RESEARCH REPORT:
AN EVALUATION OF THE PROPOSED MULTILATERAL INVESTMENT COURT SYSTEM

by Love Rönnelid
Research Report: An Evaluation of the Proposed Multilateral Investment Court System

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The current international investment regime is exceptional in many ways. It grants foreign investors a set of property rights in addition to those available in the national system where their investment takes place. It provides an enforcement system for the arbitral awards produced in a legal framework that is more powerful than the enforcement machinery for international law judgments, including the international enforcement of human rights. However, it does not impose any obligations for international investors. As a part of the European Commission's agenda to negotiate new economic agreements with third parties, there is now an attempt to provide a broad expansion of this system. This report examines some policy implications that arise from this endeavor.

EU policy with respect to international investments builds on the pre-existing tradition of investment law. The proposed reforms, such as the Multilateral Investment Court, take this tradition largely for granted. For this reason, opportunities to make significant amendments are very limited. In accepting this proposal, one would automatically also accept many controversial practices and priorities that have developed in investment law in the course of the past decades. This report discusses those practices as well as the justifications that have often been provided for them. There are already many efforts to evaluate the justifications that investment lawyers make to justify their area of expertise, including the conceptions of 'rule of law', 'depoliticisation' and (economic) 'development'. Discussions of these notions are often obscured by the open-ended nature of the relevant concepts. By describing the emergence of this system of law and its concomitant justifications policymakers can gain a better understanding of how to shape it. A proper view of the political and economic significance of the project requires a historical understanding of how these justifications emerged.

Modern investment law has an old ancestry. Rules resembling contemporary investor rights existed already during colonialism. Decolonisation pushed many industrialised countries to think of new ways to maintain control over their investments in the Third World. The development of a global 'investment law' was one such means. It was said to foster economic development, contribute to depoliticisation and advance the rule of law. What these notions came to mean was shaped by a small group of legal experts in a series of important cases and debates. The result has been a set of laws and practices – investment law – that in many ways resembles, and sometimes explicitly draws on, practices of the colonial era. This is why, for example, international investment regulation deals only with investor rights and gives no obligations to investors. This can be contrasted with the way investor regulation has been crafted in European states – herein called the 'democratic compromise'. Under this compromise, investors are granted both rights and obligations.

The historical review below is followed by a detailed discussion of three of the most common justificatory claims in discussions about investment law. Is investment law really...
good for economic development? Does it really depoliticise investment disputes? Does it contribute to the rule of law? According to the analysis below, it is hard to find any good grounds for including investor-state dispute settlement (ISDS) in the European Free Trade Agreements (FTAs). Instead, international investment law involves three significant risks. These are the risks of the so-called regulatory chill (that it becomes impossible or very expensive to draft laws or administrative rules influencing the profit-making of investors), that it might become impossible to achieve the democratic compromise at the international level, and that the investment rules negotiated between the European Union and developed countries might be replicated in the relations with developing nations. All these risks appear substantial.

Nor does ISDS respect the principle of the autonomy of EU law, as developed by the Court of Justice of the European Union (ECJ). Its incompatibility with ISDS has been most clearly formulated in the recent Achmea ruling. Although this award applies directly only to intra-EU BITs, its reasoning would seem to apply equally to other ISDS provisions. In any case, it would seem likely that ISDS in future FTAs will have to be considerably modified if it should pass the requirements of this doctrine. However, the Achmea ruling provides a chance for the EU legislator to contemplate the implications of its present agenda.

One proposal to take the investment law project forward has been to have recourse to investment insurance instead of ISDS. But investment insurance produces many of the same effects as ISDS. The so-called subrogation rights that exist in the proposed EU FTAs would make it possible for the insurer to shift the costs of the insurance onto the host state. Fundamental rethinking is needed in order for international investment law to respect the democratic compromise – i.e. the inclusion of both investor rights and investor obligations in the relevant law. In particular, it would demand a clear break with the system called ‘arbitration without privity’ in investment-law parlance.

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In view of the high stakes inherent in an expansion of investment law, there is a need for a well thought-through strategy grounded in an understanding of which type of policy the citizens of the Union would like to pursue. Reliance on the ISDS as it has developed in the past will be detrimental to interests of the European Union. The European Commission should in particular notice that the old system of investment regulation will transfer economic power from elected state representatives to foreign investors and companies and will be likely to make it harder to achieve central domestic and EU-level goals such as inclusive growth and fighting global warming. Any expansion of investor rights ought to be accompanied by a concomitant expansion of investor obligations. In view of the centrality of this goal, the current project should be amended so that a balanced system with investor rights and obligations may be created. The continued advancement of the old type of investment law – that the European citizenry has already rejected in the context of the TTIP debates a few years ago – will simply strengthen the already powerful backlash on European integration and the international governance of the economy.
On the 16th of September 2015 the responsible European Commissioner for Trade, Cecilia Malmström, presented the Investment Court System (ICS) as a way to replace the previous investment law system typically called investor-state dispute settlement (ISDS) because, as the Commissioner noted, it suffered from “widespread lack of trust by the public”. What the Commissioner had in mind was the critique directed against the European Commission’s proposals for investor rights in the draft of the Transatlantic Trade and Investment Partnership treaty (TTIP). A public consultation had flooded the Commission with widespread criticism from European citizens towards its proposals. In response to these opinions, the ICS proposal was crafted to more closely resemble national courts. It was to include a permanent bench of adjudicators appointed in advance, an appeals mechanism and mechanisms to enhance the transparency of the system. Malmström’s statement ends with a promise to carry out “far-reaching reforms” that would bring about the “[b]ig change” required by the European citizenry.

Similarly, in the new proposal for a Multilateral Investment Court (MIC), the European Commission has slightly modified its approach to investor rights while at the same time making certain adjustments to the investment regime. For example, the Commission argues that they intend to make the system more transparent and predictable. The proposal is also presented as something new and different from the old ISDS. However, the proposal still essentially mirrors the previous system for dispute resolution between an investor and a state. Above all, it still gives the investor no obligations, only rights which can be unilaterally asserted against the state. This commonly discussed fundamental inequality of the present system is not addressed in the proposal. While it is clear, not least due to the criticism, why the Commission might want to reform the present...
system, it is less obvious why it wants to expand many parts of the previous model. Several academics have called for a justification for this choice of position. The reasons given in the Malmström’s statement are that European investors are ”the most frequent users of the existing system” and that it will serve to ”encourage investment.” The Commission seems to believe that investor rights will contribute positively to the EU economy. This is, for example, how it justifies the MIC project in one statement:

"The EU is the world’s largest exporter and importer of foreign direct investment. Investment, both inward and outward, brings jobs and economic growth. That’s why encouraging and retaining investments is vital for ensuring economic growth and jobs in the EU.”

Elsewhere in EU policy documents, the economic benefits of these agreements are assumed. This type of taken-for-granted idea that investment law should have positive economic consequences is very common among policymakers and practicing investment lawyers. This report will inquire into the evidence for this assumption. However, in order to understand how it comes to pass that the European Commissioner seems to believe that this is the case, we need to revisit the way the investment regime and the various justifications for it emerged. Such a historical review explains why this idea is so common, in spite of a lack of empirical evidence.

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9 Malmström’s statement, supra.

10 This statement can be found at http://trade.ec.europa.eu/doclib/press/index.cfm?id=1608.

11 See for example, http://ec.europa.eu/trade/policy/accessing-markets/investment/. Here, the fact that international investment can have benefits is used as an argument for investor rights. For a discussion on this common conflation of the benefits (or risks) of FDI with those of investor rights, see Jonathan Bonnitcha, Lauge N. Skovgaard Poulsen, Michael Waibel, The Political Economy of the Investment Treaty Regime (Oxford University Press, 2017) [hereinafter referred to as ”Bonnitcha, Poulsen and Waibel”], p. 46.

12 This is discussed in detail in Love Rönnelid, The Emergence of Routine Enforcement of International Investment Law (Uppsala University, 2018) [hereinafter referred to as ”Rönnelid”], in particular p. 346 et seq.
Practically as soon as commerce started to expand on a global level, there have been attempts by powerful countries to find ways to protect the overseas property of their nationals. Influential international-law thinkers used natural law to craft rules for military interventions to protect property rights. Such rules were often considered a part of the law of nations, the *ius gentium*. In particular, during the colonial period colonising powers wanted to make sure that their investors would not suffer damage owing to the unstable conditions of the territories where they were operating. This meant that the colonising power often wanted to exercise economic control over the colonial territory. For this purpose, a mix of legal means and threats was used even where no formal annexation took place. The Western powers would often apply their national legislation through extraterritoriality, as local laws were not deemed ‘civilized’ enough. In ‘Siam’, for example, a mix of consular jurisdiction, control over policymaking, and military intervention was used to safeguard and expand British investments in the teak industry. Other well-known systems of extraterritoriality included the use of mixed courts in Egypt and the treaty-port system in China. Extraterritoriality was often claimed to be for the benefit of all. Partly, this idea derived from a certain type of Christian thinking that perceived free trade as a part of a divine scheme. Partly, it was justified by economic ideas, such as the theory of comparative advantage. However, in many instances, the economic rules imposed

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16 This is what historians call “informal empire”. See e.g. Gregory A. Barton, Informal Empire and the Rise of One World Culture (Palgrave Macmillan, 2014) (hereinafter referred to as “Barton”), who discusses this concept in detail.
17 A statement of this kind of law is Baron A. Heyking, “L’exterritorialité et ses applications en extrême-orient”, 7 Recueil des cours de l’Académie de droit international de La Haye 237 (1925), who argues on pp. 262–4 that these rules are necessary, as the *ius gentium* no longer was respected “dans un milieu peu civilisé”.
18 Barton, supra, p. 121 et seq. The book also includes a number of similar examples.
19 For a broad description of several systems, see Turan Kayaoğlu, Legal Imperialism: Sovereignty and Extraterritoriality in Japan, the Ottoman Empire, and China (Cambridge University Press, 2010).
20 See, for example, Martin Lynn, “British Policy, Trade, and Informal Empire in the Mid-Nineteenth Century”, pp. 101–121 in Andrew Porter (ed.), The Oxford History of the British Empire: Volume III: The Nineteenth Century (OUP 1999) (hereinafter referred to as “Lynn”), p. 103: “since free trade, it was argued, was to the benefit of all”.
Colonising powers wanted to make sure that their investors would not suffer damage owing to the unstable conditions of the territories where they were operating. These commercial treaties included both rules that we today would consider as investment rules, and other economic rules. Commercial treaties, for example, typically set maximum tariffs of 5 per cent for the countries of the South, while reserving much higher tariffs for the colonising state. Most Western countries industrialised behind tariff walls and with autonomy to regulate investors within their jurisdictions. A good example is the industrial strategy of the United States, which not only comprised very high tariff barriers that were adjusted to the needs of the economy, but also aimed at protecting the nation from the influence of foreign capital. American national regulation aimed at discouraging foreign control over investment. It included direct discrimination against foreign investors, higher levels of taxation in some states, and US monopolies. Similar investment-law strategies were employed by most of today’s industrialised countries. By contrast, colonised countries were typically subject to involuntary free trade and legal arrangements aiming at removing their capacity to regulate foreign investors and to have the policy climate resemble the one in the West.

