1139(i) and (j) NAFTA; Arts 8.1(i) and (ii) CETA.

¹⁵⁷ *The Rompetrol Group N.V. v Romania*, ICSID Case No. ARB/06/3, Decision on Jurisdiction and Admissibility (18 April 2008) para 80.

¹⁵⁸ ICSID Convention, Preamble and *Salini* (n 153) para 52.

¹⁵⁹ In this respect, for example, the ICSID Tribunal in *Biwater v Tanzania* considered that even if all of the *Salini* criteria are not satisfied in the particular case, the Tribunal should not deny jurisdiction but should also take into account all the circumstances of the particular case, including the definition of investment in the particular IIA: *Biwater Gauff (Tanzania) Ltd. v United Republic of Tanzania*, ICSID Case No. ARB/05/22, Award (24 July 2008) para 314-318. Similarly, the Annulment Committee in *Malaysian Historical Salvors v Malaysia* found that the sole arbitrator in the original award manifestly exceeded his powers by failing to exercise the ICSID jurisdiction because he did not take into account the definition of investment in Malaysia-UK BIT and instead ‘exigently’ interpreted the criterion of contribution to economic development of the host State, although it is clear from the preparatory work of the ICSID Convention that the drafters of the Convention left ‘investment’ undefined in order to give weight to the definition of investment in individual IIAs, which provide recourse to ICSID: *Malaysian Historical Salvors, SDN, BHD v The Government of Malaysia*, ICSID Case No. ARB/05/10, Decision on the Application for Annulment (16 April 2009) para 80. See also *Quiborax* (n 154) para 225, which rejects ‘a contribution to the economic development of the host State or an operation made in order to develop an economic activity in the host State’ as ‘an element of the objective definition of investment’. Even more recently, in *RREEF v Spain* the ICSID Tribunal also confirmed that ‘there is no test, set of criteria or guidelines’ in international law that could restrict or replace the definition of investment in the ECT, and that there is ‘no reason to place any such test, set of criteria or guidelines on the language of Article 25 of the ICSID Convention’: *RREEF Infrastructure (G.P.) Limited and RREEF Pan-European Infrastructure Two Lux S.à r.l. v Kingdom of Spain*, ICSID Case No. ARB/13/30, Decision on Jurisdiction (6 June 2016) para 158. See also chapter 3, section 3.1.2.

¹⁶⁰ Such intention must be undoubtedly ascertained from the particular IIA: *Romak S.A. (Switzerland) v The Republic of Uzbekistan*, UNCITRAL, PCA Case No. AA280, Award (26 November 2009) para 205. However, in this particular case, the UNCITRAL Tribunal found that the wording of the Switzerland-Uzbekistan BIT did not permit to infer such an intent. Similarly, in *Vacuum Salt Products Ltd. v Republic of Ghana*, ICSID Case No. ARB/92/1, Award (16 February 1994) fn 14 on page 90, the Tribunal ascertained that the ICSID Convention differs from ‘regimes to which parties may submit disputes based on their consent alone’, referring to Rule 1 of the Internal Rules of the International Court of Arbitration of the International Chamber of Commerce.

¹⁶¹ To that effect, the UNCITRAL Tribunal in *Romak* (ibid) noted: ‘The Arbitral Tribunal therefore considers that the term “investments” under the BIT has an inherent meaning (irrespective of whether the investor resorts to ICSID or UNCITRAL arbitral proceedings) entailing a contribution that extends over a certain period of time and that involves some risk’: para 207 (underline in original).

Ultimately, different approaches to the characterisation of investment reflect conceptual differences that underpin the international regulation of investments. If IIL serves only to promote economic liberalisation and the free flow of capital, any kind of activity, even that for purely private commercial purposes, should be regarded as investment. However, if IIL primarily seeks to facilitate global economic cooperation and development through special protections given to foreign investment, recognition should be given to genuine investments, which necessarily also have a potential to contribute to the economic development of the host State. In the latter case, the need to balance private interests of foreign investors and public interests of host States would be an essential principle.

The difference in tribunals' approaches to the characterisation of investment also reflects the need for a more consistent doctrinal development of IIL, as opposed to the currently prevailing fragmented approach in which the doctrine is used according to the needs of a particular case.¹⁶² In this context, the difference reflects divergent doctrinal approaches to the characterisation of ICSID within IIL. If ICSID is procedurally an autonomous system, it necessarily supersedes party autonomy reflected in the particular IIAs. However, if the question of the autonomy of ICSID is answered in the negative, a particular IIA would be given preference as *lex specialis*. Accordingly, the definition of investment in a particular IIA would supersede the *lex generalis* ICSID provision on investment.

2.2.1.2. Admissibility *ratione personae*: who is the 'investor'?

Similar to the definition of investment, foreign investors must meet the requirements of (i) a particular IIA and (ii) the ICSID Convention in order to bring a claim to an ICSID tribunal. Under IIAs the definition of 'investor' usually includes natural and legal persons, which must have the nationality of one of the Contracting parties to the IIA; the requirements of nationality are determined with reference to the law of the Contracting party whose nationality is claimed.¹⁶³ The ICSID Convention requires that the investor must be a national of a Contracting State,¹⁶⁴ which includes both 'natural' and 'juridical' persons with 'the nationality of a Contracting State other than the State party to the

¹⁶² This is in particular evident in the Tribunal's use of the ICSID Convention preparatory work in argumentation to support or reject the objective elements of the ICSID characterisation of investment in the *Salini* test, or in defining investment by giving preference to a particular IIA.

¹⁶³ For example, Art 1(7)(a) ECT; Art 1(3) German BIT 2008; Art 1 US Model BIT 2012; Art 1139 NAFTA; Art 1.2.3 EUSIPA; Art 8.1 CETA.

¹⁶⁴ Art 25(1) ICSID Convention.

dispute’.¹⁶⁵ The requirement of nationality in regard to natural persons is arguably easier to establish¹⁶⁶ and the nationality of legal persons is more controversial. Especially contentious is the criterion for establishing the link between a legal person submitting a claim under an IIA and the Contracting State to that IIA.

IIAs use objective criteria to determine the nationality of a legal person,¹⁶⁷ usually combining: the place of incorporation as the place where the legal person is constituted or organised in accordance with the laws of the country,¹⁶⁸ the place of the seat of the corporation (with respect to the effective management of the legal person),¹⁶⁹ and less frequently the criterion of the State which controls the operations of the legal person.¹⁷⁰

¹⁶⁵ Art 25(2) ICSID Convention. This provision also specifies the dates on which the nationality is required for the ICSID jurisdiction to be established. In this respect, natural persons must be nationals at the time of their consent to ICSID arbitration (i.e. at the date of request) as well as on the date of the registration of the arbitration request (so-called positive requirement). Legal persons must be nationals only on the date of their consent to ICSID jurisdiction.

¹⁶⁶ In regard to natural persons the requirement usually includes citizenship or in some cases permanent residency: see, for example, Art 1(7)(a)(i) ECT; Art 8.1 CETA (in the case of Canada). For IIAs of EU Member States, it excludes permanent residency but includes nationals of a Member State of the EU or of the EEA established in the territory of the State Contracting Party pursuant to Art 49 TFEU (ex Art 43 TEU): see, for example, Art 1(3)(a) German Model BIT 2008; Art 8.1 CETA (in the case of the EU, referring only to the nationality of one of the Member States of the EU and the specific case of Latvia). The ICSID Convention, in addition to above mentioned positive requirement, also disqualifies dual nationals who are also nationals of the host State (a so-called negative requirement): Art 25(2)(a). The ICSID requirement is formal and does not apply a test of dominant or effective nationality, with the effect that an individual who has no genuine link with a State would not be able to invoke citizenship of that State against another State with which s/he has a longstanding and close connection: *Ioan Micula, Viorel Micula, S.C. European Food S.A., S.C. Starmill S.R.L. and S.C. Multipack S.R.L. v Romania*, ICSID Case No. ARB/05/20, Decision on Jurisdiction and Admissibility (24 September 2008), para 100. In this case, Romania argued that the claimants, citizens of Sweden who revoked their Romanian citizenship, had no effective link to Sweden but maintained effective links to Romania. The ICSID Tribunal concluded that under the applicable test the Tribunal had to determine: (i) whether the claimants were nationals of Sweden on the date of the request for arbitration and the registration of the request by ICSID (positive requirement); (ii) that they were not nationals of Romania on neither of those dates (negative requirement); and (iii) that they acquired Swedish citizenship in accordance with Swedish law (the Romania–Sweden BIT requirement): para 85. In order to avoid the uncertainties that dual citizenship might pose, some IIAs contain specific clauses: see, for example, US Model BIT 2012, which in Art 1 specifies that ‘a natural person who is a dual citizen shall be deemed to be exclusively a national of the State of his or her dominant and effective nationality’. CETA also has a specific clause for dual citizens (citizens of both Canada and one of the EU Member States, who are deemed to be exclusively a natural person of the Party of their dominant and effective citizenship) and for concurrent citizens and permanent residents from both parties (who are deemed to be exclusively natural persons of the Party of their citizenship).

¹⁶⁷ In this respect, IIAs cover a range of different legal entities: with or without legal personality (the definition of juridical person under Art 1(3)(a) German Model BIT 2008); for profit or non profit (Art 1(3)(a) German Model BIT 2008; Art 1 US Model BIT 2012), privately or government owned (definition of an enterprise under Art 1 US Model BIT 2012, which has a non-exhaustive list of entities considered to be enterprises – a corporation, trust, partnership, sole proprietorship, joint venture, association, or similar organisation); including (US Model BIT 2012, Art 1139 NAFTA) or excluding a branch (Art 8.1 CETA, also expressly excluding a representative office).

¹⁶⁸ Most IIAs use this criterion. For example, Art 1(7)(a)(ii) ECT; Art 1.2.5 EUSIPA; Art 1 US Model BIT 2012; Art 1139 NAFTA.

¹⁶⁹ This criterion is meant to emphasise the real economic relationship between the legal person and the State where this legal person is formally incorporated. Location in the territory of the State and business activities which must be carried out in the territory of that State may be classified under this criterion: in regard to a branch of an enterprise, see, for example, Art 1 US Model BIT 2012 and Art 1139 NAFTA, which outline such criteria.

¹⁷⁰ Tribunals have usually also adopted a test of incorporation or seat rather than control when establishing nationality of a legal person, which are two standard tests of nationality of a corporation. In this respect, the place of incorporation is generally preferred in common law countries, while the place of the seat of the corporation is more accepted in civil law countries: OECD, ‘International Investment Law: Understanding

The German Model BIT 2008 abandons the earlier prevailing criterion of the seat and adopts, in line with its domestic and EU law, the principle of constitution and incorporation, recognising also the EU freedom of establishment under TFEU Articles 49 and 54.¹⁷¹ Unlike the US Model BIT, the German BIT does not require that the legal person must have substantial business activity in the host State through its denial of benefits clause.¹⁷² Under CIL a subsidiary has the nationality of the host State,¹⁷³ so the ICSID Convention in its definition of a juridical person in Article 25(1) allows a local subsidiary under the control of a foreign person to be granted ICSID jurisdiction, if the host State agrees, expressly or impliedly, to treat the subsidiary as a foreign national.¹⁷⁴ However, tribunals have approached the foreign control test differently in cases where the host State treats a subsidiary as a foreign national. Some have argued that the criteria are objectively determined to restrict the jurisdiction of ICSID tribunals to cases of real control, regardless of parties' intent.¹⁷⁵ Others have decided in favour of extending this jurisdiction by challenging the inference of jurisdictional restrictions in the text of the ICSID Convention.¹⁷⁶ In its essence, this dilemma reflects the dilemma discussed above about the jurisdictional autonomy of the ICSID in the determination of whether the dispute concerns 'investment'.

Concepts and Tracking Innovations: A Companion Volume to International Investment Perspectives' (OECD Publishing 2008) 18. There are also examples of IIAs which incorporate all criteria: see definition of 'enterprise of a Party' in Art 8.1 CETA.

¹⁷¹ Art 1(3)(a) German Model BIT 2008. EUSIPA also contain reference to Art 54 TFEU in defining the concept of 'substantive business operations': Art 1.2(5) fn 2. On freedom of establishment, see chapter 7.

¹⁷² Dolzer and Yun-I 306. The US Model BIT 2012 contains a denial of benefits clause: Art 17. Similarly, NAFTA in Art 1113 and ECT in Art 17 also contain a denial of benefits clause. These clauses effectively disallow 'shell' companies, owned/controlled by non-Contracting Party nationals incorporated in the Contracting Party or owned/controlled by nationals of the host State, to take advantage of the relevant IIA.

¹⁷³ In the *Barcelona Traction* case, concerning Belgium's claim against Spain relating to a company established in Canada, the ICJ noted that CIL gave the right of diplomatic protection of a corporation to the State under which laws the corporation was incorporated or in the State in whose territory it had its registered office (Canada in this case). Accordingly, the Court found that where an unlawful act was committed against the company representing foreign capital (in this case, harm was committed to Belgian shareholders in Canada), only the national State of the company (Canada, and not Belgium as the State of the company's shareholders) could sue the State causing harm to the company (in this case Spain): *Barcelona Traction case, Light and Power Company Limited, Case concerning (New Application, 1962)* (Belgium v Spain) (Second Phase) [1970] ICJ Rep 3. For the discussion of this case, see Malcolm N Shaw, *International Law* (5th edn, CUP 2003) 728-729.

¹⁷⁴ UNCTAD 2011 (n 146) 84-86.

¹⁷⁵ *Vacuum Salt Products* (n 160) para 36, where the Tribunal noted, by reference to the Report of the Executive Directors on the ICSID Convention, ICSID Document 2 of 18 March 1965, that the "foreign control" necessarily sets an objective Convention limit beyond which ICSID jurisdiction cannot exist and parties therefore lack power to invoke same no matter how devoutly they may have desired to do so'. See also *TSA Spectrum de Argentina S.A. v Argentine Republic*, ICSID Case No. ARB/05/5, Award (19 December 2008) paras 152-153.

¹⁷⁶ *Tokios Tokelés v Ukraine*, ICSID Case No. ARB/02/18, Decision on Jurisdiction (29 April 2004) para 46, also referring to cases *Wena Hotels Ltd. v Arab Republic of Egypt*, ICSID Case No. ARB/98/4, Summary Minutes of the Session of the Tribunal held in Paris (25 May 1999) and *Autopista Concesionada de Venezuela, C.A. v Bolivarian Republic of Venezuela*, ICSID Case No. ARB/00/5, Decision on Jurisdiction (27 September 2001). In the latter case, the ICSID Tribunal concluded that foreign control is not defined in the text of the Convention and that there is no indication in the ICSID Convention preparatory work that foreign control means 'effective control': paras 110-114. Also *The Rompetrol Group* (n 157) para 93.

2.2.2. 'Shopping' in investment treaty arbitration

Definitions of investors in IIAs, which in most cases focus on the formal nationality criteria of incorporation in accordance with local laws, and arbitral tribunals' interpretations of such definitions, allow for the practice of *treaty shopping*. This involves investors structuring investments through intermediate holding companies in order to take advantage of a particular IIA which otherwise would not have been available to these investors.¹⁷⁷ Treaty shopping can take place in several ways, which include:¹⁷⁸ structuring an investment in the host State (subsidiary) through an intermediate company established in the home State by an investor (parent company) from a third country;¹⁷⁹ structuring an investment in the host State (subsidiary) through an intermediate company in the home State, which is effectively owned and controlled by an investor (parent company) from the host State;¹⁸⁰ and structuring an investment in the host State (subsidiary) through an intermediate company in a third country which is owned by an investor (parent company) from the home State.¹⁸¹ The practice of treaty shopping can further be encouraged through broadly worded MFN clauses.¹⁸²

¹⁷⁷ Law firms provide advice on structuring their foreign investments through third countries to make them avail of host States' IIAs. See, for example, in the context of Australia, Clayton Utz, 'Guide to Protecting Foreign Investments' (2014), 26. Investors are advised to take pre-emptive actions to 'save millions of dollars' by restructuring investments through 'a subsidiary that is protected under an IIA to which the host State of the investment is a party' and by doing so in a timely manner, 'before a dispute with a host State arises': see Voltera Fietta, 'Investor-State arbitration – Protecting investments before it is too late' (*Lexology*, 25 September 2019) <<https://www.lexology.com/library/detail.aspx?g=0ab47c9c-14fc-43f6-8994-aa502696f89b>> accessed 30 June 2020.

¹⁷⁸ For detailed analysis, see UNCTAD 2011 (n 146) 86-92.

¹⁷⁹ For example, *ADC v Hungary* (n 27) involved the claim brought against Hungary (host State) on the basis of the Cyprus-Hungary BIT, by the claimants incorporated in Cyprus (home State) but, allegedly, in fact the investment was made by foreign investors from Canada (third country, non-Contracting party). The Tribunal, however, concluded that under the relevant BIT, which adopted the criterion of incorporation in accordance with Cypriot law, as well as the ICSID Convention, the claimant companies were nationals of Cyprus: paras 352-362.

¹⁸⁰ *Tokios Tokelés* (n 176) para 52. In this case, the claim was brought on the grounds of the Lithuania-Ukraine BIT against Ukraine (host State), by the claimant company which had nationality of Lithuania (home State) but was controlled by citizens of Ukraine (host State). Thus, although the claimant met the formal criteria of nationality under the BIT, the claim was in fact between the host State Ukraine and a company fully controlled by the host State (i.e. Ukraine) citizens (owning 99% of the shares and comprising two-thirds of the management). The Tribunal found that under the relevant BIT, which adopted the criterion of incorporation in accordance with Lithuanian law, as well as the ICSID Convention, the claimant companies were nationals of Lithuania, and thus it was not necessary to determine the nationality of the controlling stakeholders.

¹⁸¹ *Waste Management* (n 73) para 80-85. This was a NAFTA case involving a claim against Mexico (host State) by a claimant subsidiary of the parent company from the US (home State), owned through two holding companies from the Cayman Islands (third country), which were purchased by the US parent company (home State). The Tribunal concluded that the nationality of intermediate companies is irrelevant to the claim under the relevant provisions of the NAFTA, which allows for the claim to be made by an investor in its own right or by an investor on behalf of a subsidiary.

¹⁸² See section 2.1.3 above.

While treaty shopping disregards the origin of capital when determining the nationality of the claimant,¹⁸³ and thus supports the neoliberal vision of flow of capital, it also raises a number of policy issues.¹⁸⁴ In particular, the concerns include uncertainty of host States about the extent of their legal obligations under IIAs, because a particular IIA, instead of being a treaty with a particular Contracting party becomes in practice a treaty with an undefined number of non-Contracting parties. Additionally, treaty shopping opens doors for domestic investors to access investment arbitration, which otherwise would not be available to them, thus effectively undermining the purpose of IIAs.¹⁸⁵ In order to distinguish 'legitimate' recourse to international arbitration from 'illegitimate' which constitutes abuse of rights, tribunals engage in analysis of all the circumstances of a particular case, including the timing of the investment and of the claim, the substance of the transaction, the true nature of the operation, and the degree of foreseeability of the governmental action at the time of restructuring.¹⁸⁶ However, in light of broader policy concerns, treaty shopping beyond cases which bluntly include shell companies should also be addressed. Treaty regimes for claims by shareholders for reflective loss, which are usually available under typical BITs but unavailable under domestic corporate law, have attracted insufficient attention in policy discussions.¹⁸⁷

Apart from treaty shopping, ISDS clauses also raise concerns of *forum* shopping.¹⁸⁸ Many investment treaties allow foreign investors to bring their claims to both domestic courts and international arbitration, differently coordinating such access but often

¹⁸³ *Tokios Tokelés* (n 176) paras 80-81. See the Dissenting Opinion of Professor Weil, who considered such an approach to be contrary to the object and purpose of the ICSID Convention: Dissenting Opinion (Chairman Professor Weil) (29 April 2004) paras 19-20.

¹⁸⁴ David Gaukrodger and Kathryn Gordon, 'Investor-State Dispute Settlement: A Scoping Paper for the Investment Policy Community' (OECD Publishing 2012) 56-57.

¹⁸⁵ *ibid.*

¹⁸⁶ *Transglobal Green Energy, LLC and Transglobal Green Energy de Panama, S.A. v The Republic of Panama*, ICSID Case No. ARB/13/28, Award (2 June 2016) para 103. However, even in this respect tribunals can use different criteria. For example, in *Philip Morris Asia Limited v The Commonwealth of Australia*, UNCITRAL, PCA Case No. 2012-12, Award on Jurisdiction and Admissibility (17 December 2015), the Tribunal asserted that it is the reasonable foreseeability of a dispute that distinguishes illegitimate from legitimate restructuring (para 540). In determining what is reasonably foreseeable, the Tribunal applied a lower threshold of a 'reasonable prospect' of a dispute from *Tidewater Inc., Tidewater Investment SRL, Tidewater Caribe, C.A., et al. v The Bolivarian Republic of Venezuela*, ICSID Case No. ARB/10/5, Decision on Jurisdiction (8 February 2013) in paras 145-146, 184, thus departing from a 'very high probability and not merely a possible controversy' standard in *Pac Rim Cayman LLC v Republic of El Salvador*, ICSID Case No. ARB/09/12, Decision on Respondent's Jurisdictional Objections (1 June 2012) in para 2.99: see *Philip Morris v Australia*, para 544. Thus, by applying the *Tidewater* standard to the circumstances of the case, the Tribunal accepted Australia's argument that Philip Morris changed its corporate structure to obtain the Hong Kong-Australia BIT protection in anticipation of a foreseeable dispute, which constituted an abuse of rights.

¹⁸⁷ See David Gaukrodger, 'Investment Treaties as Corporate Law: Shareholder Claims and Issues of Consistency' (OECD Publishing 2013) and Gaukrodger (n 146). For shareholders' claims under CETA, see chapter 8, section 8.2.1.1.

¹⁸⁸ Christopher Whytock, 'The evolving forum shopping system' (2011) 96 Cornell Law Review 481. Forum shopping is a form of strategic behaviour, which is based on the plaintiff's expectations about favourable court access and choice-of-law decisions, which are formed in light of available information about other actors' past behaviour (published decisions): 487-490.

leaving open the possibility of parallel proceedings. In some IIAs generally worded umbrella clauses can also give rise to multiple proceedings in relation to the same claim.¹⁸⁹ Additionally, forum shopping can arise because investment treaties offer foreign investors a choice of international arbitration forum, usually by ICSID or *ad hoc* arbitration under UNCITRAL rules. The heterogeneity of dispute settlement options and applicable substantive and procedural rules, which can lead to different outcomes, creates an incentive for forum shopping.¹⁹⁰

In most cases, access to international arbitration is provided in addition to domestic judicial review proceedings, with States adopting different approaches in coordinating such access.¹⁹¹ Some IIAs give investors a choice between domestic or international fora; this choice can be final and exclusive by inclusion of a fork-in-the-road provision.¹⁹² In some cases, waiver of domestic remedies,¹⁹³ or more recently, exhaustion of local

¹⁸⁹ J Anthony VanDuzer, Penelope Simons and Graham Mayeda, 'Integrating Sustainable Development into International Investment Agreements – A Guide for Developing Countries', Commonwealth Secretariat (August 2012) 409. These clauses, depending on their wording, may allow a breach of a private law contract between an investor and a host State (contract claim) to be 'elevated' to a breach of an IIA between the investor's home State and the host State (treaty claim). For analysis of the inconsistent approaches of arbitral tribunals in regard to interpretation of umbrella clauses, see Katharina Diel-Gligor, *Towards Consistency in International Investment Jurisprudence: A Preliminary Ruling System for ICSID* (Brill 2017) 224-236.

¹⁹⁰ Whytock (n 188). In this sense, it can be noted that foreign investors tend to utilise national courts to achieve the removal of the national measure which allegedly breached their rights under domestic law since investment tribunals do not have the mandate to order corrective measures or policy change. Investors at the same time utilise investment tribunals to achieve financial compensation which is the norm in international investment law. See, for example, *Vattenfall II* case in which the Swedish investor in Germany challenged the constitutionality of the legislation phasing out nuclear energy before German courts, while also bringing a claim against Germany before the ICSID for financial compensation for the breaches of investor's rights under the ECT: BVerfG, *The Vattenfall Case*, Judgment of the First Senate of 6 December 2016, 1 BvR 2821/11; *Vattenfall AB and others v Federal Republic of Germany (II)*, ICSID Case No. ARB/12/12. For analysis of this case under domestic, EU and international law, see Ivana Damjanovic and Ottavio Quirico, 'Intra-EU Investment Dispute Settlement in light of *Vattenfall* and *Achmea*: A Matter of Priority' (2019) 26 Columbia Journal of European Law 102.

¹⁹¹ Pohl, Mashigo and Nohen (n 132) 8-12.

¹⁹² The 'fork-in-the-road' provision makes a foreign investor's choice of forum (host State's court or international arbitration) irrevocable, reflecting the Latin maxim *una vita electa non datur recursus ad alterem*. Once the dispute has been submitted to the domestic court, the investor loses the right to submit the same claim to investment arbitration. However, the fork-in-the-road provision does not apply to every legal action taken in the domestic court. If the domestic claim does not concern the same breach of a right granted by a BIT (e.g. an appeal to an administrative decision), the investor would not be precluded from accessing international arbitration. This also includes the use of domestic remedies to preserve some rights (such as interim measures). See Christoph Schreuer, 'Travelling the BIT Route of Waiting Periods, Umbrella Clauses and Forks in the Road' (2004) 5 The Journal of World Investment and Trade 231, 239-249. Some IIAs include provisions which explicitly grant the right to interim measures as an exception to conditions prescribed in the provisions on submission of a claim to international arbitration: for example, Art 1134 NAFTA; Art 28(8) US Model BIT 2012; Art 3.7.4 EUSIPA. In the case of EUSIPA, such interim measures are specified as interim measures of protection for the sole purpose of preservation of the claimant's rights and interests, and not involving the payment of damages or the decision on the merits of the matter.

¹⁹³ This is the case in regard to Art 1121(2) NAFTA, pursuant to which investors must 'waive their right to initiate or continue before any administrative tribunal or court under the law of any Party'; similarly, see Art 26(2)(b) US Model BIT 2012. The same principles apply here as do in the case of a fork-in-the-road provision. Thus, 'proceedings for injunctive, declaratory or other extraordinary relief, not involving the payment of damages, before an administrative tribunal or court under the law of the disputing Party' are explicitly stated to be exempt from the waiver clause. While the fork-in-the-road provision aims to eliminate other options of available dispute resolution once a choice of available forum has been made, waiver provisions aim at

remedies,¹⁹⁴ is a condition precedent to bringing a case to international arbitration. The aim of these provisions is to disallow parallel proceedings.¹⁹⁵ The new generation of EU IIAs contain more detailed provisions, which disallow parallel proceedings¹⁹⁶ but allow return to domestic proceedings after investment arbitration in certain circumstances.¹⁹⁷ In many cases, the possibility of multiple proceedings will depend on the wording of the particular IIA but also on the arbitral tribunals' characterisation of the dispute.¹⁹⁸

Some IIAs, such as the German Model BIT, contain umbrella clauses that bring 'any other obligations' between the foreign investor and the host State under international protection and dispute settlement mechanisms of IIAs. This can include contractual obligations, such as concession contracts, and unilateral commitments of the host State regarding investments in its territory.¹⁹⁹ These clauses have potential to extend the jurisdiction of international investment arbitration (jurisdiction *ratione materiae*) to

preventing foreign investors from initiating dispute resolution in another forum in order to commence ISDS, thus disallowing switching from ISDS back to domestic proceedings or 'u-turns'.

¹⁹⁴ For example, the USMCA requires investors to initiate domestic proceedings and wait for 30 months before they can initiate arbitration, unless recourse to domestic remedies would be 'obviously futile or ineffective': Art 5, Annex 14-D. The exceptions are claims under Annex 14-E (covered government contracts). Art 15 of the 2016 Indian Model BIT similarly provides for the exhaustion of local remedies, but requiring a waiting period of at least five years; however, it also imposes a lower standard of futility exception, in cases where there is no reasonably available relief. The burden of proof in both cases remains on the foreign investor: see Prabhaskar Ranjan and Pushkar Anand, 'The 2016 Model Indian Bilateral Investment Treaty: A Critical Deconstruction' (2017) 38 *Northwestern Journal of International Law and Business* 1, 48-50.

¹⁹⁵ Art 26 ICSID Convention also allows a Contracting Party to require the exhaustion of local remedies as a condition of its consent to arbitration under ICSID Convention, with the same aim of avoiding parallel proceedings.

¹⁹⁶ Arts 8.22.1(f) and (g) CETA require the investor to withdraw from or discontinue any existing proceeding, as well as the waiver of the right to initiate any claim or proceeding 'before a tribunal or court under *domestic or international* law with respect to a measure alleged to constitute a breach referred to in its claim', as procedural requirements for the submission of a claim to the tribunal (emphasis added). Similar provisions are found in Art 3.7(f) EUSIPA. In the latter case, the foreign investor is precluded from submitting their claim to another international tribunal in the future (Art 3.7(g)(ii) EUSIPA), and, in order to avoid double jeopardy, EUSIPA also prescribes that tribunal 'shall decline jurisdiction' where the claimant does not meet these requirements (Art 3.7.3 EUSIPA).

¹⁹⁷ Art 8.22.5 CETA prescribes that the waiver to submit the claim to another domestic or international tribunal or court ceases to apply if the tribunal rejects the claim on procedural grounds, dismisses the claim because it is manifestly without legal merit (under Art 8.32) or is unfounded as a matter of law (under Art 8.33), and if the investor withdraws the claim within 12 months of constitution of the division of the tribunal.

¹⁹⁸ In arbitral jurisprudence, the triple identity test, the same parties, the same object, and the same cause of action, has been developed when determining whether the claims in the domestic proceedings are the same as those in the international proceedings. The majority of tribunals have found that contractual claims are different from treaty claims, and thus claims for breach of contract submitted to domestic courts do not preclude submission of the treaty claim to arbitration: *CMS Gas Transmission Company v The Republic of Argentina*, ICSID Case No. ARB/01/8, Decision of the Tribunal on Objections to Jurisdiction (17 July 2003) para 80 (referring also to decisions of other tribunals). However, a more narrow interpretation and qualitative test was applied by two other tribunals; the tribunals identified the issue not as the assessment of whether the claims brought to the local court and the arbitration are the same but whether they 'share the same fundamental basis': *H&H Enterprises Investments, Inc. v Arab Republic of Egypt*, ICSID Case No. ARB/09/15, Award (6 May 2014) paras 368-369; *Pantechniki S.A. Contractors & Engineers (Greece) v The Republic of Albania*, ICSID Case No. ARB/07/21, Award (30 July 2009) para 67. Therefore, as the treaty claims were found to have the same fundamental basis as the contractual claims submitted before the local court, the tribunals in these two cases found that treaty claims before the two tribunals were barred by the fork-in-the-road provision.

¹⁹⁹ Art 7(2) German Model BIT 2008: 'Each Contracting State shall fulfil any other obligations it may have entered into with regard to investments in its territory by investors of the other Contracting States'.

commercial breaches of contract committed at the level of domestic law in the State's function as a merchant.²⁰⁰ They may encourage the claimant to bring the same claim under domestic law, through a dispute settlement mechanism envisaged in the contract for breach of contractual obligation, and under international law, through a dispute settlement mechanism in the particular IIA for breach of treaty obligation.²⁰¹ Accordingly, the same set of facts can give rise to different causes of action before different dispute settlement bodies.²⁰² The controversy created by arbitral tribunals' inconsistent interpretation of this clause has led to the tendency to eliminate these clauses in the new generation of IIAs;²⁰³ however, they are still present in around 40% of IIAs.²⁰⁴

IIAs also offer to foreign investors the choice of an international forum.²⁰⁵ The issue of forum shopping becomes particularly problematic when competing forums have strong incentives to retain their jurisdiction, which is more prevalent for international investment forums than for domestic courts.²⁰⁶ Unlike domestic courts, arbitral tribunals

²⁰⁰ The approach of investment tribunals in regard to the interpretation of umbrella clauses has also been inconsistent, with some adopting a more restrictive approach to the exclusion of jurisdiction over contractual claims which are not violations of a substantive protection under an IIA (a notable case is *SGS Société Générale de Surveillance S.A. v Islamic Republic of Pakistan*, ICSID Case No. ARB/01/13, Decision of the Tribunal on Objections to Jurisdiction (6 August 2003)), while others allow for the broader scope of an umbrella clause, which covers all violations of the host State's commitment in regard to investment, whether they are of commercial or a governmental nature. Thus, under the latter interpretation, arbitral tribunals have jurisdiction with respect to contractual claims, although such claims may not involve any breach of the substantive standards of the IIA. In such cases, the failure of the host State to observe contractual commitment amounts to a breach of an IIA; however, the applicable law guiding such cases remains the domestic law of the host State: *SGS Société Générale de Surveillance S.A. v Republic of the Philippines*, Decision of the Tribunal on Objections to Jurisdiction, (29 January 2004) paras 127-128.

²⁰¹ However, if an arbitral tribunal accepts that a breach of a contractual obligation also amounts to a breach of an IIA, the tribunal will not exercise its jurisdiction if the parties have already agreed how a contractual claim should be resolved and if they have done so exclusively: *SGS Société Générale v Philippines* (ibid) para 155. In this case, the Tribunal found that the contractual claim was inadmissible because the clause of the BIT in question, which conferred on the investor the right to arbitration nor Art 26 of the ICSID Convention had not over-ridden the exclusive jurisdiction clause of the contract. The claim was thus found to be within jurisdiction but inadmissible.

²⁰² Therefore, while the Tribunal in *SGS v Pakistan* (n 200) found that the contractual obligation did not elevate to a treaty obligation, it also found that it had jurisdiction for BIT breaches arising from the same host State's conduct: paras 185-189.

²⁰³ Paul Pereire de Souza Fleury, 'Umbrella clauses: a trend towards its elimination' (2015) 31 *Arbitration International* 679. For example, CETA has no umbrella clause. EUSIPA limits the scope of the umbrella clause to 'a specific and clearly spelt out commitment in a contractual written obligation', thereby also further specifying what is a 'contractual written obligation': Art 2.4.6 EUSIPA.

²⁰⁴ According to UNCTAD, of a total of 2577 mapped IIAs, ISDS clauses were found in 1109 treaties: UNCTAD, 'Mapping of IIA Project' (*Investment Policy Hub*) <<http://investmentpolicyhub.unctad.org/IIA/mappedContent>> accessed 30 June 2020. Unlike NAFTA, USMCA contains an umbrella clause for 'covered government contracts', which may give rise to treaty arbitration under Annex 14-D. These contracts are strictly limited to certain sectors: oil and natural gas, supply of power generation, telecommunications, transport services to the public, and infrastructure: see Annex 14-E.

²⁰⁵ Art 1120(1) NAFTA; Art 24(3) US Model BIT 2012; Art 26(4) ECT; CETA, as it moves from the traditional ISDS model, leaves the parties the choice of rules instead of the choice of forum: Art 8.23.2. Similarly see Art 3.6 EUSIPA.

²⁰⁶ See Gus Van Harten, 'Pro-Investor or Pro-State Bias in Investment-Treaty Arbitration? Forthcoming Study Gives Cause for Concern' (2012) *Editorials and Commentaries* 136. This study offers evidence of systematic bias of arbitral tribunals in the resolution of jurisdictional issues, favouring interpretations which allow more

are not permanent; they are constituted for the particular investment dispute, under the auspices of an arbitration administering institution or as *ad hoc* tribunals. The arbitration rules of the chosen forum govern arbitration, unless the applicable IIA has specific procedural provisions which then apply as *lex specialis*.²⁰⁷ In most cases, IIAs do not have particularly detailed rules and therefore issues such as the appointment of arbitrators, applicable law, allocation of costs, transparency and remedies are addressed in detail in arbitration rules.²⁰⁸ The ICSID and UNCITRAL, as the most prominent sets of arbitration rules, have their advantages²⁰⁹ but they are also prone to specific criticisms. The ICSID is prone to criticism for its close connections with the World Bank, and through its President, by tradition an American, with the US, and for generally favouring the role of foreign investors through its loans program, which often makes loans conditional on structural adjustments imposed on governments.²¹⁰ UNCITRAL is prone to criticism for the 'privatisation' of disputes that involve States and significant public interest.²¹¹ The lack of a coordinating mechanism between different international arbitral proceedings can lead to parallel proceedings stemming from the same investment event being pursued under different BITs.²¹²

claims to proceed, especially in cases concerning claimants from Western capital-exporting States. See also chapter 3, section 3.3.2.

²⁰⁷ Art 1120(2) NAFTA; Art 24(5) US Model BIT 2012.

²⁰⁸ Pohl, Mashigo and Nohen (n 132) 22.

²⁰⁹ For comparison of ICSID and UNCITRAL Rules, see Arif Hyder Ali and others, *The International Arbitration Rulebook: A Guide to Arbitral Regimes* (Kluwer 2019).

²¹⁰ This criticism is voiced particularly strongly by Latin American countries. See Silvia Karina Fiezzoni, 'The Challenge of UNASUR Member Countries to Replace ICSID Arbitration' (2011) 2 *Beijing Law Review* 134. See also chapter 3, section 3.3 on issues of legitimacy and the rule of law in investment treaty arbitration.

²¹¹ Giorgio Sacerdoti, 'Investment Arbitration Under ICSID and UNCITRAL Rules: Prerequisites, Applicable Law, Review of Awards' (2004) 19 *ICSID Review – Foreign Investment Law Journal* 1, 47.

²¹² The notable examples in this regard are the *CME/Lauder v The Czech Republic* arbitrations, both based on the same investment; that is, intervention of the Czech Media authority directed towards CME, a Dutch-based company controlled by the US citizen Ronald Lauder. While the company initiated and won a UNCITRAL arbitration for breaches of the Netherlands–Czech BIT before the Stockholm Chamber of Commerce (*CME Czech Republic B.V. v The Czech Republic*, UNCITRAL, Final Award (14 March 2003)), Lauder in his private capacity as an investor who controlled CME initiated and lost an UNCITRAL arbitration under the US–Czech Republic BIT in London (*Ronald S. Lauder v The Czech Republic*, UNCITRAL, Final Award (3 September 2001)). The Czech Government challenged the decision of the Stockholm Tribunal before the Swedish court, claiming, among other grounds, that the Tribunal lacked jurisdiction based on the principles *lis pendens* (disallowing parallel proceedings on the basis of the same claim) and *res judicata* (disallowing subsequent proceedings on the basis of prior resolution of the same claim). The court rejected these objections for lack of identity between the parties: *CME Czech Republic B.V. v The Czech Republic*, UNCITRAL, Challenge of Arbitral Award, Judgment of Svea Court of Appeal published at 42 ILM 919 (2003) (15 May 2003) 98.

2.2.3. *The tip of the iceberg: arbitration as a dispute resolution method*

With no uniform dispute settlement body, arbitral tribunals are selected for each case, usually consisting of three members. Each party in dispute designates one member, with the third presiding member²¹³ appointed by agreement of the parties²¹⁴ or the arbitrators.²¹⁵ The non-permanent arbitration panel format and arbitrators who sit on these panels are among the most contentious elements of the ISDS regime.²¹⁶ In practice, law firms that represent the parties propose to their clients potential arbitrators, effectively giving law firms that specialise in international investment arbitration considerable influence over people who sit on arbitration panels.²¹⁷ With parties actively participating in the process of selection, the impartiality of arbitrators remains questionable as some empirical studies indicate that arbitrators might incline to render compromised judgments which maximise their chances to be selected for future disputes.²¹⁸ In this way, arbitrators become party advocates within the system that expects their objectivity.²¹⁹ Moreover, a recent extensive study demonstrates the full extent of investment arbitration revolving-door practice, with an established practice of ‘double hatting’ and the exchange of different roles (arbitrators, counsels, expert witnesses, tribunal secretaries) between a very small pool of ‘power broker’ investment lawyers.²²⁰ Legal rules on the appointment of arbitrators, their qualifications and conflict of interest serve to eliminate these biases, although they fail to address the perceptions of systemic bias.²²¹

²¹³ The selection of the presiding arbitrator is often seen as the most important step, given the presiding arbitrator’s key role in coming to the arbitral decision: Gaukrodger (n 146) 89-91.

²¹⁴ Art 37(2)(b) ICSID Convention. If the parties cannot agree on the third arbitrator, the Chairman of the Administrative Council (i.e. the president of the World Bank) will make an appointment from the Panel of Arbitrators and this person will not be a national of either Contracting State party to the dispute or the Contracting State whose national is a party to the dispute: Ars 38 and 40(1) ICSID Convention. Also, Arts 1123 and 1124 NAFTA, and Art 27 US Model BIT 2012, similarly outline the method of selection of arbitrators.

²¹⁵ Art 9 UNCITRAL Arbitration Rules (2010). If they cannot agree, a third member can be selected by the Secretary-General of the Permanent Court of Arbitration in The Hague, or the Secretary-General of the PCA selects an appointing authority that chooses the third member: UNCITRAL Rules 9(3) and 6(2).

²¹⁶ Catherine A Rogers, ‘The Politics of International Investment Arbitrators’ (2013) 12 Santa Clara International Law Review 223, 226-228.

²¹⁷ Directorate-General for External Policies of the European Parliament, ‘Investor–State Dispute Settlement provisions in the EU’s international investment agreements: Volume 2-Studies’ (September 2014) EXPO/B/INTA/2014/08-09-10, 24-25.

²¹⁸ Jens Dammann and Henry Hansmann, ‘Globalising Commercial Litigation’ (2008) 94 Cornell Law Review 1, 34-35.

²¹⁹ Hans Smit, ‘The Pernicious Institution of the Party-Appointed Arbitrator’ (2010) 33 Columbia FDI Perspectives.

²²⁰ Malcolm Langford, Daniel Behn, and Runar Hilleren Lie, ‘The Revolving Door in International Investment Arbitration’ (2017) 20 Journal of International Economic Law 301.

²²¹ In most cases, IIAs have only basic provisions regarding these matters. The German Model BIT 2008 explicitly relies on the applicable arbitral rules. The ICSID Convention prescribes competence for arbitrators in Art 14(1). In regard to impartiality, the ICSID Convention warrants disqualification on the basis of Art 57, whereby a party may propose disqualification for ‘manifest lack of qualities’ required by Art 14, or on the basis of ineligibility for appointment under Arts 37-40. The ICSID Arbitration Rules, Rule 6 requires the

The most effective element of ISDS is enforcement. Arbitral awards are final and binding.²²² For the host State the award creates an international obligation to comply and there is very limited possibility to challenge the award. The ICSID Convention creates a self-enforcement mechanism²²³ conferring on the award a status equal to that of a judgment made by the national courts of the Contracting State²²⁴ and allowing annulment of such awards only exceptionally and for limited procedural reasons only.²²⁵ In the case of UNCITRAL or other non-ICSID arbitration awards, the recognition and enforcement is governed under the New York Convention.²²⁶ As with commercial arbitration awards, these investment awards can be challenged before national courts of the State of the seat of the arbitration. The assessment involves the prescribed grounds for refusal of enforcement in accordance with the national law.²²⁷ Accordingly, States' practice regarding enforcement of such awards may vary, although in general terms States have adopted substantively similar grounds and their courts have been restrictively applying these grounds, not involving merits review.²²⁸ Specific problems might arise in some States, which have adopted broad interpretation of the public policy exception for commercial arbitration awards.²²⁹ Additionally, in cases of both ICSID and the New York

arbitrator to submit a statement of any past or present relationship with the parties, and any circumstance that might cause the arbitrator's reliability for independent judgment to be questioned by a party. UNCITRAL Rules prescribe in Rule 11 the duty of the potential arbitrator to 'disclose any circumstances *likely* to give rise to justifiable doubts as to his or her impartiality or independence' (emphasis added). These rules are less strict compared to the requirements of judicial independence: see chapter 3.3.2.2 and chapter 9.

²²² Arts 1136(1) and (2) NAFTA; Arts 34(4) and (5) US Model BIT 2012; Art 26(8) ECT; Art 10(3) German Model BIT 2008; Art 2.22 EUSIPA; Art 8.41 CETA.

²²³ ICSID Convention Art 53 prescribes that the award of an ICSID tribunal is binding and cannot be subject to any appeal or remedy, except for those provided in the Convention.

²²⁴ Art 54(1) ICSID Convention: 'Each Contracting State shall recognize an award rendered pursuant to this Convention as binding and enforce the pecuniary obligations imposed by that award within its territories as if it were a final judgment of a court in that State'.

²²⁵ ICSID Convention Art 52(1) prescribes the following grounds for annulment: (a) tribunal not properly constituted; (b) manifest excess of tribunal's powers; (c) corruption on the part of a member of the tribunal; (d) serious departure from a fundamental rule of procedure; (e) the award failed to state the reasons on which it is based. Additionally, ICSID Convention prescribes the possibility of a review of the award in the cases of the dispute between the parties regarding the meaning or scope of the award (Art 50), or if new facts arise that might decisively affect the award, which were not due to party's negligence (Art 51).

²²⁶ Convention on the Recognition and Enforcement of Foreign Arbitral Awards (adopted 10 June 1958, entered into force 7 June 1959) 330 UNTS 3.

²²⁷ These grounds are prescribed in Article V of the New York Convention and can be classified as: grounds related to (i) *lack of jurisdiction of the tribunal to consider issues related to the arbitration agreement*: incapacity of parties (Art V(1)(a)) and an award beyond the scope of the arbitration, for example excess of mandate or power (Art V(1)(c)); (ii) *failure to accord procedural justice in the arbitral proceedings*: lack of proper notice or other inability of the party to present the case (Art V(1)(b)) and irregularities in the composition of the arbitral tribunal (Art V(1)(d)); and (iii) *the incompatibility of the award with the national law*: the award is suspended under the law of the country in which it was made (Art 1(V)(e)) or is contrary to the public policy of that country (Art V(2)). All countries that are signatories to the New York Convention have implemented these grounds in their national arbitration laws. These national laws are largely based on the UNCITRAL Model Law on International Commercial Arbitration, which incorporates the same grounds of the New York Convention in Art 36(1). In addition, Art 34 of the Model Law implements the same grounds for an action to set aside the award before the national court.

²²⁸ See Sacerdoti (n 211) 27-39.

²²⁹ Gaukrodger (n 146) 34.

Convention enforcements, the principle of sovereign immunity might cause difficulties in regard to enforcement,²³⁰ as well as the execution of awards.²³¹ The mechanism currently in place does not include appellate proceedings, which would allow for corrections of errors of law and/or fact and consistency with arbitral jurisprudence.²³²

²³⁰ ICSID Convention Art 55 allows the Contracting States to decide against enforcing an award if such award would be contrary to its law relating to sovereign immunity. Similarly, the public policy exception could be a barrier to enforcing an award under the New York Convention. See UNCTAD 2004 (n 4) 368.

²³¹ In this respect, the barrier to execution can be State immunity attached to State commercial assets or, if commercial assets are held by a State-owned corporation, they could then be considered not to belong to the State but to a third party. See Gaukrodger (n 146). See also chapter 7 for problems of enforcement of intra-EU awards in the EU.

²³² In this respect CETA departs from the old system by creating an Appellate Tribunal: Art 8.28 CETA. Some more recent IIAs leave the possibility of introducing an appeal through a future multilateral appellate mechanism: see, for example, Art 28 US Model BIT 2012; Art 9.23(11) CPTPP. There is no reference to appellate mechanism in the USMCA.

3

Mapping the challenges of ISDS reform: an array of tensions

3.1. Political, economic and legal tensions

3.1.1. *Tensions between ideologies*

3.1.2. *Tensions between economic objectives*

3.1.3. *Tensions between legal methods and cultures*

3.2. Tensions between actors and their perspectives

3.3. Intersections of law and politics in international investment regulation: normative considerations

3.3.1. *Legitimacy of international investment regulation*

3.3.1.1. Output-based legitimacy through politically acceptable norms

3.3.1.2. Output-based legitimacy through legally sound norms

3.3.2. *The rule of law in international investment regulation*

3.3.2.1. Substantive rule of law: neutrality or normativity?

3.3.2.2. Procedural rule of law: procedural justice, openness and transparency

3.3.3. *Beyond legitimacy and the rule of law: the sui generis character of arbitration*

After explaining the historical background in which international investment law (IIL) developed, and its legal complexity, this final chapter of Part I provides reflection on different issues that occupy the current debate on international investment regulation (IIR) and challenges encountered when addressing them. First, building upon issues identified in the preceding chapters, this chapter delves into tensions stemming from divergent political ideologies, economic objectives and legal methods that come into play in the interpretation and implementation of international investment agreements (IIAs). Secondly, tensions between different actors and their perspectives on these issues are considered. Thirdly, issues are placed in the conceptual framework of legitimacy and the rule of law. In this way, this chapter maps challenges to ISDS reform and provides background for the analysis in Part II, which will consider how the EU responds to these challenges in its investment regulation. The aim is not to analyse each issue exhaustively but rather to conceptualise systemic problems that are relevant for current ISDS reform.

3.1. Political, economic and legal tensions

3.1.1. *Tensions between ideologies*

History demonstrates how the development of IIR has been a contentious issue from its very beginning. The different bodies of opinion have had underlying ideological and geopolitical divisions. The earliest period was dominated by conflict about the minimum standard of treatment (MST) of foreign investments under customary international law (CIL) and it emerged as a reaction to the US attempts for economic dominance in Latin America. In the aftermath of decolonisation, the conflict about this same issue – in essence concerning the level of appropriate protection standards – continued to dominate the debate, now within a more global context. In line with the Cold-War divisions between State-controlled and capitalist economies, capital-importing developing countries sided with the political economy of the former, and capital-exporting developed countries with the latter. The inability to find a compromise ultimately led to the failure of a multilateral investment framework. As an alternative, a network of BITs between capital-importing and capital-exporting countries emerged, and the International Centre for the Settlement of Investment Disputes (ICSID) in Washington was established to provide a neutral and depoliticised forum for the resolution of potential investment disputes. These underlying conflicts in essence embraced the efforts of politically weaker developing countries to protect newly gained independence, which was under threat from politically and economically dominant developed countries. Developing countries feared that Western States, through the economic activities of their investors, would exercise political dominance, ultimately undermining their State sovereignty.

The deeply rooted ideological divisions within the international community apparently disappeared with the fall of communism, bringing victory for the liberal capitalist political and economic agenda. The era of ‘a new world order’¹ began, which prompted the idea of global governance, driven by economic globalisation. The GATT, which allowed the proliferation of trade liberalisation through a multilateral framework, was successful in reducing traditional tariff barriers in the trade of manufactured goods. GATT was then upgraded to the WTO in 1995, encompassing a broader range of issues: trade in services, intellectual property rights and trade-related investment measures. This new agenda reflected the new global commerce supported by the development of

¹ George Bush, 41st President of the USA, ‘Address Before a Joint Session of the Congress of the State of the Union’ (Washington DC, 29 January 1991) < <https://www.presidency.ucsb.edu/documents/address-before-joint-session-the-congress-the-state-the-union-1> > accessed 30 June 2020.

information technologies, which transformed trade from traditional physical exchange of goods towards complex exchange of goods and services, facilitated through the global operations of MNCs.² However, economic globalisation produced winners and losers, creating, instead of a bipolar Cold War world, the contemporary multipolar world.

The GATT had failed to eliminate asymmetries between developed and developing countries in trade of manufactured goods.³ The new, enlarged agenda of the WTO included intellectual property rights favouring developed countries but excluded issues that would be beneficial to developing countries, such as transfer of technology and agricultural trade. This further deepened the divide and facilitated the creation of monopolistic rather than competitive markets.⁴ The multilateral trade framework, from developing countries' perspective, is thus seen as a mechanism for promoting the interests of developed superpowers under the guise of global governance.⁵

Unlike trade, investment did not manage to stimulate negotiation of a multilateral framework. By creating enhanced protection rights, BITs served as a mechanism for promoting economic nationalism of developed countries rather than economic liberalism.⁶ While the more closely aligned interests of developed countries in the area of trade allowed for a common framework, their more diversified interests in relation to investment led to fragmentation of investment instruments. The US and the UK, the two countries that led the initiative for a multilateral trade framework, were sceptical or negative about the desirability of a multilateral treaty approach regarding investment; on the other hand, Germany strongly supported it.⁷ The US believed that the standard of protection for investors would be lowered in a multilateral setting; Germany believed that its interests would be better protected multilaterally since in the post-WWII period Germany lacked both political power and colonial ties through which it could afford protection for its investors in third countries.⁸ Additionally, the failed Havana Charter,⁹ which aimed to provide a multilateral framework for trade and investment, attempted to

² John M. Kline and Rodney D. Ludema, 'Building a multilateral framework for investment: comparing the development of trade and investment accords' (1997) 6 *Transnational Corporations* 1, 19.

³ For an overview of international trade between developed and developing countries, and differences in their trade policy approaches and interests, see Bela Balassa, 'Trade between Developed and Developing Countries: The Decade Ahead' (1984) 3 *OECD Economic Studies* 7.

⁴ M Ratiqul Islam, 'History of the North-South Divide in International Law: Colonial Discourses, Sovereignty and Self-Determination' in Shawkat Alam and others (eds), *International Environmental Law and the Global South* (CUP 2015) 47.

⁵ Walden Bello, 'The Iron Cage: The World Trade Organization, the Bretton Woods Institutions, and the South' (2000) 11(1) *Capitalism, Nature, Socialism* 3.

⁶ Kenneth J. Vandeveld, 'The Political Economy of a Bilateral Investment Treaty' (1998) 92 *The American Journal of International Law* 621, 633.

⁷ Rudolf Dolzer and Yun-I Kim, 'Germany' in Chester Brown (ed), *Commentaries on Selected Model Investment Treaties* (OUP 2013) 294.

⁸ *ibid* 293-295.

⁹ Havana Charter for an International Trade Organisation (1948) UN Doc E/CONF.2/78.

incorporate different economic doctrines.¹⁰ With the success of the German BIT program, the US introduced its own program, which followed a protectionist agenda.¹¹ The early US model BITs of the 1980s were the most protective investment instruments.¹² Similarly, other BITs, the majority of which were developed following the German or the early US model, embraced the same tendency towards economic nationalism.

This economic approach was in contradiction to the rhetoric of newly emergent economic globalisation and free trade, which embraced a neoliberal narrative. Yet, the vast majority of BITs were signed in the 1990s, containing elements of the past times that did not match contemporary political economy and economic realities of the present. Developed countries continued to sign these treaties to retain preferential protections for their investors abroad. Developing and transitional economies used them to demonstrate their new economic policies and to continue receiving credit ratings from international rating agencies, which allowed them to borrow money on international financial markets at lower interest rates.¹³ At the same time, the realisation of the intrinsic links between trade and investment in the times of economic globalisation led to the emergence of new preferential trade *and* investment agreements, such as NAFTA and the ECT. These agreements had economic liberalisation at the forefront of their agenda, prominently influencing evolution of IIR in the years to come.

With the stagnation and ultimate failure of the WTO negotiations in 2006, it became obvious that the future of world trade and investment would be fragmented and that new FTAs had gained an increasing geopolitical importance. Fragmentation has ultimately exacerbated the different forms of the contemporary multipolar world. With the rise of BRIC countries (Brazil, Russia, India and China, not necessarily in that order), the traditional contours of developed vs developing countries (also known as the North–

¹⁰ Kline and Ludema (n 2) 7.

¹¹ The US signed its first BIT with Egypt in 1982, which ended the earlier US FCN treaty program. Unlike FCNs, which provided a broad framework for general commercial relations between the US and developing countries, BITs were seen as more business-oriented treaties. It was also believed that FCNs were outdated and did not reflect economic realities, as they were adapted to the post-WWII era, mostly as an instrument of cooperation between the US and Europe and Japan. Since FCNs were much broader in scope, they were also perceived as a tool of political allegiance to the US, which many non-aligned developing countries wanted to avoid. Finally, political realities of the expropriation of US businesses in Iran, Libya and other developing countries on the one hand, and effectiveness of German BITs to protect German investors in developing countries on the other, prompted the US to adopt the new program: Joseph E Pattison, 'The United States-Egypt Bilateral Investment Treaty: A Prototype for Future Negotiation' (1983) 16 Cornell International Law Journal 305, 307-310.

¹² Jose E Alvarez, 'The Return of the State' (2011) 20 Minnesota Journal of International Law 223, 231-232.

¹³ Directorate-General for External Policies of the European Parliament, 'Investor-State Dispute Settlement provisions in the EU's international investment agreements: Volume 2-Studies' (September 2014) EXPO/B/INTA/2014/08-09-10, 10.

South divide) have been lost.¹⁴ Additionally, the competition between the developing countries has increased, leading to a South–South divide.¹⁵

With the start of the new millennium, IIAs advanced in their complexity. They gradually expanded their content and scope with the new generation of BITs following the trends of standards set in preferential trade and investment agreements and the new North American BIT model.¹⁶ The new approach to drafting investment treaties narrowed the scope of investor rights to some extent. This change can be explained by the pursuit of economic liberalisation on the one hand, and the move towards protection of States' sovereign policy space on the other.¹⁷

Finally, the Global Financial Crisis (GFC) of 2008 demonstrated that economic globalisation brought about divisions within the multipolar world but, even more so, divisions within society. Business elites, in both developing and developed countries, profited from globalisation, which in turn left many workers and poorer elements of society worse off. These elites, in the literature described as the transnational capitalist class, encompass business elites affiliated with multinational enterprises (MNEs), but also globalising bureaucrats, politicians, professionals, merchants and media. Altogether they form a dominant force in the political sphere of the contemporary global system.¹⁸ Their private interests extend beyond nation States and they dominate the discourse of globalisation.¹⁹ As strong market players, MNEs have the strongest capacity to survive different types of crises because their global operations allow them to shift from a troubled country or region towards more robust foreign markets.²⁰

Recent political events, such as Brexit, demonstrate citizens' concerns in the West over globalisation and neoliberal discourse, suggesting that we have not yet reached the 'end of history'.²¹ Given the global reach of private capital operating in world markets according to opportunities, incentives and disincentives determined through transnational neoliberal discourse, contrasted with the reach of States' policies limited by

¹⁴ The additional inconvenience of this systematisation is positioning Russia within the North, although Russia's political and economic circumstances considerably differ from both North and South countries. Similarly, whether China is a developing country remains a contested issue in the WTO.

¹⁵ Tony Heron, 'The Ending of the Multifibre Arrangement: A Development Boon for the South?' (2006) 18 *The European Journal of Development Research* 1. The author analyses the effects of ending the multifibre arrangement, which were generally anticipated as positive for developing countries, but have been unequally distributed between these countries, generally favouring large countries like India and China.

¹⁶ UNCTAD, 'Recent Developments in International Investment Agreements' (2005) IIA Monitor No. 2, UNCTAD/WEB/ITE/IIT/2005/1, 4-6. See also discussion on the North American model in section 3.1.2 below.

¹⁷ Cf. Alvarez (n 12)

¹⁸ Leslie Sklair, 'The Transnational Capitalist Class and the Discourse of Globalisation' (2000) 14 *Cambridge Review of International Affairs* 67.

¹⁹ *ibid*

²⁰ See empirical research conducted in the study by Desislava Dikova and others, 'Immediate Responses to Financial Crises: A Focus on U.S. MNE Subsidiaries' (2013) 22 *International Business Review* 202.

²¹ Fukuyama F, 'The End of History?' (1989) 16 *The National Interest* 3.

territorial boundaries, neoliberalism has reached the point of no return.²² States' domestic economic policies, especially since the GFC, demonstrate some forms of return to State intervention in economies, which conflicts with the neoliberal discourse promoted through IIAs. The number of investment arbitration claims has risen,²³ resulting in the rise of States' scepticism towards ISDS. Contemporary threats to State sovereignty in the area of investment do not come from other States as in the past, but from private capital. In the words of Nobel-prize winning economist Joseph Stiglitz: 'Companies can sue governments for full compensation for any reduction in their future expected profits resulting from regulatory changes'.²⁴ Modern IIAs are accordingly an attempt to align legal institutions with political and economic realities of contemporary international trade and investment, in which States are both exporters and importers of capital. While sets of standards developed in Washington or Brussels still drive the rules of global governance, new investment governance is increasingly shaped by divergent policies of the West, emerging players like China, and underlying scepticism towards ISDS, in particular in the global South.

The new US approach, under the leadership of President Trump, has been more hostile towards ISDS, significantly limiting its scope in the USMCA.²⁵ However, ISDS remains the preferred option with few limitations for government contracts in sectors such as oil and gas, turning ISDS back to its beginnings when contract-based rather than treaty-based arbitration was prevalent.²⁶ In addition, the USMCA brings back into the fray some unresolved issues of the past – by excluding non-market economies as potential claimants²⁷ and as treaty partners of the USMCA partners.²⁸ More specifically, the US concerns are focused on containing China,²⁹ while also being more generally related to

²² Heikki Patomäki, 'Neoliberalism and Global Financial Crisis' (2009) 31 *New Political Science* 431, suggesting that return of national social democracy is unlikely but might be replaced by 'green global Keynesianism'.

²³ An array of recent claims against Spain under the ECT is an example. Spain introduced a generous renewable energy incentive program in 2004, which attracted foreign investment, but was forced to cut back the incentives in 2010 due to a serious economic crisis. See Carmen Otero Garcia-Castrillon, 'Spain and Investment Arbitration: The Renewable Energy Explosion' (2016), Centre for International Governance Innovation, Investor-State Arbitration Series Paper No. 17.

²⁴ Joseph Stiglitz, 'The Secret Corporate Takeover' (*Project Syndicate*, 17 May 2015)

<<https://www.economics.utoronto.ca/gindart/2015-05-13%20-%20The%20secret%20corporate%20takeover.pdf>> accessed 30 June 2020.

²⁵ See USMCA, Annexes 14-D and 14-E. For the analysis of the relevant provisions, see chapter 2.

²⁶ See chapter 1, section 1.2.

²⁷ The new USMCA's definition of claimant explicitly excludes an investor owned or controlled by a person that the other party considers a non-market economy: Art 14.D.1.

²⁸ Art 32.10 USMCA includes the obligation of the party that seeks to negotiate a treaty with a non-market economy to present the text to the other parties, which reserve the right to terminate the USMCA if the agreement with a non-market economy enters into force.

²⁹ Michael Schuman, 'The EU Can't Make Allies Take Sides Over China' (*The Atlantic*, 25 April 2019) <<https://www.theatlantic.com/international/archive/2019/04/us-allies-washington-china-belt-road/587902/>> accessed 30 June 2020.

the impact of international rules on US sovereignty, both in trade (WTO) and investment. It remains to be seen whether this new approach to ISDS is an exceptional departure from earlier US investment policy or a new paradigm for its IIAs. The US remains committed to ISDS and the regulation of investment relations at a bilateral level, and has been critical of the EU's proposal for a permanent multilateral institution.³⁰ On the other hand, the scaling back of international standards in the USMCA and more broadly in the sphere of trade does not align with EU interests.³¹ Caught up in the US–China confrontation, the EU shares some US concerns but not the methods adopted to address them.³²

China is increasingly emerging as a rule-maker, in particular in the sphere of its own commercial interests. While concluding many IIAs, China's experience with ISDS has been limited.³³ More recently, China has advanced its own investment initiatives, most notably the Belt and Road Initiative (BRI),³⁴ and is developing more effective domestic and

³⁰ See Part III.

³¹ For the impact of the USMCA on the EU, see European Parliamentary Research Service, 'United States-Mexico-Canada Agreement (USMCA): Potential impact on EU companies' (2018).

³² The EU–US like-mindedness translates into a general objective of forcing China to reform its non-market-oriented policies and working closely together with other like-minded partners to reform the WTO and address unfair global trade practices: see European Commission Press Release, 'Joint U.S.–EU Statement following President Juncker's visit to the White House' (25 July 2018) <https://ec.europa.eu/commission/presscorner/detail/en/STATEMENT_18_4687> accessed 30 June 2020. See also Office of the US Trade Representative Press Release, 'Joint Statement of the Trilateral Meeting of the Trade Ministers of the European Union, Japan and the United States' (9 January 2019) <<https://ustr.gov/about-us/policy-offices/press-office/press-releases/2019/january/joint-statement-trilateral-meeting>> accessed 30 June 2020. However, there are also differences. The EU generally opposes President Trump's approach in using tariffs to force China to change and has criticised the US approach in blocking appointments to the WTO Appellate Body. On the other hand, the US has already indicated that it will oppose any EU proposal in respect of the WTO which would give more powers to the Appellate Body. For more detailed analysis of EU–US relations, see Marianne Schneider-Petsinger, 'US–EU Trade Relations in the Trump Era: Which Way Forward?' (2019) Chatham House Research Paper <<https://www.chathamhouse.org/publication/us-eu-trade-relations-trump-era-which-way-forward>> accessed 30 June 2020. See also Anabel González and Nicolas Véron, 'EU Trade Policy Amid the China–US Clash: Caught in the Cross-Fire' (2019) Peterson Institute for International Economics Working Paper 19-13, <<https://www.piie.com/publications/working-papers/eu-trade-policy-amid-china-us-clash-caught-cross-fire>> accessed 30 June 2020.

³³ This might be due to the China's reservations on the applicability of the ICSID Convention (limited to compensation arising from expropriation cases) and New York Convention (limited to commercial and not ISDS cases, which must be enforced before Chinese courts): see Donald J Lewis and Diana Moise, 'One Belt One Road ("OBOR") Roadmaps: the Legal and Policy Frameworks' in Julien Chaisse and Jędrzej Gorski (eds), *The Belt and Road Initiative: Law, Economics and Politics* (Brill 2018) 55-58.

³⁴ The BRI is intended to complement China's 'Going Abroad' strategy and promote connectivity and cooperation between Asia, Europe and Africa, through land and sea corridors. It covers nearly 70 countries, with an aggregate economic volume of 21 trillion US dollars. For the scope of this investment, see Anna Chuwen Dai, 'The International Investment Agreement Network under the "Belt and Road" Initiative' in Julien Chaisse and Jędrzej Gorski (eds), *The Belt and Road Initiative: Law, Economics and Politics* (Brill 2018) 220-224. In addition, there are a number of financing institutions that support this and other development initiatives in Asia, led by China, such as China policy banks, China Development Bank, Asian Infrastructure and Investment Bank (AIIB), Silk Road Fund (SRF), BRICS New Development Bank, and Shanghai Cooperation Organisation. For comprehensive analysis of these institutions and comparison with their Western counterparts, see Maria Adele Carrai, 'It is Not the End of History: the Financing Institutions of the Belt and Road Initiative and the Bretton Woods System' in Julien Chaisse and Jędrzej Gorski (eds), *The Belt and Road Initiative: Law, Economics and Politics* (Brill 2018) 111-125.

investment regulation for these new investments.³⁵ It has expanded the jurisdiction of its own arbitral institutions to include foreign investment claims.³⁶ It established a new court for BRI commercial disputes.³⁷ In Africa it started the China–Africa Joint Arbitration Centre (CAJAC), with five regional centres.³⁸ While these institutions remain embedded in the existing international system of arbitration,³⁹ China has taken a proactive approach in developing new rules with ‘Chinese’ characteristics.⁴⁰ *Inter alia*, focus has been on promoting mediation-arbitration techniques, expedient proceedings and lowering costs.⁴¹ Whether the Chinese approach threatens Western institutions or creates a ‘healthy’ competition to Bretton Woods remains the subject of debate.⁴² The EU, as a newcomer to the IIR field, is counting on China’s cooperation in developing its own set of institutions, despite the policy gap between them.⁴³ In its efforts to reform the system, the EU is proposing flexible plurilateral solutions that fit all – and a Multilateral Investment Court (MIC) that can accommodate China’s preference for an appellate mechanism in ISDS.⁴⁴ Given their overlapping interests in certain regions (Africa, European neighbourhood, Western Balkans), this approach seems sensible.

In light of political controversies around ISDS in the countries of the global North, investment dispute settlement is excluded altogether in some notable recent North–

³⁵ See Weidong Zhu, ‘Some Considerations on the Civil, Commercial and Investment Dispute Settlement Mechanism between China and the Other Belt and Road Countries’ in Julien Chaisse and Jędrzej Gorski (eds), *The Belt and Road Initiative: Law, Economics and Politics* (Brill 2018) 607–620. For an overview of the existing investment protections for BRI IIAs: see Huaxia Lai and Gabriel M. Lentner, ‘Paving the Silk Road BIT by BIT: an Analysis of Investment Protection for Chinese Infrastructure/Projects under the Belt & Road Initiative’ in Julien Chaisse and Jędrzej Gorski (eds), *The Belt and Road Initiative: Law, Economics and Politics* (Brill 2018).

³⁶ In particular, the Shenzhen Court of International Arbitration (SCIA) and China International Economic Trade Arbitration Commission (CIETAC). This is in addition to the Hong Kong International Arbitration Centre (HKIAC), which has also been designated for the BRI ISDS cases.

³⁷ China International Commercial Court in Xi’an and Shenzhen, known as the Belt and Road Court.

³⁸ In Shanghai, Beijing, Shenzhen, Nairobi, Johannesburg.

³⁹ The notable exception is the BRI Court, which has been established by the Supreme People’s Court of China: see China International Commercial Court, ‘Introduction’ (*About the CICC*)

<<http://cicc.court.gov.cn/html/1/219/193/195/index.html>> accessed 30 June 2020.

⁴⁰ For example, arbitrators of CAJAC must have ‘thorough understanding of Chinese Arbitration Act, Chinese Arbitration Practice and Procedure as well as appreciation of Chinese culture’: Interview with the CEO of the CAJAC Johannesburg, in Sadaf Habib, ‘Interview with Our Editors: Interview with Deline Beukes, CEO of the China Africa Joint Arbitration Centre Johannesburg’ (*Kluwer Arbitration Blog*, 26 November 2018)

<<http://arbitrationblog.kluwerarbitration.com/2018/11/26/interviews-with-our-editors-interview-with-deline-beukes-ceo-of-the-china-africa-joint-arbitration-centre-johannesburg/>> accessed 30 June 2020.

⁴¹ Huiping Chen, ‘China’s Innovative ISDS Mechanisms and Their Implications’ (2018) 112 *American Journal of International Law* 207.

⁴² See ‘A belt-and-road dream of rivalling the West’s tribunals’ (*The Economist*, 6 June 2019)

<<https://www.economist.com/china/2019/06/06/a-belt-and-road-court-dreams-of-rivalling-the-west-s-tribunals>> accessed 30 June 2020. Cf. Carrai (n 34) 135–145. See also Zachary Mollengarden, ‘One-Stop’ Dispute Resolution on the Belt and Road: Toward an International Commercial Court with Chinese Characteristics’ (2019) 36 *Pacific Basin Law Journal* 65.

⁴³ Hongling Ning and Tong Qi, ‘Multilateral Investment Court: The Gap between the EU and China’ (2018) 4 *The Chinese Journal of Global Governance* 154. For a comprehensive overview of the EU–China investment relationship, see Julien Chaisse (ed), *China–European Union Investment Relationships: Towards a New Leadership in Global Investment Governance?* (Edward Elgar 2018).

⁴⁴ See Part III.

North IIAs given that the risk for investors in these countries generally remains low.⁴⁵ In North–South relations, in addition to issues with China, the design of rules is more complicated in relations with strong South players.⁴⁶ With negative experience of ITA on a much larger scale, a number of these countries have decided to denounce the ICSID Convention⁴⁷ and/or BITs,⁴⁸ or alternatively have developed their own model BITs.⁴⁹ Treaties between South countries display a more balanced development-oriented standard⁵⁰ and in some cases orientate towards domestic measures and dispute prevention rather than dispute resolution.⁵¹

⁴⁵ For example, in the USMCA between the US and Canada; there is no ISDS in the EU agreement with Japan; the EU is not negotiating ISDS with Australia and New Zealand. Australia's official approach to ISDS is decided on a case-by-case basis, in light of the national interest: Australian Department of Foreign Affairs and Trade, 'Investor–State Dispute Settlement (ISDS)' (*Trade and Investment*) <<https://www.dfat.gov.au/trade/investment/Pages/investor-state-dispute-settlement>> accessed 30 June 2020.

⁴⁶ One such example is provided by India's stalled negotiations with the US, Canada and the EU respectively.

⁴⁷ Bolivia, Ecuador and Venezuela denounced the ICSID Convention in accordance with Art 71 of the Convention, in 2007, 2010 and 2012 respectively. Several States have used ICSID Convention mechanisms to limit the territorial application of the ICSID Convention and the classes of disputes that are suitable or unsuitable for submission to the ICSID jurisdiction: see Crina Baltag, 'The ICSID Convention: A Successful Story – The Origins and History of the ICSID' in Crina Baltag (ed), *ICSID Convention after 50 Years: Unsettled Issues* (Kluwer 2017) 16–17.

⁴⁸ For example, Bolivia, Ecuador, Indonesia, India, and South Africa. See, for example, Cecilia Olivet, 'Why did Ecuador terminate all its Bilateral investment treaties?' (*Transnational Institute*, 25 May 2017) <<https://www.tni.org/en/article/why-did-ecuador-terminate-all-its-bilateral-investment-treaties>> accessed 30 June 2020. David Price, 'Indonesia's Bold Strategy on Bilateral Investment Treaties: Seeking an Equitable Climate for Investment' (2017) 7 *Asian Journal of International Law* 124.

⁴⁹ In this regard, an interesting example is India, which in 2015, in response to more than two dozen claims, started significant reform of its investment agreements program, by terminating or intending to terminate a number of existing BITs, clarifying the standards of protection for investors through a Joint Interpretative Statement (JIS), and curtailing investors' rights while introducing measures to protect the regulatory space in its new Model BIT. Whereas it keeps ISDS, the Indian Model BIT introduces exhaustion of local remedies: Art 15 Model Text for the Indian Bilateral Investment Treaty (2015) <https://dea.gov.in/sites/default/files/ModelTextIndia_BIT_0.pdf> accessed 30 June 2020. For the critique of the Model BIT as 'pro-State', see Prabhaskar Ranjan and Pushkar Anand, 'The 2016 Model Indian Bilateral Investment Treaty: A Critical Deconstruction' (2017) 38(1) *Northwestern Journal of International Law and Business* 1. For the analysis of the new Model BIT in relation to State regulatory powers in environmental issues, see Romesh Weeramantry and Montse Ferrer, 'Going green? The evolution of environmental provisions in India's investment treaties' in Kate Miles (ed), *Research Handbook on Environment and Investment Law* (Edward Elgar 2019).

⁵⁰ See, for example, the Reciprocal Investment Promotion and Protection Agreement between the Government of the Kingdom of Morocco and the Government of the Republic of Nigeria (signed 3 December 2016) (2016 Nigeria–Morocco BIT). Among other provisions directed towards 'sustainable development', this BIT also envisaged the possibility for the developing States to establish new standards. For example, in Art 19 it includes the reference to corporate governance and practices, envisaging in subsection 3 that where 'relevant internationally accepted standards' are not available or 'have been developed without the participation of developing countries', the Joint Committee established for the administration of the BIT may establish such standards.

⁵¹ For example, Brazil, which has never ratified any IIA with ISDS clauses, and has developed its own Cooperation and Investment Facilitation Agreements in 2015 with dispute prevention mechanisms and state-to-state arbitration. See Geraldo Vidigal and Beatriz Stevens, 'Brazil's New Model of Dispute Settlement for Investment: return to Past or Alternative for the Future?' (2018) 19 *The Journal of World Investment and Trade* 475. The new Investment Cooperation and Facilitation Treaty between the Federative Republic of Brazil and the Republic of India (signed 25 January 2020) follows the Brazilian Model BIT by narrowing the scope of protections (e.g. to direct expropriation only: see Art 6(3)) and excluding ISDS. Instead, it envisages dispute prevention through a Joint Committee (Art 18) and State-to-State arbitration as the dispute settlement mechanism (Art 19). South Africa is another notable example. It has been replacing BITs (leaving only 10 in force) and ISDS with domestic legislation protections and dispute resolution before domestic

The contemporary political and economic world divided between North and South is more complex than the developed–developing divisions of the past. Between a neoliberal and restrictive ISDS agenda, and specific agendas of big players, the task of addressing ideological tensions in IIR remains as challenging as ever.

3.1.2. Tensions between economic objectives

Given the divergent political visions, the next relevant issue for ISDS reform embraces the objectives and purposes that IIAs aim to achieve. Are they supposed to favour investors or provide a more balanced approach? In the broader context, are they supposed to provide benefits to private investors or increase the prosperity of contracting States through protections that encourage investment activity? Or both? And in the context of the 21st century and global climate change concerns, how do they relate to sustainable development?

In general terms, BITs developed around two basic models,⁵² which still form the basis for the majority of claims.⁵³ With respect to both types, their general purpose is ‘promotion and protection’ of investment, as often stated in their titles. The differences between the two models can be linked to their different philosophical postulates. The first is the ‘European model’, based on the German model BIT, while the second is the ‘North American model’, based on the US Model BIT developed in 2004.⁵⁴ While before the 1990s both models had protectionist interests at their cores, the two models later differentiated with respect to the regulation of the access of foreign investors to the host State.⁵⁵

courts: see Engela C Schlemmer, ‘Dispute Settlement in Investment-Related Matters: South Africa and the BRICS’ (2018) 112 *American Journal of International Law* 212.

⁵² Marie-France Houde and Katia Yannaca-Small, ‘Relationships between International Investment Agreements’ (OECD Publishing 2004) 4.

⁵³ For example, according to UNCTAD, about 70% of cases in 2019 were brought under old-generation IIAs signed in the 1990s or earlier: UNCTAD, ‘Investor–State Dispute Settlement Cases Pass the 1,000 Mark: Cases and Outcomes in 2019’ (7 July 2020) IIA Issues Note, No. 2. UNCTAD/DIAE/PCB/INF/2020/6, 4. This is consistent over the years. Most 2018 ISDS decisions were based on old-generation IIAs signed in the 1990s or earlier: UNCTAD, ‘Review of ISDS Decisions in 2018: Selected IIA Reform Issues’ (23 July 2019) IIA Issues Notes, No. 4, UNCTAD/DIAE/PCB/INF/2019/6. In 2016, around two-thirds of ISDS claims were made under BITs signed in the 1980s and 1990s, while the remaining one-third were based on trade agreements with investment provisions, such as the ECT and NAFTA: UNCTAD, *Investor–State Dispute Settlement: Review of Developments in 2016* (19 May 2017) IIA Issues Notes, Issue No. 1, UNCTAD/DIAE/PCB/2017/1, 3.

⁵⁴ The German model is based on the failed Draft International Convention on Investments Abroad (Abs-Shawcross Draft Convention) model, which was endorsed by OECD ministers in 1962. The North American model, characteristic for the US and Canada, was first introduced as the US Model BIT in the early 1980s: Pattison (n 11). However, the early US Model BIT of 1984 reflected more protectionist economic policies towards investors than the later models, starting with the US Model BIT introduced in 2004: Jose E Alvarez, ‘The Evolving BIT’ (2010) *Transnational Dispute Management* 1. The US FTAs, ch 11 of NAFTA and ch 10 of The Dominican Republic–Central America Free Trade Agreement (signed 5 August 2009, entered into force 1 January 2009) (CAFTA–DR) contain investment chapters resembling the US Model BIT introduced in 2004. When referring to the North American model, reference is made to the later versions of the US Model BITs.

⁵⁵ Houde and Yannaca-Small (n 52) 4.

In the European model, the investment treatment provisions apply to an investment after establishment, leaving the regulation of access, entry and establishment of foreign investment to the control and competence of each State.⁵⁶ The main aim is the protection of property and the promotion of development of the host State⁵⁷ (as an ancillary aim), and not investment liberalisation through liberalisation of the legal regime of the counterpart State. Based on the German concept, the dominant European BIT approach generally does not include clauses advancing non-investment aims, and can be characterised as ‘investment-focused, traditional, short, not definition-prone, and embodying relatively high standards’.⁵⁸

In the North American model, the treatment provisions apply to investment after it has been established in the host State but also in the pre-establishment phase; there is prohibition of imposing performance requirements on investors or their investment,⁵⁹ and the model generally contains more detailed provisions in certain aspects, such as right of entry and the sojourn of aliens.⁶⁰ Although the European model is still more prevalent,⁶¹ the North American model seems to dominate the outline of the modern IIAs by considerably extending their length and by combining trade and investment, which is a move away from investment-only focused agreements.⁶² Thus, current developments in international investment indicate a policy shift towards investment liberalisation in

⁵⁶ This model is also called the ‘admission model’ and ‘investment-control model’, and it is usually easier to agree upon as it does not influence existing legislation. The majority of BITs today are still based on this model: European Parliament 2014 (n 13) 15. Art 2 of the 2008 German Model BIT outlines conditions for admission and protection of investments. Art 2(1) prescribes that each contracting party will admit investments in accordance with its legislation. The clause is significant as it clarifies the German position that a Sovereign State should remain free to regulate its domestic legal order and does not have a duty to change its own laws in order to allow the foreign investment, which is in particular relevant in regard to investment from covered investors: see Dolzer and Yun-I Kim (n 7) 306-307.

⁵⁷ This conclusion can be drawn from the main approach of the German BIT model and consistency of the preambles, which have not changed since the introduction of the first BIT in 1959: *ibid* 293-295.

⁵⁸ *ibid* 301. This approach is also suitable to German economic and investment policy, which is characterised as a ‘social market economy’, which is outward-oriented and strongly based on capital export, with outward FDI flows significantly exceeding inward FDI: see *ibid*, 291.

⁵⁹ See Art 8 US Model BIT 2012.

⁶⁰ Houde and Yannaca-Small (n 52) 4. However, exceptions are allowed through a Non-Conforming Measures clause in Art 14 US Model BIT 2012.

⁶¹ August Reinisch, *Standards of Investment Protection* (OUP 2008) 11 (as cited in European Parliament 2014 (n 13) 15).

⁶² Dolzer and Yun-I Kim (n 7) 290. See also UNCTAD, ‘World Investment Report 2015: Reforming International Investment Governance’ (24 June 2015), UNCTAD/WIR/2015, 110. This is also in line with the US investment policy, which is both inward and outward FDI oriented. The aim of this policy is to encourage the removal of foreign government obstacles to investment and ensure protection for US investment in the post-establishment phase: Lee M Caplan and Jeremy K Sharpe, ‘United States’ in Chester Brown (ed), *Commentaries on Selected Model Investment Treaties* (OUP 2013) 758-760. In general, the US investment policy, in line with its economic policy, aims to regulate foreign investment ‘as little as possible’, thus fostering an open and transparent investment climate, encouraging similar policy regimes in other countries: APEC, ‘2010 Guide to the Investment Regimes of the APEC Member Economies’ (2nd Revision, 2011), APEC#211-CT-03.2, 217. In the EU context, the split between trade and investment has been endorsed due to the EU’s internal division of competences: see chapter 6 in Part II.

IIAs.⁶³ In this regard, the old European BIT model can be considered an expression of a more economic nationalist policy, while the North American model, with its commitment to investment neutrality and market facilitation, is a tool for constructing a more liberal investment regime.⁶⁴ CETA provides a compromise between the old European and the North American model.⁶⁵ However, provisions on pre-investment remain outside of the scope of the dispute settlement.⁶⁶ The same approach is followed in the new USMCA.⁶⁷

The preamble of an investment agreement, although not imposing binding obligations, provides some reflections about the object and purpose of IIAs. The traditional European model, based on the German model, places an emphasis on the encouragement and protection of investment as a means of development. The North American model reflects key aspects of the US liberal economic policy with a view to stimulating flow of private capital, which is interrelated with economic development. In both cases, it is envisaged that both States will profit from the arrangement – the home State by encouraging overseas investment and the host State by receiving that investment. However, reliance on the preamble to determine object and purpose requires caution in treaty interpretation.

Many IIAs have imported the standard language developed for the first BITs when these treaties were meant to serve political purposes. With a remote prospect of their legal enforceability, they were *de facto* political statements of goodwill.⁶⁸ They were not meant to provide greater rights to foreign investors but to provide guarantees that foreign investors would not be treated worse in the host States' domestic legal systems because of deficiencies of these systems.⁶⁹ Only with the development of arbitral

⁶³ See, for example, the investment chapter in Comprehensive and Progressive Agreement for Trans-Pacific Partnership (signed 8 March 2018, entered into force 30 December 2018) (CPTPP), which follows the North American model.

⁶⁴ Vandevelde (n 6) 629-633. The US model imposes investment neutrality obligations on both home and host States by creating pre-establishment commitments, thus disallowing discrimination among investments for political reasons, grounded in the local laws. The investment neutrality is achieved through restrictions on performance requirements, thus allowing unconditional opening of different sectors of the economy to foreign investment. Neutrality is further achieved by providing foreign investors with the right to employ managerial and technical staff regardless of their nationality. Provisions on Publication of Laws (Art 10 US Model BIT 2012) and Transparency (Art 11) provide information on investment climate, thus allowing key market failures to be addressed, in particular in developing and less developed countries.

⁶⁵ See Arts 8.6 and 8.7 CETA. CETA also precludes limitations on market access (Art 8.4) and performance requirements (Art 8.5) and includes a provision to ensure the neutrality of senior management and boards of directors (Art 8.8).

⁶⁶ However, at the same time, CETA excludes from the scope of its investor-State dispute settlement mechanism in Section F claims based on breaches of Section B (establishment of investment) as well as claims based on discrimination during the pre-establishment phase (Arts 8.2.4, 8.18.1, 8.18.2 and 8.18.5). Also, the EU's position on pre-investment and dispute settlement in the context of the ECT modernisation remains the same: see European Commission, 'Recommendation for a Council Decision authorising the entering into negotiations on the modernisation of the Energy Charter Treaty' COM (2019) 231 final

⁶⁷ See Arts 14.4 (NT), 14.5 (MFN), and 14.D.3(1) (Submission of a Claim to Arbitration).

⁶⁸ Matthew Parish, *Mirages of International Justice* (Edward Elgar 2011) 132.

⁶⁹ See chapter 1. Also, see the similar approach of the CJEU in Opinion 1/17 ECLI:EU:C:2019:341, in chapter 9.

jurisprudence post-1990s have the implications of IIAs clarified, including their object and purpose as seen by those who interpret them. Tribunals have referred to the treaty preamble and treaty purpose to infer a favourable disposition to foreign investment as justification for their ‘effective’ interpretation.⁷⁰ The object and purpose of IIAs so understood – to favour investment protection – ignores the ‘idea of enhancing development’ as a rationale for protecting foreign investment.⁷¹ Additionally, even if greater protection of foreign investors was the main rationale, it would only be the reflection of political preferences of the developed nations at the time when the BITs were created. In recent times, developing States’ IIAs in particular emphasise the development purpose of the investment, clearly stating such purpose as the main rationale of investment in the preamble of their treaties. The following table provides an illustration of different objectives in the preambles of the dominant IIA models.⁷²

Table 3.1. Comparison of preambles extracted from IIAs

OLD EUROPEAN MODEL	GERMAN MODEL BIT 2008
	Desiring to intensify economic co-operation between the two States,
	Intending to create favourable conditions for investments by investors of either State in the territory of the other State,
NORTH AMERICAN MODEL BIT 2012	Recognizing that the encouragement and contractual protection of such investments are apt to stimulate private business initiative and to increase the prosperity of both nations
	Desiring to promote greater economic cooperation between them with respect to investment by nationals and enterprises of one Party in the territory of the other Party;
	Recognizing that agreement on the treatment to be accorded such investment will stimulate the flow of private capital and the economic development of the Parties;
	Agreeing that a stable framework for investment will maximize effective utilization of economic resources and improve living standards;
	Recognizing the importance of providing effective means of asserting claims and enforcing rights with respect to investment under national law as well as through international arbitration;
	Desiring to achieve these objectives in a manner consistent with the protection of health, safety, and the environment, and the promotion of internationally recognized labor rights;

⁷⁰ See, for example, *SGS v Republic of the Philippines*, ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction (29 January 2004), para 116; *Siemens A.G. v The Argentine Republic*, ICSID Case No. ARB/02/8, Decision on Jurisdiction (3 August 2004), para 81; *Noble Ventures, Inc. v Romania*, ICSID Case No. ARB/01/11, Award (12 October 2005), para 52; *Salini Costruttori S.p.A. and Italstrade S.p.A. v The Hashemite Kingdom of Jordan*, ICSID Case No. ARB/02/13, Decision on Jurisdiction (9 November 2004), para 95. On the other hand, there were also tribunals that, in the absence of specific treaty language, invoked the *dubio mitius* principle in favour of State sovereignty: see, for example, *SGS Société Générale de Surveillance v Pakistan*, ICSID Case No. ARB/01/13, Decision of the Tribunal on Objections to Jurisdiction, 6 August 2003, para 171.

⁷¹ Jan Kleinheisterkamp, ‘Investment Treaty Law and the Fear for Sovereignty: Transnational Challenges and Solutions’ (2015) 78 *The Modern Law Review* 793, 810.

⁷² Emphasis added in the table.

Desiring to further strengthen their relationship as part of and in a manner coherent with their overall relations, and convinced that this Agreement will create **a new climate for further development of investment** between the Parties;

Recognising that this Agreement will complement and promote **regional economic integration efforts**;

Determined to strengthen their economic, trade, and investment relations **in accordance with the objective of sustainable development**, in its economic, social and environmental dimensions, and to **promote investment in a manner mindful of high levels of environmental and labour protection and relevant internationally-recognised standards and agreements to which they are parties**;

Reaffirming their commitment to the **principles of sustainable development and transparency** as reflected in the EUSFTA;

Reaffirming each Party's **right to adopt and enforce measures necessary to pursue legitimate policy objectives** such as social, environmental, security, public health and safety, promotion and protection of cultural diversity;

Reaffirming their **commitment to the Charter of the United Nations** signed in San Francisco on 26 June 1945 and having regard to the principles articulated in **The Universal Declaration of Human Rights** adopted by the General Assembly of the United Nations on 10 December 1948;

Recognising the importance of **transparency** in international trade and investment to the **benefit of all stakeholders**;

Building on their respective **rights and obligations under the WTO Agreement and other multilateral, regional and bilateral agreements and arrangements** to which they are party, in particular, the EUSFTA

Some tribunals have understood present realities better than the others, with some recent awards achieving more balanced investor-State outcomes. A significant degree of deference to States' regulatory powers has been exemplified in the full dismissal of Phillip Morris' claims, thus recognising Uruguay's right to regulate a 'major' public health issue ('lethal effects of tobacco'),⁷³ and in the acceptance of Argentina's necessity defence for emergency measures following the 2001 financial crisis.⁷⁴ States have made efforts to recalibrate the normative framework of investment protection, including more explicit language about the objects and purpose of the new generation of IIAs. These attempts to bring into line policy and law in IIR might well reflect the new realities of a contemporary

⁷³ *Philip Morris Brand Sarl (Switzerland), Philip Morris Products S.A. (Switzerland) and Abal Hermanos S.A. (Uruguay) v Oriental Republic of Uruguay*, ICSID Case No. ARB/10/7, Award (8 July 2016). The Tribunal recognised that the measures adopted by Uruguay, which affected the marketing of a company's cigarettes, were implemented in good faith, and to implement Uruguay's obligation under the Framework Convention on Tobacco Control of the World Health Organization, and thus did not constitute a breach of Uruguay's obligations under the Switzerland-Uruguay BIT (the dissenting arbitrator found that the measures did breach the FET standard). The Tribunal acknowledged that 'substantial deference' was due to national authorities' decisions on measures to address 'an acknowledged and major public health problem': para 418; thus also indicating the exceptionality of the public health issue in question.

⁷⁴ *Urbaser S.A. and Consorcio de Aguas Bilbao Biskaia Ur Partzuergoa v Argentine Republic*, ICSID Case No. ARB/07/26, Award (8 December 2016). In this case, the investor's water and sewage concession was terminated following the introduction of Argentina's emergency measures in response to the 2001 financial crisis. The Tribunal found that Argentina breached the Argentina-Spain BIT but was not required to pay compensation because Argentina's constitutional obligations required the State 'to ensure the population's health and access to water and to take all measures required to that effect': para 622.

multipolar world where States exercise the roles of both exporters and importers of capital.

3.1.3. *Tensions between legal methods and cultures*

While negotiating IIAs is a political process of bargaining and consolidating different economic visions, interpretation and practical application of IIAs through dispute settlement is part of a more technical legal domain. The contemporary ISDS debate has brought into focus the legal reasoning and practice of international investment tribunals and exposed a number of issues pertinent to the character of IIL and the legal culture of its professional community.⁷⁵ Explained by scholars with reference to different figurative symbols,⁷⁶ the mixed character of IIL is due, on the one hand, to its international law basis (international treaties) and, on the other, to the commercial law character of its dispute settlement mechanism (method of interpretation and application).⁷⁷ The main challenge for ISDS reform thus lies in reconciling the private law practice of IIL with its intended international public law character. But in the sphere of legal methodology, these tensions have significant consequences for the legitimacy of ISDS; it is therefore important that any reform of ISDS appropriately addresses them.

IIL has developed from private international commercial law, encompassing substantive contract law elements and arbitration between private parties as a procedural mechanism.⁷⁸ To understand treaty-based investment arbitration, it is important to look at ways in which commercial arbitration, and in particular contract-based investment arbitration, developed as transnational law.⁷⁹ These developments can be traced back to North–South disputes and nationalisations of large oil and mega-

⁷⁵ Anthea Roberts has identified the clash of five different paradigms in international investment law: public international law; international commercial arbitration; public law; trade law and human rights: Anthea Roberts, 'Clash of Paradigms: Actors and Analogies Shaping the Investment Treaty System' (2013) 107 *American Journal of International Law* 45.

⁷⁶ Australian scholar Anthea Roberts (ibid) compares it to a platypus; Italian scholar Valentina Vadi to the façade of the church Santa Maria Novella in Florence: Valentina Vadi, *Proportionality, Reasonableness and Standards of Review in International Investment Law and Arbitration* (Edward Elgar 2018) preface. While helpful for more figurative understanding of the nature of IIL, these examples are not in any way exclusive to IIL. For example, the chameleon-like nature of the EU has long been emphasised by EU scholars, among other contexts, also for conceptual problems for law due to the changing State's role, switching between its public and private functions. See, for example, Miguel Poiares Maduro, 'The Chameleon State: EU Law and the Blurring of the Private/Public Distinction in the Market' in Nickel Rainer (ed), *Conflict of Laws and Laws of Conflict in Europe and Beyond: Patterns of Supranational and Transnational Juridification* (Intersentia 2010).

⁷⁷ See chapter 2, section 2.2.

⁷⁸ Similar to private contracts, investment treaties incorporate an offer to arbitrate, extended in a BIT by the host State to an undefined number of current and future investors of the other contracting party. See chapter 2, section 2.2.

⁷⁹ A seminal work by Dezaley and Garth explains why and how commercial arbitration developed into a transnational legal order: Yves Dezalay and Bryant G Garth, *Dealing in Virtue* (University of Chicago Press 1996).

construction projects in the 1970s and 1980s.⁸⁰ Arbitration was successful as it was seen as a way to separate business from Cold War politics. The State-centred arbitration institutions, such as the Iran–US Claims Tribunal and ICSID, were established with this rationale.⁸¹ Importantly, developing States were more willing to accept arbitration for the resolution of their disputes with Western companies. They perceived it as independent because of arbitration’s neutral setting, detached from the political conflict, and legal methods, which involved American-style adversarial tactics.⁸² Professional networks of lawyers with close personal relations played an important role in the development of the system, both in exacerbating conflicts and in taking the role of neutral intermediaries.⁸³

Apart from the need to separate State contracts from domestic *courts* through arbitration, Western investors also needed ways to separate themselves from risks of recourse to developing countries’ laws. Lawyers played an important role in developing *lex mercatoria* as ‘general principles of international commerce’ in substantive law as a way of compromise that avoided reference to either developed or developing States’ laws.⁸⁴ *Lex mercatoria* was thus meant to serve as an internationalised law in arbitration, characterised by party autonomy and broad principles that ensured flexibility.⁸⁵ Through Article 42(1) of the ICSID Convention, internationalisation of disputes found its way into the treaty-based arbitration. However, the history of the ICSID Convention demonstrates that this was not the intention of the developing States, which were concerned about losing sovereignty as a consequence of the internationalisation of State contracts.⁸⁶

⁸⁰ *ibid* 75, 80, 85.

⁸¹ See chapter 1. For a history of ICSID, see Baltag (n 47). The Iran–US Tribunal was established in 1981 on the basis of the Algiers Accord, following the 1979 crisis in relations between two countries. The Tribunal was established with a view to hearing the claims of the Contracting parties’ nationals against the other Contracting State, as well as some disputes between the two States. For an interesting data analysis on party appointed ‘politicisation’, see Damien Charlotin, ‘A Data Analysis of the Iran–US Claims Tribunal’s Jurisprudence – Lessons for International Dispute-Settlement Today’ (2019) 10 *Journal of International Dispute Settlement* 443.

⁸² Dezalay and Garth (n 79) 65-70. An additional important element was the new generation of US lawyers sympathetic to Third-World interests: *ibid* 71-74.

⁸³ *ibid* 82-83.

⁸⁴ *ibid* 86.

⁸⁵ Richard Howarth, ‘Lex Mercatoria: Can General Principles of Law Govern International Commercial Contracts?’ (2004) 10 *Canterbury Law Review* 36.

⁸⁶ Developing States objected to the application of international law to State contracts and insisted that applicable law should be limited to the host State’s law. Art 42(1) of the ICSID Convention (applicable law clause), and its reference to international law, was the bone of contention. Developing States believed that subordinating a contractual relationship to international law without clear principles, rights and obligations ‘could result in the actions of a State of a purely or internal nature being tested by an uncertain set of principles’, running counter to the doctrine of sovereignty of States. The role of international law was in any case not meant to authorise arbitral tribunals to examine the validity of national law in light of international law. Nevertheless, the later jurisprudence of arbitral tribunals demonstrates the practice of expanding the application of international law: Nagla Nassar, ‘Internalization of State Contracts: ICSID, The Last Citadel’ (1997) 14 *Journal of International Arbitration* 185, 203-206. For argument on the internationalised nature of ICSID, see Hege Elisabeth Kjos, *Applicable Law in Investor–State Arbitration: The Interplay Between National and International Law* (OUP 2013) 53-59.

With the increased dominance of Anglo-American law firms in the field of arbitration over time, the importance of *lex mercatoria* also diminished. General principles, more suitable for brief civil law contracts, did not have a place in more technical and specific common law contracts.⁸⁷ The dominance of common law practices is also noted in procedural aspects,⁸⁸ combined with some civil law elements, allowing for procedural flexibility.⁸⁹ The ongoing cooperation between academics and practitioners has promoted acceptance and recognition of the system through reputational capital.⁹⁰ Others have claimed that uniform rules and standards ('international arbitration culture') have been created to highlight expertise and to capture the network benefits between a limited number of participants.⁹¹

The *modus operandi* in treaty-based arbitration has followed the patterns of its contract-based counterpart. Available empirical research shows that arbitrators mostly come from private law backgrounds, the majority of whom from Western European or North American countries; they are either practitioners or academics (or both, with their time allocated in different proportions), and make an average of US\$200,000 per case.⁹² Appointments are made on the basis of their performance and reputation, which are key factors for their advancement in the field.⁹³ They are more likely to make decisions in favour of the party that has appointed them but this is also due to their policy preferences

⁸⁷ Dezalay and Garth (n 79) 89-90. As the authors explain, technical expertise also allowed Anglo-American practitioners to tailor contracts to the needs of their clients by minimising the risk of a dispute and optimising their client's position in case of disputes.

⁸⁸ Practitioners have noted that international arbitration 'increasingly resembles common-law litigation' in respect to evidentiary hearings and extensive questioning of witnesses by the parties (and only few questions from tribunals), party-driven discovery, and broad documentary discovery. In addition to institutional rules, procedure is also guided by soft law mechanisms, in particular IBA Rules on the Taking of Evidence in International Arbitration (IBA Rules). See Arif Hyder Ali and others, *The International Arbitration Rulebook: A Guide to Arbitral Regimes* (Kluwer 2019) 369-370.

⁸⁹ See, for example, Siegfried H Elsing and John M Townsend, 'Bridging the Common Law Civil Law Divide in Arbitration' (2002) 18 *Arbitration International* 1. As a response to this common law dominance, and 'to promote efficiency in international arbitration', a group formed mainly of lawyers from civil law jurisdictions drafted The Rules on the Efficient Conduct of Proceedings in International Arbitration (Prague Rules), which were signed on 14 December 2018 and can be used by parties in arbitration, alongside any other institutional rules that might apply. The rules have been envisaged as an alternative to the dominant IBA Rules (n 88), which due to their more expansive evidence rules have been seen as a reason behind increased cost and delays in arbitration: see Miroslav Dubovský, Ben Sanderson and Nikki O'Sullivan, 'The Prague Rules: "Civil" War On the Evidence in International Arbitration' (*DLA Piper*, 24 January 2019) <<https://www.dlapiper.com/en/czech/insights/publications/2019/01/the-prague-rules/>> accessed 30 June 2020.

⁹⁰ Dezalay and Garth (n 79) 42. See also empirical findings of Sergio Puig, 'Social Capital in the Arbitration Market' (2014) 25 *The European Journal of International Law* 387.

⁹¹ Tom Ginsburg, 'The Culture of Arbitration' (2003) 36 *Vanderbilt Journal of Transnational Law* 1335.

⁹² José Augusto Fontoura Costa, 'Comparing WTO Panelists and ICSID Arbitrators: The Creation of International Legal Fields' (2011) 4 *Oñati Socio-Legal Series* 1; Joost Pauwelyn, 'The rule of law without the rule of lawyers? Why investment arbitrators are from Mars, trade adjudicators from Venus' (2015) 109 *American Journal of International Law* 761; For similar findings in the context of ICSID appointments, see Puig (n 90) 403-407.

⁹³ Pauwelyn *ibid* 781.

and background.⁹⁴ Importantly, arbitration functions like a small club in which different roles (arbitrator, legal counsel, expert witness, tribunal secretary) are interchangeable – sequentially or even simultaneously – between a small pool of highly influential and powerful individuals.⁹⁵ While a majority of arbitrators comes from the global North, the majority of respondent States are from the global South, or transition economies in the European context. The field lacks the cultural diversity necessary to properly appreciate cultural subtleties of legal facts.⁹⁶ This includes appreciation of domestic laws, when treated either as a fact, or in rare circumstances, as applicable law.

The cooperation between practitioners (more akin to common law tradition) and academics (more akin to civil law tradition) in arbitral tribunals' practice is evident in the reference to case-law and scholarship.⁹⁷ Consistent with their role, arbitrators are more 'dispute-oriented' than 'legislator oriented'.⁹⁸ Nevertheless, their jurisprudence has effectively created rules due to vaguely defined provisions of old BITs (akin to the flexibility of the *lex mercatoria*). As a response to such jurisprudence, the new generation of IIAs is much more detailed – akin also to detailed contracts favoured by common law tradition and the prevailing Anglo-American culture in arbitration. New treaty standards are still developed from the existing standards emerging from tribunals' jurisprudence.⁹⁹

The methods of contract interpretation, flexibility and business rationale have all found their way into investment treaty arbitration (ITA). Generally speaking, in contract disputes, the main task of the adjudicator is to ascertain the intention of the parties.¹⁰⁰ This approach results in narrow interpretation, focused exclusively on the text, independent of broader public policy context and implications. Commercial contracts are thus drafted in great detail,¹⁰¹ exactly to avoid different interpretations that could arise

⁹⁴ Michael Waibel and Yanhui Wu, 'Are Arbitrators Political? Evidence from International Investment Arbitration' (2017) <<https://pdfs.semanticscholar.org/0be8/b7c939d4943917b9879ebd4183afe98b8c55.pdf>> accessed 30 June 2020.

⁹⁵ Malcolm Langford, Daniel Behn, and Runar Hilleren Lie, 'The Revolving Door in International Investment Arbitration' (2017) 20 *Journal of International Economic Law* 301. However, the authors note that the practice is not widespread across the whole network (they identified about 4000 known individuals in the network) but is among 10–15 highly visible and powerful actors within the network. Similarly, see Puig (n 90).

⁹⁶ Von L Kidane, *The Culture of International Arbitration* (OUP 2017).

⁹⁷ Empirical research demonstrates that tribunals rely more on case-law and legal doctrine in their interpretation of treaty provisions, rather than agreement between treaty parties, context, object and purpose: Ole Kristian Fauchald, 'The Legal Reasoning of ICSID Tribunals – an Empirical Analysis' (2008) 19 *European Journal of International Law* 301, 357.

⁹⁸ *ibid.*

⁹⁹ See chapter 2.

¹⁰⁰ The same applies in English common law as well as the US common law tradition. See, for example, *Siegel Transfer, Inc. v Carrier Express, Inc.* 54 F.3d 1125 (3d Cir. 1995) at 1139: 'The cardinal rule in contract interpretation is that effect must be given to the intention of the parties'. However, this is always done objectively by also taking into account the factual matrix.

¹⁰¹ This is different to civil law tradition in drafting contracts, which strives for less detail. In this tradition, the contracts and their terms are defined in a civil code or similar codification, which provides the framework

from a different context (values and backgrounds of parties).¹⁰² Applied to treaty-based arbitration, in some cases, the text of the treaties has been taken literally to justify some – from the policy perspective – doubtful interpretations; for example, parallel proceedings or treaty shopping.¹⁰³ In other cases, broad treaty provisions have allowed the importation of contract law standards, such as ‘stabilisation clauses’.¹⁰⁴ This approach has enabled claimants to argue that States have given up their right to expropriate and regulate, and must provide ‘prompt, adequate and effective compensation’ whenever regulation affects their legitimate expectations of a stable business environment.¹⁰⁵ These claims have in particular been grounded in treaty provisions guaranteeing protection against regulatory takings (indirect expropriations) or fair and equitable treatment (FET).¹⁰⁶ When specific representations are made to an investor, parallels have been drawn with a common law doctrine of estoppel.¹⁰⁷ And so on. With the dominant contract law approach,¹⁰⁸ arbitral tribunals have in many cases failed to appreciate that the rights of private parties in contract law are absolute, while in public law (e.g. in administrative law) they become relative to other public interest goals.¹⁰⁹

and reference as the applicable law for all contracts. Thus, terms that are not specified by the parties in their contract or are unclear will be dealt with by reference to the legislation.

¹⁰² Thomas W Wälde, ‘Interpreting Investment Treaties: Experiences and Examples’ in *International Investment Law for 21st Century: Essays in Honour of Christoph Schreuer* (OUP 2009) 726-728.

¹⁰³ For example, in the famous *CME/Lauder v Czech Republic* cases, it was claimed that parallel proceedings and treaty shopping are allowed under the law: *CME Czech Republic B.V. v The Czech Republic*, UNCITRAL, Partial Award (13 September 2001) para 419. In these two cases, effectively dealing with the same factual scenario, two tribunals issued contradictory arbitral awards, one in favour of the claimant (*CME Czech Republic B.V. v The Czech Republic*, UNCITRAL, Final Award (14 March 2003)) and one in favour of the respondent (*Ronald S. Lauder v The Czech Republic*, UNCITRAL, Final Award (3 September 2001)).

¹⁰⁴ This has occurred, in particular, in cases where the investment covered by the treaty is a contract between the private investor and the State: see Julian Arato, ‘The Logic of Contract in the World of Investment Treaties’ (2016) 58 *William & Mary Law Review* 351. Accordingly, some more recent IIAs explicitly exclude stabilisation obligations: see Art 4 Agreement for the Reciprocal Promotion and Protection of Investments between Columbia and France (signed 10 July 2014); Art 4(2) Agreement between Japan and the Republic of Colombia for the Liberalisation, Promotion and Protection of Investment (signed 12 September 2011, entered into force 11 September 2015).

¹⁰⁵ Dezalay and Garth (n 79) 88.

¹⁰⁶ Regarding the FET standard, there are two approaches among investment tribunals. Legitimate expectations can be based on the host State’s regulatory framework and different criteria are employed for assessing its stability and predictability. However, the second line of thought has considered this insufficient, evaluating specific representations made to the investor by the host State. A number of tribunals sit in the middle, assessing both the regulatory framework and specific representations made to investors. Recent cases against Spain under the ECT confirm the continuance of this practice. See chapter 2, section 2.1.2.

¹⁰⁷ While no tribunal made an explicit reference to estoppel, which is in international law applicable only between States, language resembling the doctrine of estoppel has been employed in practice through the reference to the investor’s expectations when making an investment.

¹⁰⁸ In this regard, contracts of common law countries have more influenced the law of foreign investment given the driving role of the common law countries in utilising the system: see Julien Chaisse and Yves Renouf, ‘Investor–State Dispute Settlement’ in Jane Drake-Brockman and Patrick Messerlin (eds), *Potential Benefits of an Australia–EU Free Trade Agreement: Key Issues and Options* (Adelaide University Press 2018) 304.

¹⁰⁹ Naturally, there are limits to what parties can legally agree and contracts can be illegal for offending public policy. However, public policy in this narrow sense concerns basic community standards (e.g. contracts to commit crime or tort, or which prejudice the administration of justice would be illegal for being contrary to public policy). For the meaning of public policy in the Australian contract law context, see Jeannie Paterson, Andrew Robertson and Arlen Duke, *Principles of Contract Law* (4th edn, Thomson Reuters 2012) 781-796. Broader than this concept, in the context of public law, private rights are balanced against general public

Interpretation of international agreements is governed by the Vienna Convention on the Law of the Treaties (VCLT).¹¹⁰ The Vienna Convention requires interpretation of the terms in good faith by giving them ‘ordinary’ meaning in their context and ‘in the light of their object and purpose’, where context also includes ‘any agreement relating to the treaty between the parties’.¹¹¹ Arbitral tribunals, although they now regularly make reference to this general rule of treaty interpretation, do not properly nor systemically apply this interpretative method in determining State parties’ intention.¹¹² The arbitrators’ typical style of reasoning and argumentation focuses rather on procedural aspects, facts, particularities and winning,¹¹³ and less on proper application of law, reasoning and soundness of argument in general, and with little understanding of international public law implications.¹¹⁴ The jurisprudence of tribunals is thus still best described in the words of the late Thomas Wälde:

Confusion, rather than clarity, prevails in today’s practice of investment arbitration, notwithstanding increasing references to the Vienna Rules. Styles of traditional, pre-Vienna public international law mingle freely with styles of reasoning from commercial arbitration, with each player inclined to resort to familiar habits in his or her domestic law and maxims of (usually) pseudo-Latin origin that seem to fit the strategy, that is, retracing from the desired outcome to the expected reasoning.¹¹⁵

The lack of a more proactive role of tribunals in establishing consistent jurisprudence and applying appropriate techniques of reasoning is an important reason why the confidence in the system has been undermined.

interest such as protection of environment, health or public safety. See, for example, comparative analysis of expropriation in domestic legal systems in chapter 2, section 2.1.1.

¹¹⁰ Vienna Convention on the Law of the Treaties (concluded 23 May 1969, entered into force 27 January 1980) 1155 UNTS 331 (VCLT). This Convention is now considered an expression of customary international law and thus applies even to those countries that are not signatories of the convention (e.g. the US). This is confirmed by the International Court of Justice (ICJ): see, for example, *Arbitral Award of 31 July 1989 (Guinea-Bissau v Senegal)* (Judgment) [1991] ICJ Rep 53, para 70. Therefore, it is the only authority for interpretation of international treaties, thus also investment treaties.

¹¹¹ The general rule of interpretation is prescribed in Art 31 VCLT, which provides the definition of context and guidance on establishing the context, object and purpose, detailing the type of evidence to be used in this process. The emphasis is on agreement and instruments made between the parties in relation to the treaty in question, including any subsequent agreement or practice which establishes the agreement of the parties regarding its interpretation, where a special meaning can be given to some term if it is established that parties so intended. When following analysis undertaken according to Art 31 the meaning of the term remains unclear or a manifestly absurd or unreasonable result would eventuate, supplementary means of evidence, including the preparatory work of the treaty, may be used to determine the meaning of the term in question: Art 32. Thus, recourse to international rules for the interpretation of treaties could be made by the States in order to influence changes in the methods currently employed by tribunals in the interpretation of IIAs: Kathryn Gordon and Joachim Pohl, ‘Investment Treaties over Time – Treaty Practice and Interpretation in a Changing World’ (OECD Publishing 2015).

¹¹² Wälde (n 102) 730.

¹¹³ Again, this style is more characteristic of common law adversarial systems of administration of justice.

¹¹⁴ Jan Paulsson, ‘Avoiding Unintended Consequences’ in Karl P Sauvant and Michael Chiswick-Patterson (eds), *Appeals Mechanism in International Investment Disputes* (OUP 2008) 262-263.

¹¹⁵ Wälde (n 102) 725.

3.2. Tensions between actors and their perspectives

The peculiar mixed nature of IIL, which combines private and public roles of the State (contractual freedom and regulation), draws a number of civil society actors into the field. The perspectives of these actors have been in particular exposed in the main reform debate in the UNCITRAL. These perspectives are divided along the lines of the business community that supports ISDS, and the NGO sector in the sphere of 'public interest' (environmental, human rights, trade NGOs and think tanks) that opposes it, either in its current form, or more prominently, in its entirety. These views transcend States' borders into transnational activism. States thus have a challenging role when seeking to satisfy divergent civil society perspectives, further compounded by interests in both exporting their own capital and attracting foreign capital in order to create positive macroeconomic growth within their borders. The way in which today's global economy works places private capital in a strong position against States.¹¹⁶ Unlike in the area of trade law, where agreed rules affect foreign investment but do not give individuals instruments with which to act, the direct standing against States enjoyed in ISDS gives foreign investors a more influential role in the development of investment law standards.¹¹⁷

From the investors' perspective, typical discussion of ISDS is based on a simple reasoning. Firstly, States need FDI to develop their economies and create jobs. While FDI does not necessarily guarantee prosperity at a microeconomic level, it is a *conditio sine qua non* of the macroeconomic growth. Secondly, FDI needs a stable investment climate, which can only be guaranteed by ISDS. States therefore need ISDS if they wish to attract FDI. This logical conclusion is further supported by economic data about FDI flows expressed in gross terms. The investor's perception is thus based on the assumption that without ISDS there would not be FDI flows into the State and that States necessarily

¹¹⁶ Kline and Ludema (n 2) 21. See chapter 1 and section 3.1.1 above.

¹¹⁷ Foreign investors' influence on the development of IIL could be examined through the lenses of Marc Galanter's seminal work 'Why the "Haves" Come Out Ahead: Speculations on the Limits of Social Change' (1974) 9 Law and Society Review 95. In this work, Galanter argued that parties with more money, power and experience (repeat players – RP) enjoy strategic advantage in the legal process and use that advantage to shape the development of the legal system. While foreign investors are rarely RPs, they have the resources to use the RP's legal advice (arbitration legal industry). On the analysis of the relationship between RP lawyers and ITA outcomes, see Susan D Franck and Lindsey E Wylie, 'Predicting Outcomes in Investment Treaty Arbitration' (2015) 65 Duke Law Journal 459, which confirms Galanter's thesis that a counsel's experience predicts dispute outcomes. For investors, an experienced counsel was able to predict the liability on the part of the State and the amounts awarded. For States, having experienced legal teams led to outcomes relatively worse for investors: *ibid* 522-523.

discriminate against foreign investment.¹¹⁸ Reform should therefore take place within the current system of arbitration institutions and rules to improve it ‘for all *users*’.¹¹⁹

On the other side of the ISDS discourse, a number of environmental NGOs, trade unions and labour groups, human rights and other sustainable development-oriented think-tanks and research institutes have been vocal about different ISDS concerns. While many participate in the debate on the reform of ISDS, there is no comprehensive coordinative mechanism between their activities. Among them, there are those that categorically reject ISDS and advocate for its abolishment;¹²⁰ and those that recognise the political realities and advocate for a broader reform agenda within the limited UNCITRAL procedural mandate,¹²¹ or more holistic reform outside UNCITRAL.¹²² Given their broader social agenda, they emphasise the importance of aligning ISDS with other State obligations, such as climate change¹²³ and balancing business enterprises’ rights with responsibilities towards local communities.¹²⁴ Similarly, as investors they reject the idea

¹¹⁸ For this reasoning, see Corporate Counsel International Arbitration Group, ‘Investor–State Dispute Settlement (ISDS) Reform, Submission by the Corporate Counsel International Arbitration Group (CCIAG) to UNCITRAL Working Group III’ (18 December 2019) (CCIAG submission to UNCITRAL).

¹¹⁹ Reference to ‘users’ in this context means foreign investors and States. See *ibid* 15–20 (emphasis added). Similarly, European Federation for Investment Law and Arbitration, ‘EFILA’s written comments made at the UNCITRAL Working Group on ISDS reform’ (June 2018). The former submission makes a case against both an appellate mechanism and a permanent court, and the later one is particularly against a permanent MIC. In both views such a court would be ‘pro-State biased’ and therefore unacceptable for investors: see CCIAG’s submission (*ibid*) at 5–6 and EFILA’s submission at para 13.

¹²⁰ See, for example, submission to UNCITRAL by Public Citizen, ‘Recommendations for UNCITRAL ISDS Discussions’ (15 July 2019).

¹²¹ These are primarily research institutes and think-tanks. See the joint submission to UNCITRAL by Columbia Center on Sustainable Development (CCSI), International Institute for Environment and Development (IIED) and International Institute for Sustainable Development (IISD), ‘UNCITRAL Working Group III on ISDS Reform: How Cross-Cutting Issues Reshape Reform Options’ (15 July 2019). These cross-cutting issues concern alternative means for the prevention and resolution of investment disputes, exhaustion of domestic remedies, implications for third parties, counterclaims, regulatory chill and calculation of damages: see a tabular overview at 5–7. See also separate joint submissions of the same organisations: ‘Draft Text Providing for Transparency and Prohibiting Certain Forms of Third-Party Funding in Investor–State Dispute Settlement’ and ‘Third Party Rights in Investor–State Dispute Settlement: Options for Reform’, both dated 15 July 2019.

¹²² This also includes encouraging States to terminate ISDS and provide legal solutions to that end: see the CCSI/IIED/IISD joint submission to UNCITRAL, ‘Draft Treaty Language: Withdrawal of Consent to Arbitrate and Termination of International Investment Agreements’ (15 July 2019). See also joint submission to UNCITRAL by NGOs Center for International Environmental Law (CIEL), Client Earth, The Centre for Research on Multinational Corporations (SOMO) and Transport and Environment, ‘Reform Options for ISDS’ <https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/uncitral_recs_and_justification_final.pdf> accessed 30 June 2020.

¹²³ See Client Earth, ‘Potential Solutions for Phase 3: Aligning the Objectives of UNCITRAL Working Group III with States’ International Obligations to Combat Climate Change’ <https://uncitral.un.org/sites/uncitral.un.org/files/media-documents/uncitral/en/wgiii_clientearth.pdf> accessed 30 June 2020.

¹²⁴ See Friends of the Earth International, ‘Remarks made during the 35th session of UNCITRAL Working Group III with regards to A/CN.9/WG.III/WP.142, Section D, Paragraphs 45–57’ <https://uncitral.un.org/sites/uncitral.un.org/files/friends_of_the_earth_international_remarks.pdf> accessed 30 June 2020.

of a MIC but for different reasons; they see it as a mechanism for ‘effectively lock[ing]-in the investment treaty regime’.¹²⁵

Finally, lawyers have the most prominent role in the current ISDS debate, mostly in their advisory role, as members of government or observer delegations, or two informal groups that have been formed to support the work of UNCITRAL: the Practitioner Group and the Academic Forum.¹²⁶ The former gathers lawyers active in the field of ISDS as counsels or arbitrators.¹²⁷ The latter is broader and gathers ‘academics active in the field of ISDS’,¹²⁸ a number of whom are engaged in some capacity with ISDS.¹²⁹ Divisions between academics follow the general division in ISDS discourse: between the investment lawyers who are interested in different degrees of reform in UNCITRAL¹³⁰ and academics who advocate for a broader reform agenda, within or outside the UNCITRAL process.¹³¹ The latter remain a minority in UNCITRAL.

In addition to these actors, different international organisations and arbitral institutions take part in the UNCITRAL reform as observers, while in parallel undertaking their own reforms.¹³² For example, ICSID reform is aimed at modernisation and

¹²⁵ ‘300+ Civil Society Organisations From 73 Countries Urge Real Reform at United Nations Discussions on Corporate Investor Rights’ (*Center for International Environmental Law*, 30 October 2018) <<https://www.ciel.org/news/300-civil-society-organizations-from-73-countries-urge-real-reform-at-united-nations-discussions-on-corporate-investor-rights/>> accessed 30 June 2020.

¹²⁶ See Bart Jaap-Verbeek, ‘A Social Mapping of the UNCITRAL Process on ISDS Reform’ (2020) <<https://kumu.io/bjverbeek/uncitral#uncitral>> accessed 30 June 2020.

¹²⁷ Practitioner Group – UNCITRAL Working Group III, ‘Statement of Purpose’ (1 May 2018) <https://uncitral.un.org/sites/uncitral.un.org/files/practitioner_group_statement_of_purpose.pdf> accessed 30 June 2020.

¹²⁸ University of Oslo, ‘Academic Forum on ISDS’ (*PluriCourts – Centre for the Study of the Legitimate Roles of the Judiciary in the Global Order*, 8 February 2019) <<https://www.jus.uio.no/pluricourts/english/projects/leginvest/academic-forum/>> accessed 30 June 2020.

¹²⁹ See University of Oslo, ‘Disclosure Register for ISDS Academic Forum’ (*PluriCourts – Centre for the Study of the Legitimate Roles of the Judiciary in the Global Order*, 8 February 2019)

<<https://www.jus.uio.no/pluricourts/english/projects/leginvest/academic-forum/disclosure-register-ids-academic-forum.html>> accessed 30 June 2020. Accordingly, the neutrality of the Academic Forum has been subject to controversies: see Alexander Beunder and Jilles Mast, ‘As the world meets to discuss ISDS, many fear meaningless reforms’ (*Transnational Institute*, 4 April 2019) <<https://longreads.tni.org/isds-many-fear-meaningless-reforms/>> accessed 30 June 2020.

¹³⁰ Some of the early considerations of the potential reform proposals came from prominent members of the Academic Forum: see Gabrielle Kaufmann-Kohler and Michele Potestà, ‘Can the Mauritius Convention serve as a model for the reform of investor–State arbitration in connection with the introduction of a permanent investment tribunal or an appeal mechanism? – Analysis and Roadmap’ (3 June 2016), CIDS-Geneva Center for International Dispute Settlement, and Gabrielle Kaufmann-Kohler and Michele Potestà, ‘The Composition of a Multilateral Investment Court and of an Appeal Mechanism for Investment Awards’ (15 November 2017), CIDS Supplemental Report.

¹³¹ See ‘An Open Letter to the Chair of UNCITRAL Working Group III and to all Participating States concerning the Reform of the Investor–State Dispute Settlement: Addressing the Asymmetry of ISDS’ (*Erasmus University Rotterdam*, 13 February 2019) <<https://www.eur.nl/en/news/erasmus-institute-public-knowledge>> accessed 30 June 2020.

