Introduction

> It is most expedient for the preservation of the state that the rights of sovereignty should never be granted out to a subject, still less to a foreigner, for to do so is to provide a stepping-stone whereby the grantee himself becomes the sovereign.
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> Jean Bodin, *Six books of the commonwealth,* 1576 (Oxford: Blackwell, 1955), p. 49

A The Background

It is almost difficult to imagine now, but there was a time – not so long ago – when foreign investment disputes were not settled using investor–state arbitration. Such conflicts were dealt with either directly by the investor at the host state's domestic courts or between the investor's home state and the host state through the institution of diplomatic protection. Under special treaties, even home state extraterritorial jurisdiction was recognized at the host state. International arbitration between host states and foreign investors was primarily based on contracts. Clearly, both home and host states had a decisive role in the settlement of foreign investment disputes.

Historically, the evolution of this treatment can be briefly summarized as follows: an initial period in which no rights for aliens were recognized was followed by an epoch in which special rights were recognized for foreigners – but different from those recognized for nationals. This period was then followed by an era in which aliens were granted the same rights – but no more – than nationals.[1] Currently, foreign investors enjoy more rights than domestic investors, as international investment

[1] J. Paulsson, *Denial of Justice in International Law* (Cambridge University Press, 2005), p. 14.

agreements (IIAs) include protections that are not available for nationals, notably with respect to dispute settlement.

Over the past decades, a regime of dispute settlement allowing foreign investors to initiate arbitrations against host states has been established mainly through IIAs. This investor–state dispute settlement (ISDS) system gives foreign investors the procedural alternative of pursuing international arbitration instead of going before the host state domestic courts, when they deem that their rights recognized in those treaties have been infringed upon by the host state.

The essence of ISDS is that controversies between foreign investors and host states are allegedly insulated against the political and diplomatic relations between states. In return for agreeing to independent international arbitration, the host state is assured that the investor's home state will not espouse the claim or intervene in a controversy and is theoretically relieved of the pressure of having its relations with the host state disturbed as a result of unwanted involvement in investment disputes.[2] The idea behind this system was to 'depoliticize' investment disputes.[3]

Before the system of investor–state arbitration was established, foreign investment disputes were settled either by the host state's domestic courts or through diplomatic protection, the latter being the most-used mechanism under international law. Once a state espoused a claim of a national that had invested in a foreign country, the means for resolving grievances included diplomatic and legal methods, and even the use of force. It was precisely such 'gunboat diplomacy' that triggered claims of abuse of power by the investor's home state and a reaction from affected countries – mainly from Latin America – taking the position that aliens had no greater rights than those recognized for the citizens of the host state. They held that domestic courts had a primary role in the settlement of foreign investment disputes and rejected diplomatic protection, except in cases of denial of justice or evident violation of principles of international law.[4] These ideas were dubbed the 'Calvo doctrine' and the 'Calvo clause', when contracts included provisions to renounce to diplomatic protection.[5]

[2] *Corn Products International, Inc.* v. *United Mexican States*, ICSID Case No ARB (AF)/04/1, Separate Opinion of Andreas F. Lowenfeld, 18 August 2009, para. 1.

[3] I. F. I. Shihata, 'Towards a Greater Depoliticization of Investment Disputes: The Roles of ICSID and MIGA', 1 (1986) *ICSID Review*, 1–25 at 1.

[4] S. Montt, *State Liability in Investment Treaty Arbitration: Global Constitutional and Administrative Law in the BIT Generation* (Hart Publishing, 2009), pp. 40–1.

[5] F. G. Dawson, 'The Influence of Andres Bello on Latin-American Perceptions of Non-Intervention and State Responsibility', *British Yearbook of International Law*, 57 (1987), 253–315 at 273.