Countries that were in a position to resist total foreign domination often strived to emulate the protectionist Western regulation. Such attempts, however, often stood in conflict with investor rights. For example, the successful industrial policies of the Kingdom of the Two Sicilies was...

23 See, for example, James A. Cypher, *The Process of Economic Development* (Routledge, 4th edition 2014) [hereinafter referred to as “Cypher”], pp. 88–9 (on plunder at the lowest cost possible) and pp. 90–2 (on specialisation in primary production), and pp. 94–5 (on the colonial drain). Deindustrialisation is discussed later in this section of the report.


25 In line with this, early international rights of traders, resembling international investment law, were established in the “chapters” with rules imposed on a losing power during a capitulations. Lillich, supra, pp. 18–9. See also Kayaoğlu, supra, e.g. pp. 104–5 with respect to the Ottoman capitulations.

26 See Ha-Joon Chang, *Kicking away the Ladder: Development Strategy in Historical Perspective* (Anthem Press, 2003, p. 53. Western tariffs at the time were considerably higher, see, e.g., p. 17, table 2.1.

27 Id., p. 40, table 3.3. With respect to the regulation of foreign direct investment, see Chang, infra.


29 Chang, supra, pp. 690.


31 Ha-Joon Chang, “Regulation of Foreign Investment in Historical Perspective”, 16 *The European Journal of Development Research* 687 (2004) [hereinafter referred to as “Chang”], giving many examples, including South Korea, Taiwan, Finland and Ireland.
abrogated in a commercial treaty with the British Empire and a concession contract that provided arbitration rights for French investors. A legal debate ended in the British sending their gunboats to the Bay of Naples. The Two Sicilies were finally forced to pay indemnities to the British Empire and to the French investors. In a similar vein, an 1838 convention between the Ottoman and the British Empires granted British traders access to the lucrative markets in the Ottoman lands, adding to the privileges already enjoyed by the French. The treaty contributed significantly to the decline of the Ottoman textile sector. Studies indicate that the economic relationships forged during this era correlate with twentieth century patterns of deindustrialisation in the world beyond Europe more broadly.

On other occasions, powerful states intervened ad hoc, where there was no treaty establishing specific investor rights. The capital-exporting state then relied on general international law to assert its claims. This took place through so-called diplomatic protection where the home state of the investor directed a claim against the state where the investment took place (the host state). These interventions often used violent means. By way of example, both the US war on Mexico of 1846 and the Boer War of 1899 were triggered by investment-related concerns. Many of these claims were enforced through the use or threat of naval force – ‘gunboat diplomacy’ in other words. One study finds more than forty armed interventions to protect economic interests between 1820 and 1914 by the British alone.

The most debated instance of gunboat diplomacy in the investment law literature is probably the intervention by Britain, Germany, and Italy in Venezuela 1902–3. The bombardment of the coast took place in order to force arbitration of claims against the country for damages to investors caused during the civil war. It was followed by no less than ten arbitral claims commissions awarding damages to foreign subjects to be paid by the Venezuelan government. In a similar vein, a US-Mexican mixed-claims commission arbitrated more than 2,000 claims between

32 For a discussion on the treaty and its effects, see e.g. John A. Davis, *Naples and Napoleon: Southern Italy and the European Revolutions*, 1780–1860 (Oxford University Press, 2006), pp. 289–90.
34 It was clear that the attempt was to supplant the Ottoman textile sector with British imports. This is revealed by the negotiator of the treaty; see David Urquhart, *Turkey and its Resources: Its Municipal Organization and Free Trade* (Saunders and Otley 1833), available at [https://archive.org/details/turkeyanditsres01urqugoog](https://archive.org/details/turkeyanditsres01urqugoog), in particular p. 141. For a discussion of the convention, including the many policy changes it triggered, see Sina Akğin, *Turkey, from empire to revolutionary republic: the emergence of the Turkish nation from 1789 to present* (New York University Press, 2007), pp. 26–7.
36 See, for an overview, Cypher, supra, p. 97–9. Paul Bairoch, “International Industrialization Levels from 1750 to 1980” *11 Journal of European Economic History* 269 (1982) constitutes a famous study. In this study, he finds that the Third World had a higher level of industrialisation than the West in 1830. From that on, the industrialisation level of the West does not only increase (as the industrial revolution takes off), the level of industrialisation in the Third World decreases sharply. This decline continues until about year 1900. It is only in 1938 that the levels are again above those of 1830.
37 Probably the most famous example of this is the British intervention in Greece during the Don Pacifico affair.
38 Lillich, supra, p. 15.
40 Lionell M. Summers, “Arbitration and Latin America”, *3 California Western International Law Journal* 1 (1972) [hereinafter referred to as “Summers”].
41 Id., p. 9, “one each with the United States, Belgium, Great Britain, Germany, Italy, Mexico, Netherlands, Spain, France, and Norway.
1871 and 1876. These interventions for the benefit of US investors were also justified by the Roosevelt Corollary to the Monroe Doctrine, which explicitly authorised US troops to intervene in the Western Hemisphere to collect claims by US investors. This Corollary seems to have reflected the United States’ will to wrestle control over Latin America from the European powers at a time when their own investors were increasingly establishing themselves there. A large majority of the disputes in the claims commissions were adjudicated by lawyers or statesmen from Europe or North America. A US legal commentator and arbitrator has held that “the Latin American countries had a pathetic trust in the rectitude of North Atlantic monarchs, statesmen and jurists”. This group of arbitrators largely developed the standards of treatment in international (investment) law.

But Latin American lawyers fought back. One response was brought forth by the jurist and statesman Carlos Calvo. The so-called Calvo Doctrine aimed at safeguarding the legislative independence of capital-importing states. Calvo argued for non-discrimination between foreign investors and national ones: “It is certain that aliens who establish themselves in a country have the same right to protection as nationals, but they ought not to lay claim to a protection more extended.” He also argued that a foreign investor should use national courts to argue its case, rather than international tribunals (with the exception of cases of denial of justice). Western commentators seldom failed to harshly criticise Calvo and his principle. Regardless, many Latin American countries have followed Calvo’s lead. Lately also democratically elected assemblies of Western countries have argued that foreign investors should receive the same treatment as national ones – and no further rights. Moreover, several capital-importing countries argued that military interventions for the collection of debt (such as debt arising from investment claims) should be outlawed under international law. This doctrine was partially accepted through the Drago-Porter Convention in 1907. Centrally, however, the outlawing of the use of force for the collection of debt did not extend to instances where the debtor state declined going to arbitration. Consequently, the right to escape

and Sweden (which at that time were still united). See further, Michael Waibel, Sovereign Defaults before International Courts and Tribunals (Cambridge University Press, 2011) [hereinafter referred to as “Waibel”], p. 30 et seq.
44 Summers, supra, p. 6, who claims that the exception was disputes between two different Latin-American countries.
45 Id., p. 257.
46 This statement of Calvo’s doctrine is translated by Donald R. Shea in The Calvo Clause: A Problem of Inter-American and International Law and Diplomacy (University of Minnesota Press, 1955) [hereinafter referred to as “Shea”], p. 18.
47 Lillich, supra, p. 16, relying on further sources, argues that Calvo defined denial of justice “very narrowly”.
48 See, for example id., pp. 16–7 and Rudolf Dolzer and Christoph Schreuer, Principles of International Investment Law (Oxford University Press, 2nd edition, 2012), pp. 1–2. Shea, supra, pp. 16–7, citing further sources quotes people arguing that “he is not considered to have been a great thinker of innovator” and as having a “lack of keen analytical mind”.
50 Wenhua Shan, “From ‘North-South Divide’ to ‘Private-Public Debate’: Revival of the Calvo Doctrine and the Changing Landscape in International Investment Law”, 27 Northwestern Journal of International Law and Business 631 (2007), in particular p. 651 where he notes that the a US negotiation position from Congress was to not afford foreign investors greater rights than national ones.
51 Other capital-importing countries also supported this approach, see Lillich, supra, p. 27.
52 See further, Waibel, supra, pp. 34–8, citing further sources.
military intervention only applied where the weaker state acquiesced to what it had often attempted to avoid in the first place.

The underlying struggle in many of these instances concerned where disputes should be settled, and who would determine the rules in these instances. Resolution in national courts allowed for retained control by capital-importing countries. These countries argued for a standard of national treatment. In contrast, capital exporters argued for an international minimum standard of treatment, under which investors were granted wider rights. Consequently, capital-exporting countries attempted to lift investment disputes from the domestic to the international context. A famous proponent of international arbitration was the US Secretary of State Elihu Root, who believed that arbitrations should in the future develop into an international court structure.

The rules that these arbitrators or courts would apply were to reflect the positions of the West. For example, in the Harry Roberts case against Mexico, the arbitral tribunal accepted that although the claimant had received the same treatment as Mexican nationals, this was not sufficient to live up to the requirements of international law. Rather, the foreigner had to be treated "according to ordinary standards of civilization". As is well-known, the 'standard of civilisation' meant 'as the West wanted'.