¹³² They have also provided their submissions or different written contributions: see UNCITRAL, ‘Investor–State Dispute Settlement Reform: On-line Resources’ (*Working Group III: Investor–State Dispute Settlement Reform*) <https://uncitral.un.org/en/library/online_resources/investor-state_dispute> accessed 30 June 2020.

simplification of its procedural rules.¹³³ The work of UNCTAD is supporting States in their bilateral treaties and investment policy reforms.¹³⁴ The OECD has undertaken work on business-related human rights,¹³⁵ which States refer to in an attempt to recalibrate the normative framework of IIL.

While many actors are interested in the outcomes of the ISDS reforms, States have a difficult task in balancing different interests and perspectives. As a multilateral forum UNCITRAL offers an opportunity for interested actors to voice their concerns and proposals; however, while inclusive, the reform process remains State-led,¹³⁶ whereas lobbying continues in the background.

3.3. Intersections of law and politics in international investment regulation: conceptual considerations

The analysis of IIR in this chapter has referred to a number of tensions existing within the field to paint the picture of reform challenges. The remaining part of this chapter places these different aspects into the conceptual framework of legitimacy and the rule of law. The aim is to conceptualise systemic problems relevant to the current ISDS reform.

3.3.1 Legitimacy of international investment regulation

As a preliminary remark, it must be said that the concept of legitimacy varies across disciplines and includes divergent standards for different categories of institutions.¹³⁷ Many scholars have approached legitimacy from two perspectives: as a normative (philosophical concept) and as descriptive or sociological legitimacy (empirical concept).

From a normative perspective, legitimacy relates to the recognition of an institution's right to rule or govern, relying on moral arguments informed by political

¹³³ For overview of the amendment process, see ICSID, 'ICSID Rules and Amendment Process' (ICSID 2019) <<https://icsid.worldbank.org/en/amendments>> accessed 30 June 2020.

¹³⁴ See UNCTAD, 'UNCTAD's Reform Package for the International Investment Regime (2018 edition)' (2018) <<https://investmentpolicy.unctad.org/publications/1190/unctad-s-reform-package-for-the-international-investment-regime-2018-edition->> accessed 30 June 2020.

¹³⁵ See OECD, 'OECD Guidelines for Multinational Enterprises' (OECD, 2018) <<https://mneguidelines.oecd.org>> accessed 30 June 2020. OECD has put forward a number of analysis as contributions to UNCITRAL's work.

¹³⁶ See UNGA 'Report of the United Nations Commission on International Trade Law Fiftieth session' (July 2017) UN Doc A/72/17, paras 250-251.

¹³⁷ For overview of legitimacy standards with respect to international courts, see Harlan Grant Cohen and others, 'Legitimacy and International Courts – A Framework' in Nienke Grossman and others (eds), *Legitimacy and International Courts* (CUP 2018).

theory¹³⁸ and not coercion by the State.¹³⁹ It is assessed against the objective criteria, which focus on qualities of the institution that justify its authority to rule. In a domestic system that is democracy, while in an international setting it is State consent, although the latter has been rejected as a sufficient basis of normative legitimacy.¹⁴⁰ A number of substantive and procedural factors, classified as input- and output-based legitimacy, related to the process by which decisions are made, and the effectiveness of the results of governance, have been identified as relevant in assessing normative legitimacy.¹⁴¹

Input-based legitimacy places emphasis on the issue of participation in the decision-making process and it can be referred to as ‘government of the people’, while *output-based* legitimacy relates to the efficiency of these decisions to provide solutions for ‘common’ problems, and can be referred to as ‘government for the people’. Together they form the basis of democratic legitimacy, which can be summed up as ‘trust in institutional arrangements’.¹⁴² An additional element of normative legitimacy, which sits between input and output-based legitimacy, is *throughput legitimacy*. Its focus is the quality of the processes by which decisions are made, with reference to:

- the efficacy of the form of government,
- the accountability and transparency of the processes, and
- the processes’ inclusiveness and openness to interest intermediation with the people, through civil society access to the process and information.¹⁴³

With the three elements put together, normative legitimacy is about input legitimacy, which is focused on politics (the ‘who’ of the decision making); throughput legitimacy, which is focused on processes (the ‘how’ of the decision making); and output legitimacy, concerned with policies (the ‘what’ of the decision making).¹⁴⁴

Sociological or descriptive legitimacy on the other hand relates to ways in which subjects of the State perceive the institution’s right to govern, regardless of how unconvincing on the merits that might be for an outside observer.¹⁴⁵ In other words,

¹³⁸ Joseph HH Weiler, ‘Europe in Crisis – On “Political Messianism”, “Legitimacy” and “the Rule of Law”’ (2012) *Singapore Journal of Legal Studies* 248, 248.

¹³⁹ Robert O Keohane, ‘Global governance and legitimacy’ (2011) 18 *Review of International Political Economy* 99, 99-100.

¹⁴⁰ Daniel Bodansky, ‘Legitimacy in International Law and International Relations’ (2011) APSA 2011 Annual Meeting Paper, 11-12 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1900289> accessed 30 June 2020.

¹⁴¹ Fritz Scharpf, ‘Economic Integration, Democracy and the Welfare State’ (1997) 4 *Journal of European Policy* 18, 19.

¹⁴² Fritz Scharpf, ‘Problem-solving Effectiveness and Democratic Accountability in the EU’ (2003) Max Planck Institute for the Study of Societies Working Paper 03/1 <http://apps.eui.eu/Personal/Researchers/pblokker/Week%206_Scharpf.pdf> accessed 30 June 2020.

¹⁴³ Vivien A Schmidt, ‘Democracy and Legitimacy in the European Union Revisited: Input, Output and “Throughput”’ (2013) 61 *Political Studies* 2, 5-7.

¹⁴⁴ *ibid* 8.

¹⁴⁵ Brad R Roth, *Governmental Illegitimacy in International Law* (OUP 2000) 9.

sociological legitimacy concerns ways in which society and its different actors see and accept the institutions, which inevitably relates to the issue of how the institutions in question meet the interests of different actors within society. With respect to international institutions, this involves the perceptions of both States and civil society, and their willingness to defer even to an institution's unpopular decisions.¹⁴⁶ While assessing normative legitimacy is subject to political, legal, philosophical and other standards, sociological legitimacy is assessed empirically.¹⁴⁷

In IIR context, normative input-based legitimacy belongs to States as masters of IIAs and procedural rules (ICSID and UNCITRAL). Unlike in the WTO or the EU, there are no international institutions with law-making powers.¹⁴⁸ Accordingly, input legitimacy relates primarily to the legitimacy of treaties laying down substantive standards and procedural rules for dispute settlement. Importantly, legality under international law (State consent) is not sufficient to ensure legitimacy.¹⁴⁹ The legitimacy of IIAs depends on the extent to which they reflect constituency preferences; thus they will be considered legitimate if they either do not violate dominant political interests, or if those who agreed to enter these agreements are subject to unlimited electoral accountability.¹⁵⁰ Generally speaking, it is more difficult for citizens to exercise democratic control over States' decisions in foreign relations.¹⁵¹ In light of the historical development of IIR, it is difficult to assess the legitimacy of the early treaties, given that States, and even more so, their political subjects, were unaware of the real impact of these instruments. A more cautious approach of States in modern treaties demonstrates enhanced awareness of the impacts of IIR domestically. Ensuring legitimacy requires appropriate consultation processes before and during negotiations and, accordingly, implementing into new IIAs input from a broad range of stakeholders. Accordingly, input-based legitimacy in IIR is a matter for the domestic phases of treaty-making processes.¹⁵²

The core of the legitimacy of IIR, however, lies in the jurisprudence of arbitral tribunals, which primarily concerns procedural issues (throughput legitimacy) and

¹⁴⁶ Daniel Bodanski, 'Legitimacy in international law and international relations' in Jeffrey Dunoff and Mark A. Pollack (eds), *Interdisciplinary Perspectives on International Law and International Relations: The State of the Art* (CUP 2013) 324.

¹⁴⁷ Cohen (n 137) 4. Where relevant, reference is made to public perception (based on secondary sources), but this is a doctrinal study and empirical assessment of sociological legitimacy is outside its scope.

¹⁴⁸ One exception would be commercial arbitral institutions, which have powers to adopt their own arbitration rules in accordance with their own governance mechanisms. However, given their primarily commercial and optional nature they are complementary, rather than the core institutions found in investment arbitration. For comprehensive comparative analysis of arbitral regimes, see Ali and others (n 88).

¹⁴⁹ Bodanski (n 140) 11-12.

¹⁵⁰ Scharpf (n 142).

¹⁵¹ Robert A Dahl, 'Can international organisations be democratic? A sceptic's view' in Ian Shapiro and Casiano Hacker-Cordon (eds), *Democracy's Edges* (CUP 2009).

¹⁵² See Part II, chapters 4 and 6 on the EU's approach towards increasing input legitimacy.

substantive outcomes of these processes – tribunals’ decisions (output-based legitimacy). Given the adjudicative character of arbitral tribunals, these criteria can be further broken down using a template for assessing the legitimacy standards of international courts. Of relevance are fairness and bias, and openness and transparency as elements pertinent to throughput legitimacy, and politically acceptable and legally sound decisions as elements pertinent to output-based legitimacy.¹⁵³ Throughput legitimacy overlaps with the procedural elements of the rule of law and will be considered in that context.¹⁵⁴

Substantive elements of output-based legitimacy concern the ‘normative currency’ of tribunals’ decisions in relation to the normative regime as envisaged by international actors.¹⁵⁵ In the case of IIL, such a normative regime is defined in applicable IIAs. The legitimacy of tribunals depends on the extent to which tribunals’ decisions coincide with the values and interests of international actors and are thus politically acceptable; and the extent to which they are legally sound.¹⁵⁶

Before turning to the analysis of particular elements of legitimacy and the rule of law, the following figure depicts the relationship between the two concepts and applies it to the specific context of IIR.

¹⁵³ This theoretical framework is taken and adjusted from Nienke Grossman, ‘Legitimacy and international adjudicative bodies’ (2009) 14 *The George Washington International Law Review* 107. While Grossman uses these criteria for sociological legitimacy, they also have a normative dimension and thus are applied in this analysis as standards of normative legitimacy. As argued by Shany, the sociological approach analyses whether judicial institutions are regarded as authoritative, while the normative approach explores whether they should be regarded as authoritative. But both categories have an external perspective (how relevant constituencies perceive or should perceive the authority of a court) and a normative component (whether the exercise of power normatively justified); Yuval Shany, ‘Stronger Together? Legitimacy and Effectiveness of International Courts as Mutually Reinforcing or Undermining Notions’ in Nienke Grossman and others (eds), *Legitimacy and International Courts* (CUP 2018) 355-356. The normativity of Grossman’s criteria in this analysis is also justified in the absence of the empirical data.

¹⁵⁴ See section 3.3.2 below.

¹⁵⁵ Grossman (n 153) 143.

¹⁵⁶ *ibid* 143-144.

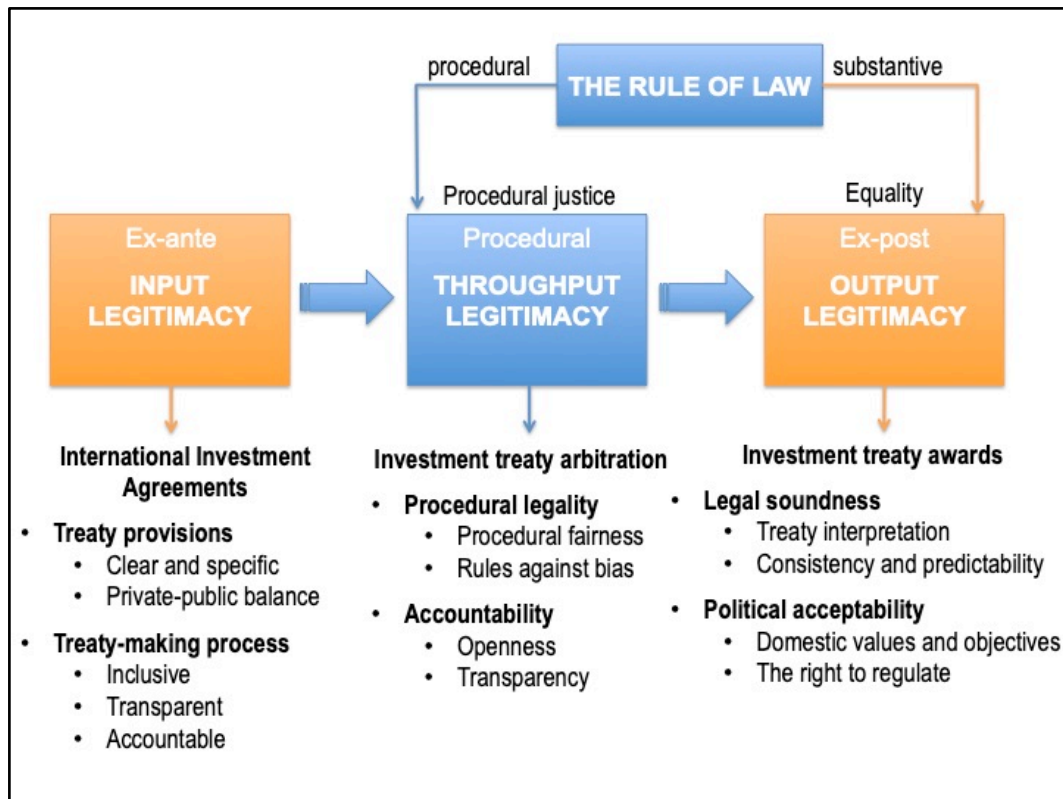


Figure 3.1. The relationship between legitimacy and the rule of law in IIR

3.3.1.1. Output-based legitimacy through politically acceptable norms

The authority of international tribunals depends on whether their decisions are consistent with the views of international actors about what the law is or should be.¹⁵⁷ In the context of ITA, political acceptability is related to the *de facto* lawmaking activity of arbitral tribunals or judicial activism. The focus is placed on the impact of tribunals' decisions on regulatory powers of the State and its sovereignty. Given the political dimension, consistency of tribunals' decisions with community values and interests enshrined in domestic law is particularly important for the adjudicators' authority among domestic constituencies.¹⁵⁸

Arbitral tribunals are adjudicators and not lawmakers. Their decisions are not precedents and thus are not legally binding *erga omnes*.¹⁵⁹ Nevertheless, in practice, broad wording of IIAs has amplified the need for tribunals' interpretations in order to

¹⁵⁷ *ibid* 143.

¹⁵⁸ *ibid* 149.

¹⁵⁹ In international law, decisions of international courts are considered secondary and not primary sources of law: Art 38(1)(d), Statute of the International Court of Justice. Also, Art 59 States that decisions of international courts have no binding force except between the particular parties in that particular case. Similar wording to Art 59 is found in Art 1136(1) NAFTA.

apply imprecise IIA provisions to specific factual situations. In this exercise, previous awards are regularly consulted and cited, contributing to the creation of case-law or jurisprudence.¹⁶⁰ In the absence of more specific provisions, tribunals have wide discretion in interpretation, which has led to a shift of interpretative power from States to tribunals, resulting in jurisprudence ‘unconstrained by the discipline of the treaty parties’ practice or expectations’.¹⁶¹ Through expansive interpretations, tribunals have engaged in lawmaking beyond their mandates, extending States’ obligations beyond those envisaged and agreed by the State signatories to the treaties. While formally not lawmakers, their jurisprudence has *effectively* become the core of IIL.¹⁶²

When adjudicating, arbitral tribunals perform an assessment of State measures at different levels (legislative, executive, judicial). They can condemn States for illegal measures exclusively through monetary compensation and cannot require that the State remove unlawful measures. In that sense, investment tribunals differ from national courts and *formally* speaking do not question a State’s sovereignty to adopt domestic measures. However, through their claims, investors have challenged a wide variety of State measures: less contentious State actions, such as direct expropriation of investments and breaches of investment contracts; but also some more dubious measures, such as changes in domestic regulation, withdrawal of subsidies, tax measures, revocation of licences, and irregularities in public procurement.¹⁶³

Cases against Argentina, brought on the basis of a number of State measures adopted in response to a major financial crisis which affected this country in late 2001 and 2002,¹⁶⁴ illustrate investment tribunals’ assessments of States’ responses in protecting the public order. Foreign investors challenged the legality of Argentina’s measures in a number of investment arbitration cases, while Argentina defended its right to impose the measures as a response to a severe economic, political and social crisis that

¹⁶⁰ Andrea Bjorklund, ‘Investment Treaty Arbitral Decisions as Jurisprudence Constrante’ (2008) UC Davis Legal Studies Research Paper No. 158.

¹⁶¹ Anthea Roberts, ‘Power and Persuasion in Investment Treaty Arbitration: The Dual Role of States’ (2010) 104 *American Journal of International Law* 179, 189-190.

¹⁶² Similarly as in common law where precedents have the force of the law.

¹⁶³ See, for example, UNCTAD 2017 (n 53).

¹⁶⁴ Argentina is one of the most frequent respondent States in investment arbitration, with a total of 62 investment claims brought by different investors under different investment agreements as of 31 December 2019: see UNCTAD, ‘Argentina’ (*Investment Policy Hub*) <<https://investmentpolicy.unctad.org/investment-dispute-settlement/country/8/argentina>> accessed 30 June 2020. Most of these cases have originated from measures adopted to stabilise the economy in response to the 2001 financial crisis. These measures included prevention of capital transfer abroad by blocking bank accounts, devaluing local currency, mandating pesification of the economy at the exchange rate of one peso per one US dollar, cancellation of a tariff indexation mechanism in public service contracts, and renegotiation of concession contracts in public service: see *Continental Casualty Company v The Argentine Republic*, ISCID Case No. ARB/03/9, Award (5 September 2008) paras 100-159.

was threatening the very existence of the State.¹⁶⁵ First, Argentina argued the non-justiciability of the imposed measures.¹⁶⁶ Tribunals nevertheless considered that measures of general economic policy, as long as they have a direct bearing on investment, do fall within their jurisdiction.¹⁶⁷ Secondly, Argentina argued that the measures were undertaken out of necessity and that the emergency measures were self-judging.¹⁶⁸ With respect to these questions the tribunals found that, in the absence of any clauses that explicitly established the self-judging nature of the non-precluded investment treaty provisions, they had the authority to *objectively* review the imposed emergency measures.¹⁶⁹

The first three Argentine cases¹⁷⁰ applied an inflexible standard for reviewing Argentina's response to the financial crisis, by importing the narrow customary international law (CIL) concept of necessity defence, as defined in Article 25 of the Draft

¹⁶⁵ Argentina argued the defence of necessity, invoking 'State of necessity' under international customary law and under non-precluded provisions of the US–Argentina BIT as an exception to substantive provisions of the treaty. Non-precluded provisions allow the application of measures 'necessary for the maintenance of public order, the fulfillment of its obligations with respect to the maintenance or restoration of international peace and security, or the protection of its own essential security interests': Art XI, Treaty between United States of America and the Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investment (signed 14 November 1991, entered into force 20 October 1994) (US–Argentina BIT). See, for example, *CMS Gas Transmission Co. v Argentine Republic*, ICSID Case No. ARB/01/8, Award (12 May 2005) paras 304–352. However, it is worthwhile noting that BITs applicable in other Argentine cases do not have such a clause.

¹⁶⁶ For example, Argentina argued that the general and economic character of the measures meant that they were aimed at restoring the economy and thus were not directed at any particular individual investor: *Suez, Sociedad General de Aguas de Barcelona SA, and InterAguas Servicios Integrales del Agua SA v The Argentine Republic*, ICSID Case No. ARB/03/17, Decision on Jurisdiction (16 May 2006) para 27. In other cases Argentina also argued that foreign investors suffered from damages that were inevitably caused by the crisis and thus could not invoke protections under BITs: *El Paso Energy International Company v The Republic of Argentina*, ICSID Case No. ARB/02/17, Award (31 October 2011) para 216. In one case Argentina also invoked an exclusive monetary sovereignty that was not reviewable by investment tribunals: *Daimler Financial Services AG v Argentine Republic*, ICSID Case No. ARB/05/1, Award (22 August 2012) paras 94–96.

¹⁶⁷ *CMS Gas Transmission Co. v Argentine Republic*, ICSID Case No. ARB/01/8, Decision on Jurisdiction (17 July 2003) para 27.

¹⁶⁸ In the alternative, Argentina argued that even if the measures were not self-judging, the requirements of public order and security under non-precluded provisions were met, thus excluding Argentina's liability: *CMS* (n 156) para 351. See William W Burke-White and Andreas von Staden, 'Private Litigation in a Public Law Sphere: The Standard of Review in Investor–State Arbitrations' (2010) 35 *Yale Journal of International Law* 283, 290–291. Authors here draw an interesting distinction between the broader meaning of the concept of public order in civil law systems, among which Argentina is numbered (stemming from the Napoleonic Code and included in Argentine Civil Code) and the narrower common law meaning of public order, which is mainly expressed through criminal law. The civil law meaning of this concept encompasses all domestic regulations of the State: at 291.

¹⁶⁹ *CMS* (n 165) para 370. Thus, the tribunal effectively decided that Argentina did not have sole discretion to adopt emergency measures under Article XI of the US–Argentina BIT.

¹⁷⁰ *CMS* (n 165); *Enron Corporation and Ponderosa Assets, L.P. v Argentine Republic*, ICSID Case No. ARB/01/3; *Sempra Energy International v The Argentine Republic*, ICSID Case No. ARB/02/16. These cases are, together with *LG&E Energy Corp. v Argentine Republic*, ICSID Case No. ARB/02/1, known in the literature as the Argentine Gas Cases. All four cases considered foreign investment in the Argentine gas sector and the claims in all four cases were brought on the basis of the US–Argentina BIT. All four tribunals adopted different interpretations of the necessity defence, with the tribunals in *CMS*, *Enron* and *Sempra* adopting similar views, and finding Argentina liable for the breach of the treaty and thus rejecting the necessity defence. The *LG&E* Tribunal took a different approach and accepted the necessity defence.

Articles on the Responsibility of States for Internationally Wrongful Acts,¹⁷¹ and conflating it with the broader concept of non-precluded provisions of the US–Argentina BIT. In this way, the tribunals essentially denied Argentina any policy choices in response to the crisis, as Argentina was not able to demonstrate that the actions undertaken were the only measures available to address the critical events.¹⁷² Given the noted errors in the tribunals’ reasoning,¹⁷³ in other cases tribunals recognised the need for deference to State regulatory powers when assessing the necessity of emergency measures.¹⁷⁴ The Argentinean cases, *inter alia*, demonstrate the tendency of arbitral tribunals to ‘second-guess’ politically sensitive actions taken by sovereign States.¹⁷⁵

More recent examples confirm that legitimacy problems persist, particularly in cases dealing with domestic law and policy, emphasising the thin line between law (presumably always objective when exercised by arbitral tribunals) and politics (presumably mainly subjective as exercised by national authorities). Decisions of tribunals in cases such as *Bilcon v Canada* exemplify the potential impact of tribunals’

¹⁷¹ ILC, ‘Report of the International Law Commission on the work of its Fifty-third Session’ (November 2001) UN Doc Supp No. 10 (A/56/10). Art 25(1) precludes invocation of the necessity defence, unless the action undertaken was the only way for the State to safeguard ‘an essential interest against a grave and imminent peril’ and does not seriously impair the essential interests of the State towards which the obligation exists. Art 25(2) in full precludes the necessity defence if the international obligation in question excludes such possibility, or the State has contributed to the situation of necessity.

¹⁷² See *CMS* (n 165) paras 323-324; *Enron* (n 170) paras 308-309; *Sempra* (n 170) paras 350-351.

¹⁷³ The ICSID Annulment Committee in the *CMS* case (n 165) found this legal reasoning of arbitrators problematic. In this regard, the Committee concluded that the Tribunal’s interpretation of Article XI of the US–Argentina BIT, which prescribes non-precluded measures, constituted a ‘manifest error of law’, describing it as not only ‘cryptic’ but also ‘defective’. However, the Committee also found that it was beyond its mandate to change this manifestly erroneous decision: see Decision on Annulment (25 September 2007) paras 95-97, 125, 130, 136, 146, 158. The ICSID Annulment Committee in *Sempra* made the same finding on the issue of conflating the customary necessity defence and the non-precluded measures provision, but it also found that the failure of the Tribunal to apply the non-precluded measures provision of the BIT (and thus applying customary international law as primary law, whereas under international law treaties have precedence over customary law) constituted a manifest excess of the Tribunal’s powers, resulting in the annulment of the award: Decision on Annulment (29 June 2010) paras 208-209. Thus, both Committees identified the same error of law; however, they did not come to the same decision. The ICSID Annulment Committee in *Enron*, releasing its decision just a month after the *Sempra* annulment decision, found different grounds for annulment, determining that the Tribunal’s application of the ‘only way’ provision of the necessity defence in Art 25(1)(a), where the Tribunal relied solely on the opinion of an economist, was a manifest excess of power: Decision on Annulment (20 July 2010) paras 373-377. For analysis of the *Enron* decision, see Michael Wilson, ‘The Enron v Argentina Annulment Decision: Moving a Bishop Vertically in the Precarious ICSID System’ (2012) 43 University of Miami Inter-American Law Review 347.

¹⁷⁴ In *LG&E* (n 170) Decision on Liability (3 October 2006), the investor’s claim was based on the same basic facts as the claim in *CME*, but the two tribunals came to two opposing decisions. The Tribunal in *LG&E* accepted the necessity defence under the non-precluded provision of the treaty and excluded Argentina’s liability during the financial crisis. The same approach was adopted by the Tribunal in *Continental Casualty* (n 164) by reference to a ‘margin of appreciation’. However, there is no agreement of the two tribunals on what constitutes the requirements of a non-precluded measures provision. The *LG&E* Tribunal suggested that these requirements, although independent from customary law necessity defence, include the same considerations as under customary international law (which is *nota bene* in contradiction to findings of the *CMS* and *Sempra* Annulment Committees): see *LG&E* Award, paras 239-242, 257-259, while the *Continental* Tribunal found that the non-precluded measures impose the burden of proof found in GATT Art XX: see *Continental* Award, paras 192-195.

¹⁷⁵ Jose E Alvarez and Kathryn Khamisi, ‘The Argentine Crisis and Foreign Investors: A Glimpse into the Heart of the Investment Regime’ in Karl P Sauvant (ed), *The Yearbook on International Investment Law and Policy 2008/2009* (OUP 2009) 383.

decisions on domestic administrative law, even in States with robust judicial review.¹⁷⁶ Canada was condemned for rejecting the operation of a quarry based on an environmental impact assessment (EIA) that found the project would have an adverse impact on the 'core community values', a new standard not recognised in Canadian law.¹⁷⁷ However, there was a disagreement whether this was indeed a new standard created by the Joint Review Panel (JRP), the body that conducted the EIA, or rather a different expression for 'human environment effects', mandated as a relevant standard under Canadian law.¹⁷⁸ Additionally, even if this had been a new standard, the assessment would have been overturned in the domestic judicial review process.¹⁷⁹

While the *Bilcon* Tribunal's decision challenged the way in which Canadian laws have been implemented rather than the laws themselves, it has significant implications for the domestic regulatory space. First, the decision creates additional control mechanisms over domestic environmental review panels with significant implications for their work and the application of environmental laws.¹⁸⁰ Human environmental concerns will be subjugated to the 'scientific and technical feasibility of the project', thus intruding 'not only into the way an environmental review process is conducted' but also 'the environmental public policy of the State'.¹⁸¹ Put in the context of legitimacy, one could ask, what more could undermine the legitimacy of a quasi-judicial international institution than condemnation of the State for 'the community's own expression of its interests and values'?¹⁸² Secondly, the Tribunal's decision allows the investors to bypass domestic judicial mechanisms of executive action (judicial review) and obtain damages in investment arbitration, which otherwise would not be available under domestic law. The

¹⁷⁶ *Bilcon of Delaware et al v Government of Canada*, PCA Case No. 2009-04, Award on Jurisdiction and Liability (17 March 2015).

¹⁷⁷ *ibid* para 505. In the Tribunal's majority opinion, the reasoning of the Joint Review Panel (JRP), the body that made the decision, was arbitrary and without authority in Canadian law, effectively denying the investor a 'fair opportunity to know the case it had to meet': *ibid* paras 590-591. In particular, Bilcon alleged that the JRP did not provide any mitigating recommendations that the investor could have implemented in order to address adverse effects: *ibid* para 544. Noting the breaches of Canadian administrative law pertinent to procedural fairness made by the JRP, the Tribunal found that Canada breached the MST, which is part of the NAFTA's FET standard: *ibid* para 594.

¹⁷⁸ Professor McRae, the dissenting arbitrator, disagreed with the majority, concluding that the JRP did not act *ultra vires* and there was no breach of due process: Dissenting Opinion of Professor Donald McRae (10 March 2015) paras 15-27.

¹⁷⁹ In any case, Professor McRae noted that the Canadian conduct would not meet a high threshold of *Waste Management* standard of treatment ('grossly unfair, unjust or idiosyncratic' and 'involving a lack of due process leading to an outcome which offends judicial propriety'): *ibid* para 40.

¹⁸⁰ It adds extra requirements for the work of JRPs, such as prohibition of the use of novel language; requirement to provide a list of possible mitigation strategies to address the adverse effects of investment on the environment, in order to meet the NAFTA FET standard. Professor McRae noted that review panels are composed of scientists and environmental experts and not lawyers, and they use different language to express similar ideas. By mandating particular language, the Tribunal insists on formalities rather than focusing on the whether the panel has correctly conducted the review: *ibid* paras 45-46.

¹⁸¹ *ibid* para 49.

¹⁸² *ibid*.

dissenting arbitrator called this ‘a significant intrusion into domestic jurisdiction’, which will ‘create a chill on the operation of environmental review panels’.¹⁸³ It could be added that it also more generally undermines the domestic rule of law. Domestic legal protection under a robust legal system such as Canada’s should thus suffice.¹⁸⁴

In light of the above examples, several conclusions can be made about tribunals’ normative legitimacy. First, under the treaties, tribunals lack lawmaking legitimacy¹⁸⁵ or input-based legitimacy. However, a *de facto* lawmaking role has been assumed through treaty interpretations and adjudication. The quality of such lawmaking has become an issue of output-based legitimacy. In this regard, and as a second point, the tribunals’ legitimacy is questioned because of the impact that tribunals’ decisions could have on the State regulatory powers and dominant community values and interests, enshrined in domestic law. Judicial activism in decisions of arbitral tribunals has the potential to *de facto*, if not *de iure*, restrain democratic majority rule expressed in the decisions made by the national authorities. This is particularly emphasised in cases in which tribunals bring into question States’ capacities to make fundamental socio-economic and political choices.

The issue is what strategies could States employ to address this problem. One such approach would be to require clearer and more detailed drafting of the provisions of the new treaties and the introduction of provisions which can provide more space for States to regulate.¹⁸⁶ In other words, addressing the *ex post* problem with *ex ante* strategies. However, it is questionable how effective this could be given the ways in which the system operates.¹⁸⁷ Another possible strategy could be to develop an *ex post* mechanism to correct tribunals’ interpretations that stray from States’ values and objectives. However, the effectiveness of this approach could be questioned from the perspective of international law imperatives. Ultimately, some values and objectives will prevail over others, which brings back into the fray the power play between the States – exactly the problem that the creation of ISDS attempted to avoid.

The current normative regime of IIL that has developed over time lacks congruence with interests and values enshrined in domestic law – both Western and developing States’ laws. While this is a relevant issue from the legitimacy point of view, its potential to demonstrate doctrinal bias against domestic law or values *per se* is limited given the

¹⁸³ *ibid* para 48.

¹⁸⁴ To that effect see also *ibid* paras 46-47.

¹⁸⁵ Mathucumaraswamy Sornarajah, ‘The Past, Present and Future of the International Law on Foreign Investment’ in Wenhua Shan (ed), *China and International Investment Law: Twenty Years of ICSID Membership* (Brill 2014) 36-37.

¹⁸⁶ On the EU strategies to secure the right to regulate, see chapter 8.

¹⁸⁷ See section 3.2 below.

existence of other cases in which the tribunals were willing to adopt a deferential approach.¹⁸⁸ More generally, the issue of domestic law and values remains a challenge for any system of international law and for IIL in particular given its broad potential to affect domestic policies.

3.3.1.2. Output-based legitimacy through legally sound norms

In addition to political acceptability, decisions of international tribunals have authority when considered legally sound and in accord with a commonly accepted legal discourse. This element is important for tribunals' authority as it prevents decisions from appearing political, arbitrary or biased.¹⁸⁹ Standards such as coherence (with previously applied rules and principles), adherence (to the organised normative hierarchy of rules), and determinacy (clarification of rules through interpretation) are used for assessing legal soundness of norms in international law.¹⁹⁰ ITA underperforms with respect to all three elements.

First, wide discretion left to arbitrators in ITA has resulted in divergent interpretations of similar treaty provisions.¹⁹¹ While these discrepancies have been justified by the specifics of each case, tribunals' practice of referring to previous decisions is rather unpredictable and the reference to case-law insufficiently scrutinised.¹⁹² In the system of numerous treaties and *ad hoc* tribunals, there is no clear hierarchy of rules.¹⁹³ Some commentators compare the present state of precedent in ITA to precedent in England prior to adopting the doctrine of *stare decisis*, with no hierarchy of courts nor reporting of cases but with judges seeking the guidance of other courts' decisions in similar cases.¹⁹⁴ A pertinent question is whether jurisprudence, in its current form as

¹⁸⁸ See Caroline Henckels, 'Balancing Investment Protection and the Public Interest: The Role of the Standard of Review and the Importance of Deference in Investor-State Arbitration' 4 *Journal of International Dispute Settlement* 197.

¹⁸⁹ Grossman (n 153) 149.

¹⁹⁰ Thomas M Franck, *The Power of Legitimacy Among Nations* (OUP 1990); Grossman (n 153) 149-151.

¹⁹¹ Anthea Roberts explains this phenomenon by investment tribunals' analogies with other legal disciplines in resolving interpretative difficulties: Roberts (n 75) 51-52.

¹⁹² Zachary Douglas, 'Nothing if not Critical for Investment Treaty Arbitration: Occidental, Eureko and Methanex' (2006) 22 *Arbitration International* 27. Douglas particularly emphasises the failure of tribunals to distinguish between *ratio decidendi* (legal rule) and *obiter dictum* (legal opinion) of previous decisions when using *obiter* as a rule in subsequent decisions.

¹⁹³ Conflicts of laws in international law are resolved with reference to general conflict rules under international law in Art 30 VCLT, but the tribunals have also been inconsistent in applying these rules. See Ivana Damjanovic and Ottavio Quirico, 'Intra-EU Investment Dispute Settlement in light of *Vattenfall* and *Achmea*: A Matter of Priority' (2019) 26 *Columbia Journal of European Law* 102.

¹⁹⁴ Jeffery P Commission, 'Precedent in Investment Treaty Arbitration: A Citation Analysis of a Developing Jurisprudence' (2007) 24 *Journal of International Arbitration* 129, 158.

developed by *ad hoc* tribunals, should be followed.¹⁹⁵ While arbitrators themselves speak about proper consideration of earlier cases as their ‘moral duty’ in fostering a predictable normative environment,¹⁹⁶ practice has not ensured legal certainty – on the contrary.

Secondly, due to the specific character of treaty-based arbitration, mixed methods of interpretation, flexibility and business rationale, as dominant features of contract-based arbitration, have found their way into ITA.¹⁹⁷ At the same time, the system is now embedded in public international law. As a consequence, the method of interpretation in IIL, which favours protection of the rights of private parties in the absolute, is in disagreement with the interpretative principles dominant in the field of public law, which require private rights to be balanced with other public policy goals.¹⁹⁸ The jurisprudence is thus discordant with what is normatively expected of a public law system.

Thirdly, the jurisprudence of arbitral tribunals can be so diverse that it is difficult to settle on what is the dominant rule and what are the exceptions.¹⁹⁹ This is further compounded by the doctrine, which is a decisive factor in distinguishing facts from *perception*, given the practical experience and *technical* expertise of those who develop the doctrine and also participate in adjudication. Others outside the system, it is claimed, lack knowledge to properly understand the complex rules and procedures, and to appreciate how the system works more generally. Given the diversity of interpretations, awards – containing (objective) facts and rules – defend the system from publicly perceived – subjective and inherently political – criticism. The mystique of legal expertise cloaks the system. For legal professionals in the field, the legitimacy of the system strictly relates to its legality. This *legal* legitimacy stems from specialisation that ensures the *correctness* of the decisions in the totality of the specific circumstances of each case.²⁰⁰ Any other legitimacy is seen as political. This also includes normative assessment of the

¹⁹⁵ For example, Douglas questions whether the ‘Tecmed standard’ test, now often followed as a definite authority for the FET standard, should be followed since it was stated in the *obiter* of that award: *Medioambientales Tecmed SA v United Mexican States*, ICSID Case ARB(AF)/00/2, Award (29 May 2003) para 154. See Douglas (n 192) 28.

¹⁹⁶ Gabrielle Kaufmann-Kohler, ‘Arbitral Precedent: Dream, Necessity or Excuse?’ (2007) 23 *Arbitration International* 357, 374.

¹⁹⁷ See section 2.1.3 above.

¹⁹⁸ See also the comparison of IIL with the EU legal order in Part II, chapter 5.

¹⁹⁹ The most notable recent example is the interpretation of the FET standard in a number of renewable energy cases against Spain under the ECT, stemming from Spain’s regulatory activity from 2010 onwards in cutting the financial benefits which were an aspect of the renewable energy scheme it introduced in 2007. See the analysis by Isabella Reynoso, ‘Spain’s Renewable Energy Saga: lessons for international investment law and sustainable development’ (2019) 2 *Investment Treaty News* 12. On other unsettled doctrines, see Andrea K Bjorklund, ‘The Legitimacy of International Centre for Settlement of Investment Disputes’ in Nienke Grossman and others (eds), *Legitimacy and International Courts* (CUP 2018) 245-246.

²⁰⁰ Parallels could be drawn here with Max Weber’s understanding of legal-rational authority, derived from legal norms that define the scope of jurisdiction of the authority. Importantly, the authority rests upon norms the legitimacy of which stem from the fact that they have been established in a manner which is recognised to be legal: see Martin E Spencer, ‘Weber on Legitimate Norms and Authority’ (1970) 21 *The British Journal of Sociology* 123, 125. Indeed, the legality of ISDS is not the issue as it stems from international law.

legal soundness of jurisprudence by those who are outside of the system, regardless of whether they are lawyers, States or the public.²⁰¹

However, it would be wrong to say that the legal profession in the arbitration field has not noted the problems of the system's legitimacy.²⁰² This problem has primarily been attributed to the *ad hoc* nature of adjudication and the lack of a mechanism that could correct inconsistent decisions. For these reasons, the profession has been generally supportive of an appellate mechanism as a reform proposal for ISDS. While this solution could improve the legal soundness of the system, it will not resolve the issue of the quality of decisions and their alignment with interests and values enshrined in domestic law (political acceptability).

To achieve a substantive reform, the system needs more radical change of the *principles* underpinning its normative framework that will ensure more balanced outcomes. This includes opening the professional network to a greater gender, regional and legal diversity and also cutting the umbilical cord with the ISDS narrative about the methods of interpretation and in the application of law. The field must be opened to those who understand how a public law system works – especially at the level of domestic law. Addressing only the former (enhancing diversity in formal terms) without the latter (addressing diversity in substantive terms) will result in the newcomers adjusting to the dominant culture and principles of the system. This will expand the pool of lawyers but not change the nature of the system. Enhancing legal legitimacy, which remains embedded in the current profession's legal specialisation, will be insufficient to ensure legitimacy and stability of the system over time. The risk of the system's encroachment on the political authority of States and the lack of value-rational authority of arbitral tribunals in the eyes of the States and/or their domestic constituencies will thus remain.²⁰³ The ongoing risk of ISDS reform is that reform solutions remain captured by the profession and its dominant ISDS culture.

The analysis so far has addressed the issues related to arbitral decisions (political acceptability and legal soundness) that are pertinent to their output-based legitimacy. The other set of legitimacy criteria – those primarily related to the procedural aspects of

²⁰¹ Normative assessment of the quality of arbitral tribunals' decisions tends to be seen as an issue of perception and thus attributed to sociological rather than normative legitimacy: see, for example, Bjorklund (n 199) 234-283.

²⁰² See, for example, Susan D Franck, 'The legitimacy crisis in investment treaty arbitration: Privatizing public international law through inconsistent decisions' (2005) 73 Fordham Law Review 1521.

²⁰³ This is the fourth type of authority which Spencer adds to Max Weber's authority types in order to explain patterns of legitimacy of democratic political institutions, which is lacking in Weber's articulation of legality. According to Spencer, 'formal legality, without a substantive principle (or value norms, where laws and authority are accepted because of their congruence with extra-legal values) is not sufficient to justify supreme authority and ensure the stability of institutions': Spencer (n 200).

ISDS as a dispute settlement mechanism and throughput-based legitimacy – overlap with the principles that are subsumed under the umbrella of the rule of law.

3.3.2. *The rule of law in international investment regulation*

Similar to legitimacy, the rule of law is a concept with many meanings across disciplines and legal and political systems.²⁰⁴ As an expression of liberal democracy, in a domestic context the rule of law places restrictions on the exercise of regulatory powers rather than duties on citizens.²⁰⁵ Although subject to different interpretations, the concept is mostly focused on formal characteristics of laws. Accordingly, laws should be known and internally consistent and applied equally to all by an independent judiciary. The rule of law is thus necessarily concerned with formal equality and procedural justice, and minimal discretion exercisable by public officials and judges in decision-making, rather than substantive justice, which is in turn concerned with distribution of goods and social welfare.

In international law, the mere existence of a mechanism through which international rules can be enforced contributes to an *international* rule of law. For example, the CJEU has emphasised that ‘the very existence of effective judicial review designed to ensure compliance with EU law is of the essence of the rule of law’.²⁰⁶ The broader notion of this concept necessarily involves the independence of courts as one of the requirements essential to ‘effective judicial protection’.²⁰⁷ Accordingly, it could be argued that the very existence of ISDS as a mechanism to enforce protections guaranteed in IIAs enhances the rule of law in IIL. Moreover, enforceable awards are the ‘essential’ feature of the current ISDS system.²⁰⁸ In addition, adherence to international investment rules is also meant to enhance the rule of law in host States as it ensures protection of the private rights of foreigners against arbitrary and undue interference by the State. In this way, ISDS ensures supremacy of law over the arbitrary power of host States.

²⁰⁴ For example, there are differences in how the rule of law is understood in the context of Western liberal democracies (supremacy of law over arbitrary power; separation of powers and checks and balances; independence of courts; authority of law stemming from the Constitution and democratic political institutions and processes) and in China (authority of law based on its legality, stemming from the authority of the lawmaking institutions and processes). In common law legal systems, the rule of law includes the uniformity of law through the system of precedent – and thus its predictability. In civil law legal systems, the concept is more abstract, and the predictability is ensured by general consistency between norms and principles of the legal system.

²⁰⁵ Stephen Bottomley and Simon Bronitt, *Law in Context* (4th edn, Federation Press 2012) 42.

²⁰⁶ Case C-64/16 *Associação Sindical dos Juizes Portugueses* ECLI:EU:C:2018:117, para 36.

²⁰⁷ In the EU such protection is guaranteed under Art 19(1) TEU and Art 47 CFR.

²⁰⁸ CCIAG submission to UNCITRAL (n 118) 4.

On the other hand, the very existence of ISDS limits the reach of domestic courts and thus undermines their authority. ISDS could be considered a method of alternative dispute resolution (ADR).²⁰⁹ ADR itself challenges the rule of law as it takes disputes away from transparent public courts into the sphere of the private and confidential. Importantly, however, ADR does not function as a parallel judicial mechanism in domestic legal systems. The control of the domestic courts over arbitration is ensured through legislation. In this way, independent domestic courts perform an oversight over private justice and its compliance with public policy. Unlike arbitration in the domestic context, ITA – in particular in the context of ICSID – functions more like an internationalised system, outside of control by domestic courts.²¹⁰ The issue is then: what ensures the accountability of ISDS and its compliance with public policy, or more broadly, the rule of law?

In theory, the concept of the rule of law is understood as a formal (narrow) and substantive (broader) concept. Formal conceptions of the rule of law focus on formal legality of laws in constraining arbitrary government power.²¹¹ In accordance with liberal rational thought, the aim of formal legality is to ensure law's neutrality. Translated into the domestic legal system, the rule of law is meant to ensure a proper system of checks and balances between the different branches of government, and more broadly between law and politics. In this system, political questions – what law *should be* – are for the democratically accountable legislatures, while matters of law – what law *is* – are for the courts. Accordingly, the courts' discretion in applying the law should be minimal.²¹² In addition, neutrality of law is ensured through the legality of the procedures by which laws are put into operation. Procedural legality presupposes adjudication conducted by independent and unbiased courts that can hear both sides of the case and whose processes and reasoning are subject to public scrutiny.²¹³ The rule of law is thus meant to be normatively neutral and fully objective. Its *ideal* is to be autonomous from politics and economics, and their goals.

Unlike the formal rule of law, which is neutral on political questions, such as what the appropriate government limits on private rights are, substantive rule of law focuses

²⁰⁹ Arbitration is a dispute settlement mechanism classified as ADR.

²¹⁰ An exception to this is arbitration under UNCITRAL rules, which provide the possibility to challenge the awards on public policy grounds in the State of the seat of the arbitration: Art V(2) New York Convention.

²¹¹ A seminal work on formal rule of law is Lon Fuller's *The Morality of Law*, in which the author outlined eight principles of legality for a functional legal system. Fuller's principles do not embrace the content of rules but only their formal characteristics (general and non-arbitrary, promulgated, prospective, understandable, logically consistent, practicable, stable, congruence between how rules are drafted and enforced in practice): see Lon L. Fuller, *The Morality of Law* (Yale University Press 1969) 41-42.

²¹² See, for example, Tom D. Campbell, *The Legal Theory of Ethical Positivism* (Routledge 1996).

²¹³ Bottomley and Bronitt (n 205) 51-52.

on the broader issue of the rules' values. Building upon formal characteristics, substantive rule of law considers the content of legal norms and their compliance with concepts such as human rights and justice.²¹⁴ Importantly, there is no universal consensus on substantive *standards* that rules should embrace, which makes this broader conceptualisation of the rule of law rather political. For example, depending on their legal and political systems, States do disagree on the scope and content of property rights or individual liberties.²¹⁵ Importantly, the formal conception of the rule of law that ensures the functionality of the legal system is a necessary condition of the broader substantive conception.²¹⁶

The international standard of the rule of law combines both formal and substantive characteristics. For example, the Commission of Venice of the Council of Europe identifies the core components of the rule of law as: legality, legal certainty, the prohibition of arbitrariness, access to justice before an independent and impartial court, non-discrimination and equality before the law, and respect for human rights.²¹⁷ The assessment of the rule of law in IIL requires the consideration of IIL as a system with substantive rules outlined in IIAs and enforced through ISDS as its procedural mechanism. The rule of law would therefore require, first, that IIAs comply with formal legality as a minimum, which can ensure the neutrality of laws and limit arbitrariness of decision-makers in the implementation of IIAs; and, second, that ISDS procedures comply with the principles of procedural legality.

We have already considered that IIAs containing vague substantive provisions and tribunals' jurisprudence that implements these provisions do not comply with the formal requirements of the rule of law.²¹⁸ We have also considered that in substantive terms tribunals' jurisprudence does not produce politically acceptable norms from the States'

²¹⁴ Matthew H Kramer, *Objectivity and the Rule of Law* (CUP 2007) 142-144. Kramer considers this conception of the rule of law as 'moral ideal' that should be considered in light of political philosophy. This concept is central to the liberal-democratic tradition, emphasising values such as liberty and autonomy of the individual, fundamental equality, limits on public power, and separation of powers.

²¹⁵ In supporting the narrow formal concept of the rule of law, Joseph Raz argues that 'the rule of law is a political ideal which a legal system may lack or may possess to a greater or lesser degree'. He explains that a non-democratic legal system can still conform to the requirements of the rule of law better than the legal systems of Western democracies. This will make such a system 'an immeasurably worse legal system' but better in its conformity with the rule of law: Joseph Raz, *The authority of law: Essays on law and morality* (Oxford Scholarship Online 2012) 210.

²¹⁶ Kramer (n 214) 183-184.

²¹⁷ Commission of Venice, 'The Rule of Law Checklist' (Council of Europe 2016) 33.

²¹⁸ Relevant in this regard is the consideration of the legal soundness of arbitral decisions, which was considered a requirement of legitimacy above: see section 3.1.1.2 In light of Fuller's principles (n 211), the jurisprudence fails beside several criteria, as a minimum on predictability but arguably also on logical consistency, stability, and enforceability in practice. The criteria of determinacy discussed in Section 3.1.1.2 concerns interpretative proficiency in public law, which could be considered a substantive rather than a formal characteristic of legality: Kramer (n 214) 181-183.

domestic perspectives.²¹⁹ What we have not yet considered is (i) whether in substantive terms tribunals' jurisprudence is neutral and apolitical or instead promotes a certain normative agenda, and (ii) whether procedures before arbitral tribunals, through which IIAs are put into operation, comply with the principles of procedural legality. Both of these aspects are considered next, the first as substantive (normative) and the second as procedural (formal) attributes of the rule of law.

3.3.2.1. Substantive rule of law: neutrality or normativity?

The logic of law's neutrality is transposed into the international context only with difficulty. The normative character of IIL more broadly concerns the role of international law in international politics, and *vice versa*. International law seeks to provide a flexible framework for cooperation; its purpose is not to determine legal standards but provide a framework for substantive resolution elsewhere in the international system.²²⁰ Law must thus ensure that 'correctness' and 'normativity' be seen as neutral.²²¹ Correctness guarantees the distance of law from natural justice theories (what law should be); while normativity guarantees the distance between the law and actual State behaviour or its interests and ensures that law is applied, regardless of the political preferences of its subjects. However, the two elements cannot exist simultaneously as they 'cancel each other out'. Correctness implies 'closeness' of law to State practice. However, if correctness is too close to State practice, it seems to be 'just another apology for existing power'; that is, the power of those States that have set the rule of correctness. On the other hand, the more the rule is 'normatively' distanced from State practice, the more political it seems, because it cannot be related to the States' social context.²²²

Applied to the realm of IIL, it has to be recalled that BITs have been introduced with an intention to depoliticise disputes between investors and States.²²³ Accordingly, the concept of 'correctness' refers to procedural correctness – the neutral forum in which ITA takes place, detached from politics of States involved in each particular case. 'Normativity' refers to the *standard* of applicable rules in this process, which determines the substantive outcomes of their application – a tribunal's decision in each case. Correctness

²¹⁹ See section 3.3.1.1 above.

²²⁰ Martti Koskenniemi, *The Politics of International Law* (Hart 2011) 58-59. For more on legal indeterminacy in international law, consider the example of the Libyan arbitrations (arbitrations stemming from Libyan Government nationalisation of concession interests in the oil sector); see Amr A Shalakany, 'Arbitration and the Third World: A Plea for Reassessing Bias under the Specter of Neoliberalism' (2000) 41 *Harvard International Law Review* 419, 448-451.

²²¹ Koskenniemi *ibid* 38.

²²² *ibid* 38-39.

²²³ See chapter 1.

disguises normativity by applying the 'correct' standard of review to a State's behaviour. It has therefore been claimed that investment arbitration has been transformed into an 'adjudicative mechanism to control the exercise of public authority', comparable to a system of administrative law.²²⁴

Because it is taking place before a neutral international forum, it is presumed that the process and applied standard of review are detached from politics. However, if this arbitration review *process* produces *outcomes* detached from the State's social context, the whole process will seem political from the perspective of that State and its domestic constituencies. Those who conduct the review will be seen as political in determining the standard of review. This can be seen as bias, either in favour of more powerful State players (Western States), or in favour of private rights, interests or capital (MNEs, the legal profession). In other words, to speak of *correctness*, even if limited to procedural correctness, means taking a *normative* stance on what 'correct' is – and that is inherently political.

What is therefore a 'correct' normative standard in IIL? And who should set such a standard? For economists of law, the appropriate standard is determined with reference to the State's interference in the functioning of the market. The State is not supposed to intervene by planning the market. The market itself is better placed to reach distributional outcomes due to its non-coercive character, competition which allows freedom of individual choice, and the price mechanism that renders decisions based on the best possible information filtered by the market itself.²²⁵ In line with this, formal law ensures the rule of law by providing a stable framework in which individuals can plan their actions, and in that sense it is meant to be instrumental in allowing individuals to realise their choices rather than making choices on their behalf. On the other hand, according to the same economic argument, government policy aimed at substantive justice is inevitably a form of arbitrary government. Accordingly, the substantive ideal of

²²⁴ Gus Van Harten and Martin Loughlin, 'Investment Treaty Arbitration as a Species of Global Administrative Law' (2006) 17 *European Journal of International Law* 121, 143. The authors also provide a comparative analysis between commercial and investment arbitration: see 139-145. In this sense, global administrative law is defined as 'a system akin to domestic judicial review in that it keeps public authorities within the bounds of legality and provides enforceable remedies to individuals harmed by unlawful State conduct': *ibid*, 149. This logic of procedural correctness, leading to substantive correctness, is fully acceptable to a procedurally oriented common law lawyer, who operates in such a system of judicial review domestically. It is, however, more difficult in a civil law tradition to appear logical by following distinct procedural steps, because civil law systems are less procedurally oriented in their pursuit of neutrality of processes. This can, for example, be seen in the differences between the rules of evidence in the two legal families.

²²⁵ Friedrich Hayek, *The Road to Serfdom* (first published 1944, University Chicago Press 1994) (as cited in Stephen Humphreys, *Theatre of the Rule of Law: Transnational Legal Intervention in Theory and Practice* (CUP 2010) 78-79).

distributive justice expressed in the concept of social welfare is incompatible with formal laws enshrined in the rule of law.²²⁶

More broadly, this neoliberal notion of the rule of law has been promoted in the policies of the World Bank following the end of the Cold War, emphasising the link between the rule of law and the market economy.²²⁷ The rule of law implies 'good governance', which serves to determine the proper delineation between the public sector and its interference with the private sector.²²⁸ Good governance further prefers 'private sector development', conditioned upon laws which create a 'stable and supportive business climate, both for domestic and foreign investors'.²²⁹ A 'sound legal and institutional framework' includes 'a comprehensive, well-defined body of laws and regulations' but also 'a court system to enforce property and contractual rights'.²³⁰ The rule of law so understood becomes the basic prerequisite of development strategy, leading to economic growth and the reduction of poverty.²³¹ Private sector investors ultimately serve the public interest. Their capital effectively *is* the public good.²³²

While the rule of law presupposes neutral law, a similar neoliberal narrative is present in IIL.²³³ The logic of economics and dichotomies between the normative notion of the rule of law, which implies 'procedural' or 'formal justice', 'private law', 'civil and political rights', 'negative freedom and government constraint' as opposed to 'substantive justice', 'public law', 'social and economic rights', 'positive freedom' through government intervention and 'administrative discretion',²³⁴ can be recognised in the manner in which IIL operates. The State is to provide a stable framework in which investors can plan their investments and know with certainty how the State will use its coercive powers. Rules

²²⁶ *ibid* 80.

²²⁷ Stephen Humphreys, *Theatre of the Rule of Law: Transnational Legal Intervention in Theory and Practice* (CUP 2010) 132-147.

²²⁸ *ibid* 133-135. In Humphreys' assessment, colonialism in the World Bank's policy documents was perceived 'as a golden era of faceless efficient civil servants' which was trustworthy, unlike the post-independence State, in which locals and foreigners have lost confidence.

²²⁹ Douglas Gustafson, Emmanuel Jimenez, Johannes F Linn, 'Developing the private sector: a challenge for the World Bank Group' (World Bank Group 1989); Humphreys (n 227) 136.

²³⁰ Ibrahim Shihata, 'The World Bank and Private Sector Development – A Legal Perspective' in Franziska Tschöfen and Antonio R Parra, *The World Bank in a Changing World*, vol 1 (Brill 1991) (as cited in Humphreys (n 227) 137).

²³¹ Humphreys (n 227) 139.

²³² See also Nicolás M Perrone and David Schneiderman, 'International Economic Law's Wreckage: Depoliticization, Inequality, Precarity' in Emiliós Christodoulidis, Ruth Dukes and Marco Goldoni, *Research Handbook on Critical Legal Theory* (Edward Elgar 2019).

²³³ Shalakany (n 220).

²³⁴ Stephen Humphreys identifies these dichotomies in his analysis of the rule of law. However, this does not exclude States with robust welfare systems from the notion of the rule of law. Rather, it explains a very English notion of the rule of law, stemming from Dicey's rule of law concept, framed in the 19th century, and which later found a fertile ground with economists such as Hayek: Humphreys (n 227) 59-62. Margaret Thatcher and Ronald Reagan both embraced Hayek's theory in their economic policies of neoliberalism: *ibid* 65, citing John Ranelagh, *Thatcher's People: An Insider's Account of Politics, the Power, and the Personalities* (Harper Collins 1991) and Martin Anderson, *Revolution* (Harcourt Brace Jovanovich 1988).

should be long-term and should not change with changing circumstances. Private rights of the individuals (property and freedom of contract) should be protected against State action and given preference over public goals. IIAs serve to ensure such a stable legal framework for foreign investors, in the absence of which they would be hesitant to invest.²³⁵ IIAs recognise a State's 'right to regulate' (negative freedom), which defies a State's *duty* to regulate (positive freedom), even when such duty is recognised as an obligation in the State's Constitution.²³⁶ ITA serves to ensure 'neutral' enforcement of foreign investors' rights, while the system's close alliance with the World Bank through ICSID ensures its effectiveness.²³⁷

Further, the neutrality of law is important for law's equality, which is one of the fundamental principles of the rule of law. Differences in treatment, as exceptions from the principle of formal equality, must be justified.²³⁸ IIL offers in any case greater procedural rights for foreign investors, and, depending on the specific circumstances, it can provide greater substantive rights. This inherent bias of the system in favour of foreign investors is nevertheless justified in the service of good governance and in order to achieve economic growth *for all*. Promotion of such rule of law is 'not political' because it addresses the 'application of rules rather than their substance'.²³⁹ Nevertheless, such 'governance' replaces formal 'government' – which presupposes some form of (democratic) accountability – with more ambivalent delegation of formal authority to international structures.²⁴⁰ Yet, the effects of foreign capital on development remain

²³⁵ See section 3.2 above.

²³⁶ For example, in the case *Vattenfall AB and others v Federal Republic of Germany (II)*, ICSID Case No. ARB/12/12 (*Vattenfall II*), Vattenfall's claim related to Germany's decision to phase out nuclear energy. Under the German Constitution, the government has not only a *right* but also a *duty* to regulate in the public interest with respect to hazards stemming from the use of nuclear energy: see Damjanovic and Quirico (n 193) 111-113.

²³⁷ States can face serious financial consequences for non-compliance with ICSID awards. For example, Operational Policies of the World Bank specify: 'When there are disputes over expropriations that, in the opinion of the Bank, the member country is not making reasonable efforts to settle and that are substantially harming the country's international credit standing, the Bank considers whether to continue making new loans to or with the guarantee of the member country.' When judging 'reasonable efforts', the Bank will take into account the country's willingness to accept independent dispute-settlement procedures or its recognition of the principle of compensation: World Bank, 'Disputes over Defaults on External debt, Expropriation, and Breach of Contract' (July 2001) Operational Manual OP 7.40, para 5.

²³⁸ In this context, the generality of laws is considered a formal criterion for ensuring law's equality. It is the first of Fuller's eight criteria (n 211) and its purpose is to ensure that the application of laws is not arbitrary but applies equally to all. See Kramer (n 214) 109-113.

²³⁹ Ibrahim Shihata, 'The World Bank and "Governance" Issues in Its Borrowing Members' in Franziska Tschofen and Antonio R Parra, *The World Bank in a Changing World*, vol 1 (Brill 1991) (as cited in Humphreys (n 227) 138).

²⁴⁰ On the difference between 'governance' and 'government' in international law, see Koskeniemi (n 220) 321. See also William E Scheuerman, 'Economic Globalization and the Rule of Law' (1999) 6 *Constellations* 3, 5. Governance thus includes emerging international decision-making mechanisms that are in an ambivalent relationship with nation States. In this sense, government implies clearly defined formal accountability (through formal institutions, elections), while reference to governance includes facilitative evolving processes (through networks of mixed State and non-State actors).

inconclusive,²⁴¹ and consequently also the justifiability of favouring private rights as a precondition of economic development,²⁴² and economic growth over other pillars of sustainable development.²⁴³

In light of arbitral jurisprudence, States are making an effort to introduce provisions with the aim of ensuring better balance between investment protection and public interest. Apart from the right-to-regulate type of clause,²⁴⁴ some new IIAs introduce the duty of foreign investors to comply with the host State's laws,²⁴⁵ include a reference to Corporate Social Responsibility (CSR) soft law commitments,²⁴⁶ and the possibility that the investor's failure to comply with these instruments could be taken into account when deciding claims.²⁴⁷ However, the soft language of socially responsible

²⁴¹ Empirical evidence in this regard is mixed. Some meta studies of this evidence show that a positive impact of BITs on FDI has not been confirmed empirically: see Christian Bellak, 'Economic Impact of Investment Agreements' (2015) Vienna University Department of Economics Working Paper Series 200 <<https://epub.wu.ac.at/4625/1/wp200.pdf>> accessed 30 June 2020. However, the positive influence of BITs might be rather indirect and their presence is thought to have a positive impact on the overall investment climate: see Shayerah Ilias Akhtar and Martin A Weiss, 'U.S. International Investment Agreements: Issues for Congress' (2013) Congressional Research Service, 16-17, which also provides a summary of different empirical studies. See also Lauge N Skovgaard Poulsen, 'The Importance of BITs for Foreign Direct Investment and Political Risk Insurance' in Karl Sauvant (ed), *Yearbook on International Investment Law and Policy 2009-2010* (OUP 2010).

²⁴² On a discussion about property rights and economic development in a broader context, see David W Kennedy, 'Some Caution About Property Rights as a Recipe for Economic Development' (2011) 1 Accounting Economics and Law 1.

²⁴³ See also Scheuerman (n 240), who claims that 'necessary "fit"' between globalising capitalism and the rule of law has been 'grossly overstated' and that the business community is 'best poised' to 'exploit legal ambiguities' of international treaties: at 19. He argues for social democracy as a model of governance that better serves the rule of law.

²⁴⁴ On the right to regulate in CETA and new EU IIAs, see chapter 8. See, for example, modernised Canada-Chile FTA (Amending Agreements to the Canada-Chile Free Trade Agreement entered into force 5 February 2019), Art G-14 (environmental measures) and Art G-15 (energy regulatory measures); the latter provision envisages that when applying energy regulatory measures regulatory bodies will 'avoid disruption of contractual relationships to the maximum extent practicable', and provide for 'orderly and equitable implementation appropriate to such measures'. The Indian Model BIT 2015 (n 49) includes a general exception clause with respect to public interest measures of general applicability applied on a non-discriminatory basis: see Art 32.1. The Nigeria-Morocco BIT (n 50) prescribes the right of the State to regulate in Art 23, which includes application of the State's non-discriminatory measures in order to comply with international obligations. The SADC Model BIT 2012 goes even further by prescribing 'the right to pursue development goals' (Art 21) and the right to establish 'own' levels of domestic environmental and labour standards, while also imposing an obligation 'not to waive or otherwise derogate from' these standards in order to attract foreign investment (Art 22): SADC Model Bilateral Investment Treaty Template with Commentary (July 2012) <<https://www.iisd.org/itn/wp-content/uploads/2012/10/sadc-model-bit-template-final.pdf>> accessed 30 June 2020.

²⁴⁵ For example, Art 7(1), the Dutch Model BIT 2018 prescribes that investors and investments 'shall comply with domestic laws and regulations of the host State, including laws and regulations on human rights, environmental protection and labour laws': Netherlands model Investment Agreement (2019) <<https://www.rijksoverheid.nl/ministeries/ministerie-van-buitenlandse-zaken/documenten/publicaties/2019/03/22/nieuwe-modeltekst-investeringsakkoorden>> accessed 30 June 2020. See also Arts 10 (Common Obligation against Corruption) and 11 (Compliance with Domestic Law) of the SADC Model BIT 2012.

²⁴⁶ See, for example, Art G-14 *bis* on CSR in the modernised Canada-Chile FTA (n 244). However, the language of these provisions remains as soft as the instruments themselves ('shall encourage' 'voluntarily incorporate'); similarly see Art 9.17 CPTPP; Art 7 Dutch Model BIT 2018.

²⁴⁷ Art 23, Dutch Model BIT 2018, which enables the tribunal to take into account 'non-compliance by the investor with its commitments under the UN Guiding Principles on Businesses and Human Rights, and the OECD Guidelines for Multinational Enterprises' when deciding on compensation. See also the SADC Model BIT 2012, which envisages that a tribunal's duty to consider whether an investor's failure to comply with the

practices leaves the investors with the benefit of the doubt and affected third parties without a procedural remedy.²⁴⁸ Some treaties include an explicit possibility of counterclaims.²⁴⁹ In an attempt to limit the availability of the system to genuine foreign investment disputes, some new treaties also exclude from the jurisdiction of investment tribunals frivolous claims, corruption or other process abuses.²⁵⁰

3.3.2.2. Procedural rule of law: procedural justice, openness and transparency

IL has developed on the presumption that ITA provides a *neutral forum* for the settlement of investment disputes. From a procedural perspective, neutrality requires procedural legality. Judicial bodies must comply with the requirements of procedural justice, which encompass the right to a fair hearing (*audi alteram partem*)²⁵¹ and the rule against bias (*nemo iudex in causa sua*).²⁵² These standards are considered fundamental rules of domestic administrative law, rooted in common law tradition.²⁵³ The fair and unbiased

obligations under the treaty is materially relevant to the issues involved in the investor's claim and what 'mitigating or off-setting effects this may have on the merits of the claim or on any damages': Art 19.1.

²⁴⁸ In most treaties that include reference to sustainable development and CSR, parties commit to best-effort obligations. One notable exception is the SADC Model BIT, which includes mandatory language ('shall comply', 'have a duty to respect', 'shall act in accordance'): see, for example, Arts 14-16. However, the liability of investors is limited to civil actions for liability in the judicial process of their *home* State in cases where their decisions led to 'significant damage, personal injuries or loss of life in the host State' (Art 17, emphasis added). Similarly, see Art 7(4) of the Dutch Model BIT 2018. The Nigeria-Morocco BIT directs human rights provisions at Contracting States (Art 15) but in many respects follows the SADC Model BIT, however with less detailed provisions. For example, it introduces an environmental and social impact assessment obligation for investments prior to their establishment (with reference to the precautionary principle – see Art 14), and post-establishment obligations (Art 18).

²⁴⁹ Art 19.2 SADC Model BIT 2012.

²⁵⁰ For example, Art 8.18.3 CETA and Art 16(2) Dutch Model BIT 2018 introduce the 'clean hands' doctrine. Similarly, the Indian Model BIT 2015 in Art 13.4. See also Art 8.32 CETA for frivolous claims. The Dutch Model BIT 2018 in Art 16(3) denies the jurisdiction of the tribunal in the case of corporate restructuring for the main purpose of gaining the protection of the agreement: see Art 16(3).

²⁵¹ The right to a fair hearing supposes the provisions that guarantee the rights of parties to present their written and oral arguments, and access the written pleadings of the other party: Grossman (n 153) 124. In arbitration, rules applying to proceedings depend on the institutional setting of the arbitration but most envisage additional written submissions by the parties, beyond the initial Request for Arbitration and Answer, which allow the parties to elaborate on the facts, law and evidence in support of their case. On rules regarding written and oral proceedings, see Ali and others (n 88) 415-444.

²⁵² A party may challenge an arbitrator's appointment for lack of independence and impartiality. Independence concerns the arbitrator's relationship with the parties, while impartiality concerns the issues in the dispute: see *ibid* 285-294. In the context of courts, independence and impartiality concern independence from external factors (autonomous decision-making without external influence; appointment and removal of judges; and remuneration) and internal impartiality (objectivity and conflict of interests): see chapter 9.

²⁵³ Procedural justice is also called natural justice. The duty to accord natural justice applies to the exercise of public power in a diversity of government decisions affecting property rights, employment, personal freedoms, and financial and commercial interests. While its philosophical origins date back to Plato, Seneca and Locke, the rules gained judicial recognition in common law in the 19th century: *Cooper v Board of Works for the Wandsworth District* (1863) 143 ER 414. For an Australian application of this doctrine, see, for example, *Re Minister for Immigration and Multicultural Affairs; Ex parte Lam* (2003) 214 CLR 1.

nature of international tribunals is equally important for ensuring their legitimacy although some studies demonstrate that the element of bias carries greater weight.²⁵⁴

Procedural rules in ITA depend on whether arbitration is *ad hoc* or institutional, and in the latter case the rules of that institution apply.²⁵⁵ The content of these rules is beyond the scope of this study but all of them aim to find an appropriate balance between procedural fairness and efficiency.²⁵⁶ Importantly, failure to accord due process in arbitration proceedings is a ground for later challenge of the award before a national court²⁵⁷ or a ground for annulment of an ICSID award before the ICSID annulment committee.²⁵⁸ Procedural justice in the ISDS context is particularly concerned with the issue of bias. In this sense, bias can be seen as institutional, stemming from the *modus operandi* of the arbitration and related conflicts of interest; and disciplinary, stemming from the attitudes of the arbitrators.

Institutional bias concerns the interpretation of treaty provisions related to a tribunal's jurisdiction (parallel proceedings, treaty shopping, forum shopping).²⁵⁹ Arbitrators, who are appointed on a case-by-case basis, have an inherent financial interest in adopting a more expansive interpretation of treaties, which can stimulate the ISDS industry.²⁶⁰ Default appointing authorities might also have a role by favouring individual arbitrators who adopt such practices.²⁶¹ Additionally, some studies indicate the

²⁵⁴ Grossman (n 153) 123, 128-129.

²⁵⁵ See chapter 2, section 2.2.3. With respect to independence, impartiality and disclosure, further soft-law standards serve to provide guidance for the interpretation of these requirements: IBA Rules of Ethics for International Arbitrators and IBA Guidelines on Conflict of Interest in International Arbitration. The latter have, however, superseded the IBA Rules of Ethics 3 and 4, which address impartiality and independence: see IBA Guidelines on Conflict of Interest in International Arbitration, 5.

²⁵⁶ See Ali and others (n 88). The ICSID Rules Amendment Process, launched in October 2016, shares the same objectives: modernisation of procedure, reducing time and cost, simplification of the rules, and reducing the paper burden of proceedings through electronic transmissions: see UNCITRAL, 'Possible Reform of investor-State dispute settlement (ISDS): Submissions from international organisations' (13 October 2017) UN Doc A/CN.9/WG.III/WP.143, 2-4.

²⁵⁷ In an action to enforce a non-ICSID award or an ICSID Additional Facility award before a national court, the enforcement of a foreign award may be refused if the losing party proves that it was not given proper notice about the proceedings; was unable to present its case; and the composition of the tribunal or the arbitral procedure was not in accordance with the arbitration agreement, or under the law of the seat of arbitration (if no procedure was chosen): Ali and others (n 88) 544.

²⁵⁸ The ICSID Convention in Art 52(1) prescribes a manifest excess of a tribunal's powers and corruption on the part of a member of the tribunal as grounds for annulment.

²⁵⁹ See chapter 2.

²⁶⁰ A recent empirical study by Van Harten found that a small number of arbitrators in the first two decades of investment treaty arbitration had an important impact on the development of the ISDS industry through expansive interpretation of contentious jurisdictional (definitions of foreign investor and investment; parallel proceedings; MFN treatment) and substantive (national treatment; FET standard; full protection and security; indirect expropriation; umbrella clauses; exclusion of national security exception) issues: Gus Van Harten, 'Leaders in the Expansive and Restrictive Interpretation of Investment Treaties: A Descriptive Study of ISDS Awards to 2010' (2018) 29 European Journal of International Law 507.

²⁶¹ Van Harten found that appointing authorities (ICSID, PCA, SCC) tend to appoint more frequently to the tribunal presiding role those arbitrators who adopt expansive rather than restrictive interpretations of contentious jurisdictional and substantive issues: *ibid*.

possibility of a bias toward investors from Western capital-exporting States.²⁶² While empirical evidence remains inconclusive, from a normative perspective there are characteristics of the system which bring into question its institutional independence: asymmetrical claims structure,²⁶³ party autonomy in arbitral appointments, and related conflict of interest. Legal rules on the appointment of arbitrators, their qualifications and conflict of interest serve to eliminate these biases but fail to address the perceptions of systemic bias.²⁶⁴ Importantly, for ensuring procedural justice, the rule against bias is infringed when bias would be *reasonably perceived*, even if not real²⁶⁵ – justice must also be seen to be done.

Disciplinary bias concerns attitudes of the legal discipline in the practice of ITA. The ‘resolutely private law sensibility’ of ITA is where ‘the fundamentally apolitical stance of neoliberalism finds its legal manifestation’.²⁶⁶ The bias of arbitration is not anymore in favour of the economic interests of the North, as was perceived in the past, but in favour of private rights and restriction of State intervention into the market.²⁶⁷ This change of approach coincides with globalisation and the move from State-centred international law towards fragmentation, with increasing normative and jurisdictional conflicts between different international law subdisciplines or ‘regimes’ (trade law, investment law, environmental law, European law, etc.).²⁶⁸ It gives an impression of a metamorphosis of international law from political into apparently apolitical and technical law.²⁶⁹

²⁶² For example, another Van Harten’s study demonstrates an expansive approach to jurisdictional and admissibility issues, in particular for claimants from France, the UK and the US (Germany being an exception): Gus Van Harten, ‘Arbitrator Behaviour in Asymmetrical Adjudication: An Empirical Study of Investment Treaty Arbitration’ (2012) 50 *Osgoode Hall Law Journal* 211.

²⁶³ The system is asymmetrical as only investors can submit arbitration claims and thus initiate arbitration proceedings. Therefore, the rise in investors’ claims drives the development of the ISDS industry.

²⁶⁴ See chapter 2, section 2.2.3.

²⁶⁵ Impartiality should be examined from a subjective as well as from an objective perspective since bias can be either manifest or apparent: International Commission of Jurists, ‘International Principles on the Independence and Accountability of Judges, Lawyers and Prosecutors’ (2007) Practitioner Guide No. 1, 28. If this standard is applied to the sphere of arbitration, for instance, a manifest bias would be a case of identity between a party and the arbitrator. In contrast, an apparent bias would occur if the arbitrator has been previously advising the party. The latter example under the IBA Guidelines on Conflict of Interest in International Arbitration would be treated as an ‘orange list’ circumstance; the arbitrator would have a duty to disclose the situation but if the parties fail to raise any timely objections, the parties would be deemed to have accepted the arbitrator: IBA Guidelines on Conflict of Interest in International Arbitration, Part II, Practical Application of the General Standards, 18. The IBA Rules of Ethics take a more categorical approach by providing examples of circumstances that create an appearance of bias and accordingly a duty to disclose them: The IBA Rules of Ethics for International Arbitrators, Rules 3-4, 2. However, these Rules have been superseded by the lists approach (non-waivable red list; waivable red list; orange list; green list) of the IBA Guidelines on Conflict of Interest in International Arbitration. For the relationship of these lists to judicial concepts of impartiality, see chapter 9.

²⁶⁶ Shalakany (n 220) 425.

²⁶⁷ In this sense, Shalakany identifies three manifestations of the public/private distinction: contracts/politics, equals/unequals, and property/sovereignty: *ibid* 455.

²⁶⁸ See Koskeniemi (n 220) 318-330.

²⁶⁹ *ibid* 358.

Given the open-ended rules in each subfield of modern international law, it is now the discipline, or rather the legal and technical experts appointed to the field's supervisory institutions, that determines their scope and substance²⁷⁰ – UNCITRAL, ICSID and the different arbitration centres in the case of IIL. In this way international rules in a particular subfield have become the instrument of the discipline itself, determined by the manner in which the relevant institution understands its mission.²⁷¹ Accordingly, reference to international law in IIAs, as understood by arbitral tribunals, does not 'incorporate the universe of international law' but only the body of law relevant to the protection and promotion of foreign investment.²⁷² If the mission of IIL is to *protect* private investors from host States' regulatory actions, the discipline interprets the rules through lenses that favour private interests rather than a State's regulatory action, even when the issue at hand concerns the public interest. In IIL so understood, the protection of foreign investment is a precondition of development and not a tool for development. IIL so perceived necessarily *favours* the economy, conventionally understood, above the other two pillars of sustainable development – society and environment.

The recent trend in the evolution of treaties sees the *disciplinary* bias of arbitrators addressed by provisions requiring that they have *additional* expertise in 'public international law', with a *dominant* specialisation in investment or trade law.²⁷³ On the other hand, some treaties empower arbitral institutions to appoint arbitrators, which effectively endorses disciplinary bias.²⁷⁴ So far, the lack of disciplinary diversity among investment adjudicators has received insufficient attention in the current UNCITRAL reform.²⁷⁵

²⁷⁰ *ibid* 334.

²⁷¹ *ibid* 336.

²⁷² See, for example, *Bernhard von Pezold and Others v Republic of Zimbabwe*, ICSID Case No. ARB/10/15, Procedural Order No. 2 (26 June 2012) para 57. The Tribunal rejected a submission that reference to international law in a clause determining the applicable law incorporated international human rights law for the protection of indigenous people.

²⁷³ See, for example, Art 8.27.4 CETA. In the Dutch Model BIT 2018 the requirement of 'necessary expertise in public international law, which includes environmental and human rights law, international investment law as well as in the resolution of disputes arising under international agreements' is in the form of a best effort obligation: see Art 20(5).

²⁷⁴ See Art 20 of the Dutch Model BIT 2018, which replaces traditional party appointment of arbitrators with appointment by an appointing authority. Also, while CETA introduces a new institution (CETA tribunals), ICSID remains the Secretariat for its First Instance Tribunal: see UNCITRAL (n 256) 2. One way to overcome investment bias could be by establishing a special roster of arbitrators for environmental issues (as the Permanent Court of Arbitration did) or human rights issues.

²⁷⁵ In the discussions, it is still the general attitude that arbitrators should primarily have knowledge of public international law, international trade and investment law; however, expertise in private international law could also be considered. They should also have an *understanding* of different investment-related policies, including sustainable development: see UNCITRAL, 'Report of Working Group III (Investor-State Dispute Settlement reform) on the Work of its Resumed Thirty-Eighth Session' (28 January 2020) UN Doc A/CN.9/1004/Add.1, 16. Current arbitrators would not have any difficulty in demonstrating that they comply with these requirements. Moreover, some reform proposals advocate for even greater specialisation in ISDS, which necessarily excludes broader understanding of different cross-sectoral policies.

Finally, openness and transparency play an important role for the rule of law and legitimacy. Within the rule of law framework these principles are important for ensuring the scrutiny and accountability of the system to the public.²⁷⁶ They allow for the assessment of whether a tribunal's application of rules is fair and unbiased. They also ensure that the voices of otherwise excluded stakeholders are heard. In the framework of legitimacy, openness and transparency are important prerequisites for evaluating a system's normative regime; that is, its dominant values and legal soundness.²⁷⁷

ITA has traditionally been rather closed to the public;²⁷⁸ however, in recent times a trend has emerged toward greater openness and transparency, at the level of procedural rules and in the new IIAs.²⁷⁹ With the UNCITRAL Rules on Transparency in Treaty-based Investor-State Arbitration, transparency has replaced confidentiality as a default rule for UNCITRAL arbitrations, albeit still with limited reach.²⁸⁰ In ICSID, the current amendment process of ICSID Rules is, *inter alia*, aimed at enhancing transparency.²⁸¹ Reforms include 'deemed' consent of the parties to publication of the awards,²⁸² publishing written

²⁷⁶ For example, see the definition of the UN Secretary-General, in UNSC 'The rule of law and transitional justice in conflict and post-conflict societies: Report of the Secretary-General' (2004) UN Doc S/2004/616.

²⁷⁷ Grossman (n 153) 152.

²⁷⁸ One exception has been the participation of non-disputing parties through *amici curiae* briefs. So far, NGOs and international organisations have taken advantage of such participation. On the practice of *amici curiae* in investment treaty arbitration, see Luigi Crema, 'Testing *Amici Curiae* in International Law: Rules and Practice' (2012) The Italian Yearbook of International Law 91, 108-117. The European Commission has been a regular *amicus curiae* in intra-EU arbitrations: see chapter 7.

²⁷⁹ See, for example, Art 8.38.2 CETA, which allows the tribunal to accept or invite oral or written submissions from non-disputing parties regarding the interpretation of the agreement. The Indian Model BIT 2015 confers on the tribunal powers to appoint experts on 'any factual issue concerning environmental, health, safety, technical or other scientific matters': Art 25.

²⁸⁰ The UNCITRAL Rules entered into force on 1 April 2014. They apply only to UNCITRAL arbitrations and to treaties concluded on or after 1 April 2014, unless the parties agree otherwise. The UN Convention on Transparency in Treaty-based Investor-State Arbitration (adopted on 10 December 2014, entered into force 18 October 2017) (Mauritius Convention) allows the application of UNCITRAL Transparency Rules to treaties concluded before 1 April 2014, regardless of the arbitration rules. As of 30 June 2020, only 23 countries have signed and five ratified the Mauritius Convention: UN Treaty Collection, 'Status of Treaties' (*Depositary*) <https://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg_no=XXII-3&chapter=22&clang=_en> accessed 30 June 2020. Many new IIAs include provisions on the application of the UNCITRAL Rules in their transparency clause: see, for example, Art 8.36 CETA, Art G-29 Canada-Chile FTA; or have an autonomous transparency clause: see, for example, Art 9.24 CPTPP.

²⁸¹ Amendments concern the Rules (ICSID and ICSID Additional Facility) and not the ICSID Convention itself, an approach which limits the scope of the reform. Of particular interest in this context is chapter X (Publication, Access to Proceedings and Non-Disputing Party Submissions). ICSID has proposed several working papers to guide the rules amendment process, with the latest the 4th working paper published on 28 February 2020, potentially being the final. Working papers incorporate reflections from the extensive consultation process. The aim of the ICSID Secretariat is to put the Rules to vote in late 2020, with possible implementation in early 2021. The amendment process itself has been guided by the principle of transparency. For a summary of Working Paper No. 4, the amendment process and proposed reforms, see ICSID, 'Updated Backgrounder on Proposals for Amendment of the ICSID Rules' (28 February 2020) <https://icsid.worldbank.org/en/Documents/WP_4_Backgrounder_EN.pdf> accessed 30 June 2020.

²⁸² Under the Convention, both disputing parties must give their consent for the publication of the award: Art 48(5) ICSID Convention. In order to comply with this Convention requirement, the new proposed Rule 62(3) envisages that consent is 'deemed to have been given' when neither party objects to the publication of the award within 60 days of the award being rendered: ICSID, 'Proposals for Amendment of ICSID Rules', (February 2020) Working Paper No. 4, Vol 1, 65

submissions or supporting documents with the consent of the parties,²⁸³ more detailed rules on non-disputing party participation²⁸⁴ and a possibility of open hearings unless either party objects.²⁸⁵ Amendments also envisage broader mandatory third-party funding disclosures.²⁸⁶ These rules improve the openness and transparency of the proceedings. However, the process still remains controlled by the parties and dependant on the tribunals' discretion, which places the interests of the disputing parties before the interest of the public participation in the process.²⁸⁷ Access to justice in the ISDS context is primarily focused on enabling greater use of the system by small and medium enterprises (SMEs).²⁸⁸

Incremental reform proposals to improve the rule of law in respect of ITA – both procedurally and normatively – are many and ongoing. While investment dispute settlement contributes to the rule of law in international law, its effects on improving the domestic rule of law remain inconclusive²⁸⁹ and arguably limited. Investment tribunals cannot mandate the removal of illegal domestic measures but only condemn the States for their non-compliance with IIL. On the one hand, this can potentially encourage States

<https://icsid.worldbank.org/en/Documents/WP_4_Vol_1_En.pdf> accessed 30 June 2002. The same applies to a supplementary decision in respect of an Award, rectification, interpretation, revision of an award, or a decision on annulment: see Rule 62(1).

²⁸³ In case the parties do not provide such consent, a party may request from the tribunal to redact its written submission, excluding supporting documents. The tribunal will decide whether to publish such a submission, while ensuring that publication does not disclose any confidential information: see proposed ICSID Rule 64, *ibid* 66.

²⁸⁴ When deciding on whether to permit a non-disputing party submission, the tribunal will, *inter alia*, take into account how the submission can assist the tribunal in determining a factual or legal issue before the tribunal by 'bringing a perspective, particular knowledge or insight that is different from that of the parties': proposed ICSID Rule 67(2)(b), *ibid* 67-68

²⁸⁵ Proposed ICSID Rule 65, *ibid* 66. Additionally, upon request of a party and unless the other party objects, the tribunal can publish recordings or transcripts of the proceedings: Rule 65(3).

²⁸⁶ Third-party funding in proposed Rule 14 is defined as situations in which the party has received, directly or indirectly, 'funds for the pursuit or defense of proceeding through a donation or grant, or in return for remuneration dependent on the outcome of the proceedings': *ibid* 37-38.

²⁸⁷ In particular, the proposed rule regarding confidential and protected information covers a wide range of possible rules, open to extensive interpretation: see Rule 66, *ibid* 66-67. Also, there is no mandatory disclosure of investors' corporate structures despite the request made by some States to include such provisions. The disclosure is, however, recommended as part of the request for arbitration: see Institution Rules, Rule 2 and 3, *ibid* 276-277. In light of the existing practice for participation by non-disputing parties, it is questionable whether new provisions would increase the potential for *amicus curiae* submissions: see Nicolette Butler, 'Non-Disputing Party Participation in ICSID Disputes: *Faux Amici*?' (2019) 66 *Netherlands International Law Review* 147.

²⁸⁸ Access to ISDS has been particularly emphasised by the EU in its proposal for a new court system. See, for example, Art 8.39.6 CETA and the commitment made by the EU in the Statement No. 36 to take the appropriate measures, which will ensure the accessibility of the ICS to SMEs (co-financing SMEs' actions and technical assistance): Council of the European Union, 'Comprehensive Economic and Trade Agreement (CETA) between Canada, of the one part, and the European Union and its Member States, of the other part – Statements to the Council minutes' (27 October 2016) 13463/1/16. In the framework of UNCITRAL, discussions about the possible Advisory Centre have also been inspired with a view to benefiting SMEs: see UNCITRAL, 'Possible reform of investor-State dispute settlement (ISDS): Advisory Centre' (25 July 2019) UN Doc A/CN.9/WG.III/WP.168.

²⁸⁹ See Benjamin K Guthrie, 'Beyond Investment Protection: An Examination of the Potential Influence of Investment Treaties on Domestic Rule of Law' (2013) 45 *New York University Journal of International Law and Politics* 1151.

to abandon illegal practices with respect to foreign investors. On the other hand, this can also have counterproductive effects by discouraging States from regulating in the public interest when such regulation could have a negative impact on investors' private rights. Some BITs take a novel approach by imposing additional duties on States in an effort to encourage them to enhance the domestic rule of law – albeit these efforts remain limited to business-related human rights abuses.²⁹⁰ In the EU, elimination of the ISDS mechanism in intra-Member States relations and providing for the supremacy of EU mechanisms, while envisaged for different purposes, could in the long run have positive effects on the rule of law beyond the narrow scope of foreign investors' protections.²⁹¹

Drawing on the discussion about legitimacy and the rule of law in this chapter, the following table summarises the key aspects of both concepts in the context of IIR.

Table 3.2. International investment regulation in the framework of legitimacy and the rule of law

	INVESTMENT TREATY ARBITRATION	INTERNATIONAL INVESTMENT AGREEMENTS
LEGITIMACY	Throughput-based legitimacy - Fairness and non-bias (institutional and disciplinary) - Openness and transparency: accountability of tribunals to the public	Input-based legitimacy Treaty-making process: - Transparent - Accountable - Inclusive - Democratic
	Output-based legitimacy - Politically acceptable decisions - Interests and values enshrined in domestic law - The right to regulate and State sovereignty - Legal soundness of decisions - Coherence - Adherence - Determinacy	
THE RULE OF LAW	Procedural legality - Procedural fairness: - Fair hearing before investment tribunals - The rule against bias: independence from external pressures and impartiality (actual or perceived) - Possibility of an appeal - Access to justice: opportunity for third parties to participate (submissions) - Public accessibility: open hearings, public pleadings and awards	Formal characteristics of treaties - Clear and specific substantive provisions to limit the discretion of arbitral tribunals in the application of IIAs - Compliance of State authorities with international obligations through effective enforcement mechanism - Equality before the law: differentiations objectively justified on the basis of a reasonable aim and in conformity with the principle of proportionality

²⁹⁰ For example, the Dutch Model BIT 2018 in Art 5 introduces 'the rule of law' clause and prescribes that States 'must take appropriate steps to ensure, through judicial, administrative, legislative or other appropriate means, that when [business-related human rights] abuses occur within their territory and/or jurisdiction those affected have access to effective remedy. These mechanisms should be free, impartial, independent, transparent and based on the rule of law.'

²⁹¹ See chapters 5 and 7.

Formal characteristics of jurisprudence	- Special regime for foreign investors should not provide greater rights - Public-private balance ▪ Effective remedy in international law - Special remedies for foreign investors should not circumvent the applicability of effective domestic remedies
Substantive characteristics of jurisprudence	
▪ Consistency and coherence ▪ Predictability and legal certainty ▪ Interpretative proficiency in public law	

3.3.3. *Beyond legitimacy and the rule of law: the sui generis character of arbitration*

The evaluation of IIL beside legitimacy and the rule of law criteria does not take into account the specific character of arbitration as a dispute settlement mechanism in the sphere of business disputes. Of importance here are the criteria usually applied to ADR mechanisms, such as efficiency, cost and duration of proceedings, party autonomy, confidentiality and continuous relationships between subjects.²⁹² In this context, legitimacy occupies a different dimension, measured by business correlations. It has been argued by scholars that the efficacy of ICSID and investment arbitration have bolstered the system's normative legitimacy but undermined its sociological legitimacy.²⁹³

The main incentives to engage in international arbitration are also some of the main points of contemporary criticism of it: party appointment of adjudicators with an expectation that the designated arbitrator will be sympathetic to the party's view, supra-national neutrality, and the promise of its simplicity, speed and economy.²⁹⁴ It has therefore been argued that the types of control mechanisms used in domestic contexts are not appropriate for international arbitration and, instead, international arbitration should develop its own mechanisms of control.²⁹⁵ Such mechanisms would preferably involve other international institutions rather than domestic courts.²⁹⁶

²⁹² See, for example, Bottomley and Bronitt (n 205) 179-186, which also provides the critique of the ADR movement in comparison to formalised proceedings before the courts.

²⁹³ Bjorklund (n 199) 234-283. In this analysis Nienke Grossman's factors have been used for the assessment of sociological legitimacy (however, without reference to empirical data which renders this analysis rather normative). On the other hand, normative legitimacy is assessed in light of Yuval Shany's (n 153) approach to legitimacy through effectiveness. Accordingly, it is argued that the ICSID has fulfilled the purpose (providing a neutral forum for the settlement of investment disputes) and it has worked effectively in achieving its mission: *ibid*, 253-268. The criticisms addressed at the ICSID are thus 'simply misdirected' because current expectations about arbitration do not match the expectations for which the ICSID was established (in the context of time when it was established): *ibid*, at 269 and *seq*.

²⁹⁴ Michael Reisman, 'The Breakdown of the Control Mechanism in ICSID Arbitration (1989) 4 *Duke Law Journal* 739, 747.

²⁹⁵ Considering the early case-law of the ICSID Annulment Committee, Reisman already then warned of practices that could undermine the effectiveness of arbitration's own systems of control. *Inter alia*, he in particular warned against nullifications for purely technical reasons or for differences in the style of legal reasoning and drafting, and limiting nullifications to cases of material violations: *ibid* 762-763, 806.

²⁹⁶ *ibid* 745-747. Some earlier proposals for control of arbitration envisaged the control of the Permanent Court of International Justice in the context of the League of Nations and the International Court of Justice in the framework of the UN: see *ibid*, 751-753. Interestingly, recently the ICSID employed a similar solution by

For investors, it is important that arbitration should retain its private law character. Accordingly, party autonomy, efficiency and effectiveness of enforcement play a more important role than proper mechanisms of public control.²⁹⁷ Abandoning party autonomy in the selection of arbitrators in favour of a permanent court would not only disturb this balance in favour of States but it would also eliminate the diversity of adjudicators.²⁹⁸ While control mechanisms remain important, it has been stressed that ‘consistency’ in jurisprudence must be balanced against ‘correctness’, which in turn must be balanced against ‘the need for finality’.²⁹⁹ An appellate mechanism would disturb such balance, in favour of consistency and against correctness and finality.³⁰⁰ Instead, effective control could be ensured by the parties themselves, for example, by parties’ prior scrutiny of awards which could better achieve ‘correctness’.³⁰¹ The investor’s vision of ISDS therefore endorses its private law character which directly contradicts the conceptualisation of ISDS as a public law system.

For States, the challenge remains in balancing their commercial with their public hat in the dispute settlement context. Under the commercial hat, States will prefer dispute settlement mechanisms that are more efficient and favourable in continuing business relationships with investors.³⁰² In such relationships, there is an expectation of mutually beneficial control on both sides.³⁰³ In these situations, conflicts are about interests and they are more likely to be settled or resolved through a private system of dispute settlement.³⁰⁴ However, under States’ public law hat, the nature of the disputes moves

requesting the Secretary-General of the Permanent Court of Arbitration to decide on Germany’s proposal to disqualify the entire *Vattenfall II* (n 236) Tribunal: email sent by the ICSID’s Acting Chairman of the Administrative Council Kristalina Georgieva to the parties on 6 March 2019, <<https://www.italaw.com/sites/default/files/case-documents/italaw10405.pdf>> accessed 30 June 2020. Morocco’s proposal of prior scrutiny of arbitral awards by an independent body such as the ICSID or PCA goes in this direction too: see UNCITRAL, ‘Submission from the Government of Morocco to UNCITRAL Working Group III’ (4 March 2019) UN Doc A/CN.9/WG.III/WP.161, para 25.

²⁹⁷ CCIAG submission to UNCITRAL (n 118) provides an excellent overview of investors’ views on ISDS reform.

²⁹⁸ *ibid* 5-8.

²⁹⁹ In this sense, control mechanisms in any case should not correct errors on the merits. Accordingly, any appellate mechanism would include longer and more expensive proceedings: *ibid* 4. While ‘correctness’ is not defined, it is contrasted with consistency. In this sense, it is claimed that precedent and *absolute* consistency would undermine correctness, implying flexibility is required for a tribunal to reach a correct decision in each particular case.

³⁰⁰ *ibid* 12.

³⁰¹ *ibid* 18. In support, the reference is made to Art 9.23(10) CPTPP, which allows parties to provide written comments on the draft award to the tribunal and Morocco’s submission to UNCITRAL (n 296) paras 22-24.

³⁰² Efficiency in view of cost and duration has also found a place among State concerns: see UNCITRAL, ‘Possible reform of investor-State dispute settlement (ISDS): Cost and duration’ (31 August 2018) UN Doc A/CN.9/WG.III/WP.153. Reasoning by analogy, Marc Galanter’s analysis (n 117) could be taken as a reference point in the context of the foreign investor-host State relationship at the level of *domestic* dispute settlement.

³⁰³ Galanter (n 117) 110-111. These controls depend on the availability of sanctions, such as withdrawal and refusal to continue beneficial relations, which are more likely in the case of larger investors (MNEs), with more resources and power.

³⁰⁴ This in the first instance includes attempting to resolve differences through informal bilateral controls and in any case outside of courts. See Galanter (n 117) 111.

from conflicts about interests (who gets what) to conflicts about value differences (who is right), and in such situations there is little incentive for the State to settle or resolve a dispute through a private dispute settlement mechanism.³⁰⁵ Accordingly, the dispute settlement mechanism that the State will prefer depends on the State's perception of its functions in a given situation.

In the broader context of legal dispute resolution, which generally exhibits a trend of shifting from courts (public) to ADR (private),³⁰⁶ the current developments in the ISDS sphere move in different directions. Some proposals aim at formalising justice in an institution that is a (quasi-)court.³⁰⁷ Some other examples show a tendency to limit arbitration to its commercial beginnings.³⁰⁸ Various multilateral proposals differently strike the balance between the private nature of ISDS and the need for public oversight – from improving the current mechanism to creating new institutions.³⁰⁹ The guiding principles of ADR mechanisms – dispute prevention and resolution through an advisory centre,³¹⁰ flexibility through expedited procedures and case management,³¹¹ and access to justice for SMEs³¹² – are also gaining strong ground in the reform of the system.

In light of different proposals and State practices, ISDS is likely to continue its existence between different degrees of informal (private) and formal (public) justice. Despite the different visions of ISDS, consensus is achieved on at least one element of the rule of law: any future mechanism must produce enforceable decisions. Effective enforcement puts the supporters of the existing arbitration system in a strong position, while posing complex difficulties for a more systemic reform of ISDS.³¹³

As a final point, the following figure depicts the discussed political and legal challenges of the reforms in the international investment realm.

³⁰⁵ Galanter (n 117) 112. In such cases, States will prefer courts in order to obtain authoritative interpretations of public policy.

³⁰⁶ For the Australian experience, see, for example, Laurence Boulle and Rachael Field, *Australian Dispute Resolution: Law and Practice* (Lexis Nexis 2017) 81-116.

³⁰⁷ See chapter 9 on the EU's Investment Court System.

³⁰⁸ See the USMCA, which limits broad application of ISDS to direct expropriation and non-discrimination; and limits standard ISDS protections to State contracts in selected industries where investments by financially more powerful investors are more likely (oil, energy, telecommunications, transport and infrastructure).

³⁰⁹ See Part III.

³¹⁰ See UNCITRAL (n 288).

³¹¹ See UNCITRAL (n 301) 19-22.

³¹² In this sense, the Advisory Centre would play a particular role and its main beneficiaries would be SMEs: see UNCITRAL (n 288) 6.

³¹³ See UNCITRAL (n 275) 11-14.

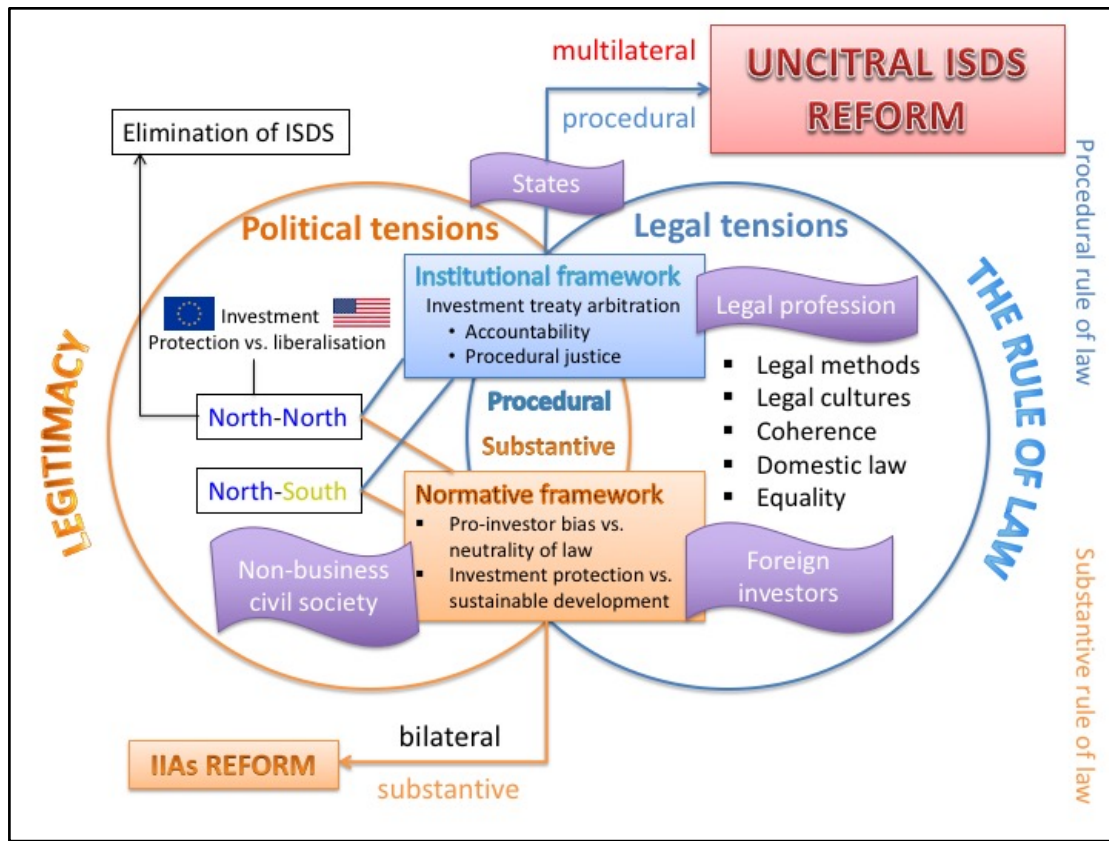


Figure 3.2. Challenges and reforms of international investment regulation

Part I Conclusion: towards international investment regulation reforms

In Part I of this study we undertook a historical overview of IIL and its institutions (chapter 1), examined the core substantive and procedural rules (chapter 2), mapped tensions and conceptualised the reform challenges (chapter 3). The complexity of this field of international law is magnified by its internal fragmentation – the large number of different legal instruments and their mixed private–public nature. The manner in which the field operates autonomously from other areas of international law supports the wider phenomenon of fragmentation in international law. Finally, the high financial stakes involved in investment have led to further politicisation of this already politicised field of international law.

The reform process in IIL is as fragmented as the field itself. The reform is ongoing and is taking place at different levels – bilateral, regional, multilateral, substantive, procedural – and in the framework of different institutions, most notably the ICSID. While a detailed account of the reform processes is beyond the scope of this study, several remarks that indicate reform trends can be made.

At bilateral and regional levels, States are making efforts to update their old BITs, introduce ‘modern’ model BITs and conclude a new generation of IIAs. While aiming to improve procedural elements of dispute settlement, the main focus of bilateral reform is on substantive provisions. On the one hand, changes include clearer and more detailed investment protection standards, while on the other explicit provisions to guarantee a State’s ‘right to regulate’ in the public interest. While these efforts will serve to limit the discretion of investment tribunals in the application of IIAs, they largely codify the existing jurisprudence in IIL. Importantly, the new generation of IIAs endorses the imperfect obligations of the old treaties. There are no obligations for investors under the new treaties beyond the already existing obligation to comply with the host States’ (domestic) laws – now stated explicitly, best effort clauses and voluntary CSR. In any case, there are no procedural remedies for those affected by the investors’ activities, with the exception of the very limited scope of still rare counterclaims. Some treaties have endeavoured to address normative asymmetry by limiting the jurisdiction of ITA through mechanisms such as the ‘clean hands’ doctrine.

At the multilateral level in UNCITRAL, the reform process is focused on investment dispute settlement. The reform does not question the desirability of a special adjudication mechanism for foreign investors over State adjudication. It proceeds on the premise that such adjudication has technocratic advantages – cheaper, faster, specialised – and thus focuses on its improvements. The reform questions are thus relocated to the technical

sphere of policy considerations (the scope of appeal, appointments of adjudicators, enforcement etc.). More broadly, the focus is on reforming the system in ways which will revive the classical advantages of a mechanism for the settlement of investment disputes; in other words, keeping it specialised but also making it cheaper, faster, more consistent and adjusted to new circumstances and public scrutiny. The reform is thus broader than adjudication and involves the creation of an advisory centre and advancement of different methods of dispute prevention and resolution (mediation, conciliation). A variety of actors take part in this reform as observers, while the reform process remains State-led.

Developments in IIL are more generally symptomatic of the fragmentation in international law, which leads to competition for 'institutional hegemony'. Given the cross-cutting nature of investment within the range of domestic policy areas (health, environment, public safety, human rights, taxation), the question is – which discipline should have the authoritative voice in deciding particular issues? As Martti Koskenniemi well notes: 'If there are no regime-independent ways of describing an issue, the door is open to the unilateral assumption of jurisdiction by experts who feel themselves powerful enough to have the last word'.³¹⁴

Accordingly, the institutional reform should provide clarity on jurisdictional issues – who and on what basis decides whether an issue should be decided by the investment dispute settlement body. Issues of substance and related balance between private and public interest considerably depend on these preliminary jurisdictional issues.

In order to ensure the accountability of investment dispute settlement bodies it is important to further develop cooperation mechanisms between States through which interpretative standards for treaty provisions can be agreed. While joint interpretative statements already exist in international law, they have been under-utilised in the area of investment. Given the fragmented nature of the field, their reach is also limited. More structured 'interpretative dialogue' can ensure the proper delegation of interpretative authority from States to tribunals;³¹⁵ however, it is important not to compromise the independence of the process and the institutions. While such a mechanism can recalibrate the power balance between the States and tribunals, it cannot avoid power play between the States in setting the dominant interpretative standards.

Finally, in light of systemic bias – institutional, disciplinary and ultimately normative – formal legality, procedural correctness and efficiency do not suffice in enhancing the rule of law or ensuring the normative legitimacy of ITA. While multilateral procedural reform aims at avoiding difficult issues of substance, which is a politically

³¹⁴ Koskenniemi (n 220) 338.

³¹⁵ See Roberts (n 161).

cunning approach, limiting the scope of reform to formal procedural issues diverts the reform process from its core rationale – addressing substantive *injustices* of the current system. A genuinely systemic reform is unlikely if the issues of the system’s objectives – what is international investment law for? – remain unsettled. This, however, opens an even more difficult but fundamental question about any legal system – justice for whom? So far, the reform has avoided dealing with these questions.

Against this background, while not attempting to answer these fundamental questions, and on the premise that political reality renders the elimination of ISDS unviable, in the remaining Parts of this study we will turn to analyse the EU solutions for investment regulation, in intra- and extra-EU contexts (Part II), and multilaterally (Part III). In this analysis, we will consider the umbrella concepts of legitimacy and the rule of law, as the guiding principles of legally functional and politically acceptable regulatory systems.

PART II

EU INVESTMENT REGULATION

Following the recent public debate, the Juncker Commission has fundamentally reformed the existing system for settling investment-related disputes. A new system – called the Investment Court System, with judges appointed by the two parties to the FTA and public oversight – is the EU's agreed approach that it is pursuing from now on in its trade agreements. ... Anything less ambitious, including coming back to the old Investor-to-State Dispute Settlement, is not acceptable. For the EU ISDS is dead.¹

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¹ European Commission, 'A new EU trade agreement with Japan', Factsheet (July 2018) 6
<http://trade.ec.europa.eu/doclib/docs/2017/july/tradoc_155684.pdf> accessed 30 June 2020

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The EU proposal for ISDS reform introduces a shift from an *ad hoc* investment arbitration to a permanent court-type adjudication in order to address the legitimacy and rule of law concerns about the current international investment regulation (IIR). This paradigmatic shift at the EU level has been triggered by political controversies within the EU, emerging primarily from public reaction against ISDS. At the same time, the proposal has been shaped by the EU’s own normative and institutional framework, based on the rule of law in which the court plays the central role.

In Part II we will explore why ISDS is ‘dead’ for the EU and what its envisaged replacement in EU external investment relations will be. We will place and examine the EU international investment policy (IIP) within the framework of the EU legal order, which has been its important defining factor, both internally and externally. In the internal dimension, the focus is placed on the objective of internal market integration. In this respect, the EU legal framework serves as a catalyst for EU integration in the field of investment, a field which was traditionally the privilege of Member States. In the external dimension, the focus is placed on the mode in which the EU incorporates its own institutional and normative ideas into international investment law (IIL). EU IIP

introduces the institution of a court to address ISDS controversies and promote legitimacy and the rule of law, one of the core EU values. Importantly, at times when unilateral protectionist tendencies are re-emerging internationally, the EU reform also serves to support the idea of multilateralism.

In Part II we will proceed as follows. First, in Chapter 4, EU investment regulation is contextualised within the framework of EU constitutional values and the broader political agenda of EU external trade relations. Chapter 5 focuses on the key features of the EU legal order, aiming to uncover the roots of systemic conflicts and incompatibilities between EU law and IIL. As such, it provides a legal framework for the analysis that follows in the remaining chapters of Part II. Chapter 6 provides an analysis of the institutional framework for investment treaty-making, in order to explain internal EU dynamics and limitations on investment policy efficiency imposed by EU law. In the remaining text of Part II we will proceed to analyse particularities of the internal and external dimensions of EU investment regulation. In both dimensions, law serves as a catalyst for political processes, while the Court of Justice of the EU (CJEU) plays the key role in the development of EU investment regulation through its case-law (Opinion 2/15, *Achmea* and Opinion 1/17).

Political context of EU investment regulation: deeper integration in the EU and with the ‘wider world’

- 4.1. The EU as a *sui generis* model of multi-level governance
 - 4.2. Values, objectives and principles of the EU as defining elements of its international identity
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 - 4.3.4. *From bilateralism to multilateralism and pragmatic plurilateralism in investment*
 - 4.4. Conclusion
-

In this introductory chapter to Part II we will examine the context of EU investment regulation. We will look at the objectives of EU trade and investment strategy, and its shift from multilateralism to bilateralism in trade, and from bilateralism to multilateralism in investment, effectively endorsing plurilateralism on both fronts. First, EU integration and its institutional framework are briefly introduced, to the extent necessary to understand the unique character of the EU’s regional integration. The second section discusses EU values, objectives and principles, and the extent to which they shape and define the EU’s international action. This is followed by examination of EU strategy for its integration with the wider world through EU trade and investment agreements (section 3) and consideration of circumstances which led to the EU’s international investment policy (IIP) reform (section 4). The aim of this chapter is primarily to provide the political background of EU investment regulation, followed by the analysis of its legal framework in chapter 5.

4.1. The EU as a *sui generis* model of multi-level governance

The EU is neither a federation nor a confederation but a supranational entity based on a series of international treaties, also called the EU founding treaties.¹ The *sui generis* character of the EU is prominently reflected in its institutional setting which is designed around the needs of the evolving process of European integration.² EU functions are performed through a complex multilevel institutional structure of both supranational and intergovernmental institutions of a political, legislative, administrative, regulatory and judicial nature.³ While traditional contours of tripartite separation of power are difficult to draw in this complex structure, the powers and competences of institutions in a particular policy area are defined by the founding treaties and clarified through the case-law of the Court of Justice of the EU (CJEU), the EU's highest judicial authority for issues of EU law. EU institutions have evolved over time and their balance of power in the institutional framework has changed.⁴ In this respect, for example, following the Lisbon Treaty, the European Parliament (EP) has institutionally received a significantly more prominent role, in particular with respect to the conclusion of international agreements.⁵ Importantly, however, inter-institutional balance is not the same across all fields of EU activity, with institutions having a more or less dominant role depending on the governance arrangement in a particular policy area.⁶ The role of the CJEU is nevertheless omnipresent and crucial for the overall functioning and development of the EU constitutional legal order.

Economic and political integration and the emergence of supranational governance over the years have taken place within the legal and institutional framework laid down

¹ Treaty Establishing the European Coal and Steel Community (signed 18 April 1951, entered into force 22 July 1952, by its terms expired 23 July 2002) 261 UNTS 140 (ESCS Treaty or Paris Treaty); Treaty Establishing the European Economic Community (signed 25 March 1957, entered into force 1 January 1958) 298 UNTS 3, 4 Eur YB 412 (EEC Treaty or Treaty of Rome); Treaty Establishing the European Atomic Energy Community (signed 25 March 1957, entered into force 1 January 1958) 298 UNTS 259, 5 Eur YB 454 (EAEC Treaty or EURATOM Treaty); Treaty on the European Union (signed 7 February 1992, entered into force 1 November 1993) [1992] OJ C191/1, 31 ILM 253 (Maastricht Treaty, TEU or Union Treaty).

² Alan Dashwood and others, *Wyatt and Dashwood's European Union Law* (Hart 2011) 66.

³ Art 13(1) TFEU lists the EU's institutions. For purposes of simplification, their nature in institutionally conventional terms can be summarised as follows: the European Parliament (supranational institution with legislative powers), the European Council (intergovernmental institution with political powers), the Council (intergovernmental institution with legislative and executive powers), the European Commission (supranational institution with executive powers), the Court of Justice of the EU (supranational institution with judicial powers), the European Central Bank (supranational institution with regulatory powers) and the Court of Auditors (supranational institution with executive review powers).

⁴ Allan Rosas and Lorna Armati, *EU Constitutional Law: An Introduction* (Hart 2010) 74. The European Council and the European Central Bank, although mentioned in earlier Treaties, have been given the status of institutions only in the Lisbon Treaty.

⁵ Art 218 (6) TFEU. See section 3.

⁶ In this regard, in certain sensitive policy areas where Member States have retained important powers intergovernmental institutions continue to play a more dominant role (e.g. in the areas of security and defence, taxation, immigration, criminal law, economic and employment policies).

by the founding treaties. However, this framework does not necessarily accommodate policy preferences of Member States. Rather, it operates in a way that facilitates the expansion of transnational activity and supranational governance, whereby the CJEU acts as an agent that develops the EU constitutional law as necessary to achieve the objectives of integration.⁷ While it is expected that the Lisbon Treaty structure will remain unchanged for the foreseeable future, the EU legal and institutional framework as set by the founding treaties is both sufficiently flexible and coherent to allow for a dynamic European integration which can, at times more or less successfully, overhaul the complexity and diversity of the Union.

4.2. Values, objectives and principles of the EU as defining elements of its international identity⁸

Values and objectives of the EU and its legal order, as defined in the founding treaties, play a prominent role in shaping the EU's internal and external actions. The Lisbon Treaty has strengthened the constitutional nature of the EU by endorsing values and streamlining the objectives pursued by the EU.

The EU legal order is shaped by six core *values* ranging from human rights to the rule of law, as outlined in Article 2 TEU.⁹ These values are a core internal component of the EU, common to all its Member States.¹⁰ Although their legal nature is imprecise, the values are not purely political aspirations. In effect, several provisions of the TEU confer on them a normative dimension ('shall respect', 'must be founded'). *Ratione personae*, EU values are binding upon both the EU institutions and its 27 Member States.¹¹ *Ratione materiae*, values cover any EU action. They apply not only internally but also externally in EU relations with 'the wider world'.¹² Values therefore must be implemented into secondary EU law and EU agreements concluded with international organisations and third States. Accordingly, the Common Commercial Policy (CCP) has to abide by the values

⁷ Alec Stone Sweet, *Governing with Judges: Constitutional Politics in Europe* (OUP 2010) 158-159.

⁸ This section draws on and incorporates ideas and language of the publication Ivana Damjanovic and Nicolas de Sadeleer, 'Values and objectives of the EU in light of Opinion 1/17: "trade for all", above all' (2020) 4(1) *Europe and the World: A Law Review* [25] <<https://www.scienceopen.com/hosted-document?doi=10.14324/111.444.ewlj.2020.24>> accessed 30 June 2020.

⁹ These values are: respect for human dignity, freedom, democracy, equality, the rule of law and respect for human rights, including the rights of persons belonging to minorities.

¹⁰ Case C-64/16 *Associação Sindical dos Juizes Portugueses* ECLI:EU:C:2018:117, para 30; Art 2 TEU, second sentence. In addition to the listed values, Art 2 TEU defines Member States' society as a society characterised by pluralism, non-discrimination, tolerance, justice, solidarity and equality between women and men.

¹¹ In particular, EU law is based on the 'fundamental premise that each Member State shares with all the other Member States, and recognises that those Member States share with it, those same values': see Case C-621/18 *Whitgman* ECLI:EU:C:2018:999, para 63, and Case C-619/18 *Commission v Poland* ECLI:EU:C:2019:531, para 42.

¹² Art 3(5) TEU.

enshrined in the TEU irrespective of its commercial nature. A legal act that infringes EU values will be nullified by the CJEU.¹³ Values are distinguished from objectives and principles, although the borderline between these different concepts is not clear even in Treaty law.¹⁴

EU acts may pursue an array of *objectives*, outlined in Article 3 TEU or in specific policy provisions. In the same manner as values, these objectives are pursued both in the internal domain of EU integration among the Member States, as well as in EU external relations.¹⁵ With respect to the latter, the Union is on the one hand obliged to ‘promote its values and interests and contribute to the protection of its citizens’ while, on the other, contribute to higher interests that surpass the narrower sphere of EU interests.¹⁶ Furthermore, Article 21(2) TEU outlines additional objectives of the EU in defining and pursuing common policies and actions.¹⁷ By virtue of Article 21(3) TEU, the same EU principles and objectives apply to the development and implementation of the EU’s external action and the external aspects of its other policies. These include objectives ranging from safeguarding EU values,¹⁸ support for democracy, human rights, the rule of law¹⁹ and promotion of peace²⁰ to progressive trade liberalisation,²¹ sustainable development²² and promotion of a multilateral international system.²³ While these objectives have a more political nature than the values and the general principles of EU law,²⁴ they enter the legal arena whenever courts review the proportionality of EU and national measures.

EU actions are further guided by a set of *principles* or have to be consistent with general principles of EU law. The term ‘principle’ is ambiguous as it encompasses customary law principles, general principles of international law,²⁵ general principles of EU law,²⁶ the principles embodied in the EU Charter of Fundamental Rights (CFR),

¹³ Joined cases C-402/05 P and C-415/05 P *Kadi* [2008] ECR I-6351.

¹⁴ For instance, under Art 21(1) TEU, the rule of law is framed both as a ‘value’ and as a ‘principle’. Judicial protection, on the other hand, is defined as a general principle stemming from the constitutional traditions common to the Member States and as a right for the purpose of Art 47 of the EU’s Charter of Fundamental Rights (CFR).

¹⁵ Art 3 TEU.

¹⁶ These higher goals include peace, security, the sustainable development of the Earth, solidarity and mutual respect among peoples, *free and fair trade*, eradication of poverty and the protection of human rights, as well as the strict observance and the development of international law: Art 3(5) TEU.

¹⁷ Art 21 (2) TEU.

¹⁸ Art 21(2)(a) TEU.

¹⁹ Art 21(2)(b) TEU.

²⁰ Art 21(2)(c) TEU.

²¹ Art 21(2)(e) TEU.

²² Art 21(2)(d) and (f) TEU.

²³ Art 21(2)(h) TEU.

²⁴ See the Common Agriculture Policy objectives listed in Art 43(1) TFEU.

²⁵ See the principle of reciprocity, mentioned by AG Bot in Opinion 1/17, Opinion of AG Bot ECLI:EU:C:2019:341

²⁶ Art 6 TEU.

sectoral policy principles,²⁷ as well as policy principles.²⁸ Some principles are expressly stated in fundamental legal texts (Member State constitutions and the founding treaties), while others can be implied in more substantive rules. They may be the product of a purely judicial construction (those set forth by the CJEU, constitutional courts, and administrative high courts), or enshrined in Treaty law and developed by the courts, like the general principle of judicial protection proclaimed in the European Convention on Human Rights (ECHR)²⁹ and the CFR. Lastly, principles can be stated in soft law documents, such as the Council of Europe Magna Carta for Judges,³⁰ which although non-binding influence the interpretation of binding rules. The term ‘principle’ thus encompasses both rules that form the foundations of the meta rules, such as the rule of law (for instance, the principles of equality, legal certainty, non-discrimination) and the rules of legal technique (for instance, the principle of proportionality).

In addition, principles are closely connected to *rights*. Under the CFR, the institutions and bodies of the Union and the Member States shall, when implementing Union law, ‘respect the rights, and observe the principles’ enshrined in it.³¹ Nevertheless, according to the controversial distinction introduced by Article 52(5) CFR, the term ‘right’ must be opposed to the term ‘principle’. On the one hand, rights are justiciable and can be invoked by litigants before EU courts as well as the domestic courts, provided that the subject-matter is covered by EU law. These subjective rights impose *duties* on State authorities. For example, with respect to Article 47 CFR, the EU and the Member States are obliged to provide litigants with effective remedies and ensure that their courts are fully independent. On the other hand, the CFR principles³² must be ‘observed’ and ‘promoted’,³³ and ‘may be implemented’ either by the EU institutions or by the Member States when they are implementing EU law.³⁴ Their application therefore often requires the adoption of implementation measures.³⁵ Accordingly, the principles are primarily binding on the legislature in the course of the implementation of EU law.

²⁷ For instance, the environmental principles listed in Art 191(2) TFEU.

²⁸ Arts 35, 37 and 38 CFR.

²⁹ European Convention on Human Rights (adopted 4 November 1950, entered into force 3 September 1953) 213 UNTS 221.

³⁰ Recommendation CM/Rec (2010)12 of the Committee of Ministers to member States on judges: independence, efficiency and responsibilities (adopted by the Committee of Ministers on 17 November 2010 at the 1098th meeting of the Ministers’ Deputies).

³¹ Art 51(1) CFR.

³² The principles are not designated as such. The CJEU considered in *Glatzel* that the integration of persons with disabilities was laid down in Article 26 of the Charter as a principle. See Case C-356/12 *Glatzel* ECLI:EU:C:2014:350, para 74.

³³ Art 51(1) CFR.

³⁴ Art 52(5) CFR.

³⁵ Case C-282/10 *Dominguez*, Opinion of AG Trstenjak ECLI:EU:C:2011:559, para 74. By way of illustration, a national energy tax which does not provide incentives for the efficient use of water can be reviewed against the ‘polluter pays’ environmental principle, grounded in Art 191(2) TFEU, and assessed in light of Art 9(1) of Directive [2000/60], which lays down the principle of the recovery of costs for water services, also requiring

The introduction of a constitutional CFR and the endorsement of values, objectives and principles in the Treaty law have clearly signalled a new phase towards an even closer integration in the EU. Moreover, new EU trade and investment strategy is based on EU values with a view to export these values to 'the wider world'.

4.3. EU trade and investment strategy for a globalised world

4.3.1. From multilateralism to bilateralism and pragmatic plurilateralism in trade

The Global Europe Strategy³⁶ of 2006 was a shift from the multilateral trade regime towards a new generation of bilateral and regional preferential trade agreements. These agreements expand beyond issues of tariff barriers and embrace a broad spectrum of regulatory areas, such as services, investment, intellectual property rights (IPR), public procurement, sustainable development, and other areas impacting domestic regulatory standards ('deep' trade issues). The EU followed this shift in international trade, which was first strongly embraced by the US in its bilateral trade relations with third States in the 1990s. The US changed its strategy from multilateralism towards bilateralism due to growing concerns about the EU's expansion, when it made its first free trade agreement concluded with Israel in 1985 and then Canada in 1988, which later included Mexico in NAFTA in 1994.³⁷ Similar trends towards regionalism emerged in the Asia-Pacific with the initiation of APEC (Asia-Pacific Economic Cooperation) in the early 1990s.