However, diplomatic protection also had limitations, as it could be successfully invoked only by the home state, under strict rules on nationality of the investors and after they had exhausted local remedies available in the host state.[6] Diplomatic protection cases were almost always concerned with alleged problems in the judicial system of the host state – namely, refusal to investigate or prosecute – but generally not with failures in administrative decision-making by the host state.[7]

B The Problem

The system of diplomatic protection for the settlement of foreign investment disputes was largely abandoned after the rise of investor–state arbitration. Although consent to arbitrate investor–state disputes had already been provided for in bilateral investment treaties (BITs) signed in the late 1960s, the possibility of using this system became common only in the late 1980s – when the number of BITs containing these provisions increased dramatically.[8]

Today, around 3,300 IIAs have been concluded and around 2,600 are in force.[9] While we can trace the foundations of the system for the settlement of investment disputes in the minimum standard of treatment of aliens under customary international law, agreements focused exclusively on foreign investment have been signed since the 1959 Germany–Pakistan BIT.

Initially, these treaties were concluded between a developing and a developed country, usually at the initiative of the latter. However, with the increasing integration of the world economy as well as investment and trade liberalization, this pattern changed – especially during the 1990s, when developing countries and economies in transition started signing BITs among themselves and in large numbers. In the same decade, investment chapters began to be included within free trade agreements.[10]

The use of investor–state arbitration has augmented spectacularly in recent years. At the time of writing, investors had initiated at least 855

[6] C. F. Amerasinghe, *Diplomatic Protection* (Oxford University Press, 2008), pp. 13–20.
[7] C. McLachlan, 'Investment Treaties and General International Law', *International & Comparative Law Quarterly*, 57 (2008), 361–401 at 363.
[8] A. Newcombe and L. Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (Kluwer Law International, 2009), p. 47.
[9] UNCTAD, 'International Investment Agreements Navigator' (February 2018).
[10] R. Polanco Lazo, 'The No of Tokyo Revisited: Or How Developed Countries Learned to Start Worrying and Love the Calvo Doctrine', *ICSID Review* 30 (2015), 172–93 at 183.

known ISDS cases under IIAs, involving 134 countries. The International Centre for the Settlement of Investment Disputes (ICSID) has become the most used forum to address investor–state disputes. Other investment arbitrations take place in ad hoc panels, mainly under United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules, or in private arbitration institutions such as the Arbitration Institute of the Stockholm Chamber of Commerce (SCC).[11]

While the ability of foreign investors to choose ISDS has gained prominence, it has also progressively come under more scrutiny. There are concerns about the qualifications and independence of arbitrators, frivolous claims, 'nationality-planning' and treaty shopping, high costs, lack of transparency and coherence, expansive or inconsistent interpretations of treaty provisions, erroneous arbitral decisions, 'regulatory chill' or restrictions on the state's 'right to regulate', and a growing perception of lack of legitimacy in the system.[12] These criticisms have surfaced not only in developing countries but also in developed ones, as witnessed during the negotiations of 'mega-regionals' such as the Trans-Pacific Partnership (TPP), the Comprehensive Economic and Trade Agreement (CETA) and the Transatlantic Trade and Investment Partnership (TTIP).

C The Thesis

This book advances the idea that in order to address some of the criticisms of the ISDS system, a large majority of states have taken a 'normative' strategy, negotiating new investment treaties (or amending existing ones), with provisions that potentially give more control and greater involvement to the contracting parties, and notably the home state. This is particularly true of agreements concluded in the past fifteen years, although still these innovations are far from being found in the majority of IIAs.

Now the same states that created ISDS are 'bringing back' the home state to the realm of investment disputes, through several innovations in treaty-making that provide for a larger role for the investor's home state in these conflicts. At the same time, there is a potential revival of the 'remnants' of diplomatic protection that are embedded in investment

[11] UNCTAD, 'Investor–State Dispute Settlement: Review of Developments in 2017', *IIA Issues Note,* 2 (2018), 1.
[12] UNCTAD, 'Reform of Investor–State Dispute Settlement: In Search of a Roadmap', *IIA Issues Note,* 2 (2013), 2–4.

treaties since their inception – such as inter-state dispute settlement: a provision that almost all IIAs include, although it is seldom used.

