General Introduction

Public and political controversies over investor-state dispute settlement (ISDS) have prompted reform processes at international and regional levels. As an emerging actor in this field, the European Union (EU) has been particularly active in shaping new developments, within and outside the EU, and proposing the establishment of a Multilateral Investment Court (MIC). This research examines the underlying reasons and ways in which the EU has been shaping the field of international investment law (IIL) in order to address its own and global ISDS problems. The analysis of EU law and policy solutions envisioned to reform investment law in this book is undertaken in light of the IIL controversies, the EU constitutional and legal framework and the rule of law and legitimacy, as the normative goals of the ISDS reforms. In doing so, this book evaluates the contribution of the EU to the development of international law in the field of foreign investment.

Fundamental Issues and the Objectives of This Book

The Reform Problem: International Investment Law between Law and Politics

International investment law sets standards according to which States must treat foreign investors. These standards include substantive and procedural rights, and most notably an option for foreign investors to sue their host State before a tribunal independent from that State. The flaws of this system have crystalised over the last twenty years, leading States to address them through a legal reform, which should improve international investment governance. However, this multilateral reform faces a number of challenges, stemming from the legal design and operation of IIL, tensions within and outside the system and its intersections between legitimacy and the rule of law. The analysis of these key features and reform challenges (Part I) lays ground for the treatment of the EU reform in this book.

International investment law lacks a multilateral legal basis and a central authority. Over 2,500 different international investment agreements (IIAs) in force are interpreted by hundreds of *ad hoc* tribunals, with no appellate mechanism nor competent international court to give authentic interpretations. Due to the factual and legal diversity of investment claims, jurisprudence lacks consistency in painting the full picture of standards of protection. Despite this fragmentation, the field functions effectively according to strikingly similar rules and principles. The private law background of the system and its narrow legal specialisation have created a distinct and uniform culture within the broader system of public international law.

The principled idea behind IIL was to establish a parallel legal system in international law with a new set of rights and procedures, unilaterally and exclusively open to foreign investors. The system was created on a rather simple assumption that it would protect 'good' (Western) investors from the hands of 'bad' (decolonised) States, revengeful for the colonial past. It was meant to provide a neutral forum, which could detach the present from the past, and law from politics. In fact, however, it largely institutionalised the application of foreign (Western) law in the new sovereign States. The colonial origins and its transnational private justice nature did not pose a problem until the system turned against its creators. In the new narrative of globalisation, capital has become the 'good', and regulatory activity of any State, which can negatively affect the interests of capital, the 'bad'. High-profile cases against developed States,[1] opened the debate: is this legal system needed alongside the functioning domestic legal systems? On the other hand, could the abolition of ISDS pose a threat for foreign investors in the countries with 'bad' legal systems? Could the system be reformed without returning it to its binary colonial origins while sufficiently protecting globalised capital?

The complexity of this essentially legal reform is further compounded by the new constellation of international relations in the post–Cold War world. Instead of reaching the 'end of history' as predicted by Francis Fukuyama in 1989,[2] a brave new multipolar world has been created,[3]

[1] *Vattenfall AB, Vattenfall Europe AG, Vattenfall Europe Generation AG v Federal Republic of Germany (I)*, ICSID Case No. ARB/09/6 and *(II)*, ICSID Case No. ARB/12/12; *Philip Morris Asia Limited v The Commonwealth of Australia*, UNCITRAL, PCA Case No. 2012-12.

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

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

resulting in a regulatory competition between the United States, the EU, China and 'the others'.[4] Globalisation has led to economic decline in the West, with domestic populism influencing foreign trade and investment policies. Contemporary IIL is accordingly shaped around the divergent interests of States, their domestic constituencies and transnational elites. International investment law, like much of international economic law, has failed to keep pace with these rapid global changes.

This legal and political complexity of international investment regulation explains the fragmentation of the system, the need for its reform and the challenges of this reform at a multilateral level.

The Normative Problem: International Investment Law between Perceptions and Law

International investment law has become perceived as a 'privatised justice system for global corporations'[5] and a 'Trojan Horse'[6] that undermines democracy, the public good and the sustainable development agenda of national public policies. Critics also emphasise the arbitration industry, 'the elite club of lawyers behind the scenes',[7] that promotes ISDS for its own interests. The perceived flaws of the system are both substantive and procedural, and intertwined. While the critics would like to see the system abolished, most States have opted for a reform, which has its normative dimension in the rule of law, as primarily a legal concept, and legitimacy, as primarily a political concept.

However, the reform debate has been caught between 'perceptions' as a subjective concept and 'law' as an objective concept. On one side of the spectrum are those within the system, who insist that most issues are only matters of perception and politics. They approach IIL purely from the perspective of technical legal rules, which are always objective, and are in principle working well. On the other side are those who perceive

[4] Depending on the context, the constellation of the big players also involves Russia. However, instead through IIL, Russia has found other ways to retain its influence in the countries of the former Soviet Union.

[5] T. McDonagh, 'Unfair, Unsustainable, and Under the Radar: How Corporations Use Global Investment Rules to Undermine a Sustainable Future' (*The Democracy Center* 2013) 8.