With a vision of bilateral FTAs intended to complement the multilateral trading system, EU FTAs were envisaged as 'fully compatible with the WTO' and aimed at 'deep integration', especially in those areas where such integration has been difficult at a multilateral level.³⁸ Similarly, the US in its bilateral trade agenda included 'deep integration' issues which it later sought to achieve in multilateral WTO negotiations, and returning to bilateralism once multilateral efforts failed.³⁹ The main objective of US policy has been 'competitive liberalisation', aimed at opening markets, adoption of US market-

the economic usage of water: Joined Cases C-105/18 to C-113/18 *Asociación Española de la Industria Eléctrica ECLI:EU:C:2019:935*.

³⁶ Communication of 4 October 2006 from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions, 'Global Europe: competing in the world – Contribution to the EU's Growth and Jobs Strategy' COM (2006) 567 final.

³⁷ World Trade Organization, 'World Trade Report 2011, The WTO and Preferential Trade Agreements: From Co-existence to Coherence (2011) 52.

³⁸ Commission staff working document – Annex to the Communication from the Commission to the Council, the European Parliament, the European Economic and Social Committee and the Committee of the Regions – Global Europe: competing in the world – Contribution to the EU's Growth and Jobs Strategy (2006) SEC/2006/1230.

³⁹ WTO (n 37) 52.

friendly business regulation and securing the US position as the rules-setter in the world trading system.⁴⁰ Such objectives were to be pursued on all fronts (bilaterally, regionally, multilaterally) in order to promote American values in international trade, strongly focusing on eliminating barriers and opening third countries' markets with respect to 'deep' trade issues.⁴¹

The EU's multilateral agenda was inspired by the EU's experience of the internal market, aimed at exporting EU regulatory principles worldwide in order to secure benefits for EU firms.⁴² In that sense, it could be said that it has the same rationale – liberalism and competitiveness – as the US policy, although the aims are to be achieved in a somewhat different manner. The EU foreign trade policy has been linked to the objective of 'managed globalisation', coined by Pascal Lamy in 1999, with the objective to codify the rules of globalisation and provide institutional structures for their compliance through organisations like the EU, WTO, IMF and OECD.⁴³ However, the origins of the doctrine can be traced to French socialist policy-makers who favour statism and who believed that global capital needs rules to gain political legitimacy in the continental European societies, a view which was informed by scepticism about globalisation in France.⁴⁴

While aimed at trade liberalisation, 'managed globalisation' was supposed to promote non-trade objectives, such as social values, sustainable development and multilateralism, meant to appeal to a variety of social actors internally and to developing countries externally.⁴⁵ It was a tool to make liberalisation happen, combining different political ideologies: UK neoliberalism, German ordo-liberalism, French statist socialist economy, the European social model more generally together with the realities of globalisation.⁴⁶ When this strategy did not gain fruitful ground at the multilateral level,⁴⁷ it became the core of the EU's bilateral trade policy under different names ('Trade, Growth and World Affairs',⁴⁸ 'Trade for All',⁴⁹ 'Harnessing Globalisation'⁵⁰), from 2006 onwards.

⁴⁰ Simon J Evenett and Michael Meier, 'An Interim Assessment of the US Trade Policy of "Competitive Liberalization"' (2008) 31 *World Economy* 31, 35.

⁴¹ *ibid* 37.

⁴² Billy Alexis Melo Araujo, *The EU Deep Trade Agenda* (OUP 2016) 30.

⁴³ Ravi Abdelal and Sophie Meunier, 'Managed globalisation: doctrine, practice and promise' (2010) 17 *Journal of European Public Policy* 350, 353.

⁴⁴ *ibid* 354.

⁴⁵ Araujo (n 42) 31-32.

⁴⁶ Abdelal and Meunier (n 40) 355.

⁴⁷ Moreover, the EU quest for multilateralism in trade was so strong that the EU effectively abandoned bilateralism from 1999 until 2006.

⁴⁸ European Commission, 'Trade, Growth and World Affairs: Trade Policy as a Core Component of the EU's 2020 Strategy' COM (2010) 612.

⁴⁹ European Commission, 'Trade for All: Towards a More Responsible Trade and Investment Policy' COM (2015) 497.

⁵⁰ European Commission, 'Reflection Paper on Harnessing Globalisation' COM (2017) 240; European Commission, 'A Balanced and Progressive Trade Policy to Harness Globalisation' COM (2017) 492.

Therefore, unlike American-style neoliberalism, focused on eliminating barriers and reducing State intervention into the markets through regulation, European-style neoliberalism has been focused on promoting rules and regulations for free market operations. These rules for globalisation, however, are now meant to be made by entities such as the EU, WTO and other international economic entities instead of States, preferably promoting EU standards and values abroad. In a way, it is the EU's version of 'America first', whereby the EU bilateral trade agenda should serve as a basis for multilateral consensus. Nevertheless, there is a level of contradiction in the EU's approach given that preferential bilateralism and divergent regulatory structures have clear potential to undermine multilateral efforts.⁵¹

The constitutional changes made by the Lisbon Treaty have further enhanced EU trade policy aspirations,⁵² contributing to different levels of domestic politicisation of EU trade.⁵³ Since the focus of the trade agenda has been placed on 'deep integration', trade now has a great potential to affect a number of non-trade policy areas, such as labour standards, environment protection, food and product safety. On the one hand, States can be inclined to lower their standards in order to attract trade and investment in a race to the bottom, while on the other, their attempts to increase standards can be undermined by trade and investment claims, leaving them reluctant to regulate – an effect known as 'regulatory chill'.⁵⁴ As a consequence, a broad range of actors, from civil society to national parliaments, has been actively engaged in EU trade policy. Given the EU's constitutional values⁵⁵ and general public perception of higher EU standards,⁵⁶ the focus of the political debate has been on the perceived negative effects of trade agreements, in particular lowering regulatory standards beneficial for consumers and the environment while empowering corporations.⁵⁷ Moreover, some studies showed that citizens generally mistrust EU institutions when negotiating trade agreements on behalf of Member States.⁵⁸

⁵¹ Directorate-General for External Policies of the European Parliament, 'Comparing International Trade Policies: The EU, United States, EFTA and Japanese PTA Strategies, European Parliament' (February 2014), EXPO/B/INTA/FWC/2009-01/Lot7/36.

⁵² See section 4.2 above.

⁵³ Patrick Leblond and Crina Viju-Miljusevic, 'EU Trade Policy in the Twenty-First Century: Change, Continuity and Challenges' (2019) 26 *Journal of European Public Policy* 1836.

⁵⁴ States can be subject to claims made in the framework of the WTO or to ISDS claims under international investment agreements.

⁵⁵ See section 4.2 above.

⁵⁶ See Pew Research Center and Bertelsmann Foundation, 'Support in Principle for US-EU Trade Deal, But Some Americans and Germans Wary of TTIP Details' (*Pew Research Center*, 9 April 2014) <<https://www.pewresearch.org/global/2014/04/09/support-in-principle-for-u-s-eu-trade-pact/>> accessed 30 June 2020.

⁵⁷ See Alasdair R Young, 'European trade policy in interesting times' (2017) 39 *Journal of European Integration* 909, 915.

⁵⁸ Pew Research Center and Bertelsmann Foundation (n 56) 16.

Public concern, expressed through NGO activism, reached its peak during negotiations for the Transatlantic Trade and Investment Partnership (TTIP) with the US and Comprehensive Economic and Trade Agreement (CETA) with Canada in 2014–15.⁵⁹ In response, the Commission has been endorsing transparency in trade negotiations, safeguarding the EU regulatory model ‘at home’ while promoting EU values (sustainable development, human rights, fair and ethical trade and the fight against corruption) in trade and investment agreements, and creating more opportunities for SMEs.⁶⁰ These key principles of the EU trade and investment agenda were meant to address the tensions between legitimacy and the effectiveness of the EU trade and investment policy,⁶¹ making benefits of trade available to ‘all’: consumers, workers, small companies, and the environment.

The Commission has also become aware that trade has had divergent negative effects domestically: job losses, factory closures, lowering wages and labour standards, stagnation of middle-class income, widening inequalities and social polarisation, threats to cultural identity and traditions; attributing these to ‘unfair trade practices’, ‘tax evasion’, and, more generally, unfair competition.⁶² The Commission’s solution for these challenges is opposed to protectionism (alluding to the US response⁶³), which can only lead to ‘short-term relief’ but ‘disastrous outcomes’. The solution is in ‘more global governance and global rules’, through multilateral institutions that will promote collective action and ensure the enforcement of rules.⁶⁴ In other words, the EU solution to the real challenges of globalisation is to bargain for the acceptance of more rules that can create a level playing field and ensure coherence between internal and external EU rule-making.

Realists among us will note that the rhetoric has changed little in more than a decade while problems have multiplied. Nevertheless, as multilateral cooperation remains the EU’s preferred option, given the realities of a multipolar global world the EU now plans to move forward through cooperation with ‘smaller coalitions’, while ‘leaving the door open for others to join when ready’.⁶⁵ Internationally, this envisages a number of mechanisms in multilateral fora aimed at promoting global rules in the international economic and financial area, climate change, labour standards, investment protection,

⁵⁹ See also section 4.4 below.

⁶⁰ European Commission 2015 (n 49).

⁶¹ On the relationship between trade policy objectives of legitimacy, policy-making efficiency and effectiveness, see Young (n 57).

⁶² European Commission, ‘Reflection Paper on Harnessing Globalisation’ (n 50) 9.

⁶³ ‘Even countries that have traditionally championed an open global economy are now looking into ways to put a brake on imports, limit immigration and favour domestic production’: *ibid* 12.

⁶⁴ *ibid* 12.

⁶⁵ *ibid* 13.

subsidies, public procurement, and taxation.⁶⁶ An alliance of partners that support the EU's vision of 'progressive rules for global trade' is to be built through the network of bilateral trade and investment agreements.⁶⁷ In order to effectively achieve this, more should be done in coordinating Member State policies, allowing the EU to speak with one voice, while domestic legitimacy should be achieved through early and appropriate involvement of civil society and national parliaments.⁶⁸

The EU trade and investment strategy for a globalised multipolar world has therefore effectively become plurilateral, involving those who are willing to accept EU rules, because of the realities of trade or because they see value in protecting the international rules-based order and its institutions. The EU rhetoric of 'like-minded' partners⁶⁹ has followed the idea of cooperation through smaller coalitions,⁷⁰ whereby like-mindedness has a potential to be formed depending on the issue at hand.⁷¹ Although not all EU trading partners may be described as 'like-minded', bilateral allegiances with these different partners are used to gain leverage for the EU in reforming the multilateral trading and investment system.

4.3.2. Post-Lisbon generation of EU trade and investment agreements

The above explained adjustments in the EU trade and investment agendas have been translated into the EU practice of concluding bilateral trade and investment agreements. Prior to the Global Europe Strategy, the so-called first-generation EU agreements primarily focused on the elimination of tariffs.⁷² From 2006 onwards, EU agreements extended to 'deep' trade issues. Depending on their legal basis,⁷³ new generation agreements embrace flexibility, taking into account the level of development of a trading

⁶⁶ *ibid* 14-15.

⁶⁷ European Commission, 'A Balanced and Progressive Trade Policy to Harness Globalisation' (n 50) 2.

⁶⁸ *ibid* 7-8.

⁶⁹ Most countries with whom the EU has concluded or is negotiating trade and investment agreements have been called like-minded: South Korea, Canada, Singapore, Japan, Mexico, Australia, New Zealand.

⁷⁰ The most recent example of such cooperation is the 'Multi-Party Interim Appeal arbitration arrangement' (MPIA) in the framework of the WTO, which is to be used until the WTO's Appellate Body becomes functional again. MPIA will operate between the EU and 19 other WTO members. See WTO, 'Statement on a Mechanism for Developing, Documenting and Sharing Practices and Procedures in the Conduct of WTO Disputes' (30 April 2020) JOB/DSB/1/Add.1

<https://trade.ec.europa.eu/doclib/docs/2020/april/tradoc_158731.pdf> accessed 30 June 2020.

⁷¹ However, the label has been used very loosely. Like-mindedness has been differently used in the context of trade and investment. Beyond trade and investment, like-mindedness also includes practical cooperation on security issues, and more broadly, an ideological stance on democracy, respect for human rights and the rule of law. In line with that, Vietnam has not been labelled like-minded although the EU has concluded a trade and investment agreement with Vietnam.

⁷² For example, Euro Mediterranean Association agreements, Stabilisation and Association Agreements with Western Balkan countries, old Association agreements with Mexico and Chile.

⁷³ See chapter 6.

partner and the desired relationship with the EU. The agreements range from more typical FTAs (South Korea, Canada, Japan, Singapore, Vietnam, Columbia, Peru and Ecuador, forthcoming agreements with Australia and New Zealand) to Association Agreements with modernised trade provisions (Central America, forthcoming agreements with Chile, Mexico, Mercosur), mostly without but some still with investment protection provisions in the same (Canada, Chile, Mexico) or a separate investment agreement (Singapore and Vietnam).

In addition, the EU has been concluding Deep and Comprehensive Free Trade Area agreements with countries in the EU neighbourhood, which aim at harmonising trading rules and the EU acquis (Ukraine, Georgia, Moldova, forthcoming agreements with Morocco and Tunisia), as well as Economic Partnership Agreements with African, Caribbean and Pacific countries, which focus on these countries' economic development.⁷⁴ Despite the large number of agreements – altogether about 100,⁷⁵ trade with preferential partners covers only about 40% of global EU trade.⁷⁶ Most EU agreements are first-generation agreements and the EU does not yet have agreements with the biggest world economies (US, China, India). Accordingly, it is actively engaged in treaty-making and treaty-updating in order to catch up with its major competitors.

Most EU agreements build upon the existing international standards, both in trade and investment, including WTO-plus rules and improving the existing investment protections.⁷⁷ Despite flexibility, there is a trend towards greater uniformity.⁷⁸ For example, new FTAs regularly include chapters on trade and sustainable development; trade and environment; labour and trade. Most recently reference is also made to climate change (TSD chapters), emphasizing the need to meet requirements of sustainable development in the liberalisation of trade. This new approach has also been embraced by the CJEU, which took the view that the objective of sustainable development 'forms an integral part' of the CCP.⁷⁹ Accordingly, the breach of the provisions related to social protection of workers and environmental protection in the TSD chapter could amount to a sufficiently serious breach which could give rise to the termination or suspension of

⁷⁴ For a more comprehensive overview of these agreements and in particular their investment provisions, see tables in chapter 6 and Appendix.

⁷⁵ For better illustration of EU trade globally, see European Parliament, 'The EU's position in world trade in figures (infographic)' (*European Parliament News*, 5 November 2019) <<https://www.europarl.europa.eu/news/en/headlines/economy/20180703ST007132/the-eu-s-position-in-world-trade-in-figures-infographic>> accessed 30 June 2020.

⁷⁶ European Commission, '2019 Annual Report on the implementation of EU trade agreements', Factsheet (14 October 2019) <<https://www.consilium.europa.eu/media/41263/2019-annual-report-on-the-implementation-of-eu-ftas.pdf>> accessed 30 June 2020.

⁷⁷ See chapter 8 for investment protections.

⁷⁸ Directorate-General for External Policies of the European Parliament (n 51).

⁷⁹ Opinion 2/15 ECLI:EU:C:2017:376, para 147.

trade treaty provisions.⁸⁰ Strong focus has been placed on ‘the right to regulate’ in the public interest, in respect to trade⁸¹ as well as investment.⁸² Therefore, regulatory cooperation in trade deals cannot call into question the EU regulatory procedures.

Whether trade and investment agreements serve as a tool for promoting high EU regulatory standards abroad⁸³ remains debatable. As admitted by the European Commission, TSD chapters do not aim to create new substantive obligations concerning labour and environmental protection, but merely reaffirm certain existing international commitments. Their primary purpose is to ensure that conditions for trade and investment are not adversely affected as a result of different levels of protection.⁸⁴ The focus is on implementing the existing labour⁸⁵ and environmental⁸⁶ multilateral obligations.⁸⁷

Finally, negotiation and conclusion of EU agreements is only one part of the trade agenda as real effects of treaties on regulatory cooperation can only be assessed in the implementation stage. While each FTA has its own dispute settlement mechanism for breaches of the agreement, TSD chapters have so far been excluded from such mechanisms and financial sanctions for non-compliance.⁸⁸ The first and only dispute settlement procedure for breach of a TSD chapter involved insufficient Korean action in implementing labour rights stemming from ILO Conventions into domestic legislation.

⁸⁰ *ibid* para 161.

⁸¹ See, for example, Arts 23.2 and 24.3 CETA.

⁸² See chapter 9.

⁸³ For this claim, see, for example, European Commission, ‘A Balanced and Progressive Trade Policy to Harness Globalisation’ (n 50) 4.

⁸⁴ Opinion 2/15, Opinion of AG Sharpston ECLI:EU:C:2016:992, para 471.

⁸⁵ The EU approach is to commit parties to implement into their domestic legislation labour rights stemming from the eight core International Labour Organization (ILO) Conventions. From a European perspective, these conventions offer a minimal level of protection. See for example, Art 13.04 Free Trade Agreement between the European Union and its Member States, of the one part, and the Republic of Korea [2011] OJ L127/6 (EU–Korea FTA).

⁸⁶ The obligation of the parties is usually to implement very basic environmental multilateral agreements that have in most cases already been ratified by the parties. However, the majority of these agreements dates back to the 1990s and as a result do not provide for the relevant mechanism to prevent the emergence of new environmental risks.

⁸⁷ Regarding climate change, rather vague reference is made to the Paris Agreement: see, for example, Articles 16.5 and 16.12 Agreement between the European Union and Japan for an Economic Partnership [2018] OJ L330/3 (EU–Japan EPA). A similarly unambitious agenda is noticed with respect to sensitive goods, such as fish stocks and timber. For example, in these areas CETA contains only loose and vague obligations of the parties to cooperate: see Art 24.11 CETA.

⁸⁸ In the case of a suspected breach of TSD obligations, a concerned party can initiate State-to-State consultations. If this fails, a panel of three independent experts can be convened in order to determine the breach and recommend solutions. For monitoring and cooperation purposes, TSD chapters also envisage establishment of specialised TSD committees and civil society dialogue through domestic advisory groups (DAGs) and Civil Society Forums but the role of these bodies as well as their concrete contribution towards implementation of sustainable development objectives is rather vague. See European Commission, ‘Implementation of the Trade and sustainable development (TSD) chapter in trade agreements – TSD committees and civil society meetings’ (*European Commission*, 15 June 2020)

<<http://trade.ec.europa.eu/doclib/press/index.cfm?id=1870>> accessed 30 June 2020.

This resulted in a consultation process which is still ongoing.⁸⁹ It could be too early to draw conclusions on the effectiveness of the FTA with the EU towards implementing sustainable development goals in Korea.⁹⁰ Some studies demonstrate that FTAs with ‘strongly institutionalised labour-related cooperation provisions are a “win-win” outcome in North–South relations’, suggesting that sustainable development provisions ‘at best contribute to achieve some (modest) positive outcomes and at worst do not harm socio-economic developments.’⁹¹ On the other hand, in its North relations, it remains to be seen how the EU will address incompatible demands of its partners and whether regulatory cooperation in the framework of FTAs provides an avenue for lowering regulatory standards.⁹² In any case, legitimacy issues of such regulatory cooperation taking place through joint committees consisting of technocrats could contribute to further politicisation of EU trade.⁹³

In light of sustainable development commitments in EU FTAs, the export of EU standards remains rather rhetorical.⁹⁴ Regulatory cooperation through FTAs with Western States such as Canada concerns cooperation in the framework of the existing international standards.⁹⁵ Regulatory cooperation with Asian States is focused on achieving compliance of these States with the basic international labour and environmental standards. In this sense, so far the EU has only been achieving one of its

⁸⁹ Following a failed consultation process, a panel of experts has been conveyed to deliver a public report with recommendations on achieving compliance. It remains uncertain what other measures can be taken if recommendations are not implemented. Nevertheless, the case will provide at least some indications regarding the functioning of this dispute settlement mechanism in practice.

⁹⁰ In assessing the contribution of the EU–Korea FTA to the overarching FTA objectives of ‘harmonious development and expansion of world trade, promotion of economic growth and stability, poverty reduction, raising standards of living, improvement of the general welfare and contribution to sustainable development’, the Commission considered that it is ‘too early to draw definitive conclusions because those objectives require a longer period of time to produce tangible results’: European Commission, ‘Executive Summary of the Evaluation of the Implementation of the Free Trade Agreement between the European Union and its Member States, of the one part, and the Republic of Korea, of the other part’, SWD (2019) 103 final. See Marco Bronckers and Giovanni Gruni, ‘Taking the enforcement of labour standards in the EU’s free trade agreements seriously’ (2019) 56 Common Market Law Review 1591.

⁹¹ Damian Raess, ‘Labour (and Environmental) Provisions in FTAs: What Do They Do?’ in Directorate-General for External Policies of the European Parliament, ‘The future of sustainable development chapters in EU free trade agreements’ (July 2018) EP/EXPO/B/INTA/2018/04 and EP/EXPO/B/INTA/2018/05, 13.

⁹² For example, in the framework of CETA, the concerns relate to the impact of CETA on EU food standards. In this regard, Canada has competing demands between the US approach to food standards, which strongly embraces strictly scientifically proven threats to health, and the EU approach, which embraces precautionary principle, and allows for considerations other than just science to be taken into account when faced with scientific uncertainty. See Jonathan B Wiener, ‘The Rhetoric of Precaution’, in Jonathan B Wiener and others (eds), *The Reality of Precaution* (RFF Press 2011) 12–23.

⁹³ See, for example, Foodwatch and The Council of Canadians, ‘The potential dangers of CETA Committees on Europe’ (2020) <https://www.foodwatch.org/fileadmin/-NL/Potential_dangers_of_ceta_committees_on_Europe.pdf> accessed 30 June 2020.

⁹⁴ For similar arguments and conclusions, see Damjanovic and de Sadeleer (n 8).

⁹⁵ On the TSD chapter in CETA and its value in the interpretation of investment protection provisions in CETA, see Stephanie Schacherer, ‘The CETA Investment Chapter and Sustainable Development: Interpretative Issues’ in Makane Moïse Mbengue and Stefanie Schacherer (eds), *Foreign Investment Under the Comprehensive Economic and Trade Agreement (CETA)* (Springer 2019) 207–236.

objectives in external relations – the compliance with international law. Given the realities of international trade, such a conclusion should not be met with surprise.⁹⁶

4.3.3. EU international investment policy

While politicisation of EU trade policy has been a general trend, the new EU IIP has attracted more significant public criticism, especially during the negotiations for the TTIP and CETA. Additionally, framing of the new IIP led to a number of inter-institutional disagreements within the EU, with an important role played by the European Parliament (EP).

The Commission introduced the concept of a comprehensive European IIP in its 2010 Communication, with a view to integrating investment liberalisation and investment protection.⁹⁷ Prior to the Lisbon Treaty changes, investment liberalisation (market access) belonged to EU/shared⁹⁸ competence and investment protection and dispute settlement to the Member States' competence. The new integrated policy was envisaged to ensure: (1) external competitiveness, by guaranteeing effective protection for EU investors abroad; (2) uniform treatment of all EU investors, by eliminating inequalities stemming from the large number of Member States' BITs; and (3) maximum leverage in negotiations, by centralising comprehensive investment competence – comprising liberalisation, protection, FDI and portfolio investment – at the EU level.⁹⁹

While placing the EU in the front seat, internally the policy envisaged coordination between EU institutions and Member States.¹⁰⁰ Externally, it was intended to be flexible and country-specific, similar to trade policy, with different investment treaty options (as part of comprehensive FTAs, stand-alone IIAs, bilateral, plurilateral and sectoral¹⁰¹), effectively thus excluding an EU model BIT. New EU agreements would gradually replace the existing network of Member States' BITs with third States. The main rationale,

⁹⁶ In a recent European Commission services' non-paper it was noted that EU negotiating partners 'have been clear' that they would not accept a broad scope of sustainable development commitments combined with trade sanctions. Instead, 'assertive enforcement' focusing on the existing review mechanisms remains a preferable way forward: 'Feedback and way forward on improving the implementation and enforcement of Trade and Sustainable Development chapters in EU Free Trade Agreements', Non paper of the Commission Services (26 February 2018) 3, 7-8

<https://trade.ec.europa.eu/doclib/docs/2018/february/tradoc_156618.pdf> accessed 30 June 2020.

⁹⁷ European Commission, 'Towards a comprehensive European international investment policy' COM (2010) 343, 5.

⁹⁸ For division of competence in relation to trade in services, see: Opinion 1/08 [2009] ECR I-11129. For the comprehensive analysis of Opinion 1/08, see Marise Cremona, 'Balancing Union and Member State Interests: Opinion 1/2008, Choice of Legal Base and the Common Commercial Policy Under the Treaty of Lisbon' (2010) 35 European Law Review 678. See also chapter 6, section 6.1.1.

⁹⁹ European Commission (n 97) 4-5, 11.

¹⁰⁰ *ibid* 11.

¹⁰¹ One such example of sectoral agreement, which is also plurilateral, is the Energy Charter Treaty (ECT).

however, was to empower the EU's position in broader negotiations with trade partners, as investment would be part of such negotiations. The Communication also envisaged the need to regulate division of financial responsibility for investor claims against EU and Member States' measures.¹⁰²

From today's perspective some policy aspects turned out to be unachievable;¹⁰³ however, the nascent policy already envisaged some of the principles that have become the guiding principles of EU investment regulation: the alignment with EU values and the objectives of EU external action; the right to regulate in pursuit of public policy objectives;¹⁰⁴ transparency; consistency and predictability; quasi-permanent adjudicators; and the possible appellate mechanism.¹⁰⁵ The general thrust of the policy was in favour of balancing the rights and responsibilities of investors, while retaining and improving the existing standards of investment protection and retaining arbitration as the dispute settlement mechanism. Investment treaty arbitration (ITA) was considered 'an established feature' of IIAs, the absence of which would 'in fact discourage investors'.¹⁰⁶ The policy was therefore built upon the traditional ISDS narrative.

In line with the EU focus on multilateralism, the Commission also envisaged the possibility of a multilateral initiative in the long run.¹⁰⁷ At that point, the Commission was already aware that the existing structures, in particular the ICSID Convention,¹⁰⁸ were, and remain, inadequate to accommodate the EU as a newcomer to the field and that this could pose a significant challenge. While indicating that the EU would first explore the possibility to join ICSID, which would have required the amendment of the Convention, a parallel intention of the EU could already then be read between the lines, should that fail, to embark on a different 'state-of-the art' dispute settlement mechanism.¹⁰⁹ The policy also indicated that, where appropriate, EU law would be shaping investment protection

¹⁰² European Commission (n 97) 10. In this sense, the Commission erred in taking the view that comprehensive investment issues fall within the exclusive external competence, rendering the EU the sole defendant in the cases which challenge Member States' measures.

¹⁰³ In particular, the scope of EU competence for investment (see chapter 6) and the list of preferable partner countries. Apart from Canada and Singapore (with which the EU has concluded treaties with comprehensive investment provisions but the process of ratification has not yet been concluded in the Member States), the list included India, Mercosur, China and Russia: European Commission (n 97) 6-7. The prospects of concluding an investment treaty with any of these countries anytime soon are uncertain.

¹⁰⁴ In particular, the protection of the environment, decent work, health and safety at work, consumer protection, cultural diversity, development policy and competition policy have been listed as such policy areas: *ibid* 9.

¹⁰⁵ *ibid* 9-10.

¹⁰⁶ *ibid* 10.

¹⁰⁷ *ibid* 7.

¹⁰⁸ Signature and ratification of the ICSID Convention is open to Member States of the World Bank or a party to the Statute of the International Court of Justice, neither of which qualifies the EU to join the Convention.

¹⁰⁹ See European Commission (n 97) 10.

provisions in EU IIAs, taking into account established EU law concepts on freedom of establishment, free movement of capital, expropriation and adequate compensation.¹¹⁰

The response to the Commission's investment Communication was mixed. The Council in most part agreed with the Commission, 'fully supporting the development of a common Policy Framework on investment',¹¹¹ emphasising also that the future legal framework should empower Member States to negotiate and conclude BITs with third parties when there is no interest in concluding an EU IIA with those States in the near future.¹¹² It stressed that EU IIP should include fundamental standards of investment protection, including the right to 'prompt, adequate and effective compensation', and effective dispute settlement.¹¹³ While recognising the importance of the social and environmental dimension, it also pointed to 'effective and ambitious investment protection and market access' as a 'crucial' focus of IIAs.¹¹⁴ It believed that keeping with the practices of existing Member States' investment policies goes hand-in-hand with the principles and objectives of the EU external action and pursuit of public policy objectives.¹¹⁵ In other words, the Council strongly endorsed its vision of subsidiarity.

Unlike the Council which took a traditional ISDS stance, the EP had more reservations on the Commission's proposal. It emphasised some of the common concerns about ISDS, many of them shared by civil society groups:

- vague substantive provisions;¹¹⁶
- the need for better balance between private and public interests reflecting the EU's obligation to exercise policy coherence for development;¹¹⁷
- the contribution to be made by investment to the development goals of host States;¹¹⁸
- the obligation to exhaust local remedies and the role of *amicus curiae* briefs;¹¹⁹
- the exclusion of 'speculative' forms of investment;¹²⁰

¹¹⁰ *ibid* 8-9.

¹¹¹ Council of the European Union, 'Conclusions on a comprehensive European international investment policy', 3041st Foreign Affairs Council Meeting (25 October 2010) para 5.

¹¹² *ibid* para 10. Based on this, new provisional arrangements in the form of regulation were developed in 2012. See chapter 8, section 8.1.2.

¹¹³ *ibid* paras 14, 18. With respect to dispute settlement, the Council invited the Commission to explore the legal and political feasibility of EU membership in international arbitration institutions: *ibid*, para 18.

¹¹⁴ *ibid* para 16.

¹¹⁵ *ibid* para 17.

¹¹⁶ European Parliament Resolution 2010/2203 (INI) of 4 April 2011 on the future of European international investment policy [2012] OJ C 296E/34, para G.

¹¹⁷ *ibid* para 6.

¹¹⁸ *ibid* para 7.

¹¹⁹ *ibid* para 31.

¹²⁰ *ibid* para 11. While alluding to portfolio investment as speculative, the EP does not provide further guidance on how to distinguish non-speculative from speculative investment.

- the need for treatment of foreign investors in line with international customary law and thus ‘adequate’ compensation;¹²¹
- the inclusion of corporate social responsibility (CSR) and effective social and environmental clauses.¹²²

The EP called on the Commission ‘to produce clear definitions of investor protection standards’ in order to limit the discretions of investment arbitrators.¹²³ It also emphasised transparency and the need for an appeal mechanism, along the lines of the EC’s proposal, as well as the need to limit ISDS to a single place.¹²⁴ This latter suggestion has indicated a possible policy direction away from conventional private arrangements towards a new public institutional setting.

That the EP’s views had been informed by the broader context could be concluded from its prophetic remark that the Council’s traditional vision of ISDS could ‘create a risk of having any new agreement opposed’ and, even more, may contradict the Common Commercial Policy (CCP) objectives.¹²⁵ Reference was also made to lessons learned from the failed OECD Multilateral Agreement on Investment (MAI) negotiations.¹²⁶ Finally, the EP called on the EC and the Member States, as ‘major international players’, to work towards necessary reforms of the ICSID and UNCITRAL rules which would allow membership of the EU in these organisations.¹²⁷ Accordingly, any new mechanisms were to be embedded in the existing IIR.

The positions of the three institutions – the Commission, the Council and the EP – therefore emphasised their dissonant positions on investment standards. The Council favoured traditional standards that would be incorporated in new EU FTAs to leverage the negotiating power of the EU and Member States in trade and investment relations with third States. The EP, taking into account public concerns, favoured a more significant move from ‘old’ ISDS standards that would ensure a better balance between private and public interests and no greater rights for foreign investors. The Commission was somewhere in between, referring to ‘the best available standards’, subject to the ‘common understanding among experts in the field (lawyers, academics, arbitrators, judges)’.¹²⁸

¹²¹ *ibid* para 19.

¹²² *ibid* paras 27-28.

¹²³ *ibid* para 24.

¹²⁴ *ibid* para 31.

¹²⁵ *ibid* para 17.

¹²⁶ *ibid* para 8. See chapter 10, section 10.1.

¹²⁷ *ibid* para 33.

¹²⁸ European Commission, ‘Follow up to the European Parliament resolution on the future European international investment policy’ (5 July 2011). The Commission, however, provided some indications of its approach: adopting more specific language to avoid abusive practices, such as the protection of mailbox companies and speculative investors for example, and instead requiring contribution and commitment of substantive resources for a longer period of time, an express obligation for investors to comply with national rules, and a requirement for substantive activities within the host State. Without going into further details,

The Council's reaction focused on retaining its power, by claiming the 'mixed competence' for the negotiation of new EU FTAs with an investment component,¹²⁹ an issue on which it disagreed with the Commission.¹³⁰ However, there was also a level of convergence about the future institutional setting, with all three institutions favouring a possibility of an appellate mechanism.¹³¹

The strongest opponents of ISDS, however, were members of the public, most apparent in the context of negotiations for the TTIP in 2014–16, and particularly in its most prominent Member States – Germany and France. While France was previously known for its anti-ISDS sentiment, actively contributing to the failure of the MAI,¹³² Germany has traditionally been its strong supporter.¹³³ Nevertheless, highly prominent ISDS claims against Germany in the field of energy prompted strong public discontent.¹³⁴ The German Social Democrats (SPD), which then formed part of the ruling coalition, sided with the public opposition to ISDS.¹³⁵ Nevertheless, anti-ISDS sentiment among politicians was limited to the TTIP and CETA, which had been seen as a blueprint for the TTIP, rather than complete elimination of ISDS.¹³⁶ Following the online citizens' petition against the proposed TTIP,¹³⁷ the EC launched an official public consultation, with a majority of the 150,000 responses received opposing ISDS in the TTIP and the TTIP generally.¹³⁸

the Commission was clear that speculation 'has never been regarded as being synonymous to portfolio investment': *ibid* 2-3.

¹²⁹ See 'EU negotiating mandates on investment (2011, EU–Canada/India/Singapore FTAs)', leaked through the NGO *bilaterals.org* website (*Bilaterals.org*, 15 September 2011) <<http://www.bilaterals.org/spip.php?article20272&lang=es>> accessed 30 June 2020. The Council emphasised that the mandate includes 'areas of mixed competence, such as portfolio investment, dispute settlement, property and expropriation aspects'. It also included the widest possible protections and effective ISDS, along the lines of the Member States' BITs. The chapter on investment was envisaged as separate from market access commitments. Similarly, see Council of the European Union, 'Directives for the negotiation on the Transatlantic Trade and Investment Partnership between the European Union and the United States of America' (17 June 2013) 11103/13 DCL 1 (declassified) paras 22-33.

¹³⁰ The disagreements continued until clarified by the CJEU in Opinion 2/15, which confirmed mixed investment competence: see chapter 6.

¹³¹ European Commission (n 97) 10; European Parliament Resolution (n 116) para 31; Council of the European Union, Directives for the negotiation on the TTIP (n 129) para 23.

¹³² See Part III.

¹³³ See chapter 1.

¹³⁴ See Ivana Damjanovic and Ottavio Quirico, 'Intra-EU Investment Dispute Settlement in light of *Vattenfall* and *Achmea*: A Matter of Priority' (2019) 26 *Columbia Journal of European Law* 102.

¹³⁵ Sabine Kinkartz, 'German Social Democrats fear free trade' *Deutsche Welle* (23 February 2015) <<https://www.dw.com/en/german-social-democrats-fear-free-trade/a-18275595>> accessed 30 June 2020.

¹³⁶ See, for example, Peter Clarke, 'Germany throws down gauntlet in CETA investor–State negotiations' (*iPolitics*, 27 April 2014) <<https://ipolitics.ca/2014/07/27/germany-throws-down-gauntlet-in-ceta-investor-state-negotiations/>> accessed 30 June 2020.

¹³⁷ The petition was organised in the framework of a citizens' initiative by the self-organised 'European Citizen's Initiative Stop TTIP' and it was signed by more than 3 million people.

¹³⁸ European Commission, 'Online public consultation on investment protection and investor-to-State dispute settlement (ISDS) in the Transatlantic Trade and Investment Partnership Agreement (TTIP)' SDW (2015) 3 final, 14. The public consultation took place between 27 March and 13 July 2014.

Public opposition in Germany prompted the then Federal Minister of Economics, Sigmar Gabriel, a Social Democrat himself, to propose an alternative investment court, to be presided over by ‘independent and professional judges’.¹³⁹ The proposal was submitted by the Socialists and Democrats (S&D group) to the EP in March 2015.¹⁴⁰ Along similar lines, the French Government and its Foreign Trade Secretary of State Matthias Fekl had their list of wishes for acceptable investment dispute settlement: sanctions for business abuses, an appellate mechanism, more transparency, and addressing conflicts of interest among arbitrators.¹⁴¹ The Dutch Parliament similarly supported the idea of a ‘Trade and Investment Court’ with a permanent secretariat and appeals mechanism, endorsing a number of methods¹⁴² aimed at ‘address[ing] concerns in the EU’ while ‘grant[ing] a high level of protection for [EU] investors abroad’.¹⁴³ Finally, Germany submitted its official proposal for a permanent international investment court in May 2015, tailored by Professor Markus Krajewski.¹⁴⁴ The French followed, endorsing the same idea.¹⁴⁵ Each and every element mentioned in these documents found its way into the later EU proposal for an Investment Court System (ICS).

4.3.4. From bilateralism to multilateralism and pragmatic plurilateralism in investment

Following fierce investment debates at the national level, the EC introduced a concept paper in May 2015, in which it proposed to replace ISDS with the ICS and an appellate mechanism.¹⁴⁶ This new adjudication mechanism was intended to ‘transform’ ISDS towards a system ‘which functions more like traditional courts systems’, by making adjudicators’ appointments permanent, assimilating their qualifications to those of

¹³⁹ Kinkartz (n 135).

¹⁴⁰ Group of the Progressive Alliance of Socialists & Democrats in the European Parliament, ‘S&D Position Paper on Investor-State dispute settlement mechanisms in ongoing trade negotiations’ (4 March 2015) <https://www.socialistsanddemocrats.eu/sites/default/files/position_paper/ISDS_mechanisms_ongoing_trade_negotiations_en_150304.pdf> accessed 30 June 2020.

¹⁴¹ Cecile Barbieri, ‘France and Germany to form united front against ISDS’ *Euractiv* (15 January 2015) <<https://www.euractiv.com/section/trade-society/news/france-and-germany-to-form-united-front-against-isds/>> accessed 30 June 2020.

¹⁴² Preventing double-hatting by means of a ‘quarantine’ period to prevent conflicts of interest; promoting mediation and consultations; frivolous claims and ‘loser pays’ principles; promoting equal opportunities for SMEs; and avoiding parallel proceedings through ‘fork in the road’ and ‘no U-turn’ rules.

¹⁴³ Tweede Kamer der Staten-Generaal, ‘Improvements to CETA and beyond’ (6 March 2015)

¹⁴⁴ Marc Bungenberg, ‘A History of Investment Arbitration and Investor-State Dispute Settlement in Germany’ (2016), Centre for International Governance Innovation, Investor-State Arbitration Series Paper No. 12, 17.

¹⁴⁵ Cecile Barbieri, ‘Mathias Fekl: The EU should have its own arbitration court’ *Euractiv* (3 June 2015) <<https://www.euractiv.com/section/trade-society/interview/matthias-fekl-the-eu-should-have-its-own-arbitration-court/>> accessed 30 June 2020.

¹⁴⁶ European Commission, ‘Investment in TTIP and beyond – the path for reform. Enhancing the right to regulate and moving from current ad hoc arbitration towards an Investment Court’ (5 May 2015).

national judges and introducing an appeal system.¹⁴⁷ The proposal envisaged a two-pronged approach: bilateral and multilateral, to be developed in parallel.

The bilateral approach at that stage still envisaged keeping arbitration at first instance with a pre-established roster of arbitrators, who would be ‘competent, independent, impartial’ and ‘trusted to decide in accordance with known and predictable legal principles’.¹⁴⁸ Eventually, the idea of a roster evolved into a permanent first-instance tribunal, as it became obvious that rosters could still lead to conflicts of interest. Additionally, the proposal envisaged a bilateral appellate mechanism, modelled largely on the institutional set-up of the WTO Appellate Body, with permanent members and similar qualifications.¹⁴⁹

The multilateral approach envisaged the establishment of an international investment court and an appellate mechanism, which would be developed separately but would form part of a ‘multilateral system’. First, a multilateral appellate mechanism would be developed from the bilateral TTIP mechanism, applying to ‘multiple agreements and between different partners’, on the basis of an opt-in system. In any case, it would become a standard feature in all EU IIAs. Secondly, given the ‘obvious technical and organisational challenges’ of pursuing an individual investment court for each EU agreement, the EU should pursue the creation of *one* permanent court. Again, just as with the appellate mechanism, such a court would allow for different membership on the opt-in basis, and it would be either a stand-alone international body or embedded into an existing multilateral organisation.¹⁵⁰ The proposal thus resonated with the German and French position of creating a permanent court in stages: initially as a European court, for all EU trade agreements, which would eventually evolve into a permanent international and multilateral court.¹⁵¹

The Commission’s approach significantly reflected the desire of States to take control over the IIR and to reintroduce the rule of law, instead of the ‘rule of lawyers’.¹⁵² This would be achieved by establishing a court as the new system’s central element that would guarantee the rule of law. The EC proposal did not question the challenges for the rule of law stemming from the international context (inevitable politicisation of courts),

¹⁴⁷ *ibid* 4.

¹⁴⁸ *ibid* 7.

¹⁴⁹ *ibid* 9.

¹⁵⁰ *ibid* 11-12. For a comprehensive analysis about the influence of the WTO rules on the EU’s ICS proposal, see Julien Chaisse and Yves Renouf, ‘Investor–State Dispute Settlement’ in Jane Drake-Brockman and Patrick Messerlin (eds), *Potential Benefits of an Australia–EU Free Trade Agreement: Key Issues and Options* (Adelaide University Press 2018) 290-294.

¹⁵¹ Barbieri (n 145).

¹⁵² Cecilia Malmström, EU Commissioner for Trade, ‘Discussion on Investment in TTIP at the meeting of the International Trade Committee of the European Parliament’ (Speech/15/4624, 18 March 2015) <https://ec.europa.eu/commission/presscorner/detail/en/SPEECH_15_4624> accessed 30 June 2020.

as compared to the domestic context (possible independence of courts guaranteeing the rule of law). The new system projected an EU vision of the rule of law, combining best rule of law practice at the domestic (independence of courts) and international level (enforcement of international obligations), similarly to the CJEU. This approach would guarantee the regulatory sovereignty of States, as the first major public concern. On the investment protection side, the mechanism was to benefit SMEs as opposed to MNEs, as the second major public concern.

Conceptually, the proposal did not question the desirability of ISDS as a mechanism that gives more rights to some (foreign investors) as compared to others (workers, the environment, consumers). The Commission did not consider excluding investment dispute settlement altogether, even in relations with developed countries. The reasons for this were explained as twofold. First, US law does not prohibit discrimination against foreign investors while international law that guarantees such protection cannot be invoked in US courts.¹⁵³ This argument narrowly understood the principle of non-discrimination, overlooking that the rule of law generally guarantees procedural justice and equality of parties in legal systems that adhere to the rule of law.¹⁵⁴ The US system generally adheres to the rule of law and provides effective mechanisms of judicial protection, and any imperfections apply to everyone, not necessarily to foreign investors only.¹⁵⁵ It is a more convincing argument that the existing regulatory and institutional *systemic* differences could place foreign investors in a more detrimental position;¹⁵⁶ however, in the absence of illegal treatment, this could be considered as part of the investment risk. The second of the Commission's reasons for keeping ISDS is thus sounder: in the absence of an ISDS mechanism in the TTIP, the EU's main competitors in the US market – Canada and Japan – would have access to investment protection, while European investors would not.¹⁵⁷

¹⁵³ *ibid.*

¹⁵⁴ See also, Committee on Legal Affairs of the European Parliament, 'Opinion of the Committee on Legal Affairs for the Committee on International Trade on recommendations to the Commission on the negotiations for the Transatlantic Trade and Investment Partnership (TTIP)' (4 May 2015) 2014/2228(INI).

¹⁵⁵ However, for an opposite view, see the case *Loewen Group, Inc. and Raymond L. Loewen v United States of America*, ICSID Case No. ARB(AF)/98/3, Award (26 June 2003), concerning the US judicial system (based on trial by jury and punitive damages). This controversial case was eventually decided in favour of the State on two rather formalistic grounds. First, it was found that the claimant had not sufficiently exhausted the available local remedies (it settled instead). Secondly, due to bankruptcy, the claimant lost Canadian nationality before the award was rendered. The apologetic *obiter dictum* of the award does, however, recognise the possibility of the miscarriage of justice: *ibid.*, para 241-242. For a critique of the award, including the double standards employed by the *Loewen* Tribunal towards the US as the respondent State, see Noah Rubins, 'Loewen v United States: The Burial of an Investor-State Arbitration Claim' (2005) 21 *Arbitration International* 1.

¹⁵⁶ See, for example, Andrej Auersperger Matic, 'Transatlantic trade and the case for investment protection' (2017), The German Marshall Fund of the United States, No. 20/2017, 14-15.

¹⁵⁷ Malmström (n 152).

Instead of eliminating ISDS as a mechanism that favours private interests, a new mechanism was developed to provide an institutional setting (a court) that would strike the appropriate balance between the competing public and private interests. The right to regulate, as one of the basic principles of the new system, would provide guidance for the new court in striking that balance, similar to the approach of the CJEU does in applying the principle of proportionality.¹⁵⁸ Clear drafting of investment protection standards, in many aspects largely inspired by the US Model BIT 2012 and NAFTA case-law, would significantly avoid expansive interpretation.¹⁵⁹ In rare cases where the new court might nevertheless ‘stray’ in its interpretations, States could correct such mistakes through binding interpretations.¹⁶⁰ The new institutional arrangement – with permanent, independent and impartial adjudicators, improved processes and an appeal – would ensure predictability, consistency and correctness of the awards. Taken together, these improvements would ensure that the issues of traditional ISDS are properly addressed and avoided.

The new adjudication mechanism, however, was not the end of the ISDS debate, which continued in the EP. The strongest opposition to ISDS came from the Committees on Legal Affairs and Constitutional Affairs, indicating that ISDS was not only a political but also significantly a legal problem in the EU context. While both committees opposed the inclusion of ISDS in the TTIP,¹⁶¹ their remarks reflected wider EU legal concerns regarding IIL: unequal treatment of local and foreign investors, inherent to ISDS;¹⁶² ‘serious’ substantive and procedural weaknesses of the existing dispute settlement mechanisms;¹⁶³ tensions between different EU policy objectives and the need for regulatory coherence, both internally and externally;¹⁶⁴ conceptual differences between regulatory approaches;¹⁶⁵ the lack of efficient parliamentary oversight over the executive regulatory dialogue taking place in the framework of trade treaties;¹⁶⁶ and the potential of private arbitration to undermine the EU constitutional framework.¹⁶⁷

¹⁵⁸ See chapter 5 for the principle of proportionality and chapter 8 for the right to regulate.

¹⁵⁹ For traditional ISDS standards, see chapter 2. For ISDS standards in new IIAs, see chapter 8.

¹⁶⁰ European Commission (n 146) 2.

¹⁶¹ Committee on Legal Affairs of the European Parliament (n 154) para c; Committee on Constitutional Affairs of the European Parliament, ‘Opinion of the Committee on Constitutional Affairs for the Committee on International Trade on recommendations to the Commission on the negotiations for the Transatlantic Trade and Investment Partnership (TTIP)’ (16 May 2015) 2014/2228(INI) para 1(d)(vi).

¹⁶² Committee on Legal Affairs of the European Parliament (n 154) para b.

¹⁶³ *ibid* para e.

¹⁶⁴ Committee on Constitutional Affairs of the European Parliament (n 161) para 1(d)(i)-(ii)

¹⁶⁵ For example, the EU precautionary principle: see Committee on Legal Affairs of the European Parliament (n 154) para k.

¹⁶⁶ New FTAs envisage regulatory cooperation through sectoral joint committees and possibilities for additional sectoral annexes once the treaty has been concluded and ratified. Committee on Constitutional Affairs of the European Parliament (n 161) para 1(d)(iv).

¹⁶⁷ *ibid*, para 1(d)(vii). This issue was later addressed by the CJEU in Opinion 1/17 ECLI:EU:C:2019:341: see chapter 8.

Due to conceptual differences, the politicisation of ISDS continued. Criticism of the new mechanism also came from civil society, which saw the ICS as disguised ISDS. Some legal experts – in particular, domestic judges – saw no need to create special courts and pointed to a number of legal problems in the proposed adjudication mechanism.¹⁶⁸ Nevertheless, the new ICS softened opposition to ISDS in the EP, in particular among the S&D group, but leading also to internal disputes, with the radical left still strongly opposing any dispute settlement mechanism.¹⁶⁹ Despite mixed sentiments among 13 EP parliamentary committees whose inputs informed the final report of the Committee on International Trade (INTA),¹⁷⁰ it was recommended that ‘a permanent solution’ with ‘independent professional judges in public hearings’ and an appellate mechanism should be introduced, while in the medium term ‘a public International Investment Court’ would be the most appropriate for resolving investment disputes.¹⁷¹ Accordingly, and in spite of a postponed vote and numerous amendments,¹⁷² in July 2015 the EP endorsed the new adjudication mechanism and voted in favour of replacing arbitration with the new system in the TTIP.¹⁷³ Effectively, at that point traditional ISDS was ‘dead’ in the EU.

The ICS was officially coined as such in the EC’s proposal in September 2015, based on the Commission’s concept paper, EP recommendations and input from Member States.¹⁷⁴ The final version for the TTIP was presented to the US in November 2015.¹⁷⁵

¹⁶⁸ Mark Juergen, ‘German Association of Judges on the TTIP Proposal of the European Commission’ (*Global Arbitration News*, 21 March 2016) <<https://globalarbitrationnews.com/german-association-judges-proposal-european-commission-introduction-investment-court-system-settle-investor-state-disputes-transatlantic-trade-investmen/>> accessed 30 June 2020. In particular, German judges pointed out that the EU does not have a competence to create an investment court and the independence of the judges in this new mechanism would not be guaranteed. On the issue of independence, see chapter 9.

¹⁶⁹ For a comprehensive analysis of the support for TTIP and ISDS in TTIP in the EP, see Dora Frantescu, ‘How will EU parliamentarians vote on TTIP?’ (*VoteWatch Europe*, 9 June 2015) <<https://www.votewatch.eu/blog/what-will-eu-parliamentarians-vote-on-ttip/>> accessed 30 June 2020.

¹⁷⁰ Aline Robert, ‘European Parliament backs TTIP, rejects ISDS’ (*Euractiv*, 9 July 2015) <<https://www.euractiv.com/section/global-europe/news/european-parliament-backs-ttip-rejects-isds/>> accessed 30 June 2020. All Committee reports are attached to the final INTA report: European Parliament, ‘Report containing the European Parliament’s recommendations to the European Commission on the negotiations for the Transatlantic Trade and Investment Partnership (TTIP)’ (1 June 2015) 2014/2228(INI).

¹⁷¹ European Parliament, Report containing the European Parliament’s recommendations to the European Commission on the negotiations for the Transatlantic Trade and Investment Partnership (TTIP), 2014/2228(INI), 1 June 2015, para 1(d)(xv).

¹⁷² Dora Frantescu, ‘What will happen to TTIP in the European Parliament’ (*Euractiv*, 25 June 2015) <<https://www.euractiv.com/section/trade-society/opinion/what-will-happen-to-ttip-in-the-european-parliament/>> accessed 30 June 2020.

¹⁷³ European Parliament Resolution 2014/2228(INI) of 8 July 2015 containing the European Parliament’s recommendations to the European Commission on the negotiations for the Transatlantic Trade and Investment Partnership (TTIP) [2017] OJ C 265/35, para 2(d)(xv). N.B. When the EU negotiates an international agreement the EP is entitled to express its position on the agreement at any stage of the negotiations, based on Rule 114.4 of the Rules of Procedure of the European Parliament (December 2019).

¹⁷⁴ European Commission Press Release, ‘Commission Proposes New Investment Court System for TTIP and other EU Trade and Investment Negotiations’ (16 September 2016) <https://ec.europa.eu/commission/presscorner/detail/en/IP_15_5651> accessed 30 June 2020.

¹⁷⁵ European Commission Press Release, ‘EU Finalises Proposal for Investment Protection and Court System for TTIP’ (12 November 2016) <<http://trade.ec.europa.eu/doclib/press/index.cfm?id=1396>> accessed 30 June 2020.

Although negotiations with Canada and Singapore were then already closed, ICS was included in the final version of agreements with both countries.¹⁷⁶ The new anti-ICS sentiment and major EU embarrassment¹⁷⁷ culminated in October 2016 when the predominantly French-speaking Socialist-led Belgian region of Wallonia conditioned its consent to its national government's consent to CETA at the EU level on the CJEU's ruling favourably on the compatibility of the ICS with EU law.¹⁷⁸ The CETA was nevertheless signed¹⁷⁹ (however, not yet ratified at the level of Member States) and the later positive Opinion of the CJEU endorsed ICS,¹⁸⁰ allowing the Commission to continue pursuing ICS and the MIC. Yet, this task remains a challenge, both internally and externally.

Negotiations with the US on the TTIP eventually failed. There was an important geostrategic reason for the EU using the TTIP to develop a new world-wide ISDS mechanism.¹⁸¹ Both the EU and the US have been the pillars of the ISDS regime, in light of historical developments and the number of their BITs. Given the size of their economies, they are the main source of FDI globally. Both have been focused on protecting the right to regulate and promoting common values in international trade. As the US made efforts over the years to improve its Model BIT and the EU endorsed such improvements in its own treaties, the EU procedural reform would bring further improvements, in addition to those already achieved by the US. In particular, an appellate mechanism was seen as 'a realistic possibility' since the US had already signalled the possibility of a future multilateral appellate mechanism in its agreements since 2002.¹⁸² Reforms implemented in a common treaty between these two investment powers would prompt other EU

¹⁷⁶ Although the Canadians at first excluded the possibility of including ICS, a breakthrough came in February 2016: see 'Joint statement: Canada–EU Comprehensive Economic and Trade Agreement (CETA)' (26 February 2016) <https://ec.europa.eu/commission/presscorner/detail/en/STATEMENT_16_446> accessed 30 June 2020. With Singapore, following the CJEU's Opinion 2/15 in 2017, agreements were split into a trade agreement and a separate investment agreement in 2018: see chapter 6.

¹⁷⁷ 'An emotional Chrystia Freeland fights back tears as she explains why Canada is walking out of EU trade talks' (Global News, 21 October 2016) <<https://globalnews.ca/video/3018394/an-emotional-chrystia-freeland-fights-back-tears-as-she-explains-why-canada-is-walking-out-of-eu-trade-talks>> accessed 30 June 2020.

¹⁷⁸ Under Belgian constitutional law, Belgium's national government cannot give its consent to the EU's Council Decision on the signing of an EU international free trade agreement without the agreement of all regional and community parliaments. Consequently, the Belgian request for a CJEU's Opinion was made in accordance with Art 218(11) TFEU.

¹⁷⁹ CETA was signed on 30 October 2016, after approval by the Council. The EP consented to it on 15 February 2017 and the Canadian Parliament on 16 May 2017. It provisionally entered into force in September 2017. The investment chapter will enter into force only after ratified by all EU Member States. See chapter 6 on EU mixed agreements.

¹⁸⁰ See chapter 9.

¹⁸¹ For the broader geopolitical importance of TTIP, see, Committee on Foreign Affairs of European Parliament, 'Opinion of the Committee on Foreign Affairs for the Committee on International Trade on recommendations to the Commission on the negotiations for the Transatlantic Trade and Investment Partnership (TTIP)' (1 April 2015) 2014/2228(INI) para 4.

¹⁸² See, for example, Art 28 of the 2012 US Model BIT.

partners to adopt similar reforms, giving the EU leverage in negotiations to upgrade the existing extra-EU BITs and conclude new bilateral EU IIAs.¹⁸³

At the same time, it was somewhat unreasonably optimistic to expect that the US would ever accept any other investment dispute settlement than arbitration. The US is generally sceptical of permanent international courts, and this would for investment disputes offer an inflexible bureaucratic apparatus, difficult to check on by the States and mistrusted by investors.¹⁸⁴ As a respondent, the US has never lost an investment arbitration case. It has been the leader in developing investment standards and has successively argued correct interpretation of disputed standards, such as the FET.¹⁸⁵ More generally, the arbitration industry has benefited US law firms.¹⁸⁶ US businesses have been the most common individual State users of ISDS and their business organisations are strong supporters of ISDS.¹⁸⁷ Thus, ISDS has been developed in ways that benefit the US and its investors the most. Moreover, the American vision of the rule of law in IIL is founded on the presumption that ISDS strengthens international law.¹⁸⁸ In light of the current administration's scepticism about international institutions,¹⁸⁹ a change in the US position regarding the EU's ICS is today even more unlikely than it was in 2015.

The contours of the early EC proposal are clearly reflected in the current EU international investment strategy, at both bilateral and international levels.¹⁹⁰ In CETA

¹⁸³ 'A new reformed approach in TTIP will be a strong starting point for reform of our 1400 European deals with our partners, including our other ongoing negotiations': Malmström (n 152). TTIP would also replace the existing nine extra-EU BITs between the US and Eastern European EU Member States, concluded before their accession to the EU. Exceptionally, only the US and Canada have adjusted these pre-accession extra-EU BITs, by means of amending protocols, to allow new Member States to harmonise their legislation with the EU *acquis*. However, adjustments do not address the issue of the potential application of EU law in investment arbitrations arising under these agreements. Therefore, it would be in the interests of Member States to replace these extra-EU BITs with a new EU-US agreement: see Philip Strik, *Shaping the Single European Market in the Field of Foreign Direct Investment* (CUP 2014) 146-150. Once it has entered into force, the CETA investment chapter will replace the existing nine extra-EU BITs, bringing international investment bilateral relations between Canada and Member States in line with EU law.

¹⁸⁴ Ted R Bromund, James M Roberts, and Riddhi Dasgupta, 'The U.S. Should Reject the European Commission's Proposed Investment Court' (2015) 4485 The Heritage Foundation.

¹⁸⁵ UK Government Department for International Trade, 'UK-US Trade & Investment Working Group' (2-7 November 2018) 32-33. The report has been leaked through the UK's NGO website (*Global Justice Now*, 27 November 2019) <<https://www.globaljustice.org.uk/news/2019/nov/27/explosive-leaked-trade-papers-show-nhs-chlorinated-chicken-already-table-us-trade>> accessed 30 June 2020.

¹⁸⁶ Yves Dezaley and Bryant R. Garth, *Dealing in Virtue* (University of Chicago Press 1996).

¹⁸⁷ See American Chamber of Commerce to the European Union, 'AmCham EU's response to the European Commission's public consultation on modalities for investment protection and ISDS in TTIP' Consultation Response (11 July 2014)

<https://www.amchameu.eu/sites/default/files/position_papers/file_20140717_105720_LFEcSE_0.pdf> accessed 30 June 2020. See also Peter Chase and Sean Heather, 'Investment Protection: If it Isn't Broken, Why "Fix" It?' (*US Chamber of Commerce*, 1 October 2015) <<https://www.uschamber.com/issue-brief/investment-protection-if-it-ain-t-broke-why-fix-it>> accessed 30 June 2020.

¹⁸⁸ Peter Chase, 'TTIP, investor-State dispute settlement and the rule of law' (2015) 14 *European View* 217.

¹⁸⁹ See James McBride and Andrew Chatzky, 'How Are Trade Disputes Resolved?' (*Council on Foreign Relations*, 6 January 2020) <<https://www.cfr.org/backgrounder/how-are-trade-disputes-resolved>> accessed 30 June 2020. See also chapter 3, section 3.1.1.

¹⁹⁰ See Part III.

and investment protection agreements (IPAs) with Singapore and Vietnam, and other negotiations that followed (Mexico), a bilateral ICS is envisaged as an interim solution, to be replaced by a similarly conceived MIC at the multilateral level,¹⁹¹ currently being negotiated in the framework of UNCITRAL.¹⁹² Yet, just as in the case of the US, there are States – the very ones that the EU considers ‘like-minded partners’ – which do not support the idea of a new international investment court that would replace arbitration (Japan, Australia) or currently oppose ISDS on conceptual grounds (the Labour government in New Zealand). The stalemate in developing trade agreements with these States (the CETA scenario) has been avoided by excluding investment protection and dispute settlement altogether from negotiations, or at least until the outcomes of the multilateral ISDS negotiations are known. The previous rule of law imperfections of the developed countries have thus become secondary to investment pragmatism.

As with its trade strategy, the EU is building strategic partnerships through bilateral agreements, which can support its multilateral efforts, or at least not undermine them. At the same time, the US is building its own obstacles to obstruct such plans.¹⁹³ While a trade language of like-mindedness does not easily translate into investment, the EU’s investment strategy is ultimately, just as in trade, in fact plurilateral, and only nominally multilateral.

4.4. Conclusion

The introduction of a constitutional CFR and the endorsement of values, objectives and principles in the Lisbon Treaty signalled a new phase towards an even closer Union and deeper integration with ‘the wider world’. The new generation of EU trade and investment agreements has become a vehicle to export EU values with a view to shaping global trade and investment governance. In a multipolar world, the EU strategy in trade has shifted from multilateralism to bilateralism and towards pragmatic plurilateralism. In investment, the emerging field of EU activity, the trend has been the opposite but with a similarly envisaged outcome: from bilateralism to multilateralism and pragmatic plurilateralism.

¹⁹¹ See Art 8.29 CETA. For the EU proposal of a MIC, see UNCITRAL, ‘Possible reform of investor-State Dispute Settlement (ISDS), Submission from the European Union and its Member States’ (24 January 2019) UN Doc A/CN.9/WG.III/WP.159/Add.1.

¹⁹² See chapter 10.

¹⁹³ For example, in the context of UK-US trade talks, it has been noted: ‘The US continued to have severe concerns with respect to the EU’s proposals for a Multilateral Investment Court (MIC) and reiterated previous statements that the US Government would be very concerned at any indication that the UK was in favour of a MIC, they were clear that this would undermine the ability of the US to work with the UK in other forums including in the context of the FTA’: UK Government Department of International Trade (n 185) 35.

The new EU investment strategy has from its early days been characterised by attempts to strike the appropriate balance between policy legitimacy (public approval) and policy effectiveness (the protection of EU investors abroad), with the result that policy efficiency (shared EU investment competence) remains the weakest link due to the lack of centralised authority at the EU level. As a consequence, EU IIP remains more exposed to politicisation due to the involvement of national and regional parliaments in the ratification of EU investment treaties.¹⁹⁴ Externally, the MIC is envisaged as a vehicle through which EU values, principles and objectives (the rule of law, strict observance of international law, protection of EU citizens (investors) abroad, free and fair trade, multilateral cooperation and good global governance) are translated into practice.

The new EU IIP outlined the contours of subsequent EU investment regulation for external relations: regulations on transitional arrangements and financial responsibility, the division of competences (Opinion 2/15) and the legality of the policy (Opinion 1/17). The CJEU played a crucial role in the development of the policy, carefully balancing considerations of the EU legal order against the objectives and effectiveness of EU action externally (Opinions 2/15 and 1/17) and the objectives of EU integration internally (the *Achmea* judgment).

Against this background, the following chapters turn to legal considerations, explaining how the EU legal order, its unique constitutional framework and its Court have shaped the EU investment regulation.

¹⁹⁴ For comprehensive analysis of the division of competences and institutional framework for treaty-making with respect to investment, see chapter 6.

Legal framework of EU investment regulation: the EU legal order and the international investment regime in comparative perspective

5.1. The autonomy of the EU legal order

5.2. The EU legal order in the international legal order

5.3. Systemic differences and parallels between the EU legal order and international investment regulation

5.3.1. *Nature of the legal system: constitutional vs international*

5.3.2. *Nature of legal obligations: public vs private*

5.3.3. *Interpretation of law*

5.3.4. *Judicial review and domestic law*

5.3.5. *The relationship with domestic courts*

5.4. Conclusion

In this chapter we will analyse the key specifics of the EU legal order, which we will compare and contrast them with international investment law (IIL). We will focus on the comparison of *systemic* features of these two legal orders, with two aims.

First, we will explain the basic features of the EU legal order. While the EU abides by international law and strongly supports the multilateral rules-based order, the EU legal order determines the level of the EU's and Member States' engagement with the international legal order. In practical terms, this engagement primarily depends on the effects of international law on the objectives of EU integration, as assessed from the point of view of EU constitutional law. EU law takes a monist approach in the internal EU dimension (relationship between Member States), which leads to tensions with IIL,¹ while it is dualist with respect to the external dimension (relationship with third States), thus avoiding such tensions.² This comparative analysis serves to explain reasons behind these dynamics.

Secondly, we will expose the *modus operandi* of the EU judicial system and the Court of Justice of the EU (CJEU) as its integral part. The aim is to demonstrate that in normative

¹ See chapter 7.

² See chapter 9.

terms the CJEU enjoys relatively higher authority compared to IIL because of its relationship with domestic law and courts. The relative success of the CJEU also explains why the EU envisaged the IIL reform through the institution of the court. The EU proposal has been inspired and shaped by its own legal system.

Any discussion of the EU legal order must start with a basic explanation of its autonomy.

5.1. The autonomy of the EU legal order

The EU legal order, like the EU itself, is a legal order *sui generis*, and combines elements of international law and constitutional law of the EU as a supranational entity. Since it is based on international treaties, EU law forms part of international law. However, unlike 'ordinary' international treaties, the EU founding treaties have created its 'own legal system' with its own set of institutions and capacity of representation on the international plane.³ EU law has been transformed and developed into an autonomous legal order with quasi-federal features through the process of 'constitutionalisation'.⁴ In this process, the EU founding treaties have evolved from international law instruments, which horizontally bind sovereign Member States into a 'vertically integrated legal order' which confers enforceable rights and obligations on Member States, their sub-components, citizens and other entities, both private and public, in the territory of the EU as a whole.⁵ The effects of the EU legal instruments in the Member States' domestic orders were clarified through the interpretation of the founding treaties by the CJEU.

Primacy is one of the 'essential characteristics' of EU law.⁶ In line with this doctrine, EU primary (treaties) and secondary (regulations, directives) sources prevail over national legal orders of Member States.⁷ Primacy of EU law extends over fundamental

³ Case 6/64, *Flaminio Costa v E.N.E.L.* [1964] ECR 1141.

⁴ In this regard, this term should not be mixed with constitutional law of Member States but parallels should be drawn with a process of constitutionalisation of organisations, which involves an attempt to subject all organisation's actions to the structures, processes, principles and values of the organisation's 'constitution'.

⁵ Alec Stone Sweet, *Governing with Judges: Constitutional Politics in Europe* (OUP 2010) 160. The EU bears similarities with a federal structure. However, the EU territory and population are derived from the territory and nationality of Member States.

⁶ Opinion 1/09 [2011] ECR I-1137; Opinion 2/13 ECLI:EU:C:2014:2454; Opinion 1/17 ECLI:EU:C:2019:341, para 109-110; Case C-621/18 *Whitgman* ECLI:EU:C:2018:999.

⁷ *Costa v E.N.E.L.* (n 3). However, *ultra vires* secondary legislation cannot prevail over national laws. National courts are empowered to express doubts about the validity of Union secondary law acts through a preliminary ruling procedure. See, for example, Case C-62/14 *Peter Gauweiler and Others v Deutscher Bundestag* ECLI:EU:C:2015:400, in which the CJEU reviewed the compatibility of the Outright Monetary Transaction program (secondary acts) with the monetary policy mandate of the European Central Bank (ECB) under the founding treaties (primary law), on the preliminary reference from the German Federal Constitutional Court. While the case caused legal and political upheaval, the German Constitutional Court eventually accepted the CJEU ruling confirming validity of the program. See Federico Fabbrini, 'The European Court of Justice, the European Central Bank and the Supremacy of EU Law' (2016) 23 *Maastricht Journal of European and*

rights in the constitutions of Member States and the principles of a national structure,⁸ although in reality the authority of EU law over constitutional laws of Member States is tolerated rather than embraced by all national constitutional courts of Member States.⁹ Accordingly, EU law renders ‘automatically *inapplicable*’ any conflicting provision of the Member States’ national law and precludes valid adoption of new national measures incompatible with EU law.¹⁰ However, a national norm inconsistent with an EU norm is not declared invalid by the CJEU. In practical terms, the national judge has a positive obligation to interpret domestic law consistently with EU law.¹¹ This duty of consistent interpretation is inevitably inherent in EU law as a system of norms since it empowers the national court to ensure the full effectiveness of EU law when deciding individual disputes.¹² If this is not possible, the domestic legislation inconsistent with EU law must be ‘disapplied’ by the national judge.¹³

EU law could not achieve its full force if it did not provide individuals with rights which can be enforced before national courts. The doctrine of direct effect¹⁴ changed the character of Community norms from international law that typically operates horizontally between the States into constitutional law that operates also vertically

Comparative Law 3; Armin Steinbach, ‘All’s well that ends well? Crisis policy after the German Constitutional court’s ruling in Gauweiler’ (2017) 24 Maastricht Journal of European and Comparative Law 140.

⁸ Case 11/70 *Internationale Handelsgesellschaft* [1970] ECR 1125.

⁹ Damian Chalmers, Gareth Davies and Giorgio Monti, *European Union Law* (2nd edn, CUP 2010) 190-197. The most recent notable example which challenges the mandate of the CJEU includes the judgment of the German Federal Constitutional Court: BVerfG, Judgment of the Second Senate of 5 May 2020, 2 BvR 859/15, paras. 1-237. In this judgment the German Court declared as *ultra vires* the judgment of the CJEU (Case C-493/17 *Weiss and Others* ECLI:EU:C:2018:1000), in which the CJEU confirmed lawfulness of the ECB’s public assets purchases program. The German Constitutional Court found that the CJEU exceeded its mandate in allowing the ECB’s transgression from monetary to economic policy without an appropriate proportionality assessment of the new policy. For comment on the assessment of proportionality, see Toni Marzal, ‘Is the BVerfG PSPP decision “simply not comprehensible”? A critique of the judgment’s reasoning on proportionality’ (*Verfassungsblog*, 9 May 2020) <<https://verfassungsblog.de/is-the-bverfg-pspp-decision-simply-not-comprehensible/>> accessed 30 June 2020.

¹⁰ Case C-106/77 *Simmenthal SpA* [1978] ECR 629, para 17 (emphasis added).

¹¹ Case C-14/83 *Von Colson v Land Nordrhein-Westfalen* [1984] ECR 1891; Case C-157/86 *Mary Murphy and others v An Bord Telecom Eireann* [1988] ECR 673; Case C-106/89 *Marleasing SA v La Comercial Internacional de Alimentacion SA* [1990] ECR I-4135. This is also known as the doctrine of indirect effect. However, the national judge need not interpret national law *contra legem*. S/he must consider national law as a whole in order to assess to what extent an EU norm could be applied, while ensuring that the objective pursued by that EU norm is achieved: Case C-212/04 *Adeneler* [2006] ECR I-6057, paras 110-111.

¹² Joint Cases C-397/01 to C-403/01 *Pfeiffer* [2004] ECR I-8835, para 114.

¹³ See Case C-282/10 *Dominguez* ECLI:EU:C:2012:33; Case C-213/89 *The Queen v Secretary of State for Transport, ex parte: Factorame* [1990] ECR I-2433, para 17. Primacy and supremacy are often used interchangeably. However, some authors note the difference between the two: the doctrine of primacy concerns the hierarchy between EU law and national law, while the notion of supremacy concerns the validity of a lower norm: see Allan Rosas and Lorna Armati, *EU Constitutional Law: An Introduction* (Hart 2010) 56. Supremacy is also related to the issue of competence. EU law is supreme to national laws of Member States within its sphere of competence. The CJEU has the exclusive authority to declare invalid EU acts challenged before national courts: Case C-314/85 *Foto Frost v Hauptzollamt Lubeck-Ost* [1987] ECR-4199.

¹⁴ The landmark Case 26/62 *Van Gend en Loos* [1963] ECR 1 concerned a negative obligation on the Member States not to impose customs duties or measures having equivalent effect in their mutual trade, proscribed in Art 12 of the EEC Treaty. The CJEU established that obligations created by the founding treaties can be enforced by individuals who suffer as a result of a breach of the Treaty provision; in this case thus making the Art 12 obligation ‘directly effective’.

between the State and individuals, and which can also operate horizontally between individuals *inter se*.¹⁵ The authority to decide which Community norms¹⁶ have and which do not have direct effect stays exclusively with the CJEU and not the Member States' legal systems; however, norms with direct effect can be invoked by private individuals before national courts and not before the CJEU. In this way, the CJEU has created an order in which the scope and effect of a Community norm is decided centrally by the CJEU but enforced peripherally by national courts of the Member States.

5.2. The EU legal order in the international legal order

The EU is an international actor. It has legal personality¹⁷ under international law and it is a party to different international agreements, including international investment agreements (IIAs). In theory, the EU takes a monist view on the status of international agreements to which the EU is a party within its legal order. These international agreements form its integral part.¹⁸ They are therefore binding on the EU institutions and the Member States.¹⁹ In the hierarchy of legal norms in the EU legal order, EU international agreements prevail over EU secondary law and the national legal orders of Member States.²⁰ The EU must respect international law in the exercise of its powers and

¹⁵ However, the horizontal direct effect in relations between private parties depends on the specific objective of the Treaty provision in question. Provisions intended to be applied in relations between private individuals, such as Arts 101 and 102 TFEU on anticompetitive behavior of firms, would thus have horizontal direct effect, while provisions involving internal market freedoms which involve duties of a State would not. However, there are certain exceptions where the CJEU found horizontal direct effect even with respect to freedoms (see, for example, for free movement of workers: Case C-281/98 *Angonese v Cassa* [2000] ECR I-4139; for freedom of establishment and freedom of services: Case C-438/05 *Viking Line ABP* [2007] ECR I-10779 and Case C-341/05 *Laval un Partneri Ltd v Svenska* [2007] ECR I-11767); Bruno de Witte, 'Direct Effect, Primacy and the Nature of the Legal Order' in Paul Craig and Gráinne de Búrca, *The Evolution of EU Law* (2nd edn, OUP 2011) 334.

¹⁶ The Community norm is understood here in its broader sense, encompassing both primary and secondary sources. For example, the CJEU established direct effect of Treaty provisions with respect to free movement of goods (e.g. Case C-2/73 *Riseria Luigi Geddo v Ente Nazionale Risi* ECLI:EU:C:1973:89) and free movement of workers (e.g. Case C-41/74 *Yvonne Van Duyn v Home Office* [1974] ECR 1337. With respect to secondary sources, most regulations have direct effect, while the situation with directives is less straightforward: see de Witte (n 15) 335. Recently, the CJEU in Case C-537/15 *Poplawski* [2017] ECLI:EU:C:2017:503 held that 'a national court's obligation to disapply a provision of its national law which is contrary to a provision of EU law, if it stems from the primacy afforded to the latter provision, is nevertheless dependent on the direct effect of that provision in the dispute pending before that court': para 68.

¹⁷ Art 47 TFEU.

¹⁸ Case C-301/08 *Irène Bogiatzi, married name Ventouras v Deutscher Luftpool and Others* [2009] ECR I-10185, para 23.

¹⁹ Art 216(2) TFEU.

²⁰ In this respect, EU secondary legislation must be interpreted harmoniously with the international agreement: Case C-61/94 *Commission v Germany* [1996] ECR I-3989, para 52. Art 216(2) TFEU serves as a legal basis for declaring invalid secondary legislation that is inconsistent with a binding international treaty: Marise Cremona, 'External Relations and External Competence of the European Union: the Emergence of an Integrated Policy' in Paul Craig and Gráinne de Búrca, *The Evolution of EU Law* (2nd edn, OUP 2011) 243-244.

EU measures adopted by the virtue of those powers must be interpreted in light of the relevant rules of international law.²¹

However, international agreements should always be compatible with primary EU law.²² In the same manner as the Member States' international agreements, provisions of international agreements to which the EU is a party cannot affect the provisions of the founding treaties nor can they have adverse effect on the autonomy of EU law.²³ Obligations imposed by an international agreement cannot have the effect of prejudicing the constitutional principles of the EU founding treaties.²⁴ Consequently, EU international agreements are applicable to the extent that they are compatible with primary EU law. The CJEU has jurisdiction, in actions for annulment and requests for preliminary rulings, to assess whether an international agreement concluded by the EU is compatible with EU law and international rules which are binding on the EU. The CJEU does not have the power to declare international agreements invalid in the case of their substantive inconsistency, however the CJEU is competent to disapply incompatible provisions of such agreements.²⁵

The relationship between EU law and international law is therefore, in practical terms, determined by the internal effects of international agreements in the EU legal order, arguably rendering EU law dualist.²⁶ Accordingly, provisions of international agreements concluded by the EU do not necessarily have direct effect in the EU legal order and in national legal orders of the Member States.²⁷ The preclusion of direct effect of some international agreements serves to shield the autonomy of the EU legal order, which is more in danger in cases of international agreements that confer rights on individuals and also establish their own dispute settlement mechanisms.²⁸ The best example in this respect, although a specific one, is the relationship between EU law and WTO trade law.²⁹

²¹ Joined Cases C-402/05 P and C-415/05 P *Kadi* [2008] ECR I-6351, para 291.

²² *ibid.*

²³ *ibid.*, para 282.

²⁴ *ibid.*, para 285.

²⁵ Case C-266/16 *Western Sahara Campaign UK* ECLI:EU:C:2018:11, para 45-48. Taking into account that the territory of Western Sahara does not form part of the territory of Morocco under international law, the CJEU reached the conclusion that the EU-Morocco Agreement was not applicable to the waters adjacent to the territory of Western Sahara.

²⁶ See Francesca Martines, 'Direct Effect of International Agreements of the European Union' (2014) 25 *European Journal of International Law* 129.

²⁷ Whether an EU international agreement has direct effect depends on the nature and broad logic of the agreement in question and its intention to 'apply directly and immediately to individuals and to confer upon them rights or freedoms capable of being relied upon against States': Case C-308/06 *Intertanko and Others v Secretary of State for Transport* [2008] ECR I-4057, para 64.

²⁸ Anna de Luca, 'Direct effect of EU Investment Agreements and the Energy Charter Treaty in the EU' *Eurojus.it rivista*, 15 November 2016) <<http://rivista.eurojus.it/direct-effect-of-eus-investment-agreements-and-the-energy-charter-treaty-in-the-eu/>> accessed 30 June 2020.

²⁹ See analysis by Helene Ruiz Fabri, 'Is There a Case – Legally and Politically – for Direct Effect of WTO Obligations?' (2014) 25 *Journal of International Law* 151.

The CJEU has refused to recognise the direct effect of WTO law within its legal order with respect to both the individuals³⁰ and the Member States,³¹ while also limiting the effects of the rulings of the WTO dispute settlement body within the EU legal order.³² While reasons could be interpreted as political³³ and justified by reciprocity,³⁴ the CJEU's approach serves to shield the autonomy of the EU legal order. It can be assumed that, for the same reasons of preserving the autonomy of the EU legal order, the new generation of EU FTAs explicitly exclude their direct effect.³⁵

The EU legal order is thus only conditionally open towards international law.³⁶ The CJEU, as the supreme guardian of the EU legal order, considers EU law as specific international law to which other international law instruments should conform, when it is necessary to achieve the objectives of the EU founding treaties. In symbolic terms, 'the entire EU enterprise is about the son (EU law) "killing" the father (international law).'³⁷ In any case, the CJEU's conditional openness to international law is always justified by the international character of EU law, as an autonomous legal order based on international treaties, which cannot be trumped by other international agreements.³⁸

³⁰ Case 21/72 *International Fruit Company* [1972] ECR 1219, para 21. See also Case C-280/93 *Germany v Council* [1994] ECR I-4973 (the Bananas case), para 105, where the CJEU applies a test based on 'the spirit, the general scheme and the terms of the GATT' to exclude direct effect.

³¹ This position was with respect to the GATT in the Bananas case, paras 109–111.

³² Case C-94/02P, *Etablissements Biret et Cie SA v Council of the European Union*, [2003] ECR I-10565.

³³ Effectively, direct effect would limit the availability of different political options available to the EU and Member States under the WTO system for implementing WTO obligations. See Rosas and Armata (n 13) 71.

³⁴ In Case C-149/96 *Portuguese Republic v Council of the European Union* [1999] ECR I-8395, in para 46, the CJEU explained this in the following terms: 'to accept that the role of ensuring that Community law complies with those rules devolves directly on the Community judicature would deprive the legislative or executive organs of the Community of the scope for manoeuvre enjoyed by their counterparts in the Community's trading partners'.

³⁵ See, for example, Art 30.6 CETA.

³⁶ De Witte (n 15) 337, who notes that the conditional openness of EU law towards international law determined by the internal effects of international legal instruments on the autonomy of EU law can be paralleled with the openness of Member States' constitutional Courts towards EU law. The overall reluctance of constitutional courts to request preliminary rulings might be indicative of their approach to the authority of EU law over national constitutional matters: see Rosas and Armata (n 13) 58. Only the Belgian Constitutional Court uses the procedure as a routine (26 references), followed by Austrian (5 references) and Italian Constitutional Courts (2 references). Lithuanian, Spanish, French, German and Slovenian Constitutional Courts have so far requested one preliminary ruling from the CJEU, while other constitutional courts have not yet made such requests.

³⁷ Pierre d'Argent, 'Sources and the Legality and Validity of International Law: What Makes Law "International"?' in Samantha Besson and Jean d'Aspremont, *The Oxford Handbook on the Sources of International Law* (OUP 2017) 560.

³⁸ *Kadi* (n 21) paras 281, 316; Case C-284/16 *Achmea* ECLI:EU:C:2018:158, para 33.

5.3. Systemic differences and parallels between the EU legal order and international investment regulation

The autonomy of the EU legal order and its specific relationship with international law shape the uneasy relationship between EU law and IIL in intra-EU relations.³⁹ Nevertheless, the two legal orders display a number of parallels, which explains how the EU constitutional and regulatory model has shaped the EU's external investment regulation.⁴⁰

5.3.1. Nature of the legal system: constitutional vs international

Although both EU law and IIL form part of the international legal order, the systemic nature of EU law and its constitutional features stand in contrast to fragmented IIL within the fragmented international law.⁴¹

The EU legal order reveals its monist supranational character in its relationship with national laws and nationals of Member States. In the complex web of different national and supranational legal instruments, their relationship is clearly defined and vertically integrated. EU law unexceptionally states its primacy over national laws of Member States and their international agreements, as well as the primacy of its founding treaties over EU international agreements concluded with third States. This supreme position of EU law has been developed by the CJEU and justified by the unique character of EU law as international law. In the EU legal order, the implementation of EU law by the Member States cannot be made subject to reciprocity, and the founding treaties provide remedies in cases when Member States fail to fulfil their obligations.⁴²

In comparison, IIL also prevails over national legal orders under the customary international rule of *pacta sunt servanda*⁴³ and the VCLT.⁴⁴ However, in the complex web of different IIAs to which States are parties, the relationship between these different agreements is rather horizontal and agreements produce vertical effects only in relation

³⁹ See chapter 7.

⁴⁰ See chapters 8 and 9.

⁴¹ ILC, 'Fragmentation of International Law: Difficulties Arising From the Diversification and Expansion of International Law' (2006) Report of the Study Group, UN Doc A/CN.4/L682, 11. However, from a sociological perspective, the international investment regime could be considered as a separate norm-producing subsystem within international law, with its own norms and logic based on investment treaties and arbitral jurisprudence shaped by investment lawyers, arbitrators and scholars: David Schneiderman, 'Global Constitutionalism and Its Legitimacy Problems: Human Rights, Proportionality and International Investment Law' (2017) 12 Journal of Law and Ethics of Human Rights 251, 274-5.

⁴² Case C- 38/89 *Blanguernon* [1990] ECR I-83, para 7; Case C-163/99 *Portugal v Commission* [2001] ECR I-2613, para 22; C-118/07 *Commission v Finland* ECLI:EU:C:2009:715, para 48.

⁴³ This rule is also enshrined in Art 26 VCLT.

⁴⁴ Art 27 VCLT precludes a party to an international treaty to rely on the provisions of domestic law as an excuse for its failure to perform a treaty obligation.

to foreign investors. While substantive protections provided in IIAs are considerably similar, their application results in rather inconsistent jurisprudence. The regime lacks integration, as specific clauses invoked by investors (e.g. MFN clauses) can on a case-by-case basis bring into play obligations not originally envisaged by the Contracting parties to a specific treaty.⁴⁵ Conflicts between rules are resolved according to the rules of priority under international law.⁴⁶ The effective dispute settlement and enforcement mechanisms ensure the compliance of States with their obligations stemming from IIAs.

Importantly, the EU doctrines of primacy and direct effect are not incompatible with international law. IIAs have provisions which are 'directly effective' on foreign investors, who can enforce them before specially created tribunals. Therefore, the principles of primacy and direct effect in EU law only confirm the nature of EU law as part of international law, if with some unusual quasi-federal features.⁴⁷

5.3.2. Nature of legal obligations: public vs private

The development of EU law in its multilevel governance is a dynamic process of interaction between different players, including the courts and private individuals but also civil society and non-governmental forums.⁴⁸ Public interest in the protection of the environment, public morals and public health is carefully balanced against other economic considerations. Economic freedoms institutionalised in the founding treaties are not unfettered. Importantly, rights of individuals under EU law are not absolute private rights but rights that stem from the EU's exercise of its public law prerogatives.

The scope of protection afforded under EU law is wide, both in terms of groups of individuals who have the right to standing, as well as the area of their protected interest. The concept of 'State' for determining a direct effect of a Member State's obligation under EU law has been interpreted broadly by the CJEU to encompass a notion of the State

⁴⁵ Cf. Schill who argues that MFN clauses allow multilateralisation of international investment protection and thus harmonise investment protection in a particular host State: Stephan W Schill, 'Enhancing International Investment Law's Legitimacy: Conceptual and Methodological Foundations of a New Public Law Approach' (2011) 52 *Virginia Journal of International Law* 57, 94. However, if the system were harmonised, the investors would not be urged to invoke an MFN clause in order to bring their investment under the scope of a more favourable treaty, nor would they be urged to treaty and forum shop.

⁴⁶ In this sense, particularly relevant are general conflict rules under the VCLT. In practice, this often leads to conflicting positions between different investment tribunals. For example, tribunals have been conflicted on the issue of priority between a specific BIT and the ICSID Convention when establishing the scope of different definitions under these instruments: see chapter 2, section 2.2. Contradictions also extend to cases involving the relationship between IIL and other international legal regimes, such as EU law, although most tribunals agree that EU law cannot trump international law: see chapter 7, section 7.3.1.

⁴⁷ De Witte (n 15) 362.

⁴⁸ Rosas and Armati (n 13) 40.

acting in its capacity as an employer or public authority,⁴⁹ thus including a range of organisations and bodies that are subject to the authority or control of the State.⁵⁰

The capacity of the EU to produce effects within the legal systems of Member States extends beyond individuals to include also proceedings initiated for the protection of a range of general public interests,⁵¹ such as the environment.⁵² The CJEU has repeatedly ruled that protection of the health and life of humans ‘rank foremost’ among the assets and interests protected by the Treaty⁵³ and that public health protection ‘must take precedence over economic considerations’ even in situations where legitimate expectations have been created.⁵⁴

As international public law instruments, IIAs impose obligations on States. However, unlike EU law, they confer private law rights on a specific category of individuals – foreign investors in the host State. IIAs thus create discriminatory effects towards other categories of economic actors, including domestic investors.⁵⁵ Other actors affected by an investment are left out from the scope of IIAs.⁵⁶ Even States, as creators of IIAs, have unbalanced obligations towards foreign investors⁵⁷ which can prevail over

⁴⁹ Case 152/84 *Marshall* [1986] ECR 723, para 49; Joined Cases C-253/96 to C-256/96 *Kampelmann and Others* [1997] ECR I-6907, para 46.

⁵⁰ The Court has held that the provisions of a directive could be relied on against tax authorities: Case 8/81 *Becker v Hauptzollamt Muenster-Innenstadt* [1982] ECR 53; Case C-221/88 *ECSC v Acciaierie e Ferriere Busseni (in liquidation)* [1990] ECR I-495; local or regional authorities: Case 103/88 *Fratelli Costanzo v Comune di Milano* [1989] ECR 1839; constitutionally independent authorities responsible for the maintenance of public order and safety: Case 222/84 *Johnston v Chief Constable of the Royal Ulster Constabulary* [1986] ECR 1651; and public authorities providing public health services: *Marshall* (n 49).

⁵¹ Alan Dashwood and others, *Wyatt and Dashwood's European Union Law* (Hart 2011) 249.

⁵² See, for example, Case C-72/95 *Kraaijeveld and Others* [1996] ECR I-5403; Case C-435/97 *World Wildlife Fund (WWF) and Others* [1999]; Case C-287/98 *Grand Duchy of Luxemburg v Berthe Linster, Aloyse Linster and Yvonne Linster* [2000] ECR I-6917.

⁵³ See, for example, Case 215/87 *Schumacher* [1989] ECR 617, para 17; Case C-347/89 *Eurim-Pharm* [1991] ECR I-747, para 26; Case C-62/90 *Commission v Germany* [1992] ECR I-2575, para 10; Case C-320/93 *Ortscheit* [1994] ECR I-5243, para 16; Case C-473/98 *Kemikalieinspektionen v Toolex Alpha* [2000] ECR I-5681, para 38; Case C-322/01, *Deutscher Apothekerverband* [2003] ECR I-14887, para 103; Case C-141/07 *Commission v Germany* [2008] ECR I-6935, para 46; Joined Cases C-570/07 and C-571/07 *Blanco Pérez and Chao Gómez* [2010] ECR I-4629, para 44; Case C-108/09 *Ker-Optika* [2010] ECR I-12213, para 58.

⁵⁴ Case C-183/95 *Affish* [1997] ECR I-4315, paras 43 and 57. This judgment confirms the case-law of *United Kingdom v Commission* concerning export prohibitions of beef and veal due to contamination by bovine spongiform encephalopathy (BSE): see Case C-180/96 *United Kingdom v Commission* [1996] ECR I-3903; Case T-76/96 *Pfizer* [1996] ECR II-815.

⁵⁵ Cf. Opinion 1/17 (n 6). See chapter 9 on the issue of equality under CETA.

⁵⁶ While not having *locus standi*, interested third parties can participate in the capacity of *amicus curiae*, but this is not common and it is left to the discretion of individual tribunals in each case.

⁵⁷ Claims by States under international investment law are possible only as counterclaims, and, even in such cases, it is in the tribunal's discretion in each case to decide whether it has jurisdiction to hear a counterclaim by a State, based on the applicable investment agreement and procedural rules. Even in this respect, the jurisprudence of investment tribunals is not consistent and tribunals generally disagree with respect to the consent to arbitrate a State's counterclaim: cf., for example, the case *Spyridon Roussalis v Romania*, ICSID Case No. ARB/06/1, in which the arbitral Tribunal rejected application to hear the counterclaim for the lack of jurisdiction under the BIT and the case *Antoine Goetz & Others and S.A. Affinage des Metaux v Republic of Burundi*, ICSID Case No. ARB/01/2, in which the Tribunal accepted the counterclaim by reasoning that its jurisdiction to hear the counterclaim stems from the implied consent to counterclaim under Art 46 ICSID Convention, regardless of the BIT provision in question: paras 278-279 (note that both cases were arbitrated under the ICSID Convention, albeit different BITs).

their other international law obligations. Therefore, compared to IIL, on a general level EU law provides for a broader access to justice, and allows for a wider scope of guarantees for both private and public interests.⁵⁸

5.3.3. *Interpretation of law*

The CJEU, as the only authority for interpretation of EU law under the founding treaties, ensures the development of consistent and systematic EU jurisprudence.⁵⁹ This contrasts with the inconsistent and often conflicting jurisprudence of investment tribunals, which lack an analogous central point for interpretation. Additionally, even with an appellate mechanism and the system of precedent, which is atypical in international law, investment tribunals would retain one important point of difference with respect to EU law: the method of interpretation of legal instruments. This difference is well described in the words of Lord Diplock:

The European Court, in contrast to English courts, applies teleological rather than historical methods to the interpretation of Treaties and other Community legislation. It seeks to give effect to what it conceives to be the spirit rather than the letter of the Treaties: sometimes, indeed, to an English judge, it may seem to the exclusion of the letter. It views the Communities as living and expanding organisms and the interpretation of the provisions of the Treaties as changing to match their growth.⁶⁰

Indeed, when developing the doctrines of primacy and direct effect, the CJEU did not interpret the EEC Treaty by determining the subjective intention of its drafters but by examining Treaty provisions with respect to the envisaged Treaty objectives relevant in its particular context. With respect to direct effect, the CJEU construed the EEC Treaty as ‘more than an agreement which merely creates mutual obligations between the Contracting Parties’, reading into the objective of establishing a common market the intention that Treaty provisions should have effect with respect to States and with effect on their citizens.⁶¹ The doctrine of primacy was justified by the objectives of equality between the Member States as enshrined in Article 4(3) TEU, and on the grounds of nationality protected by Article 18 TFEU:

⁵⁸ Of course, there are limits imposed. For example, with respect to the public interest litigation invoking judicial review of the legality of acts of EU institutions, access to justice is limited only to those individuals who are individually concerned by the decision of an EU institution in question. The case-law of the CJEU is settled on this issue since the Case 25/63 *Plaumann & Co v Commission* [1963] ECR 95.

⁵⁹ This includes powers under Arts 258 and 259 TFEU (infringement proceedings for non-compliance of Member States with EU law); Art 260 TFEU empowers the CJEU to issue fines for a Member State's failure to comply with an enforcement ruling; Art 263 TFEU allows the CJEU to invalidate acts of EU governing bodies; Art 267 TFEU outlines the preliminary rulings procedure which allows judicial dialogue between the CJEU and national courts.

⁶⁰ *Henn & Darby v DPP* [1981] AC 850, at 905 (per Lord Diplock).

⁶¹ *Van Gend en Loos* (n 14).

The executive force of Community law cannot vary from one state to another in deference to subsequent domestic laws, without jeopardizing the attainment of the objectives of the Treaty set out in Article 5(2) [TEU 4(3)] and giving rise to the discrimination prohibited by Article 7 [TFEU 18].⁶²

Moreover, teleological interpretation of the founding treaties stems from the CJEU's federalist vision of the EU, where founding treaties have had 'the nature of a real constitution', in the absence of a formal constitution.⁶³ The CJEU's interpretations can thus be compared to interpretations of a constitutional court, with the similar mission of protecting the fundamental values of the legal order in which it operates. This constitutional character of the CJEU has particularly been demonstrated in decisions concerning the relationship between the EU legal order and international law and its courts.⁶⁴

The CJEU operates on a level of abstraction which is unknown to common law courts, which focus is strongly on the facts of each case.⁶⁵ Therefore, the case-law of the CJEU sits more easily with the French notion of *jurisprudence*, which means the body of law developed through the decisions of the courts,⁶⁶ than with common law approaches. Its rulings and opinions can be applied regardless of the specific case scenario where the relevant case-law principle is part of the body of law relevant to the case. For this reason, the CJEU uses the exact wording of a particular principle from its past judgments.⁶⁷

International investment tribunals lack such focus and such clear objectives when developing their jurisprudence, mostly relying on textual interpretation of an international agreement in question, and at times on the spirit of the agreement. In the course of interpretation, tribunals are guided by the prevailing letter of IIAs, understood in light of a spirit of unreserved protection of the investors' interests of the time when the relevant agreements were created.⁶⁸ A broader range of involved interests involved in the spirit of the present times is of lesser importance, even when such focus could be supported by the letter of the treaty. In contrast, the CJEU seeks 'to strike the balance

⁶² *Costa v E.N.E.L.* (n 3).

⁶³ *Costa v E.N.E.L.* (n 3), Opinion of AG Lagrange (as cited in Antonin Cohen, 'The European Court of Justice in the emergent European field of power: Transnational Judicial Institutions and National Career Paths' in Yves Dezaley and Bryant Garth (eds), *Lawyers and the Construction of Transnational Justice* (Routledge 2012) 244).

⁶⁴ See, for example, judgments in *Kadi* (n 21) and *Achmea* (n 38) and Opinions 1/09, 2/13 and 1/17 (n 6).

⁶⁵ Konrad Schiemann, 'From Common Law Judge to European Judge' (2005) 13 *Zeitschrift für Europäisches Privatrecht* 741 (as cited in Koen Lenaerts, 'How the ECJ Thinks: A Study on Judicial Legitimacy' (2013) 36 *Fordham International Law Journal* 1302, 1303).

⁶⁶ Ian McDeod, *Legal Theory* (2nd edn, Palgrave 2003) 3.

⁶⁷ Schiemann (n 65) 1303.

⁶⁸ For example, the application of EU law in the context of the Energy Charter Treaty jurisprudence ignores the developments of EU law and integration since its creation in 1994. On the ECT, see chapter 7, section 7.2.3.

imposed by the rule of law among the different interests at stake in [the EU's] multilayered system of governance'.⁶⁹

Despite this difference in hermeneutic approach, the CJEU and investment tribunals engage in creating law through their interpretations. Just as arbitral tribunals have clarified through their jurisprudence the meaning of IIAs' vague substantive investment protections, the CJEU has fleshed out in its case-law the meaning of legal obligations under the EU founding treaties. In both cases, the interpretations arrived at have departed from the initial intentions of the respective Contracting parties. However, the CJEU has never rivalled the same level of criticism attracted by international investment tribunals. The power of the CJEU has never been contested in a way that would lead to redefining its role within the EU. Despite some predictions made by both legal and political scholars in the 1990s,⁷⁰ the power and the role of the CJEU have remained largely unchanged. Moreover, recent research demonstrates that the CJEU remains 'the most trusted governmental institution' among the EU and national institutions.⁷¹

The literature has sought to explain this phenomenon by examining the rationale of Member States' governments, including their national courts, for accepting the CJEU's jurisprudence. Of importance is the role of the CJEU in 'constitutionalising' the EU, which can also be defined as 'judicialisation of EU governance'. According to this theory, through its case-law the CJEU produces new rules, unintended by the Member States, which are implemented in subsequent policy-making and institutionalised as governance arrangements.⁷² This leads to both deepening and widening of EU integration. General geopolitical context of EU integration, including the efforts for stronger integration and the need to overcome political fragmentation of power in decentralised EU governance, has contributed to this judicialised mode of governance in the EU, leading to its acceptance.⁷³ In the words of the first Advocate General of the CJEU, Maurice Lagrange:

We will thus end up – when the European Federation comes into being – with a federal Court that will have no need to borrow its judicial system from overseas, but will quite naturally find its original foundations in the best of the legal experience of its own members.⁷⁴

⁶⁹ Koen Lenaerts, 'How the ECJ Thinks: A Study on Judicial Legitimacy' (2013) 36 *Fordham International Law Journal* 1302, 1303.

⁷⁰ See, for example Ulrich Haltern, 'Integration through Law' in Antje Wiener and Thomas Diez, *European Integration Theory* (OUP 2005) 191-195.

⁷¹ R Daniel Kelemen, 'The Court of Justice of the European Union in the Twenty First Century' (2016) 79 *Law and Contemporary Problems* 117, 123. Cf. Mark A Pollack, 'The Legitimacy of the European Court of Justice' in Nienke Grossman and others (eds), *Legitimacy and International Courts* (CUP 2018), who challenges the legitimacy of the CJEU on normative grounds.

⁷² Alec Stone Sweet, 'The European Court of Justice and the Judicialization of EU Governance' (2010) *Yale Law School Faculty Scholarship Series Paper No. 70*, 28-29. This article provides a comprehensive review of literature on this topic.

⁷³ Kelemen (n 71) 120-123.

⁷⁴ Lagrange (n 63).

Arguably, IIL has also been drawn into a process of judicialisation, at least with respect to the ICSID system, evidenced by the application by investment tribunals of reasoning methods developed by courts.⁷⁵ However, constitutionalisation in the case of IIL is rather fragmented and uncoordinated given the fragmented nature of IIR. In addition, it exposes a number of methodological problems on the side of investment tribunals in applying relevant reasoning methods that are usually applied by courts.⁷⁶ As a result, consistency, coherence and predictability of arbitral decisions by ISDS tribunals have been at the core of the concerns of States participating in the global reform of ISDS.⁷⁷ A number of States have been reforming their investment policies to address these issues.⁷⁸ Undoubtedly, new rules produced through the jurisprudence of international investment tribunals, unintended by State parties to IIAs, have influenced policy-making in the area of international investment and its global reform. However, different to judicialisation at EU level which led to strengthening of the CJEU's authority, rethinking of the IIR is aimed at restraining the activism of international investment tribunals and possibly institutional redesign of investment dispute settlement.⁷⁹

5.3.4. *Judicial review and domestic law*

Parallels between EU law and IIL can also be found with respect to the power of judicial review, exercised by their dispute settlement bodies. The EU legal system is envisaged as a complete system of remedies and procedures in which neither EU institutions nor the Member States can avoid judicial review of the legality of their measures under the founding treaties.⁸⁰ Individual parties have the right to challenge before the courts the

⁷⁵ Alec Stone Sweet, 'Arbitration and Judicialisation' (2011) 1 Onati Socio-Legal Series 1. In this respect the author lists specific indicators of judicialisation in the ICSID system: relative reliance on precedent; application of balancing and proportionality as a mode of reasoning developed by courts; admissibility of *amicus curiae* briefs; and considerations to develop a more comprehensive appeal facility. To demonstrate his argument about judicialisation, the author examines the application of proportionality in the Argentina cases: see *ibid* 15-20. Cf. Schneiderman (n 41) disputing the importance of proportionality in IIL: 'It may be more accurate to say that the embrace [of proportionality] is hesitant and resembles more of an awkward advance': *ibid* 16.

⁷⁶ N Jansen Calamita, 'The Principle of Proportionality and the Problem of Indeterminacy in International Investment Treaties' (2014) Yearbook on International Investment Law and Policy 157.

⁷⁷ See UNCITRAL, 'Possible reform of investor-State dispute settlement (ISDS): Consistency and related matters' Note by the Secretariat (28 August 2018) UN Doc A/CN.9/WG.III/WP.150.

⁷⁸ States have been restraining the leeway exercisable by investment tribunals when interpreting the scope of different protection standards by inserting more precise definitions of different standards: see chapter 3, section 3.3. Since these changes are recent, it is yet to be seen how they will influence the investment tribunals' jurisprudence. However, critical voices against ISDS emphasise that these policy changes are insufficient and continue to leave undue discretion to investment tribunals when they determine their scope: see, for example, Prabhash Ranjan and Pushkar Anand, 'The 2016 Model Indian Bilateral Investment Treaty: A Critical Deconstruction' (2017) 38 Northwestern Journal of International Law and Business 1.

⁷⁹ See UNCITRAL, 'Possible reform of investor-State dispute settlement (ISDS)' Note by the Secretariat (5 September 2018) UN Doc A/CN.9/WG.III/WP.149.

⁸⁰ Case C-294/83 *Parti écologiste "Les Verts" v European Parliament* [1986] ECR 1339, para 23.

legality of any decision or other national measures relating to the application of an EU act to them.⁸¹ Effective judicial control is a general principle of EU law, stemming from the constitutional traditions common to the Member States, enshrined in Articles 6 and 13 of the ECHR and Article 47 of the EU Charter of Fundamental Rights (CFR).⁸² The expression of this principle is in Article 19 TEU, which entrusts the exercise of judicial review in the EU legal order to the CJEU and all national courts of the Member States. In this symbiosis, the work is mostly done by national courts because private individuals are primarily invited to enforce their rights under EU law before the national courts. Although the founding treaties made it possible in a number of instances for private parties to bring a direct action before the CJEU,⁸³ its original jurisdiction is mostly limited to Member States and the EU institutions.⁸⁴

Importantly, when reviewing compliance of national legislation with EU law, Member States are endowed with procedural autonomy.⁸⁵ It is for domestic legal systems of Member States to determine the jurisdiction and procedural rules of their courts that govern actions for the protection of individual rights under EU law, including an individual's standing and legal interest in bringing procedures.⁸⁶ Accordingly, EU law intended to create new substantive *rights* for individuals but not new *remedies*, except for the cases where no legal remedy exists in national law.⁸⁷

Nevertheless, national law cannot in any case undermine the right to effective judicial protection. The protection is ensured through principles of equivalence and

⁸¹ Case C-583/11 P *Inuit Tapiriit Kanatami and Others v Parliament and Council* ECLI:EU:C:2013:625, paras 91, 94; Case C-64/16 *Associação Sindical dos Juizes Portugueses* ECLI:EU:C:2018:117, para 31.

⁸² Charter of Fundamental Rights of the European Union [2012] OJ C 326/391; *Johnston* (n 50), paras 18-19; Case 222/86 *Heylens and Others* [1987] ECR 4097, para 14; Case C-424/99 *Commission v Austria* [2001] ECR I-9285, para 45; Case C-50/00 P *Unión de Pequeños Agricultores v Council* [2002] ECR I-6677, para 39; Case C-467/01 *Eribrand* [2003] ECR I-6471, para 61; Case 432/05 *Unibet* [2007] ECR I-2271, para 37; *Associação Sindical dos Juizes Portugueses* (n 81) para 35.

⁸³ Under Art 263 TFEU private individuals (natural and legal persons) have standing only before the Court of First Instance in cases for judicial review of the legality of acts undertaken by the EU's institutions; however, such actions are limited to acts which are specifically addressed to them or are 'of direct and individual concern to them': Art 263(4) TFEU. However, this criterion has been interpreted narrowly by the CJEU. The measure must directly affect the legal situation of the individual and leave no discretion to the implementing authority, such as a Member State: Case C-386/96 P *Société Louis Dreyfus & Cie v Commission of the European Communities* [1998] ECR I-2309, para 43. Individual concern has been even more stringently interpreted and the criterion cannot apply if the act affects an individual as a member of an open group: see *Plaumann* (n 58). Since the Lisbon Treaty, individuals can also institute proceedings against 'a regulatory act which is of direct concern to them and does not entail implementing measures': Art 263(4) TFEU. A *regulatory act* is any act of general application apart from a legislative act. Thus, legislative acts can be challenged directly before the CJEU only if they are of direct and individual concern to an individual: *Inuit* (n 81) para 12.

⁸⁴ Under Art 258 TFEU, the European Commission can initiate infringement proceedings before the CJEU against a Member State for non-compliance with EU law, and under Art 259 TFEU such proceedings can be initiated by one Member State against another Member State.

⁸⁵ Rosas and Armati (n 13) 231-232.

⁸⁶ *Unibet* (n 82) paras 39, 42.

⁸⁷ *ibid* para 40-41. However, examples of new remedies grounded in EU law are interim relief: *Factorame I* (n 13), and state liability in damages: Joined Cases C-6/90 and C-9/90 *Francovich* [1991] ECR I-5357; Joined Cases C-46/93 and C-48/93 *Brasserie du Pêcheur and Factorame III* [1996] ECR I-1029.

effectiveness. Accordingly, national procedural rules for the enforcement of individual rights under EU law must be no less favourable than those governing similar domestic actions (principle of equivalence) and must not render practically impossible or excessively difficult the exercise of rights conferred by EU law (principle of effectiveness).⁸⁸ Therefore, EU law allows for procedural diversity in national laws, as long as such diversity does not adversely affect the effectiveness of EU law.

Deference to national law is also evident in the CJEU's review of Member States' legislation against grounds based in the public good which justify Member States' restrictions on free movement. These grounds are either explicitly stated in the founding treaties⁸⁹ or can be subsumed under the umbrella concept of 'public interest'.⁹⁰ In assessing these grounds, the CJEU's approach tends to be restrictive in more technical fields, while in more value-laden fields the CJEU allows the Member States leeway in defining their own values and public norms.⁹¹ A wide range of different interests has been recognised under EU law as worthy of protection in spite of their trade-restricting effects.⁹² The only interests that are fully excluded as justification for restrictions on free movement are purely economic reasons that serve protectionist purposes,⁹³ such as measures intended for the protection of a local economy⁹⁴ or States' own budgets.⁹⁵ Therefore, EU law will be willing to protect public goods as defined by national authorities, as long as the Member States' approach in protection of public goods does not put the core EU values at risk.

The assessment of public policy exceptions is carried out in light of EU obligations. The concept of 'public policy' may be relied upon only if there is 'a genuine and sufficiently

⁸⁸ Case 33/76 *Rewe-Zentralfinanz* [1976] ECR 1998, para 5; Case 45/76 *Comet BV v Produktschap voor Siergewassen* [1976] ECR 2043, paras 13-16; Case C-312/93 *Peterbroeck, Van Campenhout & Cie SCS v Belgian State* [1995] ECR I-4599, para 12; Case C-453/99 *Courage v Crehan* [2001] ECR I-6297, para 29; Case C-13/01 *Safalero* [2003] ECR I-8679, para 49; *Unibet* (n 82) para 43.

⁸⁹ For example, Art 36 TFEU defines grounds on which Member States may derogate from free movement of goods: public morality, public policy or public security; the protection of health and life of humans, animals or plants; the protection of national treasures possessing artistic, historic or archaeological value; or the protection of industrial and commercial property. However, these restrictions in any case cannot result in arbitrary discrimination nor can they constitute a disguised restriction on trade between the Member States. Art 65(1) TFEU defines circumstances in which Member States may restrict free movement of capital, related to the regulation of taxation and supervision of financial institutions: see chapter 7, section 7.1. Derogation from free movement of workers, establishments and services is allowed only on grounds of public policy, public security and public health: Arts 45(3), 52(1) and 62 TFEU

⁹⁰ See, for example, Case C-123/00 *Criminal Proceedings Against Bellamy and English Shop Wholesale* [2001] ECR I-2795, para 18.

⁹¹ Chalmers, Davies and Monti (n 9) 872.

⁹² For example, protection against market externalities in the interests of the wider public, protection of civil liberties, recognition of socio-cultural preferences, preservation of state machinery. For a detailed list of relevant interests and case-law, see *ibid* 874-875.

⁹³ Case 352/85 *Bond van Adverteerders* [1985] ECR 2085, para 34; Case C-158/96 *Kohll v Union des Caisses de Maladie* [1998] ECR I-1931, para 41.

⁹⁴ See, for example, Case C-367/98 *Commission v Portugal* [2002] ECR I-04731.

⁹⁵ See, for example, Case C-109/04 *Kranemann v Land Nordrhein-Westfalen* [2005] ECR I-2421.

serious threat to a fundamental interest of society' and must be interpreted strictly. Accordingly, 'its *scope* cannot be determined unilaterally by each Member State without the control by the [EU] institutions.'⁹⁶ When determining the *meaning* of public policy the CJEU recognises the need for flexibility by accommodating the diverse legal interpretations made by national authorities.⁹⁷ Deference to national law has been described by the CJEU as a 'margin of discretion'⁹⁸ or 'margin of appreciation',⁹⁹ and it has been explained in the following terms:

... the particular circumstances justifying recourse to the concept of public policy may vary from one country to another and from one period to another, and it is therefore necessary in this matter to allow the competent national authorities an area of discretion within the limits imposed by the Treaty.¹⁰⁰

However, Member States must comply with the principle of proportionality, meaning that their choice must be confined to what is necessary for safeguarding the particular public good, and that the measure must be proportionate to the objective pursued, which could not have been otherwise attained by measures less restrictive of intra-EU trade.¹⁰¹

In the same manner, the CJEU will be willing to allow the Member States discretion in the level of protection of their constitutional principles of fundamental importance, as long as such principles do not conflict with core values of the EU and pass the proportionality test.¹⁰² In reviewing the Member States' compliance with the fundamental rights guaranteed in the CFR, the national courts 'remain free to apply national standards of protection of fundamental rights', as long as such application does not undermine the level of protection guaranteed by the Charter, and the primacy, unity and effectiveness of EU law.¹⁰³

In a similar manner, international investment tribunals exercise the power to review national measures by assessing the effects of the challenged measures on foreign investors. Some scholars claim that, in its essence, IIL operates as a constitution-like

⁹⁶ Case C-36/02 *Omega* [2004] ECR I-9609, para 30 (emphasis added).

⁹⁷ For example, in a number of cases the CJEU ruled in favour of Member States' discretion to determine the level of protection that they wish to afford to public health and the manner in which that level is to be achieved, when justifying measures as a public interest exceptions to free movement of goods under Art 36 TFEU: see, case-law cited in fn 53 above.

⁹⁸ Case C-112/00 *Eugen Schmidberger, Internationale Transporte und Planzüge v Republik Österreich* [2003] ECR I-5659.

⁹⁹ Case C-110/05 *Commission of the European Communities v Italian Republic* [2009] ECR I-519, para 65.

¹⁰⁰ *Van Duyn v Home Office* (n 16) para 18.

¹⁰¹ Case C-95/01 *Greenham and Abel* [2004] ECR I-1333, para 39. Additionally, Member States' justifications for public policy exceptions must be consistent with the national legislation as a whole aimed at protecting that particular public interest: see, for example, Joined Cases C-338/04, C-359/04 and C-360/04 *Placanica and Others* [2007] ECR I-1891.

¹⁰² Case C-208/09 *Ilonka Sayn Wittgenstein v Landeshauptmann von Wien* [2010] ECR I-13693.

¹⁰³ Case C-399/11 *Stefano Melloni v Ministerio Fiscal* ECLI:EU:C:2013:107, para 60; Case C-617/10 *Åklagaren v Hans Åkerberg Fransson* ECLI:EU:C:2013:105, para 29.

transnational regime¹⁰⁴ or global administrative law regime.¹⁰⁵ Arguably, however, in carrying out such review investment tribunals lack the legitimacy that the CJEU and national courts enjoy, at least in relative terms.¹⁰⁶ The reason lies in the cooperative nature of the relationship between EU law and national laws, which does not exist in the relationship between IIL and domestic laws. While EU law recognises a level of deference to national laws of Member States,¹⁰⁷ IIL is exclusively focused on strict review of the compliance of the respondent States' national laws with IIL, with little regard for the national rule of law. This is, *inter alia*, evident in investment tribunals' hesitant approach to the principle of proportionality when balancing the competing interests of foreign investors and the wider public interests, in the narrow interpretations of treaty derogations in favour of public interest objectives, and in conflicting application of the margin of appreciation in interpretation of investment treaty obligations.¹⁰⁸ However, in the absence of a clear standard of review in IIAs and in the current institutional framework, some authors argue that it is better to abstain from the application of some judge-made standards than apply them as 'pseudo-standards'.¹⁰⁹ Nevertheless, an inability to appropriately accommodate the national rule of law in investment tribunals' review has led to criticism of ISDS, which is seen as a limitation to state sovereignty in domestic policy-making, and has triggered its legitimacy crisis.¹¹⁰

¹⁰⁴ Schneiderman (n 41).

¹⁰⁵ Gus Van Harten and Martin Loughlin, 'Investment Treaty Arbitration as a Species of Global Administrative Law' (2006) 17 *European Journal of International Law* 121.

¹⁰⁶ On doubtful legitimacy of the CJEU, see James L Gibson and Gregory A Caldeira, 'Challenges to the Legitimacy of the European Court of Justice: A Post Maastricht Analysis' (1998) 28 *British Journal of Political Science* 63. But for recent research that counterbalances the legitimacy doubts with respect to the CJEU, see R Daniel Kelemen, 'The political foundations of judicial independence in the European Union' (2012) 19 *Journal of European Public Policy* 43. However, legitimacy of national courts is a complex topic with different results in different Member States. New Member States still face the challenges of their legacy and transition to democracy. For example, the controversial reform of the Polish judiciary, which has been ongoing since 2015 and which has been heavily criticised by the EU for its non-compliance with the rule of law, has been justified by the Polish Government by reference to low public trust in the judiciary: see Polish Government, White Paper on the Reform of Polish Judiciary (7 March 2018)

<https://www.premier.gov.pl/files/files/white_paper_en_full.pdf> accessed 30 June 2020.

¹⁰⁷ See Art 4(2) TFEU.

¹⁰⁸ On the applicability of these tools in investment arbitration, see, for example, the analysis by Giovanni Zarra, 'Right to Regulate, Margin of Appreciation and Proportionality: Current Status in Investment Arbitration in Light of Philip Morris v Uruguay' (2017) 14 *Brazilian Journal of International Law* 98.

¹⁰⁹ Julian Arato, 'The Margin of Appreciation in International Investment Law' (2014) 54 *Virginia Journal of International Law* 545, 548. The author provides analysis of the application of the margin of appreciation by investment tribunals and argues that, in the absence of institutional centralisation through a system of appeal or formal precedent, the importation of this doctrine into international investment law brings more harm than benefits.

¹¹⁰ Schill (n 45). See also Schneiderman (n 41).

5.3.5. *The relationship with domestic courts*

The authority of the CJEU has been established through an innovative approach in the interpretation of EU law, which respects the national rule of law as an integrative part, and also by an innovative mechanism of cooperation between the CJEU and national courts.

The process of ‘constitutionalisation’ of the EU Treaty system has been possible due to the procedure prescribed in TFEU Article 267 and it has been driven by private litigants, national courts and the CJEU.¹¹¹ In this framework, each of these actors has a clearly defined role. Private litigants bring cases which involve controversies about their rights under EU law before national courts. However, private litigants do not have a say in the decision of the national court to refer questions of EU law for preliminary ruling.¹¹² This process is dependent on the initiative of the national court, which determines both the need for a preliminary ruling and the relevance of the questions put before the CJEU.¹¹³ The assessment of the facts of the case is the matter for the national court. The assessment of EU law is the matter for the CJEU, which is empowered to give rulings on the basis of the facts which the national court has put before it.¹¹⁴ These roles are fulfilled thanks to the relevant EU constitutional principles.¹¹⁵

The preliminary ruling procedure allows ‘direct cooperation’ between the CJEU and national courts. However, this cooperation embodies ‘a clear separation of functions’ between the two, and thanks to which the CJEU remains the ultimate authority for all issues of EU law.¹¹⁶ This judicial dialogue is the ‘cogwheel’ of the mechanism which enables the CJEU to centrally integrate national and supranational legal orders, but which would not be possible without national courts and private litigants.¹¹⁷ The rationale of this cooperation is not only the effectiveness of EU law but also the necessity of its very existence.¹¹⁸

¹¹¹ Stone Sweet (n 5) 160-163.

¹¹² Case 44/65 *Hessische Knappschaft v Maison Singer et Fils* [1965] ECR 965; Case C-364/92 *SAT Fluggesellschaft mbH v Eurocontrol* [1994] ECR I-43, para 9.

¹¹³ *Peter Gauweiler and Others* (n 7) para 15.

¹¹⁴ Case C-30/93 *AC-ATEL Electronics Vertriebs v Hauptzollamt München-Mitte* [1994] ECR I-2305, para 16; Case C-326/96 *Levez v T.H. Jennings (Harlow Pools)* [1998] ECR I-7835, para 25; *World Wildlife Fund (WWF)* (n 52) para 31.

¹¹⁵ Direct effect enables private individuals to sue Member States for not conforming to their obligations under EU law before their national courts. Primacy requires the national judge to resolve conflicts between national law and EU law in favour of EU law.

¹¹⁶ *Peter Gauweiler and Others* (n 7) para 15.

¹¹⁷ Stone Sweet (n 5) 165.

¹¹⁸ Monica Claes, ‘The Validity and Primacy of EU Law and the “Cooperative Relationship” between National Constitutional Courts and the Court of the Justice of the European Union’ (2016) 23 *Maastricht Journal of European and Comparative Law* 151, 154.

This process has led to judicial empowerment at the level of EU courts and in the national courts, and with respect to their mutual relationships and their relationships with other branches of government.¹¹⁹ While the CJEU needed the case-law from the national courts to build EU law and thus strengthen its role, national courts also benefited from their participation in the construction of EU law.¹²⁰ EU law has empowered national courts with the judicial review of national measures, regardless of whether they had such power under their national legal systems, therefore giving the national courts greater powers to control State acts and other branches of government.¹²¹ The lower courts also benefited from invoking EU law as they could in this way challenge the jurisdictions of higher courts and obtain alternative legal outcomes.¹²² Private litigants also had their own interests in raising legal challenges against non-compliance by Member States with their EU law obligations, fuelling the system with a number of cases.¹²³ Gradually, through incremental decision-making of the CJEU, enforced by national courts, EU law expanded its reach while influencing the Member States' behaviour and policy making in the direction of their compliance with EU law.¹²⁴ The preliminary ruling mechanism, with individual litigants as decentralised agents, the CJEU as central authority in respect of EU law and national courts who render final decisions, has ensured the effectiveness of the Member State compliance with the rule of law in the EU.¹²⁵

While EU law works to empower the role of the national judge, IIL in its essence undermines the role of national courts. International investment tribunals have been established with the principal reason of operating outside the judicial system of States.¹²⁶ On a more general level, investment tribunals have been established with a view to overcoming investors' distrust of national courts and indeed in some cases such distrust remains justified.¹²⁷ The main rationale for the establishment of the ICSID was to guarantee a neutral forum for the resolution of investment disputes and thus achieve depoliticisation of such disputes for the benefit of both investors and States.¹²⁸

¹¹⁹ Joseph HH Weiler, 'The Transformation of Europe' (1991) 100 Yale Law Journal 2403, 2419.

¹²⁰ Stone Sweet (n 5) 165.

¹²¹ Indeed, the practice of judicial review is more a characteristic of countries with common law legal tradition, where it is limited to the questions of the validity of a certain administrative act under the relevant legislation. In the countries with civil law legal traditions, judicial review is usually restricted to constitutional courts which assess the validity of a certain legislative act under the constitution, as it is the case in most EU Member States.

¹²² Karen J Alter, 'The European Court's Political Power' (1996) 19 West European Politics 458, 466-467.

¹²³ Karen J Alter, *Establishing the Supremacy of European Law: The Making of an international Rule of Law in Europe* (OUP 2001) 218.

¹²⁴ *ibid* 221.

¹²⁵ *Ibid* 217-221; Weiler (n 119).

¹²⁶ Opinion 2/15 ECLI:EU:C:2017:376, para 292; *Achmea* (n 38) para 45.

¹²⁷ See *Chevron Corporation and Texaco Petroleum Corporation v The Republic of Ecuador*, UNCITRAL, PCA Case No. 2009-23, Second Partial Award on Track II (30 August 2018).

¹²⁸ Ibrahim Shihata, 'Toward a Greater Depoliticization of Investment Disputes: The Roles of ICSID and MIGA' (1986) 1 ICSID Review-FILJ 1. See also discussion in chapter 1.

Investment tribunals challenge national courts in a number of ways. Depending on the investment agreement in question, parallel proceedings before national courts and investment tribunals are possible and can lead to diverging outcomes.¹²⁹ Arbitral tribunals have the power to review the decisions of national courts, even in States with developed legal systems.¹³⁰ They can find breaches of IIAs even when the conduct of the court has complied with the national requirements of due process, thus challenging the domestic rule of law.¹³¹ Their findings can lead to conflicts between international law and domestic law and to internal tensions between different branches of government, challenging also the principle of the separation of power.¹³²

Before concluding this chapter, the following table summarises the key features, parallels and differences between the legal orders of the EU and international investment.