Current IIAs provide for the participation of the home state in at least four different phases of an investor–state conflict: i) prior to the arbitration – through tools of dispute prevention or review of implementation of the treaty; ii) during the arbitration, via filtering of claims, joint interpretations, non-disputing state parties' submissions, regulation of the work of arbitrators, and even *renvoi* and referral mechanisms to interpret reservations or exceptions of the IIA; iii) after investor–state arbitration, facilitating the enforcement of the award or applying countermeasures to non-compliant states; and iv) instead of investor–state arbitration, through state-to-state dispute adjudication or arbitration.

But why is the home state being brought back into a domain from which it was expressly excluded several decades ago? Is this 'new' role of the home state in ISDS a 'return' to diplomatic protection of its nationals, or are we witnessing something different? Besides, having mechanisms that allow home states to participate in investment disputes does not mean that they will do so. Why would a home state be interested in doing so?

One answer to these questions would be that this normative strategy aims to bring diplomatic protection (or certain elements of it) back to the forefront in the settlement of investment disputes. The history of investment protection shows us that, before ISDS, it was the role of home states to protect their investors under international law, through diplomatic means, inter-state dispute settlement, or even with the use of force; and that role continued to be relevant even when the ISDS system was first established, as the adoption of investor–state arbitration was slow paced. Although it has taken a back seat in investor–state disputes, diplomatic protection is still relevant today as a dispute settlement mechanism in international law.

Another answer would be to consider that the increasing participation of home states – and the host states – in ISDS is a way of reasserting their control as 'masters' of the investment treaties,[13] as a reaction against a system that is providing conflicting interpretations of the obligations that were negotiated by them. This could be considered a positive development.

In theory, the involvement of home states in the prevention of investment disputes – or even in monitoring the functioning of the investment

[13] Andreas Kulick, 'Reassertion of Control: An Introduction' in A. Kulick (ed.), *Reassertion of Control Over the Investment Treaty Regime* (2017), pp. 1–29.

treaties – could favour long-term maintenance of the links between the investor and the host state, as well as decreasing the number of claims or increasing the likelihood of amicable solutions.

Similarly, it could be argued that a more active role for the home state during certain phases of investor–state arbitration could help to alleviate criticisms and improve the perception of the legitimacy of the system. Problems of lack of coherence of awards could be minimized with joint interpretations by the home and the host state of treaty provisions, or even through unilateral statements by the home state. Concerns about qualifications and independence of arbitrators could be addressed through the establishment of a roster of arbitrators selected by the states, together with the development of a joint code of conduct to guard against possible conflicts of interests. Sensitive claims could be limited using a process of filtering of claims by home and host states or their agencies acting in a coordinated way. Apprehensions about arbitrators deciding on public policies could be alleviated by setting up standing tribunals. State-to-state dispute settlement could be a mechanism to be used as a complement to or in the absence of ISDS. Enforcement of awards could be expedited with some home state participation, as a state could be better positioned than an investor to overcome the challenges that stem from a process against another state, and eventually adopt countermeasures against the non-compliant state.

This book submits the idea that the changes introduced in the treaty-making of IIAs in recent years, which give more room for home state intervention in investment disputes, allegedly with the goal of addressing some of the criticisms raised against the ISDS system, are not a 'return' to diplomatic protection, but a return of the states in order to regain control as 'masters' of the investment treaties, aiming to minimize risks in the interpretation of those agreements in potential future disputes with foreign investors. In this scenario, a home state would be willing to intervene in investment disputes only if its own public interests are affected; and these do not necessarily coincide with the interests of its investors. The normative strategy described earlier is therefore not aimed at protecting investors but at minimizing states' exposure to ISDS.