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56 For example, Lillich, supra, p. 17–21.
57 Ibid.
58 See, Root’s speech when receiving the Nobel Peace Prize (available at https://www.nobelprize.org/prizes/peace/1912/root/lecture/): “Plainly, the next advance to be urged along this line is to pass on from an arbitral tribunal, the members of which are specifically selected from the general list of the court for each case, and whose service is but an incident in the career of a diplomatist or a publicist, to a permanent court composed of judges who devote their entire time to the performance of judicial duties and proceed in accordance with a sense of judicial obligation, not to adjust or compromise differences, but to decide upon rights in accordance with the facts and the law.”
59 Newcombe and Paradell, supra, p. 14, supporting this and the two previous sentences. See also, footnote 73, where they cite five arbitral awards from the time that assert the minimum standard of treatment.
THE REVIVAL OF THE INVESTMENT LAW SYSTEM AND NEW JUSTIFICATIONS

One key struggle during decolonisation was over the amount of compensation foreign investors would receive in instances of expropriation. Many foreign investors had established themselves in the colonies during the colonial era. After independence, their host countries often resorted to nationalisation in order to seize control over their natural resources.60 Initially, the investors and their home states opposed this by reference to the legal principle of ’acquired rights’.61 In addition, France, the Netherlands and the United States concluded agreements to guarantee that rights established during the colonial era should be respected.62 The British similarly attempted to insert clauses protecting their property in the constitutions of countries that were about to become independent.63 The point was to preserve the privileges established under the colonial period. A first attempt to regulate foreign investment in the interests of developing countries was made in the proposed International Trade Organization.64 But the West did not accept ceding control over investment regulation.65 Another attempt was made by developing states to attain better control over the regulation of foreign investment in the context of the project for a New International Economic Order (NIEO) in the 1960s and 1970s.66

A key question concerned the compensation that a host country (almost invariably from the Third World) should pay to foreign investors. The United States had long argued for the so-called Hull Rule; namely that compensation was to be “prompt, adequate and effective”.67 This was furiously resisted by the developing world which believed that compensation – in the case that it should be paid at all – should be in accordance with domestic law. This led to a series of ad hoc arbitration cases in which the applicable standard was formulated in various different ways, depending on the composition of the tribunal. Sometimes, a tribunal oriented towards the

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60 Many investments – such as oil concessions in Kuwait, investments in gold in Ghana, and Ruby mines in Burma – were established in ways that attempted to freeze the unequal power relations of the colonial era. These examples are taken from M. Sornarajah, The International Law on Foreign Investment (Cambridge University Press, 4th edition, 2017), pp. 48–50.
63 Zemanek, supra, pp. 191–2.
64 This was a forerunner to the GATT (later the WTO) that largely viewed the developmental interests of the Third World to be having capacity to regulate FDI. This was also a key reason why it was in the end not accepted by the United States.
65 See, for example, Thomas L. Brewer and Stephen Young, The Multilateral Investment System and Multinational Enterprises (Oxford University Press, 1998), p. 66 et seq.
66 For some overviews of this project, see Mohammad Bedjaoui, Towards a new international economic order (United Nations and Holmes and Meier Publishers, 1979) and the contributions in Kamal Hossain (ed.), Legal Aspects of the New International Economic Order (Frances Pinter, 1980).
67 Newcombe and Paradell, supra, p. 18.
interests of the Third World might use a standard such as ‘equitable compensation’. In other instances, arbitrators rejected this, since it was not supported by “any of the developed countries with market economies which carry on the largest part of international trade”. Western countries found this situation deeply unsatisfactory. Hence they moved towards seeking protection via bilateral investment treaties and eventually via the conclusion of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the ICSID Convention) within the legal framework of the World Bank.

The ICSID Convention and the system of bilateral investment treaties that it administers was created through modification of international commercial arbitration, a legal practice that allows companies to settle disputes expediently and outside the courts. In this form of arbitration, ‘party autonomy’ is the guiding principle, meaning inter alia that the parties can only be sued where they have so agreed. Such arbitration principles are then enforced through a set of international rules, in particular the New York Convention. Many of the early arbitration cases against states over foreign investment were performed under contracts that contained arbitration clauses between states (or state agencies) and companies. However, it is unclear whether Article I of the New York Convention, which states that it applies to “persons, whether physical or legal”, was also intended to apply to states. Much of the documentation of the preparatory phase suggests that it was not. However, arbitral lawyers have interpreted this convention as being applicable to relationships between companies and states. This means that many investment awards, including those made by the International Chamber of Commerce, are enforceable against states. The ICSID Convention also draws on party autonomy as provided under the New York Convention. This endows foreign investors with much more extensive rights than they are afforded under most constitutional systems.

Former Secretary-General of the ICSID, Aron Broches, was the key architect of the ICSID Convention. His idea was to enlist developing states by proposing that this convention would not establish substantive rules. Instead, it would merely provide a framework whereby states and investors could consent to arbitration. While this was not clear at the time, we now know that

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70 Alex Mills, Party Autonomy in Private International Law (Cambridge University Press, 2018) constitutes a good overview.
71 For an overview commenting the New York Convention, see Herbert Kronke, Patricia Nacimiento, Dirk Otto, and Nicola Christine Port (eds.), Recognition and Enforcement of Foreign Arbitral Awards – A Global Commentary on The New York Convention (Kluwer Law 2010).
72 This is discussed in some detail in Rönnelid, infra, pp. 81–6, with further references i.a. to prepartatory works.
Broches had already made plans to connect a powerful enforcement system in the ICSID Convention – the "machinery" as he called it – to investor rights in bilateral investment treaties (BITs). The ICSID Convention was a part of an institutional package to solve what he called the problem of "the unfavourable investment climate." By this, he seems to have meant the project for a NIEO.

Western states relied on Broches, who was formally a neutral public servant in the World Bank to pursue their investment protection agenda. Broches framed his proposal so as to appear in the mutual interest of states exporting and importing capital. For example, he refrained from using the term 'investor rights' because such a formulation would have made it much harder to gain acceptance for the ICSID Convention. To this day, the idea of investment law as ameliorating the 'investment climate' still dominates World Bank thinking.

The idea of a 'better investment climate' as a route to economic development came to prominence in legal and economic circles after the Second World War. It was particularly stressed by the neoliberal economist Wilhelm Röpke, who was advising the German Government at the time when it launched the world’s first programme for investment insurance and BITs. Röpke wanted to achieve a certain type of "depoliticisation" of the economy. This meant in particular limiting the state’s capacity to plan, which they connected with authoritarianism. Röpke and his colleagues aimed to achieve an arrangement in which the sovereignty of the state was reduced in order to provide space for what he called the "sovereignty of the market." This would be a similar type of institutional setup to the one achieved by the British Empire during the period of Indian Law 47 (2009) [hereinafter referred to as "Lowenfeld"], p. 51.

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77 ICSID, Convention on the Settlement of Investment Disputes between States and Nationals of Other States: Documents Concerning the Origin and the Formulation of the Convention (Washington, D.C., 1968), vol. II (in two parts) [hereinafter referred to as "ICSID, Documents Concerning the Origin"], p. 73.

78 For example, Aron Broches, "Settlement of Disputes Arising out of Investment in Developing Countries", 11 International Business Law 206 (1983), p. 209, gives insights in Broches views on the NIEO.

79 See for example the thinking of the US negotiator, Lowenfeld, supra. See also, St John, supra, p. 153 et seq.

80 St John, supra, p. 146.


82 For his role as an advisor, see Ralf Ptak, "Neoliberalism in Germany" pp. 98–138 in Philip Moriwski and Dieter Plehwe (eds.), The Road from Mont Pèlerin: The Making of the Neoliberal Thought Collective (Harvard University Press, 2015) [hereinafter referred to as "Ptak"], at p. 121. For his extraordinary influence, see e.g. Michel Foucault, The Birth of Biopolitics – Lectures at the Collège de France 1978–1979 (Palgrave Macmillan, 2004), p. 104 arguing that Röpke’s trilogy on economic order was read as "a kind of bible" by German ordoliberals.

83 Wilhelm Röpke, "Economic Order and International Law", 86 Recueil des cours de l’Academie de droit international de la Haye 203 (1954) [hereinafter referred to as "Röpke, Economic Order"], pp. 224, 225, 237, and 241. In the text he calls these concepts "politicisation" and "depoliticisation", but no substantive difference seems to have been intended. See further, Razeen Sally, Classical Liberalism and International Economic Order (Taylor and Francis, 1998), p. 135.

84 See also e.g. Ptak, supra, p. 104, giving further sources. For the similar line of reasoning in the Hayekian rule of law, see the discussion in the next section.

85 Röpke, "Economic Order", supra, p. 224 et seq.
the nineteenth century. Under his ideal type of rule of law, property was protected and contracts were enforced, but states had a low capacity to regulate the economy.86 He was particularly interested in enlisting lawyers in his campaign to limit sovereignty.87 This was also similar to what he recommended for “undeveloped” states. The only way that these countries could attract foreign direct investment (FDI), he believed, was to provide adequate legal safeguards for it.88 Investor rights were portrayed as a solution in the mutual interest of capital-exporting and capital-importing countries. In due course, such ideas became commonly accepted among international lawyers specialising in investment matters.89

Since the ICSID Convention was based on a framework requiring consent from the host state, much of the discussions during the drafting concerned this question. Developing states, which were the ones that in practice could be sued due to the setup, were noticeably worried about this prospect.90 One delegate asked whether Broches was trying to create a new capitulations regime, and was answered in the negative.91 Instead, Broches insisted that strong enforcement provisions in the ICSID Convention were for the benefit of (the mostly developing) host states, that would then be in a position to enforce rights against investors.92 In practice, however, the system has almost exclusively been used by investors.93 When asked how consent could be given to the ICSID Convention, Broches mentioned two ways. Either it could be given before a dispute had arisen (such as in the disputes discussed above) or by mutual agreement after the dispute.94 While this is how

**By leading the states into a commercial arbitration-type arrangement, Broches tied their hands in advance.**

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87 Thus he argues the following to the young upcoming international lawyers attending the prestigious Hague Academy course, Röpke, “Economic Order”, supra, p. 250: “To diminish national sovereignty is most emphatically one of the urgent needs of our time. But the excess sovereignty should be abolished instead of being transferred to a higher political and geographical unit. […] A mere shift in the seat of sovereignty not only leaves the problem of its over-dose unsolved, but it even makes it worse.”


90 ICSID, *Documents Concerning the Origin*, supra, p. 501, arguing that the system might “permit the supremacy of the legislature to be challenged”. See also Broches reply to this on the same page.

91 Id., p. 500.

92 See, for example id., p. 379, where Broches “emphasized the fact that the question of the enforcement of awards had been included in the draft Convention mainly for the benefit of the developing countries that were thus given a means to enforce awards in their favour against foreign investors”.