¹²⁹ See chapter 2, section 2.2.2.

¹³⁰ See, for example, *Loewen v USA*, ICSID Case No. ARB(AF)/98/3, Award (26 June 2003), in which Canadian foreign investor challenged the domestic ruling of an US court; and *Eli Lilly and Company v The Government of Canada*, UNCITRAL, ICSID Case No. UNCT/14/2, Final Award (16 March 2017), in which the a US investor challenged the decisions of the Canadian courts that invalidated two patents for not meeting the requirements of Canadian patent law.

¹³¹ For example, in *Mr. Franck Charles Arif v Republic of Moldova*, ICSID Case No. ARB/11/23, Award (8 April 2013), the Moldavian courts invalidated the grant of a concession to the French foreign investor by the executive branch for not complying with the proper procedure (in this case the executive branch in fact favoured the foreign investor over Moldavian competitors). At para 415, the Tribunal noted: 'The Tribunal is not persuaded that there has been collusion between the courts and the investor's competitors in the proceedings before the Moldovan courts over these agreements or that the Moldovan courts have acted in denial of justice in any way (see Section VI.B.2). Moreover, there is no evidence in the record that persuades the Tribunal to conclude that the Moldovan judiciary has not applied Moldovan law legitimately and in good faith in the proceedings commenced by Claimant's competitors.' The Tribunal added in para 416: 'Le Bridge has had a fair opportunity to defend its position under Moldovan law before the Moldovan courts.' See also paras 447-453. However, the Tribunal ruled in favour of the investor, noting that the court ruling breached the Moldavian obligations under the investment treaty. Effectively, the investment Tribunal denied the Moldavian court the judicial review of the executive action, thus interfering with the domestic rule of law processes in Moldova.

¹³² For example, in *Chevron* (n 127), the Tribunal found that the judgment of the Ecuadorian Supreme Court (the Lago Agrio Judgment) against Chevron to pay US\$9.5 billion for environmental damage had been procured through judicial fraud, amounting to a breach of Ecuador's obligations under the investment treaty. However, the Tribunal, in addition to the payment of financial compensation, ordered Ecuador to 'take immediate steps' to remove 'the status of enforceability from the Lago Agrio Judgment', to preclude the enforcement of the judgment, to advise any of the States where the judgment could be enforced of its unenforceability, to return any proceeds from the enforcement of the judgment, and to take corrective measures to 'wipe out all the consequences' of the respondent's internationally wrongful acts in regard to the judgment: para 10.13. It is unusual for an investment tribunal to make any other orders other than financial compensation. Moreover, by making such orders this Tribunal effectively called upon the executive government to take responsibility and remedy the actions of its judicial branch.

Table 5.1. Comparisons between EU law and international investment law

	EU	IIR	Parallels and differences
Sources	▪ International treaties (EU founding treaties) ▪ EU secondary laws	▪ International treaties (IIAs) – bilateral (BITs) and plurilateral (PTIAs)	No secondary laws in IIR but State parties to IIAs can make binding interpretations under international law.
Hierarchy of rules	▪ Vertical and structured ▪ The doctrine of primacy of EU law	▪ Horizontal and fragmented ▪ Rules of international law in determining the primacy of rules	In both cases domestic law is subordinate but EU law prevails over the international agreements of Member States and primary EU law prevails over international agreements to which the EU is a party.
Enforcement of rights	▪ Through domestic courts and the CJEU ▪ Appeals mechanism ▪ The CJEU is the supreme authority for the interpretation of EU law	▪ Through <i>ad hoc</i> investment tribunals ▪ No appellate mechanism ▪ No supreme authority for the interpretation of rules	In both cases private individuals can directly invoke international treaties (the doctrine of direct effect in EU law and offer to arbitrate in ISDS clause in IIR). In the case of IIR, domestic courts have no role and their decisions can be made the subject of investor claims.
Scope	▪ Four freedoms in the EU ▪ Internal market ▪ Charter of fundamental rights ▪ Compliance mechanisms through the CJEU	▪ Substantive protections and a dispute resolution mechanism for foreign investors	The EU is a more comprehensive system with access to justice for a broader range of economic and non-economic actors.
Objectives	▪ Trade liberalisation and level playing field in the EU ▪ Regulatory approximation/harmonisation ▪ EU integration	▪ Protection of foreign investors and their legitimate expectations	The EU objectives are much broader in scope and include both trade and non-trade objectives. While protection of investment arguably contributes to an increase in investment flows, in essence it is a protectionist measure not aimed at achieving investment liberalisation or a level playing field.¹³³
Nature of the system	▪ Public international and supranational law ▪ Constitutional system	▪ Public international law with private law elements	Although based on public international law, EU law resembles domestic constitutional systems. Although based on public international law (IIAs), IIR has been developed on a private law model of arbitration, which is at its core.

¹³³ See the analysis in chapter 3, section 3.1.2.

Applicable law in the proceedings	▪ Founding treaties (primary EU law) ▪ International law that binds the EU ▪ Secondary EU law	▪ IIAs (BITs and PTIAs) ▪ General principles of international law ▪ Domestic law ▪ Procedural rules: UNCITRAL and ICSID	Both interpret rules of international law but the scope of applicable EU rules is wider and includes EU secondary rules. Depending on the legal instrument, IIR tribunals can interpret domestic law.
Remedies	▪ Substantive protections for private individuals under primary and secondary EU law ▪ Remedies against unlawful EU measures defined in EU law ▪ Remedies against unlawful national measures defined in domestic law	▪ Substantive protections under individual IIAs ▪ Specific procedural rights available to foreign investors only (offer to arbitrate) ▪ Remedies against unlawful host State measures defined in IIAs (limited to monetary compensation)	Both offer protections to private individuals but the scope of protection and available remedies in IIR is limited to foreign investors only. Under EU law rights are harmonised across the EU while the remedies differentiate across different Member States. In IIR both rights and remedies are defined in an individual IIA but they are mostly harmonised.
Principles of interpretation	▪ Consistent interpretation ▪ Proportionality in balancing public-private interests ▪ Teleological interpretation in view of EU policy objectives	▪ No precedent and inconsistent decisions possible ▪ VCLT but inconsistently applied ▪ Focus on textual interpretation ▪ Interpretation in favour of protection of investors	Both apply genuinely different methods of interpretation, in particular in balancing public-private interests, resulting in different outcomes and impact on domestic measures: ▪ Elimination of illegal measures under EU law; ▪ Possible 'regulatory chill' under investment law.
Applicability of decisions	▪ <i>Erga omnes</i> ▪ <i>Ex tunc</i>	▪ <i>Inter partes</i> ▪ <i>Ex nunc</i>	Decisions of the CJEU are legally binding on the courts of all Member States and in that sense have law making effect. IIR tribunals' decisions apply only to the case in point but are often referred to by subsequent tribunals.
Scope of proceedings	▪ Judicial review of the legality of EU acts ▪ The assessment of national rules that conflict with EU law through preliminary ruling procedure	▪ The assessment of national rules against international investment law (IIAs, ICSID) takes on the function of a form of judicial review	In both cases, functionally at least, judicial review of national measures and new rules produced through case-law, often unintended by the States.
Relationship with domestic courts and institutions/ domestic law	▪ Judicial dialogue through preliminary ruling procedure ▪ Procedural autonomy of the Member States	▪ No involvement of domestic courts ▪ Genuine mistrust in domestic institutions ▪ Usually no margin of appreciation nor deference to domestic law	Domestic courts are part of the EU judicial system while IIR operates as a parallel system to domestic courts. EU law more deferential towards domestic institutions and political imperatives of Member States in defending public interest.

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- Mutual trust and sincere cooperation
 - Deference to domestic law
-

5.4. Conclusion

The EU legal order is a sophisticated and highly structured legal system (primacy of EU law), which provides for a comprehensive hierarchy of norms and rules applicable to both Member States and their citizens (direct effect); a comprehensive system of judicial and non-judicial remedies for the enforcement of these rules (the rule of law); and a normative system founded on a constitutional set of values and fundamental rights. In this legal order, the compliance with EU law and successful attainment of EU objectives is secured through an innovative judicial ‘dialogue’ between the CJEU and national courts, guaranteeing uniform interpretation of EU law. The dialogue between the CJEU and national courts has ensured the relative respect for the rule of law in the EU and the relative success of EU law compared to other regimes of international law.

While in many aspects similar to IIL, the EU legal order has generally been accepted by national actors, including courts. Proportionality, balancing economic and other fundamental rights, deference to national laws through respect for Member States’ procedural autonomy and diversity of their constitutional and legal traditions in interpretation and implementation of EU rules have played a role, with the CJEU as the main constructive actor and pillar of EU legitimacy. It is therefore not a surprise that the establishment of a court for IIL reform came from the EU as a solution for its legitimacy problems.

However, the CJEU, as an international court, is a unique example. *De facto* constitutionalisation of Europe, achieved through the CJEU’s case-law, came as a substitute for the failed *de iure* constitutionalisation in the shape of a formal European Constitution. Law became ‘a convenient expedient for politics’ with the key role played by the CJEU in this process.¹³⁴ The development of EU investment regulation, as explained in the following chapters, supports this thesis. However, reference by the CJEU to internal law in developing its case-law, which brought the EU law closer to the national laws of the Member States than to international law, serves to legitimise the CJEU’s approach in

¹³⁴ Cohen (n 63) 243.

constitutionalising Europe without a formal constitution.¹³⁵ On the other hand, IIL lacks clear objectives and any centralised institution could hardly consolidate the competing and fragmented interests of States in international investment.

Importantly, the EU legal system, as explained here, works best in theory. In practice it is subject to a number of structural tensions: between international, supranational and national levels; between law and the quotidian realities of politics and economics; between market and other values, and different actors who have different ideas about what the EU should be. The CJEU has been well aware that it sits within the complex political processes of the EU. Judges are not politically accountable but they are conscious of the need to secure the acceptability of their decisions. Since the EU judicial system relies on the willingness of cooperation between central and peripheral courts, it can at times come into question.

With the EU legal order as the framework for EU investment policy, the remaining chapters of Part II focus more specifically on EU foreign investment regulation. The analysis unfolds around the central role of the CJEU in developing the EU investment policy, both internally and externally. As point from which to start, the next chapter explains how the EU institutional framework serves as a limitation to a more efficient investment policy in external EU relations.

¹³⁵ Antonin Cohen, 'Constitutionalism Without Constitution: Transnational Elites Between Political Mobilisation and Legal Expertise in the Making of a Constitution for Europe (1940s–1960s)' (2007) 32 *Law and Social Inquiry* 109.

Institutional framework of EU investment regulation: legal limitations to policy efficiency

6.1. Power to decide investment issues in the EU: a question of competence

6.1.1. *The scope of EU foreign investment competence*

6.1.2. *The nature of EU foreign investment competence*

6.2. EU policy-making in international investment: the choice of a legal basis

6.2.1. *Conclusion of 'EU-only' agreements*

6.2.2. *Conclusion of 'mixed' agreements*

6.3. EU treaty-making in international investment: policy implications

6.4. Conclusion

It has always been a particular challenge to specify the exact division of competences between the EU and its Member States. Given the relevance of international investment for the EU, on one hand, and the cross-cutting nature of investment within the range of domestic policy areas on the other, the exercise of competences relating to foreign investment has been surrounded by controversies. In this chapter we aim to explain the institutional framework for investment policy-making and its implications for the EU's power as an external actor in global trade and investment.

Following the Lisbon Treaty of 2009, foreign direct investment (FDI) has been included in the scope of the Common Commercial Policy (CCP).¹ Given that the treaties explicitly list CCP as an EU exclusive competence in Article 3(1) TFEU, FDI has accordingly become an exclusive competence of the EU. As a consequence, the EU has gained competence for foreign investment treaty-making in the area of foreign investment protections and dispute settlement, which previously fell within the scope of the Member States' treaty-making competence. However, the lack of clarity on the scope of the EU's foreign investment competence led to disagreements between the EU and Member States.

¹ Arts 206 and 207 TFEU.

The European Commission (EC) claimed exclusive EU competence to negotiate and conclude FTAs with investment chapters as ‘EU-only’ agreements while the Council and the Member States insisted that these agreements should be concluded as mixed agreements. This difference is significant as ‘mixity’ entails additional complexity in negotiations managed jointly by the EU and the Member States. It also involves likely delays of the agreements’ entry into force, since mixed agreements must be ratified by the EU and all Member States. The CJEU’s ruling in Opinion 2/15² clarified the vertical distribution of powers between the EU and Member States for external foreign investment, and as such influenced treaty-making policy change with respect to investment.

Accordingly, treaty-making procedure in the EU is not a matter of political inter-institutional preference but it is defined by the delineation of competences between the EU and its Member States and as such is grounded in law. We analyse the key legal issues related to the allocation of international investment competence within the EU and examine the political implications that these legal aspects have on policy efficiency and choices in external EU trade and investment relations. The focus is placed on the institutional framework with respect to competences and the conclusion of EU IIAs, culminating in the role of the CJEU in defining this framework (the scope of the policy). Intra-EU and extra-EU dimensions of investment policy in the EU (the content of the policy) will be examined in more detail in the remaining chapters of Part II.

6.1. Power to decide investment issues in the EU: a question of competence

As explained in the preceding chapter, the EU is not (yet) a federation. Nevertheless, similar to a federal structure, the powers and competences of EU institutions in a particular policy area are defined by the founding treaties, which serve as the EU’s Constitution, and are clarified through the case-law of the CJEU. Treaty provisions confer on the EU competence in order to achieve objectives particular to that policy area, which are interpreted in the light of the general objectives of the EU.³ Competence stems from a particular legal basis, which empowers the EU to exercise its competence in a given field. The choice of legal basis for a particular EU action determines which institution has competence to act, what procedure is to be followed, which objectives are to be achieved,

² Opinion 2/15 ECLI:EU:C:2017:376.

³ Arts 5(1) and (2) TEU. In accordance with Art 5(1) TEU, the limits of the Union governance are governed by the principle of conferral.

and what types of acts can be adopted.⁴ Competence and legal bases could therefore be described as two sides of the same coin, which define the institutional power within the EU in a certain policy area. The principle of conferred powers must be respected both in the internal (intra-EU) action and the external (international) action of the EU.⁵ In the context of international investment, this has important consequences for the efficiency of the EU's international investment policy (IIP), its policy choices and accordingly also the EU's role in geoeconomics and the geopolitics of international trade.

EU international investment competence has been the subject of marked controversy, with Member States and the EU disagreeing on the matter. Divergent institutional opinions regarding the extent and nature of EU foreign investment powers led the EC to request from the CJEU the clarification of the competence of the EU to sign and conclude an FTA with Singapore (EUSFTA).⁶ Such requests can be made pursuant to Article 218(11) TFEU and may relate to the issue of competence (whether any institution of the EU has the power to conclude the agreement) or the issue of substance (whether the content of the agreement is compatible with EU law).⁷ Request for Opinion 2/15 related strictly to the issue of competence.⁸

In order to answer the question of who holds power to decide foreign investment issues in the EU, the CJEU examined EU competence with respect to the investment chapter of the EUSFTA,⁹ clarifying two aspects: (i) the scope of EU competence regarding foreign investment, both with respect to the type of investment (FDI vs portfolio investment) as well as the phases of investment (pre-establishment vs post-establishment), and (ii) the nature of EU investment competence (internal vs external; exclusive vs shared; express vs implied). The CJEU's conclusions are explained next through the prism of these intertwined elements.

⁴ Nicholas Emiliou 'Opening Pandora's Box: the Legal Basis of Community Measures Before the Court of Justice' (1994) 19 *European Law Review* 488; Kieran St. Clair Bradley, 'The European Court and the Legal Basis of Community Legislation' (1998) 13 *European Law Review* 379; Damian Chalmers, Gareth Davies and Giorgio Monti, *European Union Law* (2nd edn, CUP 2010) 95.

⁵ Opinion 2/94 [1996] ECR I-1759, para 24.

⁶ European Commission, 'Decision Requesting an Opinion of the Court of Justice Pursuant to Article 218(11) TFEU on the competence of the Union to Sign and Conclude a Free Trade Agreement with Singapore' C (2014) 8218 final.

⁷ Opinion 2/15 (n 2) para 9 and case-law therein cited.

⁸ See the later request by the Kingdom of Belgium, which resulted in CJEU's Opinion 1/17 related to the issue of compatibility of CETA's investment chapter with EU law.

⁹ Ch 9 EUSFTA containing provisions on investment protection and dispute settlement. Importantly, since the Opinion 2/15, what is now referred as the EU-Singapore FTA differs from the EUSFTA examined by the CJEU in Opinion 2/15.

6.1.1. The scope of EU foreign investment competence

In general terms, the scope of competence determines the aspects of a certain policy area for which the Member States have conferred competence on the EU. Article 207(1) TFEU is the key provision for defining the scope of the EU's international investment competence:

The common commercial policy shall be based on uniform principles, particularly with regard to changes in tariff rates, the conclusion of tariff and trade agreements relating to trade in goods and services, and the commercial aspects of intellectual property, *foreign direct investment*, the achievement of uniformity in measures of liberalisation, export policy and measures to protect trade such as those to be taken in the event of dumping or subsidies. The common commercial policy shall be conducted in the context of the principles and objectives of the Union's external action.¹⁰

The provision lists FDI as one of the aspect of the CCP and thus provides an explicit legal basis for the EU's competence over investment regulation, including the conclusion of international agreements.¹¹ However, the definition of investment in international investment agreements (IIAs) is broader than FDI, also including portfolio investment.¹² This difference led to divergent interpretations of the exact scope of the EU foreign investment power. In its Opinion 2/15, the CJEU distinguished between two types of foreign investment: 'direct' and 'non-direct' or 'portfolio', concluding that *only* FDI falls within the scope of CCP and Article 207(1) TFEU.¹³

According to the Court, direct investment relates to those investments which 'establish or maintain *lasting and direct links* between the persons providing the capital and the undertakings to which that capital is made available in order to carry out an economic activity', thus enabling the shareholder 'to participate effectively in the *management* of [the] company or in its *control*'.¹⁴ Differently to that, 'non-direct foreign investment', also known as portfolio investment, is made 'with the intention of making a financial investment without *any* intention to influence the management and control of the undertaking', thus constituting free movement of capital for the purposes of Article 63 TFEU.¹⁵ Importantly, free movement of capital as defined in the treaties applies both

¹⁰ Art 207(1) TFEU (emphasis added).

¹¹ Art 207(3) and (4) TFEU.

¹² Art 9.1 EUSFTA defines investment as 'every kind of asset which has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, the assumption of risk or a certain duration', as long as the asset is 'owned, directly or indirectly, or controlled, directly or indirectly' by a natural or legal person of one Contracting party in the territory of the other party.

¹³ See Opinion 2/15 (n 2) para 83 (emphasis added).

¹⁴ *ibid* para 80 (citing, *inter alia*, Case C-446/04 *Test Claimants in the FII Group Litigation* ECLI:EU:C:2006:774, paras 181 and 182; Case C-326/07 *Commission v Italy* ECLI:EU:C:2009:193, para 35; Case C-464/14 *SECIL* ECLI:EU:C:2016:896, paras 75 and 76) (emphasis added).

¹⁵ Opinion 2/15 (n 2) para 227 (citing, *inter alia*, Joined Cases C-282/04 and C-283/04 *Commission v Netherlands* ECLI:EU:C:2006:208, para 19; Case C-81/09 *Idryma Typou* ECLI:EU:C:2010:622,

between the Member States as well as between Member States and third countries.¹⁶ As examples of portfolio investment the Court mentioned ‘types of investment other than the acquisition of company securities, such as certain categories of real-estate investment or the use of loans’.¹⁷

Additionally, the CJEU clarified that EU competence under Article 207(1) TFEU with respect to FDI includes acts concerned with the *admission* as well as acts concerned with the *protection* of FDI.¹⁸ The argument put forward by the Council and some Member States was that the EUSFTA investment chapter concerned only protection of FDI and not its admission, thus claiming that the chapter cannot fall within the CCP even if relates to direct investment.¹⁹ The rationale of this argument can be traced to differentiation between investment liberalisation and investment protection. The former concerns the (pre-) establishment phase – admission and post-admission treatment of the investment – while the latter the post-establishment phase (the protection of investment once the investment has been made).

The EU trade treaties with third States in pre-Lisbon times, building upon the GATS classification of services,²⁰ involved provisions on the admission of investment (investment liberalisation) and its related post-admission treatment, through provisions on establishment for supply of services and capital movements.²¹ The main purpose of

para 48; Case C-212/09 *Commission v Portugal* ECLI:EU:C:2011:717, para 47). Free movement of capital is not defined in the treaties and its meaning is determined by reference to the nomenclature in Annex I to Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty [1988] OJ L178/5. The nomenclature is not exhaustive: see Case C-222/97 *Trummer and Mayer* [1999] ECR I-1671, paras 7, 13.

¹⁶ See Art 63 TFEU. Free movement of capital is subject to limitations in Arts 64 and 65 TFEU (national law provisions on tax treatment, national law infringements and public policy exceptions, subject to proportionality test). See chapter 7, section 7.1.1 on free movement of capital.

¹⁷ Opinion 2/15 (n 2) para 228.

¹⁸ *ibid* paras 87, 109.

¹⁹ *ibid* para 85.

²⁰ In its Art I(2) GATS defines 4 modes of the supply of services: (1) cross border trade (‘from the territory of one Member into the territory of any other Member’); (2) consumption abroad (‘in the territory of one Member to the service consumer of any other Member’); (3) Commercial presence (‘by a service supplier of one Member, through commercial presence in the territory of any other Member’); (4) Presence of natural persons (‘by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member’). See Art I (2)(a)-(d) GATS. Most investments will fall into mode 3, whereby a service is provided by a locally established type of business – a juridical person (which includes any legal entity – privately or governmentally owned, for profit or otherwise – including corporations, trusts, partnerships, joint ventures, sole proprietorships or associations), or a branch or a representative office, in both cases either owned or controlled by a foreign person (natural or juridical person of other Member). WTO Members may make specific commitments (on market access, national treatment and any additional commitments under GATS part III) with respect to economic sectors specified in a schedule (Art XX), while committing to the grant of national treatment where market-access commitments are undertaken, subject to terms, limitation and conditions specified in their Schedule (Art XVI). Art II provides a general MFN clause, subject to exemptions defined in the Annex on Article II Exemptions: General Agreement on Trade in Services, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B (signed 15 April 1994, entered into force 1 January 1995) 1869 UNTS 183, 33 ILM 1167 (GATS).

²¹ In this sense, establishment refers to setting up and management of an undertaking, or setting up a subsidiary or a branch of an undertaking, and impediments in national regulation which restrict market

these provisions was to secure for EU investors market access to third countries while granting to third countries' foreign investors access to the EU market in the course of trade exchange. These agreements, depending on the third country involved, provided for different levels of investment liberalisation and reciprocity, by including diverse market access restrictions in specific sectors or by providing different levels of accorded treatment (NT or MFN, or both).²² Establishment of legal persons under these pre-Lisbon GATS regulatory model treaties, although within the EU competence, did not fall within the scope of the CCP, or, to the extent that it fell under the CCP, it was subject to different qualifications and sectoral limitations.²³ In addition, some EU agreements were inspired by primary EU law and thus contain clauses on establishment, which mirror EU law provisions on freedom of establishment and free movement of capital.²⁴ By the same logic, while these provisions fall within EU competence as they concern internal market rules, they could not be considered to be a part of the CCP.²⁵ Finally, provisions on post-establishment treatment of investments, both the narrower post-admission treatment in GATS-style agreements, as well as broader investment protection standards of traditional BITs,²⁶ equally did not exclusively fall within the pre-Lisbon CCP scope.²⁷ It is therefore clear that some but not all aspects of foreign investment fell within the scope of the CCP prior to the entry into force of the Lisbon Treaty, and such fragmentation required the EU

access by foreign investors. Capital movements concern the transfer of funds necessary to make an investment (establish an undertaking): see Angelos Dimopoulos, *EU Foreign Investment Law* (OUP 2011) 82.

²² For general overview of investment provisions in EU treaties pre- and post-Lisbon, see the table 'Overview of legal basis and investment clauses in selected EU agreements' in the Appendix.

²³ Opinion 1/94 [1994] ECR I-5267, in which the CJEU assessed different GATS modes of supply of services and concluded that 'consumption abroad' (mode 2), 'commercial presence' (mode 3) and 'presence of natural persons' (mode 4) were not covered by the CCP: see paras 43-47. In this context it is also relevant that later CJEU opinions, delivered following the changes to Art 133 TEC introduced with the Treaty of Nice, expanded the scope of the CCP to encompass also 'trade in services' and 'commercial aspects of the CCP', however subject to a number of reservations (with respect to international agreements relating to trade in cultural and audiovisual services, educational services, social and human health services, and transport). The CJEU in Opinion 1/08 confirmed that after Nice all four WTO modes of provision of services fall within the CCP, however subject to conditions laid down in Arts 133(5) and (6) TEC (agreements in defined sectors to be concluded jointly by the Community and the Member States): Opinion 1/08 [2009] ECR I-11129. For a most comprehensive analysis of Opinion 1/08, see Marise Cremona, 'Balancing Union and Member State Interests: Opinion 1/2008, Choice of Legal Base and the Common Commercial Policy Under the Treaty of Lisbon' (2010) 35 *European Law Review* 678.

²⁴ See Arts 31-35 (ch on Right of Establishment) and 40-45 (ch on Capital), Agreement on European Economic Area and establishment clauses in Stabilisation and Associations Agreements with Western Balkans; for example, Art 53 Stabilisation and Association Agreement between the European Communities and their Member States of the one part, and the Republic of Montenegro, of the other part [2010] OJ L108/3.

²⁵ In Opinion 1/94 (n 23), the CJEU reasoned that the existence in the Treaty of specific chapters on free movement of natural and legal persons showed that these matters did not fall within the CCP: para 46. Following the entry into force of the Lisbon Treaty, internal market rules are now listed as the joined competence in Art 4(2)(a) TFEU. Furthermore, Art 115 TFEU empowers the EU to issue directives for the harmonisation of laws that 'directly affect the establishment or functioning of the internal market'.

²⁶ The Energy Charter Treaty (ECT) is the only such agreement that was concluded by the EU in the pre-Lisbon era.

²⁷ Opinion 2/92 [1995] ECR I-521. The CJEU concluded that only GATS fell within the scope of the CCP, while the Community had competence to conclude GATS and TRIPS jointly with the Member States.

to conclude international agreements concerning foreign investment jointly with the Member States.

With the explicit inclusion of FDI into the CCP in the Lisbon Treaty, all aspects of FDI – admission, post-admission treatment and protection – now fall within the CCP. On the contrary, portfolio investment in its entirety falls outside the CCP scope, but it is nevertheless within EU competence. This difference is pertinent to the nature of EU competence, which ultimately determines the extent of EU powers with respect to these two different types of investment, as next explained.

6.1.2. *The nature of EU foreign investment competence*

Once it is determined which aspects of a certain policy area fall within EU competence, the nature of competence determines the extent to which the EU may exercise its competence independently from the Member States, both internally and externally.²⁸ The internal dimension relates to the adoption of secondary legislation, while the external dimension includes the conclusion of international agreements (treaty-making competence). EU competence can be either *exclusive* or *shared* with the Member States. Exclusive EU competence is either expressed in Article 3 TFEU (*express exclusive EU competence*) or can be implied with respect to external action (treaty-making) in the exercise of EU internal competence (*implied exclusive EU competence*). Therefore, to determine the exact nature of EU competence in shared policy areas, both internal and external dimensions of EU action have to be taken into consideration. The extent to which the EU can act independently from the Member States is not necessarily the same with respect to its internal and external action. Consequently, EU internal action can be a source of the EU's creeping international competence.²⁹

²⁸ In Opinion 2/94 (n 27) para 24 and Case C-370/07 *Commission v Council* [2009] ECR I-8917, para 46, the CJEU made clear that according to the principle of allocation of power, the EU must act 'within the limits of the powers conferred on it and of the objectives assigned to it by the Treaty in both the *internal* action and the *international* action of the Community' (emphasis added).

²⁹ By way of comparison with some federal states, in the Australian federal system, the situation is the opposite. The 'external affairs' head of power is the source of the federal government's creeping internal power in the Australian federal system. According to the Australian Commonwealth Constitution, the Commonwealth Parliament of Australia has the right to legislate with respect to external affairs: s 51(xxix), *Commonwealth of Australia Constitution Act 1900* (Cth). Because the Australian federal Government, according to the same principle of conferral, can act only in the policy areas enumerated in the Commonwealth Constitution (mostly in s 51), concluding international agreements allows the federal government to legislate in areas for which it does not have express powers in the Constitution. This is possible due to the Australian dualist system, which requires the implementation of international agreements through specific domestic legislation adopted in the federal Parliament. In other words, concluding international agreements allows the federal Government to legislate domestically in areas for which it otherwise would not have power to legislate. This was established by Australia's highest court, the High Court, in the landmark *Tasmanian Dams* case: *Commonwealth v Tasmania* HCA 21 (1983) 158 CLR 1.

Generally speaking, in the areas of exclusive competence, the EU is authorised to act alone and Member States can neither legislate internally nor enter into international obligations externally, unless empowered by the EU.³⁰ In the areas of shared competence both the EU and Member States may act to exercise their competence.³¹ However, Member States may exercise their competence to the extent that the EU does not exercise its own competence (principle of pre-emption).³² Nevertheless, the EU action must be in accordance with the principles of subsidiarity³³ and proportionality,³⁴ both enshrined in Articles 5(3) and 5(4) respectively. If the EU has not taken action, Member States maintain their competences but must act in accordance with EU law.³⁵ With EU eagerness to harmonise different policy areas falling into the scope of shared competences, through the adoption of secondary legislation (regulations, directives and framework decisions), national competences have been constantly shrinking, both internally and externally.

EU-treaty making competence is defined in Article 216 TFEU, which should be read in conjunction with Article 3 TFEU. Exclusive EU competence for the conclusion of international agreements can be either: (a) explicit, where the treaties provide the EU with the power to conclude an international agreement, or (b) implicit, which includes three possible situations: (i) when conclusion of an international agreement is necessary to achieve one of the objectives of the EU's policies; (ii) when an EU legislative act requires the EU to conclude an international agreement; or (iii) when it is likely that the Member States' exercise of treaty-making powers could 'affect common [internal] rules or alter their scope'. This last scenario of implied exclusive EU competence is usually the result of internal harmonisation through EU legislation, developed in line with the CJEU case-law, the so-called AETR-ERTA principle,³⁶ now enshrined in Article 3(2) TFEU. Importantly

³⁰ Art 2(1) TFEU. Member States can act only to the extent that the EU has empowered them or for the implementation of EU acts. This includes situations when the EU repeals the existing legislation without replacing it with new legislation or when the CJEU annuls the legislation: Ronald van Ooik, 'The European Court of Justice and the Division of Competence in the EU' in Daniela Obradovic and Nikolaos Lavranos (eds), *Interface between EU Law and National Law* (Europa Law Publishing 2007) 24.

³¹ Art 2(2) first sentence TFEU.

³² Art 2(2) second sentence TFEU. These are known as shared pre-emptive competences. In some areas shared competences are parallel: see Arts 4(3) and (4) TFEU.

³³ In essence, the focus of the principle of subsidiarity is to determine whether the EU is the appropriate decision maker in a certain matters of shared competence. The principle is subject to two tests: sufficiency (the objectives of the proposed action cannot be achieved at the level of Member States – either central, regional or local) and value-added test (the scale and the effects of the proposed action can be better achieved at the EU level). Importantly, the principle is subject to *ex-ante* scrutiny by national parliaments and *ex-post* judicial control: see Allan Rosas and Lorna Armati, *EU Constitutional Law: An Introduction* (Hart 2010) 24-25.

³⁴ The focus of the principle of proportionality is to determine the appropriateness of EU action in a certain matters of shared competence. In this sense, the choice of action must be confined to what is necessary to achieve the objectives of the treaties.

³⁵ Case C-114/01 *AvestaPolarit Chrome Oy* [2003] ECR I-8725, para. 57. Additionally, Member States are bound by the principle of sincere cooperation enshrined in Art 4(3) TEU and should refrain from any measure which could jeopardise the attainment of the EU's objectives.

³⁶ Case 22-70 *Commission v Council* (European Road Transport Agreement) [1971] ECR 263, para 17 in which the CJEU stated: 'each time the Community, with a view to implementing a common policy envisaged by the

therefore, internal EU exercise of shared competence may lead to implied exclusive EU treaty-making competence. Accordingly, if the EU legislates internally the Member States lose competence to legislate and they may also lose competence to conclude international agreements in the same area, under certain conditions.³⁷ This loss of competence is justified whenever a Member State's international agreement 'is capable of undermining the uniform and consistent application of the EU rules and proper functioning of the system which they establish';³⁸ in other words, any time when the objectives of EU integration *could* come under threat.

Applying these rules in the field of trade and investment, it becomes important that CCP, as the key policy area for the exercise of EU international trade and investment competence,³⁹ is listed in Article 3(1)(e) among the express exclusive EU competences. The scope of the CCP therefore determines the scope of the exclusive EU treaty-making competence in the field of trade and investment. This issue was at the core of the CJEU Opinion 2/15. The following table summarises the key EU competences in the framework of the CCP.

Table 6.1. Overview of EU competences

EU Competence	Exclusive Art 3 TFEU	Shared Art 4 TFEU	
Internal Power to legislate	Express: - EU alone - Includes CCP: Art 3(1)(e) TFEU	Shared pre-emptive (EU has legislated): - EU alone: Art 2(2) TFEU	▪ Shared non pre-emptive (EU has not legislated): - EU + Member States: Art 2(2) TFEU ▪ Shared parallel: - EU + Member States: Art 4 (3), (4) TFEU

Treaty, adopts provisions laying down common rules, whatever form these may take, the Member States no longer have the right, acting individually or even collectively, to undertake obligations with third countries which affect those rules.' See also Case C-467/98 *Commission v Denmark* ('Open Skies' Agreement) [2002] ECR I-9519, paras 77-80.

³⁷ This depends on the extent to which EU legislation and the international agreement coincide. However, it is not necessary that they fully coincide but that the area to which international agreement relates has been 'covered to a large extent' by common EU rules. The analysis of the relationship between provisions of international agreement and EU rules has to take into account the scope, nature and content of provisions and rules, as well as foreseeable future development of EU rules in that area: Opinion 1/03 (New Lugano Convention) [2006] ECR I-1145, para 126. See also Opinion 2/91 [1993] ECR I-1061, paras 25-26. Absence of contradiction between internal EU rules and the proposed agreement does not matter: Opinion 1/03, paras 143 and 151. Post-Lisbon, this position has been reiterated rather liberally: Opinion 1/13 ECLI:EU:C:2014:2303.

³⁸ Opinion 1/13 (n 37) para 74.

³⁹ In Case C-414/11 *Daiichi Sankyo Co. Ltd and Sanofi-Aventis Deutschland* ECLI:EU:C:2013:520, para 50, the CJEU stated that, in the context of the Union's external action, CCP relates to trade with third States (extra-EU), not to trade within the internal market (intra-EU).

External Treaty-making power	Express: - EU alone - Includes CCP: Art 3(1)(e) TFEU/ancillary nature of institutional provisions	Implied exclusive EU treaty-making: - EU alone: Art 3(2) TFEU (AETR-ERTA case-law)	Shared treaty-making competence: - EU + Member States - Includes 'Free movement of persons, services and capital' = internal market: Art 4(1) and 4(2)(a)

In Opinion 2/15, the CJEU confirmed the exclusive EU competence with respect to all trade EUSFTA areas. Accordingly, the EU alone is competent to conclude international agreements in these areas. The Court found that almost all trade issues fall within the scope of the CCP, and thus within express exclusive EU competence. The CJEU identified these components of the FTA by examining whether they display a 'specific link' with trade between the EU and Singapore, meaning that the commitments therein are (i) intended to promote, facilitate or govern trade *and* (ii) have direct and immediate effect on trade.⁴⁰ All trade-related chapters of the EUSFTA passed this test,⁴¹ except trade in transport services,⁴² where they relate to public procurement for identified transport services and institutional provisions.⁴³

With respect to trade in transport services and related public procurement for these services, the CJEU concluded that commitments in these EUSFTA areas fall within a field largely covered by common EU rules, thus being able to affect or alter their scope.⁴⁴ Consequently, the CJEU concluded that, in accordance with AETR-ERTA doctrine and Article 3(2) TFEU, these provisions fall within the implied exclusive EU competence. The Court further reiterated that institutional provisions of the EUSFTA, including those

⁴⁰ Opinion 2/15 (n 2) paras 36-38 and case-law therein cited (emphasis added).

⁴¹ See *ibid* paras 40-55 (market access for goods and services), para 68 ('aircraft repair and maintenance services during which an aircraft is withdrawn from service', 'the selling and marketing of air transport services' and 'computer reservation system services'), para 74 (non-tariff barriers to trade and investment in renewable energy generation), para 77 (government procurement except for identified transport services), 130 (intellectual property protection), para 138 (competition), para 167 (sustainable development).

⁴² The CJEU here identified international maritime transport services, rail transport services, road transport services and internal waterways transport services: see *ibid* para 62. For 'aircraft repair and maintenance services during which an aircraft is withdrawn from service', 'the selling and marketing of air transport services' and 'computer reservation system services' the CJEU concluded them to be within the scope of express exclusive EU competence (Arts 207(1) and 3(1)(e) TFEU).

⁴³ Provisions across different chapters, relating to exchange of information, notification, verification, cooperation, mediation, decision-making powers, and transparency.

⁴⁴ For the analysis of relevant services, see: Opinion 2/15 (n 2) paras 182-193 (maritime transport services), paras 197-202 (rail transport services), paras 206-211 (road transport services), paras 213-218 (internal waterway transport services – while finding these commitments extremely limited in scope, the CJEU determined that the nature of ch 8 – transport services – should be determined by the commitments relating to maritime, rail and road transport, and thus also implying exclusive EU competence for internal waterway transport services).

relating to transparency, because of their ancillary nature, fall within the same exclusive EU competence as substantive provisions which they accompany.⁴⁵

With respect to investment provisions, while finding that FDI falls within the scope of the CCP and thus within express exclusive EU competence, the Court identified that the EU and Member States share competence with respect to non-FDI investment (portfolio investment) and investment dispute settlement (ISDS). In other words, the CJEU clarified that the EU is not exclusively competent for all investment issues. In coming to this conclusion, the CJEU rejected the Commission's argument that the AETR-ERTA doctrine could be applicable to portfolio investment commitments specified in Section A ('Investment Protection') of EUSFTA chapter 9. Since no secondary EU legislation has been adopted under Articles 63(1) and 64(2) TFEU relating to any type of investment other than FDI,⁴⁶ the CJEU reasoned that primary EU law cannot be subsumed under 'common rules' within the meaning of Article 3(2) TFEU.⁴⁷

Nevertheless, although not exclusively competent for portfolio investment commitments in the EUSFTA, the EU shares competence for these commitments with its Member States. This is because the conclusion of an international agreement such as the EUSFTA, which contributes to free movement of capital as one of the internal market freedoms, could be necessary for the achievement of the Treaty objectives related to the internal market (an area of shared competence).⁴⁸ Further, the EU also shares competence with the Member States for commitments in Section B ('Investor-State Dispute Settlement'). Contrary to the Advocate General's Opinion, the CJEU reasoned that ISDS, as a regime which 'removes disputes from the jurisdiction of the courts of the Member States', cannot be considered ancillary in nature to substantive provisions of the EUSFTA and consequently cannot be considered an exclusive EU competence.⁴⁹ Finally, the Court also found that the institutional provisions relating to an area of shared

⁴⁵ *ibid* paras 276-277, 282-283.

⁴⁶ See Opinion 2/15, Opinion of AG Sharpston ECLI:EU:C:2016:992, para 360.

⁴⁷ Opinion 2/15 (n 2) para 235-238.

⁴⁸ In particular, the CJEU refers to the objectives of Title IV ('Free movement of persons, services and capital') of Part III ('Union policies and internal actions') of the TFEU. Given that Title IV relates to the internal market, it falls within the scope of Art 4(2)(a) TFEU. Additionally, the EU and Member States also share objectives under Art 216(1), in relation to Art 4(1) TFEU, which provides that the EU and Member States share competence in areas which do not relate to Arts 3 and 6 TFEU: *ibid* paras 240-242.

⁴⁹ *ibid* paras 292-293. The CJEU emphasised that the EU must share competence with the Member States, given that the ISDS regime cannot be established without Member States' consent. *Cf.* Opinion of AG Sharpston (n 46) para 535, where AG concluded that the EU has exclusive competence for section B of ch 9, on the basis of the ancillary nature of the dispute settlement provisions: para 529. In her view, and based on the CJEU's case-law (Opinions 1/91, 1/09 and 2/13), where the EU has competence regarding substantive provisions of an international agreement, it also has competence regarding the dispute settlement mechanism. ISDS is no exception in this regard, as it concerns the *manner* in which the competence is exercised, rather than the nature of the competence: paras 525-527.

competence in the investment chapter also fall within the competence shared between the EU and Member States.⁵⁰

The delineation of competences stemming from the CJEU's Opinion 2/15 is outlined in the following table.

Table 6.2. EU competence for trade and investment in modern comprehensive FTAs

EU competence in EUSFTA (Opinion 2/15)	
Exclusive EU competence	
Express: CCP (Art 3(1)(e) TFEU) or the ancillary nature of institutional provisions ▪ National Treatment and Market Access for Goods; ▪ Trade Remedies; ▪ Technical Barriers to Trade; ▪ Sanitary and Phytosanitary Measures; ▪ Customs and Trade Facilitation; ▪ Non-Tariff Barriers to Trade and Investment in Renewable Energy Generation; ▪ Services, Establishment and Electronic Commerce (except services relating to international maritime transport, rail transport, road transport, internal waterways transport); ▪ Government Procurement (except for international maritime transport services, rail transport services, road transport services, internal waterways transport services); ▪ Investment chapter (except non-direct investment and investment dispute settlement); ▪ Commercial aspects of intellectual property; ▪ Competition; ▪ Sustainable development; ▪ Provisions ancillary in nature to substantive provisions: - Institutional framework (except for provisions relating to 'Investment Protection'); - Transparency (except for 'Investment Protection'); - Dispute settlement between the Parties to the agreement (except for 'Investment Protection')	Implied: Art 3(2) TFEU or the ancillary nature of institutional provisions ▪ Services relating to international maritime transport, rail transport, road transport, internal waterways transport; ▪ Public procurement in the field of transport (international maritime transport services, rail transport services, road transport services, internal waterways transport services)
Shared EU (EU + Member States) competence: Arts 4(1) and (2)(a) TFEU ▪ Non-direct investment (portfolio investment) ▪ Investor-State dispute settlement ▪ Provisions ancillary in nature to substantive provisions: - Dispute settlement between states parties to an agreement with respect to 'Investment Protection'	

⁵⁰ Opinion 2/15 (n 2) paras 278-279, 284. In particular, the areas of shared competence are the provisions of ch 1 (Objectives and General Definitions), ch 14 (Transparency), ch 15 (Dispute Settlement between the Parties), ch 16 (Mediation Mechanisms) and ch 17 (Institutional, General and Final Provisions), insofar as they relate to provisions of ch 9 that fall within shared competence.

The delineation of competences between the EU and Member States has important consequences for treaty-making. Member States cannot become parties to international agreements covering the areas of exclusive (express or implied) EU competence. Instead, the EU concludes such international agreements as EU-only agreements.⁵¹ In cases when international agreements cover the areas of shared competence, both the EU and Member States become a party to such treaties in order to assume international obligations in the area of their competence. Such agreements are thus concluded as ‘mixed’ agreements.⁵² A treaty will be mixed also if, in addition to areas of exclusive EU competence, it touches the areas of exclusive Member States competence.

The classification of international agreements has significant consequences for the EU’s performance in international affairs. To cite AG Kokott: ‘the more players there are on the European side at international level, the more difficult it will be to represent effectively the interests of the Community and its Member States outwardly, in particular vis-à-vis significant trading partners’.⁵³

Further, the issue is important for the democratic legitimacy of EU treaty-making in the area of trade and investment, which is ensured through the ratification process. These implications are considered next.

6.2. EU policy making in international investment: the choice of a legal basis

Given the legal nature of EU integration, every EU action must be founded on one or more legal bases set out in the founding treaties. The legal basis determines the procedure to be followed for the adoption of a particular EU act, including the procedure for the conclusion of an international agreement. Importantly, the choice of legal basis, formally speaking, is not really a ‘choice’. It ‘does not follow from its author’s conviction alone but must rest on objective factors’, these being the aim and the content of the measure, rather than its effects.⁵⁴ This approach is also known as the ‘centre of gravity theory’.⁵⁵ When a measure has more than one aim or more than one component, that measure should still be founded on a single legal basis – the basis required by the measure’s predominant aim or component, if they can be established.⁵⁶ If, however, the measure ‘simultaneously

⁵¹ See section 6.2.1 below.

⁵² See section 6.2.2 below.

⁵³ Case C-13/07 *Commission v Council*, Opinion of AG Kokott ECLI:EU:2009:190, para 72.

⁵⁴ Opinion 2/00 [2001] ECR I-9713, para 22 and case-law cited therein.

⁵⁵ David Kleimann and Gesa Kübek, ‘The Singing, Provisional Application and Conclusion of Trade and Investment Agreements in the EU: The Case of CETA and Opinion 2/15’ (2016) EUI Working Paper 2016/58, 5 <<https://cadmus.eui.eu/handle/1814/43948>> accessed 30 June 2020.

⁵⁶ Opinion 2/00 (n 54) para 23 and case-law cited therein.

pursues several objectives which are inseparably linked without one being secondary and indirect in relation to the other', the measure can be founded on the corresponding bases,⁵⁷ unless multiple legal bases are procedurally incompatible or would undermine the role of the European Parliament.⁵⁸

The issue of legal basis can, depending on the interpretation of the content and the aim of the measure, thus lead to contradictory preferences between different EU institutions and Member States, as the institutional powers of these actors vary considerably depending on the procedure used.⁵⁹ For example, trade in hazardous substances could be regulated as a matter of the CCP or as a protection of environment matter. The choice of Article 207 (CCP) to regulate such an issue is a matter of exclusive competence, while using Article 192(1) TFEU (environment) as a legal basis would mean that the issue is subject to shared competence. Apart from a more complex procedure for the conclusion of mixed international agreements, shared competence in matters of the environment also allows the Member States to adopt more stringent measures,⁶⁰ which they would not be able to adopt under Article 207.⁶¹

On one hand, given the fluidity of the aims and objectives of the CCP, it is difficult to lay down the exact limits of the areas covered by this policy area. On the other hand, given that international agreements can include a range of different commitments over different competence areas, their conclusion often involves multiple legal bases.⁶² The choice of legal basis is of 'constitutional significance' and is subject to judicial review.⁶³ The CJEU has played an important role in shaping the CCP through review of the legal bases of different international agreements for compliance with the founding treaties.⁶⁴ EU acts based on an inappropriate legal basis can be invalidated. In the case of international agreements signed on the basis of such acts, the EU's consent to be bound by the agreement can be vitiated.⁶⁵ The CJEU has therefore emphasised the obligation to

⁵⁷ *ibid* para 23 and case-law cited therein. Such situations are considered exceptional, because, if the objectives can be separated, two separate legal acts on two different legal bases should be adopted.

⁵⁸ Case C-94/03 *Commission v Council* [2006] ECR I-1, para 52.

⁵⁹ René Barents, 'The internal market unlimited: some observations on the legal basis of EU legislation' (1993) 30 *Common Market Law Review* 85; Holly Cullen and Andrew Charlesworth, 'Diplomacy by Other Means: the Use of Legal Basis Litigation as a Political Strategy by the European Parliament and Member States' (1999) 36 *Common Market Law Review* 1243.

⁶⁰ See Art 193 TFEU.

⁶¹ On the delineation between the environment and CCP with respect to legal bases, see Nicolas de Sadeleer, *EU Environmental Law and the Internal Market* (OUP 2014) 161-167.

⁶² For a general overview of legal bases in EU treaties on trade and investment pre- and post-Lisbon, see Table 'Overview of legal basis and investment clauses in selected EU agreements' in the Appendix.

⁶³ Opinion 1/08 (n 23) para 110. See also, *inter alia*, Case C-300/89 '*Titanium Dioxide*' [1991] ECR I-2867, para 10; Case C-269/97 *Commission v Council* [2000] ECR I-2257, para 43; Case C-211/01 *Commission v Council* [2003] ECR I-3651, para 38; Case C-338/01 *Commission v Council* [2004] ECR I-4829, para 54.

⁶⁴ See Panos Koutrakos, 'Legal Basis and Delimitation of Competence in EU External Relations' in Marise Cremona (ed), *EU Foreign Relations Law* (Hart 2008) 171-198.

⁶⁵ Opinion 1/08 (n 23) para 110.

indicate the legal basis as part of the duty to state reasons. This serves to inform the Member States and third parties about the conditions that led to the adoption of a certain measure, thus also being the requirement of legal certainty.⁶⁶

Accordingly, the choice of legal basis, as an issue of substantive law, albeit open to diverging interpretations, determines the decision-making process and political outcomes in certain policy areas. The rules determining the conclusion of EU international agreements differ according to the substantive legal basis of each agreement, requiring different procedures and levels of involvement by EU institutions and the Member States. Following Opinion 2/15 and the CJEU's generous application of the centre of gravity and AETR-ERTA doctrines, Articles 206 and 207 TFEU, which define the objectives and *rationae materiae* of the CCP, form the legal bases that empower the EU to conclude international agreements in trade and FDI. The choice of CCP as the legal basis simplifies the procedure for the conclusion of trade agreements. However, since not all investment issues fall within the scope of the CCP, international investment remains subject to additional legal bases and is included in different types of EU agreements, not limited only to traditional IIAs. The following table categorises the main EU trade and investment agreements and their legal bases.

Table 6.3. Types of EU trade and investment agreements and corresponding legal bases

Association Agreements				
Main legal basis: Art 217 TFEU (substantive); Arts 218(6)(a)(i) and 218(8) (procedural)				
Type	Stabilisation and Association Agreements (SAA)	Deep and Comprehensive Free Trade Agreements (DCFTA)	Modernised Association Agreements	Other Association Agreements
Features	EU <i>Acquis</i> , potential EU membership	EU <i>Acquis</i> , no future EU membership	Political dialogue, comprehensive trade and investment component	Political dialogue, comprehensive trade component
Countries	Western Balkans	- Eastern Partnership (Ukraine, Georgia, Moldova) - Mediterranean (Morocco, Tunisia)	- Mexico - Chile	- Central America - Mercosur

⁶⁶ *Commission v Council* (n 28) paras 37-39.

Economic Partnership Agreements			
Main legal basis: Art 209 TFEU (substantive); Art 218(6)(a)(iii) and (v) (procedural)			
Type	Economic Partnership Agreements (including interim and stepping stone EPAs)	Comprehensive enhanced Partnership Agreements	
Features	Trade preferential agreements, asymmetric liberalization of investment, development cooperation	Political dialogue (CFSP), trade (CCP) and development cooperation	
Countries	- Africa: SADC, West Africa, EAC, ESA, Central Africa (interim agreement), Ghana (stepping stone EPA) - Caribbean: CARIFORUM - Pacific States: PNG, Fiji, Samoa (EU only agreement)	- Armenia - Kazakhstan	
Trade Agreements			
Main legal basis: Art 207 TFEU (substantive); Art 218(6)(a)(v) (procedural)			
Type	Free Trade Agreements only	Free Trade Agreements + Investment Protection Agreements	Investment Agreements only
Features	Comprehensive trade component and FDI liberalisation	Two agreements negotiated together	Comprehensive investment protection and investment dispute settlement provisions
Countries	- Andean Community (Peru, Columbia, Ecuador) - Republic of Korea - Japan - Australia - New Zealand	- Vietnam - Singapore	- China - Myanmar

General rules for the conclusion of all EU international agreements, including trade and investment agreements, are outlined in Article 218 TFEU. In addition, Article 207 provides rules for negotiation and conclusion of international agreements in the area of CCP and is accordingly relevant in both substantive and procedural terms. Both Treaty articles must be taken into account in determining institutional equilibrium in EU international investment treaty-making. While on the side of the EU the same procedure applies with respect to 'EU-only' and mixed agreements, in procedural terms the conclusion of mixed agreements additionally requires the ratification of the treaty by all Member States in accordance with their respective constitutional requirements.

6.2.1. Conclusion of 'EU-only' agreements

EU international trade and investment agreements are negotiated, signed and concluded with the participation of all significant EU institutions: the EC, which has the leading role in the negotiation stage; the Council, with the leading role in authorising the Commission's actions at different stages of the procedure; and the European Parliament (EP), as the key institution for the ratification of EU agreements. Since the EC negotiates with third States, it can seem that the EC has the main role in the process of the agreements' conclusion. However, the EC's powers are confined by the roles played by the Council during the entire process, and by the EP, in particular at the end of the process. Finally, every decision in the course of this process is also subject to judicial review by the CJEU, which can additionally be asked to provide binding opinions on the compatibility of the proposed international agreement with the treaties.⁶⁷

The EC has the leading role in starting and negotiating EU trade and investment agreements. It proposes the opening of negotiations of an agreement with a specific country.⁶⁸ Once the Council authorises the opening of the negotiations, the Commission will conduct negotiations within the given mandate, propose the signature and the subsequent conclusion of the agreement.⁶⁹ During the negotiating process, the EC will be in consultation with the Council via the Trade Policy Committee of the Council (TPC), and it will also keep the Parliament informed via the EP's International Trade Committee (INTA).⁷⁰ In practical terms, the EC is the first point of contact with the third country negotiators, conducting negotiations 'on the ground'.

The Council acts as the first point of scrutiny of the Commission's actions and shares responsibility for compliance of the international agreement with the internal EU rules and policies.⁷¹ It participates in the negotiations through the TPC.⁷² The Council adopts decisions on opening of the negotiations, and signing and concluding the agreement, based on the EC's proposals.⁷³ These decisions are adopted by qualified majority voting

⁶⁷ Art 218(11) TFEU.

⁶⁸ Arts 218(3) TFEU; 207(3)(2) TFEU.

⁶⁹ Art 218(4), (5), (6) TFEU.

⁷⁰ Art 207(3)(3) TFEU.

⁷¹ Art 207(3)(2) TFEU.

⁷² Arts 218(4); 207(3)(3) TFEU. The negotiations are conducted 'in consultation' between the EC and the Council, while the EP at this stage is informed only about the progress of negotiations.

⁷³ Art 218(2) TFEU.

(QMV).⁷⁴ The Council can amend the Commission's proposals but only unanimously.⁷⁵ Unanimity is also required for the conclusion of Association Agreements,⁷⁶ which can, *inter alia*, include investment protection provisions.⁷⁷ Finally, unanimity is required for the negotiation and conclusion of international agreements in the field of FDI when such agreements include provisions which require unanimity for the adoption of internal rules.⁷⁸ While in practice most decisions regarding trade and investment agreements can be adopted by QMV, the Council has discretion to act via the process of Common Accord, which requires the agreement of all Member States in order to approve the signature and conclusion of these agreements.⁷⁹

Lastly, the EP acts as the final point of scrutiny of the EC's and the Council's actions in external trade.⁸⁰ The consent of the Parliament is required for all trade and investment treaties.⁸¹ After receiving the consent from the Parliament, the Council will adopt the decision to conclude the agreement, which completes the procedure under Article 218 TFEU for 'EU-only' agreements.⁸²

During the negotiations the Parliament is only kept *informed* on the progress via its INTA,⁸³ and in accordance with the framework agreement between the EC and the EP.⁸⁴

⁷⁴ Arts 218(8)(1); 207(4)(1) TFEU. For the analysis of these situations, see Angelos Dimopoulos (n 21) 131-133. According to Dimopoulos, such situations include restrictions on the existing level of liberalisation of capital movements under Art 64(3) TFEU, any measures that would lead to harmonisation of the internal market regarding expropriation of non-direct investment under Arts 115 and 352 TFEU, as well as provisions on the establishment and treatment of FDI in cultural, audiovisual, social, education and health services in accordance with Art 207(4)(3) TFEU, when the international agreements respectively risk prejudicing the EU's linguistic and cultural diversity (a), or when they risk seriously disturbing the national organisation of social, education and health services and prejudicing the responsibility of Member States to deliver them (b).

⁷⁵ Art 293(1) TFEU.

⁷⁶ Art 218(8)(2) TFEU.

⁷⁷ See, for example, chapter on Investment in the EU-Mexico Agreement in Principle (*European Commission*, 6 May 2020) <<http://trade.ec.europa.eu/doclib/press/index.cfm?id=1833>> accessed 30 June 2020.

⁷⁸ Arts 218(8)(2); 207(4)(2) TFEU.

⁷⁹ UK Government Department for International Trade, 'Impact assessment of the EU-Vietnam Free Trade Agreement (EVFTA) on the UK' (28 March 2019) 2

<http://europeanmemorandum.cabinetoffice.gov.uk/files/2019/04/EU-Vietnam_IA_Web_final6.pdf> accessed 30 June 2020.

⁸⁰ The formal role of the EP is outlined in Arts 207(3), 218(6) and 218(10) TFEU.

⁸¹ Under Art 218(6)(a)(v) TFEU, the consent of the parliament is needed for the agreements covering fields to which the ordinary legislative procedure applies (ordinary legislative procedure is used for the adoption of legislation in the area of the CCP). Additionally, under Art 218(6)(a)(i) TFEU, the consent of the EP is needed for Association Agreements (and these can also involve investment provisions). Finally, the consent of the EP is needed for agreements establishing a specific institutional framework by organising cooperation proceedings (Art 218(6)(a)(iii) TFEU), and arguably such frameworks are established under each trade and investment treaty in the form of special committees for the implementation of agreements.

⁸² Art 218(6) TFEU. The EP gives its consent on the recommendation of its INTA Committee.

⁸³ Arts 207(3)(3); 218(10) TFEU.

⁸⁴ Framework agreement on the relationship between the European Parliament and the European Commission [2010] OJ L 304/47. However, the EP, unlike the Council, is not involved in the negotiations: it is only kept informed of the progress, hence their roles and power during the negotiations are not the same: see Art 207(3)(3) TFEU. The Council has even questioned the legality of the framework agreement between the EC and the EP given its impact on the institutional balance under the founding treaties (particularly, transfer of classified information to the EP was flagged as problematic): see Council Statement 'Framework Agreement on relations between the European Parliament and the Commission' [2010] OJ C 287/1.

Input of the EP into the policy content is formally limited since the EP cannot amend the agreement but only reject it, or accept it as it is. Nevertheless, given the EP's veto powers, this input cannot be ignored politically and has changed the balance of power between the institutions.⁸⁵ The EP's role was significant in defining the new EU IIP, exposing the traditional grudge between the EP and the Council in external trade policy.⁸⁶

The consent of the EP, which is *de facto* the EU ratification of an international agreement, is meant to ensure the democratic legitimacy of the EU's CCP.⁸⁷ Since the EU is not a parliamentary democracy, the EP can be politically more independent from the EC in exercising its power of consent, similarly to the role of the US Congress in the US presidential system.⁸⁸ However, it has been noted that the increased powers of the EP post-Lisbon, in combination with the diversity of the EU's external CCP objectives, have also increased the politicisation of the EU trade policy.⁸⁹

6.2.2. Conclusion of 'mixed' agreements

The conclusion of mixed agreements includes an additional layer of ratification by the Member States before the procedure under Article 218 TFEU can be completed. The Council will approve the conclusion of a mixed agreement only after all Member States have ratified it, in accordance with their internal ratification processes.

While Member States can impose their views through the procedures in the Council under Article 218 TFEU, mixed agreements give them much greater control over the agreements. On the other hand, the ratification of the agreement, which can include not only national but also regional parliaments, further complicates the political process for

⁸⁵ For example, in the context of the EU–Korea FTA, the EP has committed the Commission to taking a number of actions regarding the implementation of the agreement after its ratification, powers which the EP formally does not have under the founding treaties. For analysis of the EP's impact on trade policy as an actor in EU trade policy (from a political science perspective), see Guri Rosén, 'The European Parliament' in Sangeeta Khorana and María García, *Handbook on the EU and International Trade* (Edward Elgar 2018) 117-131. See also Colin M Brown, 'Changes in the Common Commercial Policy of the European Union After the Entry into Force of the Treaty of Lisbon: A Practitioner's Perspective' in Marc Bungenberg and Christoph Herrmann (eds), *Common Commercial Policy after Lisbon* (Springer 2013) 163-183.

⁸⁶ See chapter 4, section 4.3.3.

⁸⁷ To that effect, see also a declaration signed by 60 academics from more than 15 European countries: 'Trading Together – For strong and democratically legitimized EU international agreements' (25 January 2017) <<https://www.trading-together-declaration.org>> accessed 30 June 2020. This Declaration emphasises the democratic legitimacy of the decision-making process in the EU, in particular the EP's direct control over the Council, putting forward examples of international agreements (the Anti-Counterfeiting Trade Agreement; Swift Agreement) for which the EP has refused to grant ratifications due to their adverse impact on fundamental rights.

⁸⁸ Markus Krajewski, 'New Functions and New Powers for the European Parliament: Assessing the Changes of the Common Commercial Policy from the Perspective of Democratic Legitimacy' in Marc Bungenberg and Christoph Herrmann (eds), *Common Commercial Policy after Lisbon* (Springer 2013) 75-76.

⁸⁹ See Alasdair R Young, 'European trade policy in interesting times' (2017) 39 *Journal of European Integration* 909.

the conclusion of the agreement on the EU side and dilutes its position with respect to its external counterparts.

It has been claimed that the expansion of the scope of the CCP has resulted in expansion of the EP's status at the expense of the marginalisation of the national parliaments.⁹⁰ Unlike trade agreements, EU IIAs remain mixed agreements. Accordingly, national parliaments have kept direct oversight over the new EU IIAs through the ratification process. On one hand, this should provide more democratic legitimacy to the EU's external investment policy;⁹¹ however, on the other side, and as exemplified in the case of CETA, it can limit policy efficiency.

6.3. EU treaty-making in international investment: policy implications

The Opinion 2/15 of the CJEU proved crucial in setting the direction of the EU IIP. In light of the internal 'mixture' and in order to enhance the efficiency of the policy externally, the EC endorsed a new approach in trade negotiations. Trade and investment are to be split in two parts: trade in an encompassing FTA concluded as an 'EU-only' agreement (ratified only by the EU); and investment in a separate investment protection agreement (IPA) concluded as a mixed agreement (ratified by both the EU and all Member States).⁹² In principle both agreements are negotiated in parallel.⁹³

Accordingly, EU FTAs still include FDI liberalisation issues (market access), while IPAs focus on the post-establishment protection of both FDI and portfolio investment, and

⁹⁰ Krajewski (n 88) 84-85.

⁹¹ This position was expressed clearly by the national parliaments in a letter to then EU Trade Commissioner Karel de Gucht, signed by 14 national parliaments. The letter emphasised 'the important role national parliaments have in the democratic decision making process of the EU'; the reason for which trade agreements such as CETA and TTIP should be ratified as mixed agreements by the national parliaments: see Tweede Kamer der Staten-Generaal, 'The role of national parliaments in free trade agreements' (17 June 2014) <<https://www.parlament.mt/media/89931/81.pdf>> accessed 30 June 2020.

⁹² However, this approach might be unconstitutional for some Member States, which can open unpleasant legal questions about the primacy of EU law over domestic legal systems. For example, the German Federal Constitutional Court has assessed differently the division of competences between the EU and the Member States under CETA, finding that, in addition to portfolio investment and ISDS, maritime transport, mutual recognition of professional qualifications and protection of workers are also not EU-only competence: see Julien Miéral, 'The CETA, the German Federal Constitutional Court and the distribution of competences between the EU and its Member States' (*Robert Schuman Initiative blog*, 7 November 2017) <<https://rsiblog.blogactiv.eu/2017/11/07/the-ceta-the-german-federal-constitutional-court-and-the-distribution-of-competences-between-the-eu-and-its-member-states/>> accessed 30 June 2020. Accordingly, Opinion 2/15 of the CJEU could be *ultra vires* in light of this German court's judgment. German NGOs (Foodwatch, Campact and Mehr Demokratie) have launched a constitutional challenge to Germany's participation in the signing and conclusion of the EUSFTA through the Council of the EU, alleging that it amounts to a violation of the fundamental right to vote (as participation in democratic decision making) under the German Constitution (Art 38): see Foodwatch, 'Constitutional Complaint against EU Trade Agreement with Singapore' (16 May 2019) <<https://www.foodwatch.org/en/news/2019/constitutional-complaint-against-eu-trade-agreement-with-singapore/>> accessed 30 June 2020.

⁹³ Council of the European Union, 'Draft Council conclusions on the negotiation and conclusion of EU trade agreements' (8 May 2018) 8622/18.

provide for an ISDS mechanism. This approach seems pragmatic in light of the comprehensive definition of ‘investment’ in modern IIAs.⁹⁴ At the same time, for the purposes of policy efficiency, the ‘split’ approach has not been endorsed with respect to all third States.⁹⁵

In legal terms, once a mixed agreement is concluded, both the EU and its Member States are a party to such agreement. The agreement is, however, still bilateral – between the EU/Member States and the third State with which it is concluded. Until the ratification process in the Member States is concluded, the provisions of the mixed agreement that fall within the exclusive EU competence can enter into force in accordance with the Council’s decision after the EP has given its consent.⁹⁶ For example, CETA as a mixed agreement is being provisionally applied while the process of ratification in the Member States is still ongoing.⁹⁷ The same would be possible with respect to FDI provisions in EU IPAs.⁹⁸ The provisional application of the agreement thus has positive effects on policy efficiency.

As a final point, of importance is to emphasise the links between policy efficiency and policy legitimacy. Given the internal complexity of the EU treaty-making processes, the efficiency of its trade and investment policy largely depends on legitimacy. The input of domestic constituencies in the Member States’ negotiating positions but also the policy results and the ability of the EC to deliver its ‘trade for all’ promises are important factors in balancing the demands of legitimacy and efficiency in the EU trade and investment policy context. The following figure depicts the relationship between legitimacy, efficiency and effectiveness of EU trade and investment policy.

⁹⁴ See Part I, chapter 2, section 2.2.1.1.

⁹⁵ For example, no separate investment agreements have been envisaged with Australia and New Zealand. The EP supported the split of agreements and recommended that a FTA with Australia should contain comprehensive provisions on investment liberalisation within the EU’s competence, with a potential second agreement that would address investment protection and investment dispute settlement mechanisms as matters of shared competence: see European Parliament Resolution 2017/2192(INI) of 26 October 2017 containing the Parliament’s recommendation to the Council on the proposed negotiating mandate for trade negotiations with Australia [2018] OJ C 346/212.

⁹⁶ In accordance with Art 218(5) TFEU, the Council will on the recommendation from the EC adopt a decision authorising the provisional application. The agreement still needs to receive the consent from the EP to enter into force provisionally. Since such agreement has been approved by the EU, its provisions form an integral part of the EU legal order: Case C-459/03 *Commission v Ireland* [2006] ECR I-4635, para 82. An interesting issue, which has not yet been tested in practice, but which is possible, would be a situation in which the ratification of a mixed agreement would be rejected in one or more Member States. While politically sensitive, it remains unclear whether the EC could possibly start infringement proceedings against this Member State for the breach of EU law (the principle of sincere cooperation).

⁹⁷ Council Decision (EU) 2017/38 of 28 October 2016 on the provisional application of the Comprehensive Economic and Trade Agreement (CETA) between Canada, of the one part, and the European Union and its Member States, of the other part [2017] OJ L 11/1080.

⁹⁸ However, while the EU–Singapore IPA contains the provision allowing its provisional application (see Art 4.15.4 EUSIPA), the EC has not proposed the provisional application of the IPA.

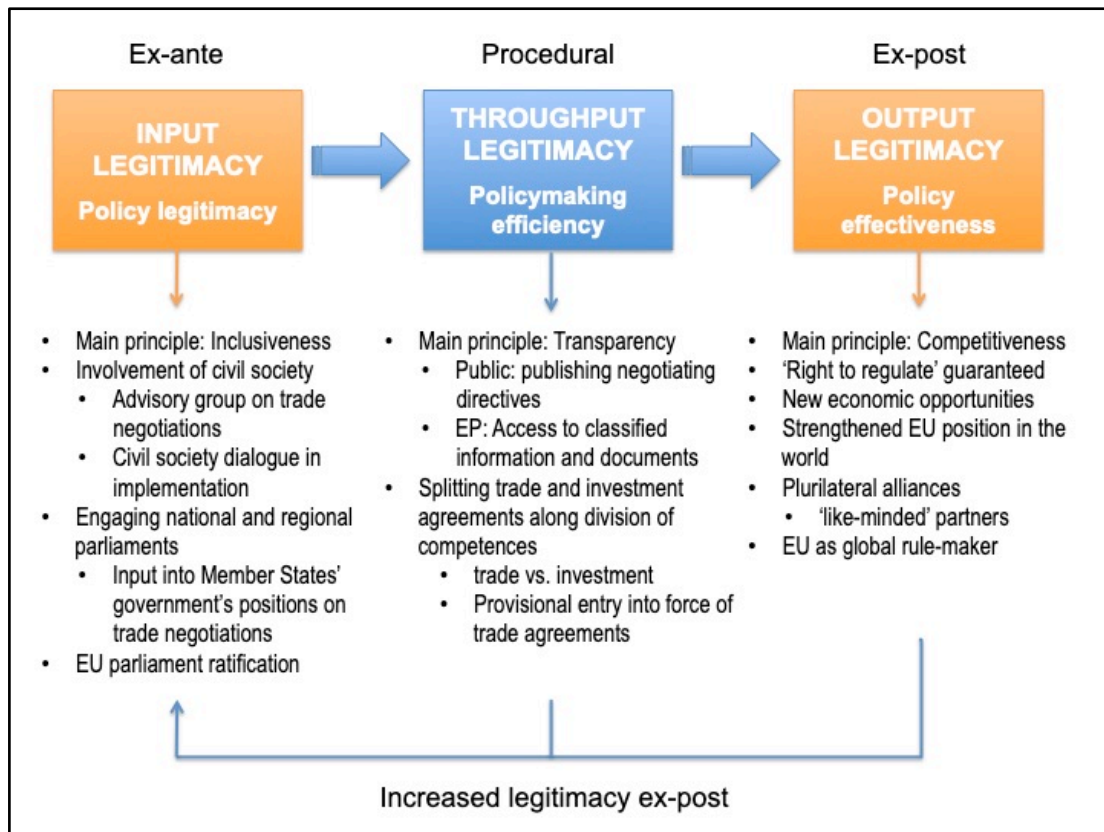


Figure 6.1. Legitimacy of EU trade and investment policy

6.4. Conclusion

The role of the CJEU in defining the EU's treaty-making powers in the field of trade and investment has been significant. In one of its early Opinions the CJEU emphasised that the CCP should be viewed as a progressive policy which should not form a barrier for the EU when developing a 'commercial policy aiming at a regulation of the world market' rather than striving for 'a mere liberalisation of trade'.⁹⁹ The scope of the CCP has been gradually expanding, culminating in the Lisbon Treaty changes. Opinion 2/15 follows this progressive understanding of the CCP while recognising still remaining limitations with respect to investment.

Opinion 2/15 clarifies the EU's exclusive competence for all aspects of FDI; however, the competence of the EU and its Member States remains shared with respect to portfolio investment and ISDS. Given that conventional IIAs regulate both FDI and

⁹⁹ Opinion 1/78 [1979] ECR 2871, paras 44-45.

portfolio investment in addition to ISDS as their crucial element, EU IIAs must be concluded as mixed agreements, leaving the Member States with an essential role in the treaty-making process.

The CJEU ruling poses an important limitation on the EU's international investment power. The CJEU had a choice between, on one hand, the narrow reading of the CCP clause (portfolio investment as an exclusive competence of Member States) advocated by the Council and some Member States, in particular Germany and Belgium, and on the other hand, the broad reading of the CCP clause (portfolio investment as an exclusive competence of the EU) advocated by the EC. The CJEU chose the middle ground by defining portfolio investment as an area of shared competence. This reading allows for expansion of the EU's competence in the future through the EU exercise of internal powers by adopting secondary legislation, without the need to amend the founding treaties. However, since Article 63 TFEU does not provide a legal basis for EU internal legislative powers with respect to the liberalisation of portfolio investment, as opposed to its harmonisation, it is difficult to conceive how the EU internal action could pre-empt Member States' external action with respect to portfolio investment.¹⁰⁰

As the CJEU clarified, the limited scope of EU investment competence is a consequence of 'unequivocal expression' of the intention of Member States, to which the Court refers to as 'framers of the TEU Treaty', not to include in the CCP types of foreign investment other than FDI.¹⁰¹ Exclusive EU competence over all foreign investment would mean a significant loss of power for the Member States when creating their national investment protection policies.¹⁰² More importantly, ISDS as a mechanism which directly affects the jurisdiction of domestic courts cannot be considered merely ancillary to investment protection provisions. The CJEU has thus impliedly recognised the profound implications of ISDS for the domestic rule of law. This view has been further endorsed in the CJEU's *Achmea* judgment, as discussed in the next chapter.

Opinion 2/15 has important implications for the efficiency of the EU investment policy. Despite only a partial EU victory in Opinion 2/15, even limited investment

¹⁰⁰ Advocate General Sharpston in her Opinion (n 46) aligned with the EC arguments, suggesting that the legal basis for the EU's internal legislative powers regarding portfolio investment would be Art 114, in so far as it concerns the approximation of laws governing internal markets, and Art 352 TFEU: see AG para 368. Art 114 TFEU provides a general legal basis for approximation or harmonisation of Member States' laws and administrative actions aimed at the establishment and functioning of the internal market. Art 352 TFEU provides a general legal basis for EU action in cases when the treaties have not provided the EU with necessary powers but the EU action is deemed to be necessary to attain one of the objectives set out in the treaties. The EU action in such cases must be within the framework of the policies defined in the treaties and in accordance with other conditions of Art 352 TFEU.

¹⁰¹ Opinion 2/15 (n 2) para 83.

¹⁰² This would particularly adversely affect the capital-exporting Member States (e.g. Germany), whose interest is to provide the best possible conditions for their investors in third countries through the conclusion of IIAs.

sovereignty gives to the EU a considerable control in setting the direction of the EU IIP and in achieving a relative coherence between the policies in investment of the EU and the Member States at the national level.¹⁰³

¹⁰³ These implications are further examined in chapter 8.

The internal dimension of EU investment regulation: internal market integration, intra-EU BITs and *Achmea*

7.1. The internal market and investment in the EU

7.1.1. *Free movement in the EU and investment*

7.1.1.1. Derogations in the Treaty law

7.1.1.2. Specific case of bilateral taxation

7.1.2. *Private rights and investment in the EU*

7.1.2.1. The right to property under EU law

7.1.2.2. The principle of legitimate expectations under EU law

7.1.3. *Enforcement and remedies*

7.1.4. *Interim conclusions*

7.2. Tensions between intra-EU IIAs and the objectives of EU integration

7.2.1. *Intra-EU BITs and their political dimension*

7.2.2. *Intra-EU BITs and their legal status under EU law*

7.2.3. *The Energy Charter Treaty and EU law*

7.3. Tensions between intra-EU investment treaty arbitration and the autonomy of the EU legal order

7.3.1. *The international investment law perspective: issues before tribunals*

7.3.2. *The EU law perspective: the Achmea judgment of the CJEU*

7.4. Intra-EU investment post-Achmea: legal and policy implications

7.4.1. *Enforcement of intra-EU arbitral awards*

7.4.2. *Adjudication of intra-EU investment disputes*

7.4.3. *The rule of law in the EU*

7.4.4. *The politics and law of EU integration*

7.5. Conclusion

Investment tribunals have been established with a view to overcoming distrust of investors in national courts, providing investors from developed States with protections against political risks in unpredictable markets of host, usually developing, States.¹ In the EU context, a *mutatis mutandi* constellation of these relations was evident in the period after the fall of communism and before the accession of Central and Eastern European

¹ See Part I, chapter 1.

(CEE) States to the EU. The Member States of the EU-12 and the EU-15 in the 1990s were keen to facilitate investments by their investors in the countries of the CEE by concluding BITs with these countries.² At the time, economic interests of EU members, mainly as providers of capital in these new markets, were more or less coordinated.³ Accordingly, BITs were intended to provide legal certainty for Western European investors in the weak legal systems of the CEE States.

The situation has changed significantly when the CEE countries joined the EU, following significant reforms of their legal systems.⁴ In the post-enlargement context that emerged, investor mistrust in the courts of the Member States and the recourse to private arbitrators through investment treaty arbitration (ITA) has become politically inappropriate and appears to be contrary to the principles on which the EU is founded. While recent judicial reforms in Poland have raised concerns about the independence of some national courts in the EU and have reinforced arguments in support of intra-EU ITA, adjudication under EU law is a more viable solution for the EU in the long term, albeit also politically a more sensitive one.⁵

In this chapter we will examine how international investment law (IIL) in relations between the Member States poses a challenge to EU law and its autonomy.⁶ Substantive provisions of intra-EU BITs challenge the functioning of the EU internal market, while ITA undermines national and EU courts in their enforcement of EU law. Consequently, international investment regulation (IIR) hinders internal market integration as one of the core EU objectives, and the rule of law in the EU as its core value. The interaction between EU law and international investment law (IIL) in the intra-EU relations must be understood in this context. Ultimately, the divergent approaches to intra-EU ISDS between investment tribunals and the CJEU epitomise the fundamental differences of the two legal orders, as identified in chapter 5.

² All but two of the 180 intra-EU BITs in force have been concluded between 'old' and 'new' Member States. The only two BITs between 'old' Member States are Germany–Greece BIT (signed on 27 March 1961, entered into force on 15 July 1963) and Germany–Portugal BIT (signed on 16 September 1980, entered into force 23 April 1982). However, both BITs were still signed before the accession of Greece and Portugal to the EU. After Brexit, the 11 intra-EU BITs between the UK and different EU Member States will become extra-EU BITs.

³ The EU and then the 12 Member States also concluded the ECT in 1994 with a view to providing a stable framework for Western capital to access energy resources in Eastern markets: Hans Jürgen Schroth, 'The Energy Charter Treaty (ECT) in the Context of the Treaties of the European Union' in Thomas W Wälde (ed) *The Energy Charter Treaty, An East-West Gateway for Investment and Trade* (Kluwer 1996) 241.

⁴ All candidates for EU membership must fulfill the so-called Copenhagen criteria, which, *inter alia*, include stability of democratic institutions, the rule of law, human rights, administrative and institutional capacity to effectively implement EU law and membership obligations. In order to achieve the satisfactory fulfillment of the criteria, candidate countries undergo a lengthy negotiation process (e.g. the negotiations of Croatia, the latest country to join the EU, lasted seven years).

⁵ Cf. Wojciech Sadowski, 'Protection of the Rule of Law in the European Union through Investment Treaty Arbitration: Is Judicial Monopolism the Right Response to Illiberal Tendencies in Europe?' (2018) 55 Common Market Law Review 1025.

⁶ The background to legal developments in this chapter is provided in chapter 5.

This chapter proceeds as follows. In the first part, we will explain the EU internal market and investment protection mechanisms under EU law. Next, we will analyse tensions between IIL and EU law, focusing first on intra-EU IIAs and the objectives of EU integration, and secondly on intra-EU ITA and the autonomy of the EU legal order. The *Achmea* judgment of the CJEU, delivered on 6 March 2018, is the apotheosis of these tensions. After analysing this judgment, we proceed by considering its practical legal and policy implications. In the concluding part we provide more general observations about consequences of these developments for the EU, its investment regulation and IIR.⁷

7.1. The internal market and investment in the EU

At the outset, it is important to explain the scope of investment issues in the context of EU law and integration. Investment primarily concerns domestic law measures and spreads across a number of areas which fall within either shared⁸ or exclusive Member States'⁹ competence. The purpose of this section is therefore to explain *mechanisms* of protection for investors under EU law rather than an exhaustive presentation of the substantive law.¹⁰ These mechanisms are explained with respect to (1) free movement provisions in the Treaty law; (2) private rights; and (3) enforcement mechanism and remedies. We conclude this section with observations about the reasons which render IIL more attractive to intra-EU investors than EU law.

7.1.1. Free movement in the EU and investment

The creation of the internal market has had an important role in enhancing intra-EU investment conditions. Its basic objective is the creation of 'an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured',¹¹

⁷ This chapter builds upon research and ideas discussed in two previous co-authored publications: Ivana Damjanovic and Ottavio Quirico, 'Intra-EU Investment Dispute Settlement in light of *Vattenfall* and *Achmea*: A Matter of Priority' (2019) 26 Columbia Journal of European Law 102, and Ivana Damjanovic and Nicolas de Sadeleer, 'I would rather be a respondent state before a domestic court in the EU than before an international investment tribunal' (2019) 4 European Papers 19.

⁸ For example, internal market, financial services, energy, transport, telecommunications, intellectual property, etc.

⁹ For example, direct taxation. Nevertheless, Member States must exercise that competence consistently with EU law: Case C-334/02 *Commission v France* [2004] ECR I-2229, para 21; Case C-155/09 *Commission v Greece* [2011] ECR I-65, para 39; Case C-10/10 *Commission v Austria* [2011] ECR I-5389, para 23. Property ownership also falls within Member States' exclusive competence under Art 345 TFEU, but in exercising their competences regarding property law Member States must comply with the fundamental principles of EU law, as prescribed by the CFR and the founding treaties: Opinion 2/15 ECLI:EU:C:2017:376, para 107.

¹⁰ The essential reading on internal market is Catherine Barnard, *The Substantive Law of the EU: The Four Freedoms* (6th edn, OUP 2019).

¹¹ Art 26 TFEU.

popularly known as ‘four freedoms’. With an aim of eliminating barriers to economic activity within the EU, the focus is primarily on eliminating divergences in Member States’ national legal systems which could be perceived as barriers to fundamental economic freedoms. This includes elimination of all national measures that serve as economic restrictions; those that are discriminatory (applied only to other EU nationals, including investors) and that are non-discriminatory (applied to both Member State and EU nationals). These Member State measures can be challenged under primary EU law (negative integration) or secondary EU law which seeks to achieve a more or less complete harmonisation (positive integration). The EU’s approach is thus functional towards achieving ‘free movement’.¹²

These economic freedoms could be considered ‘economic free movement rights’¹³ although they differ from private law rights in domestic legal systems.¹⁴ In the context of intra-EU investment, of primary importance are the Treaty provisions on the rights of establishment and free movement of capital. While the former applies only to the ‘establishment of nationals of a Member State in the territory of another Member State’¹⁵, free movement of capital involves both intra- (between the Member States) and extra-EU (between the Member States and third countries) dimensions.¹⁶ In the context of trans-border intra-EU investment liberalisation, the freedom to provide services within the EU is also of relevance.¹⁷

Freedom of establishment guarantees *access* to the market, via primary (setting up a company) and secondary (setting up a branch, agency or a subsidiary) establishment, and *operating* on the market. However, this freedom applies only to actual establishments of the investor in the host State through a fixed establishment for an indefinite period and in the pursuit of genuine economic activity.¹⁸ These conditions include only FDI types of investments which give investors ‘a definite influence over the company’s decisions’, allowing them ‘to determine [their] activities’.¹⁹ These limitations are understandable

¹² On political economy of the EU, see chapter 4. Interestingly, the reference to the ‘principle of an open economy with free competition’ in Art 3(1)(g) TEC has been removed in the Treaty of Lisbon. Since the Treaty of Maastricht the EU has been evolving from an economic to a more political union and accordingly its economic goals have been balanced more with non-economic goals. Nevertheless, ‘the principle of an open economy with free competition’ has been retained in other Treaty provisions, for example, in Art 119 TFEU, as a principle of economic and monetary policy.

¹³ Allan Rosas and Lorna Armati, *EU Constitutional Law: An Introduction* (Hart 2010) 181.

¹⁴ See section 7.1.2 below.

¹⁵ Art 49 TFEU. Nationals include private individuals and legal persons. Legal persons must be incorporated in accordance with the law of the Member State: Art 54 TFEU.

¹⁶ Art 63 TFEU.

¹⁷ Art 56 TFEU. Services are normally provided for remuneration and include all activities which are not covered by provisions on free movement of goods, capital and persons, in particular activities of an industrial character; a commercial character; of craftsmen; and of the professions: Art 57 TFEU.

¹⁸ Case C-196/04 *Cadbury Schweppes and Cadbury Schweppes Overseas* [2006] ECR I-7995, para 54.

¹⁹ Case C-231/05 *Oy AA* [2007] ECR I-6373, para 20; Case C-464/14 *SECL* ECLI:EU:C:2016:896. In a situation when a company holds a 15% share in a subsidiary, it should not be implied that such a company exercises a

given the objective of the freedom of establishment, which is ‘assisting economic and social interpenetration’ of EU nationals within the Community²⁰ and allowing them ‘to participate, on a stable and continuing basis, in the economic life of a Member State other than his State of origin and to profit therefrom’.²¹ Investments that do not satisfy freedom of establishment criteria, such as portfolio investments, are capital movements subject to the freedom of capital provisions.

Freedom of capital guarantees free movement of capital investments, which include both FDI and portfolio investment.²² A *capital movement* is defined in the secondary EU law²³ and the CJEU’s case-law. With respect to scope, capital movements in EU law are a wider concept than the definition of investment in IIL. They include investments such as ‘direct investment in the form of participation in an undertaking by means of a shareholding or the acquisition of securities on the capital market’,²⁴ ‘granting credit on a commercial basis’,²⁵ ‘the acquisition of shares on the capital market solely with the intention of making a financial investment’²⁶ or ‘a resale of shares to the issuing company’.²⁷ But capital can also take the form of a mortgage,²⁸ or other investment in real estate on the territory of a Member State by non-residents,²⁹ both in the form of ownership and administration of such property;³⁰ usufruct over agricultural land;³¹ and

definite influence over the decisions of the company distributing the dividends. Accordingly, the free movement of capital would prevail. See, to that effect, Joint Cases C-504/16 and C-613/16 *Deister Holding and Juhler Holding* EU:C:2017:1009, paras 79-80; Case C-685/16 *EV* ECLI:EU:C:2018:743, para 40.

²⁰ Case 2/74 *Reyners* [1974] ECR 631, para 21.

²¹ Case C-55/94 *Gebhard* [1995] ECR I-4165, para 25; Case C-470/04 *N* [2006] ECR I-7409, para 26. See also chapter 8, section 8.2.1.1 on ‘malibox’ companies.

²² Joined Cases C-282/04 and C-283/04 *Commission v Netherlands* [2006] ECR I-9141, para 19.

²³ Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty [1988] OJ L178/5. Annex I contains a list of transactions that fall under the category of ‘capital movements’. The CJEU held: ‘As regards the notion of “capital movements”, there is no definition thereof in the Treaty. It is, however, settled case-law that, inasmuch as Article 56 EC essentially reproduces the contents of Article 1 of Directive 88/361, and even though that directive was adopted on the basis of Articles 69 and 70(1) of the EEC Treaty, (Articles 67 to 73 of the EEC Treaty have been replaced by Articles 73b to 73g of the EC Treaty, now Articles 56 EC to 60 EC) [now articles 63-66 TFEU], the nomenclature in respect of “movements of capital” annexed to that directive still has the same indicative value, for the purposes of defining the notion of capital movements’: Case C-222/97 *Trummer and Mayer* [1999] ECR I-1671, para 21; Case C-452/04 *Fidium Finanz AG* [2006] ECR I-9521, para 41; Joined Cases C-515/99, C-519/99 to C-524/99 and C-526/99 to C-540/99 *Reisch and Others* [2002] ECR I-2157, para 30; Case C-513/03 *Van Hilten-van der Heijden* [2006] ECR I-1957, para 39. This nomenclature is therefore not exhaustive.

²⁴ Case C-367/98 *Commission v Portugal* [2002] ECR I-4731, para 38.

²⁵ *Fidium Finanz AG* (n 23) paras 42-43. This is also considered a provision of services and it is covered by Art 49 TFEU (freedom of establishment).

²⁶ *Commission v Netherlands* (n 22) para 19.

²⁷ Case C-265/04 *Margaretha Bouanich v Skatteverket* [2006] ECR I-923, para 29.

²⁸ *Trummer and Meyer* (n 23) paras 23-24.

²⁹ National measures affecting investments in real property come within the free movement of capital even when these investments are intended to permit the exercise of the right of establishment in the Member State concerned. See Case C-364/01 *Barbier* ECLI:EU:C:2003:665, paras 58-59; Case C-512/03 *Blanckaert* [2005] ECR I-7685, para 35; Case C-567/07 *Woningstichting Sint Servatius* ECLI:EU:C:2009:593, para 20; Case C-45/17 *Jahin* ECLI:EU:C:2018:18, para 22.

³⁰ Case C-386/04 *Centro di Musicologia Walter Stauffer* [2006] ECR I-8203, para 24.

³¹ Joined Cases C-52/16 and C-113/16 *SEGRO and Horváth* [2016] ECLI:EU:C:2018:157, para 57.

even an inheritance can be investment.³² Unlike *establishment*, there is no requirement that the capital movement must be an economic activity.³³ Importantly, the list of capital movements in the secondary law is not exhaustive and transactions that are linked to the listed measures can constitute capital movement.³⁴

There is a close proximity between the freedom of establishment and free movement of capital and a potential overlap of these two freedoms.³⁵ Generally speaking, freedom of capital is a precondition for the exercise of other freedoms.³⁶ The approach of the CJEU in applying relevant Treaty provisions has been to identify the principal purpose of national restrictions (whether to regulate establishment or capital), and, when both apply, the emphasis is placed on whether the measures allow a ‘definite influence over [the] company’s decision’.³⁷ The distinction between FDI and portfolio investment therefore is of relevance.³⁸ The distinction between freedom of establishment and capital is significant with respect to the territorial scope of their application,³⁹ but also with respect to the Treaty derogations from these freedoms, which are more extensive in the case of capital movements.⁴⁰ Of similar importance is the distinction between free movement of capital and services in the aspect of liberalisation of capital.⁴¹

Given that Member States are more sensitive to the impact of capital exports on national economies, liberalisation of capital generally took longer than liberalisation of other freedoms.⁴² Early in its case-law the CJEU noted the close connection between capital movements and economic and monetary policies of the Member States. The Court

³² *Van Hilten-van der Heijden* (n 23); Case C-35/08 *Busley et Cibrian Fernandez* ECLI:EU:C:2009:625; Case C-510/08 *Mattner* [2010] ECR I-3553; Case C-244/15 *Commission v Greece* ECLI:EU:C:2016:359; Case C-679/17 *Huijbrechts* ECLI:EU:C:2018:940.

³³ Barnard (n 10) 523.

³⁴ For example, receipt of dividends is not expressly mentioned in the nomenclature annexed to Directive 88/361 as capital movements, but it necessarily presupposes participation in new or existing undertakings referred to in Heading I(2) of the nomenclature and thus is considered capital movement: Case C-35/98 *Verkooijen* [2000] ECR I-4071, paras 28-30.

³⁵ See Art 65(2) TFEU.

³⁶ Case 203/80 *Casati* [1981] ECR 2595, para 8.

³⁷ Barnard (n 10) 527.

³⁸ Barnard identifies five areas in which the CJEU tends to apply exclusively capital provisions: (1) property purchase and investment, including building and land subdivision; (2) financial transactions, including currency; (3) loans; (4) investments in companies, without dominant interest in the company; (5) privatisation in sensitive sectors (in particular energy), where a State’s golden shares allow it to keep a degree of influence on the company’s activities. When it comes to taxation of capital, Art 63 TFEU applies in connection with investment, property purchase, inheritance and charitable gifts: Barnard (n 10) 528-529. However, the CJEU will apply freedom of establishment provisions in cases where national rules affect relations within a group of companies: *ibid* 383.

³⁹ Freedom of establishment applies intra-EU only, while free movement of capital both intra- and extra-EU, albeit not to the same extent in both dimensions.

⁴⁰ See Art 65(1) TFEU (freedom of capital) cf. Art 52(1) TFEU (freedom of establishment).

⁴¹ In this aspect, the CJEU assesses whether the predominant purpose of national rules is to encourage access to the market for the purpose of entrepreneurial activity, such as of offering investments for sale (in which case freedom of services applies) or financial gains from an investment (in which case freedom of capital applies): see Barnard (n 10) 528.

⁴² *ibid* 519.

thus recognised that ‘complete freedom of movement of capital may undermine the economic policy of one of the Member States or create an imbalance in its balance of payments, thereby impairing the proper functioning of the Common Market.’⁴³ Interestingly, the Court thus found a valid justification even for limitations of the EU fundamental freedoms. Importantly, the reasons were found in the potential for the complete liberalisation of capital to undermine the internal market as the ulterior goal of EU integration, rather than in protecting the interests of Member States *per se*. For this reason, the Court concluded that free movement of capital differs from other freedoms of goods, persons and services, and the obligation to liberalise exists only ‘to the extent necessary to ensure the *proper functioning of the internal market*’.⁴⁴

In the meantime, capital movements have been liberalised, at least in the intra-EU context, due to the establishment of the economic and monetary union (EMU). However, additional Treaty restrictions continue to apply,⁴⁵ in particular with respect to extra-EU movements of capital.⁴⁶ The Council has been given extra powers to adopt restrictive measures on these movements.⁴⁷ The objectives of the EU and its internal market, rather than Member States’ interests, serve as justifications for these additional extra-EU restrictions.

The main rationale of the free movement guarantees in the EU is the elimination of national measures which have, directly or indirectly, a discriminatory effect within the internal market or obstruct free circulation of investment even if non-discriminatory.⁴⁸ This is in line with the principle of the internal market as a competitive playing field that underpins the founding treaties. It is an EU version of the national treatment in IIAs, which goes beyond the equal treatment of nationals and non-nationals.⁴⁹ The CJEU emphasises

⁴³ *Casati* (n 36) para 9.

⁴⁴ *ibid* para 10 (emphasis added).

⁴⁵ Art 65 TFEU.

⁴⁶ Art 64 TFEU. This in particular concerns four types of capital movements: direct investment, establishment, the provision of financial services and the admission of securities to capital markets, with respect to which any restrictions under EU and Member States’ national laws that existed on 31 December 1999 have been grandfathered: Art 64(1) TFEU. Additionally, the EU Parliament and the Council can adopt in accordance with the ordinary legislative procedure restrictive measures regarding these four types of capital movements: Art 64(2) TFEU.

⁴⁷ The Council is empowered to ‘adopt measures which constitute a step backwards in Union law’ regarding the liberalisation of extra-EU capital movements. This can be done unanimously in accordance with a special legislative procedure and after consulting the European Parliament: Art 64(3) TFEU. Further, the Council is empowered to adopt a decision on the legality of Member State restrictive tax measures under EU law, which is usually a task of the CJEU. Such national measures must be ‘justified by one of the objectives of the Union and compatible with proper functioning of the internal market’: Art 65(4) TFEU. Finally, the Council can adopt safeguard measures when extra-EU movements of capital ‘cause, or threaten to cause, serious difficulties for the operation of EMU’. Such measures are to be taken in ‘exceptional circumstances’, if ‘strictly necessary’ and for a period not longer than 6 months: Art 66 TFEU. See also chapter 8, section 8.1.1.1.

⁴⁸ See Barnard (n 10) 529 and seq; Stephen Hindelang, *The Free Movement of Capital and Foreign Direct Investment* (OUP 2009) 166 and seq.

⁴⁹ In addition, the general non-discrimination clause in Art 18 TFEU prohibits any discrimination on grounds of nationality. Further, Art 21 CFR prohibits ‘any discrimination on any ground’.

‘national measures liable to hinder or make less attractive the exercise of fundamental freedoms guaranteed by the Treaty’,⁵⁰ demonstrating the Court’s ‘obstacle’ rather than ‘discrimination approach’.⁵¹

7.1.1.1. Derogations in the Treaty law

The CJEU has developed extensive case-law regarding national measures that are prohibited under freedom of establishment (and closely related to that, freedom to provide and receive services) and freedom of capital provisions. Additionally, the CJEU has developed a number of public interest justifications, which supplement general Treaty derogations invoked by the Member States to justify discriminatory measures or other conduct which impedes access to or the exercise of the freedoms.

While it is beyond the scope of this chapter to delve into the very complex CJEU case-law,⁵² some examples are given to illustrate the discernible approach of the CJEU in assessing the prohibited measures and striking a balance between the objectives of EU integration and Member States’ public interest with respect to freedom of establishment and capital.⁵³

Regarding free movement of capital, the CJEU has identified three types of Member State measures as restrictions that are prohibited under Article 63 TFEU.⁵⁴ First, measures that deter investment in other Member States, which are primarily discriminatory against transnational activities.⁵⁵ Further, measures which restrict investment in a Member State, for example, through prior administrative authorisation schemes.⁵⁶ Finally, measures which limit control over the investment, given the potential of such measures to undermine the decision-making authority of the undertaking and thus affect the quality and predictability of public intervention into the market.⁵⁷ The effects of any Member States’ restrictions will be reviewed against their impact on the

⁵⁰ *Gebhard* (n 21) para 37.

⁵¹ Paul Craig and Gráinne de Búrca, *EU Law, Text, Cases and Materials* (6th edn, OUP 2015) 806. Cf. the CJEU’s approach to interference with internal market freedoms by direct taxation as more of a discrimination-based approach in its essence, if not wording: Jukka Snell, ‘Non-Discriminatory Tax Obstacles in Community Law’ (2007) 56 *The International and Comparative Law Quarterly* 339, 349. See 7.1.1.2 below on taxation issues.

⁵² For extensive analysis of the CJEU’s case-law, see Barnard (n 10) chs 11, 12 and 14.

⁵³ See also more general discussion of the CJEU’s approach in chapter 5, section 5.3.

⁵⁴ Damian Chalmers, Gareth Davies and Giorgio Monti, *European Union Law* (2nd edn, CUP 2010) 725-726.

⁵⁵ These measures are ‘those which are likely to discourage non-residents from making investments in a Member State or to discourage that Member State’s residents from doing so in other States’: *Van Hilten-van der Heijden* (n 23) para 44; Case C-101/05 *A* [2007] ECR I-11531, para 40; Case C-370/05 *Festersen* [2007] ECR I-1129, para 24.

⁵⁶ Case C-302/97 *Konle* [1999] ECR I-3099.

⁵⁷ Case C-112/05 *Commission v Germany* [2007] ECR I-8995 and other ‘golden shares’ case-law. Chalmers, Davies and Monti, *European Union Law* (n 54) 725.

functioning of the internal market (through their impact on investment), and not against their impact on *investors*, although the two in many cases overlap.

Nevertheless, national restrictive measures in an intra-EU setting will be lawful if they can be justified by the pursuit of a legitimate public interest, subject to proportionality.⁵⁸ If the measure is directly discriminatory, the Member State can rely only on the express derogations in the founding treaties,⁵⁹ whereby more extensive derogations apply to the free movement of capital.⁶⁰ A critical distinction must be made between unequal treatment, which is permitted under Article 65(1)(a) TFEU, and arbitrary discrimination which is prohibited by Article 65(3) TFEU.⁶¹ Importantly, although Article 65(1) gives Member States more leeway in their regulatory activity, measures which are arbitrarily discriminatory are absolutely prohibited in virtue of Article 65(3) TFEU. As a derogation from the fundamental principle of the free movement of capital, Article 65(1) TFEU derogation must be strictly interpreted.⁶² In order to fall within the scope of Article 65(1)(a) TFEU, ‘the difference in treatment must concern situations not objectively comparable or be justified by an overriding reason in the public interest’.⁶³

When national restrictions on free movement are not arbitrarily discriminatory, the scope of public interest grounds referred to as ‘imperative requirements’ is wider and open ended.⁶⁴ For example, ensuring energy supply or the protection of the environment can be such a legitimate goal, and acquiring public control over hydropower resources and related installations can be a means of attaining these goals.⁶⁵ With many

⁵⁸ On discussion about the CJEU’s approach to the assessment of public interest, see chapter 5, section 5.3.4.

⁵⁹ Art 52(1) TFEU, which includes grounds of public policy, security and health. Of relevance is also Treaty exclusion of the applicability of freedom of establishment provisions to Member States’ activities connected, even occasionally, with the exercise of official authority: Art 51(1) TFEU. These provisions *mutatis mutandi* apply to the freedom to provide services: Art 62 TFEU.

⁶⁰ Art 65(1)(a) and (b) TFEU. First, this provides specific derogation in relation to a tax regime, while providing secondly, a more general derogation in relation to regulatory supervision of the taxation and financial institutions and grounds of public policy or public security.

⁶¹ Art 65(3) TFEU provides that the national provisions referred to in Art 65(1) ‘shall not constitute a means of arbitrary discrimination...’. See also Case C-252/14 *Pensioenfond Metaal en Techniek* ECLI:EU:C:2016:402, para 47.

⁶² Case C-181/12 *Welte* ECLI:EU:C:2013:662, para 42; Case C-322/11 *K* ECLI:EU:C:2013:716, para 34; *Jahin* (n 29) para 32.

⁶³ Case C-347/11 *Santander Asset Management SGHC* ECLI:EU:C:2012:286, para 23 and the case-law cited. By way of illustration, the social security fees to be paid by a French citizen who is a non-resident in France and contributes to a private social security scheme in a third State would fall within the scope of exception on the grounds that his situation is not comparable with the one of EU residents: *Jahin* (n 29) para 41.

⁶⁴ To be lawful such measures must be applied in a non-discriminatory manner; must be justified by imperative requirements in the general interest; must be suitable for securing the attainment of the objective which they pursue and must not go beyond what is necessary in order to attain such an objective (the principle of proportionality): Case C-19/92 *Kraus v Land Baden-Wuerttemberg* [1993] ECR I-1663, para 32; *Gebhard* (n 21) para 37.

⁶⁵ E-2/06 *EFTA Surveillance Authority v The Kingdom of Norway* [2007] OJ C301/18, para 84. However, Member States have the burden of proof. In particular, they must demonstrate that their legislation addresses an *essential interest* in the sense of an imperative requirement relating to the general interest as laid down in the case-law and that conforms to the principle of proportionality: Case C-260/04 *Commission of the European*

derogations, internal market case-law in this aspect does not provide clear dividing lines between these categories.⁶⁶ When interpreting free movement of capital Treaty derogations that are justified on the grounds of public policy and security, the CJEU has drawn parallels with its case-law on other freedoms.⁶⁷ In particular, the CJEU emphasised that any derogations must be interpreted strictly, that they cannot serve purely economic ends and that any affected individual must be granted access to a legal redress.⁶⁸ Importantly, ‘general financial interests of a Member State’ or ‘economic policy objectives’ are not adequate justifications.⁶⁹

In the context of investment, of relevance is also the requirement of legal certainty. Accordingly, any prior authorisation for FDI must be precise regarding the specific conditions in which the authorisation is required in order to indicate to investors the extent of their rights and obligations guaranteed by Article 63 TFEU.⁷⁰ Any reference formulated in general terms, such as ‘the protection of national interest’, gives ‘a wide discretionary power’ to the executive in granting prior authorisation and ‘constitutes a serious interference with the free movement of capital, and may have the effect of excluding it altogether’.⁷¹ The criteria must be objective and subject to judicial review in order to satisfy the requirements of legal certainty.⁷² Such a restricted approach of the CJEU in assessing Member States’ measures, which prohibits any arbitrary decisions based on uncertain or political criteria, can provide confidence to investors that their rights will be guaranteed.

In light of the above discussion on free movement provisions in the Treaty law and their derogations, the following table summarises the main features of the two fundamental freedoms.

Communities v Italian Republic [2007] ECR I-7083, para 33. In the quoted EFTA Court case, the Court concluded that Norway failed to demonstrate that public ownership of hydropower resources and installations was necessary to meet the objectives of security of energy supply or environmental protection (other forms of control could have achieved these objectives in an equally effective way): paras 84-88.

⁶⁶ Craig and de Búrca (n 51) 807.

⁶⁷ Barnard (n 10) 546-547.

⁶⁸ Additionally, the CJEU also noted that the scope of such derogations cannot be determined unilaterally by each Member State without any control by the EU institutions, and that accordingly public policy and public security may be relied on only if there is ‘a genuine and sufficiently serious threat to a fundamental interest of society’: Case C-54/99 *Église de Scientologie* [2000] ECR I-1335, para 17.

⁶⁹ *Commission v Portugal* (n 24) para 52.

⁷⁰ Accordingly, a requirement for prior authorisation ‘for every FDI which is “such as to represent a threat to public policy [and] public security”, without any more detailed definition’ is illegal: *Église de Scientologie* (n 68) paras 21-22.

⁷¹ Case C-483/99 *Commission v France* [2002] ECR I-4781, paras 50-52.

⁷² Case C-503/99 *Commission v Belgium* [2002] ECR I-4809, para 52.

Table 7.1. Comparison between freedom of establishment and free movement of capital in EU law

Category	Freedom of establishment (Article 49 TFEU)	Free movement of capital (Article 63 TFEU)
Type of investment	▪ Economic activity ▪ FDI	▪ Financial investment ▪ FDI + portfolio investment
Territorial scope	Intra-EU	Intra- and extra-EU
Derogations	▪ General - public policy, public security, public health; - exercise of official authority	▪ General - regulatory supervision of taxation and financial institutions; - public policy or public security ▪ Specific: taxation - discrimination between place of residence vs. place of capital invested
	▪ Imperative requirements in the general interest + non-discrimination + proportionality	
Direct effect	▪ Vertical (individual–State) ▪ Limited horizontal applicability (individual–private parties)	▪ Vertical (individual–State)

7.1.1.2. The specific case of bilateral taxation

A large number of cases in the area of freedom of establishment and capital relate to national taxation. While direct taxation falls within the competence of Member States, the exercise of power of taxation must comply with EU law and the principle of national treatment of nationals and non-nationals within the EU.⁷³ However, the prohibition of differences in treatment is not absolute. A national measure will be considered legal where the difference in treatment relates ‘to situations which are not objectively comparable’⁷⁴ or can be ‘justified by an overriding reason in the public interest’, subject to the usual proportionality test.⁷⁵ Taxpayers’ residence is a factor that may justify differences of treatment between resident and non-resident taxpayers,⁷⁶ and

⁷³ Case C-80/94 *Wielockx* [1995] ECR I-2493, para 16; *Verkooijen* (n 34) para 32; *Commission v France* (n 9) para 21; C-242/03 *Weidert and Paulus* [2004] ECR I-7379, para 12.

⁷⁴ This in line with the more general principle of equal treatment, which requires that ‘comparable situations must not be treated differently and different situations must not be treated in the same way unless such treatment is objectively justified’: Case C-580/12 P *Guardian Industries and Guardian Europe v Commission* EU:C:2014:2363, para 51; Case C-477/14 *Pillbox 38* ECLI:EU:C:2016:324, para 35.

⁷⁵ Case C-123/11 A ECLI:EU:C:2013:84, para 33 (for freedom of establishment), Case C-446/04 *Test Claimants in the FII Group Litigation* [2006] ECR I-11753, para 167 (for free movement of capital).

⁷⁶ A (n 75) para 33.

additionally, in the case of capital movements, the place where the capital is invested.⁷⁷ While the prevention of tax evasion or tax abuse is a legitimate objective,⁷⁸ the CJEU strictly scrutinises national laws, whereby *general* presumptions of tax evasion or abusive practices do not *per se* justify restrictions on freedom of establishment⁷⁹ or capital.⁸⁰

Double taxation international agreements between the Member States constitute one specific example. While they provide a special tax treatment only to the nationals of some Member States (those that are parties to a specific bilateral agreement), they are not considered to be discriminatory under EU law.⁸¹ They also demonstrate that EU founding treaties, unlike IIAs, do not recognise MFN treatment, which would extend favourable tax treatment to other non-nationals.⁸² Moreover, international double taxation more generally is not an obstacle to the free movement provisions and thus is also not illegal under EU law.⁸³ Reasoning by analogy, the Opinion of AG Wathelet in *Achmea* suggested that the same conclusion could be reached regarding intra-EU BITs.⁸⁴

However, there are important differences between treatment of taxation and investment in the EU context, in particular with respect to different interactions of investment law with the internal market. Tax law is at the core of national sovereignty and has been accordingly recognised in the allocation of powers between the EU and the Member States. The CJEU has readily applied the territoriality principle in this area of law.

⁷⁷ Art 65(1)(a) TFEU, which prescribes that Member States retain a right to differentiate between tax law provisions that apply to 'taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested'. This is a specific express Treaty derogation with respect to free movement of capital, and which is not explicitly mentioned in the Treaty with respect to the freedom of establishment. Art 65(1)(a) TFEU is subject to Art 65(3) TFEU, which explicitly and absolutely prohibits measures which are arbitrary or discriminatory, or constitute disguised protectionist measures.

⁷⁸ Moreover, in light of Art 65(1)(b) TFEU, Member States have the right 'to take all requisite measures to prevent infringements of national law and regulations, in particular in the field of taxation and the prudential supervision of financial institutions, or to lay down procedures for the declaration of capital movements for purposes of administrative or statistical information'. Such measures relate to the effective administration of the tax system and regulatory supervision of economic actors, such as banks and insurance companies: Craig and de Búrca (n 51) 724. This provision, as an express Treaty derogation of free movement of capital, is equally subject to Art 65(3) TFEU, which explicitly and absolutely prohibits measures which are arbitrary, discriminatory or constitute disguised protectionist measures.

⁷⁹ Case C-105/07 *Lammers and Van Cleeff* [2008] ECR I-173, para 27. Instead, 'in order for a restriction on the freedom of establishment to be justified on the ground of prevention of abusive practices, the specific objective of such a restriction must be to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory': para 28.

⁸⁰ Case C-478/98 *Commission v Belgium* [2000] ECR I-7587, para 45.

⁸¹ Case C-376/03 *D* [2005] ECR I-5821.

⁸² Case C-284/16 *Achmea*, Opinion of AG Wathelet ECLI:EU:C:2017:699, para 71.

⁸³ For detailed analysis of the CJEU's approach, see Snell (n 51) 358-366.

⁸⁴ See *Achmea*, Opinion of AG Wathelet (n 82) paras 73-80. However, while both BITs and double taxation conventions arguably aim at the same economic activities (entry and exit of capital), as AG Wathelet suggests (para 79), they are quite different in the way they operate; with the first allocating taxation rights between the States (in order to both confer benefits on individuals through avoidance of double taxation and to prevent tax evasion), rather than granting private rights to certain groups of individuals, like BITs. Nevertheless, both can be used as tools for investors in dealing with foreign tax authorities, with BITs being much wider in their scope (including with respect to ISDS as a dispute settlement mechanism, which is not available under double taxation agreements).

However, the principle was rejected in some other areas; for example, in intellectual property, where it held that:

the essential purpose of the Treaty, which is to unite national markets into a single market, could not be attained if, under the various legal systems of the Member States, nationals of those Member States were able to *partition the market* and bring about *arbitrary discrimination or disguised restrictions* on trade between Member States.⁸⁵

Mutatis mutandi, the same could be applied to investment law given the proprietary nature of investment. Equally fundamental to State sovereignty, tax issues are arguably also more politically sensitive for *all* Member States, unlike investment issues which seem to concern different Member States differently.⁸⁶

7.1.2. Private rights and investment in the EU

While the free movement provisions imply guarantees of access to the market in intra-EU relations (and extra-EU in the case of capital), EU law continues to apply to the established investments throughout their lifetime, alongside the national law of the Member State in which the investor has been established.⁸⁷ In this sense, the scope of EU law is much wider as it implies both investment liberalisation (market access) and investment protection (post-establishment). As discussed, IIL is mostly focused on post-establishment protections for investors.⁸⁸ Nevertheless, the scope and mechanisms of these protections under the two regimes are different. In light of the private nature of *rights* conferred on investors under IIL, it could be argued that EU law with respect to these rights plays the same role as it plays more generally regarding private law in national legal systems. The EU's power to regulate private law stems from the variety of different competences under EU treaties,⁸⁹ leading to fragmentation of EU regulation in the area of private law.⁹⁰

⁸⁵ Joined Cases 55/80 and 57/80 *Musik-Vertrieb Membran GmbH v GEMA* [1981] ECR 147, para 14 (emphasis added). The CJEU thus rejected the argument by Belgium and Italy that in the absence of harmonisation in the intellectual property rights (IPR) sector the principle of the territoriality of copyright laws should always prevail over the principle of freedom of movement of goods within the internal market. After the Lisbon Treaty, Art 118 TFEU provides an explicit legal basis for EU-wide IPR.

⁸⁶ See 7.2.1 below.

⁸⁷ For example, in Joined Cases C-52/16 and C-113/16 *SEGRO and Horváth* ECLI:EU:C:2018:157, the CJEU found that national legislation, which permits that rights of usufruct over agricultural land can be acquired in the future only by close family members of the owner of the land and thus cancels, without providing for compensation, the rights previously acquired by legal persons or by natural persons who cannot demonstrate a close family tie with the owner of the land, was discriminatory (targeting foreigners) and disproportionate, and thus contrary to free movement of capital guaranteed in Art 63 TFEU.

⁸⁸ See Part I, chapter 3, section 3.1.3.

⁸⁹ Arts 114 and 115 TFEU (harmonisation of national rules affecting the internal market); Art 153 (harmonisation of labour law); Art 118 (IPR); Art 50 (EU company law); Arts 67 and 81 TFEU (judicial cooperation in civil matters); Art 352 (the flexibility clause).

⁹⁰ European Parliamentary Research Service, 'EU Competence in private law' (2015) 14.

Rights of investors under EU law are not absolute private law rights but rights that stem from the EU's exercise of its public law prerogatives. Accordingly, investors have only limited rights under EU law, derived from the obligation of Member States to comply with the fundamental freedoms.⁹¹ For example, with respect to property rights, while Member States do have exclusive competence over property ownership,⁹² their own system of property ownership is not a valid justification for obstacles to the exercise of freedoms guaranteed under the founding treaties.⁹³

In addition, EU law attempts to harmonise substantive national rules on the functioning of the internal market across the EU. Harmonisation through secondary legislation is aimed at complementing the four freedoms and extending the reach of EU law to 'purely internal' situations to which free movement provisions otherwise do not apply.⁹⁴ Of particular importance for investors is the Services Directive that provides for specific obligations related to both services and establishment.⁹⁵ In interpreting this Directive, the CJEU has extended the freedom of establishment to internal situations, allowing domestic investors to challenge public law measures that are likely to hinder their establishment in intra-State situations.⁹⁶ In this regard, EU law aims at eliminating reverse discrimination between domestic and foreign investors, which is inherent to IIL.

Finally, the EU legal order is a constitutional order underpinned by fundamental rights, derived from the general principles of EU law and the EU Charter of Fundamental Rights (CFR).⁹⁷ These rights are applicable whenever EU institutions act and Member States take national measures that fall within the scope of EU law.⁹⁸ Rights are therefore justiciable and can be invoked by litigants before EU courts and domestic courts, provided that the subject-matter *is covered by EU law*.⁹⁹ However, these rights are not absolute and may be subject to restrictions.

⁹¹ Philip Strik, *Shaping the Single European Market in the Field of Foreign Direct Investment* (CUP 2014) 197.

⁹² Art 345 TFEU.

⁹³ Case C-463/00 *Commission v Spain* [2003] ECR I-45, para 67.

⁹⁴ Case 175/78 *Saunders* [1979] ECR 1129.

⁹⁵ Services Directive 2006/123 [2006] OJ L376/36. Its goal is 'remov[ing] barriers to the freedom of establishment for providers in Member States and barriers to the free movement of services as between Member States and to guarantee recipients and providers the legal certainty necessary for the exercise in practice of those two fundamental freedoms of the Treaty': Services Directive, recitals 43, 45, 47, and 48.

⁹⁶ In line with this, the CJEU noted that the full achievement of the internal market in services 'above all' requires 'the elimination of obstacles which are encountered by providers in becoming established in the Member States, whether in their own Member State or in another Member State, and which are liable to affect adversely their ability to supply services to recipients located throughout the European Union': Joined Cases C-360/15 and C-31/16 *Visser Vastgoed Beleggingen* [2018] OJ C 112/2, para 115.

⁹⁷ Chapter 4, section 4.2.

⁹⁸ Case C-159/90 *Grogan* [1991] ECR I-4605, para 31.

⁹⁹ Cf. CFR principles, which are obligations of the EU and Member States when implementing EU law. They cannot by themselves confer on individuals a subjective right which they may invoke as such: Case C-176/12 *Association de médiation sociale* ECLI:EU:C:2014:2, para 45; Case C-356/12 *Glatzel* ECLI:EU:C:2014:350, para 78.

7.1.2.1. The right to property under EU law

The CJEU has long recognised that the right to property under EU law is a general principle of EU law, which does not constitute an ‘absolute prerogative’ but must be viewed in relation to its social function.¹⁰⁰ Under EU law, the right to property is under Article 17 CFR a right to protection of lawfully acquired possessions. Dispossession is possible only in the public interest under conditions prescribed by law, and with the payment of fair compensation.¹⁰¹ The Charter also recognises that the use of property may be regulated if it is necessary for the general interest,¹⁰² thus also recognising the possibility of ‘indirect’ expropriation. The meaning and scope of the right to property in the CFR must be read consistently with Article 1, Protocol 1 of the ECHR.¹⁰³ The ECHR similarly recognises that deprivation of possession can only be in the public interest and subject to conditions provided for by law,¹⁰⁴ where States also retain the right to control the use of property in accordance with the general interest.¹⁰⁵ Thus, the right to property in the ECHR intends to achieve ‘a fair balance between the demands of the general interests of the community and the requirements of the protection of the individual’s fundamental rights’.¹⁰⁶

The standard of compensation depends on the assessment of proportionality, so the ECHR does not guarantee a right to full compensation in all circumstances. Legitimate objectives of public interest designed to achieve greater social justice may lead to compensation below the full market value, where the Court’s review is limited to ‘ascertaining whether the choice of compensation terms falls outside the State’s *wide* margin of appreciation’.¹⁰⁷ In the practice of the CJEU, the exercise of the right to property may be restricted, particularly in the context of the internal market, if restrictions correspond to ‘objectives of general interest pursued by the EU’ and they do not constitute with respect to their aim ‘a disproportionate and intolerable interference which infringes upon the *very substance* of the rights guaranteed’.¹⁰⁸ Not providing compensation or a

¹⁰⁰ Case C-120/06 *FIAMM v Council and Commission* [2008] ECR I-6513, para 183.

¹⁰¹ Second sentence Art 17(1) CFR.

¹⁰² Third sentence Art 17(1) CFR.

¹⁰³ Art 52 of the CFR outlines: ‘In so far as this Charter contains rights which correspond to rights guaranteed by the Convention for the Protection of Human Rights and Fundamental Freedoms, the meaning and scope of those rights shall be the same as laid down by the said Convention.’ The ECHR regulates protection of private property in Art 1 of its First Additional Protocol.

¹⁰⁴ Art 1(1) Protocol 1 ECHR.

¹⁰⁵ Art 1(2) Protocol 1 ECHR.

¹⁰⁶ *Mellacher and others v Austria* App no 10522/83; 11011/84; 11070/84 (ECtHR, 19 December 1989) para 48.

¹⁰⁷ *James and others v United Kingdom* App no 8793/79 (ECtHR 21 February 1986) para 54 (emphasis added).

¹⁰⁸ *FIAMM* (n 100) para 183. In light of Article 52(1) CFR, the right to property can be restricted if justified by ‘the objectives of general interest pursued by the EU’, if such restrictive measures are not disproportionate and do not constitute ‘intolerable interference, impairing the very substance of the right guaranteed’:

remedy in the legislation that does not fulfil these requirements and thus limits the property right can in itself constitute an infringement and gives rise to non-contractual liability.¹⁰⁹ However, only ‘a sufficiently serious breach of the appellants’ right to property, within the meaning of Article 17(1) CFR, can lead to such liability.¹¹⁰

Direct (*de iure*) expropriation fundamentally entails compensation, which can nevertheless be below market value. By contrast, indirect (*de facto*) expropriation can lead to either (below market value) compensation, or no compensation.¹¹¹ This is an important difference for investors who under IIL can claim the (fair) market value of their expropriated investment,¹¹² except in rare cases when the police powers doctrine applies, resulting in no compensation.¹¹³ Therefore, while EU law is more favourable to States in examining permissible limitations to private property, IIL mostly reflects the interests of the investors.¹¹⁴

For investors, interference with their property rights by national measures for economic governance across the EU is of particular importance, in particular with respect to instruments adopted under the European Stability Mechanism (ESM).¹¹⁵ Some intra-EU cases specifically deal with measures adopted by the Greek and Cypriot governments during their banking crises, which resulted in significant losses for investors.¹¹⁶ Most of these measures have been adopted under the Memoranda of Understanding (MoU)

C-548/09 P *Bank Melli Iran v Council* EU:C:2011:735, para 114; Joined Cases C-8/15 P to C-10/15 P *Ledra Advertising v Commission and ECB* ECLI:EU:C:2016:701, para 70; C-358/15 P *Bank of Industry and Mine v Council* EU:C:2016:338, para 56.

¹⁰⁹ Case C-120/06 *FIAMM v Council and Commission* [2008] ECR I-6513, para 183.

¹¹⁰ *Ledra Advertising* (n 108) para 68.

¹¹¹ See, for instance, *James and others v United Kingdom* (n 107) para 54. For a scholarly opinion, see Stefan Kirchner and Katarzyna Geler-Noch, ‘Compensation under the European Convention on Human Rights for Expropriations Enforced Prior to the Applicability of the Convention’ (2012) 19 *Jurisprudence* 21, 25.

¹¹² In cases of unlawful expropriation, States have a duty of full reparation to reestablish the situation which would have existed if the unlawful act had not been committed: *Case Concerning the Factory at Chorzów (Germany v Poland)* (Indemnity) [1928] PCIJ Rep Series A No 17; *Amco v Indonesia*, ICSID Case No. ARB/81/1, Award (5 June 1990). For methods of calculating damages, see Herfried Wöss and Adriana San Román, ‘Full Compensation, Full Reparation and the But-For Premise’ (*Global Arbitration Review*, 29 November 2018) <<https://globalarbitrationreview.com/chapter/1177419/full-compensation-full-reparation-and-the-but-for-premise>> accessed 30 June 2020. In essence, tribunals will award either market or fair market value (FMV). FMV does not consider the reduction in the value of the property due to distress, threat and economic crisis and thus leads to a higher compensation.

¹¹³ *Philip Morris v Uruguay*, ICSID Case No. ARB/10/7, Award (8 July 2016) para 293.

¹¹⁴ See Part I, chapter 2, section 2.1.1.

¹¹⁵ In essence, this is a crisis response mechanism for the countries of the Eurozone, which consists of financial assistance instruments subject to conditionality. It is an intergovernmental arrangement under international public law. So far it has included bailout packages for Ireland, Greece, Portugal and Cyprus.