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

[7] McDonagh (n 5) 8.

the system as unfair, for both political and legal reasons. In their view, any reform must fix the systemic problems of IIL; otherwise the system should be dissolved. Most States that participate in the reform are touting the middle ground between these two positions.

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

In considering the substantive issues of legitimacy and the rule of law, the technical legal aspects of IIL are placed in the broader perspective of general international law. In this respect we will consider how the developments in IIL relate to the transition of international law to a fragmented positivism, in which technical rules and narrow expertise dominate different fields of international law to the exclusion of others.[8] How will the EU reform affect the issues of control and fragmentation in IIL and international law more broadly? The analysis in this book thus aims at transcending the technicalities of international law and exploring its normative core in order to derive new perspectives on the link between the two.

The Aspiration: The EU as an Emerging Actor in the Field of Investment

The aspirations of the EU as a normative power are defined in its founding treaties. The Lisbon Treaty of 2009 confirmed the EU's commitment to multilateralism, development of international law and good global governance when developing and implementing foreign policy.[9]

[8] M. Koskenniemi, *The Politics of International Law* (Hart 2011).
[9] Arts. 3(5) and 21(1)(h) Treaty on the European Union (consolidated) [2010] OJ C83/13 (TEU).

These principles equally apply to its Common Commercial Policy (CCP). The Lisbon Treaty has extended the scope of the CCP to foreign direct investment (FDI).[10] This change introduced the EU to the field of investment, traditionally occupied by its Member States, and opened a new chapter of international investment policy (IIP) in Europe. The Lisbon Treaty changes have set the platform for the EU to become an international player in the field of foreign investment, as part of the EU's broader external trade agenda.

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

In developing an IIP, the EU must comply with international law and support an international system based on multilateralism and good global governance. In addition, it must comply with its own constitutional requirements. Moreover, the EU is called upon to 'promote multilateral solutions to common problems, in particular in the framework of the United Nations'.[11] To what extent does the EU achieve this objective in its reform of IIL? In what ways does its reform develop the system of international law? The EU reform strives to resolve the ISDS crisis in the EU by enhancing the rule of law in IIL, which is also its core constitutional value. This book explores how these EU aspirations are challenged by a range of internal limitations (shared competence for international investment) and external realities (complexity of IIL and its reform).

The Reality: The EU Approach to International Investment Law

The relationship between the EU and IIL in this book is examined at the level of the EU (Part II) and internationally (Part III), exposing the

[10] Art. 207 Treaty on the Functioning of the European Union (consolidated) [2010] OJ C83/47 (TFEU).
[11] Art. 21(1) TEU, second sentence.

complexity and contradictions of EU approaches to IIL. Multilateralism remains the EU's preferred option, at least in theory. In practice, however, the approaches incorporate 'pragmatic-lateralism' (multi-, pluri-, bi-, or uni-), with different solutions for the settlement of disputes between investors and States depending on the issue at hand.

Multilateral cooperation is taking place through the ISDS reform in the United Nations Commission on International Trade Law (UNCITRAL), while supporting other multilateral reform initiatives, for example, in the International Centre for the Settlement of Investment Disputes (ICSID). At the plurilateral level, the EU has lead the modernisation of the controversial Energy Charter Treaty (ECT). Bilaterally, the situation is particularly complex, due to a range of instruments: Member States' pre- and post-Lisbon BITs with third States, new EU IIAs (so far with only five countries – Canada, Singapore, Vietnam, Mexico and Chile), as well as a range of new EU bilateral trade agreements with no ISDS (e.g. Japan, New Zealand). The elimination of intra-EU BITs, which are in essence reminiscent of pre-enlargement West-East divisions, and the replacement of ISDS by the EU judicial system demonstrate the unilateral approach in situations when IIL clashes with the EU legal order.

The EU reform of IIL is piecemeal, long-term and ongoing. While it builds around the idea of a new Investment Court System (ICS) and the establishment of an MIC, in its essence it does not call the ISDS as a system into question. It does not even exclude traditional ISDS in its practice. The dispute settlement mechanism has been the core feature of the EU approach, however, the reform has also introduced new substantive standards of protection. Competence in the field of investment, shared between the EU and its Member States, further compounds the complexity of the EU approach.

The analysis of the reform in this book thus interrelates the different pieces of the EU approach and correlates them to the EU constitutional and legal framework (competences, principles, procedures), while considering both substantive and procedural aspects of the EU reform (within the EU, and in EU and Member States' IIAs). The aim of the book is to connect internal and external dimensions of the EU and to explain how the EU seeks to influence the reform of IIL and the development of international law.