94 ICSID, *Documents Concerning the Origin*, supra, pp. 335–6: “The Chairman said that as to the time when the obligation arose, there were
commercial arbitration works, in public international law, consent to arbitration is usually given only after a dispute has arisen.\textsuperscript{95} This enables the state in question to assess the appropriateness of arbitration for the case. By leading the states into a commercial arbitration-type arrangement, Broches tied their hands in advance.\textsuperscript{96} Despite efforts by a number of states to remove the possibility of advance consent,\textsuperscript{97} Broches reinserted the possibility for advance consent a final report.\textsuperscript{98} According to the American negotiator Andreas Lowenfeld, this change in the meaning as compared to how the ICSID Convention was discussed constituted a "subtle hint", which in the end gave rise to a "transformation" of this convention.\textsuperscript{99}

After the drafting, Broches was appointed the ICSID's first Secretary-General. In this capacity, he worked tirelessly to spread information about the convention and convince states to give advance consent to arbitration to resolve disputes. He even formulated 'model clauses' instructing states on how to give consent in contracts and legislation.\textsuperscript{100} Eventually, Broches also started to propose granting advance consent to arbitration in individual BITs.\textsuperscript{101} His activity in this respect was essential to the gradual spread of this practice.\textsuperscript{102}

At the end of the 1980s the number of BITs – most of them with advance consent to arbitration – started to increase rapidly. The 1990s then witnessed a real 'BIT boom'.\textsuperscript{103} To a large extent, this can be attributed to the fact that key institutions within the World Bank Group started to portray investor rights as a kind of rule of law or 'good governance'.\textsuperscript{104} Moreover, the United Nations Conference on Trade and Development (UNCTAD) began to argue that investor rights were a useful route to economic development and brought together numerous developed and developing countries to sign BITs en masse.\textsuperscript{105} Implementation of investor rights was considered a key part of rule of law reform and it was taken into the World Bank's structural adjustment programmes

\textsuperscript{97} ICSID, Documents Concerning the Origin, supra, p. 879, where the reference is removed. The proposals to do so can be found on pp. 835–9. No formal vote of this question seems to have been taken, see Schreuer et al., supra, p. 192, para. 383.
\textsuperscript{98} Id., p. 956. In this report he also added the possibility to give advance consent in legislation.
\textsuperscript{99} Lowenfeld, supra, p. 56–7.
\textsuperscript{100} This is described in some detail in St John, supra, p. 183 et seq.
\textsuperscript{101} These were proposed in ICSID, "Model Clauses Relating to the Convention on the Settlement of Investment Disputes Designed for Use in Bilateral Investment Agreements", September 1969, reprinted in 8 International Legal Materials 1341 (1969).
\textsuperscript{102} St John, supra, p. 198 et seq.
\textsuperscript{103} See, for example, Newcombie and Paradell, supra, p. 48.
\textsuperscript{104} Much of the work connecting investment treaties to this rhetoric was done by Ibrahim Shihata, who was ICSID's second Secretary-General. See, for example, Ibrahim F.I. Shihata, Legal Treatment of Foreign Investment: The World Bank Guidelines (Martinus Nijhoff Publishers, 1993). For an important discussion, see Tor Krever, "The Legal Turn in Later Development Theory: The Rule of Law and the World Bank's Development Model", 52 Harvard International Law Journal 288 (2011).
\textsuperscript{105} For a good overview of how this came about, see Lauge N. Skovgaard Poulsen, Bounded Rationality and Economic Diplomacy – The Politics of Investment Treaties in Developing Countries (Cambridge University Press, 2015), p. 92 et seq.
in the aftermath of the international debt crisis. When using the term rule of law, these institutions typically meant strong protection for property rights and a high degree of contractual enforcement.

During the beginning of the BIT boom, the first ISDS arbitral award originating in BITs was handed down. This award relied heavily on Broches’ report, mentioned above. The arbitrators interpreted the consent given in a BIT as an offer which could be taken up at any time by an investor. Since this case, arbitral tribunals have followed this jurisprudence in a way that has been called a ‘silent revolution’. International investment lawyers call this system ‘arbitration without privity’. It combines the traditions of arbitration and public international law that are the most beneficial for the investor. The state grants consent to the investor in advance but can typically only litigate against the investor where the latter grants a specific permission. Also, the host state is not entitled to revoke its consent, since the investor rights are also owed to another state. The arbitral tribunal that created arbitration without privity in BITs also applied substantive investment law. It relied on the above-discussed Venezuelan claims commission (which acted under duress), to interpret the standard of ‘full protection and security’. Both procedurally and substantively, investment law now in several ways resembles the commercial treaties of the nineteenth century.

It is worth underlining that this development differs markedly from the way rights and obligations of investors have developed at the national level. During the post-war period, many countries sought to develop a balance between investor rights and obligations. In most European states, for example, rights for corporations were combined with responsibilities. Where property rights were granted, these came with concomitant obligations, such as obligations with respect to taxation, labour rights and environmental protection. As compared to the international developments, where these obligations are often non-binding or a matter of autonomous acceptance, these national rules were typically mandatory. The combination of company rights and obligations can, in a way, be said to constitute the typical democratic compromise in most European countries.

110 Also, some tribunals have accepted counterclaims by the state, where the investor has already initiated arbitration.
111 The AAPL case, supra., para. 47 et seq.
Several justifications have been made to support the current system of ISDS. This section of the report will look closer at three of them – the arguments about economic development, depoliticisation and rule of law. Traditionally, the risks of granting investors extensive rights have rarely been discussed. Most participants in this debate have been supporters of the system. Perhaps this is not surprising because they have also, typically, been interested in taking part in the legal practice. Researchers with no direct connection to investment law practice have, however, discussed the risks to the states involved. In the second part of this section, three types of such risks will be discussed. These are the risk of ‘regulatory chill’, the risk that the democratic compromise will not be achieved and the risk that these types of agreements will support and entrench asymmetrical economic relationships between the European Union and Third World countries.

The type of limitations to state sovereignty that investment law imposes are, to a large extent, justified by the above-mentioned economic thinking that became dominant during the 1990s. Investment law is understood as a route to economic development. The European Commission appears to rely on this kind of thinking, as do many investment lawyers. This way of thinking often takes the form of arguments that growth will come about through adopting standards of rule of law or good governance. The prevalence of these ideas among investment lawyers can also probably be explained by the fact that the BIT boom of the 1990s took place at a time when such ideas were widely accepted among economists. In a sense, one can say that the small group of investment lawyers that constructed the regime were co-creators of these ideas. They created rules that mirrored the economic thinking of the time by interpreting BITs and the ICSID Convention to create the silent revolution and established and legitimated the concept of arbitration without privity. As a result, the investment regime came to limit the types of regulation that could be imposed on investors. At the time, many economists thought this was wise economic policy.

114 See further, Rönnelid, supra, in particular p. 346 et seq.
115 This concept and its emergence is discussed in the previous section.
Among present-day economists, however, these ideas are much debated. After all, the most successful countries of the post-war era in terms of economic growth – in particular South Korea and Taiwan – followed policies that were clearly in contravention of such economic prescriptions.116 Similarly, countries which have later been able to retain more policy space with respect to FDI, in particular China, have enjoyed better economic outcomes than essentially all other countries. Furthermore, countries that followed the prescriptions closely have often fared poorly.117 Findings such as these have contributed to shifting the economics profession away from the previously dominant modelling towards more empirically-grounded approaches.118 In fact, the old paradigm has almost disappeared within the economics profession. The new line of economic thinking, based less on modelling and more on real-world cases of economic success, shows a greater diversity of approaches. This suggests that since there are few economic policies that are good over the board, there is a need for context sensitivity and adaptation to the needs of particular countries.119 However, the older ideas are still strong within the investment-law community. The fact that investment lawyers believe science is on their side might partly explain the hostile tone in their responses.120

While economic arguments might already have taken too much space in the discussion on investment law, it might nevertheless be worth quickly repeating the evidence as to the economic value of granting additional investor rights. Numerous summaries of the available econometric evidence indicate that evidence is uncertain as to whether treaties with investor rights are attracting more FDI to countries that sign them.121 This is well-known among investment lawyers. However, lawyers have less often examined the (probably more important) studies on whether FDI actually contributes

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116 The clearest examples of this are the policies of the spectacularly successful South Korean and Taiwanese economies. The classic case studies of these strategies are Alice H. Amsden, Asia’s New Giant – South Korea and Late Industrialization (Oxford University Press, 1989) and Robert Wade, Governing the Market – Economic Theory and the Role of Government in East Asian Industrialization (Princeton University Press, 2nd edition, with new introduction, 2004).


118 A good discussion on the previously dominant economic paradigm can be found in Reinert, supra.


121 For a discussion and numerous references, see Bonnitcha, Poulsen and Waibel, supra, pp. 155–66. See also, in particular with respect to developing countries, Liesbeth Colen, Miet Maertens, and Johan Swinnen, “Determinants of foreign direct investment flows to developing countries: the role of international investment agreements”, pp. 116–137 in Olivier De Schutter, Johan Swinnen and Jan Wouters (eds.), Foreign Direct Investment and Human Development: The law and economics of international investment agreements (Routledge 2013).
Evidence is uncertain as to whether treaties with investor rights are attracting more FDI to countries that sign them to economic development, typically measured as growth. This proposition is anything but certain. It is quite possible that the type of FDI that typically enters the economies of rich countries might be beneficial. However, this still requires that the type of investment that is actually attracted due to increased investor rights will be of the beneficial kind. So far, there is no indication that this would be the case. Furthermore, one has to keep in mind that the differences between studies in this area seem to indicate a high degree of uncertainty in econometric research. Lastly, it is by no means clear that FDI with additional investor rights is equally as beneficial to the economy as other FDI (even where such FDI would be beneficial without investor rights). It is useful to remember that the most successful development strategies of the twentieth century have relied on policy tools that standard BIT protection would not allow. Much recent research highlights the role of the regulatory powers of the state in enhancing the productivity of the market in developed economies as well. By contrast, little evidence can be cited to support the economic case for leaving markets wholly unregulated. Moreover, not all of the criticisms against the investment regime are based on economic arguments. For example, one might favour a national capacity to regulate the economy for reasons of democratic self-governance. In any case, measures to combat climate change will require significant public interference in markets that might be complicated by onerous duties towards foreign investors.

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123 However, not even that seems clearly supported. See, for example, Jorge Bermejo Carbonell & Richard A. Werner “Does Foreign Direct Investment Generate Economic Growth? A New Empirical Approach Applied to Spain”, 94(4) Economic Geography 425 (2019).

124 The only study I know of which looks into which type of FDI that is attracted by ISDS is, Liesbeth Colen and Andrea Guariso, “That type of foreign direct investment is attracted by bilateral investment treaties?”, pp. 138–156 in Olivier De Schutter, Johan Swinnen and Jan Wouters (eds.), Foreign Direct Investment and Human Development: The law and economics of international investment agreements (Routledge 2013), which finds on p. 156: “Overall, our results suggest that BITs do not attract the most development-enhancing FDI.”

125 For example, the South Korean development strategy used expropriation to start controlling credit. The Taiwanese strategy relied on selective protectionism to support certain national investors. The Chinese strategy has made heavy use of public-private partnerships in order to force technology transfer. All these strategies were selective in that they only looked for certain types of FDI and relied heavily on performance requirements. This is discussed extensively in Rönnelid, supra, p. 367 et seq.

126 A recent influential example is, Mariana Mazzucato, The Entrepreneurial State: Debunking Public vs. Private Sector Myths (Anthem Press, 2013). See also, for an older famous contribution, Bengt-Åke Lundvall, National Systems of Innovation: Towards a Theory of Innovation and Interactive Learning (Pinter Publishers, 1992).