¹¹⁶ For example, *Theodoros Adamakopoulos, Ilektra Adamantidou, Vasileios Adamopoulos and others v Republic of Cyprus*, ICSID Case No. ARB/15/49, relates to claims arising out of alleged discriminatory treatment of investors as a result of the €10 billion bailout package for Cyprus. Cyprus claims that capital control measures that affected investors were adopted on the basis of Art 65(1) TFEU, as an express Treaty derogation of free movement of capital. The case is still pending. See also cases *Poštová Banka, a.s. and Istrokapital SE v The Hellenic Republic*, ICSID Case No. ARB/13/8; and *Marfin Investment Group Holdings S.A., Alexandros Bakatselos and Others v Republic of Cyprus*, ICSID Case No. ARB/13/27.

between the Troika¹¹⁷ and the Member State in need of financial assistance, and thus fall within exclusive Member State competence. Accordingly, acts of the ESM fall outside the EU legal order.¹¹⁸ While measures adopted within the ESM framework would thus not be subject to review by the CJEU, the CJEU found that the *conduct* of EU institutions (the Commission and the ECB) linked to the adoption of an MoU on behalf of the ESM must be consistent with EU law. Consequently, the CJEU held that it has jurisdiction to review such conduct of EU institutions and to consider an action for compensation based on its unlawfulness under EU law.¹¹⁹

In the case of Cyprus, in its *Ledra* judgment the CJEU did not find that the measures imposed on investors under the MoU were illegal. The Court found that restrictions on investors' property rights were made in the pursuit of the legitimate EU objective. The measures aimed at ensuring stability of the banking system in the Eurozone, which could otherwise produce negative spill-over effects in other sectors of the economy.¹²⁰ The CJEU found that the measures satisfied the requirements of proportionality and not did not constitute an 'intolerable interference impairing the very substance of the appellants' right to property'.¹²¹ Accordingly, there was no breach of the CFR right to property due to the MoU measures, no liability of EU institutions for any unlawful conduct, and no right to compensation for investors.

While IIL arguably provides investors with more protections,¹²² it does not guarantee their absolute protection against restrictive stabilisation measures.¹²³ The judgment in *Ledra* demonstrates that even measures falling within exclusive Member States' competence can be indirectly reviewed by the CJEU. The judgment is thus an important testament for the rule of law in the EU. However, intra-EU investors might be

¹¹⁷ European Commission, the European Central Bank (ECB) and the IMF.

¹¹⁸ Case C-370/12 *Pringle* ECLI:EU:C:2012:756; *Ledra Advertising* (n 108) para 54.

¹¹⁹ In particular under Arts 268 and 340(2) and (3) TFEU: *Ledra Advertising* (n 108) para 55. Moreover, the Commission, as the guardian of the treaties, has a duty to refrain from signing an MoU when it doubts its consistency with EU law: *ibid* paras 57-59.

¹²⁰ *ibid* para 72.

¹²¹ *ibid* para 74.

¹²² See *Achmea*, Opinion of AG Wathelet (n 82) paras 185-190.

¹²³ In the cases of *Poštová Banka* (n 116) and *Marfin* (n 116) tribunals decided in favour of the State. *Marfin* related to a recapitalisation plan enacted by Cyprus in 2012 for the stabilisation of its banking sector agreed within the ESM framework. Consequently, the State gained control over the management of the Laiki Bank to the detriment of Marfin, its former majority shareholder. The State removed the claimant bank's officers and initiated criminal proceedings against them. The bank nevertheless defaulted. The measures were part of conditionality in order for Cyprus to receive financial assistance as part of the ESM. The Tribunal decided in favour of Cyprus, reaching the conclusion that the measures were a legitimate exercise of a State's regulatory powers. *Poštová Banka* related to claims that Greece's 2012 sovereign debt restructuring reduced the value of the Greek Government's bonds against the consent of some stakeholders. The Tribunal found that government bonds are not covered by the definition of investment in the Slovakia-Greece BIT and it hence lacked jurisdiction to decide the case. The Tribunal nevertheless noted that 'the jurisdictional issue was not clear-cut and involved a complex factual and legal background': Award (9 April 2015) para 377. Whether government bonds are a covered investment depends on the BIT in question.

less enthusiastic about the practical effects of the judgment (the lack of compensation) and the CJEU's approach to private property restrictions that 'genuinely meet the objectives of general interest'.¹²⁴ It cannot be excluded that in the future the CJEU might not repurpose such interest to other legitimate objectives pursued by the EU (e.g. the fight against climate change)¹²⁵ as the Court finds fit.

7.1.2.2. The principle of legitimate expectations under EU law

EU law protects the legitimate expectations of investors. State acts must not violate the legitimate expectations of investors and must carefully balance them against the public interest. The CJEU has recognised that legitimate expectations are a basic principle of EU law, whose breach gives rise to actions for damages for non-contractual State or EU liability.¹²⁶ This principle is rooted in the principle of legal certainty. Legitimate expectations arise when the investor receives precise, unconditional, and consistent assurances from the State.¹²⁷ Therefore, national legislation breaches legal certainty and protection of legitimate expectations when it suddenly and unexpectedly withdraws existing rights, without allowing the rights-holders the necessary time to adjust.¹²⁸

However, this does not entail that legal positions cannot be absolutely altered, particularly in the field of investment, where there is a need for constant legal adjustment to economic reality.¹²⁹ On the other hand, investors can rely on their legitimate expectations when they act in a 'prudent and circumspect' manner.¹³⁰ Unlike in IIL, the principle of legitimate expectations under EU law does require the legality of national measures.¹³¹ When a diligent investors knew or should reasonably have known that the

¹²⁴ *Ledra Advertising* (n 108) para 70.

¹²⁵ See discussion on EU values and objectives in Part II, chapter 4, section 4.2.

¹²⁶ Case T-199/99 *Sgaravatti Mediterranea Srl v Commission of the European Communities* [2002] ECR II-3731, paras 111-117. The case-law on legitimate expectations in EU law is extensive and beyond the scope of this section.

¹²⁷ Case C-566/14 P *Marchiani v Parliament* ECLI:EU:C:2016:437, para 77; Joined Cases T-50/06 RENV II and T-69/06 RENV II *Ireland v Commission* ECLI:EU:T:2016:227, para 213.

¹²⁸ Case C-332/14 *Wolfgang und Wilfried Rey Grundstücksgemeinschaft GbR* ECLI:EU:C:2016:417, paras. 56-58.

¹²⁹ Case C- 526/14 *Kotnik and Others* ECLI:EU:C:2016:570, paras 66 and 68. In line with that 'economic operators are not justified in having a legitimate expectation that an existing situation which is capable of being altered by the national authorities in the exercise of their discretionary power will be maintained': Joined Cases C-37/02 and C-38/02 *Di Lenardo and Dilexport* [2004] ECR I-6911, para 70; Case C-310/04 *Spain v Council* [2006] ECR I-7285, para 81; Case C-201/08 *Plantanol* [2009] ECR I-8343, para 53

¹³⁰ *Plantanol* (n 129) para 53: 'where a prudent and circumspect economic operator could have foreseen that the adoption of a measure is likely to affect his interests, he cannot plead that principle if the measure is adopted'. It is the task of national courts to establish whether a prudent and circumspect economic operator could have foreseen the possibility of such a measure: para 57.

¹³¹ See Case SA.40348 (2015/NN) Commission Decision C (2017) 7384 final. The European Commission observed that Spain violated the principles of legal certainty and legitimate expectations under EU law and that, in the context of a State aid scheme, the FET principle under international law should not have a broader

rules on which they relied were contrary to EU law, the protection cannot be invoked.¹³² The circumstances in which investors can rely on legitimate expectations under EU law are thus more restrictive than under the FET standard in IIL.¹³³ In addition, the level of compensation under EU law is less lucrative as it usually amounts to reasonable costs that the investor incurred due to its reliance on government assurances, without taking into account the investor's interest in the future performance.¹³⁴

7.1.3. Enforcement and remedies

EU law establishes relevant enforcement mechanisms to ensure its full effectiveness of EU law. While EU law creates new substantive *rights*, national laws provide procedural *remedies* for the enforcement of these rights.

The Treaty provisions on the prohibition of restrictions of free establishment and the free movement of capital have direct effect.¹³⁵ Accordingly, they can be relied upon by individuals and invoked before the national and EU courts.¹³⁶ While vertically binding on States, it is less clear when these Treaty provisions are also horizontally applicable in relations between private parties. With respect to freedom of services and establishment, the CJEU has confirmed their horizontal effect in very specific situations.¹³⁷ However, the horizontal effect of free movement of capital is less likely.¹³⁸

scope than these two principles under EU law. In addition, no investor could have a legitimate expectation stemming from illegal State aid: see para 164.

¹³² With respect to State aid, the CJEU held that 'undertakings to which an aid has been granted cannot, in principle, entertain a legitimate expectation that the aid is lawful unless it has been granted *in compliance with the procedure* laid down in [the Treaty provision]. A diligent operator should normally be able to determine whether that procedure has been followed': Case C-169/95 *Spain v Commission* [1997] ECR I-135, para 51 (emphasis added).

¹³³ In recent practice of international investment tribunals, Spanish cases under the ECT have served as a prime example of differences between the concept of legitimate expectations under EU law and IIL. Investors, mostly from the EU, submitted claims in response to the Spanish Government's decision to modify its investment incentive scheme for the generation of renewable energy in 2013 and 2014, following the economic crisis. However, as Spain implemented the incentive scheme before it notified the EC, as required under EU law, the scheme constitutes an illegal State aid pursuant to TFEU Article 107. In its Decision in the State aid investigation (n 131), the EC emphasised that in any case Spain has not violated the principles of legal certainty and legitimate expectations *under EU law* and that no investor could have a legitimate expectation stemming from an illegal State aid: see para 164 (emphasis added).

¹³⁴ Strik (n 91) 197.

¹³⁵ In its early case-law, the CJEU found that free movement of capital in Art 63 TFEU has no direct effect: *Casati* (n 36) para 19. However, with later Treaty changes of the free movement of capital provisions this was overruled: Joined Cases C-163/94, C-165/94 and C-250/94 *Sanz de Lera* [1995] ECR I-4821, para 43.

¹³⁶ See Part II, chapter 5, section 5.2.4.

¹³⁷ Case C-341/05 *Laval un Partneri* [2007] ECR I-11767 (freedom of services) and Case C-438/05 *The International Transport Workers' Federation and The Finnish Seamen's Union* [2007] ECR I-10779 (freedom of establishment). Both cases included actions of companies against trade unions. The latter case relied exclusively on the provisions of the Treaty so it is more authoritative for determining the Court's approach. However, the scope of the horizontal applicability of Treaty provisions remains unclear (whether it is applicable by any private party or only those with the power to participate in collective regulation): see Craig and de Búrca (n 51) 798-799.

¹³⁸ Barnard (n 10) 526.

The CFR provisions are ‘judicially cognisable’ *only* when implemented in EU and domestic acts, in the course of interpretation and the review of their legality.¹³⁹ Accordingly, they can be invoked in courts exclusively in order to interpret and to review the EU or State measures that implement them. Principles can serve as a shield when a party initiates proceedings against EU and domestic acts calling into question the level of protection *already achieved*; however, they cannot act as a sword by obliging the authorities to achieve policy goals.¹⁴⁰ Accordingly, the principles enshrined in these provisions cannot by themselves confer on individuals a *subjective right*,¹⁴¹ ‘whose purpose is the protection of directly defined individual legal situations’.¹⁴² Public authorities, and in particular the legislature, are called upon to promote and transform the ‘principle’ into a judicially cognisable reality.¹⁴³ Accordingly, where a Member State measure derogates from fundamental freedoms guaranteed in Treaty law and the measure falls within the scope of EU law, the fundamental rights guaranteed by the CFR apply.¹⁴⁴

With respect to private parties, Member States must ensure the full effectiveness of EU rules within their respective jurisdictions, including the availability of appropriate legal remedies for the protection of individuals’ rights guaranteed under EU law and the access to domestic courts for their enforcement. Member States can be held liable for the loss or damage caused to individuals as a result of breaches of EU law and be ordered to pay compensation.¹⁴⁵ State liability extends to liability for all violations of EU law, even those that follow from legislative acts¹⁴⁶ or national court rulings.¹⁴⁷ However, in principle national courts assess whether a breach of EU law is sufficiently serious for a Member State to incur non-contractual liability vis-à-vis an individual.

In their mutual relations Member States are bound by the principle of mutual trust.¹⁴⁸ This includes trust that the courts and tribunals of each Member State guarantee

¹³⁹ Case C-282/10 *Dominguez*, Opinion of AG Trstenjak ECLI:EU:C:2011:559, para 74.

¹⁴⁰ The CJEU case-law is rather restrictive regarding the justiciability of the CFR principles. For example, the CJEU held that CFR Arts 26 (integration of persons with disabilities) and 27 (workers’ right to information and consultation) did not require the EU legislature to adopt any specific measure. To be fully effective, these provisions must be given more specific expression in EU or national law: see EU Network of Independent Experts on Fundamental Rights, ‘Commentary of the Charter of Fundamental Rights of the European Union’ (June 2006), 407.

¹⁴¹ *Association de médiation sociale* (n 99) para 45; *Glatzel* (n 99) para 78 (emphasis added).

¹⁴² Case C-176/12 *Association de médiation sociale*, Opinion of AG Cruz Villalon ECLI:EU:C:2013:491, para 50.

¹⁴³ *ibid.*

¹⁴⁴ Case C-685/15 *Online Games and Others* [2017] ECLI:EU:2017:452.

¹⁴⁵ Joined cases C-6/90 and C-9/90 *Francovich* [1991] ECR I-5357, paras 31-35. This is also called the doctrine of governmental liability.

¹⁴⁶ Joined Cases C-46/93 and C-48/93 *Brasserie du Pêcheur and Factorame III* [1996] ECR I-1029.

¹⁴⁷ Case C-224/01 *Köbler* [2003] ECR I-10239; Case C-160/14 *Ferreira da Silva e Birtó and Others* ECLI:EU:C:2015:565; Case C-168/15 *Tomášová* ECLI:EU:C:2016:602; Case C-620/17 *Hochtief Solutions AG* ECLI:EU:C:2019:630.

¹⁴⁸ Art 19(1) TEU.

the right to an effective remedy before an independent tribunal, as outlined in Article 47 CFR.¹⁴⁹ Accordingly, the level of justice across different EU Member States should be the same. The CJEU takes seriously any attempts that could undermine the independence of judiciary in the EU, even in politically sensitive issues,¹⁵⁰ albeit investors might be less convinced about their level of protection before domestic courts in the EU.

7.1.4. Interim conclusion

Investment protection mechanisms in the EU legal order appear less attractive to intra-EU investors than protections under IIL for several reasons.

First, the logic underlying EU law and IIL is fundamentally different. While *prima facie* both legal orders demonstrate interest in economic activity, EU law has essentially developed around the objective of EU integration. Its main paradigm has been market liberalisation, although since the Lisbon Treaty more emphasis is placed on rights. The fragmented nature of EU competences to regulate rights and the tendency to address rights from an economic-functionalist perspective¹⁵¹ renders EU law very different to IIL. The main objective of IIL has been the creation of private rights for investors. IIL's logic thus endorses the private law perspective of regulating the relationship between foreign investors as private parties and the State, which is different to regulating the internal market. While the former aims at creating protections for a certain category of private parties, the latter's focus is on creating a level playing field for the purposes of fair competition. The logic of the two legal orders is thus not only divergent but also in contradiction.

Secondly, investment protection mechanisms under EU law are scattered between EU and national laws. The numerous exceptions from fundamental freedoms under national laws compound the complexity of investors' protections in the EU. While protections under IIL are far from coherent, they are nevertheless more uniform, having their source in a particular bilateral treaty. National law primarily serves as a matter of fact which has to be proved in the ITA proceedings, and it is not a source of rights for investors.¹⁵²

¹⁴⁹ Opinion 1/17 ECLI:EU:C:2019:341, para 128.

¹⁵⁰ See C-619/18 *Commission v Poland* ECLI:EU:C:2019:615.

¹⁵¹ European Parliamentary Research Service (n 90) 20.

¹⁵² In particular, ICSID tribunals are fully internationalised as they do not apply national law despite provision of the ICSID Convention in Art 42(1), second sentence. In the case of a conflict between national and international rules, ICSID tribunals have always resolved such conflicts on the basis of international law: Hege Elisabeth Kjos, *Applicable Law in Investor-State Arbitration: The Interplay Between National and International Law* (OUP 2013) 62.

Thirdly, investment protections under EU law display a diversity of standards across the EU, which still largely depend on national laws of Member States, in particular when harmonisation has been achieved through directives. Available remedies remain the prerogative of the Member States. There are no common EU rules on damages or lost profit. There is an assumption that all national courts are equally effective in providing judicial protection. On the contrary, IIL displays more uniformity while providing similar substantive and procedural standards of protection, despite the diversity of IIAs.

Accordingly, it remains arguable whether EU treaties and intra-EU IIAs cover the 'same subject matter'.¹⁵³ Investment tribunals have dismissed this argument.¹⁵⁴ Nevertheless, it is undisputable that EU law and IIL overlap, with EU law being broader in its general scope. However, investors' privileges, such as the (in)famous FET standard, are not necessarily more limited in EU law just because they are differently defined.

While investors can be certain that the CJEU's stringent approach to free movement derogations and the general principles of EU law, such as legal certainty, non-discrimination, proportionality, and protection of legitimate expectations, will protect them from arbitrary economic policy measures of Member States, they can be less certain that their protection will be equally unqualified when the CJEU pursues the attainment of EU policy objectives. In this regard, the CJEU's approach is not different from any other State supreme court protecting its own constitutional order. Tensions between EU law and IIL became problematic only when intra-EU BITs became an impediment to the internal market and the objectives of EU integration.

Before considering specific tensions between two legal orders, the following table compares the facets of investment under IIL and EU law.

¹⁵³ This has proven to be of relevance in the context of the application of Arts 30 (Application of successive treaties related to the same subject matter) and 59 (Termination or suspension of the operation of a treaty implied by conclusion of a later treaty) VCLT.

¹⁵⁴ See section 7.3.1(ii).

Table 7.2. Investment protections under international investment law and EU law

Category	International investment law ⁱ	Investment in EU law (internal market rules)
Definition of investment	▪ Treaty specific definition of investment - Usually broad definition - Can include contractual obligations (umbrella clauses) - Includes FDI + portfolio ▪ Additional criteria for ICSID jurisdiction: (i) a substantial contribution of money and resources, (ii) a certain duration; (iii) risk, and (iv) the contribution to the economic development of the host Stateⁱⁱ	▪ Definition of capital and establishment ▪ Capital: capital movement rules apply intra-EU and extra-EU (Arts 63-66 TFEU) - All types of economic assets which involve border crossingⁱⁱⁱ - Financial operations essentially concerned with the investment of funds^{iv} - Includes FDI + portfolio^v ▪ Establishment: freedom of intra-EU establishment of companies/firms and agencies/branches/subsidiaries (Arts 49-55 TFEU) - Characteristics: (i) managerial control over the establishment^{vi}; (ii) profit-making^{vii}; (iii) permanent link with the host Member State^{viii} - Presupposes economic activity - Includes FDI only
Definition of foreign investor	▪ Applies to all investments ▪ Natural persons: nationality (law of the home State) ▪ Corporate nationality: place of incorporation; effective seat; managerial control^{ix}	▪ Not relevant for free movement of goods and capital ▪ Applies to freedom of establishment and services only - For natural persons: nationality (law of the Member States) - Corporate nationality: place of incorporation and effective seat^x
Phase of investment	▪ Focus on treatment of investment in post-establishment phase ▪ Pre-establishment costs usually excluded from definition of investment^{xi}	▪ Pre-establishment (market access) and post-admission treatment: subject to intra-EU liberalisation and NT (non-discrimination) under EU law = free movement and four freedoms apply ▪ Post-establishment: subject to domestic law and EU law protections = internal market negative and positive harmonisation
Mechanisms and level of protection	▪ Rather similar substantive and procedural standards of investors' protection across different IIAs ▪ No annulment of illegal measure as a remedy ▪ Relevance of the effect of the measure on economic value of investment (no threshold) ▪ Compensation based on market value ▪ Enforcement under ICSID and New York Convention (applies worldwide in States signatories)	▪ 28 different substantive and procedural law mechanisms for protection of investors across the EU ▪ Breach leads to annulment of illegal measure ▪ Only 'sufficiently serious' breach of EU law warrants compensation^{xii} ▪ 'Fair' compensation (can be below market value) ▪ EU rules (Brussels I Regulation^{xiii}) and national rules and procedures of the Member State of enforcement (limited to the EU)

7.2. Tensions between intra-EU IIAs and the objectives of EU integration

7.2.1. Intra-EU BITs and their political dimension

Intra-EU BITs have become a political and a legal problem in the EU following the 2004 accession of CEE States to the EU. Before joining the EU, these prospective Member States were encouraged to conclude BITs with the Member States.¹⁵⁵ Embracing the traditional ISDS narrative, BITs were intended to establish ‘a favourable climate for private investment, both domestic and foreign’ in the candidate countries.¹⁵⁶ The accession to the EU did not imply a duty to terminate BITs.¹⁵⁷ Only in the case of Croatia, which joined the EU in 2013, was the termination of intra-EU BITs raised as a legal obligation; however, due to political reasons it was enforced as an obligation of means. Austria explicitly rejected the mutual termination of its BIT with Croatia as it held that they were not in contradiction with EU law, and similar positions were taken by Germany, France and the UK.¹⁵⁸

Political sensitivity of intra-EU BITs and divergent positions of Member States first emerged in EU policy documents.¹⁵⁹ In 2006, the European Commission (EC) noted that ‘arbitration risks and discriminatory treatment of investors’ stem from intra-EU BITs, the content of which was partly ‘superseded by Community law upon accession’. It invited Member States to review the need for these agreements ‘in order to avoid legal uncertainties’.¹⁶⁰ As noted in 2007 and 2008, ‘most Member States’ did not share the EC’s

¹⁵⁵ See, for example, Art 64 of the European Agreement establishing an association between the European Economic Communities and their Member States, of the one part, and Romania, of the other part [1994] OJ L357/2.

¹⁵⁶ Art 85 Stabilisation and Association Agreement between the European Communities and their Member States, of the one part, and the Republic of Croatia, of the other part [2005] OJ L26/3.

¹⁵⁷ However, the Commission’s letter to the Czech Deputy Minister of Finance of 13 January 2006 makes a reference to ‘the concern of the Commission services on BITs in general’, which was ‘raised with the Czech Republic in very early contacts with DG ECFIN, in the Chapter 4 screening process in 1998, at a specific TAIEX seminar ... on 17 January 2000, and subsequently in the external relations chapter of the negotiation process’: see *Eastern Sugar BV (Netherlands) v The Czech Republic*, UNCITRAL arbitration SCC No. 088/2004, Partial Award (27 March 2007) para 119.

¹⁵⁸ Government of the Republic of Croatia, Answer to the written question posed by MP Goran Aleksić in relation to a proceeding before ICSID in Washington (October 2017) (in Croatian) <<https://vlada.gov.hr/UserDocsImages//2016/Sjednice/2017/10%20listopad/64%20sjednica%20Vlade%20Republike%20Hrvatske//64%20-%2024.3.pdf>> accessed 30 June 2020.

¹⁵⁹ The annual reports of the Economic and Financial Committee of the Council of the EU (EFC) provide a historical overview of the Commission’s concerns and Member States’ responses in relation to intra-EU BITs. The EFC consists of members of competent Member State authorities, the European Commission, the Member States central banks, and the European Central Bank: Art 4, Statute of the Economic and Financial Committee [2003] OJ L 158/59. As such, it provides views of both the EU institutions and the Member States regarding the freedom of capital movement in the EU. It has been established under Art 134 TFEU. Its role is, *inter alia*, to provide annual reports to the Commission and the Council on the situation regarding the movement of capital and the freedom of payments resulting from the application of the founding treaties and the Council measures: Art 134(2), point 4 TFEU.

¹⁶⁰ Economic and Financial Committee, ‘2007 EFC Report to the Commission and the Council on the Movement of Capital and the Freedom of Payments’ (8 January 2008) 5123/08, para 14.

concerns, with a ‘clear majority’ preferring to maintain intra-EU BITs.¹⁶¹ At that stage, it was also an accepted view that any concerns should be addressed through bilateral actions, rather than more coordinated action at the EU level.¹⁶²

With the conferral of competence for foreign investment on the EU in the Lisbon Treaty, the EC took a more proactive stance in ‘monitoring developments’ and ‘tak[ing] the appropriate action’.¹⁶³ The EC’s concerns were raised in all subsequent EFC reports but this had limited effects.¹⁶⁴ The split between the Member States was along political lines, between those Member States that are investors’ countries of origin and those that regularly appear as respondent States.¹⁶⁵ The Commission used its legal powers to compel some Member States to terminate their BITs but its actions were suspended in light of the pending *Achmea* proceedings before the CJEU.¹⁶⁶ While the CJEU’s judgment facilitated the achievement of political consensus, a number of Member States consider intra-EU BITs to be compatible with EU law and ‘in certain circumstances, indispensable

¹⁶¹ *ibid* para. 15; Economic and Financial Committee, ‘2008 EFC Report to the Commission and the Council on the Movement of Capital and the Freedom of Payments’ (17 December 2008) 17363/08, para 16.

¹⁶² Economic and Financial Committee, 2007 EFC Report (n 160) para 15; Economic and Financial Committee, 2008 EFC Report (n 161) para 17.

¹⁶³ Economic and Financial Committee, ‘2009 EFC Report to the Commission and the Council on the Movement of Capital and the Freedom of Payments’ (10 December 2009) 17446/09, para 18.

¹⁶⁴ Some Member States unilaterally denounced their intra-EU BITs in an earlier stage, notably Ireland and Italy in 2012 and 2013 respectively: European Commission Press Release, ‘Commission asks Member States to terminate their intra-EU bilateral investment treaties’ (18 June 2015) <https://ec.europa.eu/commission/presscorner/detail/en/IP_15_5198> accessed 30 June 2020. Ireland only concluded one BIT – with the Czech Republic, which was terminated on 1 December 2011. In 2017 Romania terminated its intra-EU BITs: SCA Volciuc-Ionescu, ‘Romania – The End of Intra-EU Bilateral Investment Treaties’ (*Mondaq*, 26 January 2018) <<https://www.mondaq.com/inward-foreign-investment/610846/romania-the-end-of-intra-eu-bilateral-investment-treaties>> accessed 30 June 2020; Denmark proposed to its intra-EU counterparts to terminate all BITs in 2016: Nikos Lavranos, ‘The end of intra-EU BITs is nearing’ (*Thomson Reuters Arbitration Blog*, 13 May 2016) <<http://arbitrationblog.practicallaw.com/the-end-of-intra-eu-bits-is-nearing/>> accessed 30 June 2020. In 2017 Poland also announced termination of its intra-EU BITs: Marcin Orecki, ‘Let the Show Begin: Poland Has Commenced the Process of BITs’ Termination’ (*Kluwer Arbitration Blog*, 8 August 2017) <<http://arbitrationblog.kluwerarbitration.com/2017/08/08/let-show-begin-poland-commenced-process-bits-termination/>> accessed 30 June 2020. The Netherlands announced that it would terminate all its 12 intra-EU BITs: see Dutch Minister for Foreign Trade and Development Cooperation, Letter to the Chairperson of the Dutch House of Representatives (26 April 2018) (in Dutch) <http://res.cloudinary.com/lbresearch/image/upload/v1525256243/kamerbrief_over_investeringsakkoord_den_met_andere_eu_lidstaten_24118_1117.pdf> accessed 30 June 2020.

¹⁶⁵ The AG listed Germany, France, the Netherlands, Austria and Finland as the Member States that are countries of origin of investors and that rarely or never appear as respondent States, and which thus do not support the argument of incompatibility. The AG noted the Czech Republic, Estonia, Greece, Spain, Italy, Cyprus, Latvia, Hungary, Poland, Romania, Slovakia as the Member States that regularly appear as respondent States in intra-EU arbitrations, and which thus support the argument of incompatibility. See *Achmea*, Opinion of AG Wathelet (n 82) paras 34-38 (preliminary observations).

¹⁶⁶ In June 2015, the EC initiated infringement proceedings against five Member States (Austria, the Netherlands, Romania, Slovakia and Sweden) in accordance with Art 258 TFEU and launched an administrative dialogue with the other 21 Member States who still had BITs in place (at that stage, all except Ireland and Italy): see European Commission Press Release (n 164).

to secure legal certainty for intra-EU investors until an alternative mechanism [is] found.’¹⁶⁷

7.2.2. Intra-EU BITs and their legal status under EU law

Intra-EU BITs are international agreements of Member States, which are valid under international law and form part of the national legal orders of Member States. As EU law prevails over the national laws of Member States, it also prevails over international agreements to which Member States are parties. Primacy is enshrined in the case-law of the CJEU¹⁶⁸ and it is codified and explicitly stated in Declaration 17 of the Treaty of Lisbon.¹⁶⁹ Accordingly, Member States cannot enter into international agreements which would contain commitments capable of jeopardising the attainment of the EU objectives or affecting EU rules.¹⁷⁰ The principle of primacy equally applies to international treaties concluded between a Member State and a non-Member State that after the conclusion of the agreement acceded to the EU.¹⁷¹ While EU law cannot invalidate such international agreements, it imposes a number of obligations on Member States, regarding their agreements with third States, and their agreements *inter se*.

Primary EU law does not affect the duties of the Member States towards third parties under their international agreements, preserving the general principle *pacta sunt servanda*.¹⁷² However, Member States still have the obligation to take all necessary steps to eliminate any incompatibilities between their pre-accession international obligations and EU law,¹⁷³ and where this is not possible, an obligation to denounce such international agreements is not excluded.¹⁷⁴ Regarding Member States’ *inter se* agreements, the position is the same as with Member States’ national laws:¹⁷⁵ EU law takes unconditional precedence. The provisions of these agreements cannot affect EU law, nor could a private party rely on such an agreement to justify a breach of EU law.¹⁷⁶ In the

¹⁶⁷ Economic and Financial Committee, ‘Annual EFC Report for 2017 to the Commission and the Council on “The Movement of Capital and the Freedom of Payments” (29 May 2018) 9411/18, 2, 11-12. For post-*Achmea* developments, see Section 7.4.2 below.

¹⁶⁸ See chapter 5.

¹⁶⁹ Consolidated version of the Treaty on the Functioning of the European Union – Declarations annexed to the Final Act of the Intergovernmental Conference which adopted the Treaty of Lisbon, signed on 13 December 2007 – A. Declarations concerning provisions of the treaties – 17. Declaration concerning primacy [2008] OJ C 115/344.

¹⁷⁰ Case 22/70 *AETR* [1971] ECR 263, paras 17, 22; Opinion 2/91 *ILO* [1993] ECR I-1061, paras 10-11.

¹⁷¹ Case C-478/07 *Budějovický Budvar* [2009] ECR I-7721, paras 97-99.

¹⁷² Art 351(1) TFEU.

¹⁷³ Art 351(2) TFEU.

¹⁷⁴ Case C-62/98 *Commission v Portugal* [2000] ERC I-5171, paras 44, 49-50; Case C-84/98 *Commission v Portugal* [2000] ERC I-5215, paras 53, 58-59.

¹⁷⁵ See, for example, Case C-235/87 *Matteucci* [1988] ECR 5589, para 22; Case 3/91 *Exportur SA v Lor SA and Confiserie du Tech SA* [1992] ECR I-5529, para 8; Case 10/61 *Commission v Italy* [1962] ECR 1, para 23.

¹⁷⁶ Case T-70/89 *BBC v Commission* [1991] ECR II-335, para 77.

same manner as a conflicting national norm, a norm of a Member State's *inter se* international agreement that conflicts with EU law does not become invalid but *inapplicable*; accordingly, it must be 'disapplied' by the national judge.¹⁷⁷ Importantly, the foreign interests of Member States cannot override their obligation to align their international agreements with EU law.¹⁷⁸

From the perspective of EU law, Member States' BITs cannot be applied whenever they conflict with EU law. This is a logical consequence of the modus in which the EU legal order operates as a whole. Member States could not be permitted to diverge from internal market rules by an international treaty any more than they could by domestic legislation.¹⁷⁹ With this in view, some intra-EU BITs have an explicit clause recognising the primacy of EU law over the BIT in question.¹⁸⁰

7.2.3. *The Energy Charter Treaty and EU law*¹⁸¹

In addition to bilateral intra-EU BITs, of relevance is the Energy Charter Treaty (ECT), as a multilateral IIA to which 26 Member States (all except Italy), as well as the EU, are parties.¹⁸² The ECT was concluded in the 1990s¹⁸³ and at that time it was a geopolitically important multilateral treaty aimed at facilitating the political and economic transition of energy markets in the countries of the CEE and the former Soviet Union following the fall of communism. The EU played a 'major role' in facilitating the conclusion of the ECT.¹⁸⁴ At the time, the EU had 12 Member States, none of which were the former communist CEE States.¹⁸⁵ The economic interests of EU Members were more or less aligned: while

¹⁷⁷ See chapter 5, section 5.1.

¹⁷⁸ Piet Eeckhout, *External Relations of the European Union, Legal and Constitutional Foundations* (OUP 2004) 342.

¹⁷⁹ See, for example, *Matteucci* (n 175) paras 19-22.

¹⁸⁰ For example, the Agreement between the Republic of Austria and the Republic of Croatia for the Promotion and Protection of Investments (signed 19 February 1997, entered into force 1 November 1999) (Austria-Croatia BIT) unequivocally states in the Art 11(2) that: 'The Contracting Parties are not bound by the present Agreement insofar as it is incompatible with the legal acquis of the European Union (EU) *in force at any given time*' (emphasis added).

¹⁸¹ This section draws on and incorporates ideas and language of the author's publication Damjanovic and Quirico (n 7).

¹⁸² See Jan Kleinheisterkamp, 'Investment Protection and EU Law: The Intra- and Extra-EU Dimension of the Energy Charter Treaty' (2012) 15 *Journal of International Economic Law* 85.

¹⁸³ 2080 UNTS 95 (adopted 17 December 1994, entered into force 16 April 1998).

¹⁸⁴ European Commission, 'Energy Charter Treaty, Background Note' (16 December 1994) MEMO/94/75 <https://ec.europa.eu/commission/presscorner/detail/en/MEMO_94_75> accessed 30 June 2020. The EC initiated the negotiation process by drafting the ECT and it hosted the ECT Secretariat on a provisional basis in one of its buildings, while the EU as a whole acted as a 'driving force behind the negotiations'.

¹⁸⁵ Eight Central and Eastern European countries joined the EU in a big enlargement wave on 1 May 2004. Romania and Bulgaria followed in 2007, and Croatia joined the EU as its most recent Member State in 2013.

ensuring Member States' expansion into new markets, the ECT was also intended to guarantee sustainable supply and the use of energy in Europe.¹⁸⁶

The ECT was concluded as an EU external agreement. Unlike BITs, the compatibility of which with the EU legal order became an issue following the accession of the CEE countries to the EU, the ECT was concluded between all Member States of the EU at that time. Effectively it was an intra-EU agreement.¹⁸⁷ Additionally, since the EU is its Contracting party, the ECT is a source of EU law,¹⁸⁸ and prevails over secondary EU law and national legislation of Member States. Accordingly, EU secondary legislation in the area of energy must be interpreted in a manner that is consistent with the ECT.¹⁸⁹ While the ECT binds Member States, as a matter of EU law and international law, it cannot override the primacy of the EU founding treaties under EU law.

Since the conclusion of the ECT, secondary law acts have profoundly transformed the EU internal energy market, transforming it into a single energy market.¹⁹⁰ While arguably still relevant for global energy markets, the added value of the ECT in the intra-EU context has significantly diminished.¹⁹¹ On the other hand, the ECT remains an effective tool of intra-EU investors. Of 128 ITA cases under the ECT, 76 are intra-EU ITAs.¹⁹²

¹⁸⁶ European Commission (n 184)

¹⁸⁷ *Achmea*, Opinion of AG Wathelet (n 82) 43. However, in 2016 Italy withdrew from the ECT.

¹⁸⁸ All Member States and the EU have ratified the ECT, which as an ordinary multilateral treaty has legal effect between Member States: See Case C-264/09 *Commission v Slovakia*, Opinion of AG Jääskinen ECLI:EU:2011:150, paras 60-63.

¹⁸⁹ The CJEU held that secondary EU legislation must be interpreted harmoniously with the international agreements of the Union: C-61/94 *Commission v Germany* [1996] ECR I-3989, para 52.

¹⁹⁰ See Leigh Hancher and Pierre Larouche, 'The Coming of Age of EU Regulation of Network Industries and Services of General Economic Interest' in Paul Craig and Gráinne de Búrca (eds), *The Evolution of EU Law* (2nd edn, OUP 2011) 752-756. EU competence on energy was consolidated in 2009 via Art 194 TFEU, which explicitly vested the EU with the power to adopt legislative measures aimed at ensuring the functioning of the energy market and security of energy supply in the EU, promoting energy efficiency, development of new and renewable energy, and the interconnection of energy networks.

¹⁹¹ The success of the ECT inevitably has to be assessed in the context of Russia, a major signatory State of the ECT, which has never ratified this agreement. Russia's withdrawal from the ECT in 2009 undermined the ECT process. The reasons are complex and geopolitical (changes in Russia's attitude under Putin), political (failure of negotiations on the Transit Protocol and major gas transit disputes with Ukraine in 2006 and 2009), and legal (the claim by private investors in the Russian energy company Yukos against the Russian State, which was in 2009 decided in favour of investors, granting them a total of US\$50 billion). The award was challenged by Russia and the case is still pending before the Dutch Supreme Court; see *Yukos Universal Limited (Isle of Man) v The Russian Federation*, UNCITRAL, PCA Case No. AA 227. Another setback for the ECT was the withdrawal of Italy, arguably under the pressure of potential investment claims, although the official reasons are budgetary constraints, owing to the high costs of Italy's contribution to the ECT Secretariat budget: Law of 23 December 2014, No. 190, Disposizioni per la formazione del bilancio annuale e pluriennale dello Stato (legge di stabilità 2015) (14G00203) (GU Serie Generale n. 300 del 29-12-2014 – Suppl. Ordinario n. 99). Finally, while the EU remains committed to the ECT. In line with its global outreach, the focus of the ECT has reoriented towards the global energy markets, as demonstrated in the CONEXO Strategy and the 2015 International Energy Charter: see European Parliamentary Research Service, 'Energy Charter: A Multilateral Process for Managing Commercial Energy Relations' (July 2015). See also chapter 8.

¹⁹² The Secretariat of the ECT, 'Statistics of the ECT cases' (18 December 2019)

<https://www.energychartertreaty.org/fileadmin/DocumentsMedia/Statistics/All_statistics_-_18_December_2019.pdf> accessed 30 June 2020. The Secretariat's statistics include in intra-EU cases the six

7.3. Tensions between intra-EU investment treaty arbitration and the autonomy of the EU legal order

7.3.1. The international investment law perspective: issues before tribunals

The legal challenge for the relationship between EU law and intra-EU ITA started soon after the 2004 EU enlargement. Member States, supported by the European Commission (EC) as *amicus curiae*, challenged the jurisdiction of arbitral tribunals in ITAs initiated under both intra-EU BITs and the ECT. The first case was the UNCITRAL arbitration of *Eastern Sugar v Czech Republic*¹⁹³ under the Netherlands–Czech Republic BIT. The reasoning of this tribunal has been reemployed in all subsequent intra-EU ITAs. In the ECT context, tribunals additionally relied on the specific character of the ECT.¹⁹⁴ However, despite immaterial nuances in reasoning, all tribunals have reached the same conclusion, confirming their jurisdiction in intra-EU disputes.

The respondent Member States and the EC used similar arguments to refute the jurisdiction of arbitral tribunals, both under intra-EU BITs and the ECT. The main objection was that these intra-EU IIAs have been superseded by EU law under the general VCLT rules¹⁹⁵ or special conflict clauses in EU law or IIAs.¹⁹⁶ With some differences between disputes of the ‘old’ Member States and those of ‘old’ and ‘new’ Member States, three main arguments have been put forward to support the intra-EU jurisdictional objection: (i) Member States intended that in *inter se* relations EU law supersedes intra-EU BITs/the ECT; (ii) intra-EU investments are covered by EU law; and (iii) intra-EU BITs/the ECT are inconsistent with the EU legal order and so the latter should prevail. The following sections discuss the intra-EU jurisdictional objection by explaining these three arguments.

cases between a UK investor and EU Member States, which we have excluded here since the UK left the EU on 31 January 2020.

¹⁹³ *Eastern Sugar* (n 157).

¹⁹⁴ The first intra-EU ECT case was *Electrabel S.A. v Hungary*, ICSID No. ARB/07/19, initiated in 2007.

¹⁹⁵ Of particular relevance are Art 59 VCLT (the termination or suspension of the operation of a treaty implied by conclusion of a later treaty) and Art 30 VCLT (application of successive treaties relating to the same subject-matter).

¹⁹⁶ Of particular relevance for the Member States and the EC is the conflict rule in Art 351 TFEU. On the other hand, the claimants rely on the ECT conflict rule in Art 16, and different conflict rules in individual intra-EU BITs (e.g. Article 3(5) of the Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Czech and Slovak Federal Republic (signed 29 April 1991, entered into force 1 October 1992) (Netherlands–Czech Republic/Slovakia BIT)).

- (i) Whether Member States intended the application of EU law in *inter se* relations

The respondent Member States and the EC have claimed that EU law was intended to be applied instead of the provisions of intra-EU BITs/the ECT in relations between ‘new’ and ‘old’ Member States, and between ‘old’ Member States.¹⁹⁷

The ‘new’ Member States claimed that intra-EU BITs were terminated by the Treaty on Accession in accordance with Article 59 VCLT,¹⁹⁸ as from the date of their accession to the EU (2004 for the majority of the new Member States).¹⁹⁹ Tribunals dismissed this argument relying on the *explicit* provisions of the Accession Treaty, in which they found no provisions terminating the intra-EU BITs.²⁰⁰ In addition, neither party gave notice to terminate the intra-EU BITs,²⁰¹ nor was there a *common* intention between the parties²⁰² or a consensus within the EU on the status of these agreements.²⁰³ Even if intra-EU BITs were terminated by the operation of the Accession Treaty in accordance with Article 59 VCLT, sunset clauses would have nevertheless continued to apply under Article 70 VCLT.²⁰⁴ For example, investments made under the Netherlands–Czech Republic BIT before 1 May 2004 (accession of the Czech Republic to the EU) would have been protected under that BIT for a further 15 years (until 1 May 2019).²⁰⁵

Due to its specific nature, the ECT deserves special attention. The respondent Member States as well as the EC claimed that the Member States’ intention when concluding the ECT was that their *inter se* relations (intra-EU) should be governed by EU

¹⁹⁷ While all but two intra-EU BITs have been concluded between ‘old’ and ‘new’ Member States, the applicability of the ECT in relations between ‘old’ Member States has become an issue following a number of cases against Spain and Italy. The (in)famous cases of *Vattenfall v Germany* (I and II) are also between two ‘old’ Member States, initiated under the ECT.

¹⁹⁸ Under Art 59 VCLT, a treaty is deemed terminated if the same parties conclude a later treaty that relates to the same subject-matter and (a) the parties *intended* that the subject-matter should be governed by the same treaty, or (b) the provisions of the later treaty are so *incompatible* with those of the earlier treaty that both treaties cannot be simultaneously applied. Both agreements should be read as compatible (the principle of harmonisation) unless the *intent* of the parties has been different: ILC, ‘Fragmentation of International Law: Difficulties Arising From the Diversification and Expansion of International Law’ (2006) Report of the Study Group, UN Doc A/CN.4/L682, paras 229-231. Hence, the emphasis has been placed on the intent of the parties.

¹⁹⁹ See Arts 2 and 6 of the Act of Accession (which is part of the Treaty of Accession) of the Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia, and the Slovak Republic [2003] OJ L236/33; Arts 2 and 6 of the Act of Accession of Bulgaria and Romania [2005] OJ L157/203; Arts 2 and 6 of the Act of Accession of the Republic of Croatia [2012] OJ L112/21.

²⁰⁰ *Eastern Sugar* (n 157) paras 147-148.

²⁰¹ *ibid* para 153.

²⁰² *ibid* para 167 (emphasis in the original).

²⁰³ *Rupert Joseph Binder v Czech Republic*, UNCITRAL, Award on Jurisdiction (6 June 2007) para 64.

²⁰⁴ Under this provision, the termination of the treaty does not affect any right of the parties created prior to its termination. Accordingly, termination would not affect the sunset clause enshrined in Art 13(3) of the Netherlands–Czech Republic BIT.

²⁰⁵ Tribunals would accordingly have jurisdiction for all arbitrations started under the intra-EU BITs before 1 May 2019. However, if an intra-EU BIT were superseded in accordance with Art 30 VCLT (general conflict rule), sunset clauses would not apply as they would be overridden by successive treaties concluded between Member States after the entry into force of intra-EU BITs/the ECT. On the applicability of Art 30 VCLT, see sections 7.3.1(ii) and (iii) below.

law. Only relations between the Member States and third States (extra-EU) were intended to be governed by the ECT. The possibility of an intra-EU claim under the ECT was accordingly *ab initio* excluded,²⁰⁶ in particular in the fields that were harmonised by EU law.²⁰⁷ In addition, the EU as a Regional Economic Integration Organisation (REIO) must be seen as a ‘single investment area’, encompassing ‘the entirety of the areas of the EU Member States’.²⁰⁸ Accordingly, the offer to arbitrate made by the Member States in the ECT ISDS clause must be interpreted as if that offer is made *only* to third State investors.²⁰⁹

However, intra-EU ECT tribunals have rejected this interpretation of the ECT relying on the interpretative rules in Articles 31 and 32 VCLT.²¹⁰ It has been noted that the ECT language does not support the Member States’ and the EC’s interpretation and that no limitation on the Member States’ competence was communicated at the time when the ECT was signed.²¹¹ EU Member States, while being members of the REIO, do not lose their national Member State character.²¹² In the absence of an explicit disconnection

²⁰⁶ This is in particular emphasised to justify inapplicability of the ECT in the relations between ‘old’ Member States. In support of this argument, it is said that the EU acted as one single block throughout negotiations, and that the ECT was conceived as a European treaty intended to promote cooperation between the European Communities on the one hand and Russia and the CEE countries on the other: *Eskosol S.P.A. in liquidazione v Italian Republic*, ICSID Case No. ARB/15/50, Decision on Termination Request and Intra-EU Objection (7 May 2019) para 65, citing the EC’s submission.

²⁰⁷ As discussed, Member States can conclude *inter se* international agreements only in those fields in which they have not transferred their external competence to the EU. In accordance with the AETR-ERTA doctrine, Member States have transferred their external competence in the field of energy to the EU through internal regulation (secondary EU law in the field of energy). For the AETR-ERTA doctrine, see section 6.1.2 in chapter 6. The problem is, however, that the ECT does not have an explicit disconnection clause, which would have ensured that, in the case of a conflict between the ECT and EU law, EU law governs relations between Member States *inter se*. However, in principle a disconnection clause does not add anything to a mixed agreement from the EU law perspective, as mixed agreements are already part of the EU legal order in which they are hierarchically below primary-EU-law sources but rank above secondary EU law. From an international law perspective, a disconnection clause adds transparency towards third parties. See Marise Cremona, ‘Disconnection Clauses in EU Law and Practice’, in Cristophe Hillion and Panos Koutrakos, *Mixed Agreements Revisited, The EU and its Member States in the World* (Hart 2010) 179-181.

²⁰⁸ *Eskosol* (n 206) para 62, citing the EC’s submission.

²⁰⁹ *ibid* (emphasis added).

²¹⁰ Only the main arguments are presented here, and briefly. Indeed, different tribunals have engaged in long elaborations of different arguments presented by the Member States and the EC. The most comprehensive elaboration was given by the *Vattenfall II* Tribunal in its special decision issued following the *Achmea* judgment. Disregarding the relevance of the judgment for the issue of jurisdiction, the Tribunal engaged in extensive explanation of the intra-EU ECT jurisdiction: see *Vattenfall AB and Others v Federal Republic of Germany (II)*, ICSID Case No. ARB/12/12, Decision on *Achmea* issue (31 August 2018). Some other later decisions have followed suit, elaborating on the intra-EU objection in a separate decision: see, for example, *Eskosol* (n 206).

²¹¹ *Blusun S.A., Jean-Pierre Lecorrier and Michael Stein v Italian Republic*, ICSID Case No. ARB/14/3, Final Award (27 December 2016) para 283. In particular, it was noted that Art 46 VCLT prescribes that a State may not invoke internal law provisions regarding competence to invalidate a treaty unless it was a manifest violation of a rule of fundamental importance. See also *Eskosol* (n 206) para 89. In the EU context, the division of competence between the EU and Member States could nevertheless be considered ‘a rule of fundamental importance’, given the powers of the CJEU to invalidate acts based on an improper legal basis: see chapter 6.

²¹² *Vattenfall II* (n 210) para 181; *Eiser Infrastructure v Spain*, ICSID Case No. ARB/13/36, Final Award (4 May 2017).

clause, inapplicability of the ECT in the relations between Member States cannot be implied.²¹³

The tribunals ruled out the termination of intra-EU BITs under Article 59 VCLT since the intention of the parties to exclude the applicability of these agreements cannot be inferred. The next issue that has been considered is whether the successive EU treaties have superseded intra-EU BITs/the ECT. There has been a number of EU treaties concluded between Member States after the entry into force of intra-EU BITs or the ECT, namely the Treaty of Amsterdam (1999), Treaty of Nice (2003), Treaty of Lisbon (2009) and all of the Member States' accession treaties. The primacy between these international treaties is determined according to special conflict rules,²¹⁴ and the general conflict rule in Article 30 VCLT.

Under EU law, the special conflict rule is primacy,²¹⁵ explicitly stated in Declaration 17 to the Treaty of Lisbon²¹⁶ and also enshrined in Article 351(1) TFEU.²¹⁷ According to the interpretation of the CJEU, *a contrario* reasoning of Article 351(1) renders inapplicable the *pacta sunt servanda* guarantee otherwise applicable to international treaties concluded between EU Member States and third States.²¹⁸ The International Law Commission (ILC) has sided with this interpretation, acknowledging that the EU Treaty takes 'absolute precedence over agreements that Member States have concluded'.²¹⁹ However, in the intra-EU context, in particular under the ECT, only one tribunal found this

²¹³ This cannot be implied either from the reference to REIO in the ECT or the EU's 1998 statement made to the ECT Secretariat. See the definition of a Contracting party in Art 1(2) ECT, the definition of a REIO in Art 1(3) ECT and the definition of 'Area' with respect to a REIO in Art 1(10) ECT. Tribunal in *RREEF* emphasised the public international law principle *pacta sunt servanda*, under which a party wishing to exclude the ECT would need to make a reservation or would need to include an unequivocal disconnection clause. Further, construing an implicit disconnection clause into the ECT would be contrary to the purpose of the ECT. In fact, Art 46 does not allow reservations and Art 26 mandates ECT Member States to give unconditional consent to ISDS, thus confirming that the ECT was intended to apply unconditionally and integrally: *RREEF Infrastructure (G.P.) Limited and RREEF Pan-European Infrastructure Two Lux S.a.r.l. v Kingdom of Spain*, ICSID ARB/13/30, Decision on jurisdiction (6 June 2016) para 85. For the Tribunal's remarks on the EU's 1998 statement made to the ECT Secretariat, see *Eskosol* (n 206) paras 92-93. In addition, the *travaux préparatoires* of the ECT reveal that, during the negotiation of the ECT, the EU had proposed the insertion of a disconnection clause, which was, however, ultimately dropped from the draft treaty: *Vattenfall II* (n 210) para 205.

²¹⁴ Art 351 TFEU, Art 16 ECT, and conflict rules in individual intra-EU BITs. For example, Art 3(5) of the Netherlands–Czech Republic BIT prescribes that rules of other international treaties concluded between the parties, which entitle investors to a more favourable treatment, shall prevail to the extent that they are more favourable than the BIT. The Austria–Croatia BIT in Art 11(2) states that: 'The Contracting Parties are not bound by the present Agreement insofar as it is incompatible with the legal acquis of the European Union (EU) in force at any given time' (emphasis added).

²¹⁵ See chapter 5.

²¹⁶ Lisbon Treaty Declaration concerning primacy (n 169).

²¹⁷ Art 351(1) TFEU provides that the EU founding treaties do not override treaties concluded by the EU Member States with third countries prior to the adoption of or accession to the founding treaties. It reads: 'The rights and obligations arising from agreements concluded before 1 January 1958 or, for acceding States, before the date of their accession, between one or more Member States on the one hand, and one or more third countries on the other, shall not be affected by the provisions of the Treaties.'

²¹⁸ See Case C-264/09 *Commission v Slovakia* ECLI:EU:C:2011:580, para 41; Case C-147/03 *Commission v Austria* ECLI:EU:C:2005:427, para 58.

²¹⁹ ILC (n 198) para 283 and seq.

reasoning convincing,²²⁰ while others ruled in favour of the ‘clearer’ ECT conflict rule in Article 16 ECT.²²¹ This provision prohibits the terms of another agreement being *construed* so as to derogate from the investors’ rights under the ECT.²²² Given that the ECT is more favourable to investors, tribunals have concluded that Article 16 poses ‘an insurmountable obstacle’ to supremacy of EU law over the ECT.²²³

In most cases, tribunals have relied on the general conflict rule in Article 30 VCLT to determine the primacy between different treaties.²²⁴ This provision was interpreted as requiring two cumulative criteria: ‘sameness’ of the subject-matter (ii) and incompatibility (iii). They held that either the subject-matter of the intra-EU BITs/the ECT and the EU treaties is not the same, or there is no conflict between their provisions, or both.

(ii) Whether intra-EU investments are protected under EU law

IIIL and EU law overlap in many aspects. Substantive protections in intra-EU BITs/the ECT overlap with EU law provisions on freedom of establishment, free movement of capital and the CFR provisions.²²⁵ In the specific ECT context, secondary EU legislation has harmonised energy and gas markets within the EU, replacing a much less integrated regime under the ECT.²²⁶ In procedural terms, EU law has its own enforcement and dispute settlement mechanisms.²²⁷

²²⁰ See *Electrabel S.A. v Republic of Hungary*, ICSID Case No. ARB/07/19, Decision on Jurisdiction, Applicable Law and Liability (30 November 2012) para 4.183.

²²¹ See, for example, the reasoning of the *Vattenfall II* Tribunal: *Vattenfall II* (n 210) paras 225-229.

²²² Art 16 ECT states that the Contracting parties to the ECT, including the EU, have agreed that any prior or subsequent treaties that parties enter into with each other shall not be construed so as to derogate from substantive protections or the right to access the dispute settlement mechanism of the ECT, where the ECT provision is more favourable to the investor or investment. Given its reference to ‘construing’ rights, Art 16 could be understood as an interpretative rather than a conflict rule.

²²³ *Vattenfall II* (n 210) para 229. In *Vattenfall II* the Tribunal applied Art 16 ECT as both a rule of treaty interpretation and a conflict rule. It was considered a rule of interpretation to support the Tribunal’s jurisdiction under Art 26 ECT: see para 194. As a conflict rule, Art 16 was used to establish not only the supremacy of the ECT over EU law, but also to assert the supremacy of Art 16 as a conflict rule in the ECT over Art 351 TFEU. In this sense, any later treaty (*lex posterior* rule under Art 30 VCLT) or any modifications of the ECT by a later treaty would not be allowed in light of Art 16 ECT: paras 217, 221.

²²⁴ Art 30 VCLT determines ‘the rights and obligations of States parties to successive treaties relating to the same subject-matter’: Art 30(1) VCLT. Of relevance for this analysis is subsection 3, which prescribes that, in situations when the earlier treaty is not terminated or suspended in accordance with Art 59 VCLT, ‘the earlier treaty applies *only to the extent* that its provisions are *compatible* with those of the later treaty’ (emphasis added).

²²⁵ See sections 7.1.1 and 7.1.2 above.

²²⁶ Of particular importance is the Third Energy Package: EP and Council Directive (EC) 2009/72 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC [2009] OJ L211/55; EP and Council Directive (EC) 2009/73 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC [2009] OJ L211/94.

²²⁷ See section 7.1.3 above.

In analysing the applicability of EU law in intra-EU ITA under Article 30 VCLT, tribunals have mostly agreed that the two legal orders do not cover the same subject-matter.²²⁸ In doing so, the emphasis has been placed on the *strict* interpretation of the requirement of sameness. For example, the *Eastern Sugar* Tribunal understood sameness as providing equal rights to investors. It therefore concluded that the mere fact that ‘the EU does not provide for a possibility for an investor *to sue a host state directly*, and that *in international BIT arbitration* this is an essential feature of most [BITs]’ was sufficient to reject the argument of *equal rights*.²²⁹

Nevertheless, a formalistic interpretation of the ‘same subject-matter’ requirement is ‘neither necessary nor reasonable’.²³⁰ As noted by the ILC, ‘terms such as “human rights law”, “trade law” or “environmental law” and so on are arbitrary labels of professional specialisation’.²³¹ The focus should thus be placed on the ‘assessment of whether the fulfilment of the obligation under one treaty affects the fulfilment of the obligation of another’. The assessment of the effects depends on whether the pre-existing agreement ‘strictly prevent[s] the fulfilment of the other obligation or undermining its object and purpose’.²³² Accordingly, the conflict between State obligations in two successive treaties rather than the formalistic criterion of sameness should be taken as a relevant criterion under Article 30 VCLT. Applied to intra-EU ITAs, of issue is whether the fulfilment of the Member State obligations under the intra-EU BIT/the ECT affects their obligations under the EU treaties. Tribunals have answered this question in the negative, while the CJEU has answered it in the positive.²³³

²²⁸ *Vattenfall II* (n 210) para 212; *Eastern Sugar* (n 157) para 159; *Achmea B.V. v The Slovak Republic (formerly Eureko B.V. v Slovak Republic)*, PCA Case No. 2008-13, Award on Jurisdiction, Arbitrability and Suspension (26 October 2010) para 258; *European American Investment Bank AG v The Slovak Republic*, PCA Case No. 2010-17, Award on Jurisdiction (22 October 2012) para 184; *Novenergia II – Energy & Environment (SCA) (Grand Duchy of Luxembourg)*, *SICAR v The Kingdom of Spain*, SCC Case No. 2015/063, Award (15 February 2018) para 439.

²²⁹ *Eastern Sugar* (n 157) para 180 (emphasis in the original). This conclusion comes after Art 30 VCLT was cited in the preceding paragraph (para 179) so it can be inferred that it is directly related to the requirements of Art 30 VCLT.

²³⁰ ILC (n 198) para 253.

²³¹ *ibid* para 254.

²³² *ibid*.

²³³ See section 7.3.2 below.

(iii) Whether intra-EU BITs/the ECT are inconsistent with the EU legal order

Is there an actual or potential conflict between substantive and procedural provisions of intra-EU BITs/the ECT and the founding EU treaties? All tribunals ruled that there is no such conflict and that two legal orders can co-exist.²³⁴

With respect to substantive issues, it has been noted that free movement of capital under EU law and protection of investment under IIL are ‘different but complementary things’.²³⁵ Free movement of capital guarantees capital flows in the pre-establishment stage of investment,²³⁶ while BITs provide protections in the post-establishment stage – ‘during the investor’s investment in the host country’.²³⁷ That BITs give to investors from some Member States more rights than to other EU investors – the fundamental problem of intra-EU BITs for the EU legal order – has been recognised but also justified. As noted by the *Eastern Sugar* Tribunal, ‘the fact that these rights are unequal does not make them incompatible’.²³⁸ Although a State measure might be non-discriminatory under EU law, it can be qualified as unfair and inequitable under IIL.²³⁹ With respect to procedural rights, tribunals did not find inconsistency between the ISDS mechanism and the dispute settlement provisions of the EU founding treaties, in particular Articles 267 and 344 TFEU.²⁴⁰ They found that Article 344 applies to inter-Member State disputes and not investor–State disputes involving intra-EU investors and Member States.²⁴¹ To sum up, tribunals have mostly found the two legal orders complementary and in any case consistent.²⁴²

While all tribunals found no conflict between intra-EU BITs/the ECT, some delved into a hypothetical analysis of primacy between the two legal orders in case of such a conflict. Of particular interest is the finding of the Tribunal in *Electrabel*, which found that EU law would prevail over international law, both under the special conflict rule of Article

²³⁴ See, for example, *Electrabel* (n 220) para. 4.146; *Charanne B.V. v Spain*, SCC Arb. No. 062/2012, Final Award (21 January 2016) para 438; *RREEF* (n 213) para 79; *Eiser* (n 212) para 199; *Novenergia II* (n 228) paras 438-442.

²³⁵ *Eastern Sugar* (n 157) para 169.

²³⁶ *ibid* paras 161-163.

²³⁷ *ibid* para 164.

²³⁸ *ibid* para 170.

²³⁹ *Achmea* PCA Case (n 228) paras 250-251, where the imposition of a flat-rate corporate tax, as a legally protected right or a legal duty under EU law, is given as an example.

²⁴⁰ See, for example, *Electrabel* (n 220) para 4.175; *Blusun* (n 211) para 303.

²⁴¹ *Charanne* (n 234) paras 441-447.

²⁴² For example, the *Eureko/Achmea* Tribunal held that ‘BIT establishes extensive legal rights and duties that are neither duplicated in EU law nor incompatible with EU law’: *Achmea* PCA Case (n 228) para 245. The *Electrabel* Tribunal noted that ‘the two legal orders are not in fact inconsistent or otherwise contradictory’: *Electrabel* (n 220) para 4.172.

351 TFEU and the general conflict rule in Article 30 VCLT.²⁴³ Other tribunals were adamant that in the case of inconsistency, absent the possibility that such inconsistency can be reconciled through interpretation, an ‘unqualified obligation’ of any arbitral tribunal constituted under an IIA would be to apply public international law. This applies to all cases, even when it undermines EU law, since ‘EU law does not and cannot “trump” public international law’.²⁴⁴

Following similar argumentation, *all* tribunals have upheld their jurisdiction in disputes between intra-EU investors and EU Member States. Although provided as *obiter*, the *Electrabel* Tribunal’s interpretation is important given that a non-EU jurisdiction acknowledged the primacy of EU law over IIL. Other tribunals have downplayed the relevance of the *Electrabel* Tribunal’s reasoning, given the *hypothetical* character of its analysis; the *ratio* of its decision confirmed tribunals’ jurisdiction for intra-EU disputes.²⁴⁵

In fact, EU law provides that investors must sue States before *domestic* courts to seek remedies under EU law. This key feature of EU law is accordingly in *direct contradiction* with the rationale of ITA, which is envisaged to bypass domestic courts. While the inconsistencies between IIL and EU law are both substantive and procedural, the CJEU focused exclusively on the compatibility of the ISDS mechanism with EU law, and both *actual and hypothetical* conflicts between two legal orders.

7.3.2. The EU law perspective: the *Achmea* judgment of the CJEU

The CJEU found the opportunity to rule on the compatibility of EU law and IIL after more than 10 years of intra-EU disputation before investment tribunals. This opportunity came with the request for a preliminary ruling from the German *Bundesgerichtshof* (Federal Court of Justice), submitted in the context of an action brought by Slovakia before the German courts seeking annulment of the *Achmea (formerly Eureko) v Slovakia* Final Award.²⁴⁶ The award concerned a claim under the Netherlands–Slovakia BIT, with the seat of arbitration in Frankfurt am Main.²⁴⁷ The German court’s request asked for the

²⁴³ *Electrabel* (n 220) paras 4.178-4.191. The Tribunal thus concluded: ‘In summary, from whatever perspective the relationship between the ECT and EU law is examined, the Tribunal concludes that EU law would prevail over the ECT in case of any material inconsistency.’

²⁴⁴ *RREEF* (n 213) para 87.

²⁴⁵ See, for example, *Blusun* (n 211) para 298.

²⁴⁶ *Achmea* PCA Case (n 228) Final Award (7 December 2012).

²⁴⁷ The case concerned a claim by a Dutch investor Achmea B.V. (formerly known as Eureko B.V.) and its investment in Slovakia’s private health insurance services in 2004. Following a change of government in Slovakia in 2006, the government partly revoked the liberalisation of the private health insurance market through new legislative measures (the measures involved a ban on the intervention of insurance brokers, distribution of profits from the private health insurance scheme and the sale of insurance portfolios; the distribution of profits was later found unconstitutional and was accordingly reintroduced in 2011). In the final award, the Tribunal held that two parts of these measures (bans on the distribution of profits and on

CJEU's assessment of the compatibility of the ISDS provision in Article 8 of the Netherlands–Slovakia BIT with Articles 344, 267 and 18 TFEU. In its landmark judgment delivered on 6 March 2018, the Grand Chamber of the CJEU ruled that ISDS clauses in intra-EU BITs, such as the one in Article 8 of the Netherlands–Slovakia BIT, *contravene* Articles 267 and 344 TFEU.²⁴⁸

This CJEU judgment is important not only for the relationship between intra-EU ISDS and EU law; more broadly, the judgment endorses the constitutional character of the EU and the autonomy of its legal order. The CJEU's reasoning in *Achmea* discusses different aspects of the EU legal order (i–ii) and the effects of the ISDS mechanism on the EU legal order (iii–vi).

- (i) The EU constitutional aspect: the autonomy of EU law, mutual trust and sincere cooperation

The CJEU emphasised the 'constitutional structure of the EU' and the autonomous character of EU law.²⁴⁹ The autonomy of the EU legal order is enshrined 'in particular in Article 344 TFEU', which precludes Member States from submitting *any dispute* concerning the *interpretation and application* of the Treaties to any dispute settlement other than the one provided for in the treaties.²⁵⁰ Observance of the autonomy is strictly ensured by the CJEU through Article 344 TFEU, ensuring that the Court is the *only* authority for the interpretation and application of EU law.²⁵¹

In addition, EU law is based on the set of common values on which the EU is founded and which are shared among the Member States.²⁵² This implies the existence of mutual trust between the Member States that these values will be recognised and that law that implements them will be respected. Mutual trust and the principle of sincere cooperation between the Member States, enshrined in Article 4(3) TEU, ensure that Member States provide in their respective territories appropriate measures, which can assure other Member States that EU law is respected and properly applied.²⁵³

transfers) breached the FET and free transfer of payments provisions, and ordered Slovakia to pay damages of 22.1 million plus interest EUR, the cost of arbitration and the legal costs of the claimant Achmea. Slovakia then challenged the award in the enforcement stage before the German courts (place of arbitration) on the grounds that it was contrary to public policy, challenging also the arbitration agreement that gave rise to the award (it was claimed that the agreement was null and void since the offer to arbitrate was made under the Netherlands–Slovakia BIT, contrary to EU law and thus public policy).

²⁴⁸ Case C-284/16 *Slovakische Republik v Achmea* ECLI:EU:C:2018:15 (emphasis added). The CJEU did not answer the question on the compatibility of the ISDS clause with the principle of non-discrimination enshrined in Art 18 TFEU.

²⁴⁹ *ibid* para 33.

²⁵⁰ *ibid* para 32 (emphasis added).

²⁵¹ To that effect, see *ibid* para 32. See also chapter 5, section 5.1.

²⁵² As stated in Art 2 TEU. For discussion on these values, see chapter 4, section 4.2.

²⁵³ *Achmea* (n 248) para 34. See also section 7.1.3 above.

- (ii) The EU judicial aspect: the preliminary ruling procedure as the ‘keystone’ of the EU judicial system

The autonomy of the EU legal order is preserved through the EU judicial system.²⁵⁴ Mutual trust also includes trust in the Member States’ courts, which, in accordance with Article 19 TEU, ensure the full application of EU law and judicial protection of individuals under EU law.²⁵⁵ The ‘keystone’ of the EU judicial system is the preliminary rulings procedure in Article 267 TFEU, which establishes a ‘dialogue’ between the national courts and the CJEU. It accordingly secures the uniform interpretation of EU law and thus ensures its consistency and effectiveness.

After reiterating the core elements of the EU legal order, the CJEU considered how the ISDS mechanism affects EU law and its autonomy.

- (iii) The EU internal market aspect: investment tribunals can interpret or apply substantive EU law

First, the CJEU considered whether an ISDS tribunal can interpret and apply EU law.²⁵⁶ In analysing the applicable law provision of the Netherlands–Slovakia BIT, the Court ascertained that a tribunal is called on to rule on possible infringements of the BIT²⁵⁷ by also taking into account ‘the law in force of the contracting party concerned and other relevant agreements between the contracting parties’.²⁵⁸ Accordingly, given the constitutional character of EU law,²⁵⁹ whereby EU law forms part of the national laws of Member States, an ISDS tribunal ‘*may* be called on to interpret or indeed apply EU law’, and *in particular* the EU founding treaties’ provisions on fundamental freedoms, including freedom of establishment and free movement of capital.²⁶⁰

- (iv) The procedural aspect: ISDS tribunals cannot refer questions for preliminary ruling to the CJEU

Secondly, since ISDS tribunals *could* interpret or apply EU law, the CJEU had to establish whether they could, in the same manner as national courts, refer questions of EU law for preliminary ruling to the CJEU, in order to secure uniform interpretation of EU law, and

²⁵⁴ *ibid* para 35.

²⁵⁵ *ibid* para 36.

²⁵⁶ *ibid* para 39.

²⁵⁷ Art 8(1) of the Netherlands–Slovakia BIT.

²⁵⁸ *Achmea* (n 248) para 40, referring to Art 8(6) of the Netherlands–Slovakia BIT.

²⁵⁹ *ibid* para 41, with reference to para 33.

²⁶⁰ *ibid* para 42 (emphasis added). Cf. *Achmea*, Opinion of AG Wathelet (n 82) para 173.

hence its consistency and effectiveness.²⁶¹ Only national courts or tribunals can refer questions to the CJEU in accordance with the procedure in Article 267 TFEU. The CJEU concluded that ISDS tribunals are *not* part of the national judicial system, and hence are also not part of the EU judicial system.²⁶² Tribunals' jurisdiction *outside* of the national judicial systems is at the very core of ISDS.²⁶³

- (v) The judicial review aspect: the CJEU and national courts do not have control over investment arbitral awards

Thirdly, given that ISDS tribunals are outside the EU judicial system, the CJEU had to ascertain whether an award issued by these tribunals could be reviewed by national courts. This would ensure the correct application of EU law, including through the preliminary ruling mechanism.²⁶⁴ The CJEU noted that ISDS awards are final and that their review depends on the choice of arbitration procedure, their seat and the applicable law.²⁶⁵ Accordingly, the possibility of judicial review and control by national courts and the CJEU over ISDS awards are rather remote and, in the case of ICSID awards, fully excluded.

The CJEU, however, made a distinction between investment and commercial arbitration, reaffirming that the latter is compatible with EU law. Two reasons were provided to support this distinction. First, commercial arbitration originates in 'the freely expressed wishes of the parties' stated in an arbitration agreement. On the other hand, IIA originates in an IIA between two Member States, which is in direct contradiction with the Member States' EU obligations, in particular Article 344 TFEU.²⁶⁶ Secondly and more importantly, the review of commercial awards regarding their compatibility with EU law is possible in the enforcement stage.²⁶⁷ When reviewing commercial awards, national courts can review the validity of arbitration agreements under the applicable law as well as the consistency of the awards with public policy. Although limited in its scope, this review allows for examination of the compatibility of commercial awards with the fundamental provisions of EU law.²⁶⁸ In the course of review proceedings, national courts

²⁶¹ *ibid* para 43.

²⁶² *ibid* para 46.

²⁶³ *ibid* para 45. This was also the main point of difference in the reasoning of the CJEU and its Advocate General Wathelet, who in his Opinion considered that ISDS tribunals are courts or tribunals of Member States: see *Achmea*, Opinion of AG Wathelet (n 82) para 127. See also analysis of the relevant criteria for national 'courts or tribunals' in paras 90-126.

²⁶⁴ *Achmea* (n 248) para 50.

²⁶⁵ *ibid* para 51.

²⁶⁶ *ibid* para 55. Accordingly, Art 344 TFEU applies to investor-State cases, in addition to inter-State cases, contrary to findings of investment tribunals: see Section 7.3.1(iii) above.

²⁶⁷ *Achmea* (n 248) para 54.

²⁶⁸ Case C-126/97 *Eco Swiss China Time Ltd v Benetton International NV* [1999] ECR I-3055, paras 35-36.

can refer questions of EU law for a preliminary ruling.²⁶⁹ Accordingly, national courts can review and control the compatibility of commercial awards with EU law, and thus ensure the full application of EU law in accordance with Member States' obligations under Article 19(1) TEU.

(vi) The international law aspect: EU law is part of international law

While emphasising the constitutional nature of the EU legal order, the CJEU also underscored its international character. The CJEU reiterated the language of its early judgments, which established the core principles of primacy and direct effect.²⁷⁰ It also restated that an international agreement establishing an international court for the interpretation of provisions of that agreement is not 'in principle' incompatible with EU law, 'provided that the autonomy of the EU and its legal order is respected.'²⁷¹ While the Court's language in earlier paragraphs points to the *potential* incompatibility of ISDS with EU law in Member States' *inter se* agreements,²⁷² the language of this paragraph indicates the need for *actual* incompatibility of EU law and an international court established by an international agreement to which the EU is a party.

(vii) Conclusion: intra-EU ITA adversely affects the autonomy of the EU legal order

Given all aspects of the *Achmea* judgment, the CJEU concluded:

In the present case, however, *apart from* the fact that the disputes falling within the jurisdiction of the arbitral tribunal ... *may* relate to the *interpretation* of both of that agreement and *EU law*, the possibility of submitting those disputes to a body which is not part of the judicial system of the EU is provided for by an agreement which is concluded *not by the EU but by Member States*. Article 8 of the BIT is such as to call into question *not only* the *principle of mutual trust* between the Member States but also the *preservation of the particular nature of the law* established by the Treaties, ensured by the preliminary ruling procedure ... and is *not* therefore *compatible* with the *principle of sincere cooperation*...²⁷³

Accordingly, several inferences can be made in relation to *Achmea*.

²⁶⁹ *ibid* para 40.

²⁷⁰ 'EU law is characterised by the fact that it stems from an independent source of law, the Treaties...': *Achmea* (n 248) para 33. See chapter 5.

²⁷¹ *ibid* para 57.

²⁷² An arbitral tribunal '*may* be called on' to interpret or apply EU law: *ibid* para 42 (emphasis added); its jurisdiction '*may* relate to the interpretation both of that agreement and EU law': *ibid* para 58 (emphasis added).

²⁷³ *ibid* para 58 (emphasis added).

First, Achmea relates to agreements concluded *between the Member States*, including *all* intra-EU BITs. The emphasis of the *Achmea* judgment is placed on the principles of mutual trust and sincere cooperation in relations between the Member States, which are called into question in any intra-EU ITA. The principle of mutual trust implies that there is no second-class justice in the EU and that investors can expect the same level of protection before the courts of any Member State.

Secondly, since intra-EU investment disputes can involve interpretation or application of EU law, Member States have an *obligation* to submit these disputes to the judicial mechanism of the EU treaties, in accordance with Article 344 TFEU.²⁷⁴ This EU judicial mechanism involves a ‘dialogue’ between national courts and the CJEU through the preliminary ruling procedure of Article 267 TFEU, ensuring the uniform interpretation of EU law by the CJEU. Accordingly, the dispute settlement mechanism under the founding treaties protects the allocation of powers fixed in the EU treaties and the autonomy of EU law.

On the contrary, the jurisdiction of an intra-EU ISDS tribunal, which is outside the EU judicial system, adversely affects the autonomy of the EU legal order. In their final award the tribunals could interpret and apply EU law without pre- or post-award recourse to the CJEU, which would ensure the correct interpretation of EU law. Awards of intra-EU tribunals can therefore affect the allocation of powers between the EU and its Member States and consequently, affect the autonomy of the EU legal system.

Thirdly, it is sufficient that conflicts between interpretation of EU law by an intra-EU investment tribunal and the CJEU are *potential*. Indeed, in most cases, domestic law and thus also EU law will be taken as a matter of fact. As discussed above, tribunals have not hesitated to interpret EU law.²⁷⁵ Moreover, they have held that there is no EU rule preventing an arbitral tribunal from applying EU law to an intra-EU dispute,²⁷⁶ which is an interpretation of EU law in itself, albeit not an authoritative one. In light of *Achmea*, the incompatibility of intra-EU ISDS with the EU legal order is not dependent on the proof that an EU issue will actually arise in a particular case; the possibility of it is sufficient.

Fourthly, for all these reasons it is likely that the *ratio* of the *Achmea* judgment equally applies to intra-EU ITA under the ECT. The fact that the ECT is a multilateral agreement, to which the EU is also a party, does not matter. Of relevance is that ITA under the ECT, as an agreement *between the Member States*, functions on the same principles as ITA under intra-EU BITs (mutual trust, sincere cooperation, autonomy of EU law). In light

²⁷⁴ *ibid* para 56.

²⁷⁵ For example, tribunals have interpreted the scope of application of Art 344 TFEU. See section 7.3.1(iii) above.

²⁷⁶ *Charanne* (n 234) para 438; *Novenergia II* (n 228) para 440.

of *Achmea*, ISDS clauses in all IIAs that contravene Articles 267 and 344 TFEU and the principles of mutual trust and sincere cooperation enshrined in Articles 19(1) and 4(3) TEU are inapplicable under EU law.

Moreover, the possibility of conflicts between ECT awards and EU law that could affect the allocation of powers fixed in the founding treaties is even higher. As a matter of EU law, the ECT has direct effect in Member States.²⁷⁷ Therefore, a private EU investor could rely on the ECT to challenge an act of an EU institution before EU courts, or the CJEU could examine the ECT on the basis of a request for a preliminary ruling from a national court of a Member State.²⁷⁸ In this case, an award issued by an arbitral tribunal under the ECT could provide an authoritative interpretation of the obligations of the ECT Contracting parties, possibly in conflict with the authoritative interpretation of the ECT as a source of EU law provided by the CJEU.²⁷⁹ Hence, the application of the ECT in intra-EU disputes could lead to different outcomes under the same legal instrument, depending on the body adjudicating such disputes, thus resulting in legal uncertainty.²⁸⁰

Fifthly, for all these reasons it is also likely that *Achmea* does not equally apply to extra-EU situations, which include bilateral agreements between Member States and non-EU States (extra-EU BITs), or bilateral agreements concluded by the EU and all Member States as one Contracting party with a third State as another party (e.g. CETA).²⁸¹ While there is still a possibility of a conflict between ISDS awards under such agreements and EU law, these inconsistencies are less likely to affect the autonomy of EU law in the same manner as agreements *between* the Member States. The conflict in extra-EU relations

²⁷⁷ The CJEU has ruled that the direct effect of EU international agreements depends on the intention of the agreement in question to 'apply directly and immediately to individuals and to confer upon them rights or freedoms capable of being relied upon against States': Case C-308/06 *Intertanko* [2008] ECR I-4057, para 64. The ECT, which confers directly applicable rights on investors against States, fulfils this criterion.

²⁷⁸ Statement submitted by the European Communities to the Secretariat of the Energy Charter pursuant to Article 26(3)(b)(ii) of the ECT [1998] OJ L69/115, [5].

²⁷⁹ Expert Opinion of Professor Piet Eeckhout on the Law applicable to the dispute under the Energy Charter Treaty 1994 (30 October 2008) in *AES Summit Generation Limited v The Republic of Hungary*, ICSID Case No. ARB/07/22.

²⁸⁰ Case C-471/98 *Commission v Belgium* ("Open Skies") ECLI:EU:C:2002:628, paras 137 to 142; and Opinion 2/13 ECLI:EU:C:2014:2454, paras 198-199 and 208.

²⁸¹ This is a different situation to the ECT, which is a plurilateral agreement with 56 Contracting parties (however, Australia, Norway and Russia never ratified it and Belarus applies it provisionally): see The Energy Charter, 'Members and Observers of the Energy Charter conference' (18 February 2019) <https://www.energycharter.org/fileadmin/ImagesMedia/Country_Flags/Energy_Charter_Process_chart.pdf> accessed 30 June 2020. Every EU Member State (except Italy) is a Contracting party to the ECT. The situation with the European Convention on Human Rights (ECHR) is the same. Every EU Member State is a party to the Convention and is subject to the decisions of the ECtHR, established under the ECHR. In its Opinion 2/13 (n 280), the CJEU rejected the possibility of the accession of the EU to the ECHR. Given the parallels between the ECHR and the ECT (multilateral agreement between the Member States), *mutatis mutandi*, the autonomy concerns of the CJEU in relation to the EU's membership in the ECHR can be applied to situations under the ECT. In fact, the ECT provides the same scenario in which the EU would find itself if it joined the ECHR. On the contrary, such a scenario is excluded in the case of CETA, which is a bilateral agreement of the EU. While concerns about autonomy of the EU legal order cannot be fully excluded, they were an acceptable risk for the CJEU: see chapter 9.

must be *actual*, therefore depending on the demonstration that a conflict exists in each particular case. Indeed, in some cases the post-award control of the CJEU would be fully excluded; for example, for ICSID awards or those arbitrations that have their seat outside the EU. However, the possibility for these awards to affect the allocation of powers fixed in the EU treaties, while not inconceivable, is rather remote.²⁸² The risk of adversely affecting the autonomy of the EU legal order is accordingly low and certainly superseded by political benefits of such agreements.²⁸³

Sixthly, the CJEU provides an authoritative interpretation of EU treaties and determination of legal rights and obligations of Member States under EU law. This jurisdiction is granted to the Court under public international law, i.e. EU founding treaties.²⁸⁴ *Rationae personae*, the ruling of the CJEU provided through the preliminary ruling procedure is directed to the national court that initiated the procedure, but it is legally binding for all national courts in the EU.²⁸⁵ The rationale is to ensure that EU law applies uniformly in the EU, thus guaranteeing legal certainty.²⁸⁶ The national court must set aside the provisions of national law declared to be inconsistent with EU law, without having to request or await its prior removal by the legislature.²⁸⁷ *Ratione temporis*, since the CJEU did not provide any temporal limitation of the effects of its ruling, all EU Member States are bound *ex tunc* by the preliminary ruling in *Achmea*.²⁸⁸

Accordingly, *Achmea* should apply to *all* intra-EU awards and arbitrations, regardless whether they occurred before or after the judgment. However, the principles of *res judicata* and legal certainty preclude questioning the legality of final awards in intra-EU ITAs where final awards have been issued prior to the *Achmea* ruling.²⁸⁹ In our particular case, the German court ruled that Slovakia's *offer to arbitrate* in the Netherlands–Slovakia BIT was *inapplicable* for its incompatibility with EU law, and thus

²⁸² Cf. Nicolas de Sadeleer, 'The End of the Game: The Autonomy of the EU Legal Order Opposes Arbitral Tribunals under Bilateral Investment Treaties Concluded between Two Member States' (2018) 9 European Journal of Risk Regulation 355.

²⁸³ Political benefits include the traditional ISDS benefits, and in particular the protection of EU investors in host States, the majority of which are developing or States transitioning to a market economy. On the other hand, the claims of foreign investors from these third States against the EU Member States are still rather exceptional. On extra-EU BITs of Member States, see chapter 8.

²⁸⁴ Art 19(1) TEU; Art 263 TFEU.

²⁸⁵ Case C-173/09 *Elchinov* ECLI:EU:C:2010:581, para 29; Case C-689/13 *Puligienica Facility Esco SpA* ECLI:EU:C:2016:199, para 38.

²⁸⁶ Case 66/80 *International Chemical Corporation v Amministrazione delle Finanze dello Stato* [1981] ECR 1191, para 11-13.

²⁸⁷ Joined Cases C-231/06 to C-233/06 *Emilienne Jonkman* ECLI:EU:C:2007:373.

²⁸⁸ This would mean that the authoritative interpretation of the rule provided in the CJEU judgment applies from the moment the rule entered into force, which in this particular case is the entry into force of the founding treaties: Morten Broberg and Niels Fenger, *Preliminary References to the European Court of Justice* (OUP 2010) 445. This is different to a precedent of a common law court, which applies *ex nunc*.

²⁸⁹ *Eco Swiss* (n 268) para 43.

no effective arbitration agreement could have been concluded.²⁹⁰ However, while *Achmea* was unlucky, in light of the post-*Achmea* developments, other intra-EU investors might eventually receive more favourable outcomes.

In light of the preceding discussion, the following figure depicts the overlap and conflict between intra-EU BITs and the EU legal order.

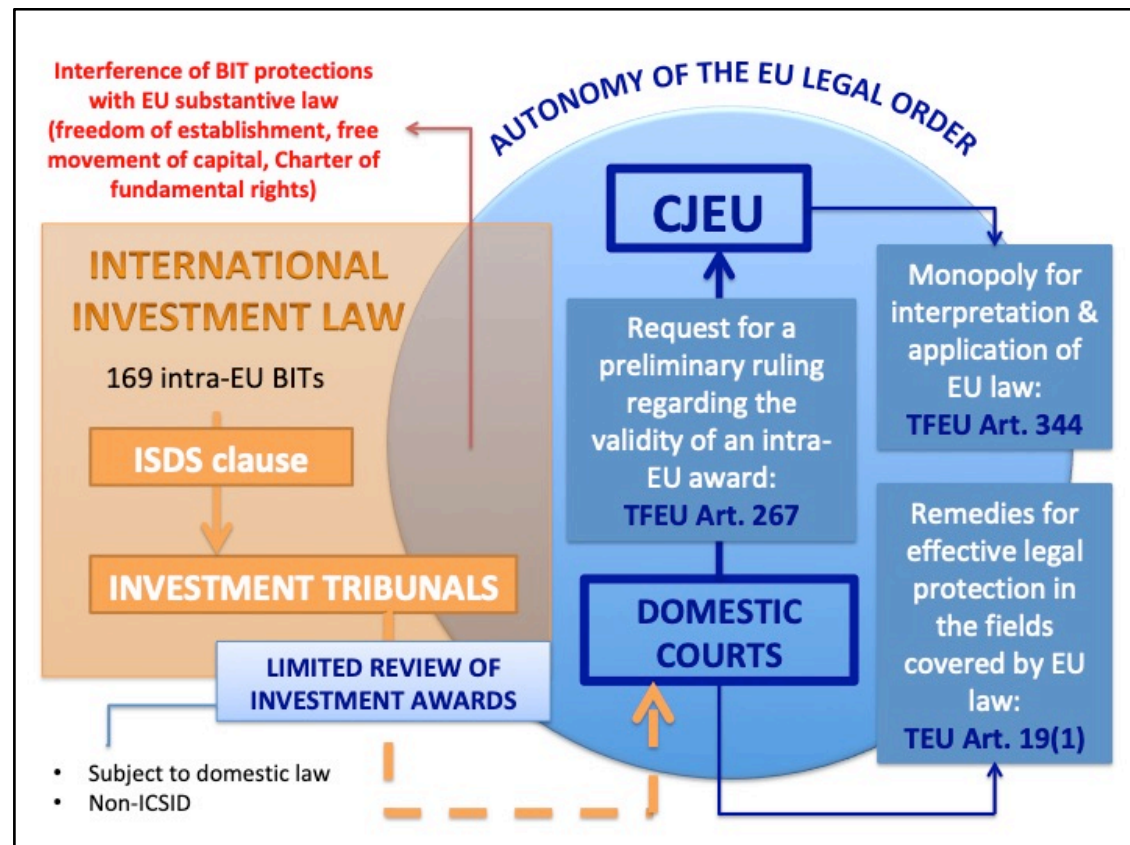


Figure 7.1. The relationship between intra-EU BITs and the EU legal order^{xiv}

²⁹⁰ BGH (German Federal Court of Justice), Judgment of 31 October 2018, I ZB 2/15, para 25.

7.4. Intra-EU investment post-*Achmea*: legal and policy implications

For investment lawyers, the CJEU's judgment left many questions unanswered.²⁹¹ Most notably, does the reference to 'such as' mean that *Achmea* applies only to those ISDS provisions that include the same language as Article 8 of the Netherlands–Slovakia BIT (reference to domestic law as applicable law)? Does *Achmea* mandate actual or potential conflict between two legal orders? Does it apply to intra-EU disputes under the ECT? Does it indeed have any relevance for ITAs under intra-EU IIAs?

Different intra-EU tribunals, whether established under a BIT or the ECT, provided different answers to these questions but all came with an explanation why *Achmea* does not apply in their particular case. In the ECT context, it was considered that *Achmea* has 'no bearing' due to the ECT's nature as a multilateral external agreement of the EU,²⁹² confirming *no conflict* between the ECT and EU law.²⁹³ In the intra-EU BITs context, in some cases it was confirmed that *Achmea* covers different subject-matter, thus excluding the priority of EU law under Article 30 VCLT.²⁹⁴ In others, it was found that it refers to the 'national or regional context' and thus has no bearing on the 'multilateral public international treaty' context of ICSID.²⁹⁵ And so on.²⁹⁶ Ultimately, the differences in reasoning between investment lawyers (as revealed in the claimants' and tribunals' arguments) and EU lawyers (as revealed in the respondent States' arguments) reflect the different interpretative approaches of these two legal orders.²⁹⁷ While both approaches

²⁹¹ As a matter of principle, the CJEU has the obligation only to answer those questions that have been posed to the Court by the referring national court, and to the extent that is necessary for the referring court to correctly apply EU law in the particular case. Accordingly, in view of the answers provided regarding Arts 267 and 344 TFEU, the CJEU did not find the need to answer one additional question posed by the German court – on the compatibility of intra-EU BITs with the principle of non-discrimination (Art 18 TFEU): see *Achmea* (n 248) para 61. Given the complexity of the issue of discrimination in the ISDS context (see chapter 9), such an approach was not only legally smart but also politically cunning.

²⁹² See, for example, *Masdar Solar & Wind Cooperatief U.A. v Kingdom of Spain*, ICSID Case No. ARB/14/1, Award (16 May 2018) paras 340–341. Many tribunals found more convincing the Opinion of AG Wathelet, in which he distinguished intra-EU BITs and the ECT. Accordingly, the *Masdar* Tribunal erroneously interpreted the CJEU's silence on the matter in *Achmea* as supporting the assertion that the CJEU endorsed the AG's Opinion: *ibid* paras 680–682.

²⁹³ In the ECT context, one of the most comprehensive of the first decisions on *Achmea* was provided by the *Vattenfall II* Tribunal. The Tribunal dismissed the relevance of *Achmea* and EU law for determining its jurisdiction. It reiterated that there is no conflict between Arts 267 and 344 TFEU and the ISDS provision in Art 26 ECT, asserting that both EU law and the ECT can operate in their separate spheres without conflict: *Vattenfall II* (n 210) para 212. In the absence of such conflict, it found moot the conflict of law analysis but it concluded that the ECT would prevail over EU law *if there were* such a conflict: see *ibid* paras 214, 229.

²⁹⁴ *Marfin* (n 116) Award (27 July 2018) para 595. On why this approach is erroneous from the perspective of international law, see section 7.3.1(ii) above.

²⁹⁵ *UP (formerly Le Chèque Déjeuner) and C.D Holding Internationale v Hungary*, Award (9 October 2018) para 253.

²⁹⁶ For the most recent elaboration of an arbitral tribunal on the inapplicability of *Achmea* to a dispute under the Austria–Croatia BIT, see *Addiko Bank AG and Addiko Bank d.d. v Republic of Croatia*, ICSID Case No. ARB/17/37, Decision on Croatia's Jurisdictional Objection Related to the Alleged Incompatibility of the BIT with EU Acquis (12 June 2020). In a nutshell, the Tribunal reasoned that the Austria–Croatia BIT does not incorporate EU law as part of its applicable law in the same manner as the Netherlands–Slovakia BIT does.

²⁹⁷ See chapter 5, section 5.3.3.

endorse ‘systemic integration’ in international law, they attach different meanings to this concept.²⁹⁸

Prior to the CJEU’s judgment in *Achmea*, tribunals were unconvinced about the overlap of the subject-matter or inconsistency between ISDS provisions in intra-EU IIAs and EU law.²⁹⁹ As *Achmea* confirmed, this was an erroneous view of the Member States’ obligations under the EU founding treaties. Nevertheless, it should be seen in light of the fact that there was no CJEU ruling on the matter.³⁰⁰ In *Achmea*, the CJEU provided an authoritative interpretation of EU law, in accordance with its jurisdiction under public international law. While recognising that *Achmea* and EU law form part of international law,³⁰¹ investment tribunals have simply disagreed with the CJEU’s interpretation provided in *Achmea* and accordingly have proceeded with intra-EU arbitration in all cases.

The present situation compounds the problem of fragmentation of international law and the competition for ‘institutional hegemony’.³⁰² Given the CJEU’s public international law jurisdiction regarding the interpretation of EU law, no arbitral tribunal should disregard the CJEU’s decisions when considering EU law. In the same manner, the CJEU held that it is beyond its jurisdiction to decide matters under a bilateral arbitration agreement between two Member States governed by international law, the subject of which does not fall within the areas of EU competence referred to in Articles 3 to 6 TFEU and to which the EU is not a party.³⁰³ A more complex issue is whether a tribunal unconnected with the EU is *bound* by the CJEU’s decisions. In any case, EU Member States and private parties from those States are bound by the CJEU’s decisions, including in

²⁹⁸ For example, in the context of the ECT, systemic interpretation under EU law means interpretation of the ECT (as a source of EU law) in conformity with the EU founding treaties, which precludes intra-EU ITA: see C-266/16 *Western Sahara* EU:C:2018:118, paras 42-51. For investment tribunals, systemic interpretation means interpreting Member States’ obligations under an international treaty harmoniously with EU law, which excludes conflict between the two: see, for example *Electrabel* (n 220) para 4.130; *RREEF* (n 213) para 76; *Ioan Micula, Viorel Micula, S.C. European Food S.A, S.C. Starmill S.R.L. and S.C. Multipack S.R.L. v Romania [I]*, ICSID Case No. ARB/05/20, Final Award (11 December 2013) paras 326-327.

²⁹⁹ See section 7.3.1 above.

³⁰⁰ In the early stages of the intra-EU jurisdictional objection, arbitral tribunals held that they were not bound by the EC’s opinion, which is not a judicial body: *Eastern Sugar* (n 157) paras 123-125. Moreover, to add insult to injury, the *Eastern Sugar* Tribunal emphasised that the EC’s views in the letter provided in this case by the Czech Republic were ‘for the most part diplomatic or ambiguous’: *ibid* para 120.

³⁰¹ The *Vattenfall II* Tribunal found that EU law, to the extent of the founding treaties, should not be excluded from ‘the purview of international law’ under Art 38(1)(a) of the Statute of the International Court of Justice: see *Vattenfall II* (n 210) paras 145-150.

³⁰² Martti Koskeniemi, *The Politics of International Law* (Hart 2011) 338; ILC (n 198)

³⁰³ Case C-457/18 *Slovenia v Croatia* ECLI:EU:C:2020:65, para 102. The case concerned a border dispute at sea and land between Slovenia and Croatia. Croatia refused to recognise the award determining the border due to a material breach of the arbitration agreement by Slovenia. Given that the resolution of the border dispute through arbitration was Slovenia’s condition for its approval of Croatia’s accession to the EU (the arbitration agreement was facilitated by the Swedish EU Presidency), Slovenia alleged that by not recognising this award Croatia breached its obligations under EU law. The CJEU dismissed the action submitted under Art 259 TFEU for the lack of jurisdiction.

situations when they are parties to the arbitral proceedings. Disregard of the CJEU's ruling in *Achmea* places EU Member States in a precarious position of choosing between their competing obligations.

The clash of these two international legal orders would be of interest only to legal scholars if it did not also have practical legal consequences for the enforcement of intra-EU arbitral awards and the adjudication of intra-EU investment disputes. Ultimately, there are also implications for the rule of law in the EU and the attainment of the EU integration objectives.

7.4.1. Enforcement of intra-EU arbitral awards

Illegality of intra-EU investment awards under EU law poses a challenge to their enforcement in the EU and possibly also outside the EU. In intra-EU arbitrations seated in the EU, awards will likely be set aside in a judicial review by the Member States' national courts as contrary to EU law. In these cases, arbitral awards could be set aside as a matter of priority of EU law over international law in the national legal orders of EU Member States. Alternatively, EU Member States could invoke Article V(2)(b) of the 1958 New York Convention,³⁰⁴ allowing the refusal of recognition or enforcement of a foreign award contrary to the public policy of a State,³⁰⁵ or could invoke illegality of the arbitration agreement in accordance with Article V(1)(a). Whether a failure by the State to raise a jurisdictional objection in intra-EU proceedings could have any effect on the validity of the arbitration agreement, and thus the enforceability of final awards under intra-EU BITs, could be soon further clarified by the CJEU.³⁰⁶

³⁰⁴ 330 UNTS 38 (adopted 10 June 1958, entered into force 7 June 1959).

³⁰⁵ *Eco Swiss* (n 268). For comment on the concept of EU public policy in this judgment, see George A Bermann, 'The Prospects of *Eco Swiss v Benetton* for International Commercial Arbitration: A Comment on *Eco Swiss v Benetton*' in Patrick Wautelet and others (eds), *The Practice of Arbitration: Essays in Honour of Hans van Houtte* (Hart 2012).

³⁰⁶ In the proceedings for the enforcement of an intra-EU award in the case *PL Holdings S.à.r.l. v Republic of Poland*, SCC Case No. V 2014/163, before the Swedish courts, the Swedish Supreme Court requested a preliminary ruling from the CJEU in December 2019. The CJEU has been asked to clarify whether under EU law an arbitration agreement is invalid due to an invalid ISDS clause in an intra-EU BIT (between Poland and the Belgian–Luxembourg Economic Union) if the Member State exercised party autonomy and did not object to the jurisdiction: see Jake Lowther Magnusson, 'Keeping Intra-EU ISDS Alive: The Supreme Court of Sweden Requests Preliminary Ruling from the CJEU on Validity of Arbitration Agreement in Light of *Achmea* Decision' (*Kluwer Arbitration Blog*, 5 March 2020)

<<http://arbitrationblog.kluwerarbitration.com/2020/03/05/keeping-intra-eu-isds-alive-the-supreme-court-of-sweden-requests-preliminary-ruling-from-the-cjeu-on-validity-of-arbitration-agreement-in-light-of-achmea-decision/>> accessed 30 June 2020. However, in light of *Achmea* this issue seems moot given that the offer to arbitrate in the intra-EU BIT is given by the State, and not by the investor. Accordingly, in the absence of such offer (the offer is inapplicable for incompatibility with EU law in accordance with *Achmea*), the arbitration agreement could not have been concluded in the first place.

The situation is more complex in the cases of ICSID awards. Under Article 53 of the ICSID Convention,³⁰⁷ these awards are considered final and are not subject to domestic judicial review. However, in the EU, the ICSID Convention cannot trump EU law. If faced with the execution of an ICSID award,³⁰⁸ the Member State national judge should apply EU law and refuse the execution of an intra-EU ICSID award, even if a particular Member State is a Contracting Party to the ICSID Convention.³⁰⁹

Intra-EU awards can thus only be enforced in non-EU States. However, even in cases of ICSID awards, investors still face the domestic sovereign immunity laws of the State in which enforcement is sought³¹⁰ and the practical problem of the availability of respondent States' assets to be seized in the State of enforcement. Enforcement has been sought before the courts in the US³¹¹ and Australia.³¹² Post-Brexit, the UK courts could be another viable avenue for the enforcement of intra-EU awards.³¹³ However, it is too early to indicate in more general terms whether intra-EU awards would be successfully

³⁰⁷ 575 UNTS 159 (adopted 18 March 1965, entered into force 14 October 1966).

³⁰⁸ Execution of ICSID awards is governed by the national laws of the State in which the execution is sought: Art 54(3) ICSID Convention.

³⁰⁹ Since the EU is not a member of the ICSID Convention, the ICSID Convention is not part of EU law. As an international agreement of Member States, in the hierarchy of legal norms in the EU legal order, international agreements of Member States rank below primary and secondary EU law. All Member States except Poland are Contracting Parties of the ICSID Convention.

³¹⁰ In accordance with Arts 54(3) and 55 ICSID Convention.

³¹¹ There are several proceedings for the enforcement of intra-EU awards (both UNCITRAL and ICSID) made against Spain under the ECT pending before the US courts. As an example, these cases include the enforcement of awards made in cases *Eiser* (n 212); *Masdar* (n 292); *Novenergia II* (n 228).

³¹² *Eiser* successfully enforced its ICSID award made under the ECT against Spain in Australia. Spain's foreign State immunity defence was rejected on the basis that Spain, as a Contracting party to the ECT and the ICSID Convention, submitted to the jurisdiction of investment tribunals as well as the designated national courts for the purposes of enforcement of awards made by investment tribunals under these conventions. This includes Spain's submission to the jurisdiction of Australian courts given that Australia is a Contracting party to the ICSID Convention. However, the waiver of foreign immunity defence regarding recognition or enforcement of an ICSID award does not include the waiver of foreign State immunity with respect to the execution of the award. Accordingly, *Eiser* must seek to *execute* the award against property held by Spain in Australia in further proceedings. See *Eiser* (n 212) Judgment of the Federal Court of Australia (24 February 2020): *Eiser Infrastructure Ltd v Kingdom of Spain* [2020] FCA 157.

³¹³ Of interest is the enforcement saga of the intra-EU ICSID award of 11 December 2013, made in the case of *Micula* (n 298). In December 2013, the ICSID Tribunal awarded the Swedish investors substantial damages against Romania due to Romania's withdrawal of an investment incentive program. This withdrawal was the result of Romania's EU membership, which subsequently led to the application of EU State aid rules. The claimants began enforcement proceedings in Romania, which led to a partial compensation of millions of euros. As a consequence, under Art 11(1) of Regulation (EU) No 659/1999, the EC ordered Romania to suspend any action which could lead to the execution or implementation of the 2013 award, as a form of State aid inconsistent with EU law. *Micula* challenged the EC's decision before the CJEU (T-624/15 *European Food and Others v Commission* ECLI:EU:T:2019:423) and sought the enforcement of the award in a number of jurisdictions, including the UK and the US. Since the State aid proceedings were pending before the CJEU, the enforcement was stayed in the UK in 2017 in accordance with the duty of sincere cooperation. In the meantime, in June 2019, the CJEU (General Court) annulled the EC's decision but the EC's appeal is still pending. Nevertheless, on 19 February 2020, the UK Supreme Court lifted the stay of enforcement, giving priority to the UK's duties under Art 54 of the ICSID Convention rather than the duty of sincere cooperation under EU law. The UK court reasoned that in accordance with Art 351 TFEU, the UK's obligations under the ICSID Convention (owed to all ICSID Contracting Parties), which precede the UK's accession to the EU, are not subject to the overriding effect of EU law: see *Micula and others v Romania* [2020] UKSC 5.

enforced and executed before third States' courts.³¹⁴ In any case, from the perspective of enforcement of intra-EU awards, investors will be better off relying on the ICSID Convention than the UNCITRAL/New York Convention rules.³¹⁵

Pre-*Achmea* investors have faced difficulties in enforcing awards which are contrary to EU law.³¹⁶ Payment of compensation under an intra-EU investment arbitral award can conflict with EU State aid rules. This issue has become prominent in the context of a significant number of ECT cases against Spain, many of which are still pending.³¹⁷ Some investors have recognised that pursuing claims under intra-EU BITs could have uncertain outcomes, with Airbus withdrawing a claim against Poland under the Netherlands–Poland BIT in May 2018.³¹⁸ It could be claimed that in all cases initiated after *Achmea*, which conclusively established the illegality of ISDS clauses in intra-EU BITs under EU law, investors had no legitimate expectations of receiving protection under these clauses. Accordingly, if after *Achmea* a non-EU court proceeds with the enforcement of an intra-EU award, the EC could eventually consider any amounts so collected by an investor to be illegal State aid and require the respondent Member States to recover it in the equivalent amount from the investor. In such situations, the only avenue for investors would be to challenge the illegal State aid decision of the EC before the CJEU.³¹⁹

³¹⁴ The *Micula* (n 298) intra-EU ICSID award was successfully enforced before the D.C. District Court. However, the US court's decision was made on the basis of the CJEU's decision in the State aid proceedings (*European Food* n 313). The CJEU (General Court) clearly distinguished the situation in *Micula* from the one in *Achmea* on the basis that Romanian measures challenged in *Micula* occurred prior to Romania's accession to the EU and thus did not concern issues of EU law (therefore, the payment of compensation was not in breach of EU State aid rules). The US court accordingly found that it was not demonstrated that 'the concern that animated *Achmea* – the un-reviewability of an arbitral tribunal's determination of EU law by an EU court – is present in [*Micula v Romania*] case': *Micula v Romania*, Case No. 17-cv-02332, (D.D.C. 2019) 19. Accordingly, the US court enforced the *Micula* award by adopting the reasoning of the CJEU. While the appeal proceedings before the CJEU are still pending, the US court was not willing to further delay the enforcement, especially since the EC did not seek to suspend the General Court's decision pending the appeal: *ibid* 26.

³¹⁵ See also observations of the arbitral Tribunal in *Eskosol* (n 206) paras 231-232.

³¹⁶ *Micula* (n 298); *European American Investment Bank* (n 228) paras 263-265.

³¹⁷ See European Commission (n 131). The EC's Decision explicitly refers to payment of the award compensation in *Eiser* (n 212), which has been enforced but not yet executed in Australia. The enforcement of the award has also been sought before the US courts.

³¹⁸ Republic of Poland, Office of the Attorney-General Press Release (2018) (in Polish) <<https://prokuratoria.gov.pl/index.php?p=new&id=mg,21&id=65&action=show>> accessed 30 June 2020. However, of additional relevance in this case might be the fact that Poland is not a party to the ICSID Convention.

³¹⁹ This happened in the case of *Micula*: *European Food* (n 313).

7.4.2. Adjudication of intra-EU investment disputes

In compliance with *Achmea*, on 15 January 2019 the majority of EU Member States adopted a Declaration on Investment Protection in the EU.³²⁰ Although legally non-binding, this Declaration has sent a clear signal to the investment community that ‘no new intra-EU investment proceedings should be initiated,’³²¹ either under intra-EU BITs or under the ECT.³²² The assurance that the intra-EU investors’ home and host States do not feel bound by obligations under intra-EU IIAs provides a strong political message to investors seeking protection under such treaties. On 5 May 2020, the majority of the Member States signed the Agreement for the termination of BITs between the Member States of the EU,³²³ which implements the CJEU’s *Achmea* judgment and the January Declaration.³²⁴

The Termination Agreement envisages the termination of all intra-EU BITs and their sunset clauses (listed in Annex A) as well as the termination of the sunset clauses of already terminated BITs (listed in Annex B), as soon as it enters into force for the relevant parties to the BIT.³²⁵ The Agreement requires ratification of only two Member States to enter into force.³²⁶ While it could enter into force rather soon, it will take much longer for its ratification by all Member States.³²⁷

The Agreement clarifies that ISDS arbitration clauses in intra-EU BITs are inapplicable as of the date of the EU accession of the last of the parties to the BIT.³²⁸ For example, in the case of the latest EU Member State Croatia, the arbitration clauses in the listed Croatian intra-EU BITs are inapplicable as of 1 July 2013. In any case, intra-EU BIT ISDS clauses cannot serve as a legal basis for any new arbitration proceedings³²⁹ – and this includes all arbitrations initiated on or after 6 March 2018 (the date of the *Achmea*

³²⁰ Declaration of the Representatives of the Governments of the Member States of 15 January 2019 on the Legal Consequences of the Judgment of the Court of Justice in *Achmea* and on Investment Protection in the European Union.

³²¹ *ibid* para 3.

³²² *ibid* para 1.

³²³ Agreement for the termination of Bilateral Investment Treaties between the Member States of the European Union [2020] OJ L 169/1 (Termination Agreement).

³²⁴ The Agreement constitutes a special agreement between the Member States in accordance with Art 273 TFEU: Art 14(3) Termination Agreement. The jurisdiction over disputes regarding the Termination Agreement is given to the CJEU, when such disputes are ‘related to’ the subject-matter of the founding treaties, which does not require that the subject-matter must be the same. Accordingly, a Member State could bring an action against another Member State for breaches of the Termination Agreement before the CJEU. The Member States have already had similar actions in cases of bilateral treaties for the avoidance of double taxation. See Case C-648/15 *Republic of Austria v Federal Republic of Germany* ECLI:EU:C:2017:664.

³²⁵ Arts 2, 3 and 4(2) Termination Agreement.

³²⁶ Art 16 Termination Agreement.

³²⁷ However, the possibility of provisional application is also envisaged in accordance with Art 17 Termination Agreement.

³²⁸ Art 4(1) Termination Agreement.

³²⁹ Art 5 Termination Agreement.

judgment).³³⁰ The Termination Agreement, however, does not affect proceedings concluded before that date.³³¹

Pending disputes – initiated but not concluded prior to the *Achmea* judgment – can be resolved through a ‘structured dialogue’ between the investor and the Member State, which is to be overseen by the commonly agreed ‘impartial facilitator’.³³² The initiative for this procedure is placed on the investor³³³ and it can be initiated only within six months from the termination of the relevant BIT under which the arbitration proceedings have been established.³³⁴ However, several provisions mandate that the settlement procedure will be conditioned upon the established actual or potential violations of EU law³³⁵ and guided by EU law.³³⁶ Unlike the arbitrator, whose role is to adjudicate on the matter, the role of the facilitator is focused on the *process* of negotiations, with the rationale that the parties would, through this process, reach between themselves ‘an amicable, lawful and out-of-court and out-of-arbitration settlement of the dispute’.³³⁷

As an alternative to the ‘structured dialogue’ for pending cases, including cases where the settlement has not been reached through the structured dialogue, the investor is entitled to access national courts in accordance with Article 10, even if national time-limits for bringing actions have expired.³³⁸ However, in these proceedings before the national courts, the provisions of BITs will not be considered applicable law and no new judicial remedies, otherwise unavailable under national law, would be created.³³⁹ Accordingly, in all other cases, including those where the cause of action involves

³³⁰ Art 1(6) Termination Agreement.

³³¹ Art 6 Termination Agreement. This includes proceedings which ended with a settlement or a final award prior to 6 March 2018 (*Achmea* judgment): Art 1(4).

³³² The procedure for the ‘structured dialogue’ is prescribed in Art 9, Termination Agreement. In a case when parties cannot agree on the facilitator, s/he will be appointed by a former Member of the CJEU: Art 9(8).

³³³ As a precondition, the investor must request the suspension of arbitration proceedings/enforcement proceedings in third States or make an undertaking that it would not start the proceedings for the enforcement of the award in third States in case the arbitration proceedings have been concluded: Art 9(1).

³³⁴ Art 9(2) Termination Agreement. It is envisaged that the settlement would also be reached within six months of the appointment of the facilitator, but it could be longer if the parties so agree.

³³⁵ The settlement procedure will not be entered into if the CJEU or a national court has found in a final judgment that the contested State measure does not violate EU law (Art 9(4)) and *vice versa*; it will be entered into if the CJEU or a national court establishes such violations (Art 9(3)), or a potential violation of EU law caused by the State measure can be identified (Art 9(6)).

³³⁶ The facilitator must possess the necessary qualifications including in-depth knowledge of EU law: Art 9(8) Termination Agreement. In the negotiation process, the facilitator will ‘take due account of rulings by the CJEU or a national court’ and the EC’s advice that it can request on its own initiative (in accordance with Art 9(9)). It will also take into consideration ‘the case-law of the CJEU on the extent of reparations of damages under EU law’: Art 9(10).

³³⁷ Art 9(7) Termination Agreement. However, in case the parties do not reach the settlement themselves within the given timeframe, the facilitator will make a final written proposal for an amended amicable settlement: Art 9(12) Termination Agreement. Any settlement will be formalised in a legally binding manner and it will include an obligation for the investor to withdraw any pending claims and to refrain from initiating new arbitration proceedings: Art 9(14).

³³⁸ This is subject to time limits and conditions laid down in Art 10(1) Termination Agreement.

³³⁹ Art 10(3) and (4) Termination Agreement. The national court will also avoid double-compensation by taking into account any compensation previously paid in the pending arbitration proceedings: Art 10(5).

measures challenged in arbitration proceedings started on or after 6 March 2018, the investor will be entitled only to the regular access to national courts. Needless to say, in any case, investors will find proceedings in national courts an unattractive alternative to intra-EU arbitration.

Different factual scenarios under the Termination Agreement are summarised in the following table.

Table 7.3. The effects of the Termination Agreement on intra-EU arbitration under intra-EU BITs

THE STAGE OF INTRA-EU ARBITRATION PROCEEDINGS	EFFECTS OF THE PLURILATERAL AGREEMENT ON THE ARBITRATION PROCEEDINGS/AWARDS
Arbitration proceedings concluded and awards/settlement agreements executed before 6 March 2018	<i>Res judicata</i> / no effect of the Termination Agreement
Arbitration proceedings concluded (with no challenge to final award pending) before 6 March 2018 but award not executed	Award can be executed under EU law before domestic courts of Member States
Arbitration proceedings concluded (with no challenge to final award pending) before 6 March 2018 and the award set aside/annulled before the entry into force of the Termination Agreement	<i>Res judicata</i> / no effect of the Termination Agreement
Pending arbitration proceedings initiated but not concluded before 6 March 2018 (and no pending parallel domestic proceedings)	Settlement in accordance with the ‘structured dialogue’ in Article 9 / access to national courts in the alternative in accordance with Article 10
Arbitration proceedings initiated before 6 March 2018 and concluded before the entry into force of the Termination Agreement (and no pending parallel domestic proceedings)	Settlement in accordance with the ‘structured dialogue’ in Article 9 / access to national courts in the alternative in accordance with Article 10
New arbitration proceedings: initiated on or after 6 March 2018 (pending or concluded)	Offer to arbitrate inapplicable / arbitration proceedings illegal under EU law /regular access to the competent national court

A number of pending arbitrations that started after 6 March 2018, but before the date of the entry into force of the Termination Agreement for the relevant Parties to the intra-EU BIT, will likely remain bones of contention due to the envisaged retroactive application of the Agreement.³⁴⁰ It cannot be excluded that investment tribunals might differently interpret the applicability of the Termination Agreement and the legal effects

³⁴⁰ Both States parties to the relevant intra-EU BIT have a duty to inform the arbitration tribunal in the *pending* or *new* arbitration proceedings about the legal consequences of the *Achmea* judgment: see Art 7(1) and Annex C, Termination Agreement. This should indicate to the tribunals the absence of a valid consent for the arbitration agreement.

of the sunset clauses. In light of the existing jurisprudence, it is possible that intra-EU tribunals will preclude arbitrations only in those cases initiated after both of the Parties to the relevant BIT ratified the Termination Agreement. This scenario would only further compound the enforcement challenges for investors.³⁴¹

The initiation of the ‘structured dialogue’ on the investors’ initiative and the limited timeframe for this procedure indicate that the settlement would be in the investors’ interests. While favouring the parties, the cost of the settlement proceedings also indicates their likely unattractiveness to investment lawyers.³⁴² It is, however, unclear whether, after the Termination Agreement enters into force, Member States would continue to participate and contest investors’ claims in the arbitration proceedings that lack legal basis in accordance with the Agreement, in particular in those cases where the structured dialogue failed to produce the settlement. In legal terms, in these situations, infringement proceedings would be possible.³⁴³

Finally, of importance is to emphasise that four Member States³⁴⁴ and the UK did not sign the Termination Agreement. The EC has earlier announced that Member States that do not terminate their intra-EU BITs will likely face infringement proceedings under Article 258 TFEU,³⁴⁵ although these processes bear political sensitivity. Because the UK remains bound by EU law only until the end of the transition period, under the terms of the Withdrawal Agreement, the EC was quick to initiate the proceedings against the UK.³⁴⁶ However, it is also likely that infringement proceeding will have no effect and that the UK will keep its 11 BITs with EU Member States post-Brexit.³⁴⁷

³⁴¹ In accordance with Art 7(2) of the Termination Agreement, a Member State that is a litigant in *pending* or *new* intra-EU arbitration also has a duty to ask the competent national court in any third country to refrain from recognising and enforcing it. Some arbitral tribunals have already recognised that even the 15 January Declaration could create pressure for non-EU courts not to enforce the award due to the lack of valid consent: *Eskosol* (n 206) para 232.

³⁴² An indicative fee schedule for the facilitator is provided in Annex D and it could lead to a maximum cost of not more than 5000 EUR.

³⁴³ The Preamble of the Termination Agreement explicitly states that its provisions are ‘without prejudice to the possibility for the European Commission or any Member State to bring a case before the CJEU based on Articles 258, 259 and 260 TFEU’. An additional option is that a Member State could submit an action against another Member State for breaches of the Termination Agreement under Art 273 TFEU: see Art 14 Termination Agreement.

³⁴⁴ The Member States that have not signed the Termination Agreement are Austria, Finland, Ireland and Sweden. However, Ireland has only ever had one intra-EU BIT (with the Czech Republic), which was terminated in 2011.

³⁴⁵ European Commission Statement, ‘EU Member States agree on a plurilateral treaty to terminate bilateral investment treaties’ (24 October 2019).

³⁴⁶ See European Commission, ‘May infringements package: key decisions’ (14 May 2020) <https://ec.europa.eu/commission/presscorner/detail/en/inf_20_859> accessed 30 June 2020. The same proceedings have also been initiated against Finland. The EC has noted that both countries ‘have failed to engage in any discussion with the Member States concerned to proceed with the bilateral termination of their intra-EU BITs’. In 2015 the EC launched infringement proceedings against five Member States (Austria, the Netherlands, Romania, Slovakia and Sweden) for not terminating intra-EU BITs but the proceedings were later suspended in light of the *Achmea* proceedings before the CJEU.

³⁴⁷ The UK has four months to respond to the Commission’s letter of formal notice (by mid-September 2020). The transition period ends 31 December 2020.

The ECT poses a bigger political and legal problem. In addition to the majority's 15 January Declaration, there were two extra declarations that excluded the applicability of the Declaration to the intra-EU disputes under the ECT in light of the fact that the CJEU did not make a specific judgment on the matter.³⁴⁸ These declarations came from six Member States; among them are some that have interests in pending ECT intra-EU arbitrations.³⁴⁹ In light of these challenges, the Termination Agreement explicitly excludes intra-EU disputes under the ECT.³⁵⁰

A new CJEU ruling would likely facilitate the achievement of the internal ECT consensus among the Member States. While a judgment on the issue through a preliminary ruling procedure is possible but unlikely,³⁵¹ another possibility would be to request an opinion from the CJEU in accordance with Article 218(11) TFEU.³⁵² After internal consensus is achieved, the additional challenge is finding an appropriate legal solution that would unequivocally exclude intra-EU ITA from the scope of the ECT. Given the number of pending intra-EU arbitrations, for the purposes of legal certainty, intra-EU arbitration should be explicitly excluded from the scope of the ECT ISDS clause as part of the ongoing ECT modernisation process.³⁵³ In any case, the ECT remains an important

³⁴⁸ 'Declaration of the Representatives of the Governments of the Member States of 16 January 2019 on the Enforcement of the Judgment of the Court of Justice in *Achmea* and on Investment Protection in the European Union' (signed by Sweden, Luxembourg, Malta, Finland, and Slovenia) <<https://www.regeringen.se/48ee19/contentassets/d759689c0c804a9ea7af6b2de7320128/achmea-declaration.pdf>> accessed 30 June 2020. Hungary went even further and issued a separate declaration in which it explicitly stated that, in its view, the *Achmea* judgment concerns *only* the intra-EU BITs and 'it does not concern any pending or prospective arbitration proceedings initiated under the ECT': 'Declaration of the Representative of the Government of Hungary of 16 January 2019 on the Legal Consequences of the Judgment of the Court of Justice in *Achmea* and on Investment Protection in the European Union', para 8 <<http://www.kormany.hu/download/5/1b/81000/Hungarys%20Declaration%20on%20Achmea.pdf>> accessed 30 June 2020.

³⁴⁹ With respect to Sweden, of interest is the pending case of its 100% State-owned energy provider Vattenfall against Germany, in which Vattenfall sued Germany for legislative measures aimed at phasing out nuclear energy in Germany: *Vattenfall II* (n 210). The January 15 declaration obliges Member States controlling undertakings that have commenced investment arbitration cases against other Member States to undertake appropriate steps and withdraw such cases (in para 4). Since Sweden owns Vattenfall, signing the January 15 declaration would mean Sweden undertaking a political promise that would lead to the withdrawal of Vattenfall's claim against Germany. In the case of Hungary, of interest is also the pending case of *MOL Hungarian Oil and Gas Company Plc v Republic of Croatia*, ICSID Case No. ARB/13/32. The Hungarian State owns shares in but does not control MOL. Nevertheless, the investor is of significant importance for Hungary.

³⁵⁰ Preamble, Termination Agreement.

³⁵¹ For example, in *Novenergia II* (n 228), the Swedish court refused Spain's request for a preliminary ruling from the CJEU in order to clarify whether the ISDS clause of the ECT is compatible with EU law. In a short Decision, which cannot be appealed separately, the Court concluded that the request for a preliminary ruling 'is currently not motivated', without specifying further reasons: see Decision of the Svea Court of Appeal, 27 May 2020 (English Translation).

³⁵² This provision relates to the opinion of the CJEU about the compatibility of an *envisaged* EU agreement with the Treaties. While the EU is already a party to the ECT, the opinion could be requested by a Member State or any of the EU institutions in the framework of the ongoing ECT modernisation process.

³⁵³ There is no reference to intra-EU arbitration in the Council's negotiating directives for the ECT modernisation: see Council of the European Union, 'Negotiating Directives for the Modernisation of the Energy Charter Treaty – adoption' (2 July 2019) 10745/19. On the ECT modernisation, see chapter 8. Another option would be to submit a statement under the Art 26(3)(b)(ii) ECT excluding the applicability of the ECT ISDS clause to intra-EU investments. In May 2019, the EU submitted to the ECT Secretariat a statement clarifying the consequences of the adoption of the Regulation (EC) 912/2014 regarding the management of

instrument for the EU's broader geopolitical interests in the energy sector, excluding easy solutions, such as the termination of the ECT.

7.4.3. *The rule of law in the EU*

The clash between IIL and EU law has significant consequences for the rule of law. In the short- and medium-term, legal uncertainty created around the adjudication of intra-EU arbitration proceedings and the enforcement of intra-EU awards undermines the rule of law, both internationally and in the EU. However, in the long-term, the legal consequences of the *Achmea* judgment should lead to the enhancement of the rule of law in the EU.

The mechanism of judicial review carried out through judicial cooperation between the CJEU and national courts is designed to ensure compliance with EU law, which 'is of the essence of the rule of law'.³⁵⁴ In the absence of ISDS, private investors will be encouraged to seek protections under EU law, ultimately fuelling the EU judicial system with cases. Accordingly, these cases will allow for more expansive judicial review of the legality of national acts under EU law and rule-making by the CJEU, through the preliminary ruling procedure.