Further, this analysis is placed in the normative framework of the rule of law and legitimacy, which form the red thread of the book. The rule of law is the central concern of the EU reform, and is also one of its core values. The improvement of rule of law qualities of IIL, in particular with

respect to the independence of adjudicators, should then also increase the legitimacy of the new system.[12] The focus is on the mode in which the EU incorporates its own vision of the rule of law, replacing traditional ISDS within the EU and externally. In the intra-EU dimension, the emphasis is placed on the role of EU law and its incompatibilities with IIL, the CJEU and the EU judicial system; in the external dimension on the independence of the ICS/MIC judges, and compatibilities with the EU constitutional framework. Ultimately, and in the long run, coherence in the external dimension is to be achieved through the institution of a court, subject to the EU requirements of independence and access to justice (constitutionalism). In its essence, an MIC is thus also a unilateral EU solution for its own investment policy within a multilateral forum, with a hope to achieve a 'Brussels effect'[13] in IIL. This book analyses the limitations of this EU approach in the specific legal and political context of IIL.

The Scope and Methodology of This Book

Because of the complexity of the topic and its related fundamental issues, the following methodological choices were made in undertaking this research.

The Scope of Investment

In this research it is the broad scope of investment that is considered. Investment encompasses a variety of economic operations and overlaps with broad areas of private and public law (property law, contract law, administrative law, etc.). Investment further overlaps with other concepts which can have legal as well as political meaning, such as public health, the environment, human rights or sustainable development. In economic and legal terms, a distinction can be made between different forms of investment (FDI, portfolio). The analysis in this book illustrates a variety of investment issues, taking into account its interdisciplinary character. The primary focus of this research is international and the EU context,

[12] See EC, 'Multilateral Reform of Investment Dispute Resolution, Impact Assessment' SWD (2017) 302 final.

[13] The process of *de facto* externalisation of EU regulation outside its borders through market mechanisms. The scholarly authority on the topic is A. Bradford, *The Brussels Effect: How the European Union Rules the World* (OUP 2020).

however, where relevant, we also consider the effects of investment regulation in domestic law.

Systemic Comparative Analysis

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

Most studies focus on some aspects of the interaction between IIL and EU law through the lens of one or the other system. However, this book attempts to explain this interaction in light of the distinct systemic features and legal postulates according to which each system operates. This approach should provide a more global understanding of investment regulation in each legal system and across them, and present the system-specific insights which can better explain their normative relationships. It will enhance the understanding of the relevant features of EU law among international investment lawyers, and *vice versa*, in dealing with legal issues that involve both legal systems.

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

Law in Context

This research takes into account relevant aspects of political economy and international relations as these contexts inevitably shape

international investment governance. On one hand, the aim is to explore the rationale of the EU investment agenda and enquire how this agenda relates to the broader EU objectives, both internally (EU integration) and externally (pragmatic-lateralism, free and fair trade). In this context, the research examines whether law serves as an instrument of politics. On the other hand, the work aims to place the EU investment agenda in the broader context of international investment governance in order to illustrate the external challenges that the EU reform faces, in UNCITRAL and beyond, as the EU needs to gather broad political support for its proposal.

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

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

From Positive Law to Legal Scholarship and Policy Considerations

This research is based on rules found in the primary legal sources (treaties, investment awards, court decisions, formal statements, proposals), which are critically considered through a variety of secondary sources (legal and political scholarship). In light of the fragmented nature of the field, in the selection of the treaties, importance has been placed on those of the Western States that have had a defining role in the development of the rules (the United States, European States in the pre-Lisbon era). In the selection of investment awards importance was given to those awards that have set important principles for the subsequent awards, dealt with important broader public policy issues or have provided relevant opinions supporting the development of legal scholarship. The focus of the analysis is placed on the main components of the system and

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

It follows from the historical and contemporary political context of IIL that analysis of the legal rules must also question the politics behind the law. International investment law as a system and its rules are evaluated normatively against their legitimacy and the rule of law. In defining and assessing the rule of law, the relevance is given to legal scholarship, soft law sources and case law (the CJEU and the European Court of Human Rights), therefore acknowledging different understandings of the rule of law in a variety of contexts (domestic, international, European). In assessing legitimacy, the approach combines theoretical concepts of political science with legal scholarship on the legitimacy of international courts. The theoretical framework of legitimacy and the rule of law guides the analysis and the proposed EU solutions for the reform of IIL throughout the book.

When examining EU law, importance has been placed on CJEU judgments that are landmarks in shaping the EU legal order, and its normative relationships with domestic (Member States' legal orders) and international law. When examining the role of law and the CJEU in defining and shaping EU investment regulation, the analysis unfolds around three core CJEU decisions in the field of investment: the *Achmea* judgment[14] (defining internal EU aspects of investment regulation), Opinion 2/15[15] (defining the EU's investment sovereignty) and Opinion 1/17[16] (defining external EU aspects of investment regulation, both bilaterally and multilaterally). Policy implications of these legal decisions are explained in order to relate the CJEU's legal reasoning to the broader policy context (law as a limitation of policy and law as an instrument of policy). They serve to support the integrationist judicial approach in the intra-EU dimension and a more politically pragmatic approach to EU international relations. The examination of EU rules is inspired by legal scholarship on the international rule of law in the EU context and constitutionalism.

[14] Case C-284/16 *Achmea* ECLI:EU:C:2018:158. See Chapter 5.
[15] Opinion 2/15 ECLI:EU:C:2017:376. See Chapter 6.
[16] Opinion 1/17 ECLI:EU:C:2019:341. See Chapters 8 and 9.