128 For this type of argument in international law, see Martti Koskenniemi, “What Use for Sovereignty Today?”, 1 Asian Journal of International Law 61 (2001), in particular p. 68 et seq.
The second justification which is often invoked in defence of investment law is that it is alleged to ‘depoliticise’ disputes. The meaning of this argument is not always clear. Sometimes it seems to mean that questions of foreign investment should be treated as legal questions rather than political ones.\(^{129}\) It will be recalled that the use of lawyers to reduce the state’s planning capacity was a key strategy for Röpke who advised the German government during the creation of the first BIT programme. Depoliticisation, in his thinking, was aimed at reducing what he called “excess sovereignty”.\(^{130}\) The assumption among investment lawyers seems to be that while regulation by the state is political – a commitment not to regulate is not political. While the former is presented as subjective, the latter is somehow considered as objective and neutral.\(^{131}\) It is typical that concerns brought forward, for example by local investors, are labelled as merely political while concerns of foreign investors would not be.\(^{132}\)

In other instances, depoliticisation is argued to mean that investment disputes should be settled as a matter of law as opposed to the gunboat diplomacy of the past.\(^{133}\) However, it should be recalled that the gunboat diplomacy of the nineteenth century was often aimed precisely at forcing arbitration. When Western states agreed to abolish the use of force to collect what they considered to be debt under the Drago-Porter Convention, it only applied where the other state instead agreed to arbitration under rules that resemble those of the investment law of today.\(^{134}\) Also, as mentioned above, this resemblance between present-day investment law and the informal empire of the past at least in part springs from the fact that tribunals have relied on rules created through arbitrations forced by gunboat diplomacy.\(^{135}\) Thus, ISDS achieves what gunboat diplomacy aimed at, but without having to invest in the guns and the boats.

A third justification often advanced, is that ISDS contributes to the rule of law. This argument is somewhat deceptive, as the concept of the rule of law is rarely defined precisely. One can better understand the meaning this expression has taken on in investment law vocabulary when one understands the kind of thinking that has influenced the investment regime. The objective is policy stability and foreseeability for the investor. This aligns with the thinking of Hayek. He believed that

\(^{129}\) For example, Schreuer et al., supra, at pp. 346 and 347.

\(^{130}\) Röpke, “Economic Order”, supra, p. 250.

\(^{131}\) Schreurer et al., supra, p. 346: “These disputes are transferred from the political bilateral arena to a judicial forum especially charged with the settlement of mixed investor-State disputes. The dispute settlement process is depoliticized and subjected to objective legal criteria.” See also Ibrahim F. I. Shihata, “Towards a Greater Depoliticization of Investment Disputes: The Roles of ICSID and MIGA”, 1 ICSID Review – Foreign Investment Law Journal 1 (1986) [hereinafter referred to as “Shihata”], p. 12 arguing that “ICSID’s fundamental objective to ‘depoliticize’ the resolution of investment disputes (by affording both States and investors access to a truly neutral forum and precluding the investors’ countries from intervening in the meanwhile”.


\(^{133}\) Schreurer et al., supra, p. 187: ‘One of the Conventions’ objectives is to depoliticize disputes. This objective is expressed most clearly in Art. 27 prohibiting diplomatic protection in favour of the investor.” See also e.g. David A. Soley, “An Effective Alternative to International Conflict”, 19 The International Lawyer 521 (1985).

\(^{134}\) Luis M. Drago, and H. Edward Nettles, “The Drago Doctrine in International Law and Politics”, 8 Hispanic American Historical Review 204 (1928), p. 221, citing the text of the Convention

\(^{135}\) For example in the first arbitration interpreting a consent in a BIT as a standing offer to arbitrate, discussed in the previous section.
planning of the economy is "arbitrary" and connected "planning" with what he referred to as the authoritarian systems of nazism and communism. For him, every step towards planning the economy meant a step towards the arbitrariness of authoritarianism. Hayek’s argument thus also seems to have been directed against systems with moderate amounts of planning, such as the social democracy of the era in which he lived. Hayek wanted to limit the state’s role to upholding property rights, enforcing contracts and making sure that the market operated in a way that was predictable for individuals. He also considered inequality an inevitable effect of this system.

Several commentators have noted the similarity between Hayekian rule of law and the way investment lawyers have interpreted key standards in BITs. This seems correct in the sense that investment treaties do serve to grant property rights and to impose foreseeability for the investor. Investment lawyers also argue that the fair and equitable treatment (FET) standard serves to uphold the rule of law, despite the great variability of this standard in practice. By way of example, this is how the tribunal in the Tecmed case interprets a fair and equitable treatment obligation:

"The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations. Any and all State actions conforming to such criteria should relate not only to the guidelines, directives or requirements issued, or the resolutions approved thereunder, but also to the goals underlying such regulations. The foreign investor also expects the host State to act consistently, i.e. without arbitrarily revoking any preexisting decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities."

137 For example, id., p. 59.
138 Id., p. 148: “There is no other possibility than either the order governed by the impersonal discipline of the market or that directed by the will of a few individuals; and those who are out to destroy the first are wittingly or unwittingly helping create the second.”
139 Id., p. 60.
140 Id., p. 59: “A necessary, and only apparently paradoxical, result of this is that formal equality before the law is in conflict, and in fact incompatible, with any activity of the government deliberately aiming at material of substantive equality of different people, and that any policy aiming at a substantive ideal of distributive justice must lead to the destruction of the Rule of Law.”
143 Tecnicas Medioambientales Tecmed S.A. v. The United Mexican States, Award of 29 May 2003, ICSID case no. ARB (AF)/00/2 available at
Several other tribunals have relied on this case in their own interpretations. However, there are also other ways to interpret the FET standard. The differences in investment law practice might in themselves be considered a defect from the point of view of certain interpretations of the concept of rule of law. While it is easy to see why a company might want a high degree of foreseeability, it is not clear from a societal standpoint that it is wise to grant it. A hint in this direction could be that no democratic legal system upholds such a standard. It is not included in domestic legislation because it effectively transfers the risk of doing business from the investor to the state. In fact, an investor-friendly understanding of the FET standard will make it possible for the investor to pressure state authorities to refrain from regulating in a way that might affect the investor’s operations. For example, environmental legislation designed to keep up to date with the findings of scientific research might become difficult to adopt.

The inability to adopt environmental regulations can be considered an example of what is often called regulatory chill. Regulatory chill means that a government will refrain from taking policy measures that might go against investor rights. This empowers investors to threaten litigation and ultimately prevent policy changes. While it is difficult to prove that an intended policy change did not take place due to fear of litigation from investors, there is still anecdotal evidence to support that regulatory chill is real phenomenon. For example, the decision to withdraw elements of an attempt to ban open-pit mines in Indonesia seems to have been prompted by the risk of litigation involved. Similarly, the Canadian decision to retract a proposed ban on the gasoline additive MMT seems to have been prompted by the risk of investment litigation. On a more general level, it would seem hard to deny that investment law is constructed so as to avert certain types of government action. It is also obvious that many of the investor

Shifting power from public decision makers to lawyers who are called upon to screen different proposals for their compatibility with investment law


rights that exist – which the European Commission pushes to expand massively in a modified form – are vaguely formulated. The fair and equitable treatment concept is just one example. There is often scope for the investor to use the vagueness of the relevant concepts and expressions to assert additional pressure on state authorities.\textsuperscript{151} This makes the problem worse, since it is hard to know how a tribunal will chose to interpret the FET standard, for example, in a particular case.

The country that has been subject to much FDI with investor rights, and whose situation therefore might resemble that of European countries the most closely, is Canada. One study has looked into how the ISDS mechanism for dispute resolution under the North American Free Trade Agreement (NAFTA) has affected decision making through interviews with public servants in the ministries of Ontario. The study finds that the way ISDS comes into play is through shifting power from public decision makers to lawyers who are called upon to screen different proposals for their compatibility with investment law.\textsuperscript{152} Litigation risk was taken into account in these reviews, which sometimes took place throughout the different stages of work on the legislative proposal.\textsuperscript{153} The internal advice by such lawyers was critical, though not always decisive.\textsuperscript{154} Some interviewees considered that this made it harder to advance proposals on environmental policy.\textsuperscript{155}

Another risk of the proposed expansion of a modified version of the investment regime is that it might make it impossible to achieve the democratic compromise at an international level. The European Commission’s proposal is built upon the concept of arbitration without privity, thus replicating a type of regulation which only grants rights to investors and obligations to states. As discussed above, this differs from the effort within most EU Member States to balance investor rights with investor obligations. Yet, the Commission’s proposal only gives investors additional rights as well as powerful procedural avenues to enforce these. The state or the local community affected by the operations of the investor will have no possibility to make claims against the investor and will not be granted new international rights. The proposal is unbalanced in a way that would be difficult to conceive in a democratic domestic setting.

For most Member States, this has not caused big problems so far. This is due to the fact that a clear majority of the BITs currently in place are with countries that do not export capital to the EU, rather in practice they export capital to developing states. Thus, while the treaties are formally reciprocal, they mostly seek to protect European investors in developing countries and have not led to de facto limitations of the regulatory power of the European Union. But as investor rights are now created for countries that do export capital to the European Union – such as Canada, the United States and Singapore – this completely changes the picture. If investor rights are already granted at this early stage without the concurrent imposition of investor obligations, this might prove very difficult to alter later on. The better solution would be to construct a balanced system from the beginning. This is further discussed in the section on possible solutions.

Finally, it is not clear that the globalisation of this one-sided system to favour investors is a wise solution – and yet this is precisely what the European Commission seems to be aiming for in speaking about the CETA as a “gold-standard agreement”\textsuperscript{156} The economic evidence in this field is both contradictory and uncertain. Different investment situations (for example, arrangements between developed states on the one hand and those between a developed and a developing state on the other hand, or between developing states themselves) surely need to be treated in different ways. As we have seen, had such regulation been in place in the past,

\textsuperscript{151} For a similar argument, see Martti Koskenniemi, “It’s not the Cases, It’s the System”, 18 Journal of World Investment & Trade 343 (2018), p. 351.
\textsuperscript{153} Id., p. 11.
\textsuperscript{154} Id., pp. 12–3.
\textsuperscript{155} Id., pp. 18–9.
\textsuperscript{156} See, for example, the joint statement by EU Trade Commissioner Cecilia Malmström met Minister of International Trade of Canada Chrystia Freeland, available at http://trade.ec.europa.eu/doclib/press/index.cfm?id=1483.
it would have distorted some of the most successful development strategies. In the course of the years, the United States employed a number of policy measures that would seem to have been outlawed under present-day BITs. When South Korea and Taiwan went from being poorer than Sub-Saharan Africa to upper-middle income countries, they made use of FDI in ways that would be impossible under a standard BIT. Similarly, China took a cautious approach to BITs during all of its spectacular development journey. It particularly, it emphasised its “sovereign right to regulate investment” which it used actively. As the Chinese development strategy was to a large extent based on the use of FDI, its policy choices should probably serve as inspiration to other developing countries. If EU investment regulation is replicated in relationships with developing countries, the approaches to investment and development that were successful for China, Taiwan and South Korea would be distorted or outlawed.