Judicial review will on one hand strengthen the role of national courts, and, on the other hand, expand the reach of EU law. Unlike ISDS arbitrators, whose powers are limited to punitive types of measures (compensation),³⁵⁵ national judges will be empowered to 'disapply' national legislation/measures inconsistent with EU law and award damages to investors. Ultimately, this will influence the Member States' behaviour and policy-making in the direction of their compliance with EU law. Therefore, illegal national policies will be eliminated through mechanisms of EU law, ensuring the Member States' compliance with the rule of law in the EU.³⁵⁶ The broader normative reach of EU law in striking the balance between private interests and public policy goals ultimately also addresses the

the financial responsibility for investment claims between the EU and Member States. This statement, *inter alia*, clarifies that a legal action of a claimant from a non-EU State undertaken in the EU judicial system (including in cases involving the CJEU through the preliminary rulings procedure) should be recognised as precluding *extra-EU* arbitration in accordance with the fork-in-the-road provision of Art 26(2)(a) ECT. However, the Statement explicitly states that intra-EU disputes under the ECT 'do not fall within the scope of this statement' and that 'the EU and its Member States may address this matter at a later stage': Statement submitted to the Energy Charter Treaty (ECT) Secretariat pursuant to Article 26(3)(b)(ii) of the ECT replacing the statement made on 17 November 1997 on behalf of the European Communities [2019] OJ L115/1.

³⁵⁴ Case C-64/16 *Associação Sindical dos Juizes Portugueses* EU:C:2018:117, para 36.

³⁵⁵ This does not imply punitive damages but refers to the fact that ISDS tribunals do not have the power to challenge the legality of measures and only have power to award monetary compensation for the adverse impact of the illegal measure on the investor.

³⁵⁶ J.H.H. Weiler, 'The Transformation of Europe' (1991) 100 *Yale Law Journal* 2403, 2421; Karen J Alter, *Establishing the Supremacy of European Law: The Making of an international Rule of Law in Europe* (OUP 2001) 217-221; see also chapter 5, section 5.3.5.

legitimacy concerns of ISDS, while still providing sufficient protections for intra-EU investors.

In their political declarations, Member States pledged to ensure effective legal protection under the control of the CJEU against State measures that are the object of pending intra-EU investment arbitration proceedings.³⁵⁷ Apart from the existing protections under EU law,³⁵⁸ the Member States ‘will intensify discussions without undue delay’ in order to enhance the mechanisms of protection of intra-EU investors under EU law, and more generally create ‘a more predictable, stable and clear regulatory framework to incentivise investments within the internal market’.³⁵⁹ One possibility could be the adoption of a regulation on protection of intra-EU investment, which would ensure that intra-EU investors are granted equal rights across the EU.³⁶⁰

On the other hand, theoretical assumptions and intentions do not in every case translate into the realities of life, and the EU is not different in this regard. The rule of law in some Member States has already been the subject of concern.³⁶¹ However, the CJEU has shown a willingness to defend national courts against the politics of Member States.³⁶² As in the case of intra-EU arbitration, by defending national courts the CJEU not only defends the EU judicial system; it also defends the broader objectives of EU integration. Its vision is ultimately long-term, despite some inevitable short-term losses.

7.4.4. *The politics and law of EU integration*

In the course of EU integration, law has played an important role in overcoming Member States’ political differences and fostering integration.³⁶³ Developments in intra-EU investment confirm this thesis. While political disagreements between Member States about intra-EU BITs started some 15 years ago, the CJEU’s *Achmea* judgment opened the way for political consensus on intra-EU IIAs. The full consensus has still not yet been reached; however, it is now well underway.

³⁵⁷ Declaration of 15 January 2019 (n 320).

³⁵⁸ See the Preamble of the Termination Agreement. See Section 7.1 above for more detailed analysis of the existing protection mechanisms.

³⁵⁹ Preamble, Termination Agreement.

³⁶⁰ The EC has also started a public consultation process, with an aim to assess the current system of investment protection and obtain views of stakeholders on how it could be improved: see European Commission, ‘Cross-border investment within the EU – clarifying and supplementing EU rules’ (26 May 2020) <<https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12403-Investment-protection-and-facilitation-framework/public-consultation>> accessed 30 June 2020.

³⁶¹ See Sadowski (n 5).

³⁶² *Commission v Poland* (n 150); Joined Cases C-585/18, C-624/18 and C-625/18 *A.K. v Krajowa Rada Sądownictwa, and CP and DO v Sąd Najwyższy* ECLI:EU:C:2019:982

³⁶³ Anne-Marie Burley and Walter Mattli, ‘Europe before the Court: A Political Theory of Legal Integration’ in Mette Eilstrup-Sangiovanni (ed), *Debates on European Integration* (Palgrave 2006) ch 9.

Intra-EU BITs and ITAs fragment the internal market. If the internal market is the quintessence of EU integration, it is quite logical that anything that undermines this goal must accommodate to it, or, if that is not possible, be eliminated. *Prima facie*, it seems that the EU and IIR have much in common, at least with respect to economic goals; however, their differences are not only institutional but also normative. The EU is envisaged to serve *all* transnational elites *within* the borders of Europe, and more broadly, all EU citizens. On the other hand, IIR is designed primarily to serve the interests of transnational foreign investors. They can coexist as long as the latter do not hamper the former. However, whenever international law hinders the objectives of EU integration EU standards must prevail, even if against the interests of strong economic players, in this case intra-EU investors. The EU's hostility towards IIL is exclusive to this context.

The core issue in *Achmea* was not the protection of intra-EU investors but the autonomy of the EU legal order. Without tools to defend its autonomy, the EU project would be seriously undermined. In the 21st century, the EU touches upon a wide number of issues of international importance and EU rules overlap with international standards. The main objective of the autonomy of EU law is not to depart from international standards – and in many cases, EU standards incorporate international norms – but to ensure that these standards do not impede the implementation of EU law and EU integration.

7.5. Conclusion

The CJEU's *Achmea* judgment has important legal, political, economic and socio-legal implications, affecting intra-EU investors, the arbitration industry, the Member States and the EU.

In legal terms, *Achmea* confirms the primacy of EU law in intra-EU investment relations. The ruling of the CJEU in *Achmea* provides the authoritative interpretation of the EU founding treaties and it should not be disregarded. In accordance with its jurisdiction under public international law, the CJEU is best placed to determine the effects of EU treaties in international law when they concern relations between Member States and their international agreements. Legal relevance of the *Achmea* judgment should not be undermined for the sake of systemic coherence in both EU and international law. Disregard of *Achmea* places Member States in a difficult situation in which they have to choose between fulfilling their obligations under international law or EU law.

In political terms, *Achmea* is a crucial step in overcoming political mistrust between EU Member States, stemming largely from their historical West-East divisions. Some

political disagreements remain, in particular in relation to the ECT, which are likely to be resolved with a new CJEU ruling on the matter. Accordingly, law has been an important integrative *factor* and the CJEU an important *actor* in consolidating divergent Member State interests in intra-EU investment. In *Achmea*, the CJEU endorsed its federalist vision of the EU, which prevails over particular interests, whether Member States' or the business sector's interests. The CJEU's approach confirms that EU integration remains its ultimate goal.

The *Achmea* judgment has significant repercussions for intra-EU investors. It provides a clear signal to potential claimants that intra-EU awards are illegal under EU law. Intra-EU BITs are well under way to being terminated. Insisting on legal formalism in ongoing intra-EU arbitrations can only further undermine the legitimacy of ISDS. It can lead to diplomatic tensions in the enforcement stage, refuting the very depoliticising purpose of ISDS.

In economic terms, the *Achmea* judgment will eventually lead to changes of the ITA market in Europe. It can be expected that the number of intra-EU disputes will continue to decline.³⁶⁴ Intra-EU claims under the ECT are likely to continue until the ECT has been amended to the effect of explicitly excluding intra-EU claims. The restructuring of investments through third countries covered with extra-EU BITs is also likely. After Brexit, the UK, which retains 11 BITs with EU Member States, could become such a third country. A coherent internal and external EU investment policy approach is needed to effectively address these issues.

In socio-legal terms, the *Achmea* judgment endorses the cooperation between national courts and the CJEU in supporting the project of EU integration. By returning intra-EU investment disputes to national courts, the CJEU not only safeguards EU fundamental freedoms from the intervention of arbitral tribunals. It also protects the EU judicial system, the integral parts of which are both national courts and the CJEU.

The clash between IIL and EU law in intra-EU investment is in its essence a clash between two autonomous legal orders in a fragmented system of international law. The post-*Achmea* developments accordingly demonstrate that fragmentation in international law has serious implications for legal certainty. Ultimately, *Achmea* is also a tale about the relationship between law and politics in (intra-EU) investment. And it is still far from being over.

³⁶⁴ According to UNCTAD, by the end of July 2018 the share of intra-EU disputes in total ISDS disputes was 20% (of the total global number of 904 ISDS cases, 174 were intra-EU cases). The same statistics recorded only three intra-EU disputes initiated in the first seven months of 2018: UNCTAD, 'Fact Sheet on Intra-European Union Investor-State Arbitration Cases' (December 2018) IIA Issues Note No. 3.

Endnotes in Tables and Figures

- ⁱ Summary based on discussion and analysis of international investment regulation in chapter 1.
- ⁱⁱ *Salini Costruttori S.p.A. and Italstrade S.p.A. v Kingdom of Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction (31 July 2001), para 52 (so-called ‘Salini test’). Cf. *Malaysian Historical Salvors, SDN, BHD v The Government of Malaysia*, ICSID Case No. ARB/05/10, Decision on the Application for Annulment (16 April 2009), paras 125-145, where the Annulment Committee found that contribution to the economic development of the host State is not a requirement for determining ICSID jurisdiction.
- ⁱⁱⁱ Movement of capital is not defined in the treaties. Its meaning is determined by reference to the nomenclature in Annex I to Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty [1988] OJ L178/5. The nomenclature is not exhaustive.
- ^{iv} Joined cases 286/82 and 26/83 *Luisi and Carbone* [1984] ECR 377, para 21. Capital movements are distinguished from capital payments which refer to payments for provision of services of the price for the sale of goods.
- ^v Opinion 2/15 ECLI:EU:C:2017:376, para 227.
- ^{vi} Case C-446/06 *Test Claimants in the FII Litigation v Commissioner of the Inland Revenue* [2006] ECR I-11753, paras 37, 81.
- ^{vii} Art 54(2) TFEU provides a broad definition of “companies or firms” but excludes from this definition legal persons which are ‘non-profit-making’. See also Case C-70/95 *Sodemare SA* [1997] ECR I-3395, para 25.
- ^{viii} In this sense, establishment allows participation by another Member State national ‘on a stable and continuous basis’ in the economic life of his host Member State, and as such is distinguished from provision of services: see Case C-55/94 *Gebhard* [1995] ECR I-4165, paras 25-26.
- ^{ix} Different approaches in IIAs with respect to the form and extent of foreign control: see chapter 2, section 2.2.1.
- ^x Art 54(1) TFEU
- ^{xi} See *Mihaly International Corporation v Democratic Socialist Republic of Sri Lanka*, ICSID Case No. ARB/00/2, Award (5 March 2002).
- ^{xii} According to the CJEU’s case-law, among the factors which can be taken into consideration in determining whether there is a sufficiently serious breach of EU law are, in particular: the degree of clarity and precision of the rule infringed; the scope of the room for assessment that the infringed rule allows for national authorities; whether the infringement and the damage caused were *intentional* or involuntary; whether any error of law was excusable or *inexcusable*; and the fact that the position taken by an EU institution may have contributed to the adoption or maintenance of national measures or practices contrary to EU law, and non-compliance by the national court in question with its obligation to make a reference for a preliminary ruling under the third paragraph of Art 267 TFEU: Joined Cases C-46/93 and C-48/93 *Brasserie du Pêcheur and Factortame III* [1996] ECR I-1029, para 56; C-224/01 Case C-224/01 *Köbler* [2003] ECR I-10239, paras 54-55; Case C-446/04 *Test Claimants in the FII Group Litigation* ECLI:EU:C:2006:774, para 213.
- ^{xiii} Regulation (EU) 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters [2012] OJ L351/1.
- ^{xiv} This illustration in its black and white version was first published in Ivana Damjanovic and Nicolas de Sadeleer, ‘I would rather be a respondent state before a domestic court in the EU than before an international investment tribunal’ (2019) 4 European Papers 19, 60. The number of BITs in this graph has been adjusted to exclude BITs between the EU Member States and the UK post Brexit.

8

The external dimension of EU investment regulation: towards comprehensive EU standards

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8.4. Conclusion

Prior to the 2009 Lisbon Treaty, protection of investors was the missing link in EU external trade relations. The EU had competence to conclude trade agreements which allowed market access for EU companies to third countries. However, the protection of EU companies in these third countries once they were established depended on their Member State nationality and a multitude of BITs concluded between individual Member States and the third countries (pre-Lisbon extra-EU BITs). This led to a differentiation in the treatment of EU investors abroad, ultimately undermining the uniformity of the Common Commercial Policy (CCP).

With the new, albeit shared, international investment competence in the Lisbon Treaty, the EU got an opportunity to develop a coherent international investment policy (IIP).¹ This policy is now being implemented through EU (mixed) IIAs² and the Member States' extra-EU BITs concluded with third countries in the post-Lisbon period (post-Lisbon extra-EU BITs). Coherent EU IIP can ensure the same level of protection for all EU economic operators investing abroad. Moreover, it supports the EU in the global reform of international investment governance. Ultimately, a coherent external approach of the EU and its Member States can improve consistency between the regulation of investment internally and externally, thus endorsing the EU vision of constitutionalism in international law.³

In this chapter we examine the EU's path towards coherence in international investment regulation (IIR). We analyse substantive and procedural provisions of pre- and post-Lisbon Member States' extra-EU BITs and EU IIAs in light of primary EU law, the existing transitional arrangements in EU secondary law and the CJEU case-law.

8.1. Member States' extra-EU regulation

Before 2009 Member States led their independent international investment policies and concluded a number of BITs with third non-EU States. In the postcolonial context, these agreements were particularly important for the Member States of the then European Economic Community (EEC), guaranteeing protection for their investors in their former colonies.⁴ The original six Member States developed an extensive network of extra-EU BITs following the entry into force of the EEC Treaty.⁵ Subsequent Member States concluded BITs before and after their accession to the EU. Extra-EU BITs with the Central and East European States became intra-EU BITs following their accession to the EU.⁶ However, Member States kept an additional 1360 BITs with third non-EU States.⁷ Unlike intra-EU BITs, they are less politically problematic for the EU.

¹ See chapter 4.

² See chapter 6.

³ See Martti Koskeniemi, *The Politics of International Law* (Hart 2011) 345-350.

⁴ See Part I, chapter 1. While Germany started the BIT program in the late 1950s because it lacked the political influence of a colonial power, its BIT practice was followed by former colonial powers: France, the BLEU (Belgium-Luxembourg Economic Union) and the Netherlands in the 1960s-1970s.

⁵ See UNCTAD, 'Bilateral Investment Treaties 1959-1999' (2000) UNCTAD/ITE/IIA/2.

⁶ See chapter 7.

⁷ List of the bilateral investment agreements referred to in Art 4(1) of Regulation (EU) 1219/2012 of the European Parliament and of the Council of 12 December 2012 establishing transitional arrangements for bilateral investment agreements between Member States and third countries [2013] OJ C131/2 (Regulation 1219/2012).

Member States' extra-EU BITs remain valid under public international law; however, their status under EU law had to be clarified in light of the new EU competence. EU Regulation 1219/2012 outlines transitional arrangements and prescribes procedures and requirements for amending the pre-Lisbon extra-EU BITs and concluding new Member States' BITs post-Lisbon.⁸ In addition to secondary legislation, the CJEU examined the compatibility of pre-Lisbon BITs with EU law in several of its judgments. It remains open to interpretation whether the recent CJEU's decisions in *Achmea* and Opinion 1/17 have relevance for Member States' extra-EU BITs. In any case, in light of the EU founding treaties, Member States have a duty to eliminate any inconsistencies between their extra-EU BITs and EU law, and must comply with the principle of sincere cooperation in exercising their remaining investment competence. Eventually, Member States' extra-EU BITs should lose relevance as the EU concludes new IIAs with third countries.

8.1.1. Pre-Lisbon Member States' extra-EU BITs

Regulation 1219/2012 'grandfathered' 1360 Member State pre-Lisbon extra-EU BITs that were notified to the European Commission (EC) under the Regulation mechanism.⁹ The majority of these BITs were concluded between 'old' Member States and developing States, while 'new' Member States concluded a number of agreements with OECD countries during their transitions to a market economies in the 1990s.¹⁰ Extra-EU BITs so notified remain in force; however, Member States still have a duty under primary EU law to bring all their agreements into conformity with EU law.

Article 351 TFEU provides that EU founding treaties do not override treaties concluded by the EU Member States with third countries *prior* to the adoption of or the accession to the founding treaties.¹¹ This provision enshrines international law principles, in particular the general *pacta tertiis nec nocent nec prosunt* rule, codified in Article 34 VCLT, and the rule regarding the application of successive treaties in Article 30(4)(b) VCLT.¹² Its purpose is merely to clarify that the application of the founding

⁸ Regulation 1219/2012

⁹ Chapter II Arts 2-6 Regulation 1219/2012.

¹⁰ For example, Australia has five BITs with EU Member States, and all concluded with 'new' Member States (Poland, Czech Republic, Romania, Lithuania, Hungary): see List of the bilateral investment agreements referred to in Art 4(1) Regulation 1219/2012.

¹¹ Art 351(1) TFEU: 'The rights and obligations arising from agreements concluded before 1 January 1958 or, for acceding States, before the date of their accession, between one or more Member States on the one hand, and one or more third countries on the other, shall not be affected by the provisions of the Treaties.'

¹² Art 34 VCLT reads: 'A treaty does not create either obligations or rights for a third State without its consent'. Art 30(4)(b) reads: 'When the parties to the later treaty do not include all the parties to the earlier one, as

treaties does not affect the *duty* of the Member State to respect the rights of third countries under a prior agreement.¹³ The provision serves to protect third States. It does not allow Member States to exercise any rights that are conferred upon them under such agreement if that would result in the breach of EU law.¹⁴ However, under EU law, Member States are obliged to bring any inconsistent pre-accession treaties into conformity with the founding treaties.¹⁵ This includes an obligation of a Member State to denounce an agreement with a third State if the Member State encounters difficulties which make the adjustment of the agreement impossible.¹⁶ Importantly, foreign interests of Member States cannot override their obligation to align their international agreements with EU law.¹⁷

Article 351 TFEU refers explicitly to Member States' pre-accession agreements with third States with the effect of suspending the principle of primacy. This entails *a contrario* that EU law overrides treaties concluded by EU Member States and third countries *after* the adoption of or accession to the founding treaties. As already mentioned, many of the Member States' extra-EU BITs have been concluded with third States as their post-accession treaties. Given the principle of primacy of EU law, Member States' post-accession extra-EU BITs must also be brought into conformity with both EU treaties and EU secondary legislation.¹⁸ This obligation also stems from the principle of sincere cooperation enshrined in Article 4(3) TEU.¹⁹ Failure of a Member State to bring its post-accession international agreements into conformity with EU law could, in cases of incompatible obligations, effectively lead the Member States to a choice between incurring liability under EU law or under international law.²⁰

Accordingly, Member States have the obligation under primary EU law to bring all their extra-EU BITs, concluded pre- and post-accession, into conformity with EU law. The same obligation is reiterated in Regulation 1219/2012 and the failure to do so can lead to infringement proceedings under Article 258 TFEU.²¹ The compatibility of substantive

between a State party to both treaties and a State party to only one of the treaties, the treaty to which both States are parties governs their mutual rights and obligations'.

¹³ See Case 812/79 *Burgoa* [1980] ECR 2787, para 8; Case C-84/98 *Commission v Portugal* [2000] ECR I-5215, para 53; and Case C-216/01 *Budějovický Budvar* [2003] ECR I-13617, paras 144-145 (emphasis added).

¹⁴ To that effect, see Case 10/61 *Commission v Italy* [1962] ECR 1, para 10; Case C-158/91 *Levy* [1993] ECR I-4287, para 12.

¹⁵ Art 351(2) TFEU: 'To the extent that such agreements are not compatible with the Treaties, the Member State or States concerned shall take all appropriate steps to eliminate the incompatibilities established.'

¹⁶ *Commission v Portugal* (n 13) para 58.

¹⁷ Piet Eeckhout, *External Relations of the European Union, Legal and Constitutional Foundations* (OUP 2004) 342.

¹⁸ See Philip Strik, *Shaping the Single European Market in the Field of Foreign Direct Investment* (CUP 2014) 163.

¹⁹ Ahmad Ali Ghouri, 'Resolving Incompatibilities of Bilateral Investment Treaties of the EU Member States with the EC Treaty: Individual and Collective Options' (2010) 16 *European Law Journal* 806, 830.

²⁰ Strik (n 18) 163-164.

²¹ See Regulation 1219/2012, Preamble, para 11.

provisions of extra-EU BITs was considered by the CJEU, however, following *Achmea* the compatibility of the ISDS mechanism in extra-EU BITs with EU law remains a controversy.

8.1.1.1. Substantive compatibility of extra-EU BITs with Treaty law

Free movement of capital in Article 63 TFEU prohibits all restrictions on the intra-EU movement of capital and, unlike other fundamental freedoms, guarantees that freedom between Member States and third countries.²² However, additional restrictions apply with respect to extra-EU free movement of capital, and in particular regarding four types of capital movements: direct investment, establishment, the provision of financial services and the admission of securities to capital markets.²³ Further, the Council is empowered to ‘adopt measures which constitute a step backwards in Union law’ regarding the liberalisation of extra-EU capital movements.²⁴ Finally, the Council can adopt safeguard measures when extra-EU movements of capital ‘cause, or threaten to cause, serious difficulties’ for the operation of the EU’s Economic and Monetary Union (EMU). These measures can be taken in ‘exceptional circumstances’, if ‘strictly necessary’ and should not last longer than six months.²⁵

In the infringement cases against Austria, Sweden and Finland, the CJEU assessed the compatibility of free transfer clauses in Member States’ extra-EU BITs with primary EU law.²⁶ The CJEU found inconsistency with the Treaty provisions on capital movements in Articles 64, 66 and 215 TFEU, which are more restrictive than free transfer of capital guaranteed under IIL.

The sued Member States claimed that the extra-EU BITs in question were not incompatible with the *existing* EU measures on free movement of capital. Since the Council had not adopted any specific measures, they claimed that incompatibility was purely *hypothetical*. According to them, a *potential future incompatibility* between their extra-EU BITs and secondary EU law does not fall within the scope of Article 351 TFEU and can, if at all, be confirmed only if the Council actually exercises its competence.²⁷ Moreover, they claimed that a wide interpretation of Article 351 TFEU would be an

²² See chapter 7, section 7.1.1.

²³ Art 64 TFEU. In particular, any restrictions under EU and Member States’ national laws that existed on 31 December 1999 have been grandfathered: Art 64(1) TFEU. Additionally, the EU Parliament and the Council can adopt in accordance with the ordinary legislative procedure restrictive measures regarding these four types of capital movements: Art 64(2) TFEU.

²⁴ Art 64(3) TFEU. This can be done unanimously in accordance with a special legislative procedure and after consulting the European Parliament.

²⁵ Art 66 TFEU.

²⁶ Case C-205/06 *Commission v Austria* ECLI:EU:C:2009:118; Case C-249/06 *Commission v Sweden* ECLI:EU:C:2009:119; Case C-118/07 *Commission v Finland* ECLI:EU:C:2009:715.

²⁷ *Commission v Austria* (n 26) paras 18-23; *Commission v Sweden* (n 26) paras 17-24 (emphasis added).

unwelcome precedent, which would challenge legal certainty and the distribution of powers between the EU and the Member States.²⁸

The CJEU sided with the European Commission (EC), reasoning that any potential Council measures would need to be applied *immediately*. Accordingly, neither the extra-EU BITs in question nor any other international law mechanism would allow the Member States to comply with their EU obligations at short notice.²⁹ In particular, the CJEU took into account the time needed to conduct international negotiations, which would conflict with the ‘practical effectiveness’ of the Council’s measures.³⁰ Also, international law mechanisms, such as suspension or denunciation of the agreement, would be uncertain to guarantee that the Council’s measures would be applied effectively.³¹ Similarly, while restrictive measures would form part of domestic law, it is too uncertain whether the interpretation of the specific extra-EU BIT clauses would allow for the application of restrictive measures under such clauses.³²

Consequently, the CJEU condemned all three Member States for the breaches of EU law and stated that ‘the Member States must assist each other with a view to eliminating the incompatibilities established and must adopt, where appropriate, a common attitude’.³³ In other words, the CJEU reiterated the Member States’ obligation in Article 351(2) TFEU as an expression of the principle of sincere cooperation of Article 4(3) TEU. It accordingly called upon the EC ‘to take any steps which may facilitate mutual assistance between the Member States concerned and their adoption of a common attitude’.³⁴

In light of the CJEU’s jurisprudence, the free transfer provisions of new EU IIAs reflect the limitations of the free capital provisions and are accordingly aligned with the Treaty law.³⁵ Many post-Lisbon Member States’ extra-EU BITs do not in their transfer

²⁸ *Commission v Sweden* (n 26) para 19; *Commission v Finland* (n 26) para 46.

²⁹ *Commission v Sweden* (n 26) paras 38-41 (emphasis added).

³⁰ *Commission v Austria* (n 26) para 39.

³¹ *ibid* para 40. The Court did not consider whether Member States could suspend free movement of capital provisions in BITs and apply the Council’s measures relying on the principle *rebus sic stantibus*, which allows for Treaty provision to become inapplicable because of a fundamental change in circumstances. However, the AG Maduro in his Opinion found that the principle is applicable in ‘very limited circumstances’ and is also ‘controversial’: *Commission v Austria* (n 26), Opinion of AG Maduro ECLI:EU:E:2008:391, para 61.

³² *Commission v Finland* (n 26) paras 38-42. In particular, the Court observed that the aim of the BITs provisions on free movement of capital is to ensure freedom of payments in respect of investments, as quickly possible: para 40. In that context, the Court expressed that it is ‘to say the least, debatable’ whether the BIT provision which guarantees the protection of investments within the limits of national legislation would allow either party to limit payment entitlement pursuant to decisions – whether national or otherwise – taken after the entry into force of the BIT, especially as in some BITs it is also stated that each Contracting party is required to act ‘in accordance with international law’: para 41.

³³ *Commission v Austria* (n 26) para 44; *Commission v Sweden* (n 26) para 44; *Commission v Finland* (n 26) para 48.

³⁴ *ibid*.

³⁵ See Arts 8.13, 13.16, 13.21 and Annex 13-B in CETA. Given that CETA is a comprehensive FTA it has a separate financial services chapter in which a prudential carve-out has been included to guarantee the States’ right to regulate in times of financial crises. These provisions can be invoked as a State defence in case of investors’ claims, whereby the validity of the defence is assessed by the CETA Financial services Committee

provisions explicitly refer to restrictive safeguard measures but contain a Regional Economic Integration Organisation (REIO) clause which aims to ensure that none of the BIT provisions prevent Member States from fulfilling their obligations resulting from their EU membership.³⁶ Some new extra-EU BITs, in addition to a REIO clause, include the possibility of measures that restrict transfers through a general exceptions clause.³⁷ The effectiveness of all these provisions remains to be tested in practice in the particular circumstances of each case.

While Member States have the obligation to bring extra-EU BITs in line with EU law, any changes to free transfer of capital provisions depend on the willingness of third States and might be subject to reciprocity. In light of the high number of extra-EU BITs that are incompatible with EU law, a coherent EU approach which replaces existing extra-EU BITs is even more salient. In any case, third States remain protected under Article 351 TFEU.

or the CETA Joint Committee. Restrictions in case of serious balance of payment and external financial difficulties are also possible under general exceptions in Arts 28.4 and 28.5 CETA. In EUSIPA the restrictive measures are included in the transfer provision of Art 2.7. These measures can be adopted 'in exceptional circumstances of serious difficulties, or threat thereof, for the operation of the economic and monetary policy or exchange rate policy in any Party', must be 'strictly necessary', not longer than six months and 'shall not constitute a means of arbitrary or unjustified discrimination' in like situations: Art 2.7.3 (cf. similar expression of Art 66 TFEU).

³⁶ See, for example, the Agreement for the Promotion and Protection of Investment between the Government of the Republic of Austria and the Government of the Kyrgyz Republic (signed 22 April 2016) (Austria–Kyrgyzstan BIT), which contains the same transfer clause as Austria's pre-Lisbon BITs (Art 9) but includes a REIO clause in Art 3(4)(b), stating that no provision of the BIT shall be construed 'as to prevent a Contracting Party from fulfilling its obligations as a member of an economic integration agreement such as a free trade area, customs union, common market, economic community, monetary union, e.g. the European Union'. Similarly, see an REIO clause in Art 2(5) of the Agreement between the Slovak Republic and the United Arab Emirates for the Promotion and Protection of Investments (signed 22 September 2016, entered into force 5 February 2018) (Slovakia–UAE BIT); Art 3(4) of the Agreement between the Slovak Republic and the Islamic Republic of Iran for the Promotion and Reciprocal Protection of Investments (signed 19 January 2016, entered into force 30 August 2017) (Slovakia–Iran BIT); Art 2(5) Dutch Model BIT 2018: Netherlands model Investment Agreement (2019)

<<https://www.rijksoverheid.nl/ministeries/ministerie-van-buitenlandse-zaken/documenten/publicaties/2019/03/22/nieuwe-modeltekst-investeringsakkoorden>> accessed 30 June 2020

³⁷ For example, the Agreement between Hungary and the Kingdom of Cambodia for the Promotion and Reciprocal Protection of Investments (signed 14 January 2016, entered into force 30 August 2017) (Hungary–Cambodia BIT) prescribes that nothing in the BIT shall be construed to prevent a Contracting party from adopting or maintaining measures that restrict transfers where the Contracting Party experiences serious balance of payments difficulties, or the threat thereof, such as restrictions ensuring the integrity and stability of a Contracting Party's financial system: Art 13(2)(a). An REIO clause is included in Art 13(5) and (6), which even clarifies that 'serious balance-of-payments difficulties, or the threat thereof' refer to the economic and monetary union of which a Contracting Party is a member. The drafting of this BIT is thus likely to be more effective than BITs which contain only a general REIO clause.

8.1.1.2. Procedural compatibility of extra-EU BITs with Treaty law

In its landmark *Achmea* judgment, the CJEU ruled that ISDS clauses in intra-EU BITs, such as the one in Article 8 of the Netherlands–Slovakia BIT, contravene Articles 267 and 344 TFEU.³⁸ According to the EC, *Achmea* applies exclusively to the intra-EU context.³⁹ However, it remains unclear whether the implications of this judgment could reach beyond Member States' *inter se* agreements.⁴⁰ The possible implications for Member States' extra-EU BITs depend on the manner in which *Achmea* is interpreted.

(i) The applicable law clause interpretation of *Achmea*

Although *Achmea* concerned a BIT between two Member States, reasoning by analogy, its findings could apply to a situation involving an international agreement between a Member State and a third non-EU State. As EU law forms part of the Member States' domestic legal orders, conflicts in the extra-EU context cannot be avoided. In fact, the ISDS mechanism in an extra-EU BIT could also violate Articles 267 and 344 TFEU when the arbitral jurisdiction concerns either the application or interpretation of EU law. For example, if under an extra-EU BIT an investor from a non-EU State challenges a measure which a host Member State adopted to comply with its EU obligations, an arbitral tribunal established under that extra-EU BIT could also interpret EU law, and thus potentially challenge its autonomy. Accordingly, in such cases the jurisdiction of arbitral tribunals to decide the case should be denied and foreign investors should challenge the relevant Member State measure before the Member State's domestic courts.

Accordingly, it could be argued that the implications of *Achmea* depend on the applicable law clause in the BIT in question, since the applicable law clause of the Netherlands–Slovakia BIT was an important consideration for the CJEU in *Achmea*.⁴¹ According to this argument, *Achmea* would apply and render inapplicable an ISDS clause in any extra-EU BIT the applicable law clause of which explicitly contains reference to

³⁸ Case C-284/16 *Slovakische Republik v Achmea* ECLI:EU:C:2018:15. See chapter 7, section 7.3.2.

³⁹ Communication of 19 July 2018 from the Commission to the European Parliament and the Council, 'Protection of intra-EU investment' COM (2018) 547 final, 3-4.

⁴⁰ See, for example, Szilárd Gáspár-Szilágyi, 'It Is Not Just About Investor-State Arbitration: A Look at Case C-284/16, *Achmea BV*' (2018) 3 *European Papers* 357; Laurens Ankersmit, '*Achmea*: The Beginning of the End for ISDS in and with Europe?' (*Investment Treaty News*, 24 April 2018) <https://www.iisd.org/itn/2018/04/24/achmea-the-beginning-of-the-end-for-isds-in-and-with-europe-laurens-ankersmit/#_edn11> accessed 30 June 2020.

⁴¹ *Achmea* (n 38) paras 40-42, 49. For this argument, see Quentin Declève, '*Achmea*: Consequences on Applicable Law and ISDS Clauses in Extra-EU BITs and Future EU Trade and Investment Agreements' (2019) 4 *European Papers* 99.

domestic law.⁴² In addition, even extra-EU BITs that are silent on the applicable law could be contrary to EU law due to investment arbitration rules on the applicable law, which provide for a possibility of the domestic law application.⁴³ Moreover, given the level of abstraction applied by the CJEU, where all *potential* conflicts between intra-EU BITs and EU law were considered a threat to the autonomy of EU law, the same abstract concerns could apply to extra-EU BITs. Indeed, if one reads *Achmea* broadly, potentially any dispute settlement mechanism outside the EU judicial system might involve the interpretation or application of EU law.⁴⁴

(ii) The mutual trust principle interpretation of *Achmea*

On the other hand, *Achmea* could be read more narrowly. According to this interpretation, it would apply only to those cases that not only violate Article 267 and 344 TFEU but also undermine the principles of mutual trust and sincere cooperation, enshrined in Articles 19(1) and 4(3) TEU. Indeed, these principles could be understood as the core elements of the *Achmea* judgment, which play an important role exclusively in the intra-EU context.⁴⁵

The principle of mutual trust includes mutual trust of Member States in other Member States' courts and tribunals. In accordance with Article 19 TEU, Member States' courts and tribunals ensure the full application of EU law and judicial protection of individuals under EU law.⁴⁶ Accordingly, courts and tribunals of each Member State guarantee the right to an effective remedy before an independent tribunal, as outlined in Article 47 CFR.⁴⁷ Therefore, effective judicial protection is guaranteed within the EU judicial system, which consists of all national courts of Member States and the CJEU. In light of effective judicial protection within the EU judicial system, there is no place for investment tribunals, which are outside the EU judicial system, to protect rights of EU investors in the EU.⁴⁸

In addition, the principle of sincere cooperation requires the Member States to 'assist each other' in fulfilling their obligations under EU law in 'full mutual respect'. In particular, they are called on to take 'any appropriate measures' to ensure the correct

⁴² Declève (n 41) 104.

⁴³ In particular, Art 42(1) ICSID Convention and Art 35 of the 2010 UNCITRAL Arbitration Rules. See Declève (n 41) 105.

⁴⁴ Nicolas de Sadeleer, 'The End of the Game: The Autonomy of the EU Legal Order Opposes Arbitral Tribunals under Bilateral Investment Treaties Concluded between Two Member States' (2018) 9 European Journal of Risk Regulation 355, 367.

⁴⁵ See, Opinion 1/17, Opinion of AG Bot ECLI:EU:C:2019:72, paras 105, 112; Opinion 1/17 ECLI:EU:C:2019:341, paras 126-129.

⁴⁶ *Achmea* (n 38) para 36.

⁴⁷ Opinion 1/17 (n 45) para 128.

⁴⁸ Cf. commercial arbitral tribunals: see chapter 7, section 7.3.2(v).

implementation of EU law or to refrain from ‘any measure which could jeopardise the attainment of the Union's objectives’.⁴⁹ In effect, Article 344 TFEU is an expression of the principle of sincere cooperation since it mandates the Member States not to submit a dispute concerning the interpretation or application of EU law to any dispute settlement mechanism *outside* the EU judicial system.⁵⁰ The core rationale of this provision is to ensure consistent interpretation and thus *equal* application of EU law across different Member States. This Member State's obligation must be enforced *within* the EU judicial system, with an aim to enhance the rule of law across the EU.⁵¹ In accordance with this reading of Article 344, two conditions must be satisfied for its application: (1) the dispute must concern the interpretation or application of EU law; *and* (2) the dispute must be submitted to a dispute settlement body placed outside the EU judicial system due to the lack of mutual trust in the institutions of the EU judicial system (the courts of other Member States). Arbitration under extra-EU BITs fulfils only the first criterion, and only in limited circumstances, when, depending on the applicable law clause, EU law could be interpreted or applied in the proceedings.

The principle of mutual trust does not apply in relations between the Member States and third States (e.g. between Belgium and China). In other words, there is no legal obligation of the Member States under EU law to trust courts or tribunals of third States, while this obligation exists with respect to Member States' courts. The jurisdiction of arbitral tribunals under Member States' extra-EU BITs, which are outside the EU judicial system, has been introduced *because* of the lack of trust in the courts of the third States. Given that effective judicial protection cannot be guaranteed before national courts and tribunals of third States, arbitral jurisdiction under extra-EU BITs could be justified in providing protection to Member States' investors abroad.⁵²

Importantly, the emphasis in *Achmea* is placed on the integrationist rationale of the CJEU, which does not equally feature in intra- and extra-EU context. The attainment of EU objectives requires that EU law is ‘fully applicable at the same time and with identical effects over the whole territory of the Community without the Member States being able to place any obstacles in the way.’⁵³ Intra-EU arbitration could clearly be considered as such an obstacle. As clarified by Advocate General Bot:

⁴⁹ Art 4(3) TEU.

⁵⁰ Stefan Hindelang, ‘Conceptualisation and Application of the Principle of Autonomy of EU Law – The CJEU's Judgement in *Achmea* Put in Perspective’ (2019) 44 European Law Review 6 (emphasis added).

⁵¹ *ibid* 6-7 (emphasis added).

⁵² To that effect, see also Opinion 1/17 (n 45), in which the CJEU on these grounds found the justification for the ICS in CETA: see chapter 9.

⁵³ Case 48/71 *Commission v Italy* [1972] ECR 529, para 8.

... by means of a bilateral investment agreement, two Member States had agreed to *remove* EU law from the jurisdiction of their own courts, and therefore from the judicial dialogue between those courts and tribunals and the [CJEU], which was capable of having an adverse effect on the *uniformity* and effectiveness of EU law.⁵⁴

Differentiation between the Member States due to international law mechanisms may be a disintegrating factor in the EU context.⁵⁵

Broad interpretation of *Achmea*, that applies to *all* intra-EU arbitrations, regardless of the applicable law clause in a particular intra-EU BIT, makes sense in light of the integrationist intra-EU considerations, but it is of less relevance in the extra-EU context. Broad intra-EU application of *Achmea* is driven by the Court's practical consideration of effective and Union-wide uniform applicability of EU law.⁵⁶ However, these integrationist practical considerations have only limited relevance for the ISDS mechanism in the extra-EU context.

Politically speaking, an interpretation of *Achmea* that would render illegal under EU law all ISDS provisions in all Member States' extra-EU BITs could lead to problems in relations between the Member States and third countries. Such an interpretation would not be in the interests of the Member States whose investors would lose protection in third countries. On the other hand, the inapplicability of ISDS clauses in extra-EU BITs whenever they could concern interpretation or application of EU law would compound asymmetry with third countries. In other words, EU investors could avail themselves of protections under extra-EU BITs before arbitral tribunals while third country investors would not receive similar protection in the EU. By way of illustration, a Belgian investor in China could initiate proceedings against the host State before an ISDS tribunal under the Belgium–China BIT, given that EU law is inapplicable. However, a Chinese investor in Belgium would be unable to avail itself of the same right on the grounds that the tribunal could interpret and apply EU law. Such an investor would instead have to seek protections under Belgian and EU law before the Belgian courts.⁵⁷ It is difficult to imagine why any third State would accept such an arrangement.

⁵⁴ Opinion 1/17, Opinion of AG Bot (n 45) para 105 (emphasis added).

⁵⁵ Bruno de Witte, 'Variable geometry and differentiation as structural features of the EU legal order' in Bruno de Witte, Andrea Ott, Ellen Vos (eds) *Between Flexibility and Disintegration: The Trajectory of Differentiation in EU Law* (Edward Elgar 2017) 26.

⁵⁶ The same practical consideration is evident in the CJEU's reasoning that the Council's restrictive measures on capital movements could *potentially* conflict with free transfer provisions of extra-EU BITs and thus would not be uniformly applied across the EU once they are adopted. See discussion above on the compatibility of extra-EU BITs with primary EU law under section 8.1.1.1.

⁵⁷ See De Sadeleer (n 44) 368.

(iii) Implications of *Achmea* for extra-EU BITs

A conflict between an ISDS clause in an extra-EU BIT and EU law, while not inconceivable, is rather exceptional. It would involve situations of non-EU foreign investors suing a host Member State under an extra-EU BIT for national measures that implement EU law where (1) the applicable law clause of the extra-EU BITs contains reference to domestic law or where procedural rules allow for such application, *and* (2) where the extra-EU arbitral tribunal applies or interprets EU law as a matter of *law*. In other words, an *actual* rather than a potential conflict between an extra-EU BIT and EU law is rare.

In most cases in practice, no questions of EU law arise under extra-EU BITs.⁵⁸ Moreover, in most investment treaty arbitrations (ITAs), domestic law is treated as a matter of fact, and only exceptionally as a matter of law, even if a BIT in question allows for the application of domestic law as a matter of law.⁵⁹ In rare cases when domestic law can be applied, international law prevails in the case of any conflicts between domestic and international law.⁶⁰ Accordingly, while investment tribunals can apply domestic law as relevant law, they primarily apply international law as law applicable to the merits of investment disputes.⁶¹ This is particularly the case in ICSID proceedings.⁶² In the case of

⁵⁸ This is because in most cases Member States' investors are more likely to bring claims against third States, and not *vice versa*. When third States' investors bring cases against Member States, in most such cases the claims will concern Member States' domestic policy measures and not EU measures. A case would concern an EU measure only when a third State investor under an extra-EU BIT challenges either an EU measure which is directly applicable in the host Member State (e.g. a regulation), or a host Member State's measure that implements EU law (e.g. a directive).

⁵⁹ If investment tribunals primarily apply international law, the question is the relevance of domestic law for ITA. For example, domestic law will be relevant in determining whether covered investment has been made 'in accordance with host State law' as such reference is explicitly made in many IIAs. Domestic law can be relevant in determining breaches of the substantive provisions of an IIA. The issue is, however, whether domestic law in such cases is taken as a fact or law. Some tribunals are more explicit about treating domestic law as a matter of fact: see, for example, *Nykomb Synergistics Technology Holding AB v Latvia*, Arbitral Award (16 December 2003) para 3.7; *International Thunderbird Gaming Corporation v The United Mexican States*, UNCITRAL, Arbitral Award (26 January 2006) paras 124-125; *Noble Ventures, Inc. v Romania*, Award (12 October 2005) para 53), while others recognise that domestic law can be a source of rights and obligations, especially in cases related to expropriation: see, for example, *Enron Corporation and Ponderosa Assets, L.P. v Argentine Republic*, Award (22 May 2007) para 206.

⁶⁰ For example, the *Eastern* Tribunal found that international law generally applies. Domestic law, and only its non-conflicting provisions, 'might be relevant' and 'could be taken into account' only where international law is silent: *Eastern Sugar B.V. v Czech Republic*, SCC Case No. 088/2004, Partial Award (27 March 2007) para 196. On this basis, the Tribunal applied domestic law (Czech law) with respect to statutory interest as these provisions did not conflict with international law: *ibid* para 373.

⁶¹ In *Achmea*, another intra-EU case, the Tribunal found that 'no question of EU law arises' and that the BIT in question could be applied without exceeding the jurisdiction of the tribunal and 'misapplying the applicable law': *Achmea B.V. v The Slovak Republic* (formerly *Eureko B.V. v The Slovak Republic*) UNCITRAL, PCA Case No. 2008-13, Award on Jurisdiction, Arbitrability and Suspension (26 October 2010) para 275. Impliedly, the Tribunal recognised that, if in the case there was an issue of EU law relevant for the proceedings, the Tribunal would not have the authority to correctly apply EU law as the applicable law in the proceedings.

⁶² Under Art 42(1) ICSID Convention 'the Tribunal shall apply the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable'. However, in the practice of investment tribunals with respect to this provision, the prevailing view is that international law can be applied directly and without reference first to domestic law: *Wena Hotels Ltd v Arab Republic of Egypt*, ICSID Case No. ARB/98/4, Decision on Annulment (5 February 2002); and that arbitration

non-ICSID awards, compatibility of extra-EU awards with EU law could be possible in the enforcement stage if the enforcement/execution takes place in the EU.

While investment arbitration cases of extra-EU BITs involving EU law are rare, they do occur. Regulation 1219/2012 prescribes the obligation of Member States to notify the EC about their disputes under extra-EU BITs and to cooperate with the EC in ensuring the effective defence.⁶³ This can include the participation of the EC in the arbitration proceedings⁶⁴ and the obligation of the Member State to take a particular position where the claim issue ‘might affect the implementation of the Union’s policies relating to investment, including in particular the CCP’.⁶⁵ So far, the EC has intervened or sought to intervene in three cases under extra-EU BITs, concerning different EU policies (State aid, the EU single resolution mechanism and EU energy policy framework).⁶⁶ The objective of these interventions was ‘to clarify the EU legal framework and procedures in connection with the facts of disputes’.⁶⁷ However, decisions of arbitral tribunals in these extra-EU cases could have an indirect impact on EU policies and the EU’s right to regulate although they do not bind the EU.⁶⁸

Therefore, categorical compatibility of ISDS clauses with EU law in all extra-EU BITs should not be assumed. This is confirmed by the CJEU’s case-law, which is strict regarding

is governed by international law: see, for example, *Compañía del Desarrollo de Santa Elena SA v Republic of Costa Rica*, ICSID Case ARB/96/1, Award (17 February 2000) para 65, confirmed in subsequent cases, in particular the Argentina cases: see, for example, *Compañía de Aguas del Aconquija SA and Vivendi Universal v Argentine Republic*, ICSID Case No. ARB/97/3, Decision on Annulment (3 July 2002) para 60. See also Domenico Di Pietro, ‘Applicable Law under Article 42 of the ICSID Convention’ (*Transnational Notes*, 19 November 2011) <<https://blogs.law.nyu.edu/transnational/2011/10/applicable-law-under-article-42-of-the-icsid-convention/>> accessed 30 June 2020.

⁶³ Art 13 Regulation 1219/2012.

⁶⁴ Art 13(b) Regulation 1219/2012.

⁶⁵ Art 13(a) Regulation 1219/2012. Obligations under Art 13 concern disputes against Member States by third State investors but also State-to-State disputes under extra-EU BITs, including such disputes that are activated by the Member State.

⁶⁶ European Commission, ‘Report from the Commission to the European Parliament and the Council on the application of Regulation (EU) No 1219/2012 establishing transitional arrangements for bilateral investment agreements between Member States and third countries’ COM (2020) 134 final, 7. The report does not specify in which cases the EC has intervened.

⁶⁷ *ibid.*

⁶⁸ For example, in the pending ICSID case *GBM Global et al. v Kingdom of Spain* brought under the 2006 Mexico–Spain BIT, a group of 46 Mexican investors have challenged Spain’s measures for the implementation of the Banco Populo Resolution Plan, which was adopted for the implementation of the EU’s Single Resolution Mechanism in Spain: Regulation (EU) 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) 1093/2010 [2014] OJ L225/1. Importantly, the investors have challenged the way in which Spain has implemented the EU mechanism (the sale of the bank as a response to the liquidity crisis, which effectively expropriated investors, leading to the loss of their invested capital) and not the mechanism itself. The case is pending: *GBM Global et al. v Kingdom of Spain*, ICSID Case No. ARB/18/33. However, hypothetically, decisions of arbitral tribunals in cases like this could have an effect on EU legislation and could force the EU to abandon its legislation in order to spare Member States from paying damages for implementing EU law. The effect is more remote than in the cases involving the EU as a respondent but still possible. On the EU’s right to regulate under CETA in Opinion 1/17, see section 8.2 below.

the legality of *any* measure – whether hypothetical⁶⁹ or actual – that is likely to breach EU law. In the absence of the CJEU’s ruling on the matter of extra-EU BITs, the potential of arbitral tribunals to interpret EU law could still be sufficient to render the ISDS mechanism in extra-EU BITs incompatible, in line with the *Achmea* judgment. In addition, following Opinion 1/17, in which the CJEU ruled that the new EU Investment Court System (ICS) in CETA must comply with the Article 47 CFR criteria, the issue is whether these criteria of independence and impartiality equally apply to ISDS tribunals under Member States’ extra-EU BITs. While extra-EU BITs do not bind the EU but the Member States that are parties to these agreements,⁷⁰ CFR applies every time when a Member State implements EU law.⁷¹ Accordingly, the right to access an independent and impartial tribunal enshrined in Article 47 CFR would be applicable in all ITAs under extra-EU BITs involving EU or national measures implementing EU law. Proceedings before such extra-EU arbitral tribunals must comply with the requirements of Article 47 CFR.⁷²

In light of *Achmea*, ISDS provisions in extra-EU BITs should be brought into conformity with EU law. In particular, applicable law clauses should exclude the application of domestic law as a matter of law.⁷³ In the meantime, ISDS provisions in extra-EU BITs remain applicable in accordance with the conflict of laws rules in Article 351 TFEU and Article 30 VCLT. Consistency between EU law and extra-EU BITs should be assessed in each particular investment case. Accordingly, the jurisdiction of an arbitral tribunal to decide a case under an extra-EU BIT should be challenged whenever EU law prevails over international law under the conflict of laws rules and the tribunal interprets or applies EU law as a matter of law.⁷⁴

⁶⁹ Case 120/78 *Cassis de Dijon* [1979] ECR 649; *Commission v Austria* (n 26); *Commission v Sweden* (n 26); *Commission v Finland* (n 26).

⁷⁰ Cf. Opinion 1/17 (n 45). CETA as an international agreement to which the EU is a party binds the EU. The ICS in Opinion 1/17 therefore concerned an ISDS mechanism in an EU agreement.

⁷¹ See chapter 4, section 4.2.

⁷² For normative analysis of the compatibility of ISDS arbitration with the rule of law requirements, see Part I, chapter 3, section 3.3.2. For the application by the CJEU to the ICS of these rule of law criteria enshrined in the CFR, see chapter 9, section 9.3. Importantly, the standard applied by the CJEU to the ICS is lower than its internal EU rule of law standard; however, it is still a minimum below which an international court or tribunal would not be considered independent and impartial. Given that the majority of ISDS standards of independence apply equally to the ICS (all except the standard of permanency/appointment), it is questionable whether the CJEU would find any ISDS tribunal not complying with the standards of independence under Art 47 CFR (see, for example, remarks by AG Wathelet in his Opinion (ECLI:EU:C:2017:699) in Case C-284/16 *Achmea*, paras 124-125. Unlike in Opinion 1/17 (n 45), in *Achmea* (n 38), the issue was not the independence of an ISDS tribunal under Art 47 CFR but the situation in which an international tribunal which is outside the EU judicial system could interpret EU law. In light of Opinion 1/17, the compliance of ISDS tribunals with the criterion of accessibility under Art 47 CFR could prove more challenging.

⁷³ This is also the conclusion which is supported by the CJEU reasoning in Opinion 1/17. See chapter 9.

⁷⁴ This scenario could happen in cases involving the application or interpretation of EU measures or Member States’ national measures implementing EU measures. In such cases, proceedings before the extra-EU arbitral tribunal would also need to comply with the requirements of Art 47 CFR. For example, in the already mentioned pending ICSID case *GBM Global* (n 68), the applicable law clause of the 2006 Mexico–Spain BIT in Art XV refers to provision of the BIT and applicable rules and principles of international law. Accordingly, EU

The other issue is, however, whether arbitral tribunals would be willing to decline their jurisdiction in these circumstances. An investment tribunal could always argue that ISDS cannot be excluded because EU law does not prevail over international law and/or the case does not concern either the application or the interpretation of EU law.⁷⁵ If the intra-EU jurisdiction is a reference point for tribunals' practice, this scenario is expected. However, the situation with these external agreements of Member States is less critical as their ability to undermine the principles of mutual trust and sincere cooperation, and thus the autonomy of the EU legal order, is less imminent.⁷⁶

8.1.2. *Post-Lisbon Member States' extra-EU BITs*

Considering the changes brought by Article 207 TFEU in the Lisbon Treaty, Member States' extra-EU BITs will eventually disappear as the EU concludes new IIAs with third countries.⁷⁷ EU IIAs will progressively replace them both as a matter of EU and international law.⁷⁸ Pre-Lisbon extra-EU BITs that were notified to the EC remain in force but cannot constitute an obstacle to the negotiation and conclusion of EU IIAs with third countries.⁷⁹

Until all extra-EU BITs are progressively replaced by EU IIAs, EU Regulation 1219/2012 re-empowers Member States to amend their existing pre-Lisbon BITs and even conclude new BITs, subject to procedural and substantive requirements outlined in chapter III of the Regulation.⁸⁰ This process is fully controlled by the EC, the role of which is to ensure the compatibility of Member States' BITs with EU law, EU international investment policy (IIP) and EU external action objectives. Accordingly, Member States must seek and obtain the authorisation from the EC in order to, first, enter into

law could not be applied as a matter of law. Since it is an ICSID arbitration, domestic law could still be applicable under Art 42(1) ICSID Convention, although that would be exceptional. It is therefore likely that EU law will be taken in this case as a matter of fact and accordingly there would be no conflict between the ISDS provision in the Mexico–Spain BIT and EU law. In other words, arbitration would be legal under EU law.

⁷⁵ It is likely that, *mutatis mutandi*, the same argumentation as in intra-EU arbitrations would be used here. For reasoning of intra-EU arbitral tribunals, see chapter 7, section 7.3.1.

⁷⁶ See also the discussion on the right to regulate in the EU in section 8.2 below.

⁷⁷ Preamble para 5, Regulation 1219/2012.

⁷⁸ Under Regulation 1219/2012: see Arts 3, 11(4) and 12(6)) and Art 59 VCLT respectively. There are also provisions to that effect in new EU IIAs. See, for example, Art 4.12.3 EUSIPA.

⁷⁹ In accordance with Art 5 Regulation 1219/2012, the EC may evaluate whether provisions of pre-Lisbon extra-EU BITs 'constitute a serious obstacle to the negotiation or conclusion' of IIAs by the EU and in light of Art 6, shall enter 'expeditiously' in consultation with the concerned Member State to resolve the matter: Art 6(2). Following these consultations, which should not last longer than 90 days, the EC may 'indicate' to the Member State the appropriate measures to be taken to remove such obstacles: Art 6(3).

⁸⁰ Since the EU competence for the regulation of FDI is exclusive (Art 207 TFEU), Member States have no powers to regulate FDI unless they have been empowered by the EU. Extra-EU BITs cover both FDI and portfolio investment. Accordingly, Member States can amend or conclude extra-EU BITs that concern FDI regulation only if so empowered by the EU (Art 2(1) TFEU). On the division of competences, see chapter 6.

negotiations with a third country⁸¹ *and*, secondly, sign and conclude the new agreement.⁸² The EC is kept informed throughout the negotiations,⁸³ while it informs other EU institutions about its decisions.⁸⁴

In substantive terms, the EC's authorisation to a Member State⁸⁵ will be granted if the extra-EU BIT: (a) complies with EU law;⁸⁶ (b) does not concern the third country with which the EU negotiates or plans to negotiate an IIA,⁸⁷ and does not create a serious obstacle to the negotiation or conclusion of an EU's IIA with that third country;⁸⁸ and (c) is consistent with the principles and objectives of the EU external action⁸⁹ and EU investment policy.⁹⁰ The EC can refuse the authorisation if the agreement fails to comply with any of these grounds⁹¹ and it will accordingly inform the Member State.⁹² Member States can challenge the EC's decisions before the CJEU in accordance with Article 263 TFEU.

The aim of the Regulation is to ensure the coherence between Member States' extra-EU BITs and EU law, and consistency of Member States' investment policy objectives with EU IIP. In accordance with their duty of sincere cooperation under Treaty law, which is also reflected in the duty to cooperate in Article 6 of the Regulation, Member States must take all appropriate measures to ensure the compliance of their existing and new extra-EU agreements with EU law and policy. Accordingly, the provisions in Member States' new extra-EU BITs must reflect the protection standards enshrined in EU IIAs.⁹³

⁸¹ Art 8 Regulation 1219/2012. This should be done at least five months before formal negotiations are to commence: Art 8(3).

⁸² Art 11 Regulation 1219/2012.

⁸³ Art 10 Regulation 1219/2012.

⁸⁴ In accordance with Arts 9(4) and 11(7) Regulation 1219/2012, the EC will inform the European Parliament and the Council about its decisions to grant authorisations for opening negotiations and concluding new agreements. In accordance with Art 15, the EC has submitted its first report on the application of the Regulation in April 2020, recommending continuing the application of ch III of the Regulation: European Commission (n 66).

⁸⁵ The criteria for the EC's authorisation to open formal negotiations are listed in Art 9(1) and (2) Regulation 1219/2012. The same criteria apply for the authorisation to sign and conclude the extra-EU BIT in accordance with Art 11(4). In accordance with Art 12, the authorisation is also envisaged for extra-EU agreements signed by the Member States between 1 December 2009 (entry into force of the Lisbon Treaty) and 9 January 2013 (entry into force of Regulation 1219/2012). These agreements must also comply with the substantive requirements of Art 9(1) and (2): Art 12(3) Regulation 1219/2012.

⁸⁶ Arts 9(1)(a) and 9(2) Regulation 1219/2012.

⁸⁷ Art 9(1)(b) Regulation 1219/2012.

⁸⁸ Art 9(1)(d) Regulation 1219/2012.

⁸⁹ Art 9(1)(c) Regulation 1219/2012.

⁹⁰ Art 9(2) Regulation 1219/2012.

⁹¹ Art 9(1) Regulation 1219/2012.

⁹² Arts 9(5) and 11(8) Regulation 1219/2012.

⁹³ As part of the authorisation process, the EC may request from the Member State the inclusion or removal of 'any clauses where necessary to ensure consistency with the Union's investment policy or compatibility with Union law': Art 9(2) Regulation 1219/2012. The EC can always start infringement proceedings against disobedient Member States under Art 258 TFEU.

The EC publishes the list of all extra-EU BITs every 12 months.⁹⁴ According to the most recent list, there are currently 1286 agreements in force.⁹⁵ In the period of six years (2013–19) the EC granted 322 authorisations in total, the majority being authorisations to open negotiations for new extra-EU BITs (164), of which only a small number have been concluded (24).⁹⁶ Some Member States have been more active in seeking requests (Czech Republic, Hungary, Italy, Lithuania), while some requested authorisations for opening multiple negotiations for amending and concluding new agreements (Spain, Slovakia and the Netherlands).⁹⁷ A high overall number of authorisations indicates that Member States remain active actors in the international investment sphere, in particular in those regions in which the EU has limited interests (e.g. the Middle East).

Since Regulation 1219/2012 entered into force, the EU has concluded three IIAs (with Canada, Singapore, Vietnam)⁹⁸ and completed negotiations with Mexico⁹⁹ but none of these IIAs have yet entered into force.¹⁰⁰ Once they enter into force, they will replace 57 extra-EU BITs of Member States concluded with these four States. The negotiations are ongoing with Japan, Chile, Indonesia, Tunisia and China.¹⁰¹ Member States are accordingly precluded from entering into negotiations with these third States.¹⁰² The third States for which Member States have submitted most requests for authorisation are Iran, Kazakhstan, Nigeria, Saudi Arabia, Qatar and United Arab Emirates.¹⁰³ Accordingly, it can be inferred that the EU has no plans for negotiating an EU IIA with these countries in the near future.

Overall, statistical data regarding both Member States and third countries are mixed. The EC's approach in granting authorisations is pragmatic but compounds the fragmentation in EU external investment regulation, in particular in light of the *relative* coherence between different new agreements, as discussed next.

⁹⁴ Art 4 Regulation 1219/2012.

⁹⁵ List of the bilateral investment agreements referred to in Art 4(1) of Regulation 1219/2012.

⁹⁶ For the full statistics of all authorisations in this period and each year, see European Commission (n 66).

⁹⁷ *ibid* 5. However, the statistics do not indicate the number of requests by each Member State.

⁹⁸ CETA and two IPAs with Singapore and Vietnam are currently in the process of ratification in the Member States.

⁹⁹ The political agreement has been reached and the text of the agreement, except the chapter on public procurement, has been finalised. The next step is the translation of the text into all official languages, after which the Council decides on the signature of the agreement. See European Commission, 'Overview of FTA and other trade negotiations' (May 2020) 5

<http://trade.ec.europa.eu/doclib/docs/2006/december/tradoc_118238.pdf> accessed 30 June 2020.

¹⁰⁰ On different types of EU agreements with investment protections, see chapter 6.

¹⁰¹ The EC publishes a periodic list of its ongoing trade negotiations. For the most recent list, see European Commission (n 99).

¹⁰² The EC has rejected six requests by Member States to open formal negotiations with third States on the ground that they were covered by negotiations at EU level: European Commission (n 66) 3. The statistics do not detail the Member States nor third States for which the requests have been rejected.

¹⁰³ *ibid* 5-6.

8.2. Foreign investment standards in EU external regulation post-Lisbon

In the post-Lisbon period, EU external investment regulation consists of: Member States' pre-Lisbon extra-EU BITs; their post-Lisbon BITs; and new EU IIAs. Pre-Lisbon extra-EU BITs have the classical features of 'old' IIAs, discussed in Part I of this study. Of particular interest in the post-Lisbon period are new EU investment standards incorporated in EU IIAs and their coherence with standards of Member States' post-Lisbon extra-EU BITs.

In this section we will analyse new EU standards in CETA with reference to corresponding standards in other EU stand-alone IIAs and Member States' post-Lisbon extra-EU BITs. First, we will discuss substantive provisions, particularly focusing on the novelties introduced in EU IIAs.¹⁰⁴ The discussion is limited to most common issues and the purpose is to provide an overview rather than being exhaustive.¹⁰⁵ Some level of generalisation is thus unavoidable. Secondly, in light of the CJEU's Opinion 1/17, we will discuss how these standards of protection are balanced against the right to regulate in the EU. In the final part we will focus on procedural novelties in new Member States' and EU IIAs,¹⁰⁶ with further analysis of the Investment Court System (ICS) in chapter 9.

8.2.1. Substantive provisions: the scope and standards of protection

Investment standards in EU IIAs are largely based on the US Model BIT 2012, with some influences of EU law.¹⁰⁷ These standards are largely adopted in the new extra-EU BITs, with different variations across BITs.¹⁰⁸ With a tedious drafting style, comprising the main text, footnotes and annexes, the new EU IIAs follow the trends of modern IIAs.¹⁰⁹ The

¹⁰⁴ The analysis builds upon standards identified and discussed in Part I, chapter 2, section 2.1. See also chapter 3, section 3.3.2.1 for ongoing substantive reforms.

¹⁰⁵ The analysis draws on the substantive standards discussed in chapter 2, section 2.1 and the definition of investor and investment in sections 2.2.1.1 and 2.2.1.2 respectively. For free transfer of capital clauses see discussion in section 8.1.1 above.

¹⁰⁶ See also Part I, chapter 2, section 2.2 for procedural features of investment treaty arbitration (ITA) and chapter 3, section 3.3.2.2 for ongoing procedural reforms.

¹⁰⁷ The focus of this analysis is placed on the Comprehensive Economic and Trade Agreement between Canada, of the one part, and the European Union and its Member States, of the other part [2014] OJ L11/23 (CETA) and the Investment Protection Agreement between the European Union and its Member States, of the one part, and the Republic of Singapore, of the other part (signed 15 October 2018) (EUSIPA). Where relevant, it will be complemented by the Investment Protection Agreement between the European Union and its Member States on the one part, and the Socialist Republic of Viet Nam, of the other part (signed 30 June 2019) (EUVIPA) and the investment chapter of the EU–Mexico Association Agreement (FTA EU-MX): European Commission, EU–Mexico Agreement in Principle (*European Commission*, 6 May 2020) <<http://trade.ec.europa.eu/doclib/press/index.cfm?id=1833>> accessed 30 June 2020.

¹⁰⁸ The focus of this analysis is placed on the Dutch Model BIT 2018 (n 36), but where relevant it will be complemented by BITs of 'new' Member States that have entered into force recently (e.g. Slovakia–UAE BIT and Iran–Slovakia BIT (n 36)).

¹⁰⁹ For illustration purposes only, EUSIPA has 100 pages. Early BITs were agreements of four pages, usually with an additional protocol of two pages (see, for example, Federal Republic of Germany and Romania Treaty

effects of new standards will be known only when implemented in practice by new EU IIA tribunals but the existing jurisprudence provides some indications about their scope.¹¹⁰

8.2.1.1. The scope of application of IIAs: ‘investment’ and ‘investor’

New EU IIAs adopt a broad definition of investment, which includes a non-exhaustive list of different forms of investment (tangible and intangible assets), in the categories of both FDI and portfolio investment.¹¹¹ Despite its form, investment must have certain non-exhaustive characteristics in order to gain protection.¹¹² In light of Opinion 1/17, the interpretation of the characteristics of investment must allow for protections of investments made by SMEs, which usually involves lower commitments of capital and resources compared to MNEs.¹¹³ Despite a detailed and extensive definition of investment, adjudicators retain considerable discretion.

concerning the Promotion and Reciprocal Protection of Capital Investment (with protocol and exchanges of letters) signed on 12 October 1979, entered into force 10 January 1981).

¹¹⁰ Importantly, none of the EU IIAs have yet entered into force. It is possible that they might never enter into force, if the ratification process is not successfully completed in the Member States: see chapter 6. Much will depend on the success of the EU’s proposal for the establishment of a Multilateral Investment Court (MIC), currently discussed in UNCITRAL: see Part III.

¹¹¹ Art 8.1 CETA; Art 1.2 EUSIPA. For definition of investment in the arbitral practice, see chapter 2, section 2.2.1.1. EU IIAs’ definition of investment is largely inspired by the definition in the US Model BIT 2012 (see Art 1). As a point of difference, CETA’s definition includes a detailed and closed list of intellectual property rights (IPR). The IP categories in the definition can only be changed by the decision of the CETA Joint Committee. EUSIPA refers to all categories of IP that are subject of Sections 1 through 7 of Part II of the TRIPS Agreement: see Art 1.2(g), fn 1. CETA explicitly excludes claims to money arising solely from commercial contracts for the sale of goods or services: see Art 8.1 CETA (claims to money). CETA also includes a specific sectoral carve-out from the application of investment protections: see Arts 8.2.2 and 8.2.3 CETA.

¹¹² Characteristics include ‘certain duration’ (which must be always met), and assessment of other characteristics, which are typically part of the assessment, such as ‘the commitment of capital or other resources’, ‘the expectation of gain or profit’ or ‘the assumption of risk’. In the jurisprudence, intended duration should be between 2 and 5 years and contributions of US\$1.5 to 3.8 million were considered minor but sufficient (again, intended rather than actual contribution should be taken into account; amount actually invested is likely to be a lower sum than the intended capital but the investor still needs to establish their intentions on the basis of evidence): see analysis of Jan Asmus Bischoff and Matthias Wühler, ‘The Notion of Investment’ in Makane Moïse Mbengue and Stefanie Schacherer (eds), *Foreign Investment Under the Comprehensive Economic and Trade Agreement (CETA)* (Springer 2019) 25-26, who also consider that this practice would be likely followed in CETA. For more elaborate discussion on the applicability of these criteria in arbitral practice, see also Angelos Dimopoulos, *EU Foreign Investment Law* (OUP 2011) 21-32. The EU IIA definition does not fully codify the so-called Salini test, which has been developed in the practice of ICSID tribunals. The EU definition does not require ‘contribution to the development of the host State’, which is the most controversial element of the Salini test, and instead lists ‘the expectation of gain or profit’, which clearly excludes non-profit activities from the scope of IIAs. In any case, claims submitted under the ICSID Convention, regardless of the BIT under which they have been submitted, should also fulfill the criteria of that Convention regarding the investment and investor: see chapter 2, section 2.2.1.

¹¹³ See Opinion 1/17 (n 45) paras 205-222. The access to new tribunals for SMEs was one of the key considerations for the CJEU in assessing the compatibility of the ICS with Art 47 CFR. While access to justice primarily relates to the financial cost of the proceedings (high financial costs of investment arbitration was considered one of the key justifications for introducing the ICS), the access to justice will make no sense if the threshold for the ‘commitment of capital and resources’ in the definition of investment is interpreted in a way that sets commitment thresholds too high for SMEs’ investments.

In addition to satisfying characteristics and form, an investment must be owned or controlled, directly or indirectly, by an investor.¹¹⁴ An investor can be a natural person or an enterprise or juridical person, in which case the corporate nationality is established with reference to a combination of criteria (incorporation, seat, control, substantial business activity).¹¹⁵ The EU–Singapore Investment Protection Agreement (EUSIPA) incorporates the language of Article 54 TFEU, clarifying that an ‘effective and continuous link’, related to EU freedom of establishment under Treaty law, is equivalent to the concept of ‘substantive business operations’ in EUSIPA.¹¹⁶ The same intention, albeit not the same treaty language, is adopted in CETA.¹¹⁷ Accordingly, a Canadian corporation not owned by a Canadian investor (but, for example, an US investor) could bring a claim only if it could establish that it has a substantive business operation in Canada. Such a US investor’s activities in Canada would be required to have an effective and continuous link with the Canadian economy in accordance with the concept of establishment under EU law.¹¹⁸ Accordingly, the EU concept of investor should disable ‘mailbox’ companies from utilising EU IIAs.¹¹⁹

¹¹⁴ Art 8.1 CETA; Art 1.2 EUSIPA.

¹¹⁵ For explanation of these criteria, see chapter 2, section 2.2.1.2. In CETA, an enterprise must be either (i) incorporated under the laws of the home State *and* have ‘substantial business activity’ in the home State; or (ii) must be incorporated under the laws of the home State *and* be owned or controlled, directly or indirectly, by a national or an enterprise of the home State.

¹¹⁶ In EUSIPA, the reference is made to ‘juridical person’, which fulfils these conditions in two alternative scenarios: (i) if incorporated under the laws of the home State *and* has a registered office, central administration or principal place of business in the home State; or (ii) if it has only a registered office or central administration, it must also engage in substantive business operations in the home State. The concept of ‘substantive business operations’ is used in WTO law in relation to the establishment of services (Arts V(6) and XXVIII(m) GATS). The EU made similar clarification in the context of the WTO, linking ‘substantive business operations’ to ‘effective and continuous link’ under Treaty law: see WTO Committee on Regional Trade Agreements, ‘Establishment of the European Union, Services, Communication from the European Commission and their Member States’ (24 April 1998) WT/REG39/1, 7-8. The concept of ‘effective and continuous link with the economy’ was utilised in the General Programme for the abolition of restrictions on freedom of establishment adopted by the Council on 15 January 1962. Moreover, the EUSIPA defines establishment in Art 1.2.9 in light of EU law, referring to the establishment of a juridical person or a branch or representative office, with a view to ‘establishing or maintaining lasting economic links’ with the host State ‘for the purpose of performing an economic activity’. For freedom of establishment, see chapter 7, section 7.1.1.

¹¹⁷ To that effect, see Council of the European Union, ‘Comprehensive Economic and Trade Agreement (CETA) between Canada, of the one part, and the European Union and its Member States, of the other part – Statements to the Council minutes’ (27 October 2016) 13463/1/16, Statement No. 31.

¹¹⁸ However, unlike the US Model BIT 2012, CETA does not contain a denial of benefits clause, whereby a host State retains a discretion to deny benefits of the treaty to an enterprise that has no substantial business activities in the home State and the enterprise is owned or controlled by third State or home State persons (see Art 17 US Model BIT 2012).

¹¹⁹ However, EU law is rather generous in extending freedom of establishment to ‘mailbox’ companies that do not have a fixed establishment or permanent presence in their home Member State: Case C-212/97 *Centros* [1999] ECR I-1459, para 17. In its judgment in Case C-106/16 *POLBUD – WYKONAWSTWO* ECLI:EU:C:2017:804, the CJEU further clarified that freedom of establishment extends to freedom of the transfer of the company’s registered office from one Member State to another even if no lasting economic connection is intended in the host Member State. Conversion of the company from one Member State (home Member State) to another Member State (host Member State) is governed by the host Member State legislation, which is the relevant legislation for determining whether the connection of a company to its legal order is satisfied (paras 33-34). At the same time, the principle of equivalence (prohibition of imposition on cross-border conversion of conditions that are more restrictive than those that regularly apply to the

CETA does not specify the relationship of the ownership or control requirement between the investor and the investment.¹²⁰ Arguably, since these requirements are not cumulative, both owner and controller could have a claim. Further, there could be several layers of control over the investment through intermediary companies, increasing the risk of numerous shareholders' claims, including those for reflective loss, otherwise excluded under customary international law (CIL)¹²¹ and domestic law.¹²² CETA, similarly to NAFTA and the US Model BIT 2012, expands the availability of recovery to the company which can eliminate the need for shareholders' reflective loss recovery, but CETA adopts less restrictive language.¹²³ In order to limit multiple claims over the same breach and avoid overlapping compensation, CETA incorporates an elaborate joinder of overlapping claims.¹²⁴ Further, any award of monetary damages or restitution of property must be

conversion of a company within the Member State) applies to both home and host Member State (para 43). Importantly, it is settled case-law that 'the fact that either the registered office or real head office or company was established in accordance with the legislation of a Member State for the purpose of enjoying the benefit of more favourable legislation, does not, *in itself*, constitute abuse': *Centros*, para 27, Case C-167/01 *Inspire Art* [2003] ECR I-10155, para 96, *POLBUD*, para 62 (emphasis added).

¹²⁰ Cf. EUSIPA, which in Art 3.1 defines that 'locally established company' is owned or controlled by an investor if either: (i) the home State's natural or juridical person owns more than 50% of the equity interest in the locally established company, or (ii) the home State's natural or juridical person controls the locally established company in a way that gives them a power to name a majority of directors in the locally established company or otherwise enables them to legally direct the actions of the locally established company: Art 3.2(c).

¹²¹ *Barcelona Traction case, Light and Power Company Limited, Case concerning (New Application, 1962)* (Belgium v Spain) (Second Phase) [1970] ICJ Rep 3.

¹²² See discussion in Bischoff and Wühler (n 112) 27-29. The authors note that CETA does not explicitly require 'overall control' of the investor in cases when investment is held through multiple layers of intermediation. However, in the absence of 'overall control', interpretation of investment could be limitless, for which reason it is more likely that an investor would need to exercise some form of *de facto* or *de iure* control over intermediary companies in order to avail themselves of the CETA protections. On investors' treaty shopping, see chapter 2, section 2.2.2.

¹²³ In Art 8.23 CETA prescribes that a claim may be submitted by an investor on his behalf or 'on behalf of a locally established enterprise which it owns or controls directly or indirectly', in which case the claim must satisfy the requirements of Art 25(1) of the ICSID Convention: see Art 8.23.5 CETA. Similarly, Art 3.2(b) EUSIPA. Art 25(2)(b) ICSID allows certain domestic companies access to ISDS, with the consent of the host State. It has been claimed that in cases when host States have provided consent for a company's ISDS claims under this regime, shareholders' claims for reflective loss should be prohibited although investment tribunals have generally rejected such a proposition: see David Gaukrodger, 'Investment Treaties as Corporate Law: Shareholder Claims and Issues of Consistency' (OECD Publishing 2013) 56-58; and David Gaukrodger, 'Investment Treaties and Shareholder Claims: Analysis of Treaty Practice' (OECD Publishing 2014). In CETA, the claim may be submitted for 'loss or damage to a locally established enterprise or to an interest in a locally established enterprise that the investor owns or controls directly or indirectly': Art 8.22.2 CETA. Cf. In the NAFTA context, the division between an investor's claims 'on its own behalf' and 'on behalf of an enterprise', in Arts 1116 and 1117 respectively, has been used to argue that only direct shareholder claims and shareholder derivative suits are permitted, implicitly excluding shareholders' claims for reflective loss: see Julian Arato and others, 'Reforming Shareholders' Claims in ISDS' Academic Forum on ISDS Concept Paper 2019/9, Version 2 (17 September 2019) 9-10

<<https://www.jus.uio.no/pluricourts/english/projects/loginvest/academic-forum/papers/papers/arato-reforming-shareholder-claims-isds-af-9-2019.pdf>> accessed 30 June 2020. Different to CETA, NAFTA further expressly excludes the possibility of claims by non-controlling shareholders and prohibits the company from bringing a claim when such a claim has been brought by a shareholder (Art 1117). NAFTA practice is mostly followed in the US Model BIT 2012: see Arts 24(1)(a) and (b); 26(2)(b)(ii).

¹²⁴ Art 8.43 CETA. The request for consolidation is submitted by a disputing party or parties (Art 8.43.1 CETA). The tribunal has a power to stay proceedings in accordance with Art 8.24 CETA. Similarly, see Art 3.24 EUSIPA.

made to the locally established enterprise rather than to the shareholders.¹²⁵ This measure is aimed at protecting the company and all its shareholders, having a similar rationale as domestic law mechanisms.¹²⁶ Finally, provisions aimed at avoidance of parallel claims apply both to the investor and a locally established enterprise.¹²⁷ These provisions together should limit, if not eliminate, the State's exposure to overlapping claims and double recovery by multiple shareholders.

New extra-EU BITs mostly follow the main features of the definitions of investment and investor in EU IIAs, with a number of variations on the theme (regarding forms and characteristics of 'investment' and the criteria for corporate nationality). Some BITs follow the list of characteristics of investment in EU IIAs, while some add additional characteristics.¹²⁸ Some exclude portfolio investment and provide a list of other forms of investment excluded from protection.¹²⁹ The Dutch Model BIT adopts the definition of investor from CETA and additionally provides the non-exhaustive list of indications for 'substantive business activity'.¹³⁰ Unlike CETA, the new Dutch Model BIT also includes specific limitations on public debt restructuring.¹³¹

EU IIAs and new extra-EU BITs additionally include provisions that serve to impose jurisdictional limitations on access to ISDS by implementing the clean hands doctrine. CETA prescribes that an investor may not submit a claim if the investment has been made

¹²⁵ Art 8.39.2 CETA. However, EUSIPA clarifies that only where a claim is submitted on behalf of a locally established company will the award be made to the locally established company: Art 3.18.3. However, both agreements prescribe that monetary damages 'shall not be greater than the loss suffered by the investor or locally established company and will be reduced by any prior damages or compensation already paid': see Arts 8.39.3 CETA and 3.18.2 EUSIPA. The CJEU did not find that this requirement would be in breach of EU competition rules nor that it breaches the requirements of equality under EU law: see Opinion 1/17 (n 45) paras 183-186. For CETA and equality between domestic and foreign investors in the EU, see chapter 9, section 9.3.1.

¹²⁶ On the more elaborate discussion about the impact of IIAs on companies, shareholders and creditors, see OECD, 'OECD Business and Finance Outlook 2016' (OECD Publishing 2016) 223-253. AG Bot equated the locally established company and the investor: Opinion 1/17, Opinion of AG Bot (n 45) para 194.

¹²⁷ Art 8.22.2 CETA. EUSIPA in Art 3.7.2 explicitly states that for the purposes of withdrawal of pending claims, the term 'claimant' includes 'all persons who directly or indirectly have an ownership interest in, or who are controlled by the investor, or where applicable, the locally established company'. The tribunal (on the request of the respondent) must decline jurisdiction if the claimant fails to respect these requirements: Art 3.7.3 EUSIPA. For procedural issues, see section 8.2.3 below.

¹²⁸ For example, 'a certain contribution to the economy of the host State or any kind of benefit or positive impact on the development of the host State': Art 1(2) Slovakia-UAE BIT. Similarly, 'an effective contribution to the host State's economy' is required under Art 1(2) Slovakia-Iran BIT (*inter alia*, instead of a 'certain' duration, an investment must be of 'a reasonable' duration etc.)

¹²⁹ Art 1(2) Slovakia-Iran BIT; However, portfolio investment is not excluded in the Slovakia-UAE BIT.

¹³⁰ They include indications about a company's establishment in the host State, such as registered office and/or administration, headquarters and/or management, the number of employees and their qualifications, the turnover generated in the host State, an office, production facility and/or research. For full definitions of investment and investor see Art 1(a)-(c) Dutch Model BIT 2018. This is important given that the Netherlands has been notorious for the number of 'mailbox' companies established in order to make use of the Dutch extensive network of BITs with very favourable conditions for investors: see Suzy H Nikiéma, 'Best Practices: Definition of Investor' (2012) International Institute for Sustainable Development, 8.

¹³¹ See Protocol on public debt Dutch Model BIT 2018, which follows similar provisions on public debt in Annex 4 EUSIPA.

through fraudulent misrepresentation, concealment, corruption, or conduct amounting to an abuse of process.¹³² However, it is not further specified with reference to which applicable law this behaviour will be established. Some other extra-EU BITs explicitly refer to investors' illegal conduct through the violations of host States' laws.¹³³ In such cases, it seems that tribunals would need to assess domestic law as a matter of *law*, which could pose a problem if EU law is to be taken into account as part of Member States' domestic laws.¹³⁴ EU IIAs and new extra-EU BITs contain an applicable law clause stating that 'in determining the consistency of a *measure* with the agreement', the tribunal may consider domestic law 'as a matter of fact'.¹³⁵ This formulation would, however, indicate that the limitation of the applicability of domestic law as a fact relates only to a host State's measures (intending to protect the State's right to regulate) but not investors' illegal conduct (whereby domestic law serves as a reference point for determining the scope and content of the obligation).

Accordingly, and more generally, the inclusion of investors' obligations with reference to domestic law as a matter of law poses a problem for EU IIAs and to a lesser extent also for extra-EU BITs. This might explain the general exclusion of mandatory investors' obligations and instead the inclusion of reference to international soft law instruments (voluntary CSR) in EU and Member States' IIAs.¹³⁶ In any case, liability of investors is not envisaged under IIAs. In the absence of liability under international law, investors are still subject to liability under general domestic laws and procedures, or, in cases of some BITs, they might be liable under their home State's laws.¹³⁷

¹³² Art 8.18.3 CETA; Art 16 Dutch Model BIT 2018. In addition to other characteristics of investment, CETA requires that investment is made in accordance with the applicable law at the time the investment is made, however such requirement is not mentioned in the EUSIPA's definition of investment. The EUSIPA in Art 3.7.5 clarifies that a tribunal must decline jurisdiction in cases of restructuring of investment for the 'main purpose' of submitting the claim under the treaty.

¹³³ See, for example, Art 14 Slovakia–Iran BIT. An investor's claim will be dismissed in cases of 'sufficiently serious or material' violations of the host State law, whereby fraud, tax evasion, corruption or bribery, or investment made through fraudulent misrepresentation, concealment, corruption, or conduct amounting to an abuse of process, are always considered as such violations: Art 14(2). In the alternative, they will be taken into account if raised by the host State as a defence, counterclaim, right of set off: Art 14(3). See similarly (but with explicit reference only to fraud and investment made through an abuse of process under the Host State's laws and regulations) Art 17(2) Slovakia–UAE BIT. However, in arbitral practice some tribunals have already assessed an investor's conduct, some declining their jurisdiction when the investor failed to comply with domestic laws: see, for example, *Cortec Mining Kenya Limited, Cortec (Pty) Limited and Stirling Capital Limited v Republic of Kenya*, ICSID Case No. ARB/15/29, Award (22 October 2018).

¹³⁴ See discussion under 8.1.1.2 above.

¹³⁵ See, for example, Article 18 Slovakia–Iran BIT; Article 20(12) Dutch Model BIT 2018. The identical clause is found in EU IIAs (see, for example, Arts 8.31.2 CETA; 3.13.2 EUSIPA). However, no reference to domestic law as a matter of fact is made in Art 19 (applicable law clause) of the Slovakia–UAE BIT. For the application of EU law as a matter of fact in light of Opinion 1/17, see chapter 9, section 9.2.1.

¹³⁶ See section 8.2.1.3 below.

¹³⁷ Article 6(4) Dutch Model BIT 2018, which envisages liability for acts or decisions made in relation to the investment where such acts or decisions lead to significant damage, personal injuries or loss of life in the host State.

8.2.1.2. Expropriation

The definition of expropriation in EU IIAs largely follows the established definition in IIL.¹³⁸ It covers both direct and indirect expropriation, which are subject to the same criteria of legality found in any BIT.¹³⁹ The clarification of criteria for establishing indirect expropriation is provided in the Annexes.¹⁴⁰ While the definition of expropriation mostly codifies past case-law of investment tribunals, it arguably also provides more clarity on the differentiation between indirect expropriation and regulatory activity that does not require the payment of compensation.¹⁴¹

The determination of indirect expropriation requires ‘a case-by-case, fact-based inquiry’, and focuses on the impact of the measure on investment, which must result in substantive deprivation of the ‘fundamental attributes’ of property.¹⁴² A number of non-exhaustive factors are to be taken into consideration in assessing whether indirect expropriation occurred: the economic impact of the measure;¹⁴³ its duration;¹⁴⁴ its interference with ‘distinct, reasonable investment-backed expectations’;¹⁴⁵ and the character of the measure (its object, context and intent).¹⁴⁶ It is also clarified that non-discriminatory measures that are designed and applied to protect legitimate public welfare objectives (a non-exhaustive list includes health, safety, and the environment) do

¹³⁸ See Arts 8.12 CETA; 2.6 EUSIPA.

¹³⁹ Expropriation is prohibited except if four cumulative criteria have been fulfilled: (a) for a public purpose; (b) under due process of law; (c) in a non-discriminatory manner, and (d) on payment of prompt, adequate and effective compensation: Arts 8.12.1 CETA; 2.6.1 EUSIPA.

¹⁴⁰ Annex 8-A CETA, Annexes 1-3 EUSIPA.

¹⁴¹ See Arnaud de Nanteuil, ‘Expropriation’ in Makane Moïse Mbengue and Stefanie Schacherer (eds), *Foreign Investment Under the Comprehensive Economic and Trade Agreement (CETA)* (Springer 2019) 127-158. Cf. Yannick Radi, “Much Ado About Nothing?” An Appraisal of CETA’s Investment Chapter’ (2017) 6 ESIL Reflection 1.

¹⁴² Indirect expropriation occurs if a State measure or series of measures has an ‘effect equivalent to direct expropriation, in that it *substantially* deprives the investor of the *fundamental attributes* of property in its investment’ (the right to use, enjoy and dispose of the investment) but without the formal transfer of title: CETA Annex 8-A para 1(b). Substantial deprivation is also required in the arbitral practice: see, for example, *CMS Gas Transmission Co. v Argentine Republic*, ICSID Case No. ARB/01/8, Award (12 May 2005) para 262.

¹⁴³ The provision also clarifies that ‘the sole fact’ that the measure has ‘an adverse effect on the economic value of the investment’ does not establish indirect expropriation. This, however, does not mean that the sole effect doctrine has been excluded: see chapter 2, section 2.1.1.

¹⁴⁴ It is, however, not specified whether duration must be permanent or temporary, and, if the latter, how long it has to last to amount to expropriation.

¹⁴⁵ However, it is open to interpretation what legitimate expectations mean in this context. Tribunals have taken into account all circumstances when assessing the existence of legitimate expectations – including special commitment or representation, the investors’ economic expectations, and whether the investment is made in a highly regulated sector (in assessing the reasonableness of the investors’ expectations). Moreover, the concept of ‘distinct-investment-backed expectation’ originates from the US, not the European legal practice: see Yannick Radi, ‘Realizing Human Rights in Investment Treaty Arbitration: A Perspective from within the International Investment Law Toolbox’ (2011) 37 North Carolina Journal of International Law and Commercial Regulation 1107, 1145-1160.

¹⁴⁶ The reference to ‘among other factors’ indicates the non-exhaustive nature of the list. See CETA Annex 8-A para 2, and similarly, EUSIPA Annex 1 para 2. However, unlike CETA, EUSIPA does not have reference to the duration of the measure and investment-backed expectations.

not constitute indirect expropriation, except ‘in the rare circumstances’ when the impact of the measure is ‘so severe in light of its purpose that it appears manifestly excessive’. This provision codifies an exception to the police powers doctrine in the arbitral practice, which is otherwise itself an exception in IIL.¹⁴⁷

These criteria have been adopted from the US Model BIT 2012 and arbitral practice.¹⁴⁸ While not including substantially new criteria, the codification avoids the risk of tribunals departing from this practice in the future.¹⁴⁹ It has also been suggested that an explicit reference to the intent of the measure is an important improvement as it removes the focus from the effect of the measure on the investor’s property to the general objective of the State measure and its overall context.¹⁵⁰ However, pursuing a public interest objective is a requirement of lawfulness of expropriation.¹⁵¹ Therefore, a measure that serves a public interest can still result in lawful expropriation, whether direct or indirect, which gives rise to liability for the payment of compensation. Any proportionality analysis takes place after it has been established that lawful expropriation occurred, and not in the course of determining the lawfulness of expropriation.¹⁵²

EU IIAs specify that the payment of compensation in case of any lawful expropriation must be ‘prompt, adequate and effective’, adopting the Hull formula.¹⁵³

¹⁴⁷ Radi, “Much Ado About Nothing?” (n 141). For police powers doctrine, see chapter 2, section 2.1.1. For the recent application of the police powers doctrine, which reiterates this CETA provision, see *Philip Morris v Uruguay*, ICSID Case No. ARB/10/7, Award (8 July 2016) para 300. Codifying the police powers doctrine without an exception would have been a more revolutionary approach in CETA.

¹⁴⁸ See Annex B US Model BIT 2012. The Annex does not refer to the duration of the measure as an explicit factor to be taken into account in determining indirect expropriation. There is also an explicit reference to both tangible or intangible property rights or property interests in investment, which is missing from the CETA Annex, but it can nevertheless be inferred from the CETA definition of investment. The exceptions are IPR. CETA prescribes that its expropriation clause does not apply to the issuance of compulsory licences consistent with the TRIPS agreements: Art 8.10.5 (again, this provision has been inspired by the US Model BIT 2012: see Art 6(5)). The same provision is included in Art 2.6.3 EUSIPA. CETA (but not EUSIPA) further clarifies that a determination of revocation, limitation or creation of IPR that is inconsistent with the TRIPS Agreement or CETA’s IP chapter does not constitute an expropriation: Art 8.10.6 CETA. Compulsory licences could qualify as indirect expropriation under IIL as they can allow beneficiaries (e.g. pharmaceutical laboratories) to access patented innovations (e.g. patented medicines) without the consent of the holder of the patent. They can therefore be an important public health policy tool.

¹⁴⁹ According to Yannick Radi, CETA codifies the proportionality approach already adopted by some investment tribunals (most notably, *Técnicas Medioambientales Tecmed, S.A. v The United Mexican States*, ICSID Case No. ARB (AF)/00/2, Award (29 May 2003) para 122) and does not bring anything new. Radi considers this approach appropriate in balancing private and public interests in investment arbitration: Radi, “Much Ado About Nothing?” (n 141). Similarly, De Nanteuil (n 141) 141-142. However, such an approach to proportionality is different to the proportionality analysis applied in European legal practice and it is only a middle way between the sole effect and police powers doctrines: see analysis in chapter 2, section 2.2.1. On different approaches to proportionality in the EU and international economic law (investment and trade), see Valentina Vadi, ‘Proportionality in International Economic Law’ in Antonio Segura Serrano (ed), *The Reform of International Economic Governance* (Routledge 2016).

¹⁵⁰ De Nanteuil (n 141) 138-139.

¹⁵¹ Article 8.12.1 CETA; Article 2.6.1 EUSIPA.

¹⁵² Cf. the ECtHR’s approach. See chapter 2, section 2.2.1.

¹⁵³ See chapter 1.

Such compensation should amount to the fair market value of the investment.¹⁵⁴ However, since these provisions do not specify any particular calculation method, they give tribunals a margin of appreciation and do not exclude the award of compensation for future profits.¹⁵⁵ Accordingly, compensation under EU IIAs will likely continue to result in higher payments than compensation available under domestic remedies. New EU IIAs in this sense do not bring substantive change compared to the current arbitral practice.

A similar standard of expropriation and compensation is endorsed in new Member States' extra-EU BITs.¹⁵⁶ Apart from nuances in wording across different Member States' BITs, some BITs also adopt a different standard of compensation. For example, the Slovakia–Iran BIT refers to the payment of 'prompt, effective and *appropriate*' compensation, which excludes losses that are not actually incurred and merely probable or unreal profits.¹⁵⁷ In practice this should result in a lower payment of compensation compared to the Hull formula. Accordingly, while generally coherent with EU IIAs, and equally adopting the middle way between the sole effect and police powers doctrines, extra-EU BITs allow for variations adjusted to a particular bilateral situation, which can result in a higher or lower level of investment protection in each particular case.

¹⁵⁴ FMV is assessed at the time immediately before the expropriation or before the impending expropriation became known, whichever is earlier. Valuation criteria include going concern value, asset value (declared tax value) and other appropriate criteria: Arts 8.10.2 CETA; 2.6.3 EUSIPA.

¹⁵⁵ De Nanteuil (n 141) 146-147.

¹⁵⁶ The Dutch Model BIT 2018 in Article 12 includes an almost identical provision to CETA and its Annex 8-A. The difference relates to excluding reference to 'distinct, reasonable investment-backed expectations' (Art 12(4)) and the broader non-exhaustive list of legitimate public interests in the clause on a State's police powers (including also public morals, social or consumer protection and protection of cultural diversity in Art 12(8)). Arguably, this does not substantively change the practical effects of the expropriation clause but clarifies the areas of relevant public interest in the relations between particular States. For example, Art 7(8) of the Slovakia–UAE BIT includes health, safety, defence and the environment in this list.

¹⁵⁷ Art 6(1)(d) Slovakia–Iran BIT (emphasis added). Contrary to that, the Slovakia–UAE BIT refers to the payment of 'prompt, effective and *just* compensation' (Art 7(1)(d)), whereby the justness of the compensation is determined in accordance with 'internationally recognised principles of valuation' and non-exhaustively taking into account an 'equitable balance between public interest and interest of those affected, the purpose of expropriation, the current and past use of the property, the history of its acquisition, the capital invested, deprivation, duration as a going concern of the undertaking, its record of profitability, *profit and loss forecast*, capital already repatriated, replacement value and other relevant factors': Art 7(4). Accordingly, two of Slovakia's BITs have a different standard of compensation, the one with Iran excluding and the one with UAE including future loss (however, in the latter case, the effect of future loss can be diminished in light of the other factors). The approach in the BIT with Iran could be explained by Iran's negative experience of the US–Iran tribunal practice. See, for example, *AIG v Islamic Republic of Iran* (1983) 4 Iran–USCTR 96, para 109-110, where the tribunal included lost profits despite expropriation being lawful. Other recent BITs of Member States (Czech Republic, Hungary, Luxembourg) with Iran have been signed but are not yet in force so this trend cannot be confirmed.

8.2.1.3. Fair and equitable treatment

Pre-Lisbon extra EU BITs do not specify the FET standard. With a more precise FET definition, EU IIAs introduce an improvement. Unlike the US Model BIT 2012 which endorses the minimum standard of treatment (MST) under CIL, EU IIAs introduce a standard independent of CIL but inspired by the NAFTA case-law.¹⁵⁸ The codified NAFTA FET jurisprudence in the CETA FET clause was a compromise between Canada's MST position¹⁵⁹ and the EU's unqualified FET stance.¹⁶⁰ This approach in some way also reflects a continued inconclusiveness about what the content of the MST under CIL is and to what extent it is different to a broader concept of the FET standard.¹⁶¹

The definition of FET in the EU IIAs contains a closed list of State actions which can lead to a FET breach, indicating Contracting parties' intentions for a narrow application of this standard.¹⁶² The list includes denial of justice; fundamental breach of due process; manifest arbitrariness; targeted discrimination on manifestly wrongful grounds; and abusive treatment; however, it is not specified what each of these terms includes.¹⁶³ While the NAFTA case-law, from which these concepts have been adopted,¹⁶⁴ arguably implements the MST under CIL, it is difficult to define with precision what the MST includes.¹⁶⁵ It does, however, include a broader meaning of the denial of justice, which entails all types of wrongful acts committed by the State's executive, legislative or judicial branches, and it is not limited to denial of access to a State's judicial system.¹⁶⁶

¹⁵⁸ However, NAFTA parties have clarified that NAFTA prescribes MST under CIL: see chapter 2, section 2.1.2.

¹⁵⁹ Canada's experience with ISDS has been mostly negative. It was subject to more claims under NAFTA than the US and Mexico and lost eight cases. On the other hand, Canadian investors have also not been particularly successful in utilising investment treaty arbitration in NAFTA: Daniel Garcia-Barragan, Alexandra Mitretodis and Andrew Tuck, 'The New NAFTA: Scaled-Back Arbitration in the USMCA' (2019) 6 *Journal of International Arbitration* 739, 742.

¹⁶⁰ In particular, the EC believed that reference to the MST would significantly reduce the level of protection under the FET standard. See Patrick Dumberry, 'Fair and Equitable Treatment' in Makane Moïse Mbengue and Stefanie Schacherer (eds), *Foreign Investment Under the Comprehensive Economic and Trade Agreement (CETA)* (Springer 2019) 98-100. Therefore, it was the EU rather than Canada that was sceptical about a more restrictive FET clause. The EC's initial minimalist FET clause approach also reflects the initial Member States' preferences for broad investment protection standards: see chapter 4, section 4.3.3.

¹⁶¹ Patrick Dumberry is of the view that the list of elements in CETA is the same as the elements of the umbrella concept of the MST. He therefore claims that the CETA FET standard ultimately reflects Canada's willingness to link the FET standard in CETA to the one under the MST: see *ibid* 103. See also Günes Ünüvar, 'Is CETA the Promised Breakthrough? Interpretation and Evaluation of Fair and Equitable Treatment and (Indirect) Expropriation Provisions' (June 2017) iCourts Working Paper Series No. 97

<https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2986049> accessed 30 June 2020.

¹⁶² Article 8.10 CETA; Article 2.4 EUSIPA.

¹⁶³ There are some nuances in the way these provisions have been drafted. For example, CETA refers to the 'fundamental breach of due process, including a fundamental breach of transparency, in judicial and administrative proceedings' (Art 8.10.2(b)), while EUSIPA's drafting refers to 'a fundamental breach of due process', without further specifying it (Art 2.4.4(b)).

¹⁶⁴ See, for example, *Waste Management, Inc. v United Mexican States* ("Number 2"), ICSID Case No. ARB(AF)/00/3, Award (30 April 2004) para 98.

¹⁶⁵ See chapter 2, section 2.1.2.

¹⁶⁶ See analysis in Stefan Matiation, 'Arbitration with two twists: Loewen v United States and Free Trade Commission Intervention in NAFTA Chapter 11 Disputes' (2003) 24 *University of Pennsylvania Journal of*

The most important difference between the FET standard under NAFTA and other BITs seems to be in the application of the legitimate expectations element of the FET standard. EU IIAs include a reference to the concept of legitimate expectations, which in the interpretation of the FET standard has been considered the core element.¹⁶⁷ However, following the NAFTA jurisprudence, legitimate expectations of investors in EU IIAs are to be taken into account only as *one of the factors* when assessing whether the FET standard has been breached.¹⁶⁸ The effects of this concept are further limited to ‘a specific representation’ made to an investor, which created a legitimate expectations ‘upon which the investor relied in deciding to make or maintain the covered investment’ but which was subsequently frustrated.¹⁶⁹ Nevertheless, this drafting provides tribunals with ‘a significant margin of appreciation’ in assessing legitimate expectations.¹⁷⁰ Specific representations can be made in any form, including legislation, with case-law indicating the criteria to be fulfilled, depending on jurisprudential interpretations.¹⁷¹ The wording of the provision also leaves open to interpretation whether the representation so made must have been objectively reasonable or reasonable only subjectively from the investor’s point of view.¹⁷² Changes made to the general regulatory framework of the host State, however, should not suffice to breach the FET standard.¹⁷³ Equally, a host State measure

Economic Law 451. However, NAFTA tribunals have required proof of a high threshold of severity and gravity in order to conclude the breach of any of the elements of the FET standard: Dumberry (n 160) 117-118.

¹⁶⁷ See Yulia Levashova, *The Right of States to Regulate in International Investment Law* (Kluwer 2019) 107-111. Importantly, in many cases, an assessment of legitimate expectations is independent from the evaluation of a State measure’s objectives, the conduct of the State in implementing these objectives and the legality of the measure under domestic law.

¹⁶⁸ In the NAFTA context, tribunals have generally considered legitimate expectations as one of the factors to be taken into account when assessing whether the FET standard has been breached and not as a stand-alone factor, which was the approach of tribunals outside the NAFTA context. The notable exception from this NAFTA practice is the approach of the tribunal in *Bilcon v Canada* PCA Case No. 2009-04. For this view, see Dumberry (n 160) 107.

¹⁶⁹ Arts 8.10.4 CETA; 2.6.3 EUSIPA.

¹⁷⁰ Ursula Kriebaum, ‘FET and Expropriation in the Comprehensive Economic Trade Agreement between the European Union and Canada (CETA)’ (2016) 13 Transnational Dispute Management; Levashova (n 167) 62.

¹⁷¹ A *specific representation* must fulfill three criteria: it must be provided by a competent State authority; it must have legal force (which is assessed with reference to the legal form, the content and the wording of the representation); and it must be designated for the investor: Levashova (n 167) 262-263. This nevertheless leaves tribunals with sufficient discretion (e.g. when determining who is the competent authority of the host State, or deciding on the legal form of the representation – which can be a law, letter, political statement, a licence etc.). See the analysis of these criteria in the arbitral tribunals’ practice by Levashova in *ibid* 123-139.

¹⁷² Dumberry (n 160) 108. However, in EUSIPA, it is required that the investor must have ‘reasonably relied upon’ the representation made. In the case-law, reasonableness of investor expectations depends on the special circumstances in the host State and investor’s due diligence but this jurisprudence is inconsistent: see Levashova (n 167) 152-166. In some recent awards, tribunals have considered that due diligence is a prerequisite for the reasonableness of an investor’s legitimate expectations (objective standard): see, for example, *Stadtwerke München GmbH, RWE Innogy GmbH, and others v Kingdom of Spain*, ICSID Case No. ARB/15/1, Award (2 December 2019) para 264.

¹⁷³ CETA specifies that the ‘mere fact that a Party regulates’, including through the legislative changes, ‘in a manner which negatively affects an investment or interferes with an investor’s expectations, including its expectations of profits’ does not amount to a breach of investment protection standards under CETA. Similarly, Art 2.2.2 EUSIPA. However, in combination with other factors (e.g. targeted discrimination, manifest arbitrariness), a change to the regulatory framework can play a role in assessing the breach of the FET standard: Levashova (n 167) 264-265. See also Dumberry (n 160) 108-109.

that breaches domestic law does not *per se* result in breach of the FET obligation.¹⁷⁴ The new FET standard further clarifies that ‘full protection and security’ does not include legal stability but is exclusively limited to ‘physical security of investors and covered investments’.¹⁷⁵

On the other hand, the EU IIAs’ FET clause does not specify any obligations on the side of the investor. In particular, no reference is made to an investor’s duty of due diligence in the assessment of the breaches of the FET clause.¹⁷⁶ Including investors’ due diligence in EU IIAs as a requirement with reference to a higher standard would also bring the concept of legitimate expectations closer to the standard of EU law.¹⁷⁷ Further, EU IIAs do not include any other specific obligations of investors. Rather, the emphasis is placed on explicitly guaranteeing the States’ right to regulate and balancing investors’ rights against the legitimate objectives of the States’ regulatory activity.¹⁷⁸ Arguably, these

¹⁷⁴ Art 8.10.7 CETA. In the case of a breach of domestic law, the tribunal would still need to consider whether the host State acted inconsistently with other factors (e.g. manifest arbitrariness etc.). In EUSIPA, the reference is made to the breaches of another provision of the EUSIPA, or of a separate international agreement, the breach of which does not establish a breach of the FET standard (Art 2.4.7). Instead, a reference to domestic laws is made with respect to the frustration or undermining of commitments in a contractual written obligation through the exercise of *governmental authority*. Such commitments shall not be frustrated or undermined deliberately or shall be reasonably compensated when the balance of rights and obligations in the contractual written obligation has been substantially altered: Art 2.4.6 EUSIPA. The emphasis in this context is on the exercise of the authority of a State as a sovereign and not as a commercial party to a contract. Ordinary contractual breaches should therefore not give rise to a breach of the FET standard unless any of the two alternative grounds in Art 2.4.6 EUSIPA have been fulfilled.

¹⁷⁵ Arts 8.10.5 CETA; 2.4.5 EUSIPA. The standard was unclear in arbitral practice. Some tribunals understood it in the same sense as the new CETA provision as the obligation of the host State to ‘adopt all reasonable measures to protect assets and property from threats or attacks which may particularly target foreigners or certain group of foreigners’, and thus ‘protect[ing] more specifically the physical integrity of an investment against interference by use of force’: *Saluka Investments B.V. v The Czech Republic*, UNCITRAL, Partial Award (17 March 2006) para 484. However, other tribunals adopted a broader scope of the standard, extending it to legislative amendments and administrative actions: see *Compañía de Aguas del Aconquija S.A. and Vivendi Universal S.A. v Argentine Republic*, ICSID Case No. ARB/97/3 Award (20 August 2007) para 7.4.15 and case-law cited in para 7.4.16.

¹⁷⁶ While many tribunals have underlined the importance of investors’ obligations of due diligence, tribunals have also employed different standards of due diligence, allowing for different levels of investors’ lenience when exercising due diligence and taking into consideration broader socio-political and economic circumstances in the host State. For example, the tribunal in *Masdar v Spain* held that an investor must demonstrate that it has exercised appropriate due diligence and that it has familiarised itself with the existing laws: *Masdar Solar & Wind Cooperatief U.A. v Kingdom of Spain*, ICSID Case No. ARB/14/1, Award (16 May 2018) para 494. In *Charanne v Spain*, the tribunal emphasised that for violation of the legitimate expectations of the investor, ‘regulatory measures must not have been reasonably foreseeable at the time of the investment’: *Charanne B.V. v Spain*, SCC Arb. No. 062/2012, Final Award (21 January 2016) para 505. Recently, tribunals employed an even higher standard, determining the threshold on the basis of whether the new regulatory changes were not foreseeable by a ‘prudent’ investor: see Levashova (n 167) 163-166. Different standards eventually have different impacts on a State’s responsibility.

¹⁷⁷ A higher standard of the *prudent investor* is closer to the principle of legitimate expectations under EU law: see chapter 7, section 7.1.2.2.

¹⁷⁸ EU IIAs have a specific clause on ‘investment and regulatory measures’, explaining the meaning of the right to regulate and providing examples of legitimate policy objectives for the purposes of that right. For example, Art 8.9.1 CETA reads: ‘For the purpose of this Chapter, the Parties reaffirm their right to regulate within their territories to achieve legitimate policy objectives, such as the protection of public health, safety, the environment or public morals, social or consumer protection or the promotion and protection of cultural diversity’. Similarly, see Art 2.2.1 of the EUSIPA, which has some nuances in the list of legitimate public policy objectives (adding to the list social services and public education; and specifying social and consumer protection privacy and data protection).

provisions provide more clarity about the intentions of Contracting States that legitimate policy objectives must be taken into account when assessing the host State's conduct.¹⁷⁹ However, given the general nature of these clauses, a State's right to regulate remains subordinate (an exception) to more specific investor rights guaranteed under EU IIAs (the rule).¹⁸⁰

The FET standard in post-Lisbon extra-EU Member States' BITs differs across the treaties. Some BITs follow the path of the FET standard in EU IIAs, with some variations and possibly improvements. For example, the 2018 Dutch model BIT contains a more elaborate closed list of illegal State behaviour that could lead to breach of the FET.¹⁸¹ On the other hand, the language related to investors' obligations is looser but still more elaborate than in EU IIAs. In addition to including a reference to voluntary CSR soft law instruments,¹⁸² the importance of conducting a due diligence process by investors is 'reaffirmed' by the Contracting Parties.¹⁸³ While these provisions can have some interpretative value, their normative value is inconclusive.¹⁸⁴ Some other BITs simply refer to the MST under CIL.¹⁸⁵ The practical effects of these BITs should not significantly differ in practice if CETA codifies the NAFTA case-law. Differing from this practice, however, some post-Lisbon extra-EU BITs still include broad wording of the FET standard of pre-Lisbon BITs.¹⁸⁶

Taking into consideration all these developments, it could be said that, overall, the new EU FET provisions codify a higher regulatory threshold for States and clearly indicate

¹⁷⁹ See Levashova (n 167) 270.

¹⁸⁰ For further discussion of the right to regulate, see section 8.2.2 below.

¹⁸¹ See Art 9(2) Dutch Model BIT 2018. For example, wrongful grounds of direct or targeted indirect discrimination are also nationality and sexual orientation: Art 9.2(d). Examples of abusive treatment are also abuse of power, corrupt practices or similar bad faith: Art 9.2(e). In the general provision on the scope of application it is also specified that 'the mere fact' that the State regulates in a way that 'negatively affects an investment or interferes with investor's expectations, including its expectation of profits' does not constitute a breach of obligation under the BIT: Art 2(2).

¹⁸² It has been emphasised that each Contracting party should 'encourage investors' in their jurisdictions to voluntarily incorporate into their internal policies internationally recognised standards, such as the OECD Guidelines for Multinational Enterprises, the UN Guiding Principles on Business and Human Rights, and the Recommendation CM/REC(2016) of the Committee of Ministers to Member States on human rights and business: Art 7(2) Dutch Model BIT. See also Slovakia-UAE BIT, which refers to 'national and international standards of corporate governance for the sector involved', in particular for transparency and accounting practices (Art 12(3)) and OECD Guidelines, which should be promoted to the extent of their compatibility with domestic law: Art 12(4).

¹⁸³ See Art 7 Dutch Model BIT 2018.

¹⁸⁴ Only the investors' obligation to comply with domestic laws and regulations is expressed in normative terms ('shall'): Art 7(1) Dutch Model BIT 2018. Investor conduct, in particular its non-compliance with CSR voluntary codes (the UN Guiding Principles on Businesses and Human Rights, and the OECD Guidelines for Multinational Enterprises), can be taken into account when deciding on compensation: Art 23 Dutch Model BIT 2018. However, this is nothing new as investor conduct has previously been taken into account by tribunals to reduce the amount of compensation: see, for example, *Biwater Gauff v Tanzania*, ICSID Case No. ARB/05/22, Award (24 July 2008).

¹⁸⁵ See, for example, Art 4 Slovakia-Iran BIT. Contrary to that, the FET in the Slovakia-UAE BIT largely follows the expression found in CETA: see Art 3.

¹⁸⁶ 'Fair and equitable treatment and full and constant protection and security'. See, for example, Art 3 Austria-Kyrgyzstan BIT; Art 2 Hungary-Cambodia BIT.

the intention of States to take control from implementing bodies over the scope and content of the FET standard.¹⁸⁷ However, some margin of appreciation is still left to investment tribunals. It is likely that it will be easier to exert interpretative control over a permanent body (in EU IIAs) than over many *ad hoc* tribunals (in extra-EU BITs).¹⁸⁸ In the latter case, and in light of the NAFTA case-law, the success will still largely depend on the argumentative skills of the respondent States.¹⁸⁹ In the context of a permanent tribunal, it might also be easier to rely on the principle *iura novit curia*, which has rarely been applied in the context of *ad hoc* tribunals.¹⁹⁰

8.2.1.4. Non-discrimination

In addition to FET, investors are protected against discrimination through the national treatment (NT) and most-favoured-nation treatment (MFN) clauses.¹⁹¹ EU IIAs follow the general trend of recent IIAs, expressly specifying that these relative obligations depend on the level of treatment provided to nationals and other foreign investors in 'like

¹⁸⁷ Such intention can in particular be seen in the FET provisions of EU IIAs, which envisage regular reviews of the content of the FET obligation by the Contracting parties. Further, States may develop recommendations about the content of the FET standard in accordance with the prescribed IIAs procedure through joint committees: see Arts 8.10.3 CETA and 2.4.4 EUSIPA.

¹⁸⁸ In this context, some prominent arbitrators have already offered their views on the matter: 'For example, should the fundamental provision for Fair and Equitable Treatment be so narrowly constricted as the draft requires, limiting its reach to denial of justice, a fundamental breach of due process, manifest arbitrariness, targeted discrimination, or abusive treatment of investors? Why, for example, must arbitrariness of the respondent state be "manifest"? Is it not enough that there be actual arbitrary action against the investor by the respondent state, even if arbitrariness is not manifest, that is obvious? Why should the tribunal be limited to sanctioning the obvious?': Stephen Myron Schwabel, as cited in Nicolas Angelet, 'CETA and the Debate on the Reform of the Investment Regime' in Makane Moïse Mbengue and Stefanie Schacherer (eds), *Foreign Investment Under the Comprehensive Economic and Trade Agreement (CETA)* (Springer 2019) 6.

¹⁸⁹ NAFTA States have had mixed success when arguing the FET standard, with the US being more successful than the others. Of interest are remarks made by US trade negotiators in the context of preliminary consultations for UK-US FTA post-Brexit (made in response to a remark by a UK negotiator that 'NAFTA tribunals have not always consistently interpreted the MST'). The US view was noted to be that 'in those cases where the US has been a respondent, the tribunals have consistently interpreted the MST because of the consistent way the US has been pleading its cases, most recently in Glamis and Apotex cases, whereas other tribunals might have not been as consistent because of the inconsistent way other NAFTA states have pleaded their cases': UK Government Department for International Trade, 'UK-US Trade & Investment Working Group' (2-7 November 2018) 32-33. The report has been leaked through the website of a UK NGO website (*Global Justice Now*, 27 November 2019) <<https://www.globaljustice.org.uk/news/2019/nov/27/explosive-leaked-trade-papers-show-nhs-chlorinated-chicken-already-table-us-trade>> accessed 30 June 2020. In the same context, US negotiators questioned the EU theory of having a closed list and wondered whether it was providing *greater* rights to investors. The US view was that 'the concepts contained in the closed list are subject to a great amount of subjectivity, which could provide investors with wider protections and lead to increased claims than originally envisaged': *ibid*.

¹⁹⁰ Generally speaking, in international arbitration, arbitrators can only in limited circumstances raise *ex officio* legal issues not discussed by parties due to the risk of the award possibly being set aside in the enforcement stage. See the overview by Anna P Mantakou, 'The Misadventures of the Principle of Jura Novit Curia in International Arbitration: A Practitioner's Approach' in Nomiki Vivliothiki (ed) *Essays in Honour of Professor Emeritus Spyridon Vrellis* (2014), 487-498 <<https://www.hiifl.gr/wp-content/uploads/MANTAKOUjuranovitcuria.pdf>> accessed 30 June 2020, referring to the practice of French and Swiss Courts in the enforcement of arbitral awards where this principle has been applied by tribunals.

¹⁹¹ See chapter 2, section 2.1.3.

situations'.¹⁹² Under CETA, NT and MFN standards apply to all levels, sub-federal in Canada, and the EU Member States' and sub-EU Member State levels in the EU.¹⁹³ In practice, this NT application could lead to a number of ambiguous situations given the differences between governmental structures in the EU.¹⁹⁴ Potentially, it could also result in a more advantageous treatment of Canadian investors than domestic investors in a particular EU Member State. Due to the broader scope of non-discriminatory treatment the EU legal order can require that Member States accord investors from other EU Member States more favourable treatment than they would accord to their own investors, which would then have to be extended to Canadian investors.¹⁹⁵

Generally, NT and MFN in both EU IIAs and extra-EU BITs apply only to the post-establishment phases of investment and the breaches of these provisions are usually subject to ISDS.¹⁹⁶ CETA is an exception given that NT and MFN apply to pre- and post-entry situations,¹⁹⁷ but with the exclusion of ISDS for breaches of these obligations regarding the establishment of investment.¹⁹⁸ This can be explained by CETA's FTA

¹⁹² Arts 8.6.1 (NT) and 8.7.1 (MFN) CETA; Arts 2.3.1 (NT) and 2.4.1 (MFN) EUVIPA; Art 2.3.1 EUSIPA (NT only). Reference is made to treatment 'no less favourable' than the treatment that each Party accords 'in like situations' to its own investments and investors (NT), or to investors of a third country and their investments (MFN). Cf. pre-Lisbon Member States' extra-EU BITs mostly have unqualified NT and MFN clauses. Post-Lisbon extra-EU BITs follow the trend of EU IIAs and include a qualifier 'in like circumstances' (see, for example, Art 5(1) Slovakia–Iran BIT) or 'in like situations' (Art 8(1) and (2) Dutch Model BIT).

¹⁹³ Arts 8.6(2) and 8.7(2) CETA contain this identical clause: 'For greater certainty, the treatment accorded by a Party under paragraph 1 means, with respect to a government in Canada other than at the federal level, or, with respect to a government of or in a Member State of the European Union, treatment accorded, in like situations, by that government to investors in its territory, and to investments of such investors, of a third country.'

¹⁹⁴ Andrea K Bjorklund and Lukas Vanhonnaeker, 'National Treatment' in Makane Moïse Mbengue and Stefanie Schacherer (eds), *Foreign Investment Under the Comprehensive Economic and Trade Agreement (CETA)* (Springer 2019) 65-66.

¹⁹⁵ Notably, this could be the case in regard to fundamental freedoms of establishment and capital movements under EU law. See Directorate General for External Policies of the European Parliament, 'The Investment Chapters of the EU's International Trade and Investment Agreements in a Comparative Perspective' (September 2015) EP/EXPO/B/INTA/2015/01, 117. Indeed, the principle of non-discrimination is a fundamental part of the EU legal order, applying also to specific policy areas in order to achieve harmonisation of national standards and integration of the EU internal market, and thus is broader in its scope than non-discriminatory treatment afforded under IIL. For example, provisions aimed at eliminating discrimination in the TFEU are: Art 18 (general principle of non-discrimination), Art 30 (the customs union), Arts 34-35 (free movement of goods), Art 45 (free movement of persons), Art 49 (freedom of establishment), Arts 101(1)(d) and 102(c) (competition), Art 56 (freedom to provide services), Art 63 (free movement of capital), Art 37 (State monopolies), Art 107 (State aids), Art 110 (prohibition of discriminatory taxation). See chapter 7 for further discussion of the EU internal market.

¹⁹⁶ See, for example, Arts 2.3.1 (NT) and 2.4.1 (MFN) EUVIPA respectively referring to 'operation of the covered investments'; Art 5(1) of the Slovakia–UAE BIT (NT and MFN in the same clause) referring 'only to management, conduct, operation, maintenance, use, enjoyment and sale or other disposition of investments' and the almost identical clause in Art 4(1) of the Slovakia–Iran BIT. Identical to these are also NT and MFN clauses in Arts 8(1) and (2) of the Dutch Model BIT 2018. The NT and MFN clause of the Slovakia–Iran BIT provides further instructions for tribunals how to assess comparable situations: see Art 4(3).

¹⁹⁷ Arts 8.6.1 and 8.7.1 CETA specify that NT and MFN respectively shall be accorded 'with respect to the establishment, acquisition, expansion, conduct, operation, management, maintenance, use, enjoyment and sale or disposal of their investment'.

¹⁹⁸ Art 8.18.1(a) CETA limits access to ISDS for the breaches of non-discrimination clauses to state measures made with respect to 'the expansion, conduct, operation, management, maintenance, use, enjoyment and sale or disposal of its covered investment'. Further, claims in relation to 'expansion' are limited to state measures

character aimed at trade and investment liberalisation, which is different to the orientation of stand-alone EU IIAs toward protecting investments after their establishment in the host State. In this regard, it could generally be said that EU IIAs and extra-EU BITs continue to follow the old European BIT type, rather than North American IIAs.¹⁹⁹ Further, EU IIAs and extra-EU BITs contain a number of other different exceptions, which limit the application of NT and MFN treatment, in the specific²⁰⁰ or more general treaty clauses.²⁰¹ Importantly, in order to limit ‘treaty shopping’,²⁰² MFN clauses specifically exclude from their application substantive and procedural obligations provided for under other international agreements.²⁰³

8.2.2. *The right to regulate in the EU*

As a preliminary remark, it should be emphasised that the right to regulate is the basic right of every State, stemming from sovereignty. As international law aims to achieve a minimum harmonisation of laws through treaties and other mechanisms of cooperation, a State’s sovereignty and the right to regulate are inevitably limited. The extent of these limitations depends on the provisions of each individual international treaty at hand. The exercise of the right to regulate, even when guaranteed in a specific provision, depends on all the terms and conditions of the treaty in question.²⁰⁴ Accordingly, the right to regulate in IIL has a narrow meaning, according to which the State retains its right to regulate within its borders but is liable for the payment of compensation stemming from

that relate to ‘the existing business operations of a covered investment’ *and*, as a result of such measures, the investor has incurred loss or damage: Art 8.18.2 CETA.

¹⁹⁹ See chapter 3, section 3.1.2.

²⁰⁰ For example, the NT clause of EUSIPA allows measures that could provide less favourable treatment to foreign investors compared to domestic investors in cases when State measures are taken towards achieving defined legitimate public policy goals (listed under (a) to (f) in Art 2.3.3), but such measures still must not be applied in a manner which would ‘constitute a means of arbitrary or unjustifiable discrimination’: Art 2.3.3 EUSIPA. In EU IPAs exceptions can also relate to market access NT and MFN clauses in related EU FTAs with the same parties. See, for example, Art 2.3.2 EUSIPA. For exceptions in extra-EU BITs, see, for example, Art 4(4) and (6) of the Slovakia–Iran BIT.

²⁰¹ See, for example, Arts 8.2.2 and 8.2.3 (sectoral exemptions), 8.15 (non-conforming measures), 28.3 CETA (general exception clause with reference to GATT Article XX) and others; however, these provisions in CETA are also due to its comprehensive FTA character, which is different to more specific EU IPAs.

²⁰² See chapter 2, section 2.2.2.

²⁰³ Art 8.7.4 CETA; EUSIPA generally excludes an MFN clause; Art 2.4.3 EUVIPA. Extra-EU BITs largely follow these trends. See, for example, Art 4(5) Slovakia–Iran BIT; Art 8(3) Dutch Model BIT 2018. For more detailed analysis of MFN clauses in CETA and other EU FTAs, see Claire Crépet Daigremont, ‘Most Favoured Nation Treatment’ in in Makane Moïse Mbengue and Stefanie Schacherer (eds), *Foreign Investment Under the Comprehensive Economic and Trade Agreement (CETA)* (Springer 2019) 71–93.

²⁰⁴ To that effect, for example, parties in CETA ‘reaffirm their right to regulate within their territories to achieve legitimate policy objectives’: Art 8.9.1 (emphasis added).

the exercise of that right.²⁰⁵ The State's right to regulate is thus an expression of the prevalent contemporary neoliberal approach to the regulation of the economy.²⁰⁶

In accordance with the EU external action objectives, in developing trade and investment policy, the EU needs to balance investment objectives and non-trade goals in ways that reflects the EU's approach in the internal market. Accordingly, the right to regulate in the EU must be guaranteed. In its Opinion 1/17 the CJEU established that the right to regulate is a new *substantive* criterion of the autonomy of EU law, according to which decisions of investment tribunals cannot undermine the capacity of EU institutions to carry out their duties under EU treaties. These duties include regulatory activity, although the CJEU framed this criterion in accordance with the prevalent liberal understanding of it as 'a right' rather than a duty.