In the current literature, the large majority of these changes have been analysed as part of the phenomenon of reassertion of control or recalibration of investment treaties from the part of states in general, and not exclusively from the perspective of the home state. That framework has focused largely on host states, and include aspects that will not be analysed in this book, such as the withdrawal from investment treaties,

defences based on legitimate regulatory interests, revisiting treaty standards in new treaties (such as indirect expropriation or fair and equitable treatment), and early dismissal of claims, among others.[14]

Although this work departs from that general analysis, focusing primarily on the home state, this book examines several mechanisms that require the active participation of other states (mostly host states, as the majority of investment treaties are bilateral), such as joint interpretations or the filtering of claims. Yet, the fact that the home state has a role in it justifies dedicated analysis, as it could be seen as a covered (or uncovered) mechanism of diplomatic protection.

Finally, this work also analyses mechanisms that are particular to home states, mostly relating to the prevention of investment disputes, unilateral interpretations and the enforcement of arbitral awards. The questions to analyse here are not only whether home states use such mechanisms, but also what the reasons are behind the decision to use them or not.

D Methodology

The research used in writing this book applied both historical and empirical methods, including a historical analysis of the regime of protection of foreign investors and investments before the establishment of ISDS; study of the current elements of the institution of diplomatic protection under international law; and case studies on investor–state arbitration and mechanisms involving state-to-state dispute settlement, inter-state interpretation of IIAs and even unilateral participation by the home state. The use of this methodology is consistent with a 'rules-based' approach to international law, focused on the existence of legal rules based on the sources of international investment law as they exist today (*lege lata*), especially international agreements, judicial decisions and customary international law.

[14] See, among others: J. E. Alvarez, 'The Return of the State', Minn. J. Int'l L., 20 (2011), 223–64; A. Kulick (ed.), *Reassertion of Control Over the Investment Treaty Regime* (2017); S. Hindelang and M. Krajewski (eds.), *Shifting Paradigms in International Investment Law: More Balanced, Less Isolated, Increasingly Diversified*, 1st edn (Oxford University Press, 2016); and S. W. Schill, '"Shared Responsibility": Stopping the Irresponsibility Carousel for the Protection of Public Interests in International Investment Law' in A. Reinisch, M. E. Footer and C. Binder (eds.), *International Law and . . . Select Proceedings of the European Society of International Law* (Hart Publishing, 2016), pp. 160–9.

Special emphasis has been given to rules that stem from state consent, and its related case law, as the current ISDS regime was created by investment treaties aimed at displacing customary international law on the treatment of aliens and their property. For that reason, I have reviewed and coded all the IIAs negotiated and concluded in the past fifteen years the text of which is publicly available (1088 agreements). The study was limited to that period as, during those years, we can detect an increasing change in treaty-making in relation to the participation of home states. The number of IIAs including provisions on home state participation in that period is 568 (hereinafter the 'data set'). When changes were found to have started in previous years, an analysis of those treaties and related cases was made in order to gain a complete understanding of that specific mechanism of home state participation.

This sample of treaties was developed using several online investment treaty databases, particularly those of the United Nations Conference on Trade and Development (UNCTAD),[15] the Organization of American States (OAS) Foreign Trade Information System,[16] Transnational Dispute Management,[17] Kluwer Arbitration,[18] and Oxford's 'Investment Claims'.[19] Several agreements that were not found in those databases were collected from different governmental websites, first privately and then as part of a project funded by the Swiss Network for International Studies (SNIS).[20]

But this research is also concerned with normative arguments about how investment law should be (*lege ferenda*) as, during the examination of the home state's participation in investor–state arbitration, there is always a separate analysis of what would be the role of the home state under the treaty, what occurs in practice and what possible roles could be assumed in the future. In different sections of this work, we examine potential uses of diplomatic protection in the current system of

[15] UNCTAD, 'International Investment Agreements Navigator'.
[16] OAS, 'SICE the OAS Foreign Trade Information System' (February 2018).
[17] Transnational Dispute Management, 'Legal & Regulatory docs' (February 2018).
[18] Kluwer Law International, 'Kluwer Arbitration' (February 2018).
[19] Oxford University Press, 'Investment Claims' (February 2018).
[20] An Electronic Database of Investment Treaties (EDIT) was created during the implementation of the SNIS-funded project 'Diffusion of International Law: A Textual Analysis of International Investment Agreements' (2015–17). Treaty texts were collected, digitized and non-English texts translated through machine translation software, complemented with manual translation. Swiss Network for International Studies (SNIS), 'Diffusion of International Law: A Textual Analysis of International Investment Agreements' (February 2018).

settlement of investment disputes and the prospective role of home states in the prevention of such disputes.