Had such regulation been in place in the past, it would have distorted some of the most successful development strategies

157 Bonnitcha, Poulsen and Waibel, supra, p. 225, citing several further sources.
There are many ways that EU law may come into conflict with ISDS provisions. Most of the debate so far, however, has concerned conflicts with the principle of autonomy of EU law. The doctrine of autonomy has a long history. It builds upon arguments about the inadmissibility of changes in the essential organisational structure of the EU treaties. This also affects the types of international agreements that the Union can conclude. The principle is central to the present report since the Court of Justice of the European Union (ECJ) considers at least some types of ISDS to be in contrast with it and, consequently, illegal under EU law. Many EU lawyers have also taken this view. Reasoning from the doctrine of autonomy has been used by the ECJ to deny the European Union accession to the European Court of Human Rights and the European Patent Court. However, additional information on the way the ECJ interprets compatibility of ISDS with EU law is now available through the seminal Achmea judgement from March 2018. After this ruling, it appears that there is an irreconcilable conflict between EU law and present-day investment law. Surveying the ECJ’s case law on the investment regime is not only important because it would seem to prohibit the present type of investment law, but also because it demonstrates the viewpoint of a legal actor which has been famously successful in asserting power through the law.

The Achmea judgement originates in a Czechoslovak-Dutch BIT. The Slovak Republic acceded to this treaty upon the dissolution of Czechoslovakia, before its accession to the European Union in 2004. In 2006 a partial privatisation effort of the health insurance market was undertaken by the Republic. After this, the Dutch investor Achmea started a company selling sickness insurance on the Slovak market. Through a change of its legislation in 2007, the Republic prohibited certain distribution of the profits generated on the sickness
The insurance market. Since the company considered the measures to have caused it damage, it initiated arbitration under the above-mentioned BIT.

In the Achmea arbitration, an arbitral tribunal operating under the Slovak-Dutch BIT found that the Slovak actions were in breach of the FET standard, as they had not been foreseen by the investor, in spite of the investors’ knowledge that far-reaching reforms were underway in the sector. The actions were also considered to breach the standard of free transfer of payments. The arbitral tribunal decided that the Slovak Republic should pay €22.1 million plus interest in compensation to Achmea. The Slovak Republic, however, argued that any such payment would contravene its obligations under the EU treaties. For this reason, the Republic tried to have the award annulled in German courts (as Germany was the place of arbitration). During these proceedings, the German Federal Court of Justice asked the ECJ for a preliminary ruling.

While noting that EU law takes precedence in the case of a conflict, the German Federal Court argued that the BIT was compatible with EU law. The ECJ's Advocate General Wathelet largely agreed with the German Court. Importantly, however, as the ECJ handed down its grand-chamber judgment in 2018, it became clear that it interpreted EU law in a markedly different way than the German Court and the Advocate General. In essence, the ruling held that ISDS was incompatible with several principles of EU law, above all the autonomy of the EU legal system, but also its effectiveness and the obligation to provide ways to ensure the uniform application of EU law. The award caused an uproar in the investment arbitration community and has already been the subject of much preliminary analysis.

According to the ECJ, international agreements establishing courts providing binding decisions are "not in principle incompatible with EU law." However, this requires that the autonomy of the European Union and its legal order is respected. Having stated that general principle, it then goes on to explain why the kind of investment arbitration provided for in the Dutch-Slovak BIT is incompatible with EU law. In particular, it refers to Article 19(1) of the Treaty on the Functioning of the European Union (TFEU) which obliges Member States to provide remedies sufficient to ensure effective legal
After Achmea it will be very hard indeed to find a plausible way of upholding any ISDS provision in EU agreements

protection in the fields covered by EU law. Effective protection requires, according to the ECJ, that the Court would preserve its power in all areas where EU law might operate. The argument would seem to cover more than ‘pure conflicts’ between EU law and other legal orders. By virtue of this connection to article 19, it seems that the ECJ intends the principles developed in this area to apply whenever EU law could come into play. This would, for example, mean that they apply with respect to areas covered by the investment chapter in CETA.

Another aspect which the ECJ brings up in its judgment is the consistency of EU law. It is worth underscoring that this type of consistency differs from the one the European Commission is aiming to advance, namely consistency in investment-law jurisprudence. The ECJ starts out by noting that the under Article 344 of the TFEU no other means of dispute resolution with respect to EU law are allowed apart from those of the treaty. Moreover, the ECJ notes that in taking account of EU law in its award, an investment tribunal would also necessarily rule on matters that “are liable to relate to the interpretation or application of EU law”. This also seems to have been the position of the European Commission as it has intervened in other investment arbitrations to stop payments considered to constitute unlawful state aid under EU law. If a matter relates to EU law in these ways, then the highest interpretative body must be the ECJ. And this does not seem possible under ISDS.

Only organs considered to constitute courts within the meaning of Article 267 of the TFEU are allowed to request preliminary rulings from the ECJ. The ECJ held that an arbitral tribunal in an investment arbitration cannot be considered a court. Consequently, this road towards ascertaining the uniformity of EU law is not open to investment tribunals. In this respect, the ECJ made a clear distinction between commercial arbitration and investment arbitration.

176 Achmea judgment, supra, para. 36. The two paragraphs of article 19(1) TEU read: “The Court of Justice of the European Union shall include the Court of Justice, the General Court and specialised courts. It shall ensure that in the interpretation and application of the Treaties the law is observed. Member States shall provide remedies sufficient to ensure effective legal protection in the fields covered by Union law.” The argument was a “newcomer” in the Court’s defence of the autonomy principle. See Harm Schepel, “From Conflict-rules to field pre-emption: Achmea and the relationship between EU law and international investment law and arbitration”, European Law Blog, 23 March 2018, available at https://europeanlawblog.eu/2018/03/23/from-conflicts-rules-to-field-preemption-achmea-and-the-relationship-between-eu-law-and-international-investment-law-and-arbitration/ [hereinafter referred to as Schepel].

177 Id., who is also arguing that it might be that this area covered by Union law is wider than the “application and interpretation of Union law”.

178 Id.: “In substance, CETA most definitely operates in a field covered by EU law, particularly the free movement provisions and bits and pieces of internal market law.”

179 Cf. the Commission factsheet, supra, p. 3.

180 Achmea judgment, supra, para. 32. Article 233 TFEU reads: “Member States undertake not to submit a dispute concerning the interpretation or application of the Treaties to any method of settlement other than those provided for therein.”

181 Achmea judgment, supra, paras. 39–40.

182 See the decision by the European Commission to stop the enforcement of the Micula award: Commission decision (EU) 2015/1470 of 30 March 2015 on State aid SA.38517 (2014/C) (ex 2014/NN) implemented by Romania — Arbitral award Micula v. Romania of 11 December 2013. All the other publicly available documentation in this complicated case can be found at https://www.italaw.com/cases/697.

183 Achmea judgment, supra, para. 49.

184 Some of the arguments also concern the “effectiveness” of EU law.

185 Achmea judgment, supra, para. 54.
case of investment law, however, the degree of review is to a large extent decided by the arbitral tribunal itself, since it often has the power to choose its own seat and consequently the applicable procedural law for review.\footnote{186} This, according to the ECJ, removes disputes that should be subject to judicial remedies under EU law from the jurisdiction of Member States.\footnote{187}

Achmea, as an investor, attempted to enforce its arbitral award in Germany. As with respect to most arbitral awards, the enforcing court had a limited possibility to review the award.\footnote{188} The ECJ noted that this level of review only extends as far as national law permits.\footnote{189} Such a lower level of scrutiny is, according to the ECJ, acceptable with respect to commercial arbitration, but not with respect to investment arbitration.\footnote{190} For these reasons, an investment tribunal such as the one in the Achmea case would not be in a position to ensure that disputes would be “resolved in a manner that ensures the full effectiveness of EU law.”\footnote{191} Effectiveness, on this reading, seems to be a precondition for autonomy.\footnote{192}

There is nothing in the Achmea judgment that indicates that it would only be applicable in the context of so-called intra-EU BITs.\footnote{193} Harm Schepel holds that “after Achmea it will be very hard indeed to find a plausible way of upholding any ISDS provision in EU agreements – and that includes CETA’s Investment Court System”.\footnote{194} Most EU law experts seem to be of the same view.\footnote{195} This would seem to indicate that ratification of the CETA agreement now would be in contravention of EU law.\footnote{196} Many experts seem to believe that the pending opinion by the ECJ on the compatibility of CETA with EU law will provide a death sentence for the investment chapter.\footnote{197} It would indeed be awkward if the ECJ were to accept ISDS in the CETA agreement while having declined the European Union accession to the European
Convention on Human Rights. It would of course be possible to try to renegotiate CETA in order to take the concerns of the ECJ into account, but the outcome of such negotiations must still be considered uncertain.199

According to the ECJ, its powers of review constitute a fundamental safeguard of the rule of law in the European Union to which domestic courts also contribute. It held in the context of EU sanctions in the Rosneft case that "the very existence of effective judicial review designed to ensure compliance with EU law is of the essence of the rule of law".200 This of course collides with the claim some investment lawyers have made that the Achmea judgment implies the demise of the rule of law in the EU.201 This would be correct if one believed that the rule of law was meant only to protect the investor. But surely it must equally protect the integrity of the legal system in which the investor operates. In the Achmea case, the ECJ regarded it as a fundamental aspect of the rule of law that the Member State’s regulatory powers were protected against intrusions by foreign investors. By contrast, the rule of law that investment lawyers preferred was the one that aimed to shield international economic operators from the state.202 These contrasting views show that mere reference to the rule of law hardly solves a jurisdictional conflict of this type.

Some of the cases against Spain concerning the re-regulation of the solar panel market constitute good examples of how these two different types of rule of law operate. Under the Renewable Energy Directive, each Member State is allowed discretion to set its own policy for transition towards less carbon-reliant economies.203 The Directive required Member States to set certain national targets and establish national action plans to ensure that these goals were met.204 Spain did so using a set of subsidies that were not required, but allowed, under the Directive. After a while, these subsidies were scaled back. This triggered a wave of claims against Spain under the Energy Charter Treaty (ECT), which includes an ISDS mechanism.205 This option was only open to foreign investors, thus putting Spanish investors at a disadvantage.