Accordingly, the right to regulate is not a subjective right that is restricted to a duty of EU authorities to protect directly defined individual legal situations, in respect of which a failure by a public authority to perform the so defined duty (e.g. duty to protect the environment) would result in liability of the relevant public authority. Rather, the right to regulate serves to protect the higher regulatory standards already achieved in the EU.²⁰⁷ It is a negative obligation that cannot be reviewed by being invoked by individual litigants nor can it be used as a standard for reviewing the legality of a specific EU or domestic act. With respect to its normative nature, the right to regulate could be considered a meta-principle,²⁰⁸ which encompasses the existing CFR principles but cannot be reviewed in the same manner as CFR principles that are implemented in EU legislation under EU law.²⁰⁹ Moreover, its applicability as a substantive criterion of EU autonomy is limited to the acts of EU institutions.²¹⁰

In Opinion 1/17, when assessing the effects of the ICS on the EU constitutional order, the Court first examined the effects of CETA tribunal decisions on the validity of EU measures, and, secondly, the effects of the ICS on the capacity of EU institutions to legislate in the public interest. With respect to both issues, the CJEU concluded that the

²⁰⁵ Catharine Titi, 'The Right to Regulate' in Makane Moïse Mbengue and Stefanie Schacherer (eds), *Foreign Investment Under the Comprehensive Economic and Trade Agreement (CETA)* (Springer 2019) 162.

²⁰⁶ See chapter 3, section 3.3.2.1.

²⁰⁷ See, for example, Arts 35, 37 and 38 CFR, which guarantee a high level of environmental, health and consumer protection under EU policies. On the legal status of these CFR principles, see chapter 2, section 4.2.

²⁰⁸ Early in the development of the EU IIP, the EC emphasised the need for the right to regulate to be confirmed as 'a basic underlying principle' in the Transatlantic Trade and Investment Partnership (TTIP), which is supposed to be taken into account by tribunals when assessing any dispute settlement case: European Commission, 'Online public consultation on investment protection and investor-to-State dispute settlement (ISDS) in the Transatlantic Trade and Investment Partnership Agreement (TTIP)' SDW (2015) 3 final, 72.

²⁰⁹ This argument is adopted from Ivana Damjanovic and Nicolas de Sadeleer, 'Values and objectives of the EU in light of Opinion 1/17: "trade for all", above all' (2020) 4(1) *Europe and the World: A Law Review* [25] <<https://www.scienceopen.com/hosted-document?doi=10.14324/111.444.ewlj.2020.24>> accessed 30 June 2020.

²¹⁰ See section 8.2.2.3 below.

ICS does not affect the operation of EU institutions within the EU constitutional framework and consequently does not adversely affect the autonomy of the EU legal order. Accordingly, the CJEU concluded that the right to regulate in the EU is guaranteed under CETA.

8.2.2.1. Validity of EU measures protected

The CJEU found that CETA tribunals cannot call into question the validity of EU measures contested before them, and thus will not have a negative effect on the acts or practices of the EU.²¹¹ In other words, CETA tribunals do not have the power to annul or to change a challenged EU measure,²¹² and accordingly cannot undermine the operation of EU institutions which undertake such measures in accordance with EU law. The only power that tribunals have is to award damages to a private investor.

On one hand, CETA can be distinguished from the unacceptable EU Patent Court in Opinion 1/09, and on the other, from the acceptable WTO regime. The Patent Court was unacceptable because it might have been called upon to examine the validity of an EU act,²¹³ which is the function of the CJEU.²¹⁴ On the contrary, ICS tribunals can order only a payment of damages.²¹⁵ On the other hand, compared to the ICS, the WTO regime offers more flexibility: apart from paying damages, the EU has a range of different options for enforcing WTO rulings, depending on the success of negotiations with States that are parties to a particular dispute.²¹⁶ Therefore, in the spectrum of different powers, the ICS is somewhere between the failed EU patent system and a more flexible and thus also more political WTO system.

In the current ISDS system, investment tribunals cannot question the *validity* of sovereign acts of State parties to IIAs. However, investment tribunals' awards can shatter the State's sovereignty in respect of the issue in dispute. States can be deterred from adopting measures that might negatively affect investors by a tribunal making a large award of monetary compensation to the investors. How can then the CJEU be certain that ICS awards would not also lead to this (in)famous 'regulatory chill'? The answer lies in the CJEU's analysis of EU regulatory autonomy, as an aspect of the substantive autonomy of the EU legal order.

²¹¹ Opinion 1/17 (n 45) paras 142-145.

²¹² See Art 8.39.1 CETA

²¹³ Opinion 1/17 (n 45) para 124.

²¹⁴ Art 267(1)(b) TFEU.

²¹⁵ Indeed, the EU will have to pay any such sum if so ordered in a final award of the ICS tribunal: Opinion 1/17 (n 45) para 145.

²¹⁶ *ibid* para 146.

8.2.2.2. Public interest protected in the EU

The CJEU was adamant that investors' claims cannot lead to changes of legislation that the EU has made in the public interest. A contrary outcome in which the right to regulate was undermined by the ICS would run counter to the principles of democracy, the guarantee of the level playing field in the EU and the objectives of the EU.

First, EU legislation aims to introduce restrictions in the internal market that apply to *all* operators who invest in a particular commercial or industrial sector to which such legislation applies.²¹⁷ Therefore, if investors' claims had an effect on EU legislation, this would run counter to the principles of democracy.²¹⁸ In such cases, the interest of the majority – the public – would be superseded by the interest of a specific category of a few (foreign) investors from third countries that have concluded an IIA with the EU.

Secondly, an adverse effect of the ICS on EU legislation would run counter to the principles of equality in the EU, allowing the minority of foreign investors to escape restrictions introduced by general legislation intended to apply to all investors in a particular sector. The CJEU's rationale for the protection of 'public interest' is thus also based on the rationale of protecting the level playing field between foreign and other investors in the EU. Nevertheless, while not affecting EU legislation, the special right to compensation available to particular foreign investors can still disturb the level playing field in the EU.

Thirdly, if the right to regulate was not guaranteed, the law-making process in the EU and its legitimate objectives would also be undermined. Every piece of EU legislation is based on the conferral of powers, subsidiarity and proportionality, and it is both appropriate and necessary to achieve a legitimate objective of the EU for which that legislation is being created.²¹⁹ Under the treaties, the authority to review the validity of EU legislation made in the public interest for its compliance with EU treaties belongs only to those courts that are situated within the EU judicial system.²²⁰ The ICS is situated outside the EU judicial system. Accordingly, changing EU public interest legislation in reaction to ICS decisions would undermine the prescribed role of EU institutions under the founding treaties. Ultimately, as EU legislation serves to achieve different EU objectives, legislative changes in response to foreign investors' claims would weaken the achievement of EU objectives and would run counter to the EU project more generally.

²¹⁷ *ibid* para 148 (emphasis added).

²¹⁸ Art 2 TEU.

²¹⁹ See Opinion 1/17 (n 45) para 151.

²²⁰ See *ibid* para 151.

In assessing the autonomy of EU institutions to operate within the EU constitutional framework, the CJEU paid particular attention to the guarantees of the State ‘right to regulate’ in CETA and its interpretative instrument.²²¹ Additionally, the Court noted the exceptionality of situations in which CETA tribunals could condemn States for indirect expropriation due to public interest measures and the exhaustive nature of the FET standard in Article 8.10.2 CETA.²²² The CJEU thus found that the manner in which these provisions have been drafted offers sufficient limitations on the discretionary powers of CETA Tribunals. Accordingly, these tribunals will have *no jurisdiction* to question public interest choices made following a democratic process in areas relating to: the level of protection of public order or public safety, public morals, health and life of humans and animals, food safety, plants and the environment, welfare at work, product safety, consumer protection or fundamental rights.²²³ The CJEU’s reference to these areas as ‘*inter alia*’ indicates that this list is non-exhaustive.

However, what in practical terms does it mean that CETA tribunals have ‘*no jurisdiction*’ to ‘call into question the level of protection of public interest determined by the Union following a democratic process’?²²⁴ Does it mean that CETA tribunals cannot ever review any public interest measure since they should decline jurisdiction every time when a question related to public interest choices of States appears in claims before them? Or does it mean that tribunals can examine the effects of a public interest measure but cannot mandate that it be changed, although they can order the payment of damages if the measure breaches investors’ substantive rights? If the former were the case, CETA tribunals’ jurisdiction would be significantly limited to review exclusively the breaches of procedural justice and due process.²²⁵ In the case of the latter, CETA tribunals would still have the jurisdiction to review a public interest measure, albeit indirectly – when examining the effects of the measure on the investor. Accordingly, they could condemn the State to pay the compensation to the investor. *De facto*, the latter scenario could still lead to controversial ‘regulatory chill’.

Therefore, the crucial question is whether the CETA substantive provisions are sufficiently ‘expressly restricting’ in their scope that they can limit the tribunals’ jurisdiction to the award of compensation without producing the ‘regulatory chill’ on the level of regulatory standards and protection of public interest in the EU. In answering this

²²¹ In particular, these are CETA Arts 28.3.2; 8.9.1; 8.9.2, Point 3 of Annex 8-A CETA and Point 2 of the Joint Interpretative Instrument.

²²² Opinion 1/17 (n 45) paras 157-158.

²²³ Opinion 1/17 (n 45) para 160.

²²⁴ *ibid* paras 160 (emphasis added), 156.

²²⁵ The analysis of CETA provisions in Section 8.2.1 does not support this conclusion.

question, the CJEU employed the same logic that the Court applies when assessing the compliance of the Member States' measures with EU law.

The role of the CJEU in the EU system is to assess which of the Member States' measures made in the public interest are justified under EU law and which are hidden obstacles to the four EU freedoms in the internal market. When the CJEU finds that a national measure is incompatible with EU law, the measure must be annulled. The annulment of the measure does not automatically nor necessarily mean compensation for the injured party. The non-contractual liability of the Member State to make reparation for loss or damage caused to individuals as a result of EU law breaches will be established only if three conditions are met: the infringed rule of EU law must be intended to confer rights on the individual; the breach of that rule must be sufficiently serious; and there must be a direct causal link between that breach and the loss or damage sustained by the individual.²²⁶ While the annulment of a national measure can happen in any case of an EU law breach, compensation for individuals stemming from such a breach is awarded only if the breach is sufficiently serious. As the breach must be sufficiently serious, the standard for determining compensation is high.²²⁷

Mutatis mutandi, these conditions apply to measures of EU institutions that breach EU law. Non-contractual liability of the EU is prescribed in Article 340(2) TFEU, which provides that the EU will 'make good any damage caused by its institutions or by its servants in the performance of their duties', in accordance with the 'general principles common to the laws of the Member States'. For example, in cases when an EU legislative measure restricts the right to property or the right to pursue a trade or profession, the EU will be held liable under EU law if the restriction imposed impairs 'the very substance of those rights in a *disproportionate* and *intolerable* manner', even if the legislation was made in the pursuit of the objectives of general interest of the EU.²²⁸

Reasoning by analogy, ICS tribunals do not have the power to annul domestic or EU measures that breach foreign investors' rights under CETA. ICS tribunals can only award compensation to foreign investors. In light of the restrictive CETA provisions, such

²²⁶ Joined Cases C-46/93 and C-48/93 *Brasserie du Pêcheur and Factortame III* [1996] ECR I-1029, para 51; Case C-224/01 *Köbler* [2003] ECR I-10239, para 51; Case C-420/11 *Leth* ECLI:EU:C:2013:166, para 41.

²²⁷ According to the CJEU's case-law, among the factors which can be taken into consideration in determining whether there is a sufficiently serious breach of EU law are, in particular: the degree of clarity and precision of the rule infringed; the scope of room for assessment that the infringed rule allows for national authorities; whether the infringement and the damage caused were *intentional* or involuntary; whether any error of law was excusable or *inexcusable*; and the fact that the position taken by an EU institution may have contributed to the adoption or maintenance of national measures or practices contrary to EU law, and non-compliance by the national court in question with its obligation to make a reference for a preliminary ruling under the third para of Arti 267 TFEU: *Brasserie du pêcheur* and *Factortame*, para 56; *Köbler*, paras 54-55; Case C-446/04 *Test Claimants in the FII Group Litigation* ECLI:EU:C:2006:774, para 213.

²²⁸ Case C-120/06 *FIAMM v Council and Commission* [2008] ECR I-6513, paras 183-184.

compensation will be awarded only in cases of *sufficiently serious* breaches of CETA investment chapter provisions. Accordingly, the goal of the ICS is not to assess the compatibility of State public interest measures with the founding treaties. The ICS is limited to awarding compensation for the impact of these measures on investors, and only in such cases when measures constitute targeted discrimination, manifest arbitrariness or abusive treatment. In the case of indirect expropriation, the impact of a measure must be ‘so severe in light of its purpose that it appears manifestly excessive’.²²⁹ In the case of FET breaches, the possible breaches are exhaustively listed and include denial of justice, fundamental breaches of due process, manifest arbitrariness, targeted discrimination, and abusive treatment.²³⁰

If the compensation conditions include a high standard, the ‘chilling’ effect of ICS awards on the EU regulatory activity will be significantly reduced. Moreover, the effects could even be positive. Sufficiently serious breaches reasonably justify compensation for a foreign investor that was genuinely mistreated by the host State. If such compensation can deter States from abusive, manifestly arbitrary and discriminatory legislation and measures, the overall outcome is a win-win situation: compensation for genuinely mistreated foreign investors and the elimination of genuinely inequitable legislation. In any case, ‘the required level of protection of a public interest’ would not be negatively affected.

The CJEU assessed CETA’s investment chapter as a breakthrough from the old ISDS regime that has been subject to public interest criticism. The ‘old’ system was based on broadly undefined standards; the ‘new’ ICS system is based on restrictive provisions which limit the discretion of ICS tribunals. However, the CJEU assessed the investment chapter provisions through the lenses of EU law. These provisions to a great extent codify the existing case-law of investment tribunals. Additionally, the impact of national public interest measures on foreign investors is assessed differently to the usual proportionality analysis of the CJEU. As a consequence, compensation can be awarded even in cases where measures have been justified by legitimate public interest goals and are proportionate under EU law.²³¹

Further, the Court did not discuss the effects of investors’ legitimate expectations on the breach of the FET standard.²³² As discussed, this concept produces different effects in EU law and international law.²³³ Investors’ legitimate expectations are important for

²²⁹ Annex 8-A point 3 CETA; Opinion 1/17 (n 45) para 157.

²³⁰ Art 8.10.2 CETA; Opinion 1/17 (n 45) para 158.

²³¹ See section 8.2.1.2 above.

²³² Art 8.10.4 CETA. On the FET standard, see chapter 2, section 2.1.2. In EU law, legitimate expectations are a general principle of EU law, the breach of which incurs non-contractual Member State or EU liability.

²³³ See section 8.2.1.3 above and chapter 7, section 7.1.2.2.

determining compensation in international law, unlike in EU law, which gives more weight to public interest.²³⁴ In practice, it is also likely that legitimate expectations of investors will be more often assessed in the context of Member States' national measures rather than EU measures.²³⁵ In light of the investment case-law, ICS tribunals might embrace the concept of legitimate expectations as developed and applied in IIL rather than EU law. Consequently, the application of this standard in the CETA context could lead to the challenges of measures made in the public interest.

While it is difficult to predict what standards and interpretative approaches will be adopted by the ICS tribunals, CETA Contracting parties have additional tools in CETA through which they can ensure the correct interpretation of the investment chapter of CETA. For example, CETA envisages that parties will regularly review the content of the FET obligation and may develop recommendations for the CETA Joint Committee.²³⁶ This Joint Committee may adopt interpretations of CETA which will be binding on the ICS tribunals.²³⁷ In the system of *ad hoc* tribunals similar interpretative statements have had limited effects (e.g. in the NAFTA context). However, the permanent character of ICS tribunals could ensure a more effective application of the interpretative statements in the CETA context. Therefore, in legal terms, parties can correct any ICS' interpretation that strays from the right to regulate as envisaged by the Contracting parties. Politically, it might be more difficult to agree on the content of the correct standard. In any case, the available mechanisms allow for some level of EU control over the compliance of CETA standards with EU law, which was sufficient for the CJEU to conclude that the right to regulate in the EU would be guaranteed.

²³⁴ Strik (n 18) 206-7.

²³⁵ In the recent practice of international investment tribunals Spanish cases under the ECT serve as prime examples of differences between the concept of legitimate expectations under EU law and IIL. Investors, mostly from the EU, submitted claims in response to the Spanish Government's decision to modify its investment incentive scheme for the generation of renewable energy in 2013 and 2014 following the economic crisis. However, because Spain implemented the incentive scheme before it notified the EC as required under EU law, the scheme constituted an illegal State aid pursuant to TFEU Article 108(3). In a Decision on State aid investigation of 10 November 2017, the EC emphasised that in any case Spain has not violated the principles of legal certainty and legitimate expectations under EU law and that no investor could have a legitimate expectation stemming from an illegal State aid: Case SA.40348 (2015/NN) Commission Decision C (2017) 7384 final, paras 164-166. However, the FET principle under international law has a broader scope than these two principles under EU law, consequently resulting in Spain's liability in a number of concluded cases.

²³⁶ Art 8.10.3 CETA.

²³⁷ Art 8.31.3 CETA. The CJEU explicitly placed two safeguards on such interpretations: they cannot have retroactive effect or direct effect on pending cases: Opinion 1/17 (n 45) para 237.

8.2.2.3. The right to regulate and extra-EU BITs

The right to regulate is a new substantive criterion of the autonomy of EU law, as declared in Opinion 1/17. However, does this CJEU finding have any consequences for Member States' extra-EU BITs? Importantly, pre-Lisbon BITs do not include the right-to-regulate clause found in CETA. The question is therefore whether Opinion 1/17 renders Member States' pre-Lisbon BITs incompatible with EU law and whether these IIAs should be changed to incorporate the right-to-regulate clause.

In light of the CJEU's reasoning in Opinion 1/17, it is likely that its effects are limited to EU agreements. The CJEU focused on the effects of CETA awards on acts of EU institutions and the public interest in the EU guaranteed under EU legislation within the EU constitutional framework.²³⁸ Since extra-EU BITs do not bind the EU, they cannot affect the powers of EU institutions under the founding treaties in the same way that EU agreements can. The impact of extra-EU BITs on the autonomy of the EU legal order is not inconceivable but it is remote.²³⁹

On the other hand, expansive extra-EU BITs could have negative effects on the protection of public interest in individual Member States. In the majority of cases, such effects are limited to the challenged Member States' measures which might or more often might not concern EU law. Nevertheless, the effects of extra-EU arbitral awards on EU legislation cannot be fully excluded. They could be more prominent in cases when a number of Member States are exposed to claims stemming from the same EU legislation. Numerous claims across Member States could create political pressure on the EU to abandon its legislation in order to exculpate Member States from paying damages for implementing EU law. On the other hand, in the absence of such a scenario, an individual Member State will be required to choose whether to comply with its obligations under EU law or under IIL, and ultimately bear the cost of this choice.

The other issue is whether adding the right-to-regulate clause, without more substantive changes to investment protection standards in pre-Lisbon extra-EU BITs, would have a desired practical impact which would guarantee the Member States' regulatory autonomy. In light of Opinion 1/17, it seems that a more substantially restrictive drafting of these standards, in addition to the right-to-regulate clause, would be required to guarantee protection of the public interest in the Member States.

²³⁸ See Opinion 1/17 (n 45) paras 137-161.

²³⁹ See section 8.1.1.2(iii) above, and in particular fn 68 and text to fn 68.

Post-Lisbon extra-EU BITs follow the pathway of EU IIAs and include the right-to-regulate clauses.²⁴⁰ Some include more specific provisions on regulating anti-competitive practices,²⁴¹ labour,²⁴² environmental standards and/or sustainable development.²⁴³ The objective of many of these BITs is to prevent a race-to-the-bottom in the developing third States rather than enabling the implementation of higher standards.²⁴⁴ The effectiveness of these clauses will be known only after their implementation in the arbitral practice.

8.2.3. *Dispute settlement and procedural provisions*

Different to investment standards, EU IIAs and Member States' post-Lisbon extra-EU BITs more substantially differentiate with respect to the dispute settlement mechanism. While EU IIAs incorporate quasi-permanent ICS,²⁴⁵ post-Lisbon extra-EU BITs continue implementing *ad hoc* ITA.²⁴⁶ The reasons for this divergent approach are mainly pragmatic and should persist only until the establishment of a Multilateral Investment Court (MIC).

The main difference between the ICS and ITA is in the permanency of the appointment of the ICS tribunal members and the availability of an appellate mechanism. The ICS tribunal members are, at both the first and the appellate instances, appointed for a fixed period of time (a minimum of five years) by the EU and the Contracting party to the respective EU IIA. Their number and terms of tenure vary on the basis of the bilateral

²⁴⁰ See Art 2(2) Dutch Model BIT 2018 (general provision on the right to regulate aimed at legitimate policy objectives, 'such as the protection of public health, safety, environment, public morals, labour rights, animal welfare, social or consumer protection or for prudential financial reasons'); Art 3 Agreement between the Government of Hungary and the Government of Cabo Verde for the Promotion and Reciprocal Protection of Investments (signed 28 March 2019) (Hungary–Cabo Verde BIT). Cf. Slovakia–Iran BIT and Slovakia–UAE BIT, which do not have such general clauses.

²⁴¹ See Art 2(3) Dutch Model BIT 2018, which reserves the right of Contracting parties to 'introduce or maintain non-discriminatory, appropriate and necessary measures for the purpose of preventing investors who, alone or together, have the ability to affect materially the terms of participation in the relevant market as a result of their position in the market, from engaging in or continuing anti-competitive practices'.

²⁴² Art 5 Austria–Kyrgyzstan BIT. The standard of labour laws refers to 'internationally recognised labour rights', in line with similar labour provisions in EU FTAs: see chapter 4, section 4.3.2.

²⁴³ See a very elaborate provision in Art 6 Dutch Model BIT 2018, which, *inter alia*, aims to ensure that States provide for and encourage high levels of environmental and labour protection (see Art 6(2)) and do not lower the existing standards in order to attract investment (Art 6(4)); cf. Art 4 Austria–Kyrgyzstan BIT, which focuses only on the latter: 'The Contracting Parties recognise that it is inappropriate to encourage an investment by weakening domestic environmental laws'.

²⁴⁴ The subsection of the Hungary–Cambodia BIT prescribes that Contracting Parties 'shall not encourage investment by lowering domestic environmental, labour or occupational health and safety legislation or by relaxing core labour standards', envisaging a State-to-State consultation procedure in such instances: Art 2(3). However, some BITs include both objectives (discouraging the relaxation of standards and establishing their own level of environmental and sustainable development policies): see Art 12(1) and (2) Slovakia–UAE BIT.

²⁴⁵ For more detailed analysis of the ICS in light of the rule of law criteria, see chapter 9, section 9.3.2.

²⁴⁶ For ITA as a dispute settlement mechanism, see chapter 2, section 2.2.3 and chapter 3, section 3.3.2.2.

IIA.²⁴⁷ This mechanism aims at ensuring independence of adjudicators from the parties and addressing the perception of bias which exists in traditional ITA. In addition, cases are randomly allocated and decided by the divisions consisting of three members and chaired by a non-national, both at first and appellate level.²⁴⁸ The appellate instance is an additional procedural instance between the issuance of the provisional award and the final award, to which, *mutatis mutandi*, a number of rules applicable in the first instance apply.²⁴⁹ The appeal is limited in its grounds and time.²⁵⁰ The final award should be issued on average within 24 months from the submission of the claim to the First Instance Tribunal.²⁵¹

The significance of the permanency of adjudicators and the appellate mechanism must be understood in the context of consistency and predictability, which are important objectives of the EU IIP's important objectives.²⁵² Apart from these two ICS features, other key elements of arbitration (submission of the claim, consent, procedural rules, and enforcement of awards) remain unchanged in the ICS framework. A claim can be submitted under the ICSID or the UNCITRAL Rules,²⁵³ which consequently determine the requirements for the consent,²⁵⁴ the procedure and the enforcement.²⁵⁵ While double-

²⁴⁷ For example, CETA envisages a First Instance Tribunal of 15 members (five nationals of EU Member States, five nationals of Canada and five nationals of third countries) appointed for a five-year term, renewable once: Art 8.27.2 and 8.27.5 CETA; the EUSIPA envisages six members (two *appointed* by the EU, two by Singapore and two jointly by the EU and Singapore, who will be nationals of third States): Art 3.9.2 EUSIPA. Their term is longer than in CETA (eight years) and 'may be renewed' by the decision of the joint Committee: Art 3.9.5 EUSIPA. The numbers of tribunal members can be increased or decreased, depending on the caseload. *Mutatis mutandi* provisions for the appointment apply to the Appeal Tribunal in EUSIPA: see Art 3.10; CETA envisages that a CETA Joint Committee will decide the number of members of the Appellate Tribunal and other related procedures: see Art 8.28.7. In addition, in the case of CETA, if the appointments for the First Instance Tribunal are unsuccessful, the Secretary General of ICSID, on the request of any disputing party, may appoint the division of three members for that particular case: see Art 8.27.17 CETA.

²⁴⁸ Art 8.27.6 and 8.27.7 CETA; Art 3.9.7 and 3.9.8 EUSIPA. However, parties may agree to have their case heard by a sole Member: Arts 8.27.9 CETA and 3.9.9 EUSIPA.

²⁴⁹ For example, composition of the tribunal, transparency, non-disputing party submissions, third party funding, costs. See Arts 8.28 CETA and 3.19 EUSIPA.

²⁵⁰ Arts 8.28 CETA and 3.19 EUSIPA. The appeal must be submitted within 90 days from the issuance of the provisional award. The award can be appealed on the basis of: (i) errors in the interpretation or application of the applicable law; (ii) manifest errors of facts, including the appreciation of domestic law as a matter of fact; and (iii) the grounds listed in Art 52 ICSID Convention. EUSIPA rules on appellate proceedings are more elaborate than CETA's. For example, the EUSIPA in Art 3.19.3 prescribes that the Appeal Tribunal may modify or reverse the legal findings and conclusions in the provisional award in whole or in part and refer the matter back to the First Instance Tribunal. The First Instance Tribunal is bound by the conclusions of the Appeal Tribunal. A new hearing seems to be possible 'if appropriate'. The revised award should be issued within 90 days after the Appeal Tribunal's referral.

²⁵¹ Art 8.39.7 CETA. In the EUSIPA the provisional award should be issued within 18 months: Art 3.18.4. As a general rule, the appeals proceedings should be finalised within 180 days and in any case should not exceed 270 days from the date a disputing party notifies its decision to appeal the provisional award: Art 3.19.4.

²⁵² See chapter 4, section 4.3.3.

²⁵³ Arts 8.23.2 and 8.23.7 CETA; 3.6.1 EUSIPA.

²⁵⁴ Arts 8.25.2 CETA; 3.6.2 EUSIPA.

²⁵⁵ Arts 8.41.3, 8.41.5 and 8.41.6 CETA; Arts 3.22.5 and 3.22.6 EUSIPA.

hatting should be disallowed,²⁵⁶ the ethics rules,²⁵⁷ the code of conduct and the remuneration of tribunal members are nevertheless developed from the existing arbitration rules.²⁵⁸

EU IIAs and extra-EU BITs include a number of procedural improvements commonly found in modern IIAs, which are aimed at enhancing transparency, openness and effectiveness of the process.²⁵⁹ Transparency is ensured by reference to the UNCITRAL Rules on Transparency in Treaty-based Investor–State Arbitration.²⁶⁰ Given the court-like features of the ICS, EU IIAs envisage a more open and inclusive process than Member States’ BITs.²⁶¹ Further rules are aimed at improving the effectiveness of the

²⁵⁶ The members of the Tribunal ‘shall refrain from acting as counsel or as party-appointed expert or witness in any pending or new investment dispute’ under CETA or any other IIA. In addition, they ‘shall not be affiliated with any government’ and ‘shall not take instructions from any organisation, or government with respect to the dispute’: Art 8.30.1 CETA; Art 3.11.1 EUSIPA. However, the formulation of this rule leaves the possibility for tribunal members to engage in other outside activities. In addition, it is explained in a footnote to these provisions that the fact that a person receives remuneration from a government or has been previously employed by a government does not in itself render the person ineligible.

²⁵⁷ However, the ethics rule in CETA in Art 8.30.2 envisages that the President of the ICJ would make a decision regarding conflicts of interest by tribunal members. In the EUSIPA, the challenge is resolved through internal procedures with the involvement of the President of the First Instance or the Appeal Tribunal respectively: see Art 3.11.2 EUSIPA.

²⁵⁸ Tribunal members are paid a monthly retainer fee and a daily fee for days actually worked, the latter being determined pursuant to the ICSID financial rules: Arts 8.27.12 and 8.27.14 CETA; see also Arts 3.9.12–14 EUSIPA. Eventually, this might transform into a regular salary: Arts 8.27.15 CETA and 3.9.15 EUSIPA. The Secretariat of ICSID acts as Secretariat for EU IIAs First Instance tribunals and provides appropriate support: Arts 8.27.16 CETA and 3.9.16 EUSIPA. The code of conduct is based on the rules in the IBA Guidelines on Conflict of Interest in International Arbitration: see Art 8.30.1 CETA. See also Art 3.11 and Annex 7 of the EUSIPA. See chapter 9, section 9.3.2.2 for further discussion on conflict of interest issues in CETA.

²⁵⁹ Although extra-EU BITs retain *ad hoc* ITA, some include innovations in the appointment of arbitrators. For example, the Dutch Model BIT 2018 envisages that all tribunal members will be appointed by an appointing authority (the Secretary General of ICSID if the claim has been submitted according to the ICSID Convention or the Additional Facility Rules – however, the appointment does not have to be from the ICSID Panel of Arbitrators, or the Secretary General of the Permanent Court of Arbitration if the claim has been submitted under the UNCITRAL Rules): Art 20(1). However, this will be done in consultation with disputing parties: Art 20(2). The requirements of qualifications are similar to those in EU IIAs. Double-hatting is also disallowed: Art 20(5). The ethics provisions follow those in CETA (reference to IBA Guidelines on the Conflict of Interest in International Arbitration or any agreed supplemental rules; challenges regarding the conflict of interest of the tribunal members resolved by the President of the ICJ): see Arts 20(6) to (8).

²⁶⁰ Art 8.36.1 CETA. In some aspects CETA goes even further by allowing the publication of a number of otherwise publicly unavailable documents (e.g. the request for consultation, the agreement to mediate, the decision on adjudicator’s challenge etc.): see Art 8.36.2–4 CETA; see Annex 8 of the EUSIPA for separate procedures on transparency in the context of that agreement. Extra-EU BITs also refer to the UNCITRAL Transparency Rules: see, for example, Art 20(13) Dutch Model BIT 2018; Art 11 Hungary–Cabo Verde BIT; Art 24 Slovakia–UAE BIT and Art 14(4) Slovakia–Iran BIT (but both UAE and Iran respectively reserve the right not to apply UNCITRAL Transparency Rules to any proceedings initiated against them).

²⁶¹ For example, CETA envisages that hearings would be open to the public, apart from issues concerning confidential and protected information: see Art 8.36.5. Interested third parties can make submissions to the Tribunal under certain conditions: Art 8.38 CETA; similarly, see Art 3.17 EUSIPA. However, EU IIAs are not bringing any revolutionary novelties, given that these options are available as part of the UNCITRAL Transparency Rules or are part of the current reform of the ICSID Rules (on this reform, see chapter 3, section 3.3.2.2). See also Art 20(13) Dutch Model BIT 2018, which envisages that the disputing parties will give ‘positive consideration’ to a third party’s request for an *amicus curiae* oral or written submission. Other extra-EU BITs are mostly silent on these issues but their inclusion in the process is possible also through the relevant arbitration procedural rules.

system by imposing procedural timelines,²⁶² encouraging mediation²⁶³ and facilitating the access of SMEs to the ICS tribunals.²⁶⁴ Finally, a number of procedural tools are envisaged to prevent undue uses of the system.²⁶⁵ For example, an expeditious procedure is envisaged for the dismissal of frivolous claims,²⁶⁶ based on the existing practice in IIL.²⁶⁷ The cost provisions are additionally aimed at discouraging unfounded claims.²⁶⁸ EU IIAs

²⁶² For example, discontinuance of the proceedings if no steps have been taken by the investor during 180 consecutive days following the submission of the claim (Art 8.35 CETA); the timeline for the appeal process (Art 3.19.4 EUSIPA) and for the issuance of the final/provisional awards (Arts 8.39.7 CETA; 3.18.4 EUSIPA; similarly also Art 22(1) Dutch Model BIT 2018) etc.

²⁶³ Recourse to mediation is possible anytime during the process and does not prejudice the legal rights of parties. Mediation freezes the procedural deadlines for the submission of the request for consultation (which is a prerequisite for the submission of the claim to the ICS tribunal) and the submission of the claim: see Arts 8.20 CETA and 3.4 EUSIPA. In the case of EUSIPA, mediation rules have already been agreed by the Contracting parties in Annex 6. In the case of CETA, the rules are yet to be agreed.

²⁶⁴ In particular, it is envisaged that the CETA Joint Committee 'shall consider supplemental rules aimed at reducing the financial burden on claimants who are natural persons or SMEs', which 'may, in particular, take into account the financial resources of such claimants and the amount of compensation sought': Art 8.39(6) CETA. See also the commitment made by the EU in the Statement No. 36 (n 117) to take the appropriate measures, which will ensure the accessibility of the ICS to SMEs (co-financing SMEs' actions and technical assistance). Similarly, see Art 3.21.5 EUSIPA. The EC has not yet made any proposals to this end. Several other provisions of EU IIAs are also aimed at enabling access by SMEs to the ICS. For example, parties may agree to have their case heard by a sole tribunal member, whereby a 'sympathetic consideration' will be given by a respondent State to a request from a claimant who is an SME or where the compensation or damages claimed are low (Arts 8.27.9 CETA; 3.9.9 EUSIPA). It is also envisaged that consultations of disputing parties (a prerequisite for the submission of the claim) can be held 'through videoconference or other means where appropriate, such as in the case where the investor is an SME': Arts 8.19.3 CETA; 3.3.7 EUSIPA. The access to the ICS as the access to justice requirement under EU law (Art 47 CFR) has been particularly emphasised by the CJEU in Opinion 1/17 (n 45): see chapter 9, section 9.3.3. Some extra-EU BITs also have provisions aimed at enabling SMEs' access to arbitration (see, for example, Arts 20(3) and 22(5) Dutch Model BIT), although reference to SMEs in extra-EU BITs is the exception rather than the rule.

²⁶⁵ See also jurisdictional limitations discussed in section 8.2.1.1 above.

²⁶⁶ 'Claims manifestly without legal merit' (Arts 8.32 CETA; 3.14 EUSIPA) and 'claims unfounded as a matter of law' (Arts 8.33 CETA; 3.15 EUSIPA).

²⁶⁷ Similar provisions are found in other modern IIAs (see, for example, Art 28(4) US Model BIT 2012). This involves situations where the claim concerns non-existent legal rights; for example, sale and purchase contracts which are not subject to protections under IIAs. Both objections are submitted as preliminary objections, at different times but involving a similar legal test. Claims manifestly without legal merit concern frivolous claims against which the objection is raised at the very start of the proceedings (no later than 30 days after the constitution of the tribunal and in any case before the first tribunal's session). Parties can still file other jurisdictional objections in the course of the proceedings. For extra-EU BITs practice, see Art 21(2) Dutch model BIT. The objection that a claim is unfounded as a matter of law (legal test: an award in favour of the claimant cannot be made, even if the facts were assumed to be true) must be submitted before the respondent's counter-memorial is submitted. Proceedings on the merits will be suspended until preliminary objections have been decided. The rule on the claims that are manifestly without legal merits is found in ICSID Rule 41(5), where it is considered a residual rule. For an analysis of the application of this rule in the practice of arbitral tribunals and the comparative practice of other international courts, see Michele Potestà and Marija Sobat, 'Frivolous Claims in International Adjudication: A Study of ICSID Rule 41(5) and of Procedures of Other Courts and Tribunals to Dismiss Claims Summarily' (2012) 3 *Journal of International Dispute Settlement* 137.

²⁶⁸ EU IIAs as a general rule incorporate the 'loser pays principle', whereby the costs of the proceedings are borne by the unsuccessful party. In 'exceptional circumstances' these costs will be apportioned. The unsuccessful party should also cover 'other reasonable costs' such as costs of legal representation and assistance, 'unless the tribunal determines that such apportionment is unreasonable in the circumstances of the claim': see Art 8.39.5 CETA. See similarly Art 3.21 EUSIPA. In the practice of post-Lisbon extra-EU BITs, similar provision is found in Art 22(8) Slovakia-UAE BIT (but cf. Art 21(4) Slovakia-Iran BIT which is silent on the issue). In the Dutch Model BIT 2018 only reasonable costs incurred by the successful disputing party will be borne by the unsuccessful party, at the discretion of the tribunal when assessing the unreasonableness of such an allocation in the circumstances of the case (the tribunal would take into account the behaviour of the successful party and whether the unsuccessful party is an SME): see Art 22(5).

also include disclosure obligations for third-party funding.²⁶⁹ All these procedural improvements take into account different outcomes of the arbitral practice and follow the current trends in IIL.²⁷⁰

A new MIC should replace both the ICS in EU IIAs as well as ITA in Member States' extra-EU BITs. EU IIAs are used as a mechanism to build support for establishment of a MIC.²⁷¹ The replacement of a bilateral ICS with a MIC should not pose a problem for the EU once the MIC has been established although the third States' commitment regarding the future multilateral mechanism varies across treaties.²⁷² Similar expressions are found in post-Lisbon extra-EU BITs.²⁷³ However, the replacement of ISDS in these agreements with a MIC will require the accession of both Contracting parties to a multilateral instrument establishing a MIC,²⁷⁴ which should not be taken for granted, in particular in the case of the Member States' post-Lisbon BITs.²⁷⁵

²⁶⁹ See Arts 8.26 CETA and 3.8 EUSIPA. However, the obligation includes only the notification to the other disputing party and to the tribunal of 'the name and the address of the third party funder', without further more specific details (e.g. terms of the funding agreement), which could limit speculative funding. New extra-EU BITs do not have provisions for third-party funding. For an overview of policy issues in regard to third-party funding in ITA, see Frank J Garcia, 'The Case Against Third-Party Funding in Investment Arbitration' (2018) 2 Investment Treaty News 7.

²⁷⁰ For a detailed analysis of CETA in light of IIL and NAFTA and other treaties practice, see Elsa Sardinha, 'Towards a New Horizon in Investor-State Dispute Settlement? Reflections on the Investment Tribunal System in the Comprehensive Economic Trade Agreement (CETA)' (2017) 54 Canadian Yearbook of International Law 311.

²⁷¹ See Arts 8.29 CETA and 3.12 EUSIPA. The parties 'shall pursue' with (each other and) other (interested) trading partners 'the establishment of a multilateral investment tribunal and appellate mechanism'.

²⁷² CETA is rather categorical (upon the establishment of a MIC, the CETA Joint Committee 'shall adopt a decision' providing for the replacement of the ICS with MIC and any appropriate transitional arrangement); the EUSIPA less so (the Committee 'shall consider adopting a decision'), while the EUVIPA in Art 3.41 is least certain about the form of the new mechanism and its applicability in the bilateral context: 'The Parties shall enter into negotiations for an international agreement providing for a multilateral investment tribunal *in combination with, or separate from*, a multilateral appellate mechanism applicable to disputes under this Agreement. The Parties *may consequently agree* on the non-application of relevant parts of this Section. The Committee *may* adopt a decision specifying any necessary transitional arrangements' (emphasis added).

²⁷³ See Art 15 Dutch Model BIT 2018; Art 24(4) Slovakia-Iran BIT; Art 9(11) Hungary-Cabo Verde BIT. But no such provision is found in the Hungary-Cambodia BIT or Austria-Kyrgyzstan BIT.

²⁷⁴ In the EU's proposal to UNCITRAL, this would involve a combination of (1) an instrument for the accession to the MIC, and (2) a multilateral instrument which would allow that a particular existing or future agreement would be subject to the jurisdiction of a MIC: see UNCITRAL, 'Possible reform of investor-State Dispute Settlement (ISDS), Submission from the European Union and its Member States' (24 January 2019) UN Doc A/CN.9/WG.III/WP.159/Add.1, paras 35-36. The latter examples include the Mauritius Convention on Transparency in ISDS and the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the 'BEPS' Convention) in the framework of the OECD. For further discussion on MIC, see Part III.

²⁷⁵ See, for example, Art 26(4) of the Slovakia-UAE BIT, which reads: 'Contracting Parties may consider implementation of future developments in policy of investment protection of either Contracting Party, including a multilateral investment court provided that both Contracting Parties are signatories of the Convention establishing such a court'.

8.2.4. The Energy Charter Treaty as an extra-EU IIA of the EU and the Member States

The ECT is a notable exception among EU IIAs. It is an ‘old-style’ pre-Lisbon IIA and the only EU agreement with traditional ISDS clauses.²⁷⁶ It has both intra- and extra-EU dimensions.²⁷⁷ It is also an extra-EU IIA of the Member States. The ECT is currently undergoing modernisation.²⁷⁸ As part of this challenging process, the EU, as the original ‘mastermind’ behind the ECT, is seeking to achieve a more substantial reform, which would align the ECT with EU law and its IIP.²⁷⁹

The substantive incompatibilities between the ECT and Treaty law, in particular the unqualified capital transfer guarantees in the ECT, must be brought in line with EU law. *Mutatis mutandi*, the CJEU’s findings regarding the Member States’ pre-Lisbon extra-EU BITs apply to the ECT.²⁸⁰

In light of Opinion 1/17, there are likely to be further incompatibilities between the ECT and EU law. The ECT contains broad substantive provisions and no specific ‘right to regulate’ clause. Nevertheless, some clauses allow for the integration of environmental aspects²⁸¹ and envisage public interest exceptions in the case of measures which are ‘necessary to protect human, animal or plant life or health’²⁸² or ‘safety’.²⁸³ However, the latter exceptions do not apply to all clauses.²⁸⁴ Given these clauses, the public interest would be differently weighed in the consideration of its effects on investors’ rights under the ECT (by arbitral tribunals) and EU law (by domestic and EU courts).²⁸⁵ It is therefore questionable whether the right to regulate in the EU, as a substantive requirement of the

²⁷⁶ For more on the ECT and its status under EU law, see chapter 7, section 7.2.3

²⁷⁷ For more extensive debate on intra-EU issues in the context of ITA, including under the ECT, see chapter 7, sections 7.2-7.5.

²⁷⁸ See Energy Charter Secretariat, ‘Decision of the Energy Charter Conference: Adoption by Correspondence – Policy Options for Modernisation of the ECT’ (6 October 2019) CCDEC 2019.

²⁷⁹ In the meantime, the compliance of the ECT with EU law remains an ongoing issue. From the very start, the position of the EC has been that ‘there is no incompatibility between the ECT and EU law’: see, for example, Case C-264/09 *Commission v Slovakia* [2011] ECR I-8065, para 18. Cf. scholarly opinions, which have early emphasised a number of problems between EU law and the ECT, in both intra- and extra-EU dimensions. See Jan Kleinheisterkamp, ‘The Next 10 Year ECT Investment Arbitration: A Vision for the Future – From a European law perspective’ (Report for the SCC/ECT/ICSID Conference on ‘10 Years of Energy Charter Treaty Arbitration’, 9-10 June 2011) <https://sccinstitute.com/media/61991/jan_kleinheisterkamp_report-ect-eu-law.pdf> accessed 30 June 2020.

²⁸⁰ See section 8.1.1.1 above.

²⁸¹ Art 19 ECT.

²⁸² Art 24(2) ECT.

²⁸³ Art 24(3) ECT.

²⁸⁴ Importantly, the much invoked Art 13 (expropriation) is excluded from the scope of public interest exceptions: Art 24(1) ECT.

²⁸⁵ For a more detailed comparative analysis, see Ivana Damjanovic and Ottavio Quirico, ‘Intra-EU Investment Dispute Settlement in light of *Vattenfall* and *Achmea*: A Matter of Priority’ (2019) 26 *Columbia Journal of European Law* 102 134-143.

EU law autonomy,²⁸⁶ is guaranteed under the ECT, which is an agreement to which the EU is a party.

A more important consideration for the EU is, however, the possibility of ECT awards to affecting the allocation of powers between the EU and the Member States fixed by the EU founding treaties. The apportionment of financial responsibility for measures challenged before the ECT tribunals is one such issue that could have an adverse effect on the autonomy of EU law.²⁸⁷ With this in view, following Opinion 1/17 the EU submitted to the ECT Secretariat a statement aimed at ensuring that in extra-EU claims that concern the implementation of measures under EU law the EU (and not the investment tribunal) will determine whether the respondent in the arbitration proceedings is the EU or the Member State.²⁸⁸ The statement therefore serves to preserve the exclusive jurisdiction of the CJEU to give rulings on the division of powers between the EU and its Member States, and thus serves to protect the autonomy of the EU legal order.²⁸⁹

In light of Opinion 1/17, a further issue is whether ITA under the ECT complies with the requirements of Article 47 CFR. The CJEU's assessment in Opinion 1/17 suggests that the new ICS is a *minimum* standard that an international tribunal must fulfil in order to comply with the right of access to an independent tribunal.²⁹⁰ It is questionable whether an ISDS tribunal under the ECT would comply with this standard.²⁹¹ While this issue would arguably be less important for extra-EU BITs since they mostly concern Member

²⁸⁶ See section 8.2.2.2 above.

²⁸⁷ In order to address these issues, the EU adopted Regulation (EU) 912/2014 of the European Parliament and of the Council of 23 July 2014 establishing a framework for managing financial responsibility linked to investor-to-state dispute settlement tribunals established by international agreements to which the European Union is party [2014] OJ L257/121. The EC recently submitted a report on the applicability of the Regulation in the extra-EU context, which concerns the ECT extra-EU claims: see European Commission, 'Report from the Commission to the European Parliament and the Council on the operation of Regulation (EU) No 912/2014 on the financial responsibility linked to investor-to-state dispute settlement under international agreements to which the European Union is a party', COM (2019) 597 final. For further discussion on this Regulation in the context of new EU IIAs, see chapter 9, section 9.2.3.

²⁸⁸ Statement submitted to the Energy Charter Treaty (ECT) Secretariat pursuant to Article 26(3)(b)(ii) of the ECT replacing the statement made on 17 November 1997 on behalf of the European Communities [2019] OJ L115/1. This EU statement clarifies the consequences of the adoption of the Regulation 912/2014 regarding the management of the financial responsibility for investment claims between the EU and Member States.

²⁸⁹ See Opinion 1/17 (n 45) para 132.

²⁹⁰ See chapter 9, sections 9.3.2 and 9.3.3.

²⁹¹ Even if the independence element were fulfilled (given the internal arbitration mechanisms for the resolution of conflicts of interest), the cost of the ECT litigation would draw into question whether the 'access to justice' element is fulfilled. However, the assessment would not be made in the abstract. The CJEU would have an opportunity to assess the compliance of the ECT award with the right of access to an independent tribunal only if the award is challenged before the domestic court in the EU in the process of the enforcement (NB. the EU is not a party to the ICSID Convention). In such a case, the CJEU would make the assessment about the compliance of that particular ECT award with Art 47 CFR, taking into account the independence and access to justice issues particular to that case (in light of Opinion 1/17, incompatibility issues of the access to justice concern only cases involving SMEs). It is likely that the CJEU would refrain from a more general interpretation of the ECT's compatibility with Art 47 CFR (cf. Opinion 1/17 (n 45), where this is necessary in light of the nature of the Opinion and the questions posed by Belgium).

States' national measures, it could be more relevant in cases when measures made by the EU have been challenged before the ECT tribunals.²⁹²

Against this background, with the first case involving a claim against the EU under the ECT recently recorded,²⁹³ the issues regarding the relationship and compatibility between the ECT and EU law in the extra-EU dimension will become more prominent. On the one hand, the issue is how the ECT tribunals will treat judgments of the CJEU.²⁹⁴ On the other hand, the CJEU might also get more opportunities to assess the ECT awards against EU law.²⁹⁵ Given the long negotiation process of the ECT reform that is ahead, in the interim, and in the general interest of legal certainty, the two judicial authorities should refrain from encroaching into other adjudication's respective competence.²⁹⁶ So far, at least in the ECT context, the CJEU has shown more willingness to adopt a consensual

²⁹² See also comments already made regarding Member States' extra-EU BITs in section 8.1.1.2(iii) above.

²⁹³ *Nord Stream 2 AG v the European Union*, PCA Case No. 2020-07, was registered in 2019 and is governed by the UNCITRAL rules. The Swiss investor's claim alleges breaches of the ECT's FET and expropriation clauses (Arts 10 and 13 ECT). The claim is made by a subsidiary of Russian Gazprom incorporated in Switzerland and it challenges the measures of the new EU Directive 2019/692 of 17 April 2019, which amends the earlier EU Gas Directive 2009/73/EC. The changes have altered the earlier regime of unbundling third party access to the internal market by extending EU gas liberalisation rules, previously applied only to intra-EU projects, to projects transporting energy from outside the EU to the EU. Nord Stream 2 AG has requested from the EU a derogation from the new regulatory regime to recover its investment made, and if such derogation is not granted, it claims a breach of the EU's FET obligations under the ECT. The EC's response has been that it considers the new EU Directive non-discriminatory and compatible with its obligations under the ECT, emphasizing the competence of the relevant Member States' authorities to grant derogations under the new Directive: see European Commission Report (n 287) 3-4. The investor has also requested the annulment of the EU Directive and the case is pending before the CJEU: Case T-530/19 *Nord Stream v Parliament and Council*. In this case, the investor has challenged the legality of the 'excessively short' deadline for obtaining the derogations under the EU principle of proportionality; alleging the violation of Art 295 TFEU for failure to state reasons for such a short deadline; and the violation of the EU principle of legitimate expectations due to unjust limits for obtaining necessary derogations. Finally, the Nord Stream 2 project has a significant (geo)political background, concerning EU relations with the US and Russia: see Fabian Simon Eichberger, 'Nord Stream 2: Arbitration Notices from Moscow' (*Völkerrechtsblog*, 1 October 2019) <<https://voelkerrechtsblog.org/nord-stream-2-arbitration-notice-from-moscow/>> accessed 30 June 2020.

²⁹⁴ The first test will be whether the CJEU's decision regarding the Nord Stream case will be taken into account for the purposes of the fork-in-the-road provision of the ECT in Article 26(2)(a) ECT. The recent EU Statement to the ECT Secretariat also clarifies that legal action of a claimant from a non-EU State undertaken in the EU judicial system (including in cases involving the CJEU through the preliminary rulings procedure) should be recognised as precluding extra-EU ITAs in accordance with the fork-in-the-road provision of Article 26(2)(a) ECT: EU Statement (n 288) paras 4-5. In the *Nord Stream 2* case, the claimant is from Switzerland and therefore the Statement should be applicable to the case.

²⁹⁵ For example, the CJEU has recently received a request for a preliminary ruling on the compatibility of the ECT Award of 23 October 2013, made in the case *Energoaliants TOB v Republic of Moldova*, under the UNCITRAL rules. The enforcement of this award has been challenged by Moldova before French courts. The Paris Court of Appeal requested from the CJEU an interpretation of the notion of investment in Art 1(6) of the ECT and in relation to its investment status, its eligibility to access ISDS under Art 26(1) of the ECT: see Case C-741/19 *République de Moldavie*. Importantly, the questions posed by the French court entail the interpretation of the ECT as an international agreement rather than an EU agreement.

²⁹⁶ The autonomy of EU law will be protected if EU law is treated as a matter of fact and the CJEU interpretations of EU law are taken as authoritative interpretations of EU law. If intra-EU arbitral jurisprudence is the reference point, it is possible that the CJEU's decisions would be ignored in this context too. See chapter 7, sections 7.3.1 and 7.4. However, the position of arbitral tribunals might be different in cases concerning challenges against the EU given the exceptional nature of these claims (only one so far) and the fact that EU law has greater relevance for the determination of these cases. It is likely that the tribunals would treat the decisions of the CJEU as decisions of any other domestic court, in which case the effects of these awards on the autonomy of EU law remain uncertain and it cannot be excluded that they could also be adverse.

approach.²⁹⁷ In light of Opinion 1/17 it is likely that the CJEU would prefer that the ECT in its extra-EU dimension should continue to operate in the sphere of international law and separately from EU law.²⁹⁸

Finally, it can be expected that the process of the ECT modernisation will be, just as in its creation, led by the EU.²⁹⁹ The main EU normative objectives of the modernised ECT are related to sustainable development and climate change, including submitting the third countries' operators in the internal market to EU and Member States' laws, such as those concerning environmental and safety policy.³⁰⁰ The modernised ECT should facilitate clean energy transition 'in line with the Paris Agreement and recently concluded EU agreements and EU positions in ongoing negotiations'.³⁰¹ Regarding investment protection, the aim is to align the ECT with new IIAs of the EU and Member States. This includes 'appropriate' standards of protection, consistent with EU law and the EU's reformed approach to investment protection.³⁰² The reform of ISDS provisions will also be in line with the EU's position taken in UNCITRAL and ICSID, and in any event the EU

²⁹⁷ The CJEU case *Commission v Slovakia* (n 279) concerned the conflict between Slovakia's ECT obligations towards a Swiss investor and Slovakia's obligations to comply with EU law. The CJEU considered Slovakia's pre-accession investment contract with a Swiss operator ATEL, which granted to ATEL preferential access to the electricity transmission line in exchange for ATEL's financial contribution of more than 50% to the construction of that line between Poland and Slovakia. The EC alleged that the investment contract was contrary to the EU Directive 2003/54/EC concerning common rules for the internal market, which required guaranteed, non-discriminatory access to the transmission system. In its defence, Slovakia invoked its obligations owed to the investor under the ECT, which predated Slovakia's accession to the EU. While acknowledging that 'it is not for the Court to interpret the Investment Protection Agreement', the CJEU examined whether Slovakia was allowed under the ECT to terminate the contract in order to align itself with obligations under the Directive, and whether such termination would result in indirect expropriation of the investor's right to transmission. The Court found that the contract 'may be regarded as investment protected by the Investment Protection Agreement' and that its termination would expropriate the investor: paras 50-51. Accordingly, the CJEU concluded that even if the investor's preferential access was not compliant with the EU Directive, it would be still protected by the conflict rule in Art 351 TFEU: para 52. While the matter in this case concerned a Member State's pre-accession obligation, of relevance is that the CJEU was willing to give to that obligation the legal status it deserved under the ECT.

²⁹⁸ For this conclusion regarding CETA, see chapter 9, section 9.2.4. Accordingly, in the case *République de Moldavie* (n 295), the CJEU should decline its jurisdiction due to the remoteness of the link between the challenged issues and EU law. For this argument, see the analysis of Quentin Declève, 'CJEU Expected to Rule on Notion of 'Investment' in Energy Charter Treaty' (*International Litigation Blog*, 20 November 2019) <<http://international-litigation-blog.com/cjeu-expected-to-rule-on-notion-of-investment-in-energy-charter-treaty/>> accessed 30 June 2020.

²⁹⁹ The Council has adopted negotiating directives, giving mandate to the EC to lead negotiations on behalf of the EU. See Council of the European Union, 'Negotiating Directives for the Modernisation of the Energy Charter Treaty – adoption' (2 July 2019) 10745/19 (The EU's ECT Negotiating directives)

³⁰⁰ The EU's ECT Negotiating Directives, 3. Sustainable development objectives include the ECT's contribution to the promotion of human rights and international labour standards (through provisions on transparency, CSR, and responsible business conduct): *ibid* 5.

³⁰¹ *ibid* 5

³⁰² *ibid* 4-5. In addition to substantive investment protection clauses, the EU position with respect to other clauses also reflects the approach aligned with EU law. For example, the provisions of the transit chapter should be 'in line with the EU legal framework and EU international commitments, notably in relation to third-party access and tariffs for infrastructure use': *ibid* 6 (NB. the *Nord Stream 2* claim against the EU concerns this issue: n 293). The traditional European approach to pre-investment issues is also notable: 'the EU does not support the inclusion of pre-investment in the ECT modernisation' (*ibid* 6), indicating the primary goal of protection of established investments rather than investment liberalisation.

will ‘strive to ensure’ that a future MIC applies to the ECT.³⁰³ In other words, the EU envisages a modernised ECT that is aligned with its own IIP. The list of topics for the ECT modernisation follows the broad EU approach to its reform.³⁰⁴

It can be also expected that the modernisation process will be politically complex and challenging, especially in light of the unanimity requirement for ECT treaty amendments.³⁰⁵ Not all ECT States consider that the reform of the ECT is necessary, including some ‘like-minded’ partners, such as Japan.³⁰⁶ The ECT is a good example of tensions between the EU’s external objectives: on one hand, the EU’s attempts to strengthen its geopolitical position by exerting influence over the international energy markets and their governance;³⁰⁷ and on the other, the EU’s aspiration to lead the climate change reform on the global scale.³⁰⁸ The EU’s ECT reform will depend on the success of the UNCITRAL negotiations. In the same way as the EU IIP more generally, the ECT modernisation is feasible as a mid- to long-term objective.

³⁰³ *ibid* 5.

³⁰⁴ The approved list of topics is broad, spanning from definitions (investment, investor), to substantive standards (such as FET, indirect expropriation) and procedural provisions (frivolous claims, transparency etc). The aim is also to address issues such as the right to regulate, sustainable development, CSR etc. For the full list, see Energy Charter Secretariat, ‘Decision of the Energy Charter Conference: Modernisation of the Energy Charter Treaty’ (27 November 2018) CCDEC 2018.

³⁰⁵ Art 36(1)(a) ECT. The governing body of the ECT is the Energy Charter Conference, composed of all ECT Contracting parties and REIOs. The requirement of unanimity includes unanimity of ‘the Contracting Parties Present and Voting’ at the meeting of the Charter Conference when the decision about the amendment is taken.

³⁰⁶ Moreover, Japan has proposed a policy option ‘to keep all ECT provisions as they are’: Energy Charter Secretariat, Policy Options (n 278) 3.

³⁰⁷ The EU also supports the inclusion of the reference to the 2015 International Energy Charter in the ECT’s definition of the ‘Charter’: the EU’s ECT Negotiating directives, 7. For analysis of the International Energy Charter in the context of international energy governance, see Pami Aalto, ‘The New International Energy Charter: Instrumental or incremental progress of governance?’ (2016) 11 Energy Research and Social Science 92.

³⁰⁸ However, it has been pointed out that retaining investment protections for fossil fuels in the modernised ECT and continuous States’ exposure to ISDS claims under the ECT for measures aimed at phasing out fossil fuels will not allow the ECT signatories to meet carbon neutrality targets, questioning thus the very purpose of this modernisation: see, for example, Martin Dietrich Brauch, ‘Modernizing the Energy Charter Treaty: A make-or-break Moment for Sustainable, Climate-friendly Energy Policy’ (International Institute for Sustainable Development 2019) <<https://www.iisd.org/library/modernizing-energy-charter-treaty-make-or-break-moment-sustainable-climate-friendly-energy>> accessed 30 June 2020; OpenEX, ‘The Energy Charter Treaty (ECT): Assessing its geopolitical, climate and financial impacts (2019)’ <<https://www.euractiv.com/wp-content/uploads/sites/2/2019/09/Report-ECT.pdf>> accessed 30 June 2020.

8.3. How coherent is EU external investment regulation?

In light of the above analysis of substantive and procedural standards in Member States' extra EU BITs and EU IIAs, a decade following introduction of the EU IIP, the EU external investment regulation is only relatively coherent. Its largest segment is still the 'old' pre-Lisbon Member States' BITs. As a minimum, capital transfer provisions in these BITs should be brought in line with EU law. These agreements remain largely inconsistent with the new EU IIP, with respect to both substantive standards and the dispute settlement mechanism.

The most important segment of external EU investment regulation is the new EU IIAs. They introduce a new ICS system, which is largely adopting the procedural elements of arbitration, with two major differences: the permanency of tribunal members and the appellate mechanism. These agreements incorporate the new EU IIP but have not yet been implemented in practice.

The most surprising segment of new EU regulation is its approach to post-Lisbon Member States' extra-EU BITs. Investment protection standards in these agreements are mostly coherent albeit not the same to those found in EU IIAs and with different variations across BITs. The Dutch Model BIT 2018 stands out from the other Member States' BITs because it more comprehensively embraces, and in some elements even further develops, the standards of EU IIAs. However, all new extra-EU BITs retain ITA as a dispute settlement mechanism. Accordingly, they are only partially consistent with the new EU IIP. While the EU declared ISDS 'dead',³⁰⁹ it continues to approve new Member States' BITs that implement ISDS, and the compatibility of which with EU law remains questionable following Opinion 1/17. The reasons are primarily pragmatic and political.³¹⁰ Ultimately, an MIC is the only viable EU solution for coherent EU external investment regulation.

The coherence between key elements of different IIAs represented in the regulation of the EU external investment is presented in the following table.

³⁰⁹ See Part II introductory quote.

³¹⁰ Different policy options and their costs are outlined in the EC's impact assessment of the MIC. The document notes that the option of including the ICS at the bilateral Member States level is 'overly burdensome in terms of time and resources' and accordingly 'not feasible': European Commission, 'Multilateral reform of investment dispute resolution, Impact Assessment' SWD (2017) 302 final, 27. The EC further notes that 'multiple ICSs trigger high costs and a significant administrative burden (in terms of workforce, time and financial resources) for the Commission': *ibid* 18. See further calculations of these ICS costs (about €800,000 per bilateral ICS per year, on the basis of one case before each instance): *ibid* 21-22 and Annex 4.

Table 8.1. Coherence of EU external investment regulation

Coherence with EU IIP	Investment protection	Dispute settlement
Pre-Lisbon extra-EU BITs	▪ Broadly drafted investment protections ▪ Capital transfer clauses inconsistent with EU law	▪ Traditional ISDS (ITA) ▪ Procedural standards of ICSID/UNCITRAL
New EU IIAs	▪ Clearly drafted investment protection clauses - Largely based on NAFTA case-law ▪ The right to regulate guaranteed (Opinion 1/17)	▪ New ICS: - permanency - appellate mechanism ▪ Improved procedural standards - jurisdictional limitations for abusive investors - transparency and openness - largely based on the existing standards ▪ MIC in the long-term
Post-Lisbon extra-EU BITs	▪ More detailed investment protections with variations across treaties	▪ Traditional ISDS (ITA) ▪ Improved procedural standards with variations across treaties ▪ MIC in the long-term

In the interim, the coherence of EU external investment regulation will depend on the interpretation of standards by adjudicative bodies. Early in the development of the EU IIP, the EC noted that investment standards are ‘subject to a common understanding among experts in the field (lawyers, academics, arbitrators, judges)’ regarding their meaning and thus are not ‘absolute rules’.³¹¹ In that sense, they are objectively defined by the legislator, but their meaning is subjectively determined by the adjudicator, depending on the case-specific circumstances. In light of different dispute settlement bodies across many different treaties, these subjective elements undermine consistency and thus also compound the fragmentation of EU external investment regulation.

Finally, a large number of different IIAs offer to strategic investors an opportunity to circumvent the EU IIP through ‘treaty shopping’, by restructuring investments in ways in which more favourable IIAs can be utilised. Since the MIC still faces a number of political and legal obstacles, the realisation of the coherent EU international investment regulation is feasible only as a long-term goal.

³¹¹ European Commission, ‘Follow up to the European Parliament resolution on the future European international investment policy’ (5 July 2011) 2.

8.4. Conclusion

EU IIAs endorse the established standards of protection in IIL. While largely codifying the jurisprudence of arbitral tribunals, new EU IIAs provide more clarity about the content of these standards. At the same time, they missed the opportunity to introduce more precision in defining limitations between State legal and illegal regulatory activity, leaving sufficient scope for jurisprudential interpretations of new standards. The scope of investors' obligations, including their due diligence, under new EU IIAs remains inconclusive but is, in any case, limited. The risk of States' regulatory measures breaching investors' rights is accordingly higher under new EU IIAs than under EU law.

Regardless, the EU provisions of IIAs should sufficiently guarantee the right to regulate in the EU and therefore the public interest should be protected. This conclusion of the CJEU was reached in the bilateral context of CETA and its specific features played a role: clearly drafted investment provisions with high thresholds, permanent tribunals, and more control by the Contracting parties over the interpretation of standards through the joint interpretative mechanism. While the right to regulate has been the exception and the compensation for State regulatory measures the rule, in its approach the CJEU is striving to bring IIL back closer to a public international law notion of regulatory sovereignty.

The investment and regulatory standards of the new EU IIAs, except for a few rare exceptions, do not endorse or promote EU standards. The inclusion of regulatory standards stemming from the NAFTA jurisprudence rather than the more expansive Member States' BITs has to be understood in the context of the early development of the EU IIP and the negotiations for TTIP.³¹² The new standards endorse higher thresholds for breaches of investors' rights and reflect positive IIL developments when balancing private and public rights. The EU's approach in its international investment policy accordingly confirms its commitment to observance and development of international law.³¹³

The reliance on extra-EU BITs remains a valid Plan B for EU investors in the transitional period. It could turn into a viable Plan A in case the EU IIP fails; for example, if neither of the EU IIAs complete the process of ratification in the Member States, or if the EU proposal for a MIC does not succeed in UNCITRAL. While these new extra-EU BITs are largely coherent with EU IIAs in regard to substantive standards, they substantially differ regarding the ISDS mechanism. A system of *ad hoc* tribunals could ultimately undermine the coherence of substantive standards in their implementation. Without reforming the

³¹² See chapter 4.

³¹³ Art 3(5) TEU.

ISDS mechanism, the EU efforts will eventually achieve more or less substantial improvements of bilateral Member States' BITs – something that all other States have been doing for some time. While still worthwhile, the reform in that case would be reduced to a mere shadow of its present potential.

In light of the 1286 Member States' extra-EU BITs in force and not a single EU IIA yet in force, fragmentation remains a dominant feature of EU external investment regulation. Consistency between these many agreements and thus the coherence of the EU IIP depends on effective implementation of the available coordination mechanisms and the Member States' compliance with their duty of sincere cooperation in the short term, and the overall success of the EU's ISDS reform in the longer term. With ITA as still the dominant ISDS mechanism, EU external regulation of investment for the moment remains as (in)coherent as the entire field of IIL.

The Investment Court System: towards the rule of EU law in international investment law?

9.1. The nature of the ICS

9.1.1. *Political background does (not) matter*

9.1.2. *Judicial albeit hybrid or ‘that which we call a rose by any other name would smell as sweet’*

9.1.3. *Outside the EU judicial system*

9.2. Autonomy of the CJEU to interpret EU law

9.2.1. *EU law as ‘a matter of fact’: interpretation vs examination of law*

9.2.2. *Interpretation of CETA as a matter of domestic vs international law*

9.2.3. *The EU decides who is the respondent before the ICS tribunals: Regulation No. 912/2014*

9.2.4. *Interim conclusion*

9.3. The compatibility of the ICS with the rule of law

9.3.1. *Equality before the law in the EU*

9.3.2. *Independence of the ICS tribunals*

9.3.2.1. *The external dimension of independence*

9.3.2.2. *The internal dimension of independence*

9.3.3. *Access to justice*

9.4. Conclusion

Following the Walloon CETA crisis¹ and the Belgian request,² in its Opinion 1/17 the CJEU confirmed the legality of the new Investment Court System (ICS) under EU law.³ This CJEU decision bears important legal and policy implications for the future co-existence of EU law and international investment law (IIL), as well as for the relationship between EU law and international law more generally.

From the perspective of EU law, this Opinion provides a number of EU constitutional law criteria intended to preserve the autonomy of the EU legal order.⁴ It provides clear criteria that any future court *outside* the EU judicial system should fulfil

¹ See chapter 4, section 4.3.4

² The Belgian request for the CJEU's Opinion was made in accordance with Art 218(11) TFEU.

³ Opinion 1/17 ECLI:EU:C:2019:341.

⁴ On ‘the right to regulate’ as the substantive criterion of the autonomy of the EU legal order, see chapter 8, section 8.2.2.

under EU law in order to co-exist with the CJEU. Following earlier failed attempts at such co-existence (EU Patent Court in Opinion 1/09, the ECtHR in Opinion 2/13 and international investment tribunals in *Achmea*), Opinion 1/17 elucidates the circumstances under which another international court would not undermine the autonomy of the CJEU as the highest authority on EU law. The Opinion therefore endorses the CJEU's constitutionalist vision of international law,⁵ in which EU law sets the minimum standards.⁶

From the perspective of international law, this Opinion provides an important insight into the CJEU's understanding of the new ISDS mechanism and its application in practice. While the ICS in CETA must have met a set of criteria determined by EU law, the Opinion suggests that the assessment of the ICS against these criteria has been made in light of the objective of free and fair trade rather than the rule of law. The Opinion thus also elucidates the EU's approach to the implementation of its values and objectives in the investment context, and its approach to the rule-of-law judicial standards in the international context, as opposed to its domestic context. Ultimately, it raises questions as to whether the EU exports new values to IIL or rather adjusts its own value system to international standards in the pursuit of particular objectives.

In policy terms, the applicability of this Opinion is not limited to CETA but extends to all EU agreements including the ICS as well as the future MIC.⁷ In immediate terms the Opinion gives the European Commission (EC) a green light to carry on with plans for the implementation of the new mechanism, both bilaterally and multilaterally, in accordance with the negotiating mandates given by the Member States. As far as the CJEU is concerned, the EU international investment policy (IIP) can proceed.

In light of these implications for the EU legal order and the EU IIP, this chapter provides a critical assessment of the ICS, examined through the CJEU's reasoning in Opinion 1/17. First, we discuss the nature of the ICS in relation to the EU judicial system. Secondly, we consider the effects of the ICS on the autonomy of the CJEU and the interpretation of EU law. Finally, we focus on the main features of the ICS in light of the rule-of-law criteria, as the core EU value. Where relevant, the CJEU's Opinion will be supplemented by remarks of late Advocate General (AG) Bot.⁸ While only advisory, the remarks of AG Bot more explicitly uncover a number of relevant political considerations, which emerge only implicitly in the CJEU's Opinion.

⁵ See Martti Koskeniemi, *The Politics of International Law* (Hart 2011) 345-350.

⁶ Joined cases C-402/05 P and C-415/05 P *Kadi* [2008] ECR I-6381.

⁷ For this conclusion, see Opinion 1/17 (n 3) paras 108, 118.

⁸ Opinion 1/17, Opinion of AG Bot ECLI:EU:C:2019:72.

9.1. The nature of the ICS⁹

Unlike the situation that emerged with respect to *Achmea*, where the CJEU delivered a judgment diametrically opposite to the Opinion of its AG Wathelet, in Opinion 1/17, the CJEU mostly agreed with the reasoning of late AG Bot. Both established the compatibility of the ICS with primary EU law. However, they differently characterised the nature of the new ICS. AG Bot emphasised the ‘hybrid’ or ‘quasi-judicial’¹⁰ nature of the ICS, which would ‘gradually acquire characteristics of a genuine court’.¹¹ The CJEU found that the ICS is ‘primarily judicial in nature’ while implicitly confirming its ‘work-in-progress’ nature. This rather pedantic differentiation enabled the Court to nuance the political background of the AG’s argumentation and eventually justify the legitimacy of the ICS under international law, although the mechanism falls short of the rule-of-law standard of a ‘genuine’ court under EU law.

9.1.1. Political background does (not) matter

AG Bot in his Opinion provided the context in which the request for an opinion was made,¹² *inter alia* referring to criticism of ISDS and challenges that the EC had to face and address in developing a new ICS model.¹³ On the political side, these challenges relate to ‘the functioning of arbitration tribunals’ and the ‘legitimacy of an arbitration scheme between investors and States’,¹⁴ in particular, the lack of guarantees of arbitrators’ independence, the lack of consistency and foreseeability of awards, the inability to review the awards, the risk of ‘regulatory chill’ and the high costs of the proceedings.¹⁵ Despite the criticism, AG Bot correctly noted the reality of IIL, where arbitration clauses continue to be ‘regarded as a key component of the protection of foreign investments in the host State’.¹⁶ In that context, and bearing in mind the EU’s urge to develop bilateral free trade relations with third States,¹⁷ the Commission’s space for manoeuvre was limited. The

⁹ Section 9.1 and its subsections draw on and incorporate ideas and language of the publication Ivana Damjanovic and Nicolas de Sadeleer, ‘Values and objectives of the EU in light of Opinion 1/17: “trade for all”, above all’ (2020) 4(1) *Europe and the World: A Law Review* [25] <<https://www.scienceopen.com/hosted-document?doi=10.14324/111.444.ewlj.2020.24>> accessed 30 June 2020.

¹⁰ Opinion 1/17, Opinion of AG Bot (n 8) para 165.

¹¹ *ibid* paras 33, 242, 260-261.

¹² *ibid* Section II (paras 10-33).

¹³ See chapter 4, sections 4.3.3 and 4.3.4.

¹⁴ Opinion 1/17, Opinion of AG Bot (n 8) para 17.

¹⁵ *ibid* para 15. NB. All ISDS elements to which AG Bot referred as being subject to criticism are, according to the Commission, being addressed through the ICS and the EU’s proposal for a MIC: see European Commission Factsheet, ‘Investment provisions in the EU-Canada free trade agreement (CETA)’ (February 2016) <http://trade.ec.europa.eu/doclib/docs/2013/november/tradoc_151918.pdf> accessed 30 June 2020

¹⁶ Opinion 1/17, Opinion of AG Bot (n 8) para 14.

¹⁷ *ibid* para 16.

choice was to be made between abandoning investment dispute settlement, which seemed unrealistic, and improving the traditional arbitration model to address the criticism.¹⁸ In opting for the second option, the EU developed a ‘hybrid’ model, which not only depicts a ‘*compromise* between an arbitration tribunal and an international court’, but also epitomises the EU’s leading role in this ‘experiment’, which could well determine the future of the whole system.¹⁹

According to AG Bot, the approach that the EU adopted is ‘*pragmatic*’. It balances the needs of EU negotiating partners (third States), which see arbitration as ‘an essential component in the protection of investors’,²⁰ with the needs of the public in the EU, expressed in the ‘spirited debate’ of the consultation process.²¹ The AG’s task was to examine whether this pragmatic hybrid compromise, which adopts the practice of investment arbitration ‘with a view to *moving towards* a judicial model’, is compatible with primary EU law.²²

The CJEU in its Opinion adopted a more cunning approach by avoiding a reference to the political background and indeed any reference to ISDS or ICS criticism, beyond what was presented before the Court in the submissions made by the parties (mostly the Kingdom of Belgium that made the request). While the CJEU could have been equally impressed with the Commission’s ability to compromise, to lead the ISDS reform and to seek pragmatic solutions, the Court saw no value in emphasising the political dimension of the Opinion. The Court thus seemingly avoided criticism for political bias in the solution that, reading the AG’s Opinion, seemed the only realistic solution for saving the EU IIP.

9.1.2. *Judicial albeit hybrid or ‘that which we call a rose by any other name would smell as sweet’*²³

In the AG’s Opinion the hybrid nature of the ICS is put forward as a solution to address political challenges but it poses a legal challenge because ‘the main principles’ governing the ICS must be consistent with the EU legal order.²⁴ All acts of EU institutions must comply with the founding treaties, general principles of law and fundamental rights,²⁵ and this also applies to EU external actions.²⁶ Accordingly, EU international agreements must

¹⁸ *ibid* para 17.

¹⁹ *ibid* para 18 (emphasis added).

²⁰ *ibid* para 19 (emphasis added).

²¹ *ibid* para 20.

²² *ibid* para 33 (emphasis added).

²³ William Shakespeare, *Romeo and Juliet*, Act II, Scene II.

²⁴ Opinion 1/17, Opinion of AG Bot (n 8) para 17.

²⁵ Case C-362/14 *Schrems* ECLI:EU:C:2015:650, para 60 and the case-law therein cited.

²⁶ Opinion 1/17, Opinion of AG Bot (n 8) para 195, Case C-455/14 P *H v Council and Commission* ECLI:EU:C:2016:569, para 41; Case C-72/15 *Rosneft* ECLI:EU:C:2017:236, para 72.

be compatible with the founding treaties and the EU constitutional principles.²⁷ In particular, as a judicial body, the ICS must comply with Article 47 CFR, which guarantees effective access to justice and a remedy before an independent and impartial tribunal previously established by law.²⁸

However, referring to the Belgian assessment of the ICS as falling short of the criterion of independence for courts, the AG found the justification in the ICS hybrid model, noting: ‘Although the term ‘tribunal’ has been chosen in the agreement envisaged, *which could suggest that it is a genuine court*, it is, however, a mechanism which remains greatly inspired by the rules of arbitration.’²⁹ The AG then listed provisions of the CETA ICS which were ‘explicitly’ inspired by the arbitration rules: the submission of a claim to the Tribunal,³⁰ the consent to the settlement of the dispute by the Tribunal,³¹ the transparency of proceedings,³² and the enforcement of awards.³³ Moreover, with respect to the remuneration of Members of the Tribunals³⁴ and the question of ethics³⁵ the AG noted that the CETA text makes reference to the rules applicable in the field of arbitration. As a final point, the AG observed that ‘the CETA Tribunal does not give judgments but rather issues awards’.³⁶

While the system is characterised by a number of arbitration-like features, it is nevertheless ‘an expression of the *wish*’ of the EU and Canada in this particular case to ‘move towards a new system *inspired by* the judicial systems of [the EU and Canada]’.³⁷ In that sense, the mechanism is only a step towards the creation of a multilateral investment court (MIC),³⁸ and it offers room for improvement with respect to procedural safeguards that could not have all been clarified in the CETA text.³⁹ Importantly, the mechanism is an expression of the political wish of the two State entities, which provides necessary legitimacy for continuing their pursuit of legal improvements.

According to the AG, the new mechanism should not be equated with a genuine court and it should rather be assessed in the context of its ‘*experimental and dynamic*

²⁷ Opinion 1/17 (n 3) para 165; Opinion 1/15 ECLI:EU:C:2017:592, para 67; Case C-266/16 *Western Sahara Campaign UK* ECLI:EU:C:2018:118, para 46).

²⁸ In that sense, the Belgian request asked the CJEU to ascertain whether the CETA Investment chapter was compatible with Art 47 CFR.

²⁹ Opinion 1/17, Opinion of AG Bot (n 8) para 242 (emphasis added).

³⁰ Art 8.23 CETA.

³¹ Art 8.25 CETA.

³² Art 8.36 CETA.

³³ Art 8.41 CETA.

³⁴ Art 8.27.14 CETA.

³⁵ Art 8.30.1 CETA.

³⁶ Opinion 1/17, Opinion of AG Bot (n 8) para 242.

³⁷ Opinion 1/17, Opinion of AG Bot, para 243 (emphasis added).

³⁸ *ibid* para 246.

³⁹ *ibid* para 247. In particular, the AG refers to additional rules regarding the Appellate Tribunal, mandatory code of conduct, which will further strengthen the guarantees of impartiality and independence, and the rules on mediation.

nature'.⁴⁰ First, the CJEU should take into account the improvements that have been made in the ICS compared to the traditional investment treaty arbitration (ITA) and assess the new model against what has been done rather than what could have been done.⁴¹ Therefore, the mechanism does not need to perfectly satisfy the conditions of a genuine court, as suggested by the Kingdom of Belgium, but only ensure a '*sufficient* level' of safeguards and protection of the right of access to an independent and impartial tribunal under Article 47 CFR.⁴² Secondly, the ICS is still, in layman's language, a 'work in progress' and the CJEU should appreciate its potential to become a genuine court. The emphasis placed on the CETA parties' wishes to adopt an imperfect court model reflects the *political* essence of international negotiations and thus also serves to justify the noted imperfections.

The CJEU came to a more nuanced conclusion about the ICS: while largely inspired by the traditional ISDS mechanism, it is nevertheless 'primarily judicial in nature'.⁴³ In the CJEU's view, regardless of whether ICS tribunals are formally classified as 'judicial bodies' and their members as 'judges', they will in any case 'in essence' be judicial bodies with judicial functions. This is because these bodies are: permanent and established by law (CETA); follow an adversarial procedure; apply rules of law; exercise their functions autonomously; and issue final and binding decisions.⁴⁴ The CJEU, while not denying the hybrid nature of the new ICS,⁴⁵ diverts the focus from impliedly *political* issues associated with 'hybrid' bodies towards *legal* issues related to the compliance of judicial bodies with the basic legal principles. In particular, judicial bodies must ensure procedural justice, which encompasses the right to a fair hearing (*audi alteram partem*) and the rule against bias (*nemo iudex in causa sua*).⁴⁶ Accordingly, the Court particularly emphasised the difference between the ICS and ISDS with respect to 'the rules on the composition of the [CETA] Tribunal and on dealing with cases [before that Tribunal]'.⁴⁷

If hybrid bodies are impliedly political and judicial bodies independent from politics, the differentiation was not only canny but also necessary. If the ICS tribunals are 'experimental', 'dynamic', 'hybrid' and a 'compromise', it is valid to ask how they could comply with legal principles for judicial bodies, in particular those outlined in Article 47 CFR. On the other hand, if ICS tribunals are, despite their other characteristics, essentially

⁴⁰ *ibid* para 246 (emphasis added).

⁴¹ *ibid* para 245.

⁴² *ibid* paras 245, 251 (emphasis added).

⁴³ Opinion 1/17 (n 3) para 190.

⁴⁴ *ibid* para 197.

⁴⁵ *ibid* para 193.

⁴⁶ See Part I, chapter 3, section 3.3.2.2.

⁴⁷ Opinion 1/17 (n 3) paras 193-194.

judicial, their compliance with essential judicial principles can be justified. This ultimately changes the impliedly political character of the ICS into, in essence and primarily, a legal body that complies with essential requirements of EU law for judicial bodies. In any case, this characterisation also transforms the ICS' political discourse into a legal one, at least in the context of its compliance with EU law. If law could be translated to poetry,⁴⁸ that which we call the ICS by any other name would perform its duties as a court would – independently and in accordance with the law.

9.1.3. *Outside the EU judicial system*

The CJEU and the AG both placed the ICS outside the EU judicial system. The Court thus followed its earlier observations about ISDS, expressed in Opinion 2/15 and *Achmea*. The CJEU also reiterated that an international dispute settlement mechanism is in principle compatible with EU law.⁴⁹ However, for the first time the CJEU explained how such a mechanism can co-exist with EU law. The Court provided a list of procedural and substantive criteria for the preservation of the autonomy of EU law.⁵⁰ The emphasis of the CJEU's analysis was placed on the separation of the ICS from the EU legal order. Since the ICS tribunals remain outside the EU judicial system, the CJEU could frame the ICS as, in principle, a world apart from the EU legal order. However, in those aspects where the two worlds meet, the Court found sufficient reasons to justify that ICS tribunals would not erode its authority on EU law.

9.2. **Autonomy of the CJEU to interpret EU law**

In examining the effects of the ICS on the EU legal order, the CJEU had to examine whether CETA tribunals could undermine the CJEU's authority to interpret EU law. The Court found that a number of procedural safeguards serve to protect its autonomy and that ICS tribunals would not interpret EU law *other than CETA*. These procedural safeguards relate to the CETA provisions on (1) the status of domestic law in the ICS proceedings, (2) the applicable law in the ICS proceedings, and (3) the apportionment of responsibility between the EU and the Member States for the measures challenged before the ICS.

⁴⁸ 'That which we call a rose by any other name would smell as sweet', William Shakespeare, *Romeo and Juliet*, Act II, Scene II.

⁴⁹ Opinion 1/17 (n 3) paras 106-107.

⁵⁰ For the substantive element – the right to regulate – see chapter 8, section 8.2.2.

9.2.1. EU law as 'a matter of fact': interpretation vs examination of law

CETA prescribes that domestic law, and thus also EU law, is to be treated as a matter of fact in the proceedings before the ICS tribunals.⁵¹ Since the application of foreign law as a matter of fact in ITA is more prevalent in the tradition of common law courts and applied less in the civil law tradition that the CJEU follows,⁵² many commentators were sceptical about the effectiveness of this provision. The CJEU provided its own view on what it means to apply EU law as a matter of fact. The Court distinguished between the interpretation of domestic law and the *examination* of the effect of a measure. The latter refers to assessing domestic law as a matter of fact, which includes the obligation of a tribunal to follow the prevailing interpretation of domestic law by domestic courts or authorities. In turn, domestic courts and authorities are not bound by the *meaning* given to their domestic law by the tribunal.⁵³

It follows that interpretation refers to assessing domestic law as a matter of law. In this scenario the ICS tribunal would determine the *meaning* of the domestic legal rule according to its own understanding, without following the prevalent interpretation given by domestic courts. Such a tribunal's determination of the meaning of the domestic legal rule would bind domestic courts. In essence, therefore, interpretation includes determining the meaning of a legal rule *in abstracto*, and it is akin to law-making. In accordance with the EU founding treaties, interpretation with respect to EU law is exclusively the prerogative of the CJEU.⁵⁴

Interpretation is therefore not the prerogative of investment arbitral tribunals since their decisions are not binding *erga omnes*. Arbitral tribunals only interpret IIAs in accordance with the criteria set out in Article 31 VCLT and their decisions apply only to a particular case in point. Therefore, standard arbitration agreements do not vest in investment tribunals law-making powers analogous to those vested by the founding treaties in the CJEU.⁵⁵ Accordingly, in Opinion 1/17, the CJEU clarified that the ICS would

⁵¹ Art 8.31.2 CETA.

⁵² This is, *inter alia*, due to the application of the doctrine *iura novit curia*, which is not accepted in common law systems. German legal doctrine also significantly influenced the continental courts' *ex officio* treatment of foreign law: see analysis by Stephen L Sass, 'Foreign Law in Civil Litigation: A Comparative Survey' (1968) 16 The American Journal of Comparative Law 332. Such application of foreign law by courts, whereby the courts ascertain on their own, in cooperation with the parties, the content of foreign law (rather than parties proving the content through their own experts) blurs the dividing line between law as a matter of fact and law as a matter of law. The court participates actively in framing both the factual and legal issues of the case, and, with such a role of the court, it is more difficult to ascertain foreign law as a matter of fact or as a matter of law.

⁵³ Opinion 1/17 (n 3) para 131. See also Art 8.31.2 CETA (emphasis added).

⁵⁴ Arts 267 and 344 TFEU.

⁵⁵ Friedrich Rosenfeld, 'Abstract Interpretations in International Investment Law' in Photini Pazartzis and others (eds), *Reconceptualising the Rule of Law in Global Governance, Resources, Investment and Trade* (Hart 2016) 339-342. However, as discussed in Part I, chapter 3, tribunals have effectively assumed such a role due to broadly worded provisions of early BITs: see section 3.3.1.1.

not have any law-making powers with respect to EU law, confirming also that the ICS will not have such powers with respect to CETA either.⁵⁶

It would have been clearer if the CJEU had explained the distinction between the application (rather than interpretation) of law and examination of the effects of law. Interpretation refers to determining the meaning of a legal rule more generally and regardless of particular facts. Contrary to that, the application of law entails the determination of the consequences of a legal rule with respect to facts specific to each particular case.⁵⁷ In the EU legal order, the role of the CJEU is to interpret an EU legal rule, while the role of the national courts is to apply that EU rule, as interpreted by the CJEU, to the particular facts of a particular case before the national court.

Instead, when explaining the difference between interpretation and examination, the Court made a reference to Opinion 1/09 and distinguished the ICS in CETA from the EU Patent Court on the basis of the applicable law in the proceedings before these courts. The EU Patent Court was incompatible with EU law because the applicable law clause in the draft international agreement allowed the proposed Patent Court to *interpret and apply* EU secondary law and to determine the dispute in light of the fundamental rights and principles of EU law.⁵⁸ It can accordingly be reasoned that, unlike the EU Patent Court, ICS tribunals will have the competence only to examine the effects of law, which does not include the competence either to interpret (determine the meaning of the rule *in abstracto*), nor to apply EU law (determine the meaning of the rule *in concreto*). The CJEU's approach clearly distinguishes the ICS from domestic courts and reaffirms its conclusion that the ICS stands outside the EU judicial system.

Accordingly, the CJEU was satisfied that the ICS, unlike the proposed EU Patent Court, would not endanger its position as the highest authority for the interpretation of EU law, although EU law could appear as an issue before ICS tribunals and despite the fact that ICS tribunals might not correctly appreciate EU law in the *examination* of its effects. The CJEU was satisfied that the appellate mechanism⁵⁹ would correct all errors made in the first instance and concluded that the CETA Appellate Tribunal, equally as the First Instance tribunal, is not called upon to interpret or apply domestic law.⁶⁰

⁵⁶ Opinion 1/17 (n 3) para. 234. In accordance with Art 8.31.3 CETA such power lies with the CETA Joint Committee, which is empowered to issue binding interpretations.

⁵⁷ Rosenfeld (n 55) 332-333.

⁵⁸ Opinion 1/09 ECLI:EU:C:2011:123, para 78. See Opinion 1/17 (n 3) para 124.

⁵⁹ The Appellate Tribunal is conferred with the power to identify manifest errors in the appreciation of the facts, and thus also the manifest errors in the appreciation of domestic law: Art 8.28.2 CETA.

⁶⁰ Opinion 1/17 (n 3) para 133.

9.2.2. Interpretation of CETA as a matter of domestic vs international law

The only EU law that CETA tribunals may interpret is the CETA, which is an international agreement to which the EU is a party. In the hierarchy of legal norms in the EU legal order, the CETA must be compatible with primary EU law but prevails over secondary EU law and national legislation of Member States. Secondary EU legislation must be interpreted harmoniously with the international agreements of the Union.⁶¹ Accordingly, insofar as possible, national courts of the Member States and EU courts must apply EU secondary legislation in a manner that is consistent with the CETA. The CETA therefore binds the EU and Member States as a matter of EU law and as a matter of international law.

National courts and EU courts could be called upon to interpret the CETA when respectively assessing the compatibility of national and EU secondary legislation with the CETA. For example, a national court of an EU Member State, in assessing an intellectual property rights matter appearing before the court, would need to assess whether the relevant national Member State legislation on the matter complies with the relevant EU secondary law and the CETA requirements.⁶² In doing so, the national court may request from the CJEU the interpretation of the CETA provisions through the preliminary ruling procedure.

The CJEU's practice has recorded cases in which national courts had referred questions for preliminary ruling on the interpretation of mixed agreements.⁶³ While this jurisprudence is far from clear, the CJEU retained its jurisdiction for the interpretation of provisions of mixed agreements falling both within the EU's exclusive and non-exclusive competence; in the case on non-exclusive competence, the Court held that its jurisdiction applies if the EU has already legislated in the area or, if the EU has not yet exercised its competence, when the provision in question could also be applied in an area in which the EU has legislated.⁶⁴ The CJEU retains its jurisdiction to interpret a mixed agreement regardless of whether the interpretation of the provision is needed for the application of national or EU law.⁶⁵

In this exercise, it is likely that the national court would apply national and EU law, including the CETA, in accordance with the domestic and EU constitutional principles. The

⁶¹ Case C-61/94 *Commission v Germany* [1996] ECR I-3989, para 52.

⁶² While the IPR chapter of CETA does not fall within the jurisdiction of CETA investment tribunals, IPR rights are nevertheless included in the definition of 'investment' in Art 8.1(g) so IPR might appear as a legal issue both before CETA tribunals and national courts, albeit in the context of separate and/or different type of legal actions.

⁶³ For shared competence and mixed agreements, see chapter 6.

⁶⁴ Morten Broberg and Niels Fenger, *Preliminary References to the European Court of Justice* (OUP 2010) 125-130.

⁶⁵ Case C-53/96 *Hermès* [1998] ECR I-3603, para 32.

CJEU's intervention in issues of mixed treaties like CETA is justified on the grounds of consistent interpretation of EU law.⁶⁶ In particular, the CJEU has held that the uniform interpretation of mixed treaty provisions is 'clearly in the Community interest', whatever the circumstances in which such a provision is to be applied, 'in order to forestall future differences of interpretation'.⁶⁷ Moreover, in cases of mixed agreement provisions that can fall both within the scope of national law and EU law, the CJEU has emphasised the obligation of close cooperation in fulfilling the commitments undertaken under the joint competence. This cooperation 'requires the judicial bodies of the Member States and the Community, for practical and *legal* reasons, to give it a uniform interpretation'.⁶⁸ While the denial of the CETA's direct effect limits the involvement of domestic courts and the CJEU in the matters of the CETA, this involvement cannot be fully avoided. The CJEU's jurisdiction to make preliminary rulings does not depend on the direct effect of the legal act in question.⁶⁹ Interestingly, and maybe exactly for this reason, the CJEU did not discuss the absence of direct effect in its Opinion as an important element for safeguarding the procedural autonomy of EU law.⁷⁰

On the other hand, the CETA tribunals must interpret the CETA as an international agreement, in accordance with the VCLT and the rules and principles of international law.⁷¹ Such interpretation would not be the same as the interpretation of the CETA in accordance with the rules and principles of EU law accorded by national or EU courts. For this reason, the CJEU highlighted in its Opinion that CETA tribunals stand outside the EU judicial system. Accordingly, any intervention of the CJEU or domestic courts into the decision-making and rulings of CETA tribunals in any given particular case should be correctly and consistently avoided. This is the case in the pre-award stage as no reference for preliminary ruling can be made, but also post-award since no procedure for the re-examination of the rendered award before the domestic courts is envisaged.⁷² This reasoning can be contrasted with the CJEU's ruling in *Achmea*, where the absence of the

⁶⁶ The principle of consistent interpretation stems from the overarching principle of primacy of EU law: see chapter 5.

⁶⁷ *Hermès* (n 65) paras 32-33, and case-law therein cited.

⁶⁸ Joined Cases C-300/98 and C-392/98 *Dior* [2000] ECR I-11307, paras 36-37 (emphasis added).

⁶⁹ See Case 111/75 *Mazzalai v Ferrovie del Renon* [1976] ECR 657, paras 6-7 and Case C-373/95 *Maso* [1997] ECR I-4051, para 28.

⁷⁰ Provision of Art 30.6.1. CETA is mentioned in Opinion 1/17 (n 3) para 40 and the Court refers to the observations made by the parties in para 77. However, the Court does not discuss the absence of direct effect in support of the separation of ICS from the EU legal order. The CJEU also does not anywhere in the Opinion support the argument made by the parties in the same paragraph that the CETA Tribunal and the CJEU operate within legal orders that are '*wholly separate*' (emphasis added).

⁷¹ Opinion 1/17 (n 3) para 122.

⁷² *ibid* paras 134-135. Aligned with this finding of the CJEU is also the EU's proposal for a MIC, which excludes the need for review of awards at the domestic level; instead the review of the future MIC's awards would take place through its second tier (the appellate mechanism): see UNCITRAL, 'Possible reform of investor-State Dispute Settlement (ISDS), Submission from the European Union and its Member States' (24 January 2019) UN Doc A/CN.9/WG.III/WP.159/Add.1, paras 30-31.

CJEU's and the domestic courts' pre- and post-award control was an important consideration which led the CJEU to conclude that ISDS is incompatible with the EU legal order in an intra-EU setting.⁷³ The main differences between the two methods of dispute settlement are outlined in the following table.

Table 9.1. Comparison of investment dispute settlement according to *Achmea* and Opinion 1/17⁷⁴

	SETTLEMENT OF INVESTMENT DISPUTES IN ACCORDANCE WITH <i>ACHMEA</i>	SETTLEMENT OF INVESTMENT DISPUTES IN ACCORDANCE WITH OPINION 1/17
APPLICABILITY	Intra-EU Between investors from EU Member States and Member States	Extra-EU Between investors from the EU/Member States and third non-EU Member States, and <i>vice versa</i>
STATUS OF EU LAW	- EU law as applicable law = as part of applicable domestic law - Exclusive jurisdiction of the CJEU to interpret EU law	- EU law is treated as a matter of fact = prevailing interpretation of EU law by the CJEU to be followed by ICS tribunals - No role for the CJEU
ADJUDICATOR	Domestic courts in the EU + the CJEU through the preliminary ruling procedure = <i>within</i> the EU judicial system	Bilateral ICS tribunals (such as CETA tribunal) or a Multilateral Investment Court = <i>outside</i> the EU judicial system
REMEDIES	- Right to effective remedy before an independent tribunal (Art 47 CFR) - Substantive protections under primary and secondary EU law - Legal remedies under Member States' domestic law available to both domestic and foreign investors	- Right to effective remedy before an independent tribunal (Art 47 CFR) - Substantive protections under EU-third States IIAs - Specific legal remedies under EU-third States IIAs available to foreign investors only
PRINCIPLES	Mutual trust and sincere cooperation within the EU	Reciprocity in relations between the EU and third non-EU States

⁷³ See Case C-284/16 *Achmea* ECLI:EU:C:2018:158, para 43.

⁷⁴ The table was presented by Ivana Damjanovic and Nicolas de Sadeleer at 'The Clash Between International Investment Law and the Autonomy of The EU Legal Order' (Max Planck Lecture Series, Max Planck Institute Luxembourg for International, European and Regulatory Procedural Law, 20 June 2019).

RATIONALE	Integration of the internal market ⇒ EU integration	Protection of EU investors in third States ⇒ Free and fair trade
	▪ Elimination of discrimination between investors from different Member States and exclusive CJEU jurisdiction to interpret EU law serve to achieve this objective	▪ Independence of ICS tribunals from the host State and the access of foreign investors to these tribunals serve to achieve this objective

The CJEU's distinction between interpretation and examination of law should be understood in this context. The rights of foreign investors, in this case Canadian investors, and the obligations of the EU and the Member States towards these investors are prescribed in the CETA. Although it forms part of the EU legal order, CETA is also an international agreement. Interpreting CETA in accordance with international law will determine the *content* of rights and obligations regarding foreign investors. If EU law appears as relevant in the proceedings – for example, if a Member State breached an obligation under CETA in order to comply with an EU law obligation – the CETA tribunal will not engage in interpreting what was the *content* of the Member State's obligation under EU law.⁷⁵

Instead, the tribunal will only examine the *effect* of the Member State's compliance with that EU law obligation on the foreign investor and whether it amounts to a breach of the Member State's obligation under the CETA and international law. In doing so, the content of the Member State's EU law obligation will be determined through expert opinion provided by both parties to the proceedings. Experts on EU law will provide their opinion about the scope of the Member State's obligation and the tribunal will, in accordance with the opinion that it finds more convincing, assess the effect of the measure on the investor and whether the measure could have been avoided. A more convincing opinion does not necessarily mean the most correct and certainly not the same opinion in each and every case; however, the limited applicability of the opinion and the tribunal's assessment in a particular case (*inter partes, res judicata*) avoids the applicability *erga omnes*, which would endanger the position of the CJEU in the EU legal order.

In light of the above discussion, the differences between the proceedings concerning investment issues before the ICS and the CJEU are summarised in the following table.

⁷⁵ Moreover, whether the EU or the Member State is the respondent in such a case will be decided by the EU in accordance with Art 8.21 CETA, while the division of financial responsibility between the EU and the Member States will be determined in accordance with Regulation (EU) 912/2014 of the European Parliament and of the Council of 23 July 2014 establishing a framework for managing financial responsibility linked to investor-to-State dispute settlement tribunals established by international agreements to which the European Union is party [2014] OJ L257/121 (Regulation 912/2014)

Table 9.2. Comparison between investment proceedings before the CETA tribunals and the CJEU⁷⁶

	CETA TRIBUNALS	CJEU
APPLICABLE LAW	CETA + International public law: Art 8.31.1	EU law + international law that binds the EU: Opinion 1/17, para 117 • Includes CETA provisions as part of the EU legal order: principle of consistent interpretation • Excludes direct effect of CETA provisions: investors cannot invoke CETA before domestic courts (Art 30.6)
APPLICABILITY	<i>Inter partes</i> : Art 8.41	<i>Erga omnes</i>
SCOPE OF THE PROCEEDINGS	Examination of the effects of the EU's or the Member State's measure: • Has the investor suffered damage due to the measure? • What compensation should be provided to the investor (monetary damages or restitution of property)? • EU law as a fact: Arts 8.31.2; 8.28.2(b)	Examination of the legality and the effects of the EU measure: • Is the measure valid under EU law? • If the measure is invalid, have the conditions for non-contractual liability been fulfilled to compensate the investor? • EU law as applicable law
OBJECTIVES	Non-discriminatory treatment and protection of foreign investments: Opinion 1/17, paras 199-200	Protection of four freedoms, in particular free movement of services and capital, and freedom of establishment

9.2.3. The EU decides who is the respondent before the ICS tribunals: Regulation No. 912/2014

As an additional safeguard of procedural autonomy, CETA provisions ensure that the Union retains the power to determine whether the challenged measure before the CETA Tribunal is an EU or a Member State measure. Accordingly, the CETA allows the EU to determine the respondent in the proceedings.⁷⁷ This is an important consideration which preserves the exclusive jurisdiction of the CJEU to give rulings on the division of powers between the EU and its Member States.⁷⁸

⁷⁶ The table was presented at the Max Planck Lecture Series, 'The Clash Between International Investment Law and the Autonomy of The EU Legal Order', Max Planck Institute Luxembourg for International, European and Regulatory Procedural Law, 20 June 2019.

⁷⁷ Art 8.21 CETA.

⁷⁸ Opinion 1/17 (n 3) para 132. In this regard, CETA is distinguished from the Opinion 2/13 in which the CJEU decided that the EU's accession to the European Convention on Human Rights (ECHR) would be contrary to EU law. This was because, *inter alia*, the ECtHR would be deciding on the apportionment of responsibility between the EU and its Member States and, thus, the ECtHR and not the CJEU would be assessing the rules

In practical terms, the apportionment of responsibility entails the obligation of an investor to deliver to the EU a notice requesting a determination of the respondent prior to submitting their claim to the ICS tribunal.⁷⁹ The EU will make a determination and inform the investor as to whether the EU or the Member State is to be the respondent in the proceedings.⁸⁰ The determination will be made in accordance with the apportionment criteria and procedural requirements set out in the 2014 EU Regulation establishing a framework for managing financial responsibility arising from investment claims under international agreements to which the EU is a party.⁸¹ As a general rule, the EU will fully bear the responsibility arising from the treatment of the EU institutions and bodies. The Member State will equally bear the responsibility arising from the treatment of its own institutions. However, if such a Member State's treatment was required by EU law, financial responsibility will be borne by the EU,⁸² subject to conditions prescribed in the Regulation.

Given the sheer complexity of interactions between domestic law and EU law in a number of policy areas of shared competence and the difficulty of determining to what extent something is 'required' or not required by Union law, internal conflicts between the EU and the Member States are likely. The situations where the EU will bear the full responsibility are limited to acts or measures undertaken exclusively by EU institutions. In practice, only a small number of such cases would concern foreign investors; for example, EC decisions regarding infringements of EU competition law.⁸³ The vast majority of cases will concern the area of shared EU and Member State competence; for example, in the area of the internal market, environmental and labour law. In these cases, what is 'required by EU law' refers only to those measures which leave no discretion or margin of appreciation for the Member States,⁸⁴ effectively excluding all directives and possibly a number of regulations too.⁸⁵ The cases of partial, if not full, Member States' financial

governing the division of powers between the EU and its Member States: Opinion 2/13 ECLI:EU:C:2014:2454, paras 224-235.

⁷⁹ Art 8.21.1 CETA. This step will take place if the dispute is not settled within 90 days of the submission of the request for consultations. Consultations are guided by Art 8.19 CETA, according to which the investor is to submit a request for consultation to the EU, regardless of whether the alleged breach concerns an EU or a Member State measure: Art 8.19.7 CETA. In the internal aspect, these consultations are guided by Art 7 of the Regulation 912/2014.

⁸⁰ Art 8.21.3 CETA.

⁸¹ Regulation 912/2014.

⁸² Art 3(1) Regulation 912/2014.

⁸³ This example is mentioned as a possibility in the Opinion 1/17 (n 3), but in the context of the effectiveness of EU law: see paras 184-186.

⁸⁴ Art 2(l) Regulation 912/2014.

⁸⁵ Although regulations have direct applicability, Member States might be required to introduce specific arrangements regarding fees, control, penalties, and setting up of enforcement bodies, which all leave a certain amount of discretion to Member States.

responsibility will be more common in practice, ultimately placing the financial burden of litigation on the Member States.

Importantly for investors, EU internal disputes about financial responsibility will not have an impact on the proceedings before the ICS nor on the promptness of the final award payments. Externally, in all such cases, the EU will act as a respondent⁸⁶ and will pay any award.⁸⁷ Internally, the Commission will apportion the financial responsibility of the Member State and this decision may always be reviewed by the CJEU.⁸⁸ Therefore, the EU and effectively the CJEU have the final say in determining the responsibility for the measure challenged by the foreign investor. In the EU internal dimension, the Commission and the Member States are required to cooperate in carrying out the ICS proceedings, in accordance with the principle of sincere cooperation.⁸⁹

9.2.4. *Interim conclusion*

In light of the CETA provisions on the applicable law and the apportionment of responsibility between the EU and the Member States, the CJEU concluded that ICS tribunals would be sufficiently separated from the EU legal order. The Court accordingly found that the procedural safeguards inserted in the CETA⁹⁰ sufficiently protect the autonomy of the CJEU from the influence of the ICS. The EU procedural autonomy protects the role of the CJEU as the highest authority for interpreting EU law and determining the meaning of EU norms. Given the *erga omnes* applicability of the CJEU's rulings, its authority is not only limited to interpretation of rules in a typical civil law setting but it is akin to the law-making authority of common law courts.

CETA tribunals are to be fully internationalised tribunals.⁹¹ They will operate in the sphere of the international legal order and apply international law – both CETA as an international treaty and general principles of international law. They will not be subject to any control mechanism of domestic law, either in the pre- or post-award stage, and will be insulated from domestic law. Their awards will be final and binding on the EU and Canada. The lack of control from domestic courts is to be substituted by the appellate

⁸⁶ Art 9(1) Regulation 912/2014.

⁸⁷ Art 18 Regulation 912/2014.

⁸⁸ Art 19 Regulation 912/2014.

⁸⁹ See in particular Arts 6, 9, 10 and 11 Regulation 912/2014.

⁹⁰ For substantive safeguards, see chapter 8 on the right to regulate.

⁹¹ For the discussion about internationalised tribunals, see Hege Elisabeth Kjos, 'Applicable Law in Investor-State Arbitration: The Interplay Between National and International Law' (OUP 2013) 44-46. According to her, internationalised tribunals satisfy three criteria: they operate according to an international treaty, which gives them mandate to render awards; they are insulated from the application of the law of the State in which they have their seat; and their awards are binding on the State parties to the treaty and are not subject to domestic law awards enforcement (e.g. the New York Convention): *ibid* 55.

mechanism of the CETA, which will review first instance awards on the basis of errors of law and manifest errors of fact. Applicable law in the appeal process is also international law, while any domestic law issues must be examined as facts, rendering the appeals separated from domestic law. State parties can exercise control over the ICS tribunals only through binding interpretations by the CETA Joint Committee (JC); however, this is the usual mechanism of State control in international law.⁹² Importantly, any decisions rendered by the CETA JC can never have retroactive effect nor direct effect on pending cases,⁹³ thus insulating closed and pending cases from any undue interventions. These ICS attributes indicate that CETA drafters have been inspired by the ICSID system, whose tribunals can also be characterised as fully internationalised tribunals.⁹⁴

9.3. The compatibility of the ICS with the rule of law⁹⁵

The CETA system, since it is established under an EU international agreement, must be compatible with the EU founding treaties and its constitutional principles.⁹⁶ Accordingly, it must be coherent with EU values, objectives and principles.⁹⁷ Given its court-like nature, the compatibility of the ICS with the rule of law as one of the EU's core constitutional values is of particular importance.⁹⁸ In its policy documents the EC has emphasised the aspiration to strengthen the rule of law in IIL as an important rationale for the ICS and a prerequisite of its legitimacy.⁹⁹

The key components of the rule of law are encapsulated in the principles of equality before the law and judicial protection.¹⁰⁰ Unlike Articles 18 TFEU and 21(2) CFR, which apply to internal discrimination based on the grounds of nationality, Article 20 CFR is

⁹² Art 31(3)(a) VCLT requires that any subsequent agreement between the parties on interpretation or application of treaty provisions is to be taken into account in the interpretation of those provisions. On the applicability of that provision in the context of IIAs, see David Gaukrodger, 'The Legal Framework applicable to Joint Interpretative Agreements of Investment Treaties' (OECD Publishing 2016). See also Opinion 1/17 (n 3) para 233.

⁹³ Opinion 1/17 (n 3) para 237.

⁹⁴ See analysis of ICSID tribunals as internationalised tribunals in Kjos (n 91) 54-56.

⁹⁵ Section 9.3 and its subsections draw on and incorporate ideas and language of the publication Damjanovic and de Sadeleer (n 9).

⁹⁶ Opinion 1/17 (n 3) para 165; Opinion 1/15 (n 27) para 67; *Western Sahara* (n 27) para 46.

⁹⁷ On EU values, objectives and principles, see chapter 4, section 4.2.

⁹⁸ Along these lines were also the issues raised by the Belgian authorities in the request for the Opinion.

⁹⁹ For example, in its impact assessment of the future MIC, the EC notes that 'ISDS lacks the necessary tools to ensure effective application of the principles emanating from public law disputes (i.e. the rule of law), including inter alia fully independent and impartial courts and effective review ensuring the legitimacy of the system is upheld Comparatively, the rule of law and its main principles are duly protected under the ICS, where disputes are decided by judges appointed on a permanent basis without any role for the disputing parties.' The EC further points to the ICS' appellate mechanism, whose role is 'to ensure that any errors in decisions issued by the First Instance are reviewed': European Commission, 'Multilateral reform of investment dispute resolution, Impact Assessment' SWD (2017) 302 final, 38.

¹⁰⁰ On the notion of the rule of law and its applicability in IIL, see Part I, chapter 3, section 3.3.2.

applicable in the EU external dimension.¹⁰¹ The general principle of judicial protection is embodied in Articles 6 and 13 of the ECHR and Article 47 CFR. The judiciary component of the rule of law in the EU law has been recently clarified in a number of the CJEU's judgments.¹⁰² Article 19 TEU 'gives concrete expression to the value of the rule of law' by entrusting both the CJEU and domestic courts to apply EU law.¹⁰³ The essence of the rule of law includes the right of individual parties 'to challenge before the courts the legality of any decision or other national measure relating to the application to them of an EU act'.¹⁰⁴

In Opinion 1/17 the CJEU assessed the new ICS in light of Articles 20 and 47 CFR. First, the Court ascertained that differentiated investment regimes under EU law and international law do not undermine the principle of equality in the EU. Secondly, the CJEU established that the ICS complies with the requirements of Article 47 CFR, which guarantees effective access to justice and a remedy before an independent and impartial tribunal previously established by law.¹⁰⁵ Effectively thus, the CJEU concluded that the ICS complies with the-rule-of-law requirements.

9.3.1. *Equality before the law in the EU*

The CJEU confirmed that the ICS complies with the requirements of equality in Article 20 CFR. In coming to this conclusion, the CJEU compared the position of third States' investors in the EU with the position of EU investors in third States. Importantly thus, the CJEU found that the situations of domestic and foreign investors in the EU are not comparable as the EU legal order offers sufficient protections for *all* investors incorporated in the EU.

The CJEU has thus reaffirmed its position that intra-EU investors enjoy equal protections across the internal market, as expressed in *Achmea*. The principle of mutual trust in the EU requires that Member States comply with the right to an effective remedy before an independent tribunal guaranteed in Article 47 CFR in order to ensure effective

¹⁰¹ To that effect, see Case C-617/10 *Åkerberg Fransson* ECLI:EU:C:2013:105, paras 19-21; Case C-418/11 *Texdata Software* ECLI:EU:C:2013:588, para 72; Case C-682/15 *Berlioz Investment Fund* ECLI:EU:C:2017:313, para 49; Opinion 1/17 (n 3) para. 176.

¹⁰² Case C-619/18 *Commission v Poland* ECLI:EU:C:2019:531; Joined Cases C-585/18, C-624/18 and C-625/18 *A.K. v Krajowa Rada Sądownictwa, and CP and DO v Sąd Najwyższy* ECLI:EU:C:2019:982; Case C-64/16, *Associação Sindical dos Juizes Portugueses* ECLI:EU:C:2018:117. The rule of law was first affirmed by the CJEU in 1986: Case C-294/83 *Parti écologiste "Les Verts" v European Parliament* [1986] ECR 1339. See chapter 4, section 4.1.

¹⁰³ *Associação Sindical dos Juizes Portugueses* (n 102) para 32.

¹⁰⁴ *ibid* para 31.

¹⁰⁵ In that sense, the Belgian request asked the CJEU to ascertain whether the CETA Investment chapter was compatible with Art 47 CFR.

judicial protection.¹⁰⁶ The principle of mutual trust ensures the equal level of justice across the EU. In this internal aspect, in Opinion 1/17 the CJEU reiterates its integrationist view of EU law.

However, the principle of mutual trust is not applicable in relations between the EU and non-EU States.¹⁰⁷ Accordingly, effective remedies before an independent tribunal and thus effective judicial protection are *not* guaranteed in third States.¹⁰⁸ For this reason, the CJEU reached the conclusion that the two categories of investors – domestic and foreign – do not find themselves in a comparable situation, and consequently cannot be treated in the same way. Only EU investors in Canada and *vice versa* find themselves in a comparable situation and, therefore, must be treated in the same way.¹⁰⁹

This differentiated treatment, as an exception to the principle of the equality before the law, is permissible whenever the situations are not comparable but must be objectively justified.¹¹⁰ AG Bot in his Opinion explained that third States' investors in the EU would not be placed in a preferential situation compared to EU domestic investors since access to the ICS compensates for the absence of direct effect of EU IIAs.¹¹¹ On the other hand, since EU internal investors enjoy better protections under the EU legal order compared to EU investors incorporated in third non-EU States, it is important to ensure effective remedies and protection for EU investors in third States. As noted by the CJEU, the purpose of the CETA 'is to give complete confidence' to EU investors investing in Canada, and *vice versa*.¹¹²

When assessing equality the CJEU has given preference to some EU values and objectives, prioritising the need to protect EU investors abroad.¹¹³ The CJEU was not focused on substantively more favourable treatment of external investors in the EU compared to internal EU investors, but on the judicial protection for EU investors abroad. In assuming that EU investors would not be equally protected abroad due to the absence of mutual trust in external relations, the CJEU endorses the traditional ISDS narrative. The

¹⁰⁶ Opinion 1/17 (n 3) para 128.

¹⁰⁷ *ibid* para 129.

¹⁰⁸ The President of the CJEU, Mr Koen Lenaerts, stressed that the status of a State as a respondent in investment proceedings raises the question 'whether its courts are effectively in a position to settle the dispute impartially, without political influence or interference or indeed the appearance of such influence or interference. The answer to that question may not be clear in certain third States in which the separation of powers and the rule of law may not apply consistently and reliably in practice. Lack of trust in a host State's judicial system may discourage EU foreign investment and thus undermine the Union's objective of contributing to free and fair trade, set out in Article 3(5) TEU': Koen Lenaerts, 'Modernising trade whilst safeguarding the EU constitutional framework: an insight into the balanced approach of Opinion 1/17' (Seminar on Opinion 1/17, Belgian Ministry of Foreign Affairs, 6 September 2019).

¹⁰⁹ Opinion 1/17 (n 3) paras 180-181; Opinion of AG Bot (n 8) paras 201-203.

¹¹⁰ Case C-101/12 *Schaible* ECLI:EU:C:2013:661, para 76, and Case C-540/16 *Spika and Others* ECLI:EU:C:2018:565, para 35.

¹¹¹ Opinion 1/17, Opinion of AG Bot (n 8) para 205.

¹¹² Opinion 1/17 (n 3) para 199.

¹¹³ In accordance with Art 3(5) TEU.

CJEU's immediate concern is not the protection of EU investors in Canada but the desirability of the ICS in relations with third States more generally.

The CJEU also emphasised the necessity of the ICS in fostering trade with third States and, more generally, in achieving the objective of free and fair trade.¹¹⁴ The ICS is needed to ensure a fair treatment of EU investors in third countries and accordingly their confidence to invest.¹¹⁵ In emphasising the objective of free and fair trade the CJEU assumes that trade cannot be free and fair without the ICS. The reasoning of the Court thus endorses a traditional economic paradigm in international trade and investment.

9.3.2. *Independence of the ICS tribunals*

According to the CJEU, judicial independence is an 'essential' element of the rule of law, as emphasised in judgments regarding domestic courts.¹¹⁶ Since the judicial nature of the ICS was acknowledged in Opinion 1/17, the first issue is whether the ICS complies with the criteria for judicial independence under EU law. Secondly, given that the ICS stands outside the EU judicial system, the question is whether the standard of independence that applies to domestic courts in the EU should equally apply to international courts formed under an international treaty to which the EU is a party, such as the CETA.

In Opinion 1/17, the CJEU implied that the rule-of-law standards for external courts might be lower than standards for EU courts but are sufficient as long as they satisfy the minimum standards of Article 47 CFR. The right to an effective remedy before an independent and impartial tribunal prescribed in Article 47 CFR constitutes 'a reaffirmation of the principle of effective judicial protection'¹¹⁷ and a general principle of EU law.¹¹⁸ In virtue of Article 52(3) CFR, Article 47 must be interpreted in light of Article 6 ECHR, while the provisions of the Charter must be interpreted in light of the case-law of the European Court of Human Rights (ECtHR). Accordingly, the ECtHR case-law is relevant for assessing the requirements of independence and impartiality of Article 47 CFR. Further, as a general principle, the scope of the right to effective judicial protection in Article 47 CFR is broader than the scope of Article 6 ECHR, which is restricted to 'civil

¹¹⁴ Opinion 1/17, Opinion of AG Bot (n 8) paras 173-178, Opinion 1/17 (n 3) paras 199-200.

¹¹⁵ Opinion 1/17 (n 3) para 200.

¹¹⁶ *Associação Sindical dos Juizes Portugueses* (n 102)

¹¹⁷ See, to that effect, judgments in Case 432/05 *Unibet* [2007] ECR I-2271, para 37, and Case C - 93/12 *Agrokonsulting-04* ECLI:EU:C:2013:432, para 59. This provision provides that 'everyone whose rights and freedoms guaranteed by EU law are violated has the right to an effective remedy before a tribunal in compliance with the conditions laid down in that article': Case C-562/13 *Centre Public d'Action Sociale d'Ottignies-Louvain-la-Neuve v Abdida* ECLI:EU:C:2014:2453, para. 45.

¹¹⁸ Case C-97/91 *Borelli* [1992] ECR-I 6313.

rights and obligations' and criminal proceedings.¹¹⁹ In contrast to Article 6 ECHR, Article 47 CFR imposes obligations and restrictions on the EU both internally and externally. This is confirmed in Opinion 1/17 where the CJEU for the first time applied Article 47 CFR to a court outside the EU judicial system.

The ECtHR case-law highlights four elements of judicial independence that are either external or internal: the method of judicial appointment; the term of office; the existence of guarantees against outside pressures – including in budgetary matters; and whether the judiciary *appears* independent and impartial.¹²⁰ Similarly, the notion of independence in the CJEU's case-law encompasses both external and internal dimensions. The rationale of these two dimensions is related to the public perception of independence of courts. The aim is 'to dispel any reasonable doubt in the minds of individuals as to the imperviousness of that body to external factors and its neutrality with respect to the interests before it'.¹²¹ Accordingly, 'justice must not only be done, it must also be seen to be done'.¹²² This principle has been embraced in the EU's ISDS reform¹²³ and emphasised by other States in UNCITRAL.¹²⁴

9.3.2.1. The external dimension of independence

According to the settled case-law of the CJEU, the concept of independence in its external dimension presupposes:

that the body concerned exercises its judicial functions wholly autonomously, without being subjected to any hierarchical constraint or subordinated to any other body and without taking orders or instructions *from any source whatsoever*, and that it is thus protected against external interventions or pressure liable to impair the independent judgment of its members and to influence their decisions.¹²⁵

¹¹⁹ Dinah Shelton, 'Article 47' in Steve Peers and others (eds), *The EU Charter of Fundamental Rights: A Commentary* (Hart 2014) 1210 (para 47.44).

¹²⁰ *Campbell and Fell v the UK*, App nos 7819/77 and 7878/77 (ECtHR, 28 June 2014) para 78 (emphasis added).

¹²¹ Case C-222/13 *TDC* ECLI:EU:C:2014:2265, para 32 and the case-law cited.

¹²² See, for example, *De Cubber v Belgium* App no 9186/80 (ECtHR, 26 October 1984) para 26; *Micallef v Malta* App no 17056/06 (ECtHR, 15 October 2009) para 98; *Oleksandr Volkov v Ukraine* App no 21722/11 (ECtHR, 9 January 2013) para 106.

¹²³ Lord Chief Justice Gordon Hewart in *R v Sussex Justices, Ex Parte McCarty* [1924] 1 KB 256 (as cited in UNCITRAL, 'Possible reform of Investor-State dispute settlement (ISDS)', Submission from the European Union' (12 December 2017) UN Doc A/CN.9/WG.III/WP.145, para 27.

¹²⁴ See Anthea Roberts and Zeineb Bouraoui, 'UNCITRAL and ISDS Reforms: What are States' Concerns?' (*EJIL Talk*, 5 June 2018) <<https://www.ejiltalk.org/uncitral-and-isds-reforms-what-are-states-concerns/>> accessed 30 June 2020.

¹²⁵ See, to that effect Case C-506/04 *Wilson* ECLI:EU:C:2006:587, para 51, and Case C-503/15 *Margarit Panicello* ECLI:EU:C:2017:126, para 37 and the case-law cited (emphasis added). See also Principle 12 of the Magna Carta of Judges: Council of Europe, Recommendation CM/Rec (2010)12 of the Committee of Ministers to member States on judges: independence, efficiency and responsibilities (adopted by the Committee of Ministers on 17 November 2010 at the 1098th meeting of the Ministers' Deputies).

Accordingly, the ICS should be fully immune from the external influence. However, the ICS is subject to the control of the CETA Joint Committee (hereafter CETA JC) in a number of ways: through binding interpretations; the appointment and removal of tribunal members; and their remuneration. The issue is whether this influence would adversely impact the autonomy of the ICS. The CJEU concluded that it would not.

First, the CETA JC can adopt interpretations of the CETA provisions that would be binding on the ICS tribunal.¹²⁶ One of the Belgian observations was that the CETA JC can be qualified as an executive body exerting a significant influence on the ICS's adjudication and is thus likely to undermine the autonomy of the ICS. The argument of Belgium has to be placed in the context of the rule-of-law standard, which presupposes the separation of powers as the cornerstone of the independent judiciary. There lies a paradox: the separation of powers is engrained in domestic legal systems, not in the international realm, part of which is CETA. The challenge is to safeguard the independence of the new court in a regime that is ill tailored for full independence from political influence.