There are, of course, limitations on this analysis. The number of IIAs that have been examined is limited by the accessibility of their texts, and thus the conclusions presented here reflect only the agreements that are publicly known. Similarly, as the focus has been to examine the state practice in IIAs treaty-making, we have reviewed texts of investment treaties that have been signed or concluded in the last fifteen years, even if they are not currently in force. Although the general tendency is that the majority of these agreements enter into force later, the conclusions presented in this work could have the bias of not representing treaties that are actually operative.

With respect to the analysis of investment disputes, this research focuses only on investor–state and state-to-state cases that are publicly available, and therefore its conclusions cannot represent the overall reality of the settlement of investor–state disputes. Likewise, due to the reserved nature of most methods of diplomatic protection, the exercise of diplomatic protections could be taking place in different forms than those described in this book, but they are not in the public domain. The conclusions made in this regard therefore also suffer from an unwanted selection bias.

E Structure

The book is divided into seven chapters, preceded by an Introduction and followed by a Conclusion. The Introduction provides the presentation of the topic, the context of the research and the main questions that guided its development. Chapter I examines the role of diplomatic protection as the main international dispute settlement mechanisms for investment disputes that were available before investor–state arbitration. This is followed by an analysis of its roots and main characteristics throughout history.

Chapter II delves into the origins of investor–state arbitration, the reasons behind its creation, and the evolution of the system, since the ICSID Convention and the consolidation of treaty-based arbitration by the end of the twentieth century, and briefly describes the backlash against ISDS that we are currently witnessing.

Chapter III explores the prospective role of the home state in the prevention of investment disputes, based on provisions included in recent IIAs, or following principles of domestic or international law.

Chapter IV examines the present role of the home state in ISDS, together with the host state, considering a wide range of mechanisms of participation, including the filtering of certain claims, joint interpretation of investment treaties, technical referrals during arbitral proceedings, and the regulation of the work of arbitrators. In each case, the relevant case law is analysed, and the characteristics of every type of intervention are considered in order to determine whether it resembles diplomatic protection.

Complementing the previous chapter, Chapter V deals with unilateral home state participation in ISDS, through non-disputing state party submissions, consultation of draft awards and enforcement of awards. Here, the relevant case law is also analysed, and the characteristics of each type of intervention are examined to define whether it corresponds to diplomatic protection.

In Chapter VI, the book deals with the 'remnants' and the future of diplomatic protection, presenting the cases in which diplomatic protection is expressly excluded from investment treaties and their consequences, and, the current mechanisms for diplomatic protection in investment disputes, concluding with an analysis of inter-state dispute settlement, its main characteristics and its interplay with investor–state arbitration. This section includes recent developments brought about by the new Brazilian approach to investment treaties and the European Union proposal for a standing investment tribunal and an appellate tribunal.

Chapter VII examines the reasons behind the actual non-intervention of home states in investment disputes, even in the presence of a legal framework that would make it possible, and draws lessons from the system for settling investment disputes before ISDS that can be useful for the current discussions in this field.

In the Conclusion, I submit that the evolution of investment treaties in recent years, including more room for the participation of home states in investment disputes, is not a return to an updated version of diplomatic protection in order to enhance the defence of its national interests. Rather, it is more a return to seeing states as masters of investment treaties, to regain control of the interpretation and application of the agreements, with the aim of avoiding expansive or unintended interpretations of IIAs against the contracting parties. In this context, the home state may have more interests in common with the host state than with its national investors.