Some, but not all, of these arbitral awards under the ECT have been handed down. By way of example, in the Novenergia II arbitration, the tribunal found that there was no incompatibility between EU law and the ECT and even if such incompatibility were to exist, the ECT would prevail.206 In the award, the tribunal considered that Spain had breached the FET obligation in Article 10(1) of the ECT through its changed regulation.207 It awarded € 53.3 million in damages and legal costs of € 2.6 million, in spite of the fact that the investment was still profitable.208 It is worth underlining that

199 There are simply to many possible factors to take into account, including how the ECJ will view mixed agreements, how it will view a treaty negotiated by the EU as one entity, and how it will think of changes in a possible future ICS.
200 Case C-72/15 Rosneft, EU:C:2017:236, para. 73.
201 Lavranos, supra, states: “Whether or not one agrees with the commission’s approach, the fact remains that with the Achmea judgment, the level of investment and investor protection has been significantly reduced. This, in turn, will give member states more leeway to get away with expropriation or discriminatory measures against foreign investors without punishment. As a result, rule of law standards – which are already deteriorating in many parts of the EU – will be further weakened.”
202 This is for example evident in much of the discourse on “depoliticisation”, discussed above in sections 3. 4 and 5.
204 This is prescribed in detail in articles 3 and 4 of the Directive.
207 Id., paras. 662–681 (on that the Claimant had established a legitimate and reasonable expectation) and 682–697 (on that the measures were “radical and unexpected” and therefore breached the expectations).
208 Id., para. 860. The fact that the retained (but decreased) profitability did not change this breach in the tribunal’s view is discussed in
nothing in the Renewable Energy Directive explicitly required the particular measures taken by Spain. In one sense, therefore, there was no concrete conflict between these two systems of law. However, in another sense, the capacity to regulate the energy market was considered a fundamental precondition for carrying out the intended greening of the energy policy of the Union. When petitioned on the position of the Member States under the Renewable Energy Directive, the European Commission underlined this need for regulatory capacity: "Member States retain full discretion over whether they use support schemes or not and, should they use them, over their design, including both the structure and the level of support. This comprises the right for Member States to enact changes to their support schemes, for example to avoid over-compensation or to address unforeseen developments such as a particularly rapid expansion of a precise renewables technology in a given sector."\(^\text{209}\)

On the one hand, the BIT in question did not in a strict sense conflict with the Directive as EU law would probably have allowed the outcome that the Novenergia II arbitration under the BIT forced.\(^\text{210}\) On the other hand, one can think of the policy area established by EU law as a sphere of regulatory discretion mandated by EU law in order to achieve a goal deemed important. In this sense, the ECT probably applies in a sphere covered by EU law, as the ECJ had it in the Achmea case.\(^\text{211}\) From this point of view, the ECT seems to distort and diminish regulatory capacity in an area where EU law intended to assert it.\(^\text{212}\) In this sense, the discretion judged necessary by the European legislator for achieving goals of sustainable development was reduced through the interpretations adopted by the arbitral tribunal. That constitutes a sharp difference between these two types of rule of law.

In sum, the Achmea judgment probably prohibits the kind of ISDS inherent in present-day BITs. This prohibition is likely to apply to ISDS both in intra- and extra-EU situations. Only this would seem to safeguard the kind of European rule of law that the ECJ seems to regard as relevant. This is not to say that the reasons motivating the Court were identical with those that underlie the critique of ISDS by the European citizenry. Rather, it is likely that the ECJ has been predominantly motivated by the desire to safeguard the autonomy and coherence of EU law and protect it from outside interference. While it would seem difficult to draft new types of ISDS clauses that can take the Achmea case law into account, one cannot exclude that this can happen. Another option would be to rethink the system so that it allows for a regulatory setup in line with the central policy objectives of the European Union.


\(^{210}\) This important point is discussed in Niemelä, supra.

\(^{211}\) Achmea judgment, supra, para. 55.

\(^{212}\) For a similar type of reasoning, see Schepel, supra, who calls this "field preemption", drawing on a similar doctrine from Federal US law.
This section will look further into two alternatives to present-day ISDS mechanisms that have been discussed recently. The first one is the use of investment insurance instead of ISDS protection. The second is to craft the kind of democratic compromise within investment law that domestic laws have typically enacted. A push for investment insurance as an alternative to ISDS intuitively makes sense. Most insurance places the costs of the system on those buying insurance. An ideal insurance system typically spreads the costs of the risk onto the collective of actors paying for the insurance. By way of example, people with car insurance share the costs of the potential risk of damages to their cars. When a risk materialises, the payment of the damages is drawn from the resource pool of the insurer, who claims what remains of the funds collected from those who bought the insurance. Investment insurance, however, has come to work in a different way. In some instances, investment insurance reduces state sovereignty more than ISDS mechanisms.

Investment insurance has come to resemble ISDS mainly due to the way subrogation rights have come to be interpreted. Subrogation rights in much of insurance law constitute a common way for the insurer to recoup some of its losses from a third party who has caused, or contributed to, the loss. Through such a recovery, parts of the costs for the insurance can thus be shifted from the insurer to a third party. Where the full cost of the insurance can be transferred, the insurer in effect decides on how to transfer money from the third party to the investor. In the investment-law setting, this means a transfer from the host state to the investor. This explains why the early efforts to establish international investor rights came as much through insurance as through ISDS. It should be recalled that the first investment insurance programmes emerged at the same time as the first ISDS in BITs and were considered a part of the same strategy for depoliticisation.

In investment law, subrogation rights have been established by different means. Traditionally, the bulk of investment insurance came from state-backed investment insurance agencies. The two largest systems are the German investment insurance system and the US system administered through its agency the Overseas Private Investment Corporation (OPIC). These have both been central in enforcing investor rights on the international stage. In the German model, subrogation rights have been established in BITs. This approach has carried on to the present day. By way of example, the German model BIT from 2008 establishes these rights. Many countries have emulated this approach and it is also the one found in CETA, which is discussed further below. The US investment insurance agency OPIC, on the other hand, has separate treaties

213 A number of NGOs and some academics have proposed this.
214 Elsewise in national insurance, the function of subrogation is typically to prevent the insured from making a profit considered unjust or to shift costs between different insurers; see, John Lowry, Philip Rawlings and Robert Merkin, Insurance Law – Doctrines and Principles (Hart Publishing, 3rd edition 2011), pp. 370–1.
215 See, for example, Shihata, supra. This is discussed in section 3 above.
providing for subrogation. These differ in that they are often not reciprocal. The Multilateral Investment Guarantee Agency (MIGA) of the World Bank Group works in a similar way. The result of these subrogation rights is to further shift interpretive power of investment rules to actors with a clear interest in expanding the substantive rights at stake in order to sell their insurance products to national companies.

There is also a growing private investment insurance sector. Initially, this sector perceived itself to be in conflict with the public sector. This was partly due to the fact that the private sector had less capacity to recover losses from host states and thus charged more for its insurance. The recovery capacity of state-backed agencies and multilateral institutions arises from several sources. Powerful capital-exporting countries and central international organisations hold diplomatic power against weaker capital-importing states in particular for many reasons. Some of these take legal form. Such examples include the possibilities to withhold aid and preferential trade, or to vote against the granting of loans in multilateral institutions.

The techniques developed by public investment insurance agencies – called the ‘umbrella of deterrence’ or the ‘halo effect’ among practitioners – are advertised as a selling point by these institutions. Some interventions to safeguard the interests of investors take place before a regulatory or legislative action has materialised in order to avert the insured risk from even occurring. This capacity is sometimes considered more valuable to the investor than actual payment under the insurance. The German investment insurance scheme, for example, details many such instances in its annual reports. Furthermore, MIGA advertises its capacity to perform this type of actions, due to its status as a

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220 See, for example, the Investment Incentive Agreement between the People’s Republic of China and the US, Beijing 30 October 1980, reprinted in 19 International Legal Materials 1482 (1980).


224 For example, DeLeonardo, supra, p. 743.


227 These is often called avoidance techniques among insurance experts.

228 Sources showing that avoidance is more valuable than recovery for investors.

229 These are given almost in each yearly report. See for example, Investment Guarantees of the Federal Republic of Germany Direct Investment Abroad, “Annual Report 2012”, available at [https://www.investitionsgarantien.de/ Resources/](https://www.investitionsgarantien.de/ Resources/)
The first investment insurance programmes emerged at the same time as the first ISDS in BITs and were considered a part of the same strategy.

Other interventions triggered by investment insurance take place when the insured risk has already materialised, in order to recover losses. By way of example, when Indonesia privatised much of its power sectors, the foreign investors that received the contracts often bought investment insurance. These contracts were constructed in inventive ways so as to transfer money to the family and political allies of the then President Suharto. However, almost all the risks inherent in the structure were placed on the Indonesian government. These contracts remained in force when Indonesia transitioned to relative democracy. When the Asian financial crisis hit, these particularly inflexible contracts became completely commercially untenable. Under a commercial deal, the entity signing this type of contract would go bankrupt. However, this option was not open to Indonesia as a state. The hundreds of millions of USD paid out under a number of investment insurance contracts – one of the investors received USD 572 million for two projects – had to be paid by the Indonesian tax payers.

The possibilities to persuade and coerce host states into compliance or payment that state-backed insurers enjoy, initially did not exist for private insurers. However, as this sector was more flexible it could tailor insurance to the

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230 The numerous interventions that insurers have made constitute examples that in the ISDS debate would be called regulatory chill. Thus, for example, MIGA allegedly informed a Guyanese Member of Parliament that new environmental regulations in the wake of a cyanide spill would be considered “tantamount to expropriation” and thus trigger a guarantee. Investment insurance in Cambodia and Nicaragua is also reportedly used as a disincentive for regulatory action.


232 Id., p. 144 et seq., with the quote on p. 145.

233 Id. supra, p. 187.

234 This includes the possibility to initiate arbitration between the insurer and the host state in accordance with the BIT, an investment incentive agreement (in the case of OPIC), or under separate agreements for MIGA.


237 See id., for a detailed description of these outcomes. The investor that received a total of USD 572 million was first called CalEnergy; see further on the legal aspects, Rönnelid, supra, p. 293–304.
requests of investors. This at times could compensate for the lack of deterrence and recovery capacity. Moreover, two developments emerged that cured this lack. Firstly, the BIT boom enabled private insurers to use the investor to recoup losses. Often this is regulated in the insurance contract. Secondly, public and private insurers started to cooperate intensively, which enabled the public capacity to deter and recover to be shared with the private sector. Through reinsurance and coinsurance agreements, the two sectors in effect exchanged the umbrella of deterrence of the public sector for additional capital from the private sector.

At first, investment insurance was used to create acceptance for, and norms of, investor rights in the Third World. Later, it was used to create more expansive interpretations of these rights. This is the case in spite of the fact that subrogation should not, formally speaking, expand the duties of the host state. Where an insurance determination is performed through an arbitration between the investor and the insurer (subject to party autonomy), the host state cannot affect that determination. In practice, big state-backed investment insurers usually recover what they pay out to their insurers. This means that the costs in practice are transferred from the host state to the investor. This structure closely resembles the outcome of ISDS, but with the difference that in this setup the interpretative power is shifted to a legal relationship where the host state is not heard. Even in situations where the host state might be powerful enough to challenge the arbitration over the insurance determination, it is plausible that a later tribunal in an arbitration over the insurance payment will draw on the previous determination by the insurer or from the arbitration concerning it.