In Opinion 1/17 the CJEU resolved this paradox by touting the middle ground. It embraced an international law standard of binding interpretations issued by States, while subjecting these interpretative instruments to a basic rule-of-law standard: the binding interpretations cannot have retroactive effect nor direct effect on pending cases.¹²⁷ The Court particularly noted that it is 'neither illegitimate nor unusual under international law' for the *joint wishes* of the parties to be expressed in such binding statements.¹²⁸ In other words, the Court expressly distinguished the rule of law in a domestic context where any political interference should be absolutely excluded from the international context in which such interference – as expressed through the wishes of the State parties to an international agreement – is acceptable.¹²⁹

With respect to the correct application of EU law, the Court has set forth a safeguard: the binding interpretations are governed by Article 218(9) TFEU. Nevertheless, such a safeguard has its limitation. The CETA JC decisions cannot be

¹²⁶ Art 8.31.3 CETA.

¹²⁷ Opinion 1/17 (n 3) para. 237.

¹²⁸ *ibid* para. 233 (emphasis added).

¹²⁹ Despite the CJEU's condition, the EC's proposal for the procedure for adoption of binding interpretations does not include an explicit prohibition of retroactive application of such instruments. In para 5 of the proposed Annex to the Rules of Procedure of the CETA Joint Committee, it is only stated that the Committee 'may decide that an interpretation shall have binding effect from a specific date': Proposal for a Council Decision on the position to be taken on behalf of the European Union in the CETA Joint Committee established under the Comprehensive Economic and Trade Agreement (CETA) between Canada, of the one part, and the European Union and its Member States, of the other part as regards the adoption of a decision on the procedure for the adoption of interpretations in accordance with Articles 8.31.3 and 8.44.3(a) of CETA as Annex to its Rules of Procedures, COM/2019/458 final. Importantly, the proposal must be adopted in the Council so it could be subject to further amendments. Afterwards, the proposal must also be accepted by Canada. Therefore, the EC's proposal is only indicative of what the final version of the CETA procedure for binding interpretations might be.

challenged *per se*, only the consent of the EU to such decisions can be subject to judicial review by the CJEU. The standing for this judicial review is restricted to the Member States, the European Parliament, and the Council.¹³⁰ In practice, only a few Member States have initiated proceedings. It is rather the Council that challenges the positions adopted by the EC, and *vice versa*. While judicial control exists as a matter of principle, it remains to be seen whether review of the consistency of the CETA JC decisions with primary EU law would be effective. Further, if the ICS is under the control of the CETA JC, under which control is the CETA JC? How can a flawed interpretation of the Appellate Tribunal be corrected if a disagreement about the interpretation persists at the CETA JC level? Under these circumstances, a breach of EU law principles (for instance, compliance with the right to regulate) could not be corrected.¹³¹ Ultimately, a potential judicial review of the EU's consent to the CETA JC decisions also compounds the risk of a disagreement between the EU and Canada in issuing binding interpretations.

Secondly, the CETA JC exerts other powers over the ICS, in particular regarding the appointment and the removal of its members. According to a non-binding statement by the Commission and the Council,¹³² the members nominated by the EU must comply with the standards for candidates to the CJEU pursuant to Article 253(1) TFEU. However, this statement does not guarantee that Canada would comply with similar standards. Further, there is no independent judicial council intervening in the assessment of the quality of the candidates that could offset the politicisation of the appointment regime.¹³³ Given the significant impacts that investment awards have on communities and decision-makers, a degree of democratic control in the appointment of the ICS members, in some form of parliamentary involvement, would be a welcome development towards a more legitimate system.¹³⁴ *Mutatis mutandis*, these arguments about the appointment of the ICS members could be made with respect to their removal.

The CJEU nevertheless noted that decisions of the CETA JC would be made by mutual consent, which is in the Court's reasoning a sufficient guarantee that both the

¹³⁰ Under Art 263 TFEU, the CJEU is called on to review the legality of acts of the institutions provided that they are 'intended to produce legal effects vis-à-vis third parties'. In accordance with the CJEU settled case-law, acts open to action for annulment are any measures adopted by the institutions, whatever their nature or form, which are intended to have legal effects. Therefore, a decision made on behalf of the EU in a body set up by an international agreement can be challenged: see Case C-687/15 *Commission v Council* ECLI:EU:C:2017:803.

¹³¹ On the right to regulate, see chapter 8, section 8.2.2.

¹³² Council of the European Union, 'Comprehensive Economic and Trade Agreement (CETA) between Canada, of the one part, and the European Union and its Member States, of the other part – Statements to the Council minutes' (27 October 2016) 13463/1/16.

¹³³ Commission of Venice, *The Rule of Law Checklist* (Council of Europe 2016) para 2.

¹³⁴ However, there is no requirement of that sort even in the TFEU for the appointment of EU judges: Art 253(1) TFEU. However, the involvement of national parliaments in the appointment of constitutional court judges is a practice adopted in several Member States.

appointment and the removal of the ICS members would not be subject to any other conditions but those laid down in CETA.¹³⁵ Bipartite and equal composition of the CETA JC is to serve as such a guarantee.¹³⁶

Thirdly, in its request Belgium stressed, referring to Article 6 of the European Charter on the Statute for Judges, that the remuneration of members must be fixed 'so as to shield them from pressures aimed at influencing their decisions'.¹³⁷ The German Magistrates Association also questioned whether the criteria for the financial independence of judges have been met.¹³⁸ The AG noted that the remuneration of Members of the Tribunals in CETA makes reference to the rules applicable in the field of arbitration¹³⁹ and that these rules have not yet been fully developed.¹⁴⁰ The Court follows that reasoning, noting that the remuneration rules permit 'the gradual establishment of a court composed of members who will be employed full time'.¹⁴¹ In the long run, full-time employment, as opposed to an *ad hoc* engagement currently present in the arbitration regime, should be sufficient to guarantee financial independence of the ICS members.

In its impact assessment, the EC has expressed the adjudicators' full-time employment with a fixed salary as a preferred albeit more expensive option for a MIC, which would contribute to a higher level of adjudicator independence and impartiality and thus would be more consistent with the right to an effective remedy before an independent tribunal under EU law.¹⁴² However, the EC does not exclude the option of adjudicators commencing part-time before becoming full-time. In the interim, it is claimed that their independence would be 'effectively managed' through the code of conduct.¹⁴³ While this would be a more pragmatic option, it might also have negative consequences for the new system's legitimacy. Ultimately, if the remuneration of new adjudicators depends on the frequency of cases, stimulating the industry by increasing the caseload could be perceived as an ulterior motive of the adjudicators, similar to such public perception in the current system.¹⁴⁴

¹³⁵ Opinion 1/17 (n 3) para 228.

¹³⁶ Opinion 1/17, Opinion of AG Bot (n 8) para 267.

¹³⁷ Opinion 1/17 (n 3) para 61.

¹³⁸ German Magistrates Association, 'Opinion No 04/16 on the Establishment of an Investment Tribunal in TTIP' (February 2016).

¹³⁹ Art 8.27.14 CETA.

¹⁴⁰ Opinion 1/17, Opinion of AG Bot (n 8) paras 260-261.

¹⁴¹ Opinion 1/17 (n 3) para 231.

¹⁴² European Commission, MIC Impact Assessment (n 99) 42-43.

¹⁴³ *ibid* 43. For the code of conduct, see section 9.3.1.2 below.

¹⁴⁴ For empirical studies on this issue, see Part I, chapter 3, section 3.3.2.2.

9.3.1.2. The internal dimension of independence

The internal dimension in the CJEU's case-law 'is linked to impartiality and seeks to ensure that an equal distance is maintained from the parties to the proceedings and their respective interests with regard to the subject matter of those proceedings'. It requires 'objectivity and the absence of any interest in the outcome of the proceedings apart from the strict application of the rule of law'.¹⁴⁵ In the context of the ICS, there are two relevant issues regarding the internal dimension: first, whether the rules of ethics ensure the equal distance of the ICS members from the interests at stake (prevention of conflicts of interest), and secondly, whether the composition requirements ensure the objectivity of the ICS members in balancing different interests involved in the investment disputes (the lack of disciplinary bias).¹⁴⁶

According to the ECtHR, the judiciary must be and *appear* to be independent and impartial. The impartiality should be examined from a subjective as well as an objective perspective since bias can be either manifest or apparent.¹⁴⁷ The subjective approach relates to 'the personal conviction of a given judge in a given case', while the objective approach determines whether s/he 'offered guarantees sufficient to exclude any legitimate doubt'. In this respect, any judge 'of whom there is a legitimate reason to fear a lack of impartiality must withdraw. At stake is the confidence which the courts must inspire in the public in a democratic society.'¹⁴⁸ Accordingly, a trial is unfair not only if the judge is not impartial but also if s/he is not *perceived* as impartial.

The CETA endorses a narrow approach to the requirement of impartiality.¹⁴⁹ First, it limits the scope of potential conflict of interests to those related to the dispute at stake, mandating that tribunal members shall not take instruction from any organisation or government, or participate in the consideration of any dispute that would create a direct or indirect conflict of interest. Given that the terms 'direct or indirect conflict of interest' are not defined, Article 8.30 CETA further refers to the International Bar Association (IBA) Guidelines on Conflict of Interest in International Arbitration.¹⁵⁰ The IBA Guidelines classify arbitrators' direct or indirect interest in the dispute under the 'Waivable Red List'

¹⁴⁵ *Wilson* (n 125) para 52.

¹⁴⁶ For disciplinary bias, see Part I, chapter 3, section 3.3.2.2.

¹⁴⁷ See also International Commission of Jurists, 'International Principles on the Independence and Accountability of Judges, Lawyers and Prosecutors' (2007) Practitioner Guide No. 1, 28. If this standard is applied to the sphere of arbitration, for instance, a manifest bias would be in the case of identity between a disputing party and the arbitrator. In contrast, an apparent bias would be if the arbitrator previously advised a disputing party.

¹⁴⁸ *Piersack v Belgium*, App no 8692/79 (ECtHR, 1 October 1982) para. 30. Similarly, see Art 3.2 Council of Europe, European Charter on the Statute for Judges (1998).

¹⁴⁹ See Art 8.30 CETA.

¹⁵⁰ Approved on 22 May 2004 by the IBA Council.

referring to only three situations (holding shares, close family members having significant interest in the outcome, close relationship with a non-party who may be liable on the part of the unsuccessful party).¹⁵¹ These situations mirror only manifest biases. The prohibition of double-hatting in CETA is also loosely worded; the text requires members of the tribunal only to '*refrain from*' acting as counsel or a party appointed expert or witness in any pending or new investments disputes under the CETA or any other international agreement.¹⁵²

In addition to these rules, the EC's proposal for the code of conduct¹⁵³ envisages a duty of disclosure of any conflicting activities, whether real or apparent, in at least five years preceding the candidature.¹⁵⁴ However, the proposal does not specify situations of such conflict, so the reference in the main text of CETA to the IBA Guidelines remains relevant. The code proposal also prescribes obligations for former members, requiring from them not to act as representatives of any of the disputing parties appearing before the CETA tribunals.¹⁵⁵ It remains unclear whether they could nevertheless act before other ICS tribunals, which would render this provision only narrowly effective.

Additionally, and more generally, the concept of impartiality has been defined as creating a correlative duty for a judge to withdraw from a case in which s/he is unable to decide the matter impartially or in which it may appear to a reasonable observer that the judge is unable to decide the matter impartially.¹⁵⁶ This duty relates both to cases of manifest and apparent bias. Contrary to this, CETA does not provide for the duty of withdrawal in the case of an apparent bias. In IBA Guidelines the concept of conflict of interest does include a 'reasonable third person' but limits the justifiable doubt to a very narrow list of situations which would amount to a serious conflict of interest and thus a manifest bias.¹⁵⁷ In addition, the IBA Guidelines enumerate, albeit not exclusively,

¹⁵¹ See IBA Guidelines on Conflict of Interest in International Arbitration, Part II, Practical Application of the General Standards, Waivable Red List, 20 (point 2.2).

¹⁵² Arti 8.30 CETA (emphasis added). While the provision prescribes that members of the tribunal 'shall not participate' in disputes creating a direct or indirect conflict of interest, double-hatting is worded with reference to 'shall refrain'.

¹⁵³ Proposal for a Council Decision on the position to be taken on behalf of the European Union in the Committee on Services and Investment established under the Comprehensive Economic and Trade Agreement (CETA) between Canada, of the one part, and the European Union and its Member States of the other part as regards the adoption of a code of conduct for Members of the Tribunal, the Appellate Tribunal and mediators, COM/2019/459 final (EU Proposal for the Code of Conduct). Importantly, just as in the EC's proposal on the procedure for the adoption of binding interpretations (n 129), this proposal needs to be adopted in the Council so it could be subject to further amendments. Afterwards, the proposal needs to be accepted by Canada. Therefore, it is only indicative of what the final version of the CETA Code of Conduct might be.

¹⁵⁴ Article 3(1) EU Proposal for the Code of Conduct.

¹⁵⁵ *ibid* Article 5(2).

¹⁵⁶ UNDOC, 'The Bangalore Principles of Judicial Conduct' (2018) ECOSOC 2006/23, Principle 2.5. A similar duty is recognised as part of the rule against bias (*nemo iudex in causa sua*) in domestic administrative law practice.

¹⁵⁷ See IBA Guidelines on Conflict of Interest in International Arbitration, Part II, Non Waivable Red List, 20.

different situations which do not mandate a duty for an arbitrator to step down.¹⁵⁸ The IBA's list of situations referring to 'specific situations where no appearance and no actual conflict of interest exist from an objective point of view' would create an apparent bias in the eyes of the public if such a standard were applied to judges.¹⁵⁹ The EC's proposal for a CETA code of conduct is silent on the duty of withdrawal.¹⁶⁰

Therefore, the CETA's prescription of impartiality endorses only subjective impartiality but excludes apparent bias, a circumstance under which the member of the tribunal should withdraw if a legitimate doubt would exist *in the eyes of the public* (objective impartiality). The IBA Guidelines nominally refer to both subjective and objective impartiality but in fact endorse only a narrow concept of subjective impartiality. This is not surprising given that the IBA Guidelines have been conceived for arbitrators and not judges. They were intended to be applied in a private law dispute resolution framework, relying on the consent of the parties. On the contrary, the ICS is deemed to be a body performing judicial functions and should be subject to court standards. The reference to the IBA Guidelines does not support this claim. The CJEU recognised that the rules of the IBA Guidelines must be 'adapted' to the 'realities of an investment tribunal that is primarily judicial in nature'.¹⁶¹ The EC's proposal seems to be bringing only cosmetic adaptations.¹⁶²

Finally, the CETA prescribes that tribunal members 'shall possess the qualifications required in their respective countries for the appointment to judicial office or to be jurist of recognised competence', with demonstrated expertise in public international law.¹⁶³ This requirement repositions the ICS towards the judicial sphere and public law. Nevertheless, it remains 'desirable' that future members have particular expertise in IIL, in international trade law, and the resolution of disputes arising under international investment or international trade agreements.¹⁶⁴ The criteria set forth under the CETA therefore narrow down the general level of competence of the ICS members.¹⁶⁵ Given that the newly appointed members would shape the ICS case-law, specialisation in trade and investment law could likely retain the disciplinary bias of the current system. Judicial techniques appropriate for adjudicating disputes involving conflicts between private and

¹⁵⁸ See *ibid* Waivable Red List, Orange List, and Green List.

¹⁵⁹ See the Green List, *ibid* 25-26. This list includes, among others, 'the arbitrator and counsel for one of the parties have previously served together as arbitrators' (4.3.2.). 'The arbitrator holds an insignificant amount of shares in one of the parties or an affiliate of one of the parties which is publicly listed' (4.4.2).

¹⁶⁰ See EU Proposal for the Code of Conduct (n 153).

¹⁶¹ Opinion 1/17 (n 3) para 243.

¹⁶² See EU Proposal for the Code of Conduct (n 153).

¹⁶³ Art 8.27.4 CETA.

¹⁶⁴ *ibid*.

¹⁶⁵ German Magistrates Association (n 138).

public interests are also less likely in a system that requires a narrow competence gained through arbitration.

In light of the preceding discussion, the following table summarises and compares the core features of the rule-of-law standard, as applied externally (in CETA) and internally (in the EU).

Table 9.3. Comparison of the rule-of-law standards in CETA and in the EU

Rule of law	CETA	EU
Equality before the law	▪ Art 20 CFR ▪ Equality of treatment for foreign investments only	▪ Art 18 TFEU and Art 21(2) CFR ▪ No discrimination on grounds of nationality
Effective legal remedy	Specific legal remedy for foreign investors	Complete system of judicial remedies for all EU citizens
Judicial review	All EU measures against foreign investors are subject to review by ICS tribunals for their compliance with CETA and public international law	All acts of EU institutions are subject to review by the CJEU for their compliance with the founding treaties, general principles of law and fundamental rights
Independence of tribunals	ICS tribunals are subject to an indirect control and directions by the CETA Joint Committee	EU courts are not subject to executive control nor receive directions from other EU institutions
Compliance with the rule of law standard	Complies with the rule of law in international law (compliance and implementation of international rules)	Complies with the rule of law in robust constitutional systems (full independence of judiciary that ensures compliance and implementation of EU rules)

9.3.3. Access to justice

The Belgian request for an opinion gave the CJEU its first opportunity to consider in detail whether an international jurisdiction established by the EU complies with the right to effective judicial protection. The CJEU confirmed that the ICS complies with the requirements of Article 47 CFR, albeit imperfectly. As discussed, throughout its Opinion the CJEU emphasised different restrictions on the rule of law imposed by CETA (the indeterminacy of the remuneration of the tribunal members; the incomplete rules on the conflict of interest of the tribunal members; the financial burden of proceedings for SMEs¹⁶⁶).

While it is legitimate to expect that the standards for an external EU jurisdiction could be lower than the standards expected for an EU domestic court, of relevance is

¹⁶⁶ Opinion 1/17 (n 3) paras 208-213.

whether such a different standard of the rule of law is justified under EU law. It is settled case-law that EU fundamental rights do not ‘constitute [an] unfettered prerogative’; they may be restricted provided the restrictions correspond to objectives of general interest’.¹⁶⁷ The question is thus whether the limitations accepted by the CJEU in its Opinion 1/17 ‘touch the essence of the right or only one element at the periphery of the scope of protection’.¹⁶⁸ In other words, whether limitations placed on the rule of law in the ICS context affect the core of the rule of law or whether they are peripheral. The limitations touching the periphery are permissible provided that they pursue a legitimate public policy objective and are proportionate.¹⁶⁹

Given that the CJEU found the ICS compatible with EU law, it considered the mentioned limitations peripheral and permissible. However, proportionality was not at the core of the Court’s concern when assessing the rule of law restrictions in the CETA. The CJEU mentions proportionality only in relation to access to justice.¹⁷⁰ In this sense, a reference is made to the financial aspects of access to ICS tribunals rather than formally guaranteed access to the court system structured by rules of standing or procedure.¹⁷¹

It follows that if the ICS cannot entirely comply with Article 47, EU institutions must demonstrate that the rule of law restrictions are proportionate, which entails a test of suitability and necessity. The objectives to protect EU investors abroad and free and fair trade are legitimate and the establishment of the ICS is appropriate for achieving these objectives, satisfying the test of suitability.¹⁷² Further, it is settled case-law that the restrictions affecting a protected interest (the rule of law) or a fundamental right (effective judicial protection) must prove to be necessary in achieving the purpose being pursued (free and fair trade; protection of EU investors abroad). If it appears that an alternative, less-burdensome measure would achieve the same goal in a less restrictive manner, the contested measure does not appear to be necessary.¹⁷³ Accordingly, it must be demonstrated that the restrictions of the rule of law are not entirely unreasonable and could not be replaced by less burdensome measures.

¹⁶⁷ Joined Cases C-317/08 to C-320/08 *Alassini* [2010] ECR I-2213, para 63.

¹⁶⁸ Herwig CH Hoffman ‘Article 47’ in Steve Peers and others (eds), *The EU Charter of Fundamental Rights: A Commentary* (Hart 2014) 1225 (para 47.83).

¹⁶⁹ *ibid.*

¹⁷⁰ Opinion 1/17 (n 3) para 201.

¹⁷¹ On the definition of access to justice, see Stephen Bottomley and Simon Bronitt, *Law in Context* (4th edn, Federation Press 2012) 159-162. For example, in formal terms, access to justice would be limited if the definition of ‘investment’ in CETA were interpreted in a way that would make an investment made by an SME ineligible to qualify for CETA protections. On the definition of investment in CETA and EU IIAs, see chapter 8, section 8.2.1.1.

¹⁷² The test of suitability concerns the appropriateness of the measure for attaining the legitimate objective. It requires a causal relationship between the measure and the objective pursued.

¹⁷³ In that case the institution must refrain from action or replace the contested restriction by a less-burdensome measure if the latter one allows the institution to achieve the same goal: Xavier Groussot, *General Principles of Community Law* (Europa Law Publishing 2006) 147.

In contrast to its case-law on economic freedoms, the CJEU does not compare the restrictions placed by CETA on Article 47 CFR with measures that could appear less burdensome. The CJEU only stressed the evolving character of the mechanism under CETA.¹⁷⁴ Thus, the focus is placed on ‘the work in progress’ in order to conclude that at this stage the measures are sufficient not to impair the rule of law.¹⁷⁵ However, the CJEU has taken for granted that the ICS would be improved, endorsing AG Bot’s position on the ‘gradual establishment of a court’.¹⁷⁶ Finally, in the CJEU’s assessment that the benefits of the ICS (protection of EU investors abroad; free and fair trade) outweigh its costs (the limitations placed on the right of access to an independent and impartial tribunal). However, the CJEU did not assess how protected interests of investors may be directly or indirectly affected by such restrictions.¹⁷⁷ Such analysis would have addressed the concerns that the investment business community has expressed in regard to the ICS.¹⁷⁸

The CJEU’s Opinion 1/17 leaves the impression that the ICS was ‘saved’ thanks to the promises of financial assistance for SMEs in accessing the new system.¹⁷⁹ The all-inclusive character of the ICS for all foreign investors has been emphasised as an important improvement of the ICS compared to ISDS. At the same time, the ICS excludes other categories of potential litigants, such as affected local communities. This has been one of the main criticisms of ISDS by NGOs and human rights activists.¹⁸⁰ While it was not posed to the CJEU as a question and thus it was not for the CJEU to answer it, the approach endorsed in the CETA demonstrates the lack of ambition for the reform of the ISDS system, which is not likely to be eradicated by a MIC.¹⁸¹

¹⁷⁴ See, for example, Opinion 1/17 (n 3) para 231.

¹⁷⁵ The CJEU has endorsed this pragmatic approach before and held that whenever EU regulatory schemes are new and complex, the EU lawmaker may lawfully make use of a step-by-step approach that applies imperfectly at the outset of the principle of equal treatment: Case C-127/07 *Arcelor* [2008] ECR I-9895, paras 60-62.

¹⁷⁶ See Opinion 1/17 (n 3) para 231; Opinion of AG Bot (n 8) para 242; see section 9.1.1 above.

¹⁷⁷ In EU law proportionality requires the assessment of whether some legally recognised right has been unacceptably infringed: Gráinne de Búrca, ‘The Principle of Proportionality and its Application in EC Law’ (1993) *Yearbook on European Law* 125.

¹⁷⁸ See Part I, chapter 3, section 3.2.

¹⁷⁹ Opinion 1/17 (n 3) para 201. In particular, it is envisaged in CETA that the CETA Joint Committee ‘shall consider supplemental rules aimed at reducing the financial burden on claimants who are natural persons or SMEs’, which ‘may, in particular, take into account the financial resources of such claimants and the amount of compensation sought’: Article 8.39(6) CETA. See also the commitment made by the EU in the Statement No. 36 (n 132) to take the appropriate measures, which will ensure the accessibility of the ICS to SMEs (co-financing SMEs’ actions and technical assistance). The EC has not yet made any proposals to this end.

¹⁸⁰ See Part I, chapter 3, section 3.2

¹⁸¹ In its submission to UNCITRAL in which it proposes a new MIC, the EU suggests that ‘the precise scope of jurisdiction of the standing mechanism and the substantive rules that it would apply are determined by the underlying treaties. This implies that the substantive rules that the standing mechanism would apply may evolve with the underlying treaty rules’: UNCITRAL, Submission from the European Union and its Member States (n 72) para 37. In other words, the EU proposal envisages that the jurisdiction of the new MIC would be defined by the existing IIAs rather than by the statute of the new court, which could limit or broaden that jurisdiction. CETA as the ‘underlying treaty’ does not envisage such rules.

9.4. Conclusion

The CJEU's Opinion 1/17 offers fresh perspectives on the EU constitutional order and its values and objectives in EU external trade and investment relations.

First, by placing the ICS outside the EU judicial system and separating it fully from the EU legal order, the CJEU endorses a dualist approach to international law.¹⁸² While adverse effects of the ICS' jurisdiction are 'not inconceivable' in 'exceptional circumstances', such effects are highly unlikely.¹⁸³ In any case, they were sufficiently unlikely to convince the CJEU that the ICS would not have negative effects on the autonomy of the EU legal order.

Secondly, the CJEU confirmed that EU trade relations with third States are subject to a new set of constitutional values underpinning the EU legal order, including the CFR. However, compared to its earlier case-law,¹⁸⁴ conditions that primarily-in-nature international law instruments must fulfil seem to be relaxed, depending on specific circumstances. In view of free and fair trade, which is conditioned upon an effective mechanism for protection of EU investors in third States, the Court concluded that the ICS in CETA complies with the general EU principle of equal treatment and the right to an independent tribunal, guaranteed under Articles 20 and 47 CFR respectively.

Thirdly, considering all aspects, the standard of autonomy and compliance with EU law is not the same for the courts in the EU and the ICS. While a higher standard of independence is required for domestic courts in the EU, as exemplified recently by the CJEU in a number of cases against Poland, the ICS must comply only with the minimum rule-of-law requirements under the CFR. On the one hand, this approach is justified by the necessity of the protection of EU investors abroad, whereby the *independence* of ICS tribunals *from the host State* is the core element for assessing independence. However, this approach confirms the primarily political nature of EU objectives, in particular free and fair trade. On the other hand, the CJEU's approach in requiring a lower rule-of-law standard is justified by the 'work-in-progress' premise of the ICS. The CJEU has accepted

¹⁸² See chapter 5, section 5.2.

¹⁸³ Opinion 1/17 (n 3) para 186.

¹⁸⁴ In particular, *Kadi* (n 6), in which the CJEU effectively assessed the validity of the UN Security Council measures under EU law. The case concerned the adoption of restrictive measures executing the UN sanctions against the Taliban regime in Afghanistan. The adoption of national measures freezing the assets of the claimants in each Member State would have been ineffective given the free movement of capital within the internal market. Accordingly, the EU adopted a series of measures at the Community level to give effect to Member States' UN obligations, including an EU regulation. The claimant whose funds were frozen as a consequence of this action challenged the EU regulation before the CJEU as the violation of his fundamental rights to property and a fair hearing. For discussion of *Kadi* in the international investment law context, see Ivana Damjanovic and Nicolas de Sadeleer, 'I Would Rather Be a Respondent State Before a Domestic Court in the EU than Before an International Investment Tribunal', (2019) 4 European Papers 19, 24-28.

the restrictions on the rule of law as long as they would be attenuated in the future (in the new MIC).

Finally, Opinion 1/17 elucidates the significance that the CJEU attaches to different EU values and objectives in external relations. The protection of EU investors abroad has the highest importance, being the *conditio sine qua non* of another priority – free and fair trade.¹⁸⁵ The rule of law, while endorsed by the CJEU, evolves around ‘strict observance and development of international law’.¹⁸⁶ The rule-of-law standard could have been taken to a new level in IIL if the vision of the EU’s domestic rule-of-law standard of independence had been promoted in the ICS framework. Instead, by placing the emphasis on the protection of EU investors abroad, the CJEU has embraced a traditional ISDS narrative.

Ultimately, in light of the ICS’ political dimension, the CJEU has adjusted its own standards of the rule of law to the given international trade and investment context with a view to ‘promote an international system based on stronger multilateral cooperation and good global governance’.¹⁸⁷ EU values in international sphere are focused on the promotion of EU commercial objectives rather than its broader set of other values. While this approach allows the EU to maintain its assumed leadership role in the ISDS reform, it also reduces the opportunity for the EU to become a leader in a genuine change in IIL.¹⁸⁸

¹⁸⁵ Art 3(5) TEU: ‘In its relations with the wider world, the Union shall uphold and promote its values and interests and contribute to the protection of its citizens. It shall contribute ... free and fair trade ...’.

¹⁸⁶ *ibid.*

¹⁸⁷ In light of Art 21(5) TEU.

¹⁸⁸ See similar conclusions in Damjanovic and de Sadeleer (n 9).

Part II Conclusion: EU investment regulation between international and EU law

The constitutional character of the Lisbon Treaty signalled a new phase of EU integration and its engagement with ‘the wider world’. With the FDI competence, EU institutions have assumed the leading role in designing the EU IIP and the EU has emerged as a new actor in the field of IIR. The EU IIP and its improved investment standards are implemented in EU IIAs, post-Lisbon Member States’ BITs and the EU proposal for a new MIC in the UNCITRAL. Between the Member States, investment is to be regulated and protected under EU law, replacing the existing network of intra-EU BITs.

The key aspect of the EU investment policy has been the relationship between EU law and international law. The core concern in the policy design was the protection of the autonomy of the EU legal order. Accordingly, law has been the key factor and the CJEU the key actor in defining the policy scope. With every key decision, the Court has allowed the institutions and the Member States to move forward, assisting them in legitimising the policy.

First, Opinion 2/15 determined the scope of the new IIP by delineating the competence for investment treaty-making between the EU and its Member States. This Opinion indicates that investment dispute settlement concerns more deeply the issues of sovereignty than trade does; ISDS cannot be considered simply ancillary to the substantive provisions on investment.¹⁸⁹ Courts and tribunals, even those that stand outside the domestic legal systems (such as ISDS), remain an expression of the Member States’ sovereignty, albeit one shared with the EU.

Following Opinion 2/15 EU trade and investment agreements have been separated to allow the EU to conclude new trade agreements more efficiently. While the split procedure complicates the political process and weakens the EU’s power in global terms, the silver lining could be the improved internal democratic legitimacy in the EU.

Secondly, the *Achmea* judgment ascertained the incompatibility between EU law and IIL in the intra-EU dimension. This judgment confirms that Member States’ sovereignty in international law ends where their sovereignty has a potential to undermine the objectives of EU integration, in particular the internal market. Accordingly, investment within the EU is to be protected under EU law and before the domestic courts, which are an integral component of the EU judicial system.

Notably, *Achmea* has bridged the divide between Western and Eastern Member States and has set the way forward in eliminating the remaining intra-EU BITs. While the

¹⁸⁹ Opinion 2/15 ECLI:EU:C:2017:376, paras 292-293. Cf. Opinion 2/15, Opinion of AG Sharpston ECLI:EU:C:2016:992, paras 529-535.

investment community in the EU might not be convinced that domestic courts in each and every Member State can afford the full protection of their interests, *Achmea* is an important step towards enhancing the rule of law in the EU. Many controversial issues demonstrate the political sensitivity of investment law. Regardless, *Achmea* has started the final countdown for intra-EU ISDS with a finishing time that cannot be predicted, in particular in the ECT context.

Finally, Opinion 1/17 clarified the compatibility of the new EU IIP, particularly the compatibility of the ICS as its core element, with EU law. Unlike its international adjudicative predecessors – the EU Patent Court in Opinion 1/09, the ECtHR in Opinion 2/13 and intra-EU investment tribunals in *Achmea* – the ICS confirms that the CJEU and a dispute settlement mechanism outside the EU judicial system can co-exist in their own separate universes. While it is ‘not inconceivable’ that CETA awards could, in exceptional cases, undermine the effectiveness of EU law,¹⁹⁰ it is sufficiently improbable that this scenario will adversely affect the autonomy of EU law.

The treatment of EU law in proceedings before the ICS seems to be the core argument for the CJEU’s conclusion that the autonomy of EU law is sufficiently preserved in the CETA. EU law (other than the CETA) is to be treated as a matter of fact and the ICS tribunals are not to interpret EU law but to examine its effects on foreign investors. Nevertheless, in the absence of a less abstract distinction between interpretation and examination, the impression is that the CETA restricts ICS tribunals from interpreting and applying EU law on rather formalistic grounds. Opinion 1/17 thus confines the autonomy of EU law to the interpretative autonomy of the CJEU. Since the CJEU’s autonomy is sufficiently preserved, the right to regulate in the EU is also guaranteed. And while the new ICS does not embrace the same rule-of-law standard which is required for EU courts, the restrictions placed on the rule of law by the CETA are not such to render the ICS incompatible with EU law (Articles 20 and 47 CFR).

Against this background, it is legitimate to ask, in what ways has the EU IIP improved IIL? EU IIAs are built upon and developed from the existing IIL. They largely follow the trends of modern IIAs and codify the existing arbitral tribunals’ case-law, thus providing more clarity about the content of investment standards. The core departure from IIL relates to the permanency of ICS tribunal members and the appellate mechanism. Accordingly, the scope and content of EU standards will depend on their interpretation by the new court(s). In the short-term, the EU remains primarily focused on concluding comprehensive FTAs with trading partners and on establishing a MIC.

¹⁹⁰ See Opinion 1/17 (n 3) para 186.

Given the long-term feasibility of the EU IIP, the CJEU's approach in Opinion 1/17 was pragmatic as it allows the EC to move forward with its implementation, both bilaterally and multilaterally. With the vision of a MIC as a 'work-in-progress', the CJEU gave the ICS a 'bare pass'. At this stage, it is important for the EU to establish an international investment court, while the identified issues can be improved through further negotiations. However, the CJEU's review of the ICS' validity involves a dynamic approach. The establishment of a MIC will entail a multilateral agreement to which the EU will also be a party. With respect to that and all future EU IIAs, a new opinion on the compatibility of the new arrangements with the rule of law could be requested under Article 218(11) TFEU. Accordingly, the standards laid down by the CJEU in its Opinion 1/17 are the minimal standards that must be improved.

While the CJEU's reasoning in all three CJEU decisions has firm grounds in the founding treaties, these decisions provide an important insight into the CJEU's vision of the EU and its political objectives, which extend beyond the narrow field of investment.

Opinion 2/15 confirms that the CJEU does not see the EU as ready to take the treaty-making sovereignty away from the Member States in all aspects of investment. However, the CJEU's ruling leaves a possibility for that to happen incrementally. The lack of investment sovereignty weakens EU global power in the medium term, but it also ensures more domestic legitimacy for EU IIP and thus safeguards the EU project more generally.

Achmea, which eliminates intra-EU ISDS, demonstrates the CJEU's direction towards a stronger internal integration and ultimately a stronger rule of EU law across all Member States. This serves several objectives. First, it has helped to overcome, albeit not eliminate, the conflicts between the Member States' political interests in investment. Secondly, it serves to enhance the legitimacy of domestic courts over a 'parallel justice' that would be brought by investment tribunals in the EU. Finally, it fosters the rule of law in the EU, which implies the control of governmental compliance with EU law through effective judicial review. Accordingly, it contributes to EU integration more generally.

Opinion 1/17 confirms the CJEU's vision of constitutionalism in international law,¹⁹¹ endorsed in the earlier *Kadi* judgment. Any international law mechanism that enters the EU legal order – in this case the ICS in CETA – must meet a set of criteria determined by EU law. However, the CJEU's approach in assessing these criteria has been adjusted to the specific context of IIL. The CJEU has recognised the importance of a future MIC in providing an effective remedy to foreign investors while ensuring the compliance of States with international law. The criteria of 'independence' and 'accessibility' in Article

¹⁹¹ See Koskeniemi (n 5) 345-350.

47 CFR must primarily be seen in these specific circumstances. Independence of ICS tribunals prioritises independence *from the host State* and the *access* to these tribunals the access *for foreign investors*, whereby both serve the *objective of free and fair trade*.¹⁹²

In the EU internal context, the CJEU has focused on enhancing the rule of law. In the extra-EU context, the emphasis has been placed on the EU's geoeconomic interests. A specific protection regime for EU investors should encourage their investments abroad and ensure that they are placed on a par with the US, Chinese and other third countries' investors. This should result in fair competition and consequently *free(r) and fair(er)* trade, with these benefits extending beyond the internal market.

The CJEU has recognised the practical realities of international trade; however, the EU's aspiration to export its own values into IIL for now remains mainly an aspiration. Since the EU has declared ISDS 'dead',¹⁹³ the future of EU investment regulation ultimately depends on the outcome of the multilateral negotiations for a MIC, which will make or break the EU IIP.

¹⁹² Opinion 1/17 (n 3) paras 199-200 (emphasis added).

¹⁹³ See the quote at the beginning of Part II.

PART III

TOWARDS A NEW INSTITUTIONAL AND NORMATIVE FRAMEWORK IN INTERNATIONAL INVESTMENT LAW?

The EU is committed to multilateralism in all its forms. Increasingly, countries are standing up for the multilateral system. There is one lesson we can take away from the challenges and crises of late: If we want our systems to survive, they need to be able to adapt. The WTO guarantees stable open trade in the world. We propose a Multilateral Investment Court to create a stable international investment environment – one we can all trust.¹

In Part I of this study we examined international investment regulation (IIR) at a macro level. In Part II we analysed at micro level the EU investment regulation. In this concluding Part we shall analyse the EU's plan to expand its investment regulation from a micro to a macro level through the establishment of a Multilateral Investment Court (MIC). Since the reform process is ongoing and its outcomes are still uncertain, this is also the shortest Part of the study. It contains a single chapter, in which we discuss the EU's proposal for a MIC in the context of the multilateral ISDS reform in the UNCITRAL. The *de lege ferenda* character of this study is emphasised by separation of it into a distinct Part.

¹ Cecilia Malström, EU Commissioner for Trade 'A Multilateral Investment Court: a contribution to the conversation about reform of investment dispute settlement' (Speech at Belgian Ministry of Foreign Affairs, Brussels, 22 November 2018) 3
<https://trade.ec.europa.eu/doclib/docs/2018/november/tradoc_157512.pdf> accessed 30 June 2020.

The ISDS reforms of the EU and UNCITRAL: towards a Multilateral Investment Court

10.1. A history of failed multilateralism in international investment law, or not so?

10.2. The ISDS concerns and the UNCITRAL reform(s)

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The future of ISDS is at a historic crossroads. In this final chapter of the study we overview the ISDS reform process in the UNCITRAL and discuss the EU proposal for a Multilateral Investment Court (MIC) in the context of this reform. First, we contextualise the current ISDS reform against earlier attempts to negotiate multilateral IIAs to explain how the current reform is different. Second, we discuss the scope of the reform and its process in the framework of UNCITRAL, particularly focusing on the identified ISDS concerns. Third, we outline the reform options that have so far emerged in the discussion and explain their correlation to the EU's MIC proposal. In the final part of this chapter we consider the potential contributions that a MIC could make to the rule of law and the legitimacy of international investment law (IIL). While the negotiations are ongoing, the aim of this chapter is to outline the EU's external challenges in establishing a MIC and to reflect on the ISDS reform process.

10.1. A history of failed multilateralism in international investment law, or not so?

The UNCITRAL reform is not the first attempt at multilateral reform in IIL. Some of the early multilateral attempts have been successful, but others failed.

In the IIL literature, the ICSID and its Convention are considered a ‘success story’.² The system was conceived to address the perceived political and non-commercial risks in developing countries, which were seen as the major impediment to private investment.³ At the time, a number of initiatives were undertaken with a view to establishing a multilateral framework for the protection of foreign investment, most notably the Abs-Shawcross Draft Convention on Investments Abroad⁴ and the 1962 OECD Draft Convention on the Protection of Foreign Property.⁵ Both proposals envisaged arbitration as a dispute settlement mechanism and a potential process for direct claims against host States, albeit with differences.⁶ Both proposals also had substantive provisions on the treatment of investment.

Additionally, and at the same time, in the framework of the UN, emphasis was placed on the development of different arbitral mechanisms⁷ as well as on accommodating the existing arbitral institutions to adjudicate investment claims.⁸ However, the ICSID was also established because the commercial arbitration mechanisms were, in light of their private nature, seen as inadequate for claims against States.⁹ Ultimately, both the Abs-Shawcross and OECD Draft Conventions failed.¹⁰ On the other hand, ICSID and UNCITRAL rules, as multilateral procedural mechanisms, continued.

² Crina Baltag (ed) *ICSID Convention after 50 Years: Unsettled Issues* (Kluwer 2017).

³ United Nations Economic and Social Council (ECOSOC), ‘The Promotion of International Flow of Private Capital: Progress Report by the Secretary General’ (26 February 1960) E/3325 (as cited in Antonio R Parra, *The History of ICSID* (2nd edn, OUP 2018) 12. See also Part I, chapter 1.

⁴ The International Convention for the Mutual Protection of Private Property Rights in Foreign Countries was prepared by the Society to Advance the Protection of Foreign Investments under the guidance of Herman Abs in 1957 and it was combined with a draft prepared under the guidance of Lord Shawcross in 1959. See Franziska Tschöfen, ‘Multilateral Approaches to the Treatment of Foreign Investment’ in Ibrahim FI Shihata (ed), *Legal Treatment of Foreign Investment: The World Bank Guidelines* (Nijhoff 1993) 272.

⁵ Draft Convention on the Protection of Foreign Property, Text with Notes and Comments (OECD Publication No. 15637, December 1962).

⁶ For example, the 1962 OECD Draft Convention was limited to the post-admission phase of investment; it would have allowed a foreign investor individual to bring a claim against the host State only if the investor’s home State had not already initiated proceedings in the same matter; it would have given powers to the arbitral tribunal to dismiss frivolous or vexatious claims; it would have allowed the intervention of an interested non-disputing party to the convention; and proposed provisions on the possibility of a stay of proceedings in cases of parallel proceedings before other international bodies. The Abs-Shawcross Draft Convention envisaged direct claims against States that made a general declaration to that effect, effectively proposing ISDS in the form we know it today. See Parra (n 3) 14-15.

⁷ For example, the 1958 UN Convention on the Recognition and Enforcement of Arbitral Awards and UN’s International Law Commission Model Rules on Arbitral Procedure.

⁸ Notably, the Permanent Court of Arbitration (PCA) and the International Chamber of Commerce (ICC).

⁹ See ICSID, ‘History of the ICSID Convention, Documents Concerning the Origin and the Formulation of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States’ (1968).

¹⁰ However, substantive provisions of these two conventions survived through bilateral treaties. For example, principles embedded in the OECD Draft Convention were accepted by the OECD Council in a Resolution (as a

Globalisation sparked the idea to make another attempt to conclude an agreement that would regulate investment comprehensively. The OECD's negotiations on an (in)famous Multilateral Agreement on Investment (MAI) ultimately collapsed in 1998 due to the French opposition.¹¹ The pressure from the global citizens' movement was crucial for its failure.¹² A similar attempt was made in 2003 when a WTO-led Multilateral Investment Agreement (MIA) was proposed as part of the WTO's 'Singapore issues' agenda.¹³ As the 'deep' trade multilateral agenda,¹⁴ it failed due to the opposition from the developing States.¹⁵ If the multilateralisation of IIL could not succeed at the peak of globalisation, how it can succeed post-GFC?¹⁶

Multilateral initiatives which attempted to institutionalise substantive protections in a multilateral agreement did not succeed. On the contrary, initiatives which focused on procedural mechanisms were successful.¹⁷ This was an important lesson for the UNCITRAL process, which is limited to ISDS as a procedural mechanism.¹⁸

soft law instrument) adopted on 12 October 1967. They were later incorporated in the US BITs. See GW Haight, 'International Organisations O.E.C.D. Resolution on the Protection of Foreign Property' (1968) 2 The International Lawyer 326. The Abs-Shawcross Draft Convention was submitted as a proposal by Germany to the OECD but was not adopted. Its principles were incorporated in German BITs.

¹¹ In addition to investment protection, investment liberalisation (market access) was one of the MAI's main goals. Both aspects would have been subject to ISDS, envisaging a very ambitious capital liberalisation agenda. The agreement envisaged negotiations between 25 OECD countries, part of which was the EU (then the EC) but it would be open to accession by non-OECD countries: see William H Witherell, 'The OECD Multilateral Investment Agreement' (1995) <https://unctad.org/en/docs/iteiitv4n2a2_en.pdf> accessed 30 June 2020; and William H Witherell, 'Developing International Rules for Foreign Investment: OECD's Multilateral Agreement on Investment' (1997) 32 Business Economics 38.

¹² In its study on MAI, UNCTAD has identified several reasons for the failure of this agreement: a strong opposition from the NGOs; the diminished interest of the business community once it became obvious that the scope of liberalisation would be limited and taxation excluded from the scope of the agreement; and the political cost-benefit analysis of the centre left governments: see UNCTAD, 'Lessons from the MAI' (1999) UNCTAD/ITE/IIT/Misc.22.

¹³ See Jürgen Kurtz, 'A General Investment Agreement in the WTO? Lessons from Chapter 11 of NAFTA and the OECD Multilateral Agreement on Investment' (2002) 23 University of Pennsylvania Journal of Economic Law 713.

¹⁴ See chapter 4, section 4.3.

¹⁵ See chapter 3, section 3.1 and chapter 4, section 4.3.1.

¹⁶ In the scholarship it has been claimed that despite the lack of a formal multilateral agreement on investment, *de facto* multilateralisation has been achieved through the clauses of bilateral IIAs, such as MFN, corporate restructuring, enforcement etc. See Stephan W Schill, *The Multilateralisation of International Investment Law* (CUP 2009). Moreover, in spite of the failure of the 'Singapore' issues agenda, *de facto* integration of investment and trade law could also be possible. See, for example, Sungjoon Cho and Jürgen Kurtz, 'Convergence and Divergence in International Economic Law and Politics' (2018) 29 The European Journal of International Law 169.

¹⁷ However, the early attempts to create an international court in the Hague and Paris Conferences (1899–1919) did fail, *inter alia*, for reason of the inability of States to agree on the composition of the court: see José Manuel Álvarez Zárte, 'Legitimacy Concerns of the Proposed Multilateral Investment Court: Is Democracy Possible?' (2019) South Centre Investment Policy Brief, 4–6.

¹⁸ However, the UNCITRAL's mandate explicitly mentioned that the reform should not be limited to procedural issues but should also consider substantive aspects, such as the right to regulate, FET, and expropriation. At the same time, it was noted that 'work on substantive standards was deemed less feasible than work on the procedural aspects': UNGA 'Report of the United Nations Commission on International Trade Law Fiftieth session' (July 2017) UN Doc A/72/17, para 257 (UNGA Report 2017)

10.2. The ISDS concerns and the UNCITRAL reform(s)

The choice of the forum for deliberation about the proposed reforms was another important factor in the initiation of the new ISDS reform. The OECD was to be avoided as a forum of developed States. The UNCTAD, as a forum considered overly sympathetic to the interests of developing States, would not be appropriate either. The Solomon's solution was found in the UNCITRAL, the UN's technical body on private aspects of international law on trade, which had recently successfully concluded the reform on transparency in investment treaty arbitration (ITA).¹⁹

There were several reasons why UNCITRAL was the best possible choice for the EU's policy agenda. First, UNCITRAL allows non-Member States to participate in debates in the same manner as its full-fledged Members.²⁰ Accordingly, the EU can participate as an observer and propose solutions that contribute to shaping the reform debate. Secondly, this UNCITRAL *modus operandi* allows wide participation by other observers – NGOs, professional organisations of investors and lawyers, arbitral organisations, etc. – to raise their voice in the debate. Ultimately, inclusiveness in combination with transparency²¹ provides the required legitimacy.²² Thirdly, legislative work by UNCITRAL is based on consensus which does not require unanimity, and any text adopted by consensus is soft law in nature.²³ This approach allows for broader flexibility in

¹⁹ UNCITRAL was established under the UN umbrella in 1966. One aim was to play an active role in reducing barriers to trade through harmonisation of national laws on international trade (international commercial dispute settlement, electronic commerce, insolvency, international sale of goods etc.). In the area of international commercial dispute settlement, UNCITRAL's biggest achievement is its Arbitration Rules, which were approved by the UN General Assembly in 1976 and widely incorporated in IIAs and FTAs since. They have been used in *ad hoc* arbitrations under these international treaties and administered by the established arbitral institutions. The 1976 rules were updated in 2010 and in 2013 amended to include UNCITRAL Rules on Transparency: see Arif Hyder Ali and others, *The International Arbitration Rulebook: A Guide to Arbitral Regimes* (Kluwer 2019) 113-116.

²⁰ UNCITRAL is composed of 60 Members but non-Members are invited to participate in different UNCITRAL working groups as observers. The mandate of the Members is six years, and half of Members are elected every three years by the UN General Assembly. Thirty new UNCITRAL Members were elected in 2019 and include four EU Member States (Belgium, France, Germany and Finland – the first three particularly active supporters of the new MIC). Their mandate expires in 2025. It might be expected that the EU would like to see the new court established in the current mandate of the new UNCITRAL Commission, which will be refreshed by new Members in 2022. See UN Press Release, 'United Nations General Assembly elects new UNCITRAL Members' UNIS/L/270 (*UN Information Service*, 20 December 2018) <<http://www.unis.unvienna.org/unis/en/pressrels/2018/unisl270.html>> accessed 30 June 2020.

²¹ Transparency has been fully embraced with all official information publicly available through the UNCITRAL's website: UNCITRAL, 'Working Group III: Investor-State Dispute Settlement Reform' <https://uncitral.un.org/en/working_groups/3/investor-state> accessed 30 June 2020

²² This was one of the important lessons from the MAI experience: see UNCTAD (n 12) 29. See also the remark of the UNCITRAL Commission noting suitability of the UNCITRAL as a multilateral, inclusive and transparent forum: UNGA Report 2017 (n 18) para 258.

²³ The consensus is based on a widely prevailing majority and the absence of a formal objection. In the case of a formal objection, a vote is triggered. While extremely rare, the vote in this context has already taken place for the election of the chairperson of the working group in charge of the ISDS reform. See UNCITRAL, 'Report of Working Group III (Investor-State Dispute Settlement Reform) on the work of its thirty-fourth session (Vienna, 27 November – 1 December 2017)' (19 December 2017) UN Doc A/CN.9/930/Rev.1, paras 11-14.

considering different reform options. Finally, given its legally technical orientation, UNCITRAL is the ideal forum for watering down the heated politicisation of the ISDS debate. The UNCITRAL's Secretariat has played an important role in setting the reform's agenda and direction even before the official start of the reform.²⁴

In July 2017, the UNCITRAL's Commission decided that work on the possible ISDS reform should take place.²⁵ The Commission gave its Working Group (WG) III a broad mandate to undertake this work in three phases, with distinct tasks: to identify issues and concerns (Phase I); to consider accordingly whether the reform is desirable (Phase II) and in the affirmative, to develop recommendations (Phase III).²⁶ Given the connection of the ISDS to a number of policy issues, it was made clear that the reform would be State-led.²⁷

WG III relatively quickly identified major concerns to be addressed by the reform:²⁸ (1) concerns pertaining to consistency, coherence, predictability and correctness of arbitral awards;²⁹ (2) concerns pertaining to arbitrators and decision makers;³⁰ (3) cost and duration of ISDS proceedings;³¹ and (4) third-party funding.³² While noting other concerns, including those related to substantive standards, it was reiterated that the

²⁴ The Secretariat conducted a study in conjunction with interested organisations, including the Center for International Dispute Settlement (CIDS) at the University of Geneva, on whether the Mauritius Convention on Transparency could provide a useful model for ISDS reforms: see UNGA, 'Report of the United Nations Commission on International Trade Law Forty-eighth Session' (July 2015) UN Doc A/70/17, para 268. The CIDS produced this report (and later a supplementary report), which was heard by the UNCITRAL's Commission at its forty-ninth session in 2016: Gabrielle Kaufmann-Kohler and Michele Potestà, 'Can the Mauritius Convention serve as a model for the reform of investor-State arbitration in connection with the introduction of a permanent investment tribunal or an appeal mechanism? – Analysis and Roadmap' (3 June 2016), CIDS-Geneva Center for International Dispute Settlement, and Gabrielle Kaufmann-Kohler and Michele Potestà, 'The Composition of a Multilateral Investment Court and of an Appeal Mechanism for Investment Awards' (15 November 2017), CIDS Supplemental Report. Following the report, the UNCITRAL's Commission requested from the Secretariat a broad consultation with States and regional economic integration organisations: UNCITRAL, 'Possible future work in the field of dispute settlement: Reforms of investor-State dispute settlement (ISDS)' Note by the Secretariat (20 April 2017) UN Doc A/CN.9/917.

²⁵ UNGA Report 2017 (n 18).

²⁶ *ibid* para 264. Usually work on arbitration would be conducted in the framework of WG II, but given its work at the time on international commercial conciliation and the enforcement of mediation agreements, additional work on ISDS would unnecessarily burden its work (see para 260). For example, UNCITRAL Transparency Rules were discussed in WG II. The previous work of the UNCITRAL's Working Group III concerned online dispute resolution (2010–2016), transport law (2002–2008) and international legislation on shipping (1970–1975).

²⁷ UNGA Report 2017 (n 18) para 250. This also indicated that negotiations would be different to usually apolitical issues discussed by UNCITRAL.

²⁸ See UNCITRAL, 'Possible reform of investor-State dispute settlement (ISDS)' Note by the Secretariat (30 July 2019) UN Doc A/CN.9/WG.III/WP.166, paras 4–8.

²⁹ UNCITRAL, 'Possible reform of investor-State dispute settlement (ISDS): Consistency and related matters' Note by the Secretariat (28 August 2018) UN Doc A/CN.9/WG.III/WP.150.

³⁰ UNCITRAL, 'Possible reform of investor-State dispute settlement (ISDS), Ensuring independence and impartiality on the part of arbitrators and decision makers in ISDS' Note by the Secretariat (30 August 2018) UN Doc A/CN.9/WG.III/WP.151, and UNCITRAL, 'Possible reform of investor-State dispute settlement (ISDS), Arbitrators and decision makers: appointment mechanisms and related issues' Note by the Secretariat (30 August 2018) UN Doc A/CN.9/WG.III/WP.152.

³¹ UNCITRAL, 'Possible reform of investor-State dispute settlement (ISDS): Cost and duration' Note by the Secretariat (31 August 2018) A/CN.9/WG.III/WP.153.

³² UNCITRAL, 'Possible reform of investor-State dispute settlement (ISDS), Third-party funding' Note by the Secretariat (24 January 2019) A/CN.9/WG.III/WP.157.

mandate of WG III requires focus on procedural aspects of ISDS while ‘taking due note of the interaction with underlying substantive standards’.³³ Accordingly, the reform entered into Phase III in April 2019, with a number of reform options in consideration.

In light of the broad discretion given to the WG in discharging its mandate, the chairperson and the Secretariat have had an important role in framing the issues for the debate and in setting its direction.³⁴ The debate was highly politicised in its early stage; however, the focus has been shifting from ‘big questions’ (e.g. do we need a new court?) to more technical questions (financing the court, qualifications of adjudicators, the scope of appeal etc.).³⁵ From the very start, the emphasis of the debate has been placed on separation of ‘facts’ from ‘perceptions’, in which facts have been supported by ‘constructive contributions’ from the experts in the field (informal Academic Forum and Practitioners’ Group).³⁶ It is possible that with more technicalities the interest of different stakeholders wanes, especially those in the civil society.³⁷

While no time framework has been set for completion of WG III’s work, the aim is to work at a ‘measured pace, to allow sufficient time for all States to express their views and avoid unnecessary delay’.³⁸ Given the usually slow pace of these kinds of negotiations, additional time for deliberations and meetings should speed up the process.³⁹ The importance of inclusiveness is expressed through the developed countries’ financial

³³ The substantive issues considered in discussion of concerns include: means other than arbitration to resolve investment disputes and dispute prevention; exhaustion of local remedies; third-party participation; counterclaims; regulatory chill; and calculation of damages. It was noted that any solutions developed by WG III should be flexible enough to accommodate the developments on these and other substantive standards in IIAs: see UNCITRAL, ‘Report of Working Group III (Investor–State Dispute Settlement Reform) on the work of its thirty-seventh session (New York, 1-5 April 2019)’ (9 April 2019) A/CN.9/970, paras 26-40. While it was noted that no additional concerns could be identified at this stage, the inclusion of other concerns that might be identified and dealt with at the later stage was not precluded. It is, however, difficult to see why any such issue would be included later if it was not included in the early stage.

³⁴ Even in the consensus-based UNCITRAL, the chairperson (Shane Spelliscy from Canada) had to be elected by a vote, which was indeed a rare occasion. The Secretariat prepares the information notes for deliberations in advance of each meeting.

³⁵ See, for example, UNCITRAL, ‘Report of Working Group III (Investor–State Dispute Settlement Reform) on the work of its thirty-eighth session’ (28 January 2020) UN Doc A/CN.9/1004, and its addendums.

³⁶ See UNCITRAL, Report of Working Group III, April 2019 (n 33) para 42. While it was emphasised that the process should remain government-led (meaning State-led and not practitioner-led), the Secretariat does significantly rely on the input from these non-government experts, who also have significant vested financial interests in the outcomes of the reform. However, apart from civil society and some academics, this issue has not been prominent among State stakeholders. For controversies about the neutrality of the Academic Forum, see, for example, Alexander Beunder and Jilles Mast, ‘As the World Meets to Discuss ISDS, Many Fear Meaningless Reforms’ (*Transnational Institute*, 4 April 2019) <<https://longreads.tni.org/isds-many-fear-meaningless-reforms/>> accessed 30 June 2020.

³⁷ However, so far, the list of stakeholders that have been attending the meeting has been increasing. See, for example, UNCITRAL, Report of Working Group III, January 2020 (n 35) para 9.

³⁸ See, for example, UNCITRAL, ‘Report of Working Group III (Investor–State Dispute Settlement Reform) on the work of its thirty-fifth session (New York, 23-27 April 2018)’ (14 May 2018) UN Doc A/CN.9/935, para 99.

³⁹ For example, the 38th session, which took place in Vienna (14-18 October 2019), had an additional week of deliberations in January 2020 (20-24 January). There were also three intersessional regional meetings in Korea (10-12 September 2018), the Dominican Republic (13-14 February 2019) and Guinea (25-26 September).

contributions to the UNCITRAL trust fund, aimed at financing the participation of representatives from the developing States at the meetings, as well as the Secretariat's outreach activities.⁴⁰

10.3. The MIC and the main reform options

In the preparation for the reform, the consultation process of the UNCITRAL Secretariat indicated three possible options for the reform: (1) adjustments to the current ISDS regime; (2) the establishment of a stand-alone appellate body; and (3) the establishment of an international investment court.⁴¹ At the time of the UNCITRAL Commission's decision to undertake the reform, the report noted that 'a significant number of references' about a possible permanent MIC were made. It was said that this option 'should be given due consideration' and that such a court 'might be a built-in appellate mechanism'. The report also mentioned suggestions to establish regional courts.⁴²

The UNCITRAL Commission's mandate to WG III indicated that reform solutions would be designed by taking into account the ongoing work of relevant international organisations and 'with a view to allowing each State the choice of whether and to what extent it wished to adopt the relevant solution(s)'.⁴³ Already then, doubts were expressed about the feasibility of the reform, which does not tackle substantive investment protections, and the need for diversified approaches, which would allow States to adopt those that best suit their particular legal, political and economic circumstances.⁴⁴ In light of these remarks, *flexibility* and *consensus* have been the guiding principles of the reform. In addition, work on all reform options in parallel was also adopted as a middle-ground solution.⁴⁵

In these negotiations the interests of the EU are represented by the European Commission (EC), which has received a mandate from the EU Member States to negotiate

⁴⁰ UNCITRAL, Report of Working Group III, January 2020 (n 35) paras 4-5. For example, such financial support has been provided by the EU, France, the German Federal Ministry for Economic Cooperation and Development, and the Swiss Agency for Development and Cooperation.

⁴¹ The Secretariat's note in fact indicates two main options for the reform: (1) adjustments to the current ISDS regime, which could include a stand-alone appellate body as a sub-option; and (2) setting up an international investment court, with two sub-options – either as a two-tier adjudicative system, or a one-tier court without an appeal. See UNCITRAL, Possible future work in the field of dispute settlement, Note by the Secretariat (n 24) 5-14. In the later discussion, the first Secretariat's first option crystallised as two separate options since not all States who support the improvements of the current regime actually support the establishment of a stand-alone appellate body: see, for example, UNCITRAL, 'Possible reform of Investor-State dispute settlement (ISDS), Submission from the Governments of Chile, Israel, Japan, Mexico and Peru' Note by the Secretariat (2 October 2019) UN Doc A/CN.9/WG.III/WP.182.

⁴² UNGA Report 2017 (n 18) para 255.

⁴³ *ibid* para 264.

⁴⁴ *ibid* para 244.

⁴⁵ See UNCITRAL, 'Possible reform of investor-State dispute settlement (ISDS)' Note by the Secretariat (30 July 2019) UN Doc A/CN.9/WG.III/WP.166.

the establishment of a MIC. In accordance with the principle of sincere cooperation, the EU and its Member States should speak with a coordinated voice throughout the negotiations.⁴⁶ In the event of a vote, Member States which are Members of the UNCITRAL should vote in accordance with the agreed EU positions.⁴⁷ The EU's strategy to create one court for all its external agreements has been carefully planned to take advantage of the UNCITRAL reform.

The proposal for a 'standing mechanism' submitted by the EU to UNCITRAL provides a 'systemic response' to the UNCITRAL's concerns and accommodates the demand for flexibility. It is envisaged that a MIC would combine *judicial independence* with an *appellate mechanism*.⁴⁸ It should further ensure the integration of other mechanisms, such as amicable dispute resolution, and avenues for a '*dialogue*' between the treaty parties, which should guarantee long-term State control over the interpretation of IIAs.⁴⁹ The 'systemic' and 'alternative' lenses approach to the concerns identified by UNCITRAL should appease those States whose vision of ISDS reform goes beyond the UNCITRAL's mandate.⁵⁰

Since States have different preferences, the jurisdiction of the MIC would be open to all existing IIAs, allow opt-ins for future agreements⁵¹ and accommodate more

⁴⁶ Council of the European Union, 'Negotiating directives for a Convention establishing a multilateral court for the settlement of investment disputes' (20 March 2018) 12981/17 ADD 1 DCL 1, para 1 (EU Negotiating Mandate). The mandate to the EC echoes the UNCITRAL's principles for conducting negotiations: all interested countries to participate; government-led; international organisations to effectively participate; consensus based; transparent; representatives of civil society organisations to participate as accredited observers; conducted under the auspices of UNCITRAL: paras 2-4. The same principles are reflected in the 'Possible work plan for Working Group III', proposed as part of the EU submission: see UNCITRAL, 'Possible reform of investor-State Dispute Settlement (ISDS), Submission from the European Union and its Member States' (24 January 2019) UN Doc A/CN.9/WG.III/WP.159/Add.1 (EU submission to UNCITRAL)

⁴⁷ At the moment, there are 12 EU Members which are Members of the UNCITRAL. There are also four EU trading partners that have already concluded or negotiated an IIA with the EU (Canada, Singapore, Vietnam and Mexico, which all started their terms in 2019). The EU has so far secured the support of the Dominican Republic. The membership of some States which might be against the MIC expires in 2022 (India, Iran, Israel, Chile, United States, Brazil). This puts the EU in a rather good position to secure consensus in the current UNCITRAL Commission's term (however, still depending on 30 new Members which will start their terms in 2022).

⁴⁸ See the EU submission to UNCITRAL (n 46) paras 40-56. These proposed arrangements correspond to the characteristics of the future MIC specified in the negotiating mandate: see EU Negotiating Mandate (n 46) paras 10-11; 13-15.

⁴⁹ EU Negotiating Mandate (n 46) para 9; EU submission to UNCITRAL (n 46) para 26.

⁵⁰ Some strong players of the South have endorsed the need for a systemic reform, which would not 'divorce' procedural from substantive concerns, supporting a genuine paradigmatic shift with a sustainable-development oriented reform: see UNCITRAL, 'Possible reform of Investor-State dispute settlement (ISDS), Submission from the Government of South Africa' (17 July 2019) UN Doc A/CN.9/WG.III/WP.176. Further, Brazil has continuously promoted ADR (through an Ombudsperson and State-to-State consultations) as a better option for the settlement of investment disputes: See UNCITRAL, 'Possible reform of Investor-State dispute settlement (ISDS), Submission from the Government of Brazil' (11 June 2019) UN Doc A/CN.9/WG.III/WP.171. For a more detailed analysis on the polarisation between the States on ISDS reform in UNCITRAL, see Anthea Roberts, 'Incremental, Systemic and Paradigmatic Reform of Investor-State Arbitration' (2018) 112 American Journal of International Law 410.

⁵¹ EU Negotiating Mandate (n 46) paras 6-7; EU submission to UNCITRAL (n 46) para 35-36. This is particularly important in the context of numerous Member States' extra-EU BITs and new EU IIAs.

progressive bilateral reforms of IIAs.⁵² Flexibility should be ensured by exploring whether the MIC could be utilised in cases when only the respondent State is a party to it.⁵³ Moreover, given its standing nature, the ‘open architecture’ of a future MIC would provide flexibility even for those countries that only support the establishment of an appellate mechanism.⁵⁴ In the big picture, the MIC would be part of a multilateral convention that will reform ISDS. This arrangement should thus offer sufficient flexibility to those States that support the ISDS reform within the existing arbitration framework and through a less ambitious ‘suite approach’.⁵⁵ The following figure contextualises the EU’s proposal in the broader UNCITRAL reform debate.

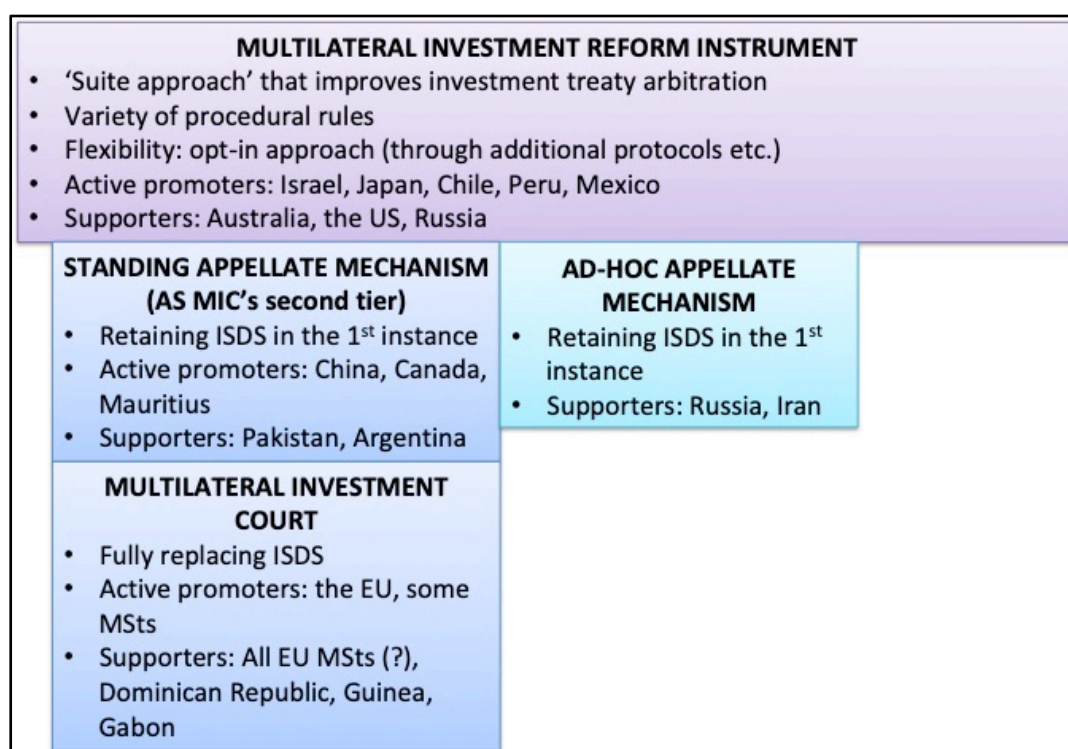


Figure 10.1. The EU proposal for a MIC in perspective with other reform proposals in UNCITRAL

⁵² EU Negotiating Mandate (n 46) para 12; EU submission to UNCITRAL (n 46) para 37.

⁵³ EU Negotiating Mandate (n 46) para 8; EU submission to UNCITRAL (n 46) para 35.

⁵⁴ EU submission to UNCITRAL (n 46) para 39. Importantly, in this category of States is China, which supports a permanent appellate mechanism (along the lines of the WTO experience and probably inspired by its own positive experiences in the framework of the WTO) but wishes to retain party autonomy in the appointment of adjudicators engrained in the current arbitration mechanism. See UNCITRAL, ‘Possible reform of Investor–State dispute settlement (ISDS), Submission from the Government of China’ (19 July 2019) UN Doc A/CN.9/WG.III/WP.177. This arrangement should also allow China to utilise its new network of arbitral institutions: see Part I, chapter 3, section 3.1.

⁵⁵ This approach would involve a Multilateral Investment Reform Agreement, which would provide States with different opt-in options, which could be adopted individually, in combination or in their entirety as a package. According to this approach, some solutions could have an immediate impact, without waiting for all proposals to be completed. According to the States that advocate it, this approach would offer ‘maximum flexibility’: see UNCITRAL, ‘Submission from the Governments of Chile, Israel and Japan’ (15 March 2019) UN Doc A/CN.9/WG.III/WP.163, and UNCITRAL, ‘Possible reform of Investor–State dispute settlement (ISDS), Submission from the Governments of Chile, Israel, Japan, Mexico and Peru’ Note by the Secretariat (2 October 2019) A/CN.9/WG.III/WP.182.

The EU internal negotiating mandate for a MIC corresponds to the demands of the UNCITRAL's mandate for the ISDS reform. In the same manner, the EU solution corresponds to the identified UNCITRAL concerns. The EU proposal for a MIC has been promoted as the only solution that addresses all of the concerns identified in the UNCITRAL.⁵⁶ At the same time, it ensures flexibility, the continuation of arbitration and fulfilment of the mandate of WG III in a multilateral instrument on ISDS reform.⁵⁷ This marriage of convenience between the EU and UNCITRAL for now continues as seemingly flawless.⁵⁸

10.4. Preface to the general conclusion: MIC between aspirations and reality

The EU proposal for a MIC is an expression of the EU's aspiration to promote multilateral solutions to common IIL problems through the ISDS reform in UNCITRAL. It is currently being executed with care not to undermine the success of either the EU's own policy agenda or the ongoing multilateral reform. But what can be concluded about the realities of the new EU vision for IIL and its contribution to the development of international law?

10.4.1. MIC and the procedural rule of law

The EU proposal for the establishment of an international court for the settlement of investment disputes is a contribution to the international rule of law, despite its main procedural focus. From the EU perspective, it is the most comprehensive and coherent solution for its external regulation (the EU's and Member States' extra-EU BITs), likely to

⁵⁶ EU submission to UNCITRAL (n 46) para 57. Moreover, following CJEU Opinion 1/17, the EU has been promoting its MIC not only as a solution that would address all procedural concerns identified in UNCITRAL but would also have positive effects on ensuring the right to regulate as a substantive standard. On the right to regulate in the EU context, see chapter 8, section 8.2.2.

⁵⁷ In this sense, a multilateral instrument would provide a framework for the implementation of various reform options, one of which would be a MIC (this could be done through an additional protocol). Alternatively, a multilateral institution for investment dispute settlement could be set up as an umbrella institution, allowing States to choose between different modes of dispute settlement, which would be administered by that institution (e.g. reformed arbitration, State-to-State arbitration, MIC with an appellate mechanism, domestic remedies); however, it remains unclear how this institution would relate to the existing institutions in the field (e.g. ISCID and PCA). Inspiration for the solutions could be found in the United Nations Convention on the Law of the Sea (UNCLOS), while a possible model for the application of a MIC to the existing IIAs could be found in the Mauritius Convention on Transparency or the OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Sharing (MLI): see UNCITRAL, 'Possible reform of Investor-State dispute settlement (ISDS), Multilateral instrument on ISDS reform' Note by the Secretariat (16 January 2020) UN Doc A/CN.9/WG.III/WP.194.

⁵⁸ The work of WG III, just as the rest of the world, has not been spared from the impact of the COVID-19 pandemic. While the main meetings have been postponed, other activities continue online. Accordingly, momentum even in the pandemic has not been lost.

increase the consistency, coherence and predictability of the case-law stemming from these agreements.

This EU proposal subjects international investment dispute settlement to a set of constitutional rights and principles. In particular, the EU must guarantee to its investors the right of access to an independent court as ensured by the EU Charter of Fundamental Rights (CFR). By subjecting the EU to this obligation, a new MIC must be independent and allow equal access to all potential claimants as long as the EU is a party to the MIC. Through the establishment of a MIC, the EU will expand the reach of its constitutional rights and obligations into international law.

The EU reform of IIL places the issues of independence and access to justice into the limelight of the global IIL reform. The EU vision of independence reduces the autonomy of private parties as the core element of the traditional ISDS system while it guarantees the independence of the new MIC from the host State, in line with the established ISDS narrative. Access to justice focuses on removing financial barriers to accessing the current ISDS system, thus making justice before the new court affordable to *all* foreign investors. This should make the investment dispute settlement system fairer for the category of foreign investors as a whole – regardless of their corporate power.

In limiting party autonomy, this EU vision of the rule of law in the form of a court goes to the heart of arbitration as the defining element of ISDS. It shifts the private law character of ITA towards a public law paradigm in IIL. Courts must be independent from the parties and their independence is a precondition for delivering natural justice. The work of the court is further subject to public scrutiny. The EU model changes the narrative of ISDS from a secretive transnational private justice system into an international court specialised for investment disputes. No other reform option goes as far in an attempt to enhance the transparency and independence of proceedings.

10.4.2. MIC and substantive law

However, this metamorphosis is not as systemic as it has been presented by the EU. The new MIC would rely on the underlying substantive rules of the existing IIAs. How will the new court interpret these rules? Will it adopt the interpretative approach of the tribunals and interpretations of standards currently existent in IIL? How will it strike the balance between private and public interests? In doing so, will it be more inclined to adopt judicial principles and methods of interpretation of the CJEU and standards of EU law? Will it continue making large awards of compensation, taking into account speculative future profits? How will it treat other international agreements – in line with the dominant

interpretation of the specialised international courts (labour, environmental, human rights, the UNCLOS, the CJEU) or would it continue to interpret all international law through the paradigm of the law of contracts rather than public international law?

The difficulty of the continuous application of the existing substantive rules by the new court is the underlying private law paradigm of IIAs. The arbitration agreement, which is concluded on the basis of the offer to arbitrate extended by States to investors in IIAs, would remain the basis of claims submitted to a new international court. How will these underlying arbitration agreements restrain the performance of the functions of the new MIC? Will the MIC adopt the principle *iura novit curia*? If so, how will that principle interact with the limitations of the mandate defined in the arbitration agreement? Will the procedures before the court substantially differ from the adversarial type of procedures currently adopted in arbitration? If that is not the case, what is the added value for the States?

While the EU proposes a new multilateral institutional framework, the normative attributes of that new framework are ‘relegated’ to a bilateral level of IIAs. It is left to individual States and bilateral negotiations to determine the substantive rules that would be applied by the new MIC, such as: What are the specific rights and duties of investors? When the access to ISDS would be granted to investors, what kinds of defences could States use against investors’ claims? Would counterclaims be possible? Would local communities adversely affected by foreign investment also have some kind of access to dispute resolution? The EU proposal for a MIC thus avoids the core difficult issues and ‘devolves’ their resolution from the multilateral to a bilateral level of IIAs.

However, a number of normative issues could still be addressed in defining the scope of jurisdiction and the relevant procedures before the MIC. For example, the Statute could adopt *sui generis* definitions of ‘investor’ and ‘investment’ which could address controversial issues of reflective loss, corporate restructuring and the abuse of process.⁵⁹ The ICSID Convention adopts such definitions, and these conditions must be fulfilled alongside the underlying IIA requirements. A number of precisely defined public interest carve-outs could also be prescribed in order to better protect States’ right to regulate. Further, procedures before the new MIC could be inspired by the ICJ rather than the arbitration approach in order to reduce the complexity and thus also cost and duration.

In light of the cross-cutting nature of investment, it would be important that the new court provides a sufficient margin of appreciation for domestic public policy

⁵⁹ However, in light of the MAI’s experience, one of the unsettled issues concerned the definition of investment: see UNCTAD (n 12) 11. Accordingly, UNCITRAL would be unlikely to consider any controversial issues. However, the problem with the MAI’s definition was that it was too broad, while the new Statute of the potential MIC should aim for a narrower definition.

decisions. This approach could assist in distinguishing between good faith practices of States and bad faith conduct of investors, and *vice versa*. It could further ensure that international law does not amount to a race to the top in determining the appropriate investment standards, compared to those standards in developed legal systems. Additionally, insufficient regard for domestic public policy can produce invasive effects of international law on domestic legal systems and thus undermine the legitimacy of international institutions. Ultimately, a different approach to domestic public policy would change the 'parallel justice' nature of the current ISDS.

In response to the challenges of climate change and global pandemic, the regulatory activity of States has intensified, and this trend is likely to continue. Accordingly, a MIC should be able to correctly balance obligations of States towards investors with their other obligations under international law, in particular those concerning sustainable development and public health initiatives.

A MIC should embrace a wide spectrum of values and cultures represented in domestic law and other areas of international law, especially given the complex regulatory context in which investment takes place. The composition of the new court could address this issue in a way similar to that in which the composition of domestic constitutional courts is addressed – by a careful balance between different political beliefs and values that can ensure the long-term prevalence of law over politics. This should involve the appointment of specialists from different fields that interact with investment – international law generalists, environmentalists, human rights experts, constitutional lawyers, alongside the trade and investment law specialists. A new court staffed only by judges with the same investment and trade background as the legal professionals in the current ISDS system cannot bring a substantive change.

While a new MIC would be a contribution to the international rule of law, the exact extent of its normative contribution will depend on the Statute of the new court and its jurisdiction.

10.4.3. MIC and legitimacy

By enhancing procedural rule of law, the new court could likely enhance throughput legitimacy. With norms sounder from a legal perspective, due to increased coherence and predictability at least in the EU external relations field, it could also achieve more output legitimacy. In the EU, input legitimacy could be increased through greater involvement of civil society and Member States' parliaments in the discussions of EU IIAs. The following

figure depicts the possible effects of the new MIC on legitimacy and the rule of law in the EU context.

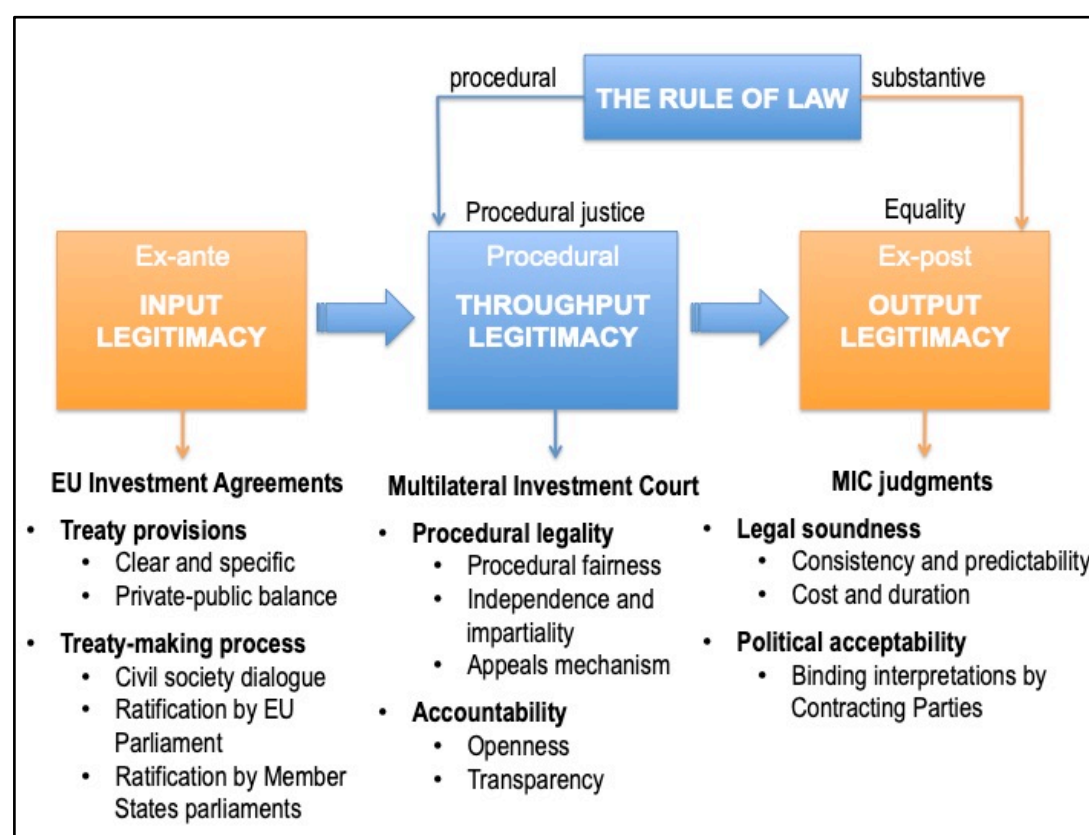


Figure 10.2. The Multilateral investment court in the framework of legitimacy and the rule of law in the EU context

However, will this normative approach be sufficient for the acceptance of the system by a variety of stakeholders? Despite the technicality of legitimacy criteria, the more a system reflects a society's values the more likely it is that such a system would be accepted as authoritative. For the time being, and for different reasons, the MIC largely remains 'an unwanted court' for the majority of the different stakeholders, both within and outside the EU.

The EU's main trump card for increasing legitimacy is the promise of independence a MIC and greater access to justice. In line with the EU's 'trade for all' strategy, a new MIC should be a court that will deliver 'justice for all'. The financial openness of the new court to all foreign investors is aimed at ensuring the support of the small business sector that has been excluded from the benefits of ISDS.⁶⁰ This argument should also attract the

⁶⁰ In particular, the EU Negotiating Mandate for a MIC (n 46) emphasises the need for provisions that will ensure the access of small and medium-sized enterprises and natural persons to the MIC: para 17.

support of the political centre and it can be used as leverage in opposing the radical left, which detests the power of big capital and has expressed the strongest opposition to ISDS.

However, the logic of the rule of law in the form of an independent court, which should restore the legitimacy of ISDS,⁶¹ has not convinced the sceptical public. The core concern for the general public remains the legacy of the current ISDS system in any new ISDS arrangement. The most controversial element of the EU reform is the removal of arbitration, however this could be futile if the new court will only institutionalise the current system's rules and culture. If it does, it would be a worse version of the current ISDS.

At the same time, the EU must convince investors that its court model, eliminating party appointed adjudicators, would be sufficiently independent from the States' politics and that it would deliver enforceable judgments.⁶² The success of the future court will depend on investor confidence. Due to the underlying arbitration agreement, without investors' claims, the court as a business model could fail. As long as investors have recourse to arbitration through restructuring, it is unlikely that they would favour a court.⁶³

Externally, the very typically EU style of thinking about a court as a solution is unlikely to be shared by those with a more pragmatic mindset in other legal systems; in particular, those in the common law family. For the US, regardless of the particularly strong sentiments of the current administration, international institutions and courts in particular have always been met with scepticism. Similar sentiment can be found among all great powers that are reluctant to submit themselves to the power of international law. The unusual alliances in the UNCITRAL are a testament to this – with the US, Russia, Iran and Israel united in opposition to the 'EU court'. The success of the EU project will largely depend on its ability to convince the developing States, which have so far been on the 'losing' side of ISDS, about the salience of the new EU vision.⁶⁴

⁶¹ See, for example, the submission from the EU to UNCITRAL emphasising the perception of justice dependant on the perception of independence of the adjudicators: UNCITRAL, 'Possible reform of Investor-State dispute settlement (ISDS), Submission from the European Union' (12 December 2017) UN Doc A/CN.9/WG.III/WP.145, para 27.

⁶² Indeed, enforcement of future MIC judgments could pose a difficulty and it remains to be considered whether the possible MIC would establish its own specific enforcement regime under its founding mechanism, and, if so, how decisions would be enforced with respect to non-participating States of such a mechanism: see UNCITRAL, Report of Working Group III, January 2020 (n 35) Addendum IV.

⁶³ See Part I, chapter 3, section 3.3.3.

⁶⁴ Accordingly, in the EU's proposal, the emphasis is placed on establishing 'an assistance mechanism', which could 'aid least developed and developing countries in litigation in international investment disputes and possibly in other aspects of the application of international investment law': EU submission to UNCITRAL (n 46) para 38. An identical aspiration has been included in the EU Negotiating Mandate for a MIC (n 46): see para 16.

10.4.4. MIC and fragmentation

As contradictory as it sounds, fragmentation is, and is likely to remain for some time, the only common denominator in IIL. Since IIL has not been redesigned in its substance, fragmentation will continue due to numerous IIAs. Moreover, it could be even further increased if the new court develops its own set of standards through the interpretation of new EU IIAs. On the other hand, if the MIC does not develop its own standards, one might ask (just as China did), what would be the added value of the court of first instance? An appellate body could more practically resolve the issues of correctness, consistency and predictability if the new system only embraces the dominant investment law paradigm of the current ISDS system.

Further, the EU has proposed a MIC as one of the options for ISDS reform. This flexible approach is in contradiction to the aspiration for a multilateral solution to common ISDS problems. However, more flexibility provides more chances for the establishment of a new court. Importantly, a MIC is the EU solution for its own external fragmentation. One single court should ensure consistency among many extra-EU IIAs. For the EU and its Member States the court would also be more affordable than the expensive ITA. The EU's 'open architecture' approach is thus a pragmatic strategy with a view to establishing a MIC. Given the proportion of the BITs of EU Member States in the total number of IIAs, coherence of dispute settlement among extra-EU BITs could in the long-term have a positive integrating spill-over effect on the coherence of IIL.

Multilateralism in the context of IIL reform does not mean one single solution but an opportunity for developing 'like-minded' plurilateral partnerships tailored to specific investment contexts. It includes convincing as many 'smaller' players to join as possible. The EU has a challenging task to persuade 'the others' that its reform of IIL is not a self-centred expression of multilateralism on EU terms but a savvy pragmatic solution for avoiding the difficult choice between the US and China. This strategy goes hand-in-hand with the EU plurilateral approach in trade. In the multilateral rules-based order that is currently under threat, having rules, albeit imperfect rules, is still better than having no rules. It remains to be seen whether the impact of COVID-19 on the UNCITRAL negotiations remains operational or the new political circumstances in international trade could also affect the ISDS reform.

CONCLUSION

The purpose of this dissertation was to evaluate the contribution of the EU to the development of international law in the field of investment, and in particular to assess whether the ISDS reforms of the EU address the international investment law problems and contribute to the achievement of the rule of law and legitimacy as the reform's normative goals. In order to answer this question, this dissertation has provided a substantial analysis of EU investment law and policy (Part II) in the broader context of international investment law (Part I) and its reform (Part III). In doing so, this research has aimed at making a substantial contribution to the international investment law reform debate.

The undertaken analysis aimed at transcending the technicalities of law and exploring its normative core in order to derive new perspectives on the link between the two, and to provide an enduring evaluation of the normative leverage of the EU to achieve reform of international investment law. As many textbooks and even more scholarly articles have been written on international and EU investment law, what value could this dissertation add to the ongoing debate? The following observations encapsulate the findings of this research which has taken a unique direction and attest to its relevance.

First, this dissertation has shed light on questions about *the rule of law* in international law more broadly and in the autonomous legal discipline of international investment law more specifically. The reform of international investment law ultimately exposes the clash of different visions of the rule of law in international law.

International investment law and its dispute settlement mechanism touch upon the core of State regulatory processes. By eschewing domestic courts in favour of a private law dispute settlement mechanism, ISDS disturbs the domestic democratic process of checks and balances in the creation and domestic implementation of public policy. It shifts from States to international arbitration tribunals the judicial (public domestic) control over States' legislative and executive action in issues of public importance. The EU reform contemplates a new shift – from internationalised tribunals controlled by disputing parties to an internationalised court controlled by States.

For the EU, the reform of international investment law should return control over international investment law back to States. By transforming quasi-private arbitration to a public court, the EU vision of a Multilateral Investment Court should take international investment law away from the special interests of transnational elites and the 'managerial world' of narrowly specialised investment lawyers to a domain of more traditional State-controlled public international law. However, this shift will not eliminate the power game in international investment law; it will rather recalibrate the power balance between States and tribunals and

shift the power to where it was at the time when the system was created. The financial arrangements of the new court should make the new system more attractive to developing States that have been on the receiving end of investors' claims.

This dissertation has examined the rule of law as the central issue of the reform debate. As States contemplate change of the dispute resolution paradigm, perhaps the core question for them to consider is what this change entails for the international rule of law and whether it gives States more control over this autonomous legal discipline that so significantly affects their domestic policy processes. Will the new court allow more influence of the States – the actual masters of international treaties – in setting the standards in international investment law?

Secondly, too few studies have focused on the case of the EU in the field of investment with an aim of disentangling the complexities of the interplay between EU law and international investment law in a comprehensive manner. Scholars have mainly focused on the selected issues arising out of this relationship. By examining the normative leverage of the EU in reforming international investment law, this dissertation has shed light on the ways in which the EU attempts to influence international investment law developments, and also on the extent to which the EU's own reform solutions have been influenced by international investment law. This *cross-fertilisation* process has been an important aspect of this dissertation.

In the external dimension, new standards in post-Lisbon investment agreements of the EU and the Member States embrace the standards the EU has sought to establish in international investment law. In line with the constitutional aspiration of the EU to contribute to the development of international law, the later EU agreements integrate the best practice of modern investment treaties. At the same time, they incorporate EU law by ensuring that international investment law standards do not conflict with the free movement of capital and freedom of establishment principles of EU law.

The aspirational coherence between the internal and external EU dimensions is not to be ensured through substantive standards of protection but through the requirement for independence of the dispute settlement body. The new MIC will have to comply with the criteria of independence and access to justice enshrined in the EU Charter of Fundamental Rights, just as the CJEU and all domestic courts in the EU are obliged to do. In reality these criteria are not identical to the EU internal criteria but dwell on the same principle; primarily the independence of the new court from the host State must be ensured. This requirement of independence should ensure a sufficient level of protection for EU investors in third countries and ultimately promote the free-and-fair-trade paradigm, which ensures that EU investors compete with the rest of the world on an equal footing.

While this dissertation aimed to demonstrate how these two international legal systems share the same paradigm (the protection of foreign investors abroad), it has also striven to

demonstrate how the differences between the two systems stem from their fundamentally different visions of the rule of law in international law.

The assumed anti-ISDS discourse of the EU must be placed in the broader context of international law, the place of the EU legal order within international law and the general objectives of EU integration. In addition to socio-political domestic opposition, the core ISDS philosophy, which mistrusts domestic courts, is in direct contradiction with the core principle of mutual trust in domestic courts under EU law. The elimination of ISDS in the intra-EU dimension serves to achieve the objectives of closer EU integration and to enhance the rule of law in the EU through the implementation of EU law. International law aims to ensure the compliance of domestic law with international legal standards, while the rule of law guarantees supremacy of law over politics. In the EU these goals are ensured through EU law and the founding treaties, which are ultimately instruments of international law.

In the internal EU dimension, parallels can be drawn between the EU as a quasi-federation and other federations. For example, in view of the CJEU's objective of EU integration, the elimination of ISDS between the Member States (e.g. between Germany and Poland) finds almost a *reductio ad absurdum* in the hypothetical scenario of the Australian High Court aiming to eliminate ISDS between the Australian states (e.g. between New South Wales and Victoria) with an objective to strengthen the Federation – if such a situation did exist in Australia then doubtless the High Court would seek to eliminate it. This scenario might be politically justifiable to some outside observers,¹ however the legal basis on which the effects of international agreements would be assessed is fundamentally different. The legal basis of the Australian Federation is its domestic *Constitution*.² The legal basis of EU integration is international law. Accordingly, the relationship between international investment law and EU law should not be framed as a relationship between international and domestic law. In its essence, it is the relationship between two international legal orders within broader international law.

By contributing to the domestic rule of law in the EU, the EU is also contributing to the international rule of law. The success of the EU lies in its ability to integrate international law into domestic law, while subjecting Member States to the control of international law. This is the core aspect of the EU and its legal order that has been somewhat absent from the debate. 'Legalism' in this thinking might not be convincing for 'realists' among international investment lawyers who mistrust the assumption of EU law of equal justice in the Member States. However, should international investment law be about the race to the top in protecting investors or about ensuring the compliance by States with the minimum standards of treatment under international

¹ Unlike the CJEU, the Australian High Court does not yet have a clear vision of what the Australian Federation should look like.

² Formally, the Australian *Constitution* is an Act of the British Parliament due to the Australian colonial past.

law? Do EU law and its enforcement mechanisms fall so far short of these standards when protecting EU investors who invest in other Member States? The realist perspective is in its essence also an issue of institutional hegemony in international law.

Thirdly, this dissertation has shed light on the extent to which the EU is caught between internal and external limitations in achieving its investment strategy. The *limited EU sovereignty* to conclude international investment agreements affects EU external action because it disallows conclusion by the EU of modern comprehensive free trade agreements. These limitations on EU sovereignty stem from the internal factors – the EU constitutional framework – and ultimately pose a challenge for both deepening (internally) and widening (externally) of the EU investment policy.

Externally, the EU approach is as pragmatic as it can be, with fragmentation (between many investment treaties of the EU and the Member States) and flexibility (the new court's 'open architecture') as dominant features. Because the ratification of mixed EU international investment agreements is a lengthy and politically complex process domestically, the EU is engaged in parallel in a bilateral and multilateral agenda. The critical mass of support expressed through the conclusion of bilateral investment agreements should give the EU important political leverage in the UNCITRAL negotiations. The aspiration is to establish a new multilateral court as quickly as possible, which in reality needs to be only plurilateral. At the same time, a new adjudication mechanism should eventually enhance coherence between all Member States' and EU investment agreements by integrating one single court instead of many tribunals.

Fourthly, this dissertation has shed light on the relationship between the *legitimacy*, primarily a political concept, and the rule of law as a legal concept. Legitimacy is essentially a matter of perception, despite its normative dimension. It is difficult to draw a line between its objective and subjective criteria. Ultimately, legitimacy depends on the perspective from which the system in question is examined – and it differs between States, investors, and society as a whole. It also entails different visions of the rule of law in international law. For civil society, it means endorsing more domestic rule of law. For investors, it is about party autonomy and effective enforcement of the awards. For States, it is a choice between the visions of the rule of law of the big powers (the US, China and the EU). As a contribution to this debate, this dissertation has striven to analyse possible malfunctions of the current system of international investment law on one hand, and the advantages and drawbacks of the envisaged reform on the other.

Finally, this dissertation has questioned the effectiveness of a procedural approach to reform in an autonomous area of international law, which functions in accordance with its established standards, methods and culture. Can the procedural reform, which avoids the issues of substance, achieve consensus on the desired normative goals? As the reform process continues, it might be years before a conclusive answer about its outcomes can be given. At this stage, it is

too early to say whether a new Multilateral Investment Court will be established, let alone the kind of legacy it will create.

In light of the historical context of international investment law, procedural reform is politically more salient, or in realistic terms it has more potential to succeed. Procedural reform could also be a first step towards a more substantive reform. It could enhance the rule of law by implementing more prominently the procedural requirements of the rule of law. These requirements are also institutional in character: a court with judges who are independent from political influence; the access to this court guaranteed to all investors; its procedures, reasoning and decisions open to public scrutiny; and legal methods that could achieve more equilibrium between different interests, in particular between the investors' rights and public policy goals. The assumption of many lawyers, in particular those in the common law world, is that proper procedure expressed in the concept of the procedural rule of law eventually leads to a fair outcome. More rule of law could also lead to more legitimacy – with independent judges the system could also be *seen* as more just. On the other hand, not everyone is convinced that an approach focused on the procedure would eventually lead to substantive justice, in the same way that the formalism enshrined in the rule of law is not convincing for everyone, and indeed can create substantive inequalities.

The overarching goal of the rule of law is to achieve the supremacy of law over politics. International investment law seems to share that same goal. However, despite the attempts to transform difficult political issues into a technical sphere of law's objectivity, its core unanswered substantial and ultimately existential questions keep returning. Despite the attempts to neutralise law, the core of law remains its values. Every system that calls itself a rule of law system is eventually able to answer the difficult questions about its values through its domestic democratic processes. But what are the values of international investment law? Is that the rule of law? And if it is the rule of law, what is its meaning in international law? The movements for reform of international investment law avoid answering these core existential questions. Accordingly, regardless of the outcome of the reform, they are likely to return.

Flexibility, fragmentation, and complexity in international investment law are likely to remain, both as 'a trap and a display' – it is what each of us makes of it.³ However, the post-COVID 19 world will only further expose the existential questions. The Global Financial Crisis of 2008 has already proven that the system of international investment governance is ill-tailored for State measures that are required to address situations of crisis.

³ 'Everything is a trap and a display; the secret reality of the object is what the Other makes of it': Jean Paul Sartre, *Critique of Dialectical Reason* (Alan Sheridan-Smith tr, Verso 2004) vol 1, 135.

The EU solution for the reform of international investment law seems like a Belgian solution,⁴ with a still unlikely ‘Brussels effect’.⁵ As in trade, the EU approach to investment is a trade-off between the aspiration for multilateralism and the reality of plurilateralism. However, and more optimistically, not every solution must be an answer to *every* problem.⁶ For the EU, the establishment of a Multilateral Investment Court would be an important first step.

⁴ Allusion made here refers to a ‘Belgian compromise’, which implies the resolution of social and political problems in Belgium through a process of negotiation and adaptation. Complicated issues are settled through a complex and ambiguous compromise, which is usually insufficient to resolve the issues but is sufficient to stop the existing conflict and allow life to continue without obstructions. See Francis Heylingen, ‘Belgium: Society, Character and Culture, An Essay on the Belgian Identity’ (*Principia Cybernetica Web*, 1998) <<http://134.184.131.111/BelgCul2.html>> accessed 30 June 2020.

⁵ Brussels effect refers to the process of *de facto* externalisation of EU regulation outside its borders through market mechanisms. The scholarly authority on the topic is the monograph by Anu Bradford, *The Brussels Effect: How the European Union Rules the World* (OUP 2020).

⁶ The reader is here reminded of the quote on page vii.

**Appendix: Overview of investment provisions in different types of EU trade
and investment agreements**

Agreement	Legal basis – substance	Legal basis – procedure	Investment clauses	Type, scope and status
Pre-Lisbon				
Agreement on the European Economic Area (EEA)¹	Art. 238 TEC ²	Art. 228(3) second subparagraph TEC ³	• Liberalisation of investment: - Free movement of capital: FDI + portfolio investment (Art. 40) - Freedom of establishment (NT): companies/firms + agencies/branches/subsidiaries (Art. 31) • Treatment (post-establishment): NT (Art. 34) • Dispute settlement: Domestic courts/EFTA Court and CJEU	- Mixed EU + 3 EFTA - 4 freedoms + Single Market harmonisation - In force
General Agreement on Trade in Services (GATS)⁴	Art. 43, 54, 57, 66, 75, 84(2), 99, 100, 100a, 113, 235 TEC ⁵	Art. 228(3) second subparagraph TEC ⁶	• Liberalisation of investment: - Provision of services through ‘commercial presence’: includes establishment of a juridical person or branch/representative office (Art. I (2)(c)) - Market Access (Art. XVI), NT (Art. XVII), MFN (Art. II). - Capital movements: FDI (Art. XVI (1)) • Treatment (post-admission): NT (Art. XVII), MFN (Art. II) • Dispute settlement: State-to-State arbitration (WTO DSU)	- Mixed EU + third countries - WTO Agreement - Conditions of entry of FDI in service sectors - In force
Energy Charter Treaty and the Energy Charter Protocol⁷	▪ Art. 95 ECSC; ▪ Art. 54(2), 57(2) last sentence, 66, 73c(2), 87, 99, 100a, 113, 130s(1), 235 TEC; ▪ Art. 101 second paragraph Euratom⁸	Art. 228(2) second sentence, 228(3) second subparagraph TEC ⁹	• Definition of investment: FDI + portfolio (Art. 1(6)) • Pre-establishment: <i>Endeavour</i> to accord NT/MFN (Art. 10(2), (3) (6)) • Post-establishment: old style protection (Part III): FET (Art. 10(1); NT/MFN (Art. 10(7)); expropriation (Art. 13); freedom of transfer (Art. 14) • Dispute settlement: ISDS (for breaches of Part III)	- Mixed EU + third countries (Intra- & Extra-EU) - Traditional IIA (investment protection and ISDS) - In force
Stabilisation and Association Agreements (SAAs) with countries of Western Balkans (Albania,¹⁰ Bosnia and Herzegovina,¹¹ North Macedonia,¹² Montenegro,¹³ Serbia,¹⁴ Kosovo¹⁵)	▪ Art. 217 TFEU; ▪ Art. 101 second paragraph Euratom¹⁶	Art. 216(6)(a), 218(8) TFEU ¹⁷	• Liberalisation of investment: - Capital movements: FDI + portfolio investment¹⁸ - Establishment (limited in economic activity scope¹⁹) of business undertakings or subsidiaries/branches: NT/MFN²⁰ • Treatment (post-admission): - NT/MFN²¹ - Endeavour to bring about favourable climate for private investment and improve legal framework for protection of investment²² • Dispute settlement: State-to-State arbitration	- Mixed EU/Euratom - Association Agreement - Includes regulatory approximation²³ + potential for EU membership²⁴ - Individual agreements in force with all WB countries

<i>Post-Lisbon</i>				
Association Agreement with Ukraine²⁵	▪ Art. 217 TFEU²⁶ ▪ Art. 79(2)(b) TFEU²⁷	Art. 218(6)(a), 218(8) second subparagraph, 218(7) TFEU ²⁸	• Liberalisation of investment: - Capital movements: FDI + portfolio investment (Art. 145) - Establishment (limited in economic activity scope²⁹) of subsidiaries/branches/ representative offices of legal persons: NT/MFN (Art. 88) • Treatment (post-admission): - NT/MFN (Art. 88(1)(ii), (2)(ii)) - Existing MSts IIAs (Art. 90) - Endeavour to negotiate investment protection and investor-to-state dispute settlement procedures (Art. 89) • Dispute settlement: State-to-State arbitration/interpretation of EU law by CJEU: Art. 322	- Mixed EU/Euratom - Association Agreement - Deep and Comprehensive Free Trade Area (includes regulatory approximation³⁰) - Provisional application
EU–Mexico modernised Global Agreement³¹	▪ Art. 37, 31(1) TEU, ▪ Art. 217 TFEU³²	Art. 218(5), 218(6)(a), 218(8) TFEU ³³	• Definition of investment: FDI + portfolio³⁴ • Liberalisation of investment:³⁵ - Capital movements: FDI + portfolio investment³⁶ - Establishment of investment (subject to economic sector limitations³⁷): Market Access (Art. 6)/NT (Art. 7(1))/MFN (Art. 8(1))/ prohibition of Performance Requirements (Art. 9) • Post-establishment: NT (Art. 7(2)), MFN (Art. 8(2)), improved protections in Section B:³⁸ FET (Art. 15), freedom of transfer (Art. 16), expropriation (Art. 18) • Investment dispute settlement: ICS;³⁹ commitment to MIC (Art. 14)	- Mixed EU - Modernisation of the trade part of the Association Agreement - CCP + investment (trade + investment liberalisation <i>and</i> improved protection + ICS) - Pending signature
EU–Kazakhstan Enhanced Partnership and Cooperation Agreement⁴⁰	▪ Art. 37, 31 TEU, ▪ Art. 91, 100(2), 207, 209 TFEU⁴¹	Art. 218(5), 218(8) TFEU ⁴²	• Liberalisation of investment: - Capital movements: FDI + portfolio investment (Art. 58) - Establishment (all economic activities other than services⁴³) of juridical persons: MFN (Art. 45(1)); NT – includes branches of the EU (Art. 46(b)) • Treatment (post-admission): - MFN (Art. 45(2)); MFN in strategic resources and objects for subsidiaries of juridical persons of the EU (Art. 45(5)) - NT (Art. 46(a)) - Endeavour to negotiate general principles of investment protection (Art. 56) • Dispute settlement: State-to-State arbitration	- Mixed EU - Economic Partnership Agreement - CCP (trade + investment liberalisation) + development cooperation - Provisional application
EU–South African Development Community Economic Partnership Agreement⁴⁴	Art. 209(2) TFEU ⁴⁵	Art. 207(3), 207(4), 218(5) TFEU ⁴⁶	• Liberalisation of investments: no new provisions - Reaffirming commitments regarding liberalisation of services in accordance with GATS (Art. 72) - Guiding principles for future negotiation on trade in services: include market access/NT (Art. 73(2)(b))	- Mixed EU + SADC - WTO compatible Economic Partnership Agreements (in the framework of the

(Botswana, Lesotho, Mozambique, Namibia, South Africa, Swaziland)			• Treatment (post-admission): possibility of negotiating an agreement on investment in economic sectors other than services (Art. 74)⁴⁷	Cotonou Agreement⁴⁸) - Provisional application
Comprehensive Economic and Trade Agreement with Canada (CETA) ⁴⁹	Art. 43(2), 91, 100(2), 153(2), 192(1) TFEU ⁵⁰	Art. 207(4) first subparagraph, 218(5) TFEU ⁵¹	• Definition of investment: FDI + portfolio (Art. 8.1) • Liberalisation of investment: - Capital movements: FDI + portfolio investment - Establishment or acquisition of investment (subject to economic sector limitations⁵²): Market Access/prohibition of Performance Requirements⁵³/NT/MFN (Art. 8.4-8.7) • Post-establishment: improved protections (Section D): FET (Art. 8.10); NT (Art. 8.6); MFN (Art. 8.7); expropriation (Art. 8.12); freedom of transfer (Art. 8.13) • Investment dispute settlement: ICS (Section F); commitment to MIC (Art. 8.29)	- Mixed EU - Comprehensive modern FTA - CCP + investment (trade + investment liberalisation <i>and</i> improved protection + ICS) - Provisional application
EU–Republic of Korea Free Trade Agreement ⁵⁴	Art. 91, 100(2), 167(3), 207 TFEU ⁵⁵	Art. 218(5) TFEU, ⁵⁶ 218(6)(a)(v) ⁵⁷	• Liberalisation of investment: - Capital movements: FDI + portfolio investment (Art. 8.2) - Establishment (subject to economic sector limitations⁵⁸) of juridical person or branch/representative office: Market Access/NT/MFN (Art. 7.11-7.14) • Treatment (post-admission): - NT/MFN (Art. 7.12, 7.14) - Existing MSts IIAs (Art. 7.15) - Endeavour to negotiate general principles of investment protection (Art. 7.16(2)) • Dispute settlement: State-to-State arbitration	- Mixed EU - FTA - CCP = trade + FDI liberalisation - In force
EU–Japan Economic Partnership Agreement ⁵⁹	Art. 91, 100(2) TFEU ⁶⁰	Art. 207(4) first subparagraph, 218(6)(a)(v) second subparagraph, 218(7) TFEU ⁶¹	• Liberalisation of investment: - Capital movements: FDI (Art. 9.2) - Establishment (subject to economic sector limitations⁶²) of a juridical person or branch/representative office: Market Access (Art. 8.7)/NT (Art. 8.8(1))/MFN (Art. 8.9(1)); Prohibition of performance requirements (Art. 8.11) • Treatment (post-admission): - NT (Art. 8.8(2))/MFN (Art. 8.9(2))/Prohibition of performance requirements (Art. 8.11) • Dispute settlement: State-to-State arbitration	- EU-only - FTA - CCP = trade + FDI liberalisation - In force
EU–Singapore Free Trade Agreement	Art. 91, 100(2) TFEU ⁶³	Art. 207(4) first subparagraph, 218(5) ⁶⁴ ,	• Liberalisation of investment: - Capital movements: FDI (Art. 16.7) - Establishment (subject to economic sector limitations⁶⁵) of a juridical person	- EU-only - FTA (alongside an IPA)

		218(6)(a)(v)	or branch/representative office: Market Access (Art. 8.10)/NT (Art. 8.11) • Treatment (post-admission): - NT (Art. 8.11) • Dispute settlement: State-to-State arbitration	- CCP= trade + FDI liberalisation - In force
EU–Singapore Investment Protection Agreement	Art. 207 TFEU (FDI only) ⁶⁶	Art. 207(4) first subparagraph, 218(5) ⁶⁷ , 218(6)(a)(v) TFEU	• Definition of investment: FDI + portfolio (Art. 1.2) • Post-establishment: improved protections (Chapter II): - NT (Art. 2.3(1)) – including for Compensation for Losses (Art. 2.5); - FET (Art. 2.4); - Expropriation (Art. 2.6); - Freedom of transfer (Art. 2.7) • Investment dispute settlement: ICS (Chapter III); consideration of MIC (Art. 3.12) • Dispute settlement (interpretation and application of IPA): State-to-State arbitration	- Mixed EU - New IIA alongside FTA (improved investment protection and dispute settlement) - Pending ratification in MSts
EU–Australia Trade Agreement⁶⁸	Art. 91, 100(2) and 207 TFEU	Art. 207(4) first subparagraph, 218(5), 218(6)(a)(v) TFEU	• Liberalisation of investment:⁶⁹ - Capital movements:⁷⁰ FDI - Establishment of a juridical person or branch/representative office of a juridical person: Market Access (Art. 2.2)/NT (Art. 2.3(2)); Prohibition of performance requirements (Art. 2.6) • Treatment (post-admission): - NT (Art. 2.3(2))/MFN (Art. 2.4(2))/Prohibition of performance requirements (Art. 2.6) • Dispute settlement: State-to-State arbitration	- EU-only - Broad FTA⁷¹ - CCP = trade + FDI liberalisation - Under negotiation

Endnotes in the Appendix Table

¹ Agreement on the European Economic Area – Final Act – Joint Declarations – Declarations by the Governments of the Member States of the Community and the EFTA States – Arrangements – Agreed Minutes – Declarations by one or several of the Contracting Parties of the Agreement on the European Economic Area [1994] OJ L1/3.

² Decision of the Council and the Commission of 13 December 1993 on the conclusion of the Agreement on the European Economic Area between the European Communities, their Member States and the Republic of Austria, the Republic of Finland, the Republic of Iceland, the Principality of Liechtenstein, the Kingdom of Norway, the Kingdom of Sweden and the Swiss Confederation, 94/1/EC, ECSC [1994] OJ L1/1.

³ *ibid.*

⁴ General Agreement on Trade in Services (WTO) – Annex 1 – Annex 1B – WTO [1994] OJ L336/191.

⁵ Council Decision of 22 December 1994 concerning the conclusion on behalf of the European Community, as regards matters within its competence, of the agreements reached in the Uruguay Round multilateral negotiations (1986-1994), 94/800/EC [1994] OJ L336/1.

⁶ *ibid.*

⁷ 2080 UNTS 95; 34 ILM 360 (adopted 17 December 1994, entered into force 16 April 1998).

⁸ Council and Commission Decision of 23 September 1997 on the conclusion, by the European Communities, of the Energy Charter Treaty and the Energy Charter Protocol on energy efficiency and related environmental aspects, 98/181/EC, ECSC, Euratom [1998] OJ L69/1.

⁹ *ibid.*

¹⁰ Stabilisation and Association Agreement between the European Communities and their Member States, of the one part, and the Republic of Albania, of the other part [2009] OJ L107/165.

¹¹ Stabilisation and Association Agreement between the European Communities and their Member States, of the one part, and Bosnia and Herzegovina, of the other part [2015] OJ L164/2.

¹² Stabilisation and Association Agreement between the European Communities and their Member States, of the one part, and the former Yugoslav Republic of Macedonia, of the other part – Protocol 1 on textile and clothing products – Protocol 2 on steel products – Protocol 3 on trade between the former Yugoslav Republic of Macedonia and the Community in processed agricultural products – Protocol 4 concerning the definition of the concept of "originating products" and methods of administrative cooperation – Protocol 5 on mutual administrative assistance in customs matters – Final Act [2004] OJ L84/13.

¹³ Stabilisation and Association Agreement between the European Communities and their Member States, of the one part, and the Republic of Montenegro, of the other part [2010] OJ L108/1.

¹⁴ Stabilisation and Association Agreement between the European Communities and their Member States of the one part, and the Republic of Serbia, of the other part [2013] OJ L278/14.

¹⁵ Stabilisation and Association Agreement between the European Union and the European Atomic Energy Community, of the one part, and Kosovo [this designation is without prejudice to positions on status, and in line with UNSCR 1244/1999 and the ICJ Opinion on the Kosovo declaration of independence], of the other part [2016] OJ L71/3.

¹⁶ See, for example, Council and Commission Decision of 22 July 2013 on the conclusion of the Stabilisation and Association Agreement between the European Communities and their Member States, of the one part, and the Republic of Serbia, of the other part, 2013/490/EU, Euratom [2013] OJ L278/14.

¹⁷ *ibid.*

¹⁸ See, for example, Art 63 EU–Montenegro SAA. Other SAAs include transitional period for portfolio investment: see, for example, Art 61(3) EU–Bosnia and Herzegovina SAA.

¹⁹ See, for example, Art 55(1) EU–Montenegro SAA.

²⁰ See, for example, Art 53(1)(a), (2)(a) EU–Montenegro SAA.

²¹ See, for example, Art 53(1)(b), (2)(b)) EU–Montenegro SAA.

²² See, for example, Art 93 EU–Montenegro SAA.

²³ See, for example, Art 70 EU–Bosnia and Herzegovina SAA.

²⁴ Preambles of all SAAs.

²⁵ Association Agreement between the European Union and the European Atomic Energy Community and their Member States, of the one part, and Ukraine, of the other part [2014] OJ L161/3.

²⁶ Council Decision (EU) 2017/1247 of 11 July 2017 on the conclusion, on behalf of the European Union, of the Association Agreement between the European Union and the European Atomic Energy Community and their Member States, of the one part, and Ukraine, of the other part, with the exception of the provisions relating to the treatment of third-country nationals legally employed as workers in the territory of the other party [2017] OJ L181/1.

²⁷ *ibid* 4-5.

²⁸ *ibid* 1-3.

²⁹ Art 87 EU–Ukraine Association Agreement.

³⁰ Regulatory approximation includes Ukraine's aligning with the EU's *acquis* contained in: ch 3 (Technical Barriers to Trade), ch 4 (Sanitary and Phytosanitary Measures), ch 5 (Customs and Trade Facilitation), ch 6

(Establishment, Trade in Services and Electric Commerce), ch 8 (Public Procurement), ch 10 (Competition) and with other obligations defined by reference to EU law: see Art 322(1). The EU's *acquis* includes all common rights and obligations of the EU (primary law, secondary legislation, declarations and resolutions of the EU, measures related to CFSP and justice and home affairs, international agreements). It is binding on all Member States and any applicant for EU membership must incorporate the *acquis* into their national legal order. See EUR-Lex, 'Acquis' (*Glossary of summaries*)

<<https://eur-lex.europa.eu/summary/glossary/acquis.html>> accessed 30 June 2020.

³¹ EU–Mexico Agreement in Principle, announced on 21 April 2018. See European Commission, EU–Mexico Agreement in Principle (*European Commission*, 6 May 2020)

<<http://trade.ec.europa.eu/doclib/press/index.cfm?id=1833>> accessed 30 June 2020. This new Agreement will replace the currently in place Global Agreement between Mexico and the EU, which entered into force in 2000: Economic Partnership, Political Coordination and Cooperation Agreement between the European Community and its Member States, of the one part, and the United Mexican States, of the other part [2000] OJ L276/45.

³² The Council Decision authorising negotiations with Mexico is not publicly available. However, see indicative draft: Council of the European Union, 'Council Decision authorising the European Commission and the High Representative of the Union for Foreign Affairs and Security Policy to open negotiations and negotiate, on behalf of the European Union, the provisions that fall within the competence of the Union, of a modernised Global Agreement between the European Union and its Member States, of the one part, and Mexico, of the other part' (4 May 2016) EU/7826/16 <<http://data.consilium.europa.eu/doc/document/ST-7825-2016-INIT/en/pdf>> accessed 30 June 2020.

³³ *ibid.*

³⁴ Art 3, Investment ch, EU–Mexico Agreement in principle.

³⁵ Section A (Liberalisation of investments), Investment ch, EU–Mexico Agreement in principle.

³⁶ Art x.2, ch on Capital movements, payments and transfers and temporary safeguard measures, EU–Mexico Agreement in principle.

³⁷ Art 5, Chapter on Investment ch, EU–Mexico Agreement in principle.

³⁸ Section B (Investment protection), Investment ch, EU–Mexico Agreement in principle.

³⁹ Section on Resolution of investment disputes, EU–Mexico Agreement in principle.

⁴⁰ Enhanced Partnership and Cooperation Agreement between the European Union and its Member States, of the one part, and the Republic of Kazakhstan, of the other part [2016] OJ L29/3.

⁴¹ Council Decision (EU) 2016/123 of 26 October 2015 on the signing, on behalf of the European Union, and provisional application of the Enhanced Partnership and Cooperation Agreement between the European Union and its Member States, of the one part, and the Republic of Kazakhstan, of the other part [2016] OJ L29/1.

⁴² *ibid.*

⁴³ Art 44 EU–Kazakhstan Enhanced Partnership and Cooperation Agreement.

⁴⁴ Economic Partnership Agreement between the European Union and its Member States, of the one part, and the SADC EPA States, of the other part [2016] OJ L250/3.

⁴⁵ Council Decision (EU) 2016/1623 of 1 June 2016 on the signing, on behalf of the European Union and provisional application of the Economic Partnership Agreement between the European Union and its Member States, of the one part, and the SADC EPA States, of the other part [2016] OJ L250/1.

⁴⁶ *ibid.*

⁴⁷ Note that the Council reiterated that the wording of this article 'does not and cannot derogate from the division of competences between the Union and its Member States under the Treaties, including for investment': Declaration of the Council regarding Article 74(1) of the Economic Partnership Agreement between the European Union and its Member States, of one part, and the SADC EPA States, of the other part, see Monthly Summary of Council Acts – June 2016 (14 December 2016) 15567/16

<<http://data.consilium.europa.eu/doc/document/ST-15567-2016-INIT/en/pdf>> accessed 30 June 2020.

⁴⁸ Partnership agreement between the members of the African, Caribbean and Pacific Group of States of the one part, and the European Community and its Member States, of the other part, signed in Cotonou on 23 June 2000 – Protocols – Final Act – Declarations, 2000/483/EC [2000] OJ L317/3. The ACP-EU Partnership Agreement provides the framework for the EU relationship with countries of Africa, the Caribbean and the Pacific (ACP). In its Art 37 it envisages the conclusion of WTO-compatible Economic Partnership Agreements, emphasising the need for flexibility, taking into account 'the level of development and the socio-economic impact of trade measures on ACP countries, and their capacity to adapt and adjust their economies to the liberalisation process': Art 37(7). In June 2018, the Council of the EU approved negotiating directives for a new Partnership Agreement, to consist of a common foundation (general objectives, principles, priorities) and three regional partnership (Africa, Caribbean, Pacific), each with their own region-specific priorities: see Council of the European Union, 'Negotiating directives for a Partnership Agreement between the European Union and its Member States of the one part, and with countries of the African, Caribbean and Pacific Group of States of the other part' (21 June 2018) 8094/18.

⁴⁹ Comprehensive Economic and Trade Agreement (CETA) between Canada, of the one part, and the European Union and its Member States, of the other part [2017] OJ L11/23.

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- ⁵⁰ Council Decision (EU) 2017/38 of 28 October 2016 on the provisional application of the Comprehensive Economic and Trade Agreement (CETA) between Canada, of the one part, and the European Union and its Member States, of the other part [2017] OJ L11/1080.
- ⁵¹ *ibid.*
- ⁵² Art 8.2(2), (3) CETA.
- ⁵³ Applies to 'any investments': Art 8.2(1)(c) CETA.
- ⁵⁴ Free trade Agreement between the European Union and its Member States, of the one part, and the Republic of Korea, of the other part [2011] OJ L127/6.
- ⁵⁵ See Council Decision (EU) 2011/265 of 16 September 2010 on the signing, on behalf of the European Union, and provisional application of the Free Trade Agreement between the European Union and its Member States, of the one part, and the Republic of Korea, of the other part [2011] OJ L127/1.
- ⁵⁶ *ibid.*
- ⁵⁷ Council Decision (EU) 2015/2169 of 1 October 2015 on the conclusion of the Free Trade Agreement between the European Union and its Member States, of the one part, and the Republic of Korea, of the other part [2015] OJ L307/2.
- ⁵⁸ Art 7.10 EU–Korea FTA.
- ⁵⁹ Agreement between the European Union and Japan for an Economic Partnership [2018] OJ L330/3.
- ⁶⁰ Council Decision (EU) 2018/1907 of 20 December 2018 on the conclusion of the Agreement between the European Union and Japan for an Economic Partnership [2018] OJ L330/1.
- ⁶¹ *ibid.*
- ⁶² Art 8.6(2) EU–Japan EPA.
- ⁶³ Council Decision (EU) 2018/1599 of 15 October 2018 on the signing, on behalf of the European Union, of the Free Trade Agreement between the European Union and the Republic of Singapore [2018] OJ L267/1.
- ⁶⁴ *ibid.*
- ⁶⁵ Art 8.9 EU–Singapore FTA.
- ⁶⁶ See European Commission, 'Proposal for a Council Decision on the signing, on behalf of the European Union, of the Investment Protection Agreement between the European Union and its Member States, of the one part, and the Republic of Singapore of the other part' COM/2018/195 final – 2018/0096 (NLE), Explanatory Memorandum, 3.
- ⁶⁷ Council Decision (EU) 2018/1676 of 15 October 2018 on the signing, on behalf of the European Union, of the Investment Protection Agreement between the European Union and its Member States, of the one part, and the Republic of Singapore, of the other part [2018] OJ L279/1.
- ⁶⁸ European Commission, 'EU–Australia Trade Agreement negotiation' (*European Commission*, 18 June 2020) <<http://trade.ec.europa.eu/doclib/press/index.cfm?id=1865>> accessed 30 June 2020.
- ⁶⁹ European Commission, EU–Australia Trade Agreement, Chapter on Investment Liberalisation and Trade in Services, EU Textual proposals (22 October 2018) <http://trade.ec.europa.eu/doclib/docs/2018/december/tradoc_157572.pdf> accessed 30 June 2020.
- ⁷⁰ European Commission, EU–Australia Trade Agreement, Chapter on Capital Movements, Payments and Transfers and Temporary Safeguard Measures, EU Textual proposals (22 October 2018) <http://trade.ec.europa.eu/doclib/docs/2018/december/tradoc_157569.pdf> accessed 30 June 2020.
- ⁷¹ See Council of the European Union, 'Negotiating directives for a Free Trade Agreement with Australia' (8 May 2018) 7663/18 ADD1.

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