Investment insurance systems have developed in tandem with investor rights in BITs. The close connection between insurance and ISDS provides one explanation for why investor rights have come to be interpreted evermore broadly. In particular, OPIC seems to have

There is a need to uphold minimum levels of environmental and labour standards

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239 DeLeonardo, supra, p. 745. See, also for the flexible nature, Gordon, supra, p. 103: “All of the companies that discuss their contracting practices describe contracts that tailored to the needs of client’s business situation (many of them stress the ‘bespoke’ – or tailor made – element of the PRI products).”
240 Id., p. 757–60.
241 While these contracts are often confident, some standard wordings are available. See, for example, Noah Rubins and N. Stephan Kinsella, International Investment, Political Risk and Dispute Resolution – A Practitioner’s Guide (Oxford University Press and Oceana Publication, 2005), p. 551.
243 Heppel, supra, p. 155.
244 Shihata, supra, p. 20–1.
245 At least, this seems to be the case with respect to OPIC, MIGA and German investment-insurance scheme. Heppel, supra, p. 144 writes: “[M]any of them contribute handsome checks into their governments’ treasuries every year.”
247 For a good description of how these programs expanded partially in tandem, see Bonnitcha, Poulsen and Wailbel, supra, pp. 186–8. It is noteworthy that Dutch negotiators considered investment insurance more important the ISDS protection.
Furthermore, investor obligations could be directed towards strengthening the capacity to tax or to stop tax avoidance

contributed to this through new insurance products. The Canadian investment insurance agency has also taken the lead in creating public-private partnerships that extend enforcement power to private insurers. Due to the flexibility that this contractual form lends to these setups, new insurance products are created for insurers to better meet the needs of investors. These are seen by company lawyers and investors as parts of larger packages aimed at protecting the interests of investors against those of the host state. Furthermore, in the investment literature, lawyers strategise about how to best use the diplomatic power of OPIC in order to expand investor rights through ‘aggressive coinsurance’. As long as sovereigns or arbitrators do not put an end to this ‘product development’, the expansion of investor rights is likely to continue.

A similar type of development can be foreseen in the proposed FTAs of the European Union. In the CETA agreement, for example, Article 8.14 provides a right for subrogation for home countries and their agencies. There is, however, nothing in the construction of investment insurance itself that compels such restraints on sovereignty. In a system balanced along the lines of the democratic compromise, for example, one could imagine mandatory investment insurance, the proceeds of which could be used to indemnify aggrieved investors as well as parties with claims against investors. This pool of funds could then cover expenses where company structures shield bankrupt investors from paying for decontamination or to cover claims by aggrieved communities. Such a recalibration of the investment regime, however, would require a break with the existing tradition.

This brings us to the next solution, which is to replicate the democratic compromise at the international level. Such rebalancing requires a break with the tradition of arbitration without privity. This can be done in several different ways. In order to do so, however, two sets of questions have to be addressed: firstly, how investor obligations should be constructed, and secondly, which

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250 Moran and West, supra, p. 167 et seq. Moreover, the community of experts that shape the legal discussion on investment insurance nearly only comprise private insurers, brokers, and public servants of investment insurance agencies of capital-exporting countries.
252 DeLeonardo, supra, p. 782–3. See similarly, Bekker and Ogawa, supra, p. 346 on using this political power to enforce claims where international law is “unsettled”.
253 Johnston, supra, p. 135.
254 Article 8.14 has the heading Subrogation and reads: “If a Party, or an agency of a Party, makes a payment under an indemnity, guarantee or contract of insurance that it has entered into in respect of an investment made by one of its investors in the territory of the other Party, the other Party shall recognise that the Party or its agency shall be entitled in all circumstances to the same rights as those of the investor in respect of the investment. These rights may be exercised by the Party or an agency of the Party, or by the investor if the Party or an agency of the Party thereof so authorises.” The agreement is available at http://trade.ec.europa.eu/doclib/docs/2014/september/tradoc_152806.pdf.
255 For a discussion on the present inability of local populations to be heard, see Nicolás M. Perrone, “The international investment regime and local populations: are the weakest voices unheard?”, 7(3) Transnational Legal Theory 383 (2016).
groups will be given legal standing under such a system. These two questions will be discussed in turn.

There are many investor obligations that could usefully be added to investment law. Most acutely, there is a need to uphold minimum levels of environmental and labour standards. Furthermore, investor obligations could be directed towards strengthening the capacity to tax or to stop tax avoidance. This could be done by negotiating such obligations in each agreement separately. This might have the advantage of gearing the particular obligations to the needs of the particular relationship. For example, when the European Union creates agreements with countries that have a particular problem with tax avoidance, such obligations can be placed centre stage. Another way to do this would be to provide for investor obligations directly in the treaty establishing the MIC. Such an approach would provide less room to tailor obligations to the needs of the particular bilateral relationship. However, it would contribute to creating an international minimum standard.

A second question concerns who will have legal standing in the system. In national legal systems, investors are not the only parties that can initiate litigation. Under certain conditions, consumers, labour organisations, agencies, individuals and NGOs can also initiate litigation against companies. By providing additional litigation rights for investors – but not against them – the existing investment law tradition shifts the national balance in favour of one specific group; foreign investors. For this reason, rethinking of the investment regime along the lines of the democratic compromise would require instituting new litigation rights. If labour unions and environmental organisations could use the investment regime to assert rights against foreign investors, this would better constitute a democratic. In this respect as well, it is important that litigation rights should not be set in stone, rather it should be possible to modify them in the future. As in other democratically controlled systems, the EU legislator or national parliaments might want to have influence over which groups would be entitled to have legal standing against investors.

Investor rights ought to be made conditional on the presence of investor obligations and the right of representative groups to invoke them. Without achieving such a balance, investment law will be one-sided and undemocratic. If it were not agreed now, it might prove hard to restore it at a later stage. As long as the traditional international law rule on exhaustion of local remedies applied, one-sided investor rights were not too grave a problem. However, without it, a massive expansion of investor rights in the European Union will have substantial consequences for the democratic systems over time. If a balanced system turns out unachievable, it would be better not to grant the additional investor rights at all.

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257 In fact, the EU legislator has itself granted standing to new groups, such as environmental NGOs in order to achieve desired policy objectives.

258 For classic statement on this rule of international law, see Chittharanjan Felix Amerasinghe, Local Remedies in International Law (Cambridge University Press, 2nd edition, 2004).
This overview of the investment regime and its justifications has underlined some of the characteristics of present-day investment law. It is essential to understand that investment law builds on centuries-old legal ideas. During the period of colonialism it was, for the most part, enforced by the threat or use of force. The idea that some national legal systems are too unstable or simply not trustworthy has existed for centuries. It has been common for powerful states in those situations to lift the rules that concern their investors out of the ambit of domestic law. This has not taken place without resistance. There are many states that have developed with large amounts of FDI while at the same time refusing to let go of their capacity to regulate and not opting into the investment regime. Many of the policy measures taken by these countries would arguably have been more difficult or even impossible to achieve had these countries been subjected to the rules of investment law.

Of course, today’s investment regime came about through the consent of the parties involved. Nevertheless, what most states can reasonably be said to have consented to when joining the ICSID Convention is a far cry from what this convention became in the hands of the investment lawyers in charge of interpreting it. The interpretations and the case law in many ways replicate the previous rules that were obtained under duress. Reading the travaux préparatoires (preparatory works) of the ICSID Convention, it is clear that the developing states had good grounds to believe that it would function in a completely different way than it actually did. Had these countries been able to foresee these the later developments, it is likely that they would never have joined the ICSID Convention in the first place.

It is true that states nevertheless later accepted the rules in BITs. This is the result of the general acceptance of the view that these treaties constituted best practices for development within the field of investment law. Pressures inherent in threats of withholding lending or trade privileges also affected the decisions of developing states. Some leaders might genuinely have believed that these treaties would benefit their countries. Whatever the reason, we can now say that the countries that have fared the best have stayed out of the investment regime. Also, we have very few examples of economically successful countries with much inward FDI that have been a part of the regime. The strategy of China to avoid granting additional investor rights underlines the fact that capital-importing countries are likely to be hurt by such measures. As the European Commission has noted, the European Union is a big capital importer.

The strategy behind the ICSID Convention was to first provide the procedural avenue and then add the substantive rules later. The MIC project is now following a similar path. By creating a new framework for enforcement of investor rights, the door is open for a later expansion with respect to the legal substance. It is hard to see in which sense this constitutes the big change promised by the European Commission. Rather, apart from procedural detail, the main thrust of the proposal remains unchanged. The system is still one-sided and ends up with the threat of causing regulatory chill in the member states. It is still unclear why this proposal is needed – what are the systemic problems that foreign investors face that make it necessary to lift the rules concerning their treatment from the jurisdiction of domestic authorities? Even in human rights law, the person who has allegedly suffered a violation must first turn to domestic authorities with his or her grievance, thus allowing them to correct any injustice that may have occurred. Why should foreign investors be immediately entitled to raise their grievances at an international level, without first being required to exhaust domestic remedies? If the European Commission pushes for this proposal using technical language and without responding to the criticism of the European citizenry – or worse, if it pretends to have taken the criticism into account – a backlash can be expected.
In many European countries, concerns have arisen over the domestic government’s ability to regulate matters of domestic concern in the face of ‘unelected international bureaucrats’. In the case of the European Union, these sentiments culminated in the Brexit vote. Irrespective of how one feels about that decision, or the concerns that lay behind it, it would seem undeniable that a message about ‘taking back control’ is resonating across the polities of the European Union. One does not have to agree with such messages to suspect that it has been triggered by precisely the kinds of projects of which the MIC is an example. In the particular case of international investment law, such constraints on democratic policymaking have been justified on economic grounds. But the economic data is anything but unequivocal. In this report, and many others, many of the economic assumptions behind the MIC project have been called into question. But the main issue may not be predominantly economic in nature. A project that reduces the policy choices of governments and removes the capacity of citizens to affect important changes in domestic laws or administrative practices will be resisted in many places. In the end, the central democratic policy tools that would be removed by adding this kind of investor rights are just too important to gamble away. Fundamental matters of the present era – such as transformation into a carbon-free economy or tackling economic inequality – might be heavily affected by them.

Considerations of this type also lie behind the ECJ’s concern over the effects of investment law on the autonomy and coherence of EU law. International investment law is based on a history and on economic and political presuppositions that represent a wholly different world view than that represented by the legal order of the European Union. After the Achmea judgement, it seems increasingly likely that the ECJ will not accept the current type of ISDS mechanism that is also planned for the MIC. Hopefully, this inevitable slowdown can allow the European Commission to reformulate its proposals in ways that do not to upset the democratic compromises of Europe. A number of ideas for how to begin thinking about such solutions were brought forth in this report. It is a daunting task, but the possible gains are also enormous. If the European Union were the driving force in a project that would seek to fit economic globalisation with domestic democracy, European citizens would have every reason to feel proud of the politics of the Union.

Why should foreign investors be immediately entitled to raise their grievances at an international level, without first being required to exhaust domestic remedies?

259 See, in particular, the end of section 6